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Banking Sector Reforms in Nigeria's Fourth Republic: A Review of Evidence

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Abstract
One of the most outstanding debates in recent times is whether government banking sector reforms promotes growth and development. Objectively, this study is quite significant as it empirically re-investigates the role of the Nigerian banking sector reforms especially of the fourth republic (2000-2010) on the economy. The study adopts the Granger-causality and Johansen co-integration econometric approaches in the estimation procedure. Overall, evidence from the study shows that there is no link between fourth republic banking sector reform and economic growth in Nigeria, thereby contradicting the finance-growth nexus of Mckinnon and Shaw (1973) hypothesis. The study, therefore, concludes that any serious effort to ensure the strengthening of the banking sector should be preceded by the narrowing down of the interest rate spread. Moreover, the reform programmes of the Nigerian banking sector should be sustained so as to channel resources from the surplus sector (savings) to the deficit sector (investment) by putting in place appropriate macroeconomic policies that will engender productive activities and ensure sustainable economic growth.
Keywords: Governance, Banking sector reform, economic growth, co-integration.

1. Introduction

> *Regulatory reforms would benefit all G20 countries. The economic cost of excessive government regulations is substantial. In some cases, simply complying with regulations is costly for small and medium-sized companies. In other cases, uncertainty over future regulatory changes results in postponed investment decisions and slower job creation. For many, excessive regulations prevent market signals from being fully received by consumers and investor (Robert Fauver, 2011).*

There is no gain saying that personal savings are the most reliable source of investment capital, however, it is doubtful whether investors and entrepreneurs would be able to save enough of their personal income to meet the investment capital needs of their investments. However, since the savings and investment functions are carried out by different households and firms for different purposes, there is the need for a vibrant banking sector, to mobilize funds from the surplus (savings) segment of the economy and lend to the deficit (investment) segment of the economy in the form of loans and advances

Moreover, it is generally accepted that a well developed banking sector contributes to economic growth by mobilizing savings and efficiently allocating them among the competing investment projects and other demands for funds. The existing positive correlation between indicators of financial development and economic growth reflects the importance of the deposit money banking sector in particular and the financial system in general. The financial system of most developing countries, including Nigeria, is dominated by the banking sector, especially the deposit money bankings which provide the foundation for the development of the financial system. The International Monetary Fund (IMF) (1996:68) contends that financial intermediation through the banking system, whether measured by the ratio of deposit money bank liabilities to gross domestic product (GDP) or by the ratio of private sector bank credit to GDP, has a strong positive relationship with economic growth. Similarly, the credit component of the deposit money banks constitutes a major link between the monetary sector and the real sector of any economy, Nigeria inclusive.

An economic reform on the other hand, refers to the process of getting policy incentives right and restructuring key implementation institutions. As part of economic reforms, banking sector reform focus mainly on restructuring financial banking institutions and markets through various policy measures. In the same vein, the reforms seek among others to get the incentives right for the sector to take its leading role in financial intermediation and to enable the bank to contribute to economic growth.

The Nigerian banking sector has witnessed five distinct phases of banking sector reforms (Anyanwu, 2010). Chronologically, the first occurred during 1986 to 1993, when the banking industry was deregulated in order to allow for substantial private sector participation. Before then, the industry was dominated by banks which emerged from the indigenization programme of the 1970s, which left the Federal and State governments with majority stakes. The second was the re-regulation period of 1993-1998, following the deep financial distress. The third was initiated in 1999 with the return of liberalization and the adoption of the universal banking model. The fourth phase commenced in 2004 with banking sector consolidation as a major component and was meant to correct the structural and operational weakness that constrained the banks from efficiently playing its leading role of intermediation. The fifth was to address the combined effects of the global financial and economic crisis, as well as the banks' huge exposure to oil/gas and margin loans, which were largely non-performing; corporate mis-governance and outright corruption among operators in the system.

Criticisms of the reforms and emerging banking sector challenges raise several fundamental questions. Among these are: What do we know and what have we learnt about banking sector reform in Nigeria? How effective and efficient are the banking sector reforms in resource mobilization from the surplus to the deficit units? What are the key challenges to banking sector reforms in Nigeria? What are the blueprints that will form future banking sector reform in Nigeria? However, the nature and content of the responses to these questions and related policy challenges will shape the future banking sector reform in Nigeria and the rest of the African continent.

The main but limited purpose of the study is to re-examine the banking sector reform in Nigeria with particular reference to the fourth republic banking sector reforms whose significance cannot be overemphasized in the Nigerian political- economic history.

The rest of the paper is structured as follows. Following the introduction is the literature review and theoretical framework. Section three is for methodology and model estimation, while section four consists of discussion of empirical results. Section five contains conclusion and policy recommendation.

1.1 Fourth Republic Banking Sector Reform: A Snapshot

Nigeria returned to democracy in 1999 after sixteen years of military rule (1983-1999). The return to democratic governance signaled the commencement of Nigeria's fourth republic. Banking sector reform within the period 2000 to 2010 constitute the Fourth Republic Banking sector reform in Nigeria (Okafor, 2011)

The reforms of the period are grouped into two phases. The phase one comprises the period 2004 to 2008 and the second phase covers the period 2009 to 2010. Some of the reform measures of the two periods are summarized as follows: the minimum recapitalization of the banks from ₦500m to ₦1bn in 1999, ₦1bn to ₦2bn in 2001 and ₦2bn to ₦25bn in 2004, the introduction of the Universal Banking model in 2000, the introduction of the Small and Medium Industries Equity Investment Scheme(SMIESIS) in August 2001, consolidation of direct responsibility for the regulation, supervision and control of non-bank financial institutions in the Central Bank of Nigeria(CBN) through an amendment of the Banks and Other Financial Institutions Act(BOFIA) 1991, further liberalization of the foreign exchange market through the introduction of the Dutch Auction System(DAS) in July 2002 and subsequent upgrading of this market making procedure to the Wholesale Dutch Auction System(WDAS) on February 20, 2006 and the inauguration of the National Micro-Finance Policy in 2004 and consequently the introduction of micro-finance banks(MFBs) banking module. Two categories of MFB's were introduced namely state-wide MFB' with minimum capitalization of ₦1bn and local government area MFB' with minimum capitalization of ₦20m.While the former category of MFB's are allowed to open branches anywhere within the chosen state of operation , the operation of the later was confined to the local government area of operation.

The other reform measures of the period include: the bail-out option, through the injection of a total sum of ₦620bn , in the form of tier II capital by the CBN, into eight banks adjudged , by the apex bank(CBN) to have failed the stress test of an industry-wide special audit undertaken by the CBN and NDIC(National Insurance Deposit Corporation), the repeal of the Universal Banking model and the consequent withdrawal of UB licenses from banks with effect from November, 2010, the establishment of the Asset Management Corporation of Nigeria(AMCON) to provide a sustainable platform for relieving banks of non-performing (toxic) assets, the introduction of non-interest Islamic banking in the country through the roll-out, by the CBN, of modalities for the operations of Islamic banking and the licensing of the first of such a bank by the CBN in June 2011, the introduction of a new cash policy designed firstly to reduce the level of cash based banking transactions, secondly to expand the market share of e-banking and thirdly, to substantially reduce the high cost of cash management in the economy, the nationalization of three of the eight afflicted banks in the first week of August, 2011 based on in-house assessment, by the CBN which apparently indicated that the three banks, Afribank, Bank PHB and Spring Bank , would be unable to meet the September 30, 2011 deadline given to afflicted banks to fully recapitalize or be liquidated

The tabular representations (i-iii) at the illustration section provides a platform for assessing the impact of the fourth republic banking sector reforms on banking performance over the period using performance indicators as highlighted in the tables

2. Literature Review and Theoretical Framework

The notion that financial institutions, especially deposit money banks, play a significant role in real sector development and occupy a critical position in a complex financial system that supplies the money and credit needs of the economy has received widespread acceptance. The major function of banks is financial intermediation. In the performance of this function, banks may be visualized as borrowing at one level of interest rate and lending at another rate. The cost of serving as intermediaries is met by the excess of the lending rate over the borrowing rate. Intermediation, however, affects the saving-investment process in a number of ways: it facilitates the separation of the investment decision from the savings decision, since the investment decision can be made with no direct tie to any savings decisions; it encourages savings by providing diversification of assets available to lenders, according to risk, yield and liquidity. It also encourages investment by providing a variety of available sources of funds that differs with regards to maturity of loans, interest charges and repayment provision among others.

In neo-classical economic literature, the price system allocates scarce resources among alternative uses. All processes are interrelated and all are relative, indicating the rate at which one commodity will exchange for another at any point in time. The interest rate is viewed as a unique form of pricing and indicates the rate at which a commodity can be exchanged for itself at two points in time. Thus, interest rate serves to determine the time pattern of resource allocation. Individuals have preferences with a time dimension. Households and firms may wish to borrow now or later to engage in productive investment.

Classical economists also highlighted on the combination of productivity and thrift as the two major determinants of interest rate. While neo-classical economists emphasized on the desire for a certain pattern of consumption and savings amid recognizing the importance of production and thrift. Thus, borrowing to increase current consumption was also seen as a determinant of the demand for loanable funds and therefore, of the level of interest rate. The understanding of the causality between saving and investment is significant in the sense that the link will help to assess the validity of the traditional belief that increasing savings will promote growth and at the same time translate to higher domestic investment. Schumpeter (1934) was among the foremost economic theorist that stressed the role of the banking sector towards productive investments and economic growth. According to him, the financial system that is well functioning would encourage technological innovation by selecting and financing businesses that are expected to be successful. Later works include those of Greenwood and Jovanovic(1990), Levine(1997) and Bencinvenga and Smith (1991), which involved theoretical constructs, wherein an efficient financial market raises the quality of investments, thus leading to economic growth. Specifically, Greenwood and Jovanovic(1990) built in their model a financial sector whose main objective is to direct funds to high-yielding investments with the assistance of information. This then would lead to economic growth, which in turn enable the implementation of expensive financial structures. In Nigeria, several attempts have been made to assess more generally the relationship between banking sector liberalization and economic growth. For instance, Soyibo and Adekanye (1992) explores the links between interest rates, savings, investment and money supply in Nigeria. They found out that there exists positive relationship between returns on financial assets and the rate of savings.Nnanna (2004) in a similar manner adopted the Ordinary Least Square (OLS), Two Stage Least Square (TSLS) and Vector Autoregressive (VAR) techniques to investigate the relationship between output growth and bank lending in Nigeria. The study covers the regulation and deregulation periods (1970 – 1999). He observed that there exists a significance relationship between bank lending behavior and output growth. The analysis further reveals that the influence of government policy distortions and inappropriate interest rate regimes will have negative impact on banks' credit expansion.

Further empirical studies include that of Asogwa (2005) who reported on the oligopolistic competition in the Nigerian banking industry for the period 1997 – 2001, using a conjectural variation analysis. The general evidence from this study shows that the entries of new banks have not substantially improved both operational and allocative efficiency in the banking industry. Balogun (2007) in his own study explored the prospective of banking sector reforms in Nigeria, viz-a-viz: pre-SAP (1970 – 1985), post SAP (1986 – 1993), reforms lethargy (1993-1998), pre – Soludo (1999 – 2004) and Post – Soludo (2005 – 2006). Using both descriptive and econometric methods, he tested for three sets of hypothesis: first that each phase of reforms culminated in improved incentives, second, that policy reforms which results in increased capitalization, exchange rate devaluation, interest rate restructuring and abolition of credit rationing may have had positive effects on real sector credit, and thirdly, that implicit incentive which accompany the reforms had salutary macroeconomic effects. The empirical results confirm that eras of pursuits of market reforms were characterized by improved incentives. However, these did not translate to increased credit to the real sector.

Subsequent relevant studies include that of Ogunmuyiwa and Ekone (2010), Nkoro and Uko(2013) who concludes in their studies that money supply during the reform period was positively related to growth but the result is however insignificant in the case of GDP growth rate and again, to sustain and enhance the existing relationship between banking sector development and economic growth, there is need to adequately deepen the banking system through innovations, adequate and effective regulation and supervisions, efficient mobilization of funds and making such funds available for productive investment and improved services

3 Methodology and Model Estimation

3.1 Model Specification

This paper employs the granger causality and co-integration techniques to examine the relationship between banking sector reforms and economic growth in Nigeria. The model for this study was adapted from Odedokun (1996) and Onwioduokit(2009) with the above underlying framework.It is specified as follows:

$$RGDP = \gamma_0+\gamma_1 INVY + \gamma_2 LDR +\gamma_3 M_2Y+\gamma_4 IRS +\gamma_5 EXPG +\gamma_6 DM + U \text{ ---(1)}$$

$$\gamma_1, \gamma_2, \gamma_3, \gamma_{5,}\gamma_6 > 0, \gamma_4 < 0$$

Where: RGDP = real GDP growth rate, INVY = the ratio of domestic investment to GDP, LDR = the ratio of loan to deposits, IRS = interest rate spread (difference between deposit and prime lending rate), EXPG = Annual export growth rate and DM = Dummy measuring the effects of reforms. The study employs annual data spanning 2000 to 2010; the fourth republic banking sector reform in Nigeria. The data were sourced from the Central Bank of Nigeria Bulletin of various years and Nigeria's National Bureau of Statistics. The study conducted the unit root test and causality test to eliminate spurious results emanating non-statationary data as well as to ascertain the relationship existing between the variables of interest. The unit root tests showed that some of the variables are stationary at levels while some are stationary at first difference at 1%, 5% and 10% critical values. The next step is to determine the direction of causality between the variables. In order to conduct the causality test, we employed the Johansen Granger causality approach was adopted. According to Granger (1969), variable X is said to "Granger –cause" Y if and only if Y is better predicted by using the past values of X than by not doing so with the past values of Y being used in either case. In other words, if a scalar X can help to forecast another scalar Y, then we say that X Granger causes Y. Our objective is to see whether current values of the dependent variable can be explained by past values of the explanatory variable (unidirectional relationship), or if the relationship is two way (bi-directional or feedback), that is, both dependent and explanatory variables explain each other. The specification for the Granger causality test is:

$$RGDP_t = \sum_{i=1}^{n}\alpha_1 INVY_t + \sum_{i=1}^{n}\alpha_2 LDR_t + \sum_{i=1}^{n}\alpha_3 M_2Y_t + \sum_{i=1}^{n}\alpha_4 IRS_t + \sum_{i=1}^{n}\alpha 5EXPG + \sum_{i=1}^{n}\alpha 6DMt_{-1} + \underset{i=1}{\overset{n}{U_{2t-1}}} \text{ ----(2)}$$

Where $RGDP_t$ represent both present and lagged values of the dependent variable, (t). The decision rule for the test is where the value of the f-statistics is low and the probability value is high, we reject the null hypothesis. On the contrary, where the f-statistic value is high and the probability value blow, we accept the null hypothesis. The result is presented in table IV (see illustration). The test results shows that IRS, LDR and M_2Y granger – causes RGDP at 1 per cent significance level

From the result, economic growth did not, granger cause interest rate spread. Again, economic growth did not granger-cause loan deposit ratio and growth in broad money supply. Surprisingly, export growth did not granger-cause economic growth in Nigeria. This could be better explained by the dominance of oil in the nations export, which has very little domestic value-added. It is glaring from the above results that there is no link between banking sector development and economic growth in Nigeria during the fourth republic. This contradicts the finance-growth hypothesis of McKinnon and Shaw in the sense that the growth of the economy does not appear to be driven by the developments in the banking sector. Evidence from the table also reveals that the impact of investment on growth rate of GDP is positive but not significant. This could be as a result of the low level of investment arising from low savings. It should be noted at this point that it is difficult for savings to transform itself into investment in Nigeria due to poor banking habits in the country.

The table VI (see illustration) showed the estimated results of the model. The a priori expectations of the variables were met with regard to their signs. Except for XGR, all the variables are statistically significant. The coefficient of XGR was not significant at the 5 percent level. The implication of these results is quite insightful. Investment has positive impact on economic growth; a unit increase in investment would lead to 4.9 percent growth in the economy. In the case of interest rate spread, a negative relationship was established. The implication is that a unit reduction in the interest rate would increase growth by 1.2 per cent. However, the negative spread could be that irrespective of the state of the banking sector development, the spread in interest rate would be counterproductive to the economy. Thus, any serious effort to ensure the strengthening of the banking sector by the government to contributing to significant growth should be preceded by the narrowing down of the interest rate spread.

Similarly, the result of the loan-deposit ratio shows that a 1 percent increase in the ratio could raise growth by about 2.6 percent. The growth of export was found to be insignificant in explaining economic growth in Nigeria. This may be explained by the fact that Nigeria's huge oil export have not translated significantly to any meaningful increase in the standard of living for many Nigerians. Moreover, exports of primary commodities, including oil have persistently suffered from the declining terms of trade. These may have accounted for the insignificant impact of exports on economic growth in Nigeria.

4 Discussion of Empirical Results

This section discusses the results obtained from the estimation process. The stationarity test indicates that some of the variables of RGDP, INVY, LDR and EXPG are stationary at their levels while, M_2Y, IRS and DM are stationary at their first difference. From the granger-causality test, it was found out that there is no link between banking sector development and the real sector, a situation that contradicts McKinnon and Shaw (1973) hypothesis. Evidence from the analysis shows that the low level of investment is as a result of low savings and high interest rate spread. The estimated model result also shows that the value of export was found to be insignificant in explaining economic growth in Nigeria and this has indirectly or directly translated to poor standard of living of Nigeria in the midst of huge oil export revenue.

5 Conclusion and Policy Recommendation

This paper has empirically reviewed the Nigerian banking reform experience with reference to the fourth republic and its impact on the growth of the Nigerian economy by employing the ordinary least square, granger-causality and Johansen & Juselius co-integration techniques. Some econometric tests was carried out to ensure robustness of the empirical results and to enhance policy recommendation. The evidence from the results of the study suggests that the development of the banking sector and the institutions as they are now in Nigeria is strongly and significantly but negatively related to the Nigerian economic growth. This shows that the Nigerian banking sector is not yet virile to produce the much need real sector growth. Further revelation from the causality test between the real growth rate and measures of the banking system indicators shows that there is no relationship between banking sector development and economic growth in Nigeria. This is clear since the banking sector has failed in its intermediation role over the years between the surplus and deficit units and between the monetary sector and real sector of the economy as the link between the banking sector and the real sector of the economy remains weak. Generally, the result indicates that the McKinnon and Shaw hypothesis does not hold in the Nigerian case. Based on the above empirical evidence, it is therefore recommended that the present banking sector reforms be sustained given the fact that the banking sector of the economy has a major and critical role to play in channeling resources for investment and productive purpose. Secondly, government should ensure that appropriate macroeconomic policies that will boost productive activities are put in place.

ILLUSTRATIONS

Table I: Nigerian Deposit Money Banks' Profile and GDP during Fourth Republic Banking Sector Reform (In ₦M)

Years	Total Asset	Demand Deposit	Capital Account	Total Loans	GDP
2000	1,568,838.7	345,001.4	196,662.9	508,302.2	4,582,127.0
2001	2,247,039.9	448,021.0	364,258.8	796,164.8	4725,086.0
2002	2,766,880.3	503,870.4	500.751.0	954,628.8	6,912,381.3
2003	3,047,056.3	577,663.7	547,208.0	1,210,033.1	8.487,031.6
2004	3,753,277.8	726,552.0	206,063.1	1,519,242.7	11,411,066.9
2005	4,515,117.6	946,039.6	419,417.2	1,976,711.2	14,562,239.0
2006	7,172,932.1	1,497,904.0	872,513.3	2,524,207.9	18,564,594.7
2007	10,981,694.0	2,307,911.6	1,560,032.4	4,813,488.8	20,627,317.7
2008	15,919,559.8	3,650,543.9	2,577,601.1	7,799,400.1	24,296,329.3
2009	17,522,856.2	-	1,982,326.0	9,667,876.7	24,712,669.9

Source: CBN Statistical Bulletin and Statement of Annual Reports of various issues

Table II: Nigerian Deposit Money Banks' Selected Ratios Profile and GDP during the Fourth Republic Banking Sector Reform (in %)

Years	Bank Asset to GDP Ratio	Bank Deposit to GDP Ratio	Bank Loan and Advances to GDP Ratio
2000	34,24	7.53	11.09
2001	47.56	9.48	16.85
2002	40.03	7.29	13.81
2003	35.91	6.81	14.26
2004	32.89	6.37	13.31
2005	30.98	6.49	13.56
2006	38.64	8.07	13.60
2007	53.16	11.17	23.30
2008	65.52	15.03	32.10
2009	70.91	0	39.12

Source: CBN Statistical Bulletin and Statement of Annual Accounts of various issues

Table III: Capital Loans, Advances and Capital Adequacy Ratio of Nigerian Deposit Money Banks' during the Fourth Republic Banking Sector Reform.

Years	Capital (in ₦m) A	Lad (in ₦m) B	Capital ratio C = A/B
2000	196,662.90	508,302.20	0.387
2001	364,258.80	796,164.80	0.458
2002	500,761.20	954.628.80	0.525
2003	537,207.80	1,210,033.10	0.444
2004	206,063.10	1,519,242.70	0.136
2005	419,417.20	1,976,711.20	0.212
2006	872,513.30	2,524,207.90	0.346
2007	1,560,032.40	4,813,488.80	0.324
2008	2,577,601.10	7,799,400.10	0.330

Source: CBN Statistical Bulletin and Statement of Account of various issues

Table IV: Unit Root Test Results

Variables	ADF Statistic		Critical Values	Remark
	Level	Difference		
RGDP	-5.47	-10.42	1% = -3.62678 5%= -2.945842 10%=-2.611531	Stationary at level
INVY	-3.22	-4.78	1% = -3.62678 5%= -2.945842 10%=-2.611531	Stationary at level
LDR	-5.92	-7.39	1% = -3.62678 5%= -2.945842 10%=-2.611531	Stationary at level
M_2Y	-1.57	-4.61	1% = -3.62678 5%= -2.945842 10%=-2.611531	Stationary at level First difference
IRS	-1.25	-6.82	1% = -3.62678 5%= -2.945842 10%=-2.611531	Stationary at level First difference
EXPG	-6.33	-9.41		Stationary at level
DM	-1.43	-4.3855	1% = -3.62678 5%= -2.945842 10%=-2.611531	Stationary at First difference

Source: Author's Computation using E-view 8

Table V: Causality Test Result

Null Hypothesis	Probability Value	Remark
INVY does not granger –cause RGDP RGDP does not granger –cause INVY	0.025 0.014	Rejected Rejected
IRS does not granger –cause RGDP RGDP does not granger –cause IRS	0.0499 0.6412	Rejected Accepted
LDR does not granger –cause RGDP RGDP does not granger –cause LDR	0.0582 0.1463	Rejected Accepted
M_2Y does not granger –cause RGDP RGDP does not granger –cause M_2Y	0.0121 0.2475	Rejected Accepted
EXPG does not granger –cause RGDP RGDP does not granger –cause EXPG	0.6986 0.3582	Accepted Accepted

Source: Author's compaction using E-View 8

Table VI: Ordinary Least Square Estimation Result.

Variables	Coefficient	Std. Error	T-Statistic	Prob. Values
C	0.216853	9.311855	0.023288	0.9816
INVY	4.854536	1.746724	2.519441	0.0399
IRS(-1)	-1.150124	0.508939	-2.26397	0.0365
LDR	2.620379	0.769782	3.407931	0.0115
$M_2Y(-1)$	1.109429	0.185466	6.113262	0.597
XGR	0.038935	0.021653	1.798098	0.083

R-Squared 0.66322, F-Statistic 7.696606, DW 2.298896

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