

FINANCIAL SECTOR REFORMS AND ECONOMIC GROWTH IN NIGERIA

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ABSTRACT

The financial sector development in Nigeria has been accompanied by structural and institutional changes however; it faces enormous challenges leading to weak performance of banks. The paper examines the trend of financial sector reforms and its relationship on economic growth in Nigeria from 1980 to 2016. Financial reform dummy, bank lending to manufacturing sector, inflation rate, exchange rate, deposit rate, and lending rate were the independent variable while Gross domestic product was the dependent variable. Ordinary least square (OLS) and Autoregressive Distributed Lag (ARDL) were employed. The regression result showed that; financial reform dummy as well as bank lending to manufacturing sector, exchange rate, and deposit rate, all had a positive and significant effect on gross domestic product except for lending rate though positive but insignificant. However, inflation had a negative and insignificant effect on gross domestic product. The autoregressive distribution lag revealed a long run relationship between the variables and gross domestic product. The conclusion derived is that financial sector reforms impacted significantly positively on economic growth during the study period. The paper recommends that the regulatory authority and the policy maker should promote financial sector reforms in order to encourage financial development and strengthen their intermediating roles in the economy.

Keywords: Financial sector, Economic growth, Inflation, Financial development, Ordinary Least Square Model.

Introduction

The effect of the global melt-down inflicted unknown suffering to millions of people across the world, it also brought into sharp focus, the role of regulators in the financial arena and more so on private lending, which was the precursor of credit creation and eventual financial reform (Udoka & Anyinyang, 2012). Mostly, policy makers and firms always seek finances from financial institutions to get credit to either finance their budget or expand their businesses, money demand become one of the factors that economist, financiers and everyone in the economy considers. The Nigerian financial system is vulnerable to a number of risks, and there are serious concerns about the soundness and stability of the banking system (Sanusi, 2010, Soludo, 2008).

Banks and their owners are primarily in business to make profit, then, conscious of the need not to jeopardize this, is the key driving motivation for innovation and entrepreneurship. However, the banking system occupies a unique position in every economy and that is why it often attracts more than a casual regulatory attention. A part of the most central economic policy problem is to strike a balance between stability and reform in the financial sector. Ultimately, the issue is about balancing the economic, financial, and social costs in the short term to medium term with potential gains in the long term (Okerere, 2012). Allowing problems in the financial sector to fester may preserve stability in the short run, but could lead to pronounced distress and higher costs later on. At a minimum, sufficient progress has to be made to avoid deepening existing vulnerabilities, while building the capacity to manage financial distress when and if it occurs in the future (Fadare, 2010). This study therefore seeks to look at the relationship between these reforms from 1980 to 2016 and the growth of the Nigerian Economy.

Reforms to modernize and strengthen the financial sector have continued in recent years. The cleaning-up of the stock of non-performing loans is yet to be completed and considerable progress has been made in improving commercial banks' corporate governance structures and risk management systems (Ajayi, 2012, Asher, 2012). Also in the international financial system, substantial progress has been made during recent years in forging a consensus on the importance of strengthening the architecture of the international financial system. The international community, acting through various forums, has identified a number of priorities, including the need to enhance its own—and the markets'—ability to assess the strengths and vulnerabilities of financial systems, and to develop the analytical and procedural tools needed to perform this task (Emenuga, 1996). With the collapse of the international oil market in the early 1980s, the Nigerian economy began to show signs of distress. The emerging problems culminated in the introduction of an economic stabilization policy package in 1981. Since then, efforts to solve the country's economic problems led to the introduction of various rounds of budget-tightening austerity measures (1982-1985), structural adjustment programmes (1986), NEEDS agenda (2004) and the Seven Point Agenda (2007). Financial sector reforms in Nigeria have mainly been motivated by the financial repression paradigm amongst others.

The broad objective of the study is to examine the effect of financial sector reforms on economic growth in Nigeria. The specific objective is to investigate the relationship between financial sector reforms and economic growth in Nigeria. The study is a country specific study; it focuses on the financial sector of the Nigerian economy using time series data covering the period 1980 to 2016. Therefore, the financial sector reforms impacted positively to economic growth and it is significant during the study period. The paper recommends that the government and the monetary authority should introduce different policy reforms that will enhance the activities of financial sector to improve price stability and economic growth. The paper is structured as follows: Section 2 reviews the importance of financial sector reforms on economic growth from a policy and empirical perspective. Section 3 explains the methodology and data used. Section 4 presents the results of the analysis. Concluding remarks are reflected in Section 5

Literature Review

The process of liberalizing the financial sector of a country by creating a favourable environment, resulting in increase in the demand for money within the economy; is referred to as financial sector reforms. This comes to bear in the form of increase in financial resources to result in supply-induced money demand and an enabling environment created for investments in the economy.

Agu (2008) argues that numerous theoretical and empirical writings on this subject have shown that financial development is important and causes economic growth. McKinnon (1973), King & Levine (1993), all support the supply-leading phenomenon. On the other hand, the —demand-following hypothesis postulates a causal relationship from economic growth to financial development. Here, an increasing demand for financial services might induce an expansion in the financial sector as the real economy grows (i.e. financial sector responds positively to economic growth), (Goldsmith, 1969) supports this hypothesis as well. Others like Goldsmith (1969), Mckinnon (1973) & Shaw (1973) also acknowledged this view through positive response of saving to interest rate.

Akingunola & Adegoke (2006) argue that economic problems in Nigeria mirror deep concern considering the avalanche of strategies and measures reflecting various thoughts implemented to achieve development. The authors stress that recapitalization directive in 2005 by the central Bank of Nigeria has resulted into mergers and acquisitions. The study explores secondary data and adopted descriptive-cum comparative analytical method. Finding of the study reveals that poor performance of financial sector particularly the banking system in sustaining economic performance in Nigeria may not be unconnected with the low capitalization of the sector and the expectation of the emerging mega banks to impact positively on economic performance.

Akinlo et.al (2010) examines the long run and causal relationship between financial development and economic growth for ten countries in sub-Saharan Africa. Using the vector error correction model (VECM), the study finds that financial development is cointegrated with economic growth in the selected ten countries in sub-Saharan Africa. It shows a long run relationship between financial development and economic growth in the selected sub-Saharan African countries. The results show that financial development Granger causes economic growth in Central African Republic, Congo Republic, Gabon, and Nigeria while economic growth Granger causes financial development in Zambia. However, bidirectional relationship between financial development and economic growth was found in Kenya, Chad, South Africa, Sierra Leone and Swaziland.

Ojo (2007) highlights main features of financial sector mal-adaptation, the expected role of financial structure in economic performance, the resource curse and financial sector mal-adaptation link. The paper collected data on revenues generation in Nigeria, growth performance in Asia and Sub-Sahara Africa countries (SSAC), indicators of economic performance and governance in Botswana and Sub-Sahara Africa and other group of countries. The findings show that the expected role of mature financial structure is to appropriately adapt the mobilization and utilization of huge financial resources emanating from petroleum exploitation in Nigeria which would impact positively on the economic and social development of the country such that the natural resources curse imposed by petroleum

could have turned out to be a blessing. However, he postulated from the data collected that the oil boom has become a doom to constitute development dilemma manifested in form of high level of poverty, poor impact of reform on economic and social transformation and mass exodus of Nigerians to other countries. It recommends the need to evolve new financial culture, productive management and utilization of petroleum resources, diversification of the economy and the apex monetary authority should take positive measures and make development a priority task.

Methodology

Theoretical Framework

There are many theories (the Mckinnon-Shaw theory, Supply-leading theory, Structuralist theory and the Circuit theory) that explain financial sector reforms and economic growth in Nigeria, For the purpose of this study, the relevant theory is the Mc-Kinnon-Shaw model. Economic growth (the rate of change of real GDP with time) is the central concern of policy makers in a nation. Economic activities can be fostered in a country with sustainable economic growth. It is said that because of financial sector reforms; increased savings, increased investments and financial institutions contribute to economic growth. Also, that the ultimate target of all financial and an economic policy is to achieve a higher rate of economic growth in a country. The intellectual framework for financial reforms in developing countries in the 1980s was provided by the works of Mckinnon (1973) and Shaw (1973).

Model Specification

The increase in the saving rate in the economy will increase the capital efficiency per unit, which in turn stimulates more research and development activities via innovation. This will bring about growth in the economy; as a result, economic growth is expressed as a function of financial intermediation,

$$\text{Economic growth is } F_t \dots \dots \dots (i)$$

and a set of control variable, Z. This is expressed by equation below;

$$Y_t = f(F_t, X_t) \dots \dots \dots (ii)$$

Following the empirical specifications in Shittu (2012), the equation above will be expanded to accommodate the indicators of financial intermediation, as well as the determinants of traditional growth, such as capital stock and trade ratio. Thus,

$$Y_t = \alpha + \beta F_t + \delta Z_t + \varepsilon_t \dots \dots \dots (iii)$$

The functional form of the model is specified thus;

$$\text{Log}(GDP) = \sum f(FRD + BLM + INF + EXR + DR + LR)_t \dots \dots \dots (iv)$$

$$\text{Log}(GDP)_t = \alpha_0 + a_1 FRD_t + a_2 BLM_t + a_3 INF_t + a_4 EXR_t + a_5 DR_t + a_6 LR_t + \varepsilon_t$$

$$\dots \dots \dots (v)$$

$$\Delta(Y)_t = \alpha_0 + \alpha_1(Y)_{t-1} + \sum_{i=1}^p \pi_i \Delta(X)_{t-1} + \mu_t \dots \dots \dots (vii)$$

A simple model as mentioned in equation (vii) has been developed to explain the ARDL approach to co-integration.

$$Y_t = a + \beta X_t + \gamma Z_t + \varepsilon_t \dots \dots \dots (vii)$$

Results and Discussion

Descriptive statistics was used to test the normality of the data, unit root test was also conducted to test for the stationarity of the data, ordinary least square, autoregressive distributed lag and VAR were equally employed in this study.

Descriptive Statistics of Data

Table 1: Summary of Statistical data

Variables	Mean	Median	Max.	Min.	Std. Dev.	Skewness	Kurtosis	Jarque-Bera	Probability	Observations
GDP	2.529	2.493	2.989	1.312	0.360	-1.413	6.078	26.931	0.000	37
FRD	0.405	0.000000	1.000	0.000	0.497	0.385	1.148	6.200	0.045	37
BLM	3258.866	488.150	15158.62	11.860	4712.091	1.280	3.154	10.151	0.006	37
INF	20.016	12.400	72.800	4.700	17.962	1.542	4.125	16.615	0.000	37
EXR	159.246	168.290	480.000	0.100	130.771	0.385	2.221	1.852	0.396	37
DR	1.021	1.004	1.455	0.806	0.178	0.560	2.452	2.399	0.301	37
LR	20.943	21.080	38.210	6.230	10.013	0.094	1.942	1.779	0.411	37

Source: Authors' computation 2018

As shown in Table 1, the mean, median, standard deviation as well as the skewness, kurtosis Jarque-Bera of the variables of interest are evident. The various statistics indicates that the variables have different distributions. GDP shows the mean value of 2.529, median value of 2.493, the maximum and minimum values of 2.989 and 1.312. Meanwhile, the Skewness value is -1.413 implying that the GDP is negatively skewed, the Kurtosis value is 6.078 indicating that it is leptokurtic (fat tail) because it is more than 3 while the Jarque-Bera p-value is 0.000001 implying that GDP is not normally distributed. Inflation as one of the variables used in this study shows the mean value of 20.016, median value of 12.400, the maximum and minimum values of 72.800 and 4.700. However, the Skewness value is 1.542 indicating that the INF is positively skewed, the Kurtosis value is 4.125 signifying that it is leptokurtic (fat tail) in nature while the Jarque-Bera p-value is 0.000247 suggesting that INF is not normally distributed.

Financial reform dummy reveals the mean value of 0.405, median value of 0.000, the maximum and minimum values of 1.000 and 0.000. However, the Skewness value is 0.385 indicating that the FRD is positively skewed, the Kurtosis value is 1.148 signifying that it is platykurtic (thin tail) that is less than 3 while the Jarque-Bera p-value is 0.045 implying that FRD is not normally distributed. Exchange rate indicates the mean value of 159.246, median value of 168.290, the maximum and minimum values of 480.000 and 0.100. The Skewness value is 0.385 indicating that the EXR is positively skewed, the Kurtosis value is 2.221 meaning that it is platykurtic (thin tail) while the Jarque-Bera p-value is 0.396 implying that EXR is normally distributed. Also, deposit rate shows the mean value of 1.021, median value of 1.004, the maximum and minimum values of 1.455 and 0.806. The Skewness value is 0.560505 representing that the DR is positively skewed, the Kurtosis value is 2.452369 meaning that it is platykurtic (thin tail) while the Jarque-Bera p-value is 0.301239 implying that DR is normally distributed.

More so, bank loan to manufacturing sector shows the mean value of 3258.866, median value of 488.150, the maximum and minimum values of 15158.62 and 11.860. On the other hand, the Skewness value is 1.280 indicating that the BLM is positively skewed, the Kurtosis value is 3.154 signifying that it is leptokurtic (fat tail) in nature while the Jarque-Bera p-value is 0.006 indicating that INF is not normally distributed. Furthermore, lending rate shows the mean value of 20.943, median value of 21.080, the maximum and minimum values of 38.210 and 6.230. However, the Skewness value is 0.094 indicating that the LR is positively skewed, the Kurtosis value is 1.942 meaning that it is platykurtic (thin tail) while the Jarque-Bera p-value is 0.411 implying that LR is normally distributed during the study period.

Table 2: Regression Result

Dependent Variable: GDP				
Method: Least Squares				
Variables	Coefficient	Std. Error	t-Statistic	Prob.
C	1.604038	0.239247	6.704525	0
INF	-8.27E-05	0.002314	-0.035729	0.9717
FRD	0.150116	0.070441	2.131078	0.0414
EXR	0.001475	0.000553	2.665705	0.0123
DR	0.502809	0.250249	2.009232	0.0536
BLM	3.12E-05	1.36E-05	2.292211	0.0291
LR	0.000758	0.005028	0.150787	0.8812
R-squared	0.748377	Durbin-Watson stat		1.677103
Adjusted R-squared	0.698052			
F-statistic	14.87097			
Prob(F-statistic)	0			

Source: Author's computation (2018)

The coefficient of multiple determination which is also known as R-squared (R^2) has the value 0.748377 indicating that 74.8% of total variation in gross domestic product (GDP) can be explained by the control variables such as financial reform dummy (FRD), bank loan to manufacturing sector (BLM), inflation (INF), exchange rate (EXR), deposit rate (DR), and lending rate (LR) while the remaining 25.2 is being explained by other variables. The adjusted R-square, the Durbin- Watson, and the F-test indicates that the independent variables jointly can influence the dependent variable.

From the above result, the differences in coefficient of the variables representing the financial reforms show different contributions to the gross domestic product in Nigeria. In this result, using the coefficient, GDP is positive at constant with the value of 1.604038. This means that when all variables are held constant, there will be a positive variation to the tune of 1.604038 units in GDP.

The regression coefficient value of financial report dummy (FRD) is 0.150116 and its P-value is 0.0414 which implies that FRD has a positive and significant effect on gross domestic

product in Nigeria. That is, a unit increase in financial reforms will lead to increase in GDP with the tune of 0.150116. The coefficient value of bank lending to manufacturing sector (BLM) is 3.12E-05 and its p-value is 0.0291. This implies that BLM has a positive and significant effect on gross domestic product in Nigeria. The sign is in conformity with the a priori expectation. The result further showed that the coefficient value of inflation (INF) is -8.27E-05 and its P-value is 0.9717, implying that INF has a negative and insignificant effect on gross domestic product in Nigeria. Thus, a unit increase in INF will lead to decrease in GDP with the value - 8.27E-05. The sign is in conformity with the a priori expectation. Also, the coefficient value of exchange rate (EXR) is 0.001475 and its P-value is 0.0123, implying that EXR has a positive and significant effect on gross domestic product. This however denotes that a unit increase in EXR will lead to increase in GDP with the value of 0.001475. The sign is not in conformity with the a priori expectation.

The regression coefficient value of deposit rate (DR) is 0.502809 and its P-value is 0.0536 indicating that DR has a positive and significant effect on gross domestic product in Nigeria. However, a unit increase in deposit rate will lead to increase in GDP with the tune of 0.502809. The sign is in conformity with the a priori expectation. Meanwhile, the coefficient value of lending rate (LR) is 0.000758 and its P-value is 0.8812, meaning that LR has a positive but insignificant effect on gross domestic product. This then implies that a unit increase in lending rate will lead to increase in gross domestic product with the value of 0.000758. The sign is in conformity with the a priori expectation.

Table 3: Serial Correlation

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	3.593572	Prob. F(2,28)	0.3408
Obs*R-squared	7.557428	Prob. Chi-Square(2)	0.3229

Source: Author's computation (2018)

Serial correlation result presented in table 3 reveals the observations R-squared value of 7.557428 and its probability chi-square value of 0.3229 which implies that the null hypothesis fails to be rejected that no serial correlation in the residual.

Table 4: Heteroskedasticity Test

Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	2.688864	Prob. F(6,30)	0.1329
Obs*R-squared	12.93923	Prob. Chi-Square(6)	0.1440
Scaled explained SS	34.00881	Prob. Chi-Square(6)	0.0000

Source: Author's computation (2018)

The table above shows heteroskedasticity test of Breusch-Pagan-Godfrey and the result reveals the observation R-squared value of 12.93923 and it probability Chi-square is 0.1440 indicating that the null hypothesis fail to be rejected that residuals are not heteroskedasticity that is the variables are homoscedastic.

Table 5: Lag Length Result

VAR Lag Order Selection Criteria						
Endogenous variables: GDP FRD BLM INF EXR DR LR						
Exogenous variables: C						
Lag	LogL	LR	FPE	AIC	SC	HQ
0	-732.4190	NA	1.83e+10	43.49524	43.80949	43.60241
1	-566.4880	253.7768	20069228	36.61694	39.13095	37.47429
2	-506.8950	66.60395	15932713	35.99383	40.70759	37.60135
3	-378.7384	90.46350*	538587.9*	31.33755*	38.25107*	33.69526*
* indicates lag order selected by the criterion						
LR: sequential modified LR test statistic (each test at 5% level)						

Source: Authors' computation (2018)

The results presented in table 5 reveals the lag length criteria to be used for Autoregressive Distributed Lag and Vector Autoregressive techniques. The result indicates that Likelihood Ratio (LR), Final Prediction Error (FPE), Akaike information criterion (AIC), Schwarz Criterion (SC) and Hannan-Quinn Criterion (HQ) predicted 3, 3, 3, 3, and 3 lag respectively which implies that the lag length to be employed for ARDL and VAR is 3.

Table 6: ARDL Bound Test Result

ARDL Bounds Test		
Test Statistic	Value	K
F-statistic	10.61456	6
Critical Value Bounds		
Significance	I0 Bound	I1 Bound
10%	1.99	2.94
5%	2.27	3.28
2.5%	2.55	3.61
1%	2.88	3.99

Source: Author's computation (2018)

Table 6 shows the result of the bound test reveals that the F-statistics value is 10.61456 and K value is 6. The critical bound values of lower and upper bounds at 10% are 1.99 and 2.94, at 5% are 2.27 and 3.28, at 2.5% are 2.55 and 3.61 and at 1% are 2.88 and 3.99 meaning that the F-statistic value is more than the critical value bounds at 10%, 5%, 2.5% and 1% respectively. This implies that the null hypothesis of no long-run relationship exist will be rejected that is the explanatory variables such as FRD, BLM, INF, EXR, DR and LR as the proxies for financial sector reforms have long-run relationship to gross domestic product (GDP) during the study period.

Discussion of Findings

The findings from the study revealed that the variables employed such as gross domestic product (GDP), financial reform dummy (FRD), bank loan to manufacturing sector (BLM), inflation (INF) and deposit rate (DR) were stationary at level while lending rate (LR), and exchange rate (EXR) were stationary at first difference. Descriptive statistic showed that GDP

was negatively skewed, the Kurtosis revealed that it was leptokurtic (fat tail) while the Jarque-Bera showed that GDP is not normally distributed. Inflation was positively skewed; the Kurtosis was leptokurtic (fat tail) in nature while the Jarque-Bera suggested that INF was not normally distributed.

Financial reform dummy revealed that it was positively skewed, the Kurtosis signified that it was platykurtic (thin tail) while the Jarque-Bera revealed that FRD was not normally distributed. Exchange rate indicated it was positively skewed, the Kurtosis was platykurtic (thin tail) while the Jarque-Bera revealed that EXR was normally distributed. Also, deposit rate showed that it was positively skewed, the Kurtosis revealed that it was platykurtic (thin tail) while the Jarque-Bera was normally distributed. More so, bank loan to manufacturing sector showed that it was positively skewed, the Kurtosis was leptokurtic (fat tail) in nature while the Jarque-Bera indicated that INF was not normally distributed. Furthermore, lending rate showed that the LR was positively skewed, the Kurtosis was platykurtic (thin tail) while the Jarque-Bera p-value revealed that LR is normally distributed during the study period.

The findings from regression analysis revealed that GDP was positive at constant that is, when all variables are held constant, there will be a positive variation to the tune of 1.604038 units in GDP. The result further showed that INF has a negative and insignificant effect on gross domestic product in Nigeria. This implied that a unit increase in INF will lead to decrease in GDP with the value -8.27E-05. Financial reform dummy (FRD) revealed a positive and significant effect on gross domestic product in Nigeria. That is, a unit increase in financial reforms will lead to increase in GDP with the tune of 0.150116. Also, exchange rate (EXR) exhibited a positive and significant effect on gross domestic product. This however denotes that a unit increase in EXR will lead to increase in GDP with the value of 0.001475. The sign is not in conformity with the a priori expectation. This is similar to the findings of Pagano and Jappelli (1994), they suggested that financial intermediaries can contribute positively to growth of the economy.

Deposit rate (DR) indicated a positive and significant effect on gross domestic product in Nigeria. However, a unit increase in deposit rate will lead to increase in GDP with the tune of 0.502809. The sign is in conformity with the a priori expectation. Bank lending to manufacturing sector (BLM) revealed a positive and significant effect on gross domestic product in Nigeria. Meanwhile, lending rate (LR) showed a positive and significant effect on gross domestic product. This then implies that a unit increase in lending rate will lead to increase in gross domestic product with the value of 0.000758. The sign is in conformity with the a priori expectation. Nonetheless, the post estimation tests revealed that no serial correlation in the residual and the residuals were not heteroskedasticity that is the variables were homoscedastic.

The autoregressive distributed lag revealed that the null hypothesis of no long-run relationship exist was rejected that is the explanatory variables such as FRD, BLM, INF EXR, DR, and LR as the proxies for financial sector reforms have long-run relationship to gross domestic product (GDP) during the study period. This result is similar to the findings of Agbor (2016) who opined that there exist a strong positive long run relationship between financial sector development and economic growth in Cameroon.

Conclusion and Policy Recommendations

The study concludes that financial report dummy impacted a positive and significant effect on economic growth; bank lending to manufacturing sector exerted a positive and significant effect on economic growth, as well as exchange rate and deposit rate. Lending had a positive but insignificant effect while inflation has a negative and insignificant effect on economic growth in Nigeria. Also, financial sector reforms have long-run relationship to gross domestic product (GDP) during the study period.

The paper recommends that the regulatory authority and the policy maker should promote financial sector reforms in order to encourage financial development and strengthen their intermediating roles in the economy. The government and the monetary authority should introduce different policy reforms that will enhance the activities of financial sector to improve price stability and economic growth.

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