The Nexus between Financial Development, Trade Performance and Growth in Nigeria

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Abstract: *The study investigates the nexus between financial development, trade performance and growth in Nigeria between the period 1985 to 2020. Financial development, government expenditure, inflation rate and trade openness were used as dimensions of independent variables while real gross domestic product was used as the dependent variable. Annual time series data on our targeted variables were obtained from secondary sources including the Central Bank of Nigeria annual statistical bulletin, World Bank development indicators. The Eview9 Statistical Software was employed to analyze the data empirically. The Unit root test shows that financial development, government expenditure, trade openness and real gross domestic product are all stationary after first difference I(1) while inflation rate was stationary at level I(0). The data were analyzed using the Autoregressive distributed lag (ARDL). The results of the ARDL estimates indicate that in the long run financial development and government expenditure coefficients have positive relationships with real gross domestic product and they are also statistically significant. The study recommends amongst others that Nigerian trade performance should be improved through economic diversification so as to reduce much emphasis on oil export and availability of funds from private sector at competitive interest rate in order to produce internationally competitive products should be encouraged. Also, there should be the implementation of monetary policies that would bring about stability in exchange rate, promote trade openness and ensure government purchases that enhances financial development.*

Keywords: financial development; trade performance, economic growth, Nigeria

INTRODUCTION

The engine oil of any economy is the financial sector as it makes resources available for investment, and therefore leading to economic growth. There have been so many studies that recommended the need for capital market development. For instance, a more developed financial sector, according to Bencivenga et al. (1996), may provide liquidity that lowers the cost of the foreign capital essential for development purposes, especially when it involves low-income countries that cannot generate sufficient domestic savings. The development of the financial sector can also be seen to be a factor for poverty reduction, especially through their intermediation activities. Credit availability has assisted in the expansion of small businesses, leading to increase

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in income and employment generation. In Nigeria, the financial sector has grown steadily in recent times, albeit, the socio-economic peculiarities of the country, occasioned by weak institutional quality, poor governance, corruption and insurgency in some parts of the country, among others. Over the years, the stock market has been very active with high performance ratings, reflecting a steady increase in margin loans to customers. The All Share Index (ASI) returned +40.99 per cent on year-to-date (YTD), at end-December 2017, the highest by any African country during the period (Bloomberg, 2017). An analysis of the trend of monetary and financial variables also shows that credit to the private sector, money supply and market capitalization have been on an annual increase and have boosted economic growth. However, the recent low levels of economic growth, even in the face of notable financial sector developments, raises doubts about the role of the financial system in promoting economic growth in Nigeria. There is, therefore, the need to re-evaluate this relationship with a view to understanding whether finance still matters significantly in the face of other variables that could be impacting output growth. Financial development is considered to be the principal input for economic growth and an important component that affects growth through adjustment in productivity growth and efficiency of capital. It affects the accumulation of capital through its impact on the savings rate by altering the proportion of savings (Pagano, 1993; Levine, 1997). This theoretical support can be traced to the work of Schumpeter (1911), the first to argue that the development of the financial sector spurs technological innovation and economic growth (James, 2011; Bah et al., 2016).

The financial sector provides an enabling environment for economic growth and development, productive activity, financial intermediation, capital formation and management of the payments system (CBN, 2017). Financial development is the process that marks improvement in quantity, quality and efficiency of financial intermediary services. This process involves the interaction of many activities and institutions and possibly associated with economic growth. In other words, it implies the level of development and innovation of traditional and non-traditional financial services (Valverde, et al., 2004). Many other authors have also defined financial development in various ways. The World Economic Forum (2012) defines it as the factors, policies, and institutions that lead to effective financial intermediation and markets, as well as deep and broad access to capital and financial services. Noureen (2013) sees it as a catalyst in economic development and is widely recognized by both the monetary and development economists. For Garba (2014) he perceived it as the increased provision of financial services with a wider choice of services geared towards the development of all sectors of the economy. According to the new growth theorists, a well-developed financial system facilitates high and sustainable economic growth (Hicks, 1969). Oloyede (1998) remarked thus, "Financial development is the outcome of accepting appropriate real finance policy such as relating real rate of return to real stock of finance".

Financial systems play a vital role in economic development and, to be successful in the longer term, countries must take a holistic view by identifying and improving long-term factors that are

crucial to their development. Such a process would allow countries to encourage economic prosperity for all participants in the global economy. This approach is supported by empirical studies that have generally found that cross-country differences in levels of financial development explain a considerable portion of the cross-country differences in growth rates of economies.The objective of this study is to empirically investigate the nexus between financial development, trade performance and economic growth in Nigeria from 1985 –2020.

REVIEW OF LITERATURE

Conceptual Clarification
Nigeria's Export Performance
The economy of Nigeria has been basically an agrarian economy which the majority part of its foreign exchange comes from the sales of cash crops such as cocoa, groundnut, coffee, cotton, solid minerals and palm produce. Due to the oil boom of 1970s, crude oil then took over from agricultural as the major foreign exchange earner and contributed to the country 96.8%, while by 2000; it got to 99%. The government made efforts to restore the non-oil sector of the economy during the structural Adjustment Programme period. Despite all the measures that were put in place, the performance of the non-oil export sector has remained encouraging as crude oil still remains the major Nigeria's export. Furthermore, on the trends of the structure of Nigerian economy, her trade exports make it unlikely that the country will be able to take the advantage of increased liberalization and openness of the economy to achieve trade induced growth.

Contribution of Exports to Economic Growth
The following are some of the ways through which exports can contribute positively and meaningfully to economic growth in Nigeria:
i. Export expansion may result in efficient resource allocation since it brings incentives for domestic resource allocation closer to international opportunity costs.
ii. An increase in exports could promote specialization in the production of export commodities that in turn may increase the productivity of the export sector.
iii Export may also give access to advanced technological improvement in the economy due to foreign market competition.
iv. Exports expansion benefit from international market also allows greater capacity utilization exploiting increasing foreign demand in world markets.
v. Exports that are based on comparative advantage would allow the exploitation of economies of scale that are external in the non-export sector, but internal to the overall economy.

Economic Globalization has two dimensions: actual economic flows and restrictions to trade and capital. The sub-index on actual economic flows includes data on trade, FDI, and portfolio investment. The sub-index on restrictions takes into account hidden import barriers, mean tariff rates, taxes on international trade such as a share of current revenue, and an index of capital controls. Dos Santos believed that, unequal exchange led to the development of dependency

relationship where third world has their economies conditioned by the growth and expansion of another economy. Nigeria as an example experienced dependent economy which is considered among the factors responsible for economic slow growth rate. Globalization imposed a dependent capitalist social system and western values in the forms of industrialism, market principle and institutions on Nigeria. Nigeria has been experiencing disappointing performance in terms of growth in GDP and the general development of her economy. As a result, there is no improvement in the reduction of poverty. In the last decades, the global economy suggests a challenge; the utilization of the opportunity engineered by globalization while at the same time managing the problem and tension it poses, for developing countries like Nigeria. Rather than strengthening the economy, globalization seeks to retrench it, thus Nigeria enters the global market at a competitive disadvantage as a largely mono-product economy with weak currency, shrinking indigenous industrial space, mounting debt profile, corruption-infested political and economic climate.Energy is an extremely important source of economic growth as it feeds in to other productive economic activities.

THEORETICAL REVIEW

Stage of Development Theory: The theoretical basis of this study is anchored on stage of development hypothesis of financial development by Hugh Patrick (1966) which states that the direction of causality between financial development and economic growth changes over the course of development. That is, at the early stage of development, the supply- leading impetus is evident but as real growth occurs in the economy, it will spark demand for financial services. This theory suggests a demand – following relationship between financial and economic developments. High economic growth creates the demand for modern financial institutions; their services, their assets and liabilities and arrangements, by investors and savers in the real economy. The financial market in turn responds to such demands. In this case, the evolutionary development of the financial system is a continuing consequence of the pervasive, sweeping process of economic development. The level of demand for financial services Financial Development and Economic Growth Nexus in Nigeria depends upon growth of real output, and commercialization and monetization of agriculture and other traditional substance sectors.

Financial Liberalization Theory: This hypothesis as postulated by Mckinnon and Shaw (1973) sees the role government intervention in the financial markets as a major constraint to savings mobilization, investment, and growth. The main critique of the financial liberalization theory emanates from the imperfect information paradigm. This school of thought disagrees with the proposition of these scholars and examines the problem of financial development in the context of information asymmetry and costly that results in credit rationing. As observed by Stiglitz and Weiss (1981), asymmetric information leads to two serious problems, first, adverse selection and second, moral hazard. The implication is that the information asymmetries of higher interest rates which actually follow financial reforms and financial liberalization policies in particular exacerbates risk taking throughout the economy and hence threatens the stability of the financial

system, which can easily lead to financial crises while the feedback theory suggests a two-way causality between economic growth and financial development.

Financial Repression Theory: This hypothesis refers to the notion that a set of government regulations, laws and other non-market restrictions prevent the financial intermediaries of an economy from functioning at their full capacity. The policies that cause financial repression include interest rate ceilings, liquidity ratio requirements, high bank reserve requirements, capital controls, and restrictions on market entry into the financial sector, credit ceilings or restrictions on directions of credit allocation and government ownership or domination of banks. Economists have commonly argued that financial repression prevents the efficient allocation of capital and thereby impairs economic growth (Okpara, 2010).

Empirical Literature
Some empirical studies carried out have supported the idea that financial development does indeed brings about economic growth while others opposed the proposition that financial development leads to economic growth. Adekunle, Salami and Adedipe (2013) examined the impact of financial sector development and economic growth in Nigeria. They contended that an efficient financial system is essential for building a sustained economic growth and an open vibrant economic system. According to the study, Countries with well-developed financial institutions tend to grow faster; especially the size of the banking system and the liquidity of the stock markets tend to have strong positive impact on economic growth. They employed the OLS method of the regression analysis; the financial development was proxied by ratio of liquidity liabilities to GDP (M2GDP), real interest rate (INTR), ratio of credit to private sector to GDP (CPGDP) while the economic growth was measured by the real GDP (RGDP). The study finds that only the real interest rate is negatively related. All the explanatory variables were statistically insignificant. For example, Oriavwote and Eshenake (2014) examined the implications of financial development on economic growth in Nigeria, using time series data for the period of 1990-2011. The study applied the co-integration analysis with its error correction mechanism; the variables included Real Gross Domestic Product, Financial deepening (ratio of money supply to GDP, liquidity ratio, interest rate and the credit to private sector). These findings show that financial sector development has not significantly improved private sector development, while the capital base and liquidity ratio has improved the level of economic growth in Nigeria. Madichie, et al., (2014), applied OLS, ADF and PP unit root tests, Johansen cointegration, error correction model, and the Granger causality procedures to examine the relationship between financial development and economic growth in Nigeria using data from 1986 – 2012. The results revealed that financial development affects economic growth negatively in the long run whereas its impact on economic growth is positive in the short run. The results also revealed that long run relationship exist between financial development and economic growth while causality runs from economic growth to financial development in Nigeria.

Olanrewaju, Aremo and Aiyegbusi (2015) studied the causal linkages between banking sector reforms and output growth of manufacturing sector as well as the direction of such causality. A

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selected sample of financial development and manufacturing output of Nigeria with annual data between 1970 and 2008 were used and co integration and Granger-causality techniques were applied to ascertain evidence regarding this important issue. The result of Granger causality analysis according to the study showed that the MGDP and banking sector reforms indicators (BF) move differently with one not predicting the other within the study period. Moreover, the empirical results showed that Bank assets, lending interest rate with co-efficient, exchange rate and real rate of interest positively and significantly affected the manufacturing sector"s output growth in Nigeria. On the other hand, the financial deepening indicator (M2/GDP) and Interest rate spread negatively and significantly impacted on the MGDP in Nigeria, showing that the effects of banking sector reform indicators could vary widely in an economy. The study concludes that with proper banking policy formulations and guidance in the financial sector, the manufacturing output growth would be positively affected.

Chude and Chude (2016) investigate the impact of financial development on economic growth in Nigeria from 1980-2013. Vector error correction model were employed. They obtained the following results, firstly, the trace statistics of the Johansen co integrating equation shows that there exist a long run equilibrium relationship between financial development and economic growth in Nigeria, secondly, ratio of broad m one y supply to GDP have no significant impact on economic growth in Nigeria, thirdly, ratio of domestic credit to private sector to GDP have no significant impact on economic growth in Nigeria, fourthly, the causal relationship between financial development and economic growth indicated that ratio of Domestic Credit to the Private sector granger cause the economy.

METHODOLOGY

Model Design
Research design is referred to as a blueprint for data collection prior to the study. It can be either of experimental or quasi-experimental types. Given the nature of this study, the study employed a quasi-experimental research design which is suitable for the social sciences. The complexities and dynamic nature of the relationships existing between the variables informed the use of quasi-experimental design. Such relationships are not subject to manipulation. Basically, the study adopted the quasi-experimental design which places emphasis on the systematic generation of the sample for the study of the relationships among the variables.

Model Specification

The mathematical form of the model is expressed as

RGDP = F (FD, INFL, GOVEXP, TOP)   1

Where RGDP = Real gross domestic product

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FD = Financial development

INFL = Inflation rate

GOVEXP = Government expenditure

TOP = Trade openness

F = Functional notation

RGDP is the dependent variable

The linear regression model based on the above functional relation is expressed as:

$$RGDP = \beta_0 + \beta_1 FD + \beta_2 INFL + \beta_3 GOVEXP + \beta_4 TOP \qquad\qquad 2$$

$$\Delta RGDP_t = \alpha_{0i} + \beta_{1i} RGDP_{t-1} + \beta_{2i} FD_{t-1} + \beta_{3i} PINFL_{t-1} + \beta_{4i} GOVEXP_{t-1} + \beta_{5i} TOP_{t-1} + \sum_{i=1}^{q} \alpha_1 \Delta RGDP_{t-1} + \sum_{i=1}^{p1}\alpha_2 \Delta FD_{t-1} + \sum_{i=1}^{p2}\alpha_3 \Delta INFL_{t-1} + \sum_{i=1}^{p3}\alpha_4 \Delta GOVEXP_{t-1} + \sum_{i=1}^{p4}\alpha_4 \Delta TOP_{t-1} + et$$

$$3$$

ECM

$$\Delta RGDP_t = \alpha_{0i} + \sum_{i=1}^{q} \alpha_{1i} \Delta RGDP_{t-1} + \sum_{i=1}^{p1} \alpha_{2i} \Delta FD_{t-1} + \sum_{i=1}^{p2} \alpha_{3i} \Delta INFL_{t-1} + \sum_{i=1}^{p3} \alpha_{4i} \Delta GOVEXP_{t-1} + \sum_{i=1}^{p4} \alpha_{5i} \Delta TOP_{t-1} + \lambda ECT_{t-1} + et \qquad 4$$

$B_1 \geq 0, \beta_2 \geq 0, \beta_3 \geq 0, \beta_4 \geq 0, \beta_5 \geq 0$

Where β_0 is the regression constant or intercept, $\beta_1, \beta_2 \beta_3 \beta_4$ and β_5 are the regression coefficients or parameters and U is the random variable. All other terms are as earlier defined.

EMPIRICAL RESULTS AND DISCUSSIONS

Table 1: Augmented Dickey Fuller and Philips Perron Unit Root Test for LITR Model

Variable	ADF					PP				
	Level		1st Diff		I(.)	Level		1st Diff		I(.)
	Coeff.	5% CV	Coeff.	5% CV		Coeff.	5% CV	Coeff.	5% CV	
FD	-0.898	-3.530	-4.965	-3.530	I(1)	-0.643	-3.530	-5.074	-3.533	I(1)
GOVEXP	-3.060	-3.540	-5.297	-3.533	I(1)	-2.150	-3.530	-5.383	-3.533	I(1)
TOP	-2.325	-2.939	-5.227	-2.943	I(1)	-2.236	-2.939	-8.092	-2.941	I(1)
RGDP	-2.231	-1.953	-2.413	-3.558	I(1)	-2.365	-3.530	-4.191	-3.530	I(1)
INFL	-2.967	-2.939	---	---	I(0)	-2.983	-2.939	---	---	I(0)

Table 1, shows the result of unit root test conducted with both Augmented Dicky Fuller Test (ADF) and Philips Perron Test (PP). To get a robust result for this empirical study, we adopted the outcome of Philip Perron statistics due to the robustness of the result in point of structural breaks. In line with the prepositions of Jenkins and Box (1970). Variable that are not stationary at levels would be made stationary after first difference. The following variables in the model were made stationary after first difference, FD, GOVEXP, TOP and RGDP while INFL rate was stationary at level.

Autoregressive Distributed Lag (ARDL) Model and Bounds Test for Cointegration The (ARDL) model approach of Pesaran, Shin and Smith (2001) is applied to investigate the relationship between financial development and trade balance in Nigeria. The ARDL model is chosen because of the inbuilt cointegration procedure called the bounds test for cointegration or long-run relationship. The ARDL bounds test is more flexible when compared to other cointegration methods.

The ARDL bounds test is used to test the null hypothesis that there is no Cointegration among the variables against the alternative hypothesis. If the calculated F-statistics is greater than the upper

bound then the null hypothesis is rejected in favour of the alternative hypothesis and if it is below the lower bound then there is no co-integration.

Table 2: Bound Test for RGDP Model

ARDL Bounds Test
Date: 03/19/22   Time: 12:03
Sample: 1984 2020
Included observations: 37
Null Hypothesis: No long-run relationships exist

Test Statistic	Value	K
F-statistic	4.030823	4

Critical Value Bounds

Significance	I0 Bound	I1 Bound
10%	2.45	3.52
5%	2.86	4.01
2.5%	3.25	4.49
1%	3.74	5.06

Source: Computed from E-view

The result presented in table 2, shows that the calculated F-statistics of 4.030823 is higher than the upper bound critical value of 4.01 at 5% significant level. Based on this result, it is concluded that a long run relationship exists among the variables of RGDP model. So, there is a long run co-integration amongst the variables in the model.

Table 3: ARDL-ECM Short-run Results for RGDP model

ARDL Cointegrating And Long Run Form
Dependent Variable: RGDP
Selected Model: ARDL(2, 3, 1, 0, 0)
Date: 03/19/22 Time: 12:09
Sample: 1981 2020
Included observations: 37

Cointegrating Form				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(RGDP(-1))	-0.510055	0.245924	-2.074037	0.0481
D(FD)	-0.020260	0.011548	-1.754460	0.0911
D(FD(-1))	-0.002846	0.013270	-0.214437	0.8319
D(FD(-2))	-0.043731	0.015023	-2.910895	0.0073
D(GOVEXP)	10.496573	5.208248	2.015375	0.0543
D(INFL)	-0.452626	0.304892	-1.484543	0.1497
D(TOP)	1.795057	0.547470	3.278822	0.0030
CointEq(-1)	-0.296494	0.122097	-2.428354	0.0224

Cointeq = RGDP - (0.0289*FD + 101.1991*GOVEXP -1.5266*INFL + 6.0543 *TOP -237.1860)

Source: Computed from E-view

Explanation of estimated short run for RGDP model

The result of the short – run dynamic regression of the model is presented in table 3. The regression result indicates that in the short run, FD and INFL coefficients have negative relationship with RGDP but positive relationships for GOVEXP and TOP. What this means is, increase in financial development and inflation rate would lead to decrease in real gross domestic product in Nigeria in the short run ceteris paribus. Also increase government expenditure and trade openness would lead to increase in real gross domestic product in the short run all things being equal. Though financial development and inflation rate coefficient are negative but do not significantly affect the relationship that exists between FD, INFL and RGDP. This means that financial development and inflation rate do not meaningfully pose any problem to economic growth in Nigeria. What could be adduced for this type of relationships between RGDP and FD, INFL rate is the fact that there are other factors other than financial development and inflation rate that could negatively affect economic growth (RGDP) such as high unemployment, pandemic, illiteracy etc.

The ECM turned up with a negative value of -0.296494 as the ECM coefficient which suggests 29% speed of adjustment. This means that approximately 29% of discrepancy in the previous year is adjusted for the current year.

Table 4: ARDL Long Run Regression for RGDP Model

Long Run Coefficients				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
FD	0.028935	0.009182	3.151310	0.0041
GOVEXP	101.199058	39.744566	2.546236	0.0172
INFL	-1.526591	1.063589	-1.435320	0.1631
TOP	6.054268	3.541151	1.709689	0.0992
C	-237.186001	156.445638	-2.516092	0.0141

Source: Computed from E-view

Explanation of the Estimated Long-run for the Model

The result of the long run regression estimates for RGDP model is presented in table 4. The regression estimates indicate that all the coefficients except that for inflation rate are positively signed. But it is only government expenditure and financial development that are statistically significant. This indicates that in the long run, an increase in government expenditure and financial development would positively affect real gross domestic product (economic growth) in Nigeria. This result is consistent with that of Hassan et al. (2011) and Botev et al. (2019), which confirms a long-term positive relationship between financial development and economic growth in developing countries like Nigeria. However, inflation rate is negatively signed but is not statistically significant.

Tables 4.1 Residual Diagnostics Test for RGDP

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	2.164719	Prob. F(2,24)	0.1367
Obs*R-squared	5.654515	Prob. Chi-Square(2)	0.0592

Source: Computed from E-view

The null hypothesis states that there is no serial correlation. Since each of the F-statistics probability value is greater than five

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percentage we cannot reject the null hypothesis of no serial correlation. It means that the result is good.

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	3.463057	Prob. F(10,26)	0.0053
Obs*R-squared	21.13342	Prob. Chi-Square(10)	0.0202
Scaled explained SS	8.769233	Prob. Chi-Square(10)	0.5541

Source: Computed from E-view

The null hypothesis states that there is no heteroskedasticity. Since each of the F-statistics probability value is greater than five percentage we cannot reject the null hypothesis of no heteroskedasticity. It thus mean that the result of the model can be taken seriously, that is the result is good.

Stability Tests for RGDP

The test is meant to test the appropriateness and stability of the estimated ECM model. This is to check if the coefficients of the model are stable and can be used for prediction. The stability test was conducted using the cumulative sum (CUSUM) and cumulative sum of square (CUSUMSQ) tests. If the plot of the CUSUM and CUSUMSQ for the model lies within the 5 percent critical bound it is suggestive that the model is stable. From our results, the model is stable.
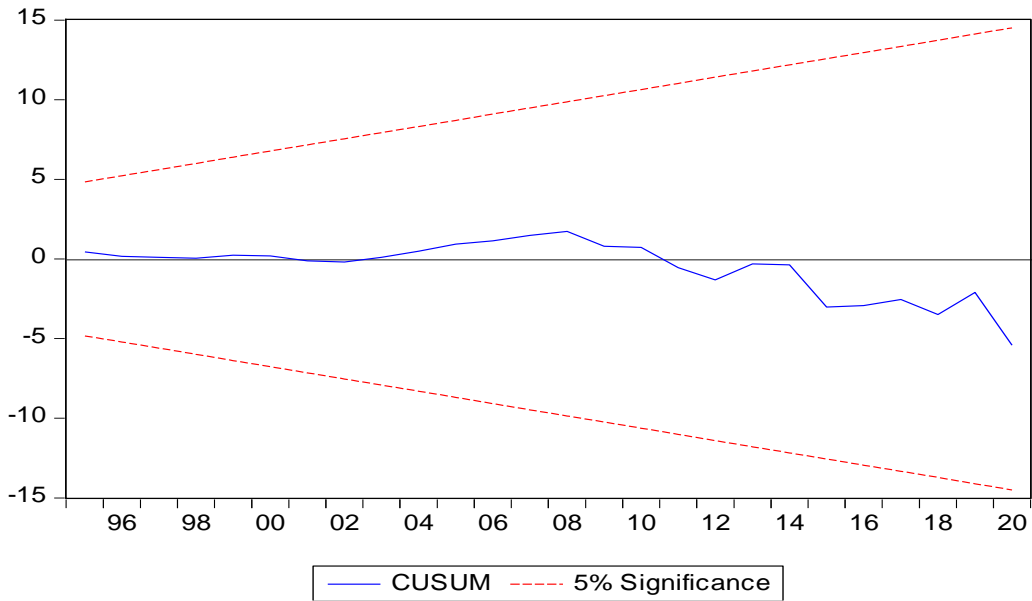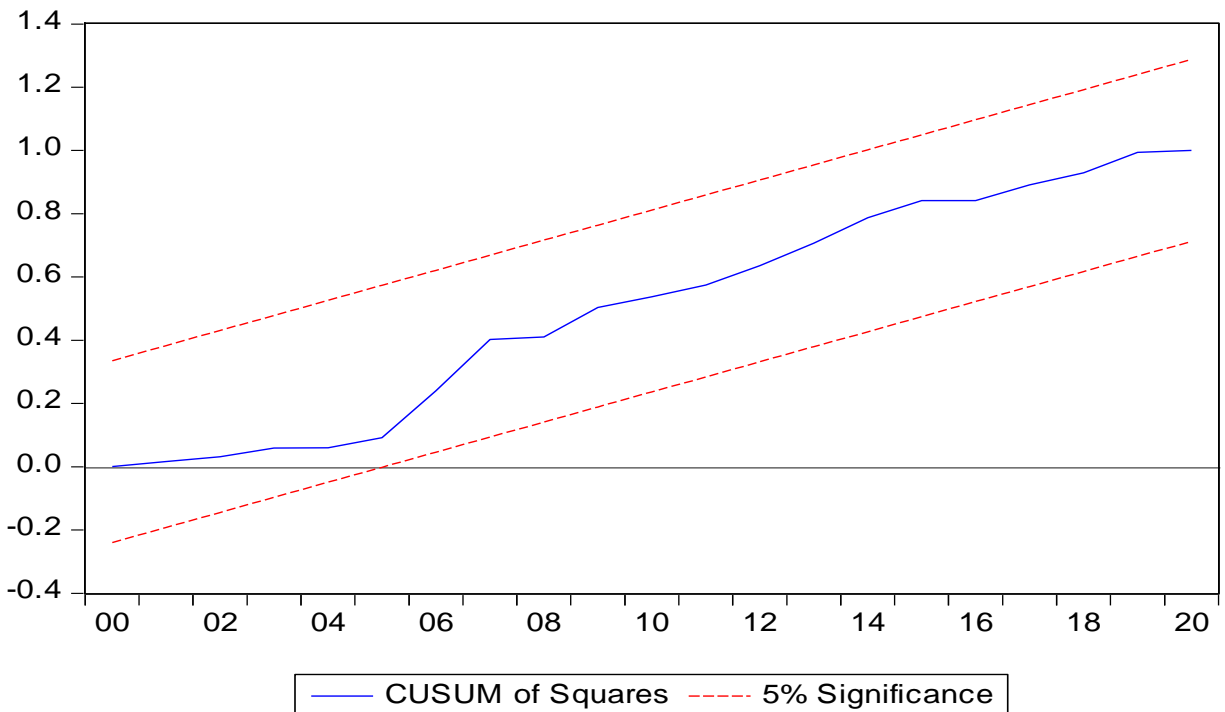
Figure 1b: Cumulative sum for the Model

Figure 1b: Cumulative sum of Square for the Model

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CONCLUSION/RECOMMENDATIONS

This paper examined the nexus between financial development, trade performance and economic growth in Nigeria from the period 1981 – 2020. The study investigated the long run and short run relationship between the variables by using Autoregressive distributed lag (ARDL). The empirical results show that Real gross domestic product (RGDP) is influenced positively by government expenditure (GOVEXP) and trade openness (TOP) in both the long run and short run. GOVEXP coefficient is found to be statistically significant only in the long run, while TOP coefficient is statistically significant only in the short run. Financial development coefficient (FD) and inflation rate coefficient (INFL) are negatively signed and it is only FD coefficient that is statistically significant in the long run. The study recommends that Nigerian trade performance should be improved through economic diversification so as to reduce much emphasis on oil export and availability of funds private sector at Competitive interest rate in order to produce internationally competitive products should be encouraged. Also, there should be the implementation of monetary policies that would bring about stability in exchange rate, promote trade openness and ensure government purchases that enhances financial development. Such policies could include increasing the number of bank branches to improve financial access and inclusion, increasing the supply of money to enhance financial depth and advancement in technology to achieve financial efficiency. Government should improve on fighting corruption in financial sector and other sectors, arrest and prosecute corrupt public office holders.

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