FINANCIAL SECTOR ISSUES AND ECONOMIC DEVELOPMENT IN NIGERIA

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Foreword

I consider it a great privilege to write the foreword of this second volume of the two books written in honour of my good friend for over three decades, Professor Adedoyin Soyibo who retired formally from the University of Ibadan on 30th September 2011 although he is still in active service to the national and global academic community. As a well deserved way of paying tribute to an academician who has been a colleague, friend, and mentor to many in the Department of Economics, University of Ibadan, this book was put together. I am of a strong persuasion that this is a worthy tribute to someone who has contributed tremendously to the field of economics and entrepreneur in Nigeria, and Africa at large, through his teaching, research, and community service.

With a first class in Mathematics background at first degree, Professor Soyibo had his Masters in Management, and doctoral degrees from Massachusetts Institute of Technology, Cambridge, Massachusetts, USA, and University of Ibadan, respectively in 1979, and 1983. For more than 31 years, in the course of his service at the University of Ibadan, he had the privilege of serving as lecturer to more than 5,000 students at both the undergraduate and postgraduate (M.Sc. Economics, Business Administration, and Banking and Finance) levels. He supervised more than 30 PhD students, serving as chairman in more than half of their thesis committees. He also pioneered the training of PhD students in the field of Health Economics, and was a founding member of the Health Policy Training and Research Programme (HPTRP) in the Department of Economics, where he acted as director for more than 14 years. His contribution to the convergence of health, finance and development in Nigeria and Africa cannot be overestimated. During his tenor as the director of HPTRP, he led the estimation processes of the first two-rounds of National Health Accounts for Nigeria. He is also one of the two foremost African professionals in the less than a decade old newly emerging research area of National Transfer Accounts (NTA). He contributed to the formation and establishment of the Entrepreneurship and Innovation Centre of the University of Ibadan, where he served as the pioneering director of the center before moving to

Durham as a Distinguished Visiting Professor at Duke University, USA. He, at various times served as the Dean of the Faculty of the Social Sciences, and Head, of Department of Economics, University of Ibadan.

While this book cannot adequately express the warmth and closeness of the students of Doyin, it is symbolic of the impact of his interaction and influence he has over the years had on them. The book represents a collection of the various parts of Doyin's contribution to academics. Given the high quality of the collection of articles in the book, it will satisfy a range of academic interests especially in the field of Financing Sector Development and Economic Growth.

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INTRODUCTION AND OVERVIEW

Olanrewaju A. Olaniyan and Akanni O. Lawanson

This book is the second volume of essays in honour of Professor Adedoyin Soyibo who retired from the University of Ibadan on September, 2011 after 31 years in service. Given the diverse areas of economics that Prof Soyibo had conducted research, it became necessary to have two volumes with each volume focusing on specific area of economic research. The first volume contains papers on health economics where his research has affected both policy and practice of health planning in Nigeria. This volume contains papers addressing financial sector issues and their implication for economic growth. This is because apart from being an area of research by Prof Soyibo, sustainable economic growth of any country depends on a virile financial sector management and performance. The topics covered in this book, as in the first volume, were self-determined by the authors and focus on different aspects of the financial sector and how its performance has shaped the rate of Nigeria's economic growth. One of the chapters was even derived from a project which he was the principal investigator. Following this overview and an introductory article on Professor Adedoyin Soyibo, the articles are then presented.

The articles in this book address issues of finance sector and growth in Nigeria. In recent years, Nigeria's financial sector has proven to be a major driver of the country's economic growth. This has been traced to the liberalization and deregulation that have been introduced in the sector over the years. ***Fowowe*** in Chapter 3 throws more light into the sector by developing quantifiable measures of financial liberalization in Nigeria. While most of the earlier studies have examined the effects of financial liberalization policies, and these studies typically employ proxies such as interest rates to measure liberalization, the chapter develops alternative financial liberalization indexes for Nigeria, and gives a summary measure of eight liberalization measures and these types of indexes will be able to give a more robust result of the effects of financial liberalization on macroeconomic variables.

Chapter 4 by ***Olayiwola, Osabuohien and Rapuluchukwu*** was motivated by the quest for making contribution based on empirical evidences in Nigeria with respect to inflation and financial development. Long-run dynamics and the short-run phenomena were assessed in the study given political and financial episodes the Nigerian economy has witnessed. It employed Vector Error Cointegration technique within the framework of Autoregressive Distributed Lags-ARDL in estimating the formulated model. The study found financial maturity, openness of the financial intermediaries, stock market development and interest rate to have positive effects on the inflation rate in the long-run. It was established that inflation has been quite burdensome on Nigeria's financial development. Some implications for both policy and research were made in the study.

Following from Chapter 4 above, ***Folawewo and Olakojo*** in Chapter 5 revisit the empirical investigation of the sources of inflation persistence in Nigeria, using a simple accommodating monetary policy framework. The model is estimated using the ECM technique and quarterly data covering 1970:1 to 2009:4. The study showed that the current level of inflation is significantly affected by its past levels and real interest rate, while the nominal effective exchange rate, imported inflation (measured by US inflation) and real GDP have little effect on inflation. An important finding of the study is that, like most other studies, inflation persistence in Nigeria is more pronounced with floating exchange rates.

In Chapter 6, ***Oyinlola and Fakiyesi*** note that the 2007/2008 global financial crisis was triggered by the turmoil in the financial sector of the United States, spreading swiftly to other developed and developing countries with severe effects that almost halted the global output growth. Estimating the effect of the crisis is the objective of their study and they found that the effect on Nigeria was devastating. The price of crude oil crumbled by about 71% between July 2008 and January 2009; the stock market crashed with a fall in market capitalization and All-Share Index by 67% and 62% respectively, between March 2008 and March 2009. The external reserve also dropped from $67 billion in June 2008 to $43 billion in October 2009 while the exchange rate depreciated from ₦118/$ to ₦145/$ between November 2008 and February 2009. The crisis entered the economy through two main channels: the financial and real sector channels. The channels tended to suggest that depreciation of exchange rate and higher-than-target inflation rate might persist till the end of 2009. The study suggested that government policy should focus on the reform that could diversify the foreign exchange inflow base of the economy.

In Chapter 7, ***Salisu's*** attempts to provide a framework for modelling and forecasting volatility in the Nigerian stock market. The chapter first evaluates the probable incidence of volatility in the stock market returns over the period 1985:01 to 2010:12 using the pre-tests suggested by Engle (1982). It finds evidence of volatility, and consequently subjects the returns to both symmetric and asymmetric GARCH modelling. The latter appears superior to the former and specifically, the EGARCH (1,1) model gives the best fit using appropriate model selection criteria. Negative shocks have the potentiality of increasing volatility of the Nigerian stock returns more than the positive shocks of the same magnitude. In addition, based on the MAE, MAPE, RMSE and TIC, the EGARCH (1,1) generates the best forecasting perform-ance at best for 12-month ahead forecast. Therefore, ignoring the EGARCH framework in the modelling and forecasting of stock returns in Nigeria may yield inefficient results and misleading policy prescriptions.

In Chapter 8 ***Amaghionyeodiwe and Omoke*** investigate the effect of corporate governance on bank performance in Nigeria. Using a panel data analysis for the period 2000 to 2009 for some selected banks, the study found that the board size of a bank and its performance was inversely related. Also, a statistical inverse relationship was found between the composition of the audit committee and the banks' performance. There was also a positive relationship between the independence of the board and the firms' performance. These results suggest that firms with a larger proportion of ordinary shareholders on their board will experience declining performance, and by implication, it is not just sufficient for shareholders to be appointed to the audit committee, they must be appointed based on merit and qualifications, and not by political, biased, processes. Furthermore, the larger the percentage of outside directors, the more likelihood for a non-performing CEO to be dismissed; hence, it can be concluded that for a firm to experience growth, it should have more independent directors. Thus, we advocate that structures and agencies are set up to ensure that corporate laws, and standards set in place, are strictly complied with to achieve effective governance of financial firms.

Chapter 9 by ***Babatunde*** is based on the assumption that African economies have been characterized by weak growth in the productive sectors. This is coupled with the fact that the initial spurt of industrial growth has been faltering as shown by poor export performance and reflected in the falling share of African exports in world trade and the unchanged export structure, and by increasing debt, a deteriorating economic and social infrastructure and increasing environmental degradation. This crisis has important implications for the prospects of transforming African economies, as envisaged by African governments. Africa's development challenges go deeper than low income, falling trade shares, low savings, and slow growth. They also include high inequality, uneven access to resources, social exclusion, and insecurity. The stagnation of the African continent has been linked to the set of economic reforms imposed by the BWIs irrespective of the structural characteristics of economies in Africa. Consequently, it is imperative for a new development policy agenda that focuses on domestic demand-led growth in Africa.

In Chapter 10, ***Aregbeyen*** further investigates the factors that influence the growth rate of private firms in Nigeria with a sample of 94 firms, publicly listed on the Nigerian Stock Exchange (NSE) during the period 1994-2005. The motive is to provide empirical support for policy formulation and implementation with regards to government avowed commitment to private firms/sector development in Nigeria. The theoretical/analytical framework for the study is the optimal firm size growth theory. The choice of the optimal firm size theory is justified by the fact that it offers us the most practical approach. The empirical methodology combines descriptive/statistical analysis with econometric analysis. The descriptive/statistical analysis was used to characterize the firms' growth rates, while the econometric analysis was deployed to identify the firms' growth determinants. The findings show that the significant determinants of the firms' growth rates are the previous year growth rate of the firms, their size, age, capital intensity, financial constraints, management efficiency, and the extent of vertical integration. However, the significance of these factors depends on how growth of firm is defined and/or measured as well as the estimation methods.

The objective of Chapter 11 by ***Oyeranti*** and ***Ishola*** is to examine the direction and strength of the relationship between taxation, public expenditure and economic growth in Nigeria, using time series data from 1970 to 2008. Endogenous growth theory as extended by Marrero (2007) forms the theoretical framework for the work, while OLS served as the estimation technique. The study examines the unit root problem and cointegrating properties of the data. The unit root problem was tested for by using Augmented Dickey Fuller (ADF) and Philip Perron tests. Diagnostic tests employed for cointegration are the Engel granger OLS approach and the Johansen and Jeselius test. Then the speed of adjustment of the error generated by each of the endogenous variables is explored using Vector Error Correction (VEC) model; also Granger causality test was carried out. Taxation and public expenditure were disaggregated into distortionary and non-distortionary taxes, recurrent and capital expenditure respectively. Results show that while the recurrent component of public expenditure, total distortionary taxes, private capital and technology impact positively on economic growth, capital expenditure and non-distortionary taxes have a growth inhibiting effect. The study recommends that privatization and public-private partnership will boost growth, thus the Nigerian government needs to come up with more friendly economic policies and business environment, which will make its business climate more conducive.

Also ***Bankole*** in Chapter 12 sought to determine the potential implications of the adoption of the CET on Nigeria's manufacturing sector, by analysing the evolution of the CET in Nigeria, the costs and benefits of CET and the performance of manufacturing over time. Analysis suggests that the CET resulted in substantial reduction of the simple average import tariff rate of the manufacturing sector, with all the types of imports have exceptionally and substantially increased after the adoption of CET; while the upward trends of inputs such as raw materials, intermediate and capital goods imports have been unstable. In the case of intermediate goods, tariff rate increased faster than for consumer goods at first but lost momentum to the latter by 2010; exports have also responded to CET-induced import liberalization and appears to confirm economists age-long dictum that a 'tax on imports is also a tax on exports'. It is expected that a streamlining of the procedural aspects of doing business in Nigeria be combined to achieve excellent results in the manufacturing sector. So also, the establishment of mitigating measures will be needed, if not for the CET regime, obviously for the impending economic partnership agreement with the EU. Government needs to be proactive in establishing or strengthening, where applicable, certain elements of mitigating measures and safeguards.

In addition, Chapter 13 by ***Adewuyi*** analyses the developmental implications of the recent resurgence in the economic relations (trade, foreign direct investment-FDI and aid) between China and Nigeria with a view to drawing lessons for policy initiatives. Analysis shows that Chinese FDI inflows are in the range of about 0.13% of the total inflow in 2006. Some of the Chinese investments and aid in Nigeria are directed at addressing critical gaps in the provision of basic infrastructure, but these are not comparable to the level at which the Chinese are seeking Nigeria's oil and gas and other raw materials. The study found that while the share of Nigeria's export to China has been less than 2.0%, the share of import has risen to about 17.0%. Further, there exists inter-industry trade between the two countries. Thus, the observed structure of trade pattern is inconsistent with Nigeria's quest to diversify export, and export manufactured or processed products. Balance of payments position has consistently been in favour of China. This suggests the need to examine the structure of tariff and non-tariff barriers facing Nigeria's exports to China and find out constraints facing producers and exporters in responding fully to market openings.

In addition, Chapter 14 ***Alayande*** examines the funded pension-financial sector development-economic growth nexus in Nigeria by employing vector error correction modelling. While previous studies have worked on OECD countries and emerging market economies, none has examined this nexus within the Nigerian context to our knowledge. Indeed, the existence of relationships between the financial sector development, funded pension, and economic growth has mainly been conducted within the cross-country framework with very few exceptions. The results obtained in such analyses are rarely quite easy to interpret, because they are based on a fragile statistical basis. In order to account adequately for the specificity of the Nigerian situation as well as provide the opportunity to analyse the effects of funded pension on financial sector development and economic growth, the study adopted a time-series analysis of the problem at hand. It found that dual causality between funded pension and economic growth cannot be rejected and therefore notes that the ongoing reform in the financial sector is a step in the right direction given that some of the indicators were not significant and came up with wrong signs in the growth regressions. The need for the reform is further underscored by the fact that causality could not be established between funded pension and some of the indicators of financial sector development adopted in the study. Generally, all the chapters in this book attest to the importance of human capital and financial sector issues in the economic development of Nigeria.

The last chapter in the book by ***Olaniyan and Lawanson*** addresses the issue of demographic transition in Nigeria and how changes in population age structure can open windows of opportunity for rapid increase in economic growth. The simulation in the paper is based on age profiles of consumption and labour income for Nigeria for 2004. The paper found that population age structure is important for economic growth because it can have a permanent effect on consumption by influencing the accumulation of assets but the outcome is highly policy-dependent. This study has shown that the demographic transition in Nigeria is capable of leading to more rapid growth in output per capita if the right policies are put in place. The current transition being experienced in the country suggests that the first population dividend offers a positive development opportunity during the coming decades. The paper recommends creating policy environment, to accommodate the increase in working population to harness the opportunity for economic growth, while it is still available. This will include tackling increase in unemployment in the country, by providing the adequate infrastructure development, and improving human capital in the country, through the development of education (emphasising the right relevance entrepreneurship) and health in the country so as to improve the overall productivity within the country. Furthermore, the paper prescribes a right policy environment with low inflation, transparency, efficiency of the financial institutions and enforcement of the rule of law to encourage individual saving and investment. Social protection for the elderly must be put in place by increasing pension coverage by emphasising an asset-based pension systems and free health for the elderly.