Financial sector development and economic growth in Nigeria: an empirical investigation

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Financial Sector Development and Economic Growth in Nigeria: An Empirical Investigation

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In this paper, a single equation econometric model is specified to assess the impact of the Nigerian financial sector on economic growth. Contrary to a priori expectations, the results did not suggest any significant positive impact. The under-developed financial markets, policy inconsistencies, and inadequate financial instruments, were some of the identified constraining factors. In recognition of the key role the financial sector plays in economic development, the paper recommends the sustenance of distress resolution initiatives, adequate capitalisation of the banks, reduction of government dominance in the credit market, and a comprehensive approach to financial sector surveillance as some of the steps necessary to ensure the development of the sector in order to enhance economic growth.

Keywords: *Technical progress, financial depth, risk aversion*

JEL Classification Numbers: C22, E20, E44, G21

I. Introduction

It is incontrovertible that economic growth and poverty reduction have been very high on the development agenda of successive administrations in Nigeria, in the past four decades. Given the per capita income of US$300, this preoccupation does not come as a surprise. Indeed, the economy is expected to grow by a minimum of 7.0 per cent per annum, if the millennium development goal of reducing the level of poverty by half is to be achieved by 2015.

There are numerous growth models in the literature. However, there is no consensus as to which strategy will achieve the best success. As noted by Kuznets (1959), "the achievement of sustained growth requires minimum levels of skills and literacy on the part of the population, a shift from personal or family organizations to larger scale units,

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the creation of transportation and communication infrastructure, some level of urbanization, a shift away from (peasant) agriculture, changes in the social values and industrialization."

Indeed, these factors are generally considered as the necessary pre-conditions for economic growth by developmental economists.

Since the seminal works of Mckinnon and Shaw (1973), the effect of financial market repression on investment and growth, has become also prominent. The general consensus is that low investment efficiency and slower output growth rates are positively associated with repressed financial system. Thus, it is assumed that a liberalized and stable financial system will – all things being equal, contribute to a rapid and sustained output growth.

The purpose of this paper is to assess the role of the financial sector of Nigeria on the growth of the economy. To achieve this objective, the paper is organised in seven sections. Following this introduction is section II, which contains the literature review and conceptual framework. Section III presents an overview of Nigeria's financial sector development. Section IV x'rays the major developments in the real sector. Section V presents an empirical model of the economy's growth determinants. Section V1 examines key constraints to financial sector development in Nigeria while section VII concludes the paper.

II. Conceptual Framework/Literature Review

The traditional literature on economic growth has focused on the supply-side, particularly, on the production function. Solow (1956/57) and Denison (1974), neo-classical framework links growth to the accumulation of: capital, labour and technical progress. Overall, the major determinant of growth was ascribed to *technical progress* and less to *capital.*

The World Bank "two gap" model emphasized the role of savings-investment balance, and foreign exchange constraints on the growth process. Most importantly, the role which foreign capital flows can play in closing these gaps, especially, in developing economies was underscored. Although, lessons of experience seem to indicate that the reliance on FDI flows may be misplaced, in view of the apparent inability of most developing African countries to attract, sustain or adapt foreign capital/technologies on long-term basis.

For Nigeria and several African countries, the achievement of a sustained non-inflationary growth has remained elusive-notwithstanding the adoption of IMF designed growth oriented adjustment programs. Several reasons have been adduced for this failure – They include: weak institutions, bad infrastructure and shallow financial markets. As Fischer (1987), noted: "domestic monetarism of the old Chicago School, like international monetarism did not pay particular attention to growth policies. It relied on non-interventionist microeconomic policies, combined with macroeconomic stability to allow markets to produce the right allocation of resources, both at a moment of time and inter-temporally". Indeed, Fischer echoed the minds of most African policy makers when he observed that: "markets in developing countries are badly distorted ... the financial markets are shallow, exchange rate overvalued, capital controls in place, high tariff walls and subsidies ubiquitous". Against this backdrop, the need to de-regulate the Nigerian economy in general and deepen the financial market in particular, in order to achieve the growth objectives of the policy makers cannot be overemphasized.

There is sizeable empirical evidence, which has linked economic growth to the ebb and flow of the financial system. In particular, the rate of output growth is said to be determined by the accumulation of capital, the efficiency of resource utilization and the ability to acquire and adopt modern technology Nnanna (2001). The degree of financial system development is therefore regarded as crucial for attracting and sustaining capital flows, savings mobilization and utilization.

A very good attempt was made by Levine et al (1999), to establish empirically, a relationship between financial sector deepening and economic growth, using cross-country data on financial system developments. The authors found that financial sector deepening exerts a statistically significant influence on economic growth. They also observed that countries with functional legal system and those with good accounting standards tend to have better developed financial systems and higher growth performance.

The pathway to economic growth when the financial system is well developed was the subject of interest in a stũdy by Denizer et.al (2000). Accordingly, the authors found that a developed and efficient financial system would, ceteris-paribus, ensure a long-run high growth rate, by minimizing macroeconomic shocks that truncate output growth. Beck and Levire (2001) analyzed the interactions between stock markets, banks and output performance using panel data involving 40 countries. The objective of the study was to ascertain, the relationship between financial system deepening and growth and to assess the independent impact of stock markets and banks on economic growth. Overall, the authors found that stock markets and banks are very critical for economic growth – a conclusion, which a priori was self evident.

Finally Demirguc-Kurt and Detragiache (1977) remarked that banking crisis disrupt the flow of credit to households and enterprises – reducing aggregate demand and possibly, forcing viable firms into bankruptcy and liquidation. Furthermore, banking crisis can jeopardize the functioning of the payments system, as well as induce disintermediation and capital flight. Accordingly, the authors opined that systemic banking crisis tends to occur in a weak macroeconomic system characterized by low GDP growth, excessively high real interest rate and inflation. These are indeed, factors, which may influence output growth in an economy.

In order to ascertain the impact of the financial system on output growth in Nigeria, it is pertinent to briefly analyze the Nigerian financial system and see how it fits the stylized theoretical and empirical evidence described above. Accordingly, the next section presents an overview of the Nigerian financial system – its developmental transformation, mutations and constraints.

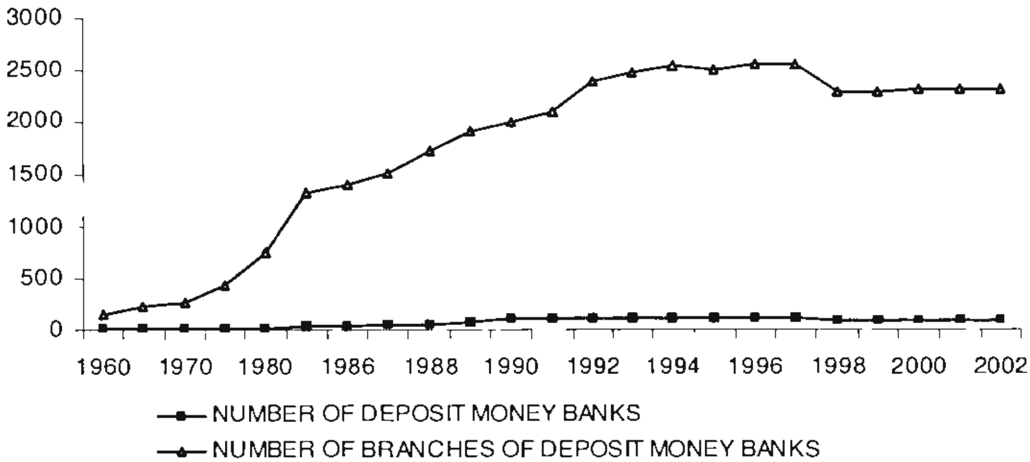
III. An Overview of the Nigerian Financial System

The Nigerian financial system is comprised of 89 deposit money banks (DMBs), with 2,306 branches nationwide in 2003, including a total of 769 community banks (operating either with provisional or permanent licence). The non-bank financial institutions include: 6 development finance institutions, 102 finance companies, 118 insurance companies, 80 primary mortgage institutions, 5 discount houses, 83 bureaux de change and 2 stock exchanges. The banking sector (including the DFIs and, non-bank finance institutions), is regulated and supervised by the Central Bank of Nigeria, which is also, the monetary authority, by virtue of the CBN Act of 1991 as amended. After a bout of systemic distress in the 1990s, the banking industry can now be described as relatively sound and stable. The rating of DMBs in 2003 using the CAMEL parameters revealed that out of the existing 89 DMBs, 11 were rated "sound" 53 were rated "satisfactory" while 14 and 9 banks were rated "marginal" and "unsound" respectively. Banking systems is largely oligopolistic in structure as 5 banks control over 60 per cent of the total assets and deposit liability of the system. The insurance companies are regulated and supervised by the National Insurance Commission (NAICOM). While the stock exchange is regulated and supervised by the Securities and Exchange Commission (SEC), under the operational mandate of the Federal Ministry of Finance.

The Nigerian Deposit Insurance Corporation (NDIC), exercises joint supervisory powers with the CBN over the deposit money banks (DMBs), since it was established in 1987. In addition to its major function of insuring depositors' funds, the NDIC is also the sole agent of the CBN in its role as bank liquidator.

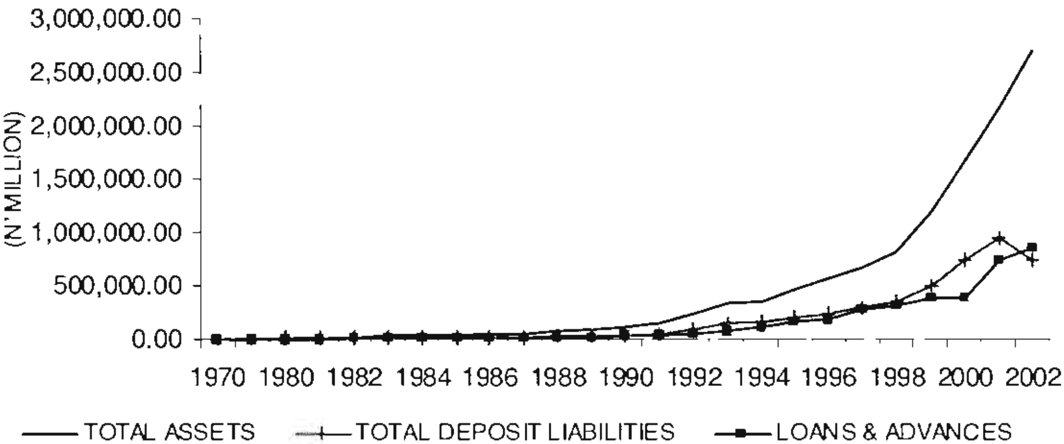
Nigeria's financial system witnessed rapid development and systemic crisis with the introduction of economic reform (SAP), in 1986. From 26 banks (comprising 13 commercial (retail) and 13 merchant (wholesale) banks in 1986, the number rapidly grew to 120 banks in 1992, before declining to 89 in 2002. The banking crisis of the mid 1990s saw the liquidation of 32 banks in 1996 alone. Two more distressed banks were also liquidated in 2002/2003.

Figure 1
Number of Deposit Money Banks and their Branches
(1960 - 2002)



While some considerable measure of financial deepening has occurred in Nigeria, as evidenced by the ratio of M2/GDP, number of bank branches and the size of the balance sheet of the DMBs and Discount houses etc., the contribution of the banking industry to Nigeria's economic growth is very controversial and inconclusive.

Figure 2
Activities of Deposit Money Banks
(1970 - 2002)



While bank lending is considered very critical in enhancing output growth in Nigeria because of the relative underdevelopment of the domestic capital market, and the dearth of direct foreign investment flows into the non-oil sector of the economy; it is however, evident that banks in Nigeria are very risk averse and as such, prefer holding government's debt instruments with relative lower yields, than lend to the private sector, with high yield and higher risk Nnanna (2001).

Thus, it seems that, the liberalization of Nigeria's banking sector has not significantly changed the modus operandi of the operators, with respect to their lending behaviour. Typically, it is generally acknowledged that the structure of the economy's interest rate has a strong influence on the decision as to when to consume or invest and as to how banks go about playing their intermediation roles. Until 1993, interest rates in Nigeria were highly regulated by the CBN, and generally, negative real terms. Thus, in the quest to achieve rapid growth, the economy was sub-divided into "preferred" and "non-preferred" sectors. Accordingly, borrowers in the preferred sectors, which included: agriculture and manufacturing, were subsidized and allowed to borrow at a preferential lower rate of interest than other borrowers in the economy. The objective was to enhance rapid growth in these preferred sectors. Overall, available data indicate that the nominal maximum lending rates to the preferred sectors of agriculture and manufacturing ranged between 3-5 per cent per annum during the three decades of interest rate regulation. The question whether the policy achieved its ultimate objective, remains an empirical question which this paper intends to provide an insight.

The deregulation of the interest rate regime commenced in 1987. It was briefly discontinued but later re-instated and sustained in 1993 by the monetary authority. Under the deregulated regime, developments in interest rates are generally driven by market forces – though, subject to some degree, to the changes in the CBN's Minimum Rediscount Rate (MRR). The MRR is an important monetary policy instrument. It is the nominal anchor rate, which drives other rates in the money market. Its variation generally signals CBN's intention to pursue a policy of monetary contraction or ease. Specifically, the MRR is the minimum rate charged by the CBN when lending to DMBs, in the performance of its role as the lender of last resort. All things being equal, the higher the MRR, the higher the cost of funds to DMBs. Similarly, the more expensive the cost of investment, the lower the rate of economic growth. The MRR is not set arbitrarily by the CBN – it is generally driven by the rate of inflation. In other words, the MRR is inversely related to the inflation rate.

IV. The Productivity Of The Nigerian Economy

Nigeria became a mono-product economy when crude oil was discovered in commercial quantity and the global economy became addicted to oil consumption in the 1970s. The output growth rate as measured by changes in the real gross domestic product (GDP), has been very volatile. For example, the economy recorded negative growth rates between 1981 and 1984. However, between 1985 and 1990, an average growth rate of 6.3 per cent was recorded. Thereafter, economic performance deteriorated – with GDP declining to barely 1.0 per cent by 1994. Between 1999 and 2002, the GDP growth rate has averaged 3.5 percent, compared with the policy target of 5.0 per cent, per annum.

Although Nigeria is generally regarded as oil rich economy, the contribution of the non-oil sector still remains very dominant in the overall GDP. While the oil sector is the major contributor to government's revenue (78 percent), and foreign exchange earnings (97 per cent), its contribution to the gross domestic product has not exceeded 14 per cent, over the years.

The main drivers of growth in the non-oil sector are: agriculture, manufacturing and services. In the 2002 for example, analysis of sectoral contributions showed that the share of agricultural output rose to 41.2 per cent of GDP, from 40.4 per cent in 2001. The manufacturing sector's share was 8 per cent, while the contribution of commerce and services sectors was approximately 29 per cent of the GDP (Table 1).

Overall, the existence of a significant output gap in the economy is incontrovertible. Both economists and political commentators seem to agree that the factors responsible for the weak growth performance include inter alia: inadequate capital and social infrastructure, structural rigidities, institutional weakness, policy errors and most importantly, the persistence of a shallow financial market which is characterized by risk aversion and rent-seeking operators.

We shall attempt to ascertain the relative influence of these variables and other determinants, which have been identified in the literature.

TABLE 1
SELECTED ECONOMIC INDICATORS

		1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
DMBs credit to the Private Sector (₦ million)		35,230.90	43,033.90	57,094.10	90,625.30	116,675.60	141,671.00	171,643.00	238,188.00	238,019.00	350,575.00	500,017.50	854,999.40	955,762.00	1,182,964.10
DMBs credit to the Public Sector (₦ million)		7,352.10	6,375.80	2,059.30	37,909.00	46,156.70	17,365.00	41,548.00	29,441.00	24,970.00	148,154.50	204,302.30	187,116.20	237,148.50	296,440.70
Maximum Lending Rate (%)		20.80	31.20	18.32	21.00	20.79	20.86	23.32	25.51	26.12	27.19	26.36	31.15	25.65	21.61
Prime Lending Rate (%)		20.01	29.80	36.09	21.00	20.18	19.74	13.54	20.46	21.22	21.32	21.33	25.98	20.59	19.60
MRR (%)		14.50	17.50	26.00	13.50	13.50	13.50	13.50	13.50	13.50	20.70	14.00	20.50	16.50	15.00
Inflation Rate (%) 12 Month Average		7.5	12.7	44.8	57.2	57.0	72.8	29.3	8.5	10.0	6.6	6.9	18.9	12.9	14.0
End Period		3.6	22.9	46.8	81.3	76.8	51.6	14.3	10.2	11.9	0.2	14.5	16.5	12.2	23.8
Real GDP (GDP at 1994 Prices) (₦ million)		92,236.50	94,236.30	97,020.10	99,604.70	100,936.70	103,060.66	108,600.50	109,972.42	113,509.01	116,657.58	121,208.02	126,373.68	131,489.98	136,480 1
Of which															
Oil Sector		13,542.20	12,338.40	12,649.22	12,675.67	12,348.31	12,638.74	13,544.36	13,744.06	14,042.20	12,989.03	14,434.60	15,189.90	13,118.00	13,118.00
Agriculture		36,277.25	36,522.67	37,273.04	37,780.75	36,692.35	40,107.42	41,743.37	43,495.23	45,253.20	47,596.59	48,981.52	50,861.50	53,630.63	55,000.00
Manufacturing		7,361.42	8,046.02	7,657.23	7,340.99	7,274.92	6,874.80	6,943.54	6,934.36	6,692.77	6,927.01	7,175.39	7,475.73	7,999.03	8,720.00
Commerce 2/	11,488.80	11,856.30	12,223.82	12,590.53	12,592.96	12,601.80	12,706.91	12,899.54	13,286.53	13,618.69	13,836.59	14,187.50	15,317.10	15,457.00	
Others		24,569.03	25,471.96	27,216.79	29,216.26	30,028.14	30,857.90	31,660.32	32,861.21	34,234.31	35,527.26	36,779.92	38,614.05	41,425.22	44,177.00

Real GDP Growth Rate (%)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total	10.9	2.2	3.0	2.7	1.3	2.1	3.4	3.2	3.2	2.8	3.9	4.2	4.1	3.8
Oil Sector	26.4	-8.9	2.5	0.2	-2.6	2.4	7.2	1.5	2.2	-7.5	11.1	5.2	13.6	0.0
Agriculture	4.2	3.5	2.1	1.4	2.4	3.7	4.1	4.2	4.0	5.2	2.9	3.8	5.4	2.6
Manufacturing	7.6	9.3	-4.8	-4.1	0.9	5.5	1.0	0.3	-3.9	3.5	3.6	4.2	7.0	9.0
Commerce 2	3.0	3.2	3.1	3.0	0.0	0.1	0.8	1.5	3.0	2.5	1.6	2.5	8.0	0.9
Others	19.1	3.7	6.9	7.3	2.8	2.8	2.6	3.8	4.7	3.8	3.5	5.0	7.3	6.6

Note:
1/Provisional
2/This is Wholesale & Retail Trade
Sources: Central Bank of Nigeria (CBN), National Planning Commission / Federal Office of Statistics (FOS)

TABLE 2
SELECTED ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
DMB/s Credit to the Private Sector (N million)	35,230.90	43,033.90	57,094.10	90,625.30	116,675.60	141,671 00	171,643 00	238,188 00	238,019.00	350,575.00	500.017.50	854,999 40	955.782.00	1 182,964.10
DMB's Credit to the Public Sector (N-million)	7 352.10	6,375.80	2,059.30	37,909.80	46 156.70	17,365.00	41,548 00	29,441 00	24,970 00	148,154.50	204,302.30	182,116.20	237 148 50	298 440 70
Maximum Lending Rate (%)	20.80	31.20	18.32	21.00	20.79	20.86	23.32	25.51	26.12	27 19	36.35	31.15	25.65	21 61
Prime Lending Rate (%)	20.01	29.80	36.09	21.00	20.18	19.74	13 54	20.46	21.22	21.32	21.33	25 98	20 59	19.60
MRR (%)	14.50	17 50	26.00	13.50	13.50	13.50	13.50	13.50	13.50	20.70	14.00	20.50	16.50	15.00
Inflation Rate.														
12-Month Average	7.5	12.7	44.8	57.2	57.0	72.8	29.3	8.5	10.0	6.6	6 9	18 9	12 9	14.0
End Period	3.6	22.9	48 8	61.3	76.8	51.6	14.3	10 2	11 9	0.2	14 5	18.5	12 2	23.8
Real GDP (GDP at 1990 Prices) (N-Million)	267,549.98	265.379 13	271,365.50	274,833.27	275,450 53	281.407.40	293,745.36	302,022 45	310.890.06	312,183.47	328.178.71	344,285.86	356.305.82	371,532.88 1
Of Which:														
Oil Sector	100,223.36	91,313.92	93,614.32	93,810.06	91,387.37	93,536.04	100.239.04	101.716.98	103.923.47	98.129.21	106.827.53	112,417.40	106 002 10	116.066.56
Agriculture	84,344.61	87,503.53	89.345.43	90,596.51	92,832.95	96,220.67	100.216.18	104,514.00	108,817.07	114,570 71	117.945 07	122,522.34	127,730.23	133,008.30
Manufacturing 2/	14,702.40	18.076.45	15,357.18	14,788.13	14,591.36	13.836.14	13,953.42	14,009.95	13,046 30	13,494.64	13,958.82	14.935.10	16.439 36	17,369 63
Commerce 3/ 36,837 66	36.984.48	38,130.98	39.274.90	39,282.54	38,310.05	39,644.17	40,238 82	41,446.00	42,482.14	43,161.85	44,240.89	47,106.79	49,180.39	
Others	32.441.96	33,498.75	34,917 59	38,383.67	37,356.31	38,504.50	39.892.56	41,542 70	43,880 22	45,506.77	47,285.44	50,170.13	59,025.34	55,907 98
Real GDP Growth Rate (%)														
Total	13 0	- 0.8	2.3	1.3	0 2	2.2	4.4	2.8	2.9	0.4	5.4	4.6	3.5	4 3
Oil Sector	26.4	-8.9	2.5	0.2	-2.6	2.4	7.2	1.5	2.2	-7.5	11.1	5.2	5 7	9 5
Agriculture	4.3	3.7	2.1	1.4	2.5	3.6	4.2	4.3	4.1	5 3	2.9	3.9	4.3	4.1
Manufacturing	4.9	9.4	-4.5	-3.7	-1.3	-5.2	0.8	0.4	-8.9	3.4	3.4	7.0	10.1	5 7
Commerce	3.0	3 2	3 1	3 0	0.0	0.1	0.8	1.5	3.0	2.5	1 6	2 5	6.5	4.4
Others	17 0	3.3	4.2	4.1	2.7	3.1	3.1	4.7	5.1	4.2	3.9	6 1	17.7	-5.3

Note:
1/Provisional
2/Comprises Oil Refining, Cement Manufacturing and Other Manufacturing
3/This is Wholesale & Retail Trade
Sources: Central Bank of Nigeria (CBN), National Planning Commission / Federal Office of Statistics (FOS)

V. Model of Financial Sector Development and Economic Growth

In order to properly locate and situate the role of financial sector development in the growth of an economy, an ordinary least squares (OLS) estimation technique is used to estimate the impact of the financial sector development on economic growth. The major determinants of economic growth are financial depth, level of investment, real interest rate, domestic credit from the banking system and the extent of financial sector liberalization. The study adopts the ratio of broad money supply to GDP (nominal) as a proxy for financial sector development. The number of branches of deposit money banks (DMBs) is used to proxy the extent of financial sector liberalization. This is necessary because of the phenomenal growth in the number of banks since the adoption of the Structural Adjustment Programme (SAP) in 1986. Investment variables include gross fixed capital formation and foreign direct investment (FDI). Literature has extensively given credence to the positive impact of these investment variables on economic growth, which informed their inclusion. The size of credit that flows from the banking system to the domestic economy and real interest rate (prime lending rate deflated by inflation rate) are measures of incentive for investment and were also included as explanatory variables of economic growth.

Intrinsic linearity was assumed for the relationship between real GDP and its determinants. Thus, the functional relationship is expressed as follows:

$$LRGDP = f(\underset{(+)}{LM2GDP}, \underset{(+)}{RTR}, \underset{(+)}{LINV}, \underset{(+)}{LFDI}, \underset{(+)}{LTDC}, \underset{(+)}{LBB}, \mu_t) \quad \ldots\ldots (1)$$

Where,

LRGDP	=	Log of Real GDP
LM2GDP	=	Log of the Ratio of Broad Money to GDP
RTR	=	Real Interest Rate
LINV	=	Log of Investment
LFDI	=	Log of FDI
LTDC	=	Log of Total Domestic Credit
LBB	=	Log of Number of Branches of DMBs
μ_t	=	Random Error Term

The coefficients in the model are elasticities, since the variables are in logarithm form and as a result measure direct response of economic growth to unit changes in the explanatory variables. Data for the study spanned 1981-2002 and were obtained from the CBN Statistical Bulletin and Annual Report, various issues.

Results and Major Findings

The result in tabular form is presented below:

Dependent Variable: LRGDP				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	8.843358	0.217189	40.71725	0.0000
RTR	0.000779	0.000331	2.355249	0.0325
LINV	0.132764	0.015269	8.694892	0.0000
LM2GDP	0.028806	0.038821	0.742025	0.4695
LBB	0.165984	0.044264	3.749867	0.0019
LTDC	0.023504	0.036065	0.651725	0.5244
LFDI	-0.031784	0.030204	-1.052287	0.3093
R-squared	0.989852	Mean dependent var		11.41801
Adjusted R-squared	0.985793	S.D. dependent var		0.231499
S.E. of regression	0.027593	Akaike info criterion		-4.089105
Sum squared resid	0.011421	Schwarz criterion		-3.741955
Log likelihood	51.98015	F-statistic		243.8516
Durbin-Watson stat	1.901255	Prob(F-statistic)		0.000000

Financial Depth

The result of the OLS showed that there was no significant relationship between the depth of the financial sector and economic growth in Nigeria. In other words, economic growth process could not be explained by changes in the financial sector. This result is not surprising given the distorted, rudimentary and shallow nature of the financial markets in Nigeria. Financial sector liberalization (the number of branches of DMBs), however, showed a positive relationship with economic growth, and was highly significant, even though the elasticity ratio was low. It thus, upholds the positive influence of the financial sector liberalization on economic growth.

Investment

Investment was highly significant in the explanation of changes in the direction of economic growth. This justifies the position of the neo-classical growth theory that savings, hence investment was crucial although the quantum desired was still far from being met. Foreign direct investment (FDI), however, was not significant in explaining growth. This is likely due to the low level of inflow of FDI into the country; and thus suggests that gross fixed capital formation forms the bulk of investments that, significantly, drives growth in Nigeria. The reliance on FDI for growth may indeed be misplaced, in view of the inability of Nigeria to attract and sustain foreign capital on a long-term basis.

Credit

There was an insignificant relationship between domestic credit from the banking system and economic growth. It may be explained by the low level of credit to the private sector occasioned mostly by the crowding out effect as a result of government competition for credit and which ultimately undermines the efficiency of credit resource utilization.

Real Interest Rate

The model indicated a significantly strong positive relationship between real interest rate and economic growth. This upholds the a priori that positive real interest rates are required for growth. Economic growth hinges on the availability and accessibility of loans at the right price. Consequently, investment spending would be encouraged, so long as the programmed net returns on investment yields a profitable income.

Overall, the result indicates that the financial sector impact on the direction of economic growth is at present moderate. The financial sector in Nigeria has without doubt gone through some turbulent periods in its evolution, which perhaps give credence to the result in this analysis. However, as a major service sector, it can be a dynamic interface in facilitating the mobilization of funds necessary for investment and hence economic growth. The model, however, was a good fit as indicated by the R^2, while the probability of the F-statistic showed that the model was significantly robust. The Durbin-Watson statistic was, in the safe region, indicative of the lack of serial correlation.

VI. Major Constraints to the Nigerian Financial Sector Development

Indeed, the recent reform efforts have transformed the financial sector from a rudimentary and underdeveloped sector into a much more vibrant sector. It has also made the Nigerian financial system a key sector in the development strategy. However, despite the achievements thus far, anecdotal and empirical evidences suggest that the financial sector has made minimal contribution to economic growth. There are still major constraints facing the sector. For instance, the basic measures of efficiency and coverage of the financial sector are still below standard. These are due mainly to the following constraints:

Judicial System

A transparent and effective judicial system is essential for the smooth functioning of the financial system. Weak legal institutions that cannot enforce contracts and protect properly rights endanger banking sector soundness. There is need for a Judicial System Reform that encompasses a strict adherence to the rule of law. The current legal system that condones protracted litigation undermines mercantilism. It is also counterproductive and a veritable source of speculation, which is capable of eroding public confidence in the financial system. Against this backdrop, the need for a judicial reform or the establishment of a special commercial court of law for the speedy adjudication of mercantile cases cannot be over-emphasized.

Dearth of Skilled Manpower

The financial sector has over the years suffered from lack of skilled manpower. Generally, the significant increase in the number of banks and bank branches have not been matched with commensurate output of trained bankers from the nation's tertiary institutions. Consequently, the system has been bedeviled with the worst case of human resources mismatch a case of putting square pegs in round holes. Hence, the need to ensure that qualified personnel with adequate years of experience are appointed to position of responsibility in the banking sector cannot be overstated. Professional training, particularly training in banking ethics will also go along way in stemming, significantly, financial distress arising from fraudulent practices and management incompetence which has given rise to banks' poor asset quality, high operating cost and diminishing profitability.

Technological constraint

The financial sector, in a globalize world is technologically driven. The inability of the sector to upgrade and acquire the latest information technology that would facilitate a smooth and efficient service delivery poses a threat to the development of the Nigerian financial system. As such, there is need for the sector to operate in line with recent developments in communication and information technology.

Policy Inconsistency

Policy reversals have often undermined Nigeria's financial sector development. The guided-deregulation of 1993 after the period of deregulation beginning from 1986 is a clear case. Similarly, the "gentleman" agreement on interest rate ceiling, which DMBs can charge their customers, undermines the policy of interest rate deregulation. Market forces should ideally drive the interest rate in liberalized financial system.

VII. Concluding Remarks

The paper reviewed developments in the Nigerian Financial Sector as it relates to economic growth and noted that the sector has witnessed significant growth since the adoption of the Structural Adjustment Program (SAP) with potentials to contribute immensely to the growth process. However, the liberalization of the banking sector has not completely changed the modus operandi of the operators, who are still largely risk averse. Indeed, empirical evidence emanating from the paper suggest that despite the recent developments in the sector, it still made less than significant contribution to economic growth.

The sector is still faced with several challenges. However, appropriate policies that would increase credit to the private sector and ensure efficient allocation of credit to the growth sectors of the economy are required. This is in addition to evolving policies to positively change banks' lending behaviour and preferences as well as curtailing government interference in the sector through crowding out effects.

In conclusion, the financial sector remains an important component of the Nigerian economy, as it plays a crucial role in the process of financial intermediation when public confidence in the sector is sufficiently in place. Efforts should therefore be made to ensure its viability to further enhance its contribution to the overall development of the economy.

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