Banking Sector Reforms And Economic Performance:

Analysis Using Credit To Private Sector.

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Abstract

This study focuses on the implications of Credit to private Sector on the economic growth of Nigeria. Reforms have been introduced and implemented in Nigeria over the last three decades. The impact of these reforms on the economic growth have not been well felt by the citizens. The study is to determine the relationship between Credit to private Sector and economic growth of Nigeria. Regression model was used to present the estimates evaluated with T-test, F-test, DW-test and standard error estimates used to test the level of significance. The study found out statistical significance between Credit to Private Sector (CPS) and Real Gross Domestic Product (RGDP) in billions (N).furthermore, if there is one (1) million of Credit Private Sector (CPS) in the economy, the real output (RGDP) of the economy will increase by some significant percent of total increase in Credit to Private Sector (CPS).The Nigerian banking sector should increase the amount of credit given to private sector; this will in turn contributes greatly to the growth of Real Gross Domestic Product (GDP)bringing about increase in economic growth of the economy at large. The research concludes that bank reforms have resulted in making banks more efficient, reliable and their intermediating potentials have also been revived.

Keywords: *Bank, reforms, economic growth, credit and private sector*

Introduction

The relevance of banks in the economy of any nation cannot be overemphasized. They are the cornerstones of the economy of a country. The encyclopedia Americana International edition put the position thus "economic activities as it is known could not be sailing without the continuing flow of money and credit. The economies of all market oriented nation depend on the efficient operation of complex and delicately balanced systems of money and credit. Banks are indispensable element in these systems. They provide the bulk of the money supply as well as the primary means of facilitating the flow of credit". Consequently, it's submitted that the economic wellbeing of a nation is a function of advancement and development of her banking industry and the economy at large.

The financial deregulation in Nigeria that started in 1987 and the associated financial innovations have generated an unprecedented degree of competition in the banking industry. The deregulation initially pivoted powerful aid for the expansion of both size and number of banking and non-banking institutions. The consequent phenomenal increase in the number of banking and non-banking institutions providing financial services led to increased competition amongst various banking institutions, and between banks and non-banking financial intermediaries all targeted at increasing the level of economic growth. Apart from the keen competition with the range of financial activities, banks have also faced problems associated with a persistent slowdown in economic activities viz economic growth, severe political instability, virulent inflation, worsening economic financial conditions of their corporate borrowers and increasing incidence of fraud and embezzlement of funds. Hence, the continuing decline in the financial standard of banks and increasing incidence of bank failure since

deregulation have raised question about the state and nature of the Nigerian banking sector.

Banks facilitate economic growth in variety of ways. In the first instance, they act as financial intermediaries between the surplus generating units and the deficit spending ones. Ubom (2009) This is a twofold function involving the mobilization of saving from the former group which are then channeled to the later to support productive economic activities, Afolabi (2006). This intermediary role is important in two respects, first, by pooling together savings that would have otherwise been fragmented, banks are able to achieve economies of scale with potential benefit for the users of such funds, secondly in the absence of banks each person or business seeking credit facilities would have had to individually look for those with such funds as negotiable with them directly.

Theoretical Framework and Literature Review

Banks occupy a vital position in the economic life of nation, be it developed or developing. They are the pivot on which the economy of any nation revolves.

The word "Bank" is derived from the Italian word "Banco" meaning bench. The laws in Lombardy, the early bankers conducted their businesses in the market place. (Goshit, 2008). According to Afolabi (2006), a bank is a financial house established for the purpose of accepting deposits and other related precious commodities from the public for safe keeping as well as acting as intermediaries between owners of deposits funds or lenders and users of the funds.

On the other hand, Bergrof and Roland (1995) describes banks as the most entity in a country's financial system of mobilizing funds. As a result they constitute the centre piece of the financial system. While Ubom (2009) describes banks "as financial intermediaries that assist in channeling funds from surplus economic units to deficit one to facilitate business transaction and economic developments in general."

An Overview of the Banking Reforms in Nigeria

This research has utilized reforms in the banking sector from the 1990s. This is because the 1980s reforms are outdated for current review. Therefore, prospective banking sector reforms in Nigeria overtime include the following:

The Post SAP Era (1993)

This era witnessed a brief period (1993) of renewed regulation (with interest and exchange rates fixed subsequently, the period of guided deregulation. The deregulation approach to monetary management and the resultant proliferation of banking and financial institutions in the early 1990s brought about an increased number of players far beyond what could be effectively managed by the CBN. As a result, the financial industry witnessed serious waves of distress that caused crises of confidence in the industry (Ayanwale 2007). The failed banks (Recovery of Debts) and financial malpractice in Banks Decree was promulgated in 1994 to sanitize the banking industry.

The Reform Lethargy (1993 - 1998)

This phase of reform led to the reduction regulations. During this period the banking sector suffered deep financial distress, beginning with the civilian democracy in 1999, while it led to the return to liberalization of the financial sectors, accompanied with the adoption of distress resolution programmes. This era also saw the introduction of universal banking which empowered the banks to operate in all aspects of retail banking and non-banking financial markets (Hancock 1995).

Pre Soludu Era (1999 – 2004)

During this phase of banking reforms, the number of banks in the economy did not change (i.e. remained at 89). But it was noted that, the number of banks' branches increased from 2306 to 3383 (CBN statistical bulletin 2005). The total assets base of banks increased within this phase from 15.6 billion dollars, 21.9 billion dollars and 24.2 from 2001, 2002 and 2004 billion dollars respectively. The capital

and reserves of banks increase in billions of Naira from 394.6 in 2000 to 821.9 in 2002 and 1060.0 in 2004 (CBN statistical Bulletin 2005).

The Soludo Era (2004 – 2005)

The banking sector reforms which started in 2004 and focused on strengthening and consolidating the banking system, ended on December 31st 2005 (CBN Briefs 2006 – 2007). The major emphasis of the reforms on recapitalization and proactive regulation under a risk-based or risk-focused supervision framework-has ensured competition and safety of the system and has proactively positioned the industry to perform its role of intermediation and economic development specifically, the successful consolidation of the industry has ushered in a number of positive developments to the banking sector in particular and economy at large (Soludo 2004).

The Soludo's banking sector reforms is the most well recognized reform since the history of the Nigerian banking sector. The nature of these reforms and outcomes can be categorized under Bank consolidations, Foreign exchange market stabilization, Interest rate restructuring, and the pursuit of stabilization as against an inflationary control and Currency control.

Post Soludo (2005 — 2006)

After the Soludo's consolidation, several issues occurred. Following the successful consolidation of the Nigerian banking industry, a number of consolidation challenges emerged. These challenges relate to the stake holders in the industry particularly the operators, regulatory authorities and the government. In this case operators lost focus; regulators became corrupt and failed in control, while government also became corrupt and did not monitor.

Sanusi Era (2009 – 2012)

The CBN is empowered to regulate both the micro and macro-economic policies on

behalf of the federal government and has sweeping authority in financial matters to regulate the sector and ensure the sustainability in the long run (Sanusi 2010). An important responsibility of the central bank is to regulate the banking sector as well as act as the lender of last resort. (CBN 2005)

On assumption of office in June 2009, the CBN governor Mallam Sanusi Lamido Sanusi launched a crusade aimed at sanitizing the banking sector which was at the verge of collapse going by the result of the joint Audit - inducted by the banks depositors insurance Scheme (NDIC 2010). Sanusi's crusade was basically aimed at sanitizing the sector and to streamline the banking industry along the lines of good corporate governance and internationalizes its practice (Sanusi, 2010).

The reforms ensured that banks pay greater attention to the design of their international process and procedures with respect to risk management. In this perspective, the asset management initiative was established in order to ensure that banks operate with international standard. The ACM was an initiative which was adopted during the period of financial crisis in 2007. The ACM initiative is basically established in order to improve the capital and liquidity positions by taking over toxic assets from banks and stimulate bank lending by equity injection in other to stabilize the banking sector (Sanusi 2010). In a nutshell Uwu (2010) summarizes the four basic pillars of Mallam Sanusi's reforms to include ,enhancing the equity of banks, establishing financial stability, ensuring that the financial sector contributes to the real economy. It is important to note clearly that since this era is still in process and has to end part of these reforms have been achieved. The CBN governor, Barro (1991) held that the reforms in order to achieve its goals must encapsulate a holistic set of strategies designed to stabilize the banking sector and the economy as a whole. These strategies include, fixing the problems the banks, tighter regulation of the banking sector, adoption of a risk based supervision, effective consumer protection and the reform of the CBN itself.

Broad Objectives of Banking Sector Reforms

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, Levine and Zervos (1998), CBN (2005) and several financial sector analysts summarized the objective to include:

(a) Less intervention in the market with the view to promote a more efficient resources allocation.

(b) Expending the saving mobilization base in support of investment and growth through market base interest rates.

(c) Improving the regulatory framework and procedures so as to forestall distress.

(d) Laying the basis for minimal inflationary growth or conclusive enabling environment.

Among the policy instruments often employed to attain these objectives are:

i) Foreign exchange markets and interest rates deregulations.

ii) Adaptation of market base approach to credit allocations.

iii) Pursuit of sustainable fiscal and monetary policies

iv) Reforms or restructuring of financial markets via legislative changes.

v) Active use of prudential regulations and enforcement of capital adequacy requirements.

Theoretical Framework on economic growth

Economic literature as developed over time states two most basic growth theories that have been developed since the thirties (Hahn 1964) as cited by Ubom (2009). The theory that serves as the point of departure in economic survey and the one that usually receives first consideration in any current discussion of modern growth theory is one that relates the growth rate of economy's aggregate output to that of its capital stock. In this approach, capital is the only factor of production explicitly considered, and it's assumed that labour is determined with capital in fixed proportions (Shapiro, 1985).

With regards to this, the theories in this respect include the classical theories of economic development and the endogenous growth model. Hence, it is essential to mobilize domestic and foreign savings in order to generate adequate investment to accelerate economic growth for an economy to take off

In this case the increase in capacity output in Harrod-Domar growth involves a simple production function that relates the generation of total output to the stock of capital via the capital output ratio.(Jhinghan 2003) In contrast) the marginal capital - output ratio $\Delta K/\Delta Y$ tells us how much additional capital to that flow of output. The marginal ratio need not be equal to the average ratio as long as technology changes over time.

Hence, this theory of growth came into a conclusion that capital output ratio should borrow and fill the gap between aggregate capital, savings and investment.

Correlates of Economic Reforms and Economic Growth

There is fair agreement in literature that economic reforms, especially what came to be tagged structural adjustment program (SAP), have almost always been pressured response to national financial distress whose foundation could be traced to macroeconomic distortions Levine and Renelt (1992). While such distress manifest mainly as deep economic problems (stagflation and huge external debts), distortions are often evident in the pursuit of unsustainable fiscal, monetary and exchange rate policies in addition to widespread government intervention in enterprises that can best be handled by the private sector. In general, several analysts believe that economic mal-adjustment is associated with policy pursuits which depart from free market pricing policies (Chiber et al, 1986; Ray, 1986).

Although there exist an extensive body of literature on the link between finance sector development, economic growth and poverty reduction, there is no consensus on the effects of explanatory variables on economic growth. For

example, these were explained by King and Levine (1993), Levine and Zerves (1998), Rajan and Zingales (1998) and Levine, Loayza and Beck (1999).

The direction of causal relationship between economic growth and banking sector is one area of contention amongst economists. Schumpeter (1934) for example was a strong advocate of the role of the banking sector in stimulating economic growth and stated that "the banker stands between those who wish to form new combinations and the processors of productive means. He is essentially a phenomenon of development, through only when no central authority directs the social process. He makes possible the carrying out of new combinations in the name of exchange economy". Harrison et al (1999) however argue that banking activities and profitability are functions of economic growth.

According to Barvraktar and Wang (2006), banking sector openness had a direct and indirect effect on economic growth through a combination of improvement in access to financial services, and the efficiency of financial intermediaries as both of these causes a lowering of financing which in turn stimulates capital accumulation and economic growth. Bayraktar and Wang (2004) demonstrated that the role of foreign banks was both statistically and economically insignificant in increasing growth and improving the operations of local banks. Guryay et al (2007) also finds that the effect of financial development or economic growth of Northern Cyprus although positive was negligible.

Economics literature is replete with possible qualitative and quantitative explanatory variables that influence the growth rate of per capital output overtime Tuuli (2002) for example, uses the ratio of banks claims on the private sector to GDP, annual consumer price index, and the interest rate margin to analyze the relationship between finance and economic growth. The model specified by Balogun's (2007) theoretical model were more expansive and included money supply, minimum rediscount rates, private sector credit, ratio of banking sector credit to government, ratio of stock market capitalization to credit to the private sector and exchange rates.

Methodology

The study covered up to two decades and a period of 1990-2010, the pattern and plan of this research work were based on historical design, as most of the data used for the study are secondary data which were obtained from CBN bulletin The available data for credit available to private sector (CPS) and Real Gross Domestic Product for the period of 1990 - 2010 is presented using table to facilitate easy understanding. The ordinary least square (OLS) is used for estimation and tests for analysiss. The research adopted regression equation to estimate and test for reliability.

Therefore, based on this research, the following is formulated as hypothesis for this research:

H_0: There is no statistical significance between credit to private sector and the level of economic growth.

Tools of Analysis

The method of analyzing data was the regression of analysis. Here, the general regression equation is given as:

$$RGDP = \beta_0 + \beta_{1X1} + ui \quad (1)$$

RGDP = Real Gross Domestic Product,

β_0 = Constant Intercepts

β_1 = Coefficient of Credit availability to private sector

X1 = Annual credit availability to private sector,

Ui = Disturbance or Error term.

The above regression equation will be estimated using ordinary least square (OLS). In verifying the result of estimate, the standard error tests, T-test, and the F – test will be employed for easy verification, interpretation, and testing. Apart from the model above, the shareholder's fund, assets base and total deposits immediately after consolidation are

also useful criteria for testing bank performance on economic growth.

Table 1: Data Presentation

Years	RGD (Y) N Billion	Credit to Private Sector (N) X
1990	267,550.0	36,630,000
1991	265,379.9	45,330,000
1992	271,365.5	61,200,000
1993	273,833.3	92,500,000
1994	275,450.6	122,300,000
1995	281,407.4	185,600,000
1996	293,745.4	219,700,000
1997	302,022.5	272,500,000
1998	310,890.1	352,400,000
1999	312,183.5	455,200,000
2000	329,178.7	596,000,000
2001	356,994.3	9,167,525,300
2002	433,203.5	11,165,927,100
2003	477,533.0	13,158,426,800
2004	527,576.0	15,805,968,800
2005	561,931.4	22,060,678,100
2006	595,821.6	28,655.320,300
2007	634,251.1	44,675,412,400
2008	674,889.0	76,318,785,100
2009	716,949.7	184,630,440,000
2010	745,627.7	121,691,364,300

Source: *CBN Statistical Bulletin 2009*

Presentation of Results

Table 2: The results of the regression for the two models are shown below:

Functional Forms	**Constant B_0**	**Regression Coefficient**	**Adj**	**F**	**Dw**
		X CPS			
Linear t-values S.E	2.84 E-6 14.765 24201.958	0.818 6.202 0.000	0.652	38.465	0.809
Double log t-values S.E	10.186 64.630 0.158	0.126 17.289 0.007	0.937	298.913	0.760

Table 3: Model Summary

Model	R	R^2	Adj R^2	Std Error Estimate	Durbin Watson	F	T
Results	0.883	0.779	0.767	0.06733	1.689	63.39	7.962

The Durbin Watson statistics which is used to test for the first order serial correlation for the error term is given in the table 2 using 0.05 significant level for the D.W, the d_L = 1.221 and du = 1.420 are the upper and lower limits respectively. For each of the model, there is a problem of the first order serial correlation of the error term But the adjusted R value for the double-log model is higher than that of the linear model.

The first order serial correlation for the error terms has to be eliminated. When it is eliminated, the adjusted R value will be reduced. This is the disadvantage of eliminating the first order serial correlation. So the double log model with higher R value is used here.

In eliminating the first order serial correlation for the error term in the double log model the dependent and the independent variables in the previous double log model were transformed to become.

Log RGDP2=log RGDP -log I and Log CPS2 = log CPS -log CSPt. XO.588 (2)

Where 0.588 is the correlation between the residual values and the lead residual values. Therefore, we obtain the equation after double log is conducted to enable elimination of first order serial correlation.

RDGP=4.421+0.1 (3)

T* = (41.210) (7.962)

DW-test = (1.689)

Discussion

As presented above, coefficient is 4.421 known as constant intercept shows that the regression line did not pass through the origin. This implies that any regression line that passes through the origin does implt efficiency. Hence, it gives the value of RGDP when CP is equal to zero (0), while β_1 coefficient is 0.1000, this implies that when the value of (PS increases by one (l) unit, it would contribute 0.1000 unit to RGDP of the economy which is a positive figure. Hence, the slope coefficient (CPS) based on the results above predicts that if CPS increases by one (1) million naira, RGDP will increase by N100,000. This result shows that the effect of CPS on RGDP is positive. Therefore from the above analysis one can conclude that CPS as positive effects on economic growth measured in RGDP of Nigerian economy. The E test shows that if S.E (is < /2 the explanatory variable under study is a true parameter Hence, it is statistically significant, from the above if applied. Therefore, CPS has significant relationship with RGDP.

R^2 value of 0.779, this means 77.9 percent of the variability in the RGDP is explained by the CPS while the remaining 22 1 percent is caused by other factor accounted by the error term. The Durbin Watson value finally is 1.689. The new confidents limits of the DW is D = 1.201 and d = 1.411 since the size of the sample is 20, DW. (1.689)> d (1.411) we now conclude that there is no first order serial correlation in the error terms.

The F-statistic value (F cal value) is 63.391, testing at 19(df) under 0.05(5%) level of significance. we obtain the F- tab value as 5.98. since F-cal >F-tab we reject H and then accept H_1 which states that there is statistical significance between the reforms in the banking sector and the level of economic growth (RGDP) in Nigeria.

Since the t-cal (7 962) > t-tab (2.09), we reject the null hypothesis and conclude that the CPS coefficient or paramater is significant. The same is applicable for the constant therefore, the estimated regression equation is Log $RGDP_i$ = 4.421 + 0.100log_i CPS_i, I=1 …$_{n.}$ The interpretation is, for every unit increase in the log of CPS, the log of RGDP increase by 0.1 units.

Conclusion

In this study we attempted to measure impact of bank reforms on economic growth in Nigeria from 1990-2010. More specifically an inquiry was made on how CPS could lead to more growth of GDP in Nigeria. Based on the methodology adopted for this study and findings, it is concluded that CPS contributes significantly to economic growth for the period under study; CPS has the capacity to increase GDP of the Nigerian economy. But the rate of contribution depends on the amount of credit given to Private sector in Nigeria. From economic literature other factors that accounted for the 22.1% may be unavailability of credit, improper utilization of available credit, among other factors.

Recommendations

Based on the findings of this study, the following recommendations were made so as to facilitate the effort being made to keep the Nigerian economy on growth path.

1. The Nigerian banking sector should increase the amount of credit given to the private sector; this will in turn contribute greatly to the growth of GDP

bringing about increase in economic growth of the economy at large.

2. This study recommends the need to strengthen and encourage the existing microfinance banks so that they can serve the interest and the need of small customers.

3. With respect to consolidation, there is also need to encourage efficiency and prevent consolidation that lead to situations where excessive risks are generated and most importantly the consolidation of the entire financial institution.

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