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Banking Sector Reforms as a Catalyst for Economic Growth of Nigeria

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ABSTRACT

This paper investigated the impact of reform in banking sector and its contribution to economic growth in Nigeria for the period 1993-2019. Unit root test, co-integration test and vector error correction model (VECM) estimation techniques were utilized in the analysis. Secondary data obtained from the Central Bank of Nigeria statistical bulletin on gross domestic product, money supply, minimum rediscount rates, private sector credit, bank sector credit to government and exchange rate were analyzed in the study. The unit root test discovered that all variables were stationary at differencing. It was also indicated that long-run equilibrium relationship exists among the variables. The estimation results revealed that money supply and private sector credit contributed positively and significantly to economic growth while exchange rates had a negative and significant influence on economic growth in Nigeria. More so, the results also indicated that minimum rediscount rates and bank sector credit to government had negative and insignificant impact on the Nigeria's economic growth. On the above note, the study recommended prudent reforms in the banking system for optimal economic role. Central Bank should build and maintain a sound and vibrant banking system such that ensures efficient and effective economic activities in the nation; and that its policies are sustained and the regulatory and supervisory framework are strengthened.

Keywords: Banking, Sector, Reform, Catalyst, Economic, Growth

INTRODUCTION

One most important task before the developing countries is to realize high rate and sustainable economic growth in their economies. Due to the influence banking sector activities on the economy, every nation strives toward achieving innovative banking sector. Banking sector, no doubt is a very essential part of nations' economy; hence, any reforms carried out in the sector spread across other sectors of economy. This, therefore, represents a transformational moment for the economy and its people as a whole. However, reforms in the banking sector have been a regular feature of the banking system [1,2,3,4]. The reforms evolved as a result of the response to the challenges posed by developments in the system including technological innovation, globalization, systemic crisis, and banking crisis. In Nigeria, banking reforms is traced to 1952 with the enactment of banking Ordinance. In 1986, the deregulation of banking provided impetus for the adoption of Structural Adjustment Program [5,6,7,8]. The banking system reform in this period saw a policy shift from direct control to a market based Banking system, especially on the areas of the risk management, monetary management and asset holding capabilities of the institutions. Other reforms associated with this period include the banks consolidation policy of 2005 and insurance policy of 2007 [9,10,11,12]. Globally, banking system plays important roles in the growth and development of any economy, depending on the political, economic and legal system within which the banks operates. As financial institutions, banks perform intermediation roles by mobilizing resources from the surplus units and channeling same to the deficit units for productive purposes in the economy. Among the responsibilities of

banking system is the holding of financial assets. The responsibility indeed is core objective for all banking, and where it began, though it extended beyond the days of holding gold coins in exchange for promissory notes. A bank holds assets or deposits for its customers, with a promise that deposits can be withdrawn at demand by the depositors. To avoid devastating bank operations that could destroy the sector entirely, banks are required to maintain at least 8% of their book values as actual money [13,14,15,16]. As a result, the banking sector always attempts to diversify its risks by investing as widely as possible in order to prevent unexpected loan default from sinking the entire bank. Therefore, in effort for banks to officially and effectively discharge its responsibilities of propelling economic activities as well as solve economic problems, policy reforms become routine imperative. Reforms are inventions, fresh ways or schemes enunciated to improve or change the old ways in which things were being done which is usually introduced either in response to changing developments, operational challenges or as proactive measures to strengthen banking structure mainly to avoid total crisis [17,18,19].

However, despite the plausible benefits of a developed banking system to an economy, the inability of Nigeria's banking system to voluntarily embark on reform in accordance with the global practices motivated the need to consider adoption of appropriate legal and supervisory frameworks as well as comprehensive incentive package to facilitate mergers and acquisitions in as well as crisis resolution, stability, promote soundness and enhance efficiency in the banking system [20]. Meanwhile, the Nigeria's banking sector reforms have remained a reference point for the positive development among economies across the world. This is because, the new banking environment created by the reforms made it possible to delisting of Nigeria from the Financial Action Tax Forces (FATF) register of countries that are in breach of the global anti-money laundering and anti-corruption code [21]. More so, the Nigeria's banking system has over time, undergone several reforms with the aim to strengthen the economy in face of global competition. Despite these reforms, the banking industry still encumbered with numerous hindrances, which negatively impacted on its efficiency. Consequently, the major issue posed in the industry relates to the long and short run possible effects of banking sector reforms and unsatisfactory results occasioned by lack of proper attention to the needs of the real sector of the economy; weak regulatory supervision in a highly liberalized financial environment, inadequate policy framework for financial development, allowing banks become over confident, less transparency, audacious and less accountability in the handling of their diverse portfolios of services. To tackle these menaces, government of Nigeria often adopts policies aimed at achieving specified objectives such as; interest rate ceilings and selective sectorial policies. Those policies were introduced primarily to direct credit to priority sectors and securing inexpensive funding of its own activities [22]. It is on the above note, that this paper examines the impact of banking sector reforms on Nigeria's economic growth.

Literature Review

Theoretical Review

The theory anchored on this research is the financial intermediation theory. The theory according to [23] explains the situation in which institutions mobilizes idle funds from savers and channels to investors. The proper functioning and performance of backing system facilitates economic activities of a country. The theory believed in improving the quality of market signals. The literature is replete with studies, which show that the objectives of financial sector reforms are broadly the same in most countries of Sub-Sahara Africa. [7,9] and several financial sector analysts summarized these objectives to include market liberalization for the promotion of a more efficient resource allocation; expansion of

savings mobilization, promotion of investment growth through market-based interest rates. It also means the improvement of the regulatory and surveillance framework; fostering healthy competition in the provision of services and laying the basis for inflation control and

economic growth. In literature, there appears to be general agreement among scholars that the aforementioned objectives can be attainable via deregulation of erstwhile regulated domestic currency and foreign exchange markets, market based approach to credit allocation and the pursuit of sustainable fiscal and monetary policies. It could also require the restructuring of financial markets via legislative changes and active use of prudential regulations and enforcement of capital adequacy requirements. With regard to banking sector, the literature is of the view that its reform is imperative if it is to play a key role in pricing and trading risks and implementing fiscal and monetary policies as process part of a shift in emphasis to a private sector-led economy. It further argued by this school of thought that reforms which foster institutional efficiency is imperative, if the banking sector is to play the desired catalytic role in the real sector [11]. The arguments are that for efficiency, such reforms should address the issues that militate against the efficiency of the banking sector, including dependence of financial sector on public sector, shallow depths of the capital market, foreign exchange trading as sources of funding; monetary policies, apparent lack of harmony between fiscal and poor loans repayments performance as well as bad debts, [16]. In terms of policy thrust, it is expected that the banking sector reforms should build and foster a healthy and competitive financial system to support development and avoid systemic distress [11]. It argued that deepening banking sector regarding asset volume and instrument diversity could lead to drastic reduction of fiscal deficit financing and freeing resources for lending to the private sector. Generally, banking sector reforms is interpreted to mean embarking on a comprehensive process aimed at substantially improving the financial infrastructure, strengthening the regulatory and supervisory framework to address the issue of low capitalization and a structured financing for cheap credit to the real sector and financial accommodations for small and rural credit schemes.

Empirical Review

[7] investigated the impact of banking sector reforms on economic growth in Nigeria for the period 1970-2013 using the Autoregressive Distributed Lags (ARDL) Bounds test to determine the short-run and long-run relationships between the variables. The results indicated that the interest rate margin had a significant influence on economic growth; while banking sector credit to the private sector had a negative and insignificant impact on the growth of the Nigerian economy. More so, inflation negatively and significantly impacted economic growth in the economy. [9] examined the influence of banking sector reforms on Nigeria's economic growth from 1970 to 2015 using the Autoregressive Distributive Lag (ARDL) model. The estimation results showed evidence of long-run relationship among the variables. It was also discovered that interest rate spread had a positive and significant impact on economic growth of Nigeria while exchange rate, corporate governance disclosure index and bank capital base negative influence on gross domestic product in Nigeria. [14], examined the influence of banking reforms on economic development of Nigeria from 1986 to 2014 through the application of ordinary least square. The results showed that minimum capital base of banks positively and significantly impacted economic growth of Nigeria. The results also indicated that banks' minimum capital base had a negative and significant influence on Inflation. It was also revealed that banks' minimum capital base had a positive and significant effect on Unemployment. [15], investigated the impact of bank capital reforms on economic growth of Nigeria from 1986 to 2013 using unit root test, co-integration

test and ordinary least square technique. The variables used in the study include gross domestic product, bank total capital and total bank reserves. The results indicated evidence of long-run relationship among variables. The estimation results showed that bank capital reforms had a significant positive effect on economic growth of Nigeria. Ezeocha (2020) assessed the effect of banking sector reforms on economic growth in Nigeria for the period 1975-2018 through the applications of descriptive statistics and ordinary least square technique. The variables modeled in the study include ratio of broad money to gross domestic product, ratio of private sector credit to gross domestic product, real gross domestic product, capital base, minimum rediscount rate, cash reserve ratio, credit allocation to private sector. Others include investment rate, commercial bank loan and advances, and lending rate. The results showed that there was a negative association between loan and gross domestic product. This implies that increase in commercial bank loan and advances reduce economic growth. Furthermore, there was a significant nexus between banking reforms and real sector financing. [15], assessed the influence of banking reforms on banks' performance and economic growth from 1981 to 2015 by fitting an ANOVA model into Stepwise regression. Applying dummy variables to isolate reform periods, results showed that banking reforms contribute to economic growth positively. More so, banking reforms were found to negatively contribute to banks' performance, following the 1993 reforms. The research confirms that banking system reforms in Nigeria had dual impact on the economy and banks' performance. The banking reforms are capable of promoting growth in the economy.

METHODOLOGY

To examine the influence of banking sector reforms on the growth of the Nigerian economy, gross domestic product, money supply, minimum rediscount rates, private sector credit, bank sector credit to government and exchange rate are employed in the study. Unit root test, co-integration test and vector error correction model are engaged in the analysis. Data for the research are generated from the Central Bank of Nigeria (CBN) bulletin, volume 31, 2019.

Model Specification

The empirical model illustrating the relationship between banking sector reforms and economic growth are expressed below:

$$GDP = f\,(M2, MRR, CP, CG, EXHR) \quad (1)$$

In linear form, it is modeled as:

$$GDP = b_0 + b_1M2 + b_2MRR + b_3CP + b_4CG + b_5EXHR + U_t \quad (2)$$

Where, GDP = Gross Domestic Product, M2 = Money supply, MRR = Minimum Rediscount Rates, CP = Private Sector Credit, CG = Bank Sector Credit to Government and EXHR = Exchange Rate.

A Priori Criterion

Table 1: A priori Expectation

Variable	A priori sign
M2->GDP	$b_1>0$
MRR->GDP	$b_2>0$
CP->GDP	$b_3>0$
CG->GDP	$b_4>0$
EXHR->GDP	$b_5>0$

Author's Compilation, 2022.

RESULTS AND DISCUSSION

The study utilized analytical techniques such as unit root test, co-integration test and vector error correction model in the study and the results are presented below. Since empirical analysis based on time series data would be biased if the underlying data contain unit root, stationarity test is therefore necessary to check for unit root status of the variables. The results are as follows:

Unit Root Test

The Augmented Dickey-Fuller (ADF) is utilized to test for unit roots in the data series using trend and intercept. The test results are expressed in table 2 below:

Table 2: Unit Root Test

Method	Statistic	Prob.**
ADF - Fisher Chi-square	23.1172	0.0267
ADF - Choi Z-stat	-0.93397	0.1752

** Probabilities for Fisher tests are computed using an asymptotic Chi -square distribution. All other tests assume asymptotic normality.

Table 3: Intermediate ADF test results UNTITLED

Series	Prob.	Lag	Max Lag	Obs
GDP	0.4701	4	4	21
M2	0.9828	0	4	25
MRR	0.0073	3	4	22
EXCH	0.1728	4	4	21
CP	0.8721	0	4	23
CG	0.0187	0	4	25

Author's Compilation, 2022 from E-View 10.0

From table 3, it is noted that each cross-section, the auto-regression coefficient, variance of the regression, the selected lag order, maximum lag, and the number of observations used are displayed. Auto-regression coefficient revealed that if lag polynomial has one root equal to one, the study concludes that it has a unit root. Therefore, the result revealed that the Lag values are different, which indicate a stationary at difference level that provide strong criterion for co-integration.

Table 4: Co-integration result

Unrestricted Co-integration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.966676	159.1196	95.75366	0.0000
At most 1 *	0.783417	87.68879	69.81889	0.0010
At most 2 *	0.715380	55.56339	47.85613	0.0080
At most 3	0.631541	29.17482	29.79707	0.0589
At most 4	0.241230	8.207881	15.49471	0.4434
At most 5	0.108451	2.410693	3.841466	0.1205

Trace test indicates 2 cointegratingeqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Source: Research's compilation, 2022 from E-view 10.0

From table 4 above, it was discovered that there are two co-integrating equations at 0.05 levels at trace test in the series. Hence, we reject the null hypothesis and accept alternative hypothesis, concluding that there exist long-run equilibrium relationship among the variables.

Vector Error Correction Model Result

Table 5: Regression result: Dependent variable – GDP

Variable	Coefficient	Std. Error	t-Statistic	Prob.
M2	3388.404	205.4423	16.49322	0.0000
MRR	-41977.91	87290.59	-0.480899	0.6361
EXCH	-104331.8	35278.46	-2.957379	0.0081
CP	2412.999	935.6992	2.578819	0.0184
CG	-2434.307	4945.573	-0.492219	0.6282
C	-7470868.	8258622.	-0.904614	0.3770

Source: Research's compilation using E-view 10 (2020).

R^2= 0.991402, F stat= 438.1810, R^2Adj= 0.989140, F-Statistic = 438.1810, F- prob = 0.000000

Table 5 above depicts the estimation results between banking sector reforms and economic growth in Nigeria. The results indicated that money supply and private sector credit have a positive and significant impact on economic growth in Nigeria. On the other hand, exchange rate has a negative and significant influence on economic growth while minimum rediscount rates and bank sector credit to government have negative and insignificant effects on the growth of the Nigeria's economy. Evidence of these claims is supported by the coefficients and P-values of the corresponding variables. From the results, the coefficients of M2, MRR, EXCH, CP and CG are 3388.404, -41977.91, -104331.8, 2412.999 and -2434.307, respectively whereas its associated P-values its 0.0000,

0.6361, 0.0081, 0.0184 and 0.6282, respectively. Similarly, the results showed adjusted R^2 value of 0.991402, which implies that 99.1% changes in the gross domestic product (GDP) are accounted for by the independent variables while the remaining 0.9% is attributed to other variables excluded from the specified model. More so, the F-statistic value is 438.1810 while its F-prob. value is 0.000000. This result implies that joint influence of the independent variables on the dependent variable is statistically significant. These results imply that on average, N1 increases in money supply, private sector credit, bank credit to government will result in 3388.404 and 2412.999 units respectively improvements in gross domestic product of Nigeria. Furthermore, N1 rise in MRR, EXCH and CG will bring about 41977.91, 104331.8 and 2434.307 decreases in the growth of the Nigerian economy

Table 6: Heteroscedasticity test

				Decision
F- statistics	3.020754	Probability	0.0500	Accept
Obs* R-Squared	0.991402	Probability	0.3223	Accept

Source: Research Computation, 2022.

From the above table 7, it was observed that P value of 3.020754 > 0.05. Hence, the study rejects the null hypothesis and concludes that there is homoscedasticity in the series. To this case, P value is greater than 0.05 Null hypothesis is rejected while alternative hypothesis is accepted which says, banking sector reforms in the Nigerian economy has not impacted on the growth and development of the economy.

CONCLUSION

This study examined the impact of banking reform on economic growth of Nigeria, using multiple regression analysis. The result showed that Nigeria's economic growth is responsive to some of the macroeconomic variables. Furthermore, the reforms were intended to ensure a diversified, strong and reliable banking sector which guarantees the safety of depositor's money, play active developmental roles in the Nigerian economy, be competent and competitive players in the African and global financial system. Although long-run relationship exists between bank reforms and economic growth in Nigeria, capital reform has affected economic growth and interest rate deregulation has not impacted positively on economic growth. The result of the co-integration equations indicated that long run relationship exists between the dependent variable (Gross Domestic Product) and the independent variables (banking sector reforms). This follows that well articulated and properly implemented banking reform should lead to enhanced economic growth. This implies that financial reforms influence the direction of banking sector performance in Nigeria.

RECOMMENDATION

Since the banking sector occupies a critical spot in the economy, the study recommends that government should encourage regular but prudent reforms in the system for optimal economic role. Although long run relationships exist between the selected variables for measuring banking sector reforms and economic growth, Central Bank should build and maintain a sound and vibrant banking system as such will ensure that its banking sector policies are sustained. The study further recommends that the regulatory and supervisory framework be further strengthened. More so, money supply policy be made to regulate inflation via high regulation of price and such monetary policy should be more targeted on the creation of employment opportunities so as to affect financial deepening and thus, economic growth in the economy. Since banking sector reforms have significantly impacted on Nigeria's economy in the long-run, there is need for more financial reforms to be for a better banking performance.

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