

# Examining Africa Economic Performance: An Issue for Market Base Monetary Policy and Financial Sector Development

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**Abstract:** The study aim at examining Africa economic performance for financial sector development. The study uses secondary data sourced from World Development Indicators (WDI) for the period of 37 years which span from 1980-2017. The study link Africa financial sector development and economic performance with emphasis on selected 46 African countries. The data obtained on broad money supply (BMS), number of commercial bank branches (NCBB), bank deposit (BD), interest rate spread (IRS), stock market capitalization (SMC), bank credit to private sector (BCPS) economic performance index (EPI), financial development (FD) and financial liberalization (FL) were analyzed using pair-wise correlation metrics and Arellano-Bond Dynamic Panel. The findings revealed that the current period economic performance in sub-Saharan Africa will decrease financial liberalization by 3.87e–05 while financial development decreases financial liberalization of the current period by 0.195. This is so because liberalizing the financial system when there high rates of unemployment, high inflation rate and high level of deficit which might likely retard financial development as more is captured by the economic problems. The study recommended that there should be financial discipline in Africa financial sector and this should be guided by financial liberalization for successful economic performance.

**Keywords:** Economic performance, Financial sector, development, Pair-wise correlation, Arellano-Bond Dynamic Panel, Liberalization.

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## Introduction

Some countries in Africa move faster with bold steps, while trying to bring changes in their economies financial sector. But others made slow progress within the same area of reforms and implementation of financial activities.

Mehran, Ugolini, Briffay, Iden, Lybek, Swaray and Harward (1998) observed that some countries in Africa made progress in national operations by building up market based monetary policy. By 1997 in almost all the countries, credit policies and interest rate had been liberalized by the Central Bank using open market operations. Still activity in primary markets was mostly dedicated in trading of government securities. Interbank markets were limited and secondary markets, if they existed, were at their initial stage. Some countries made progress in liberalizing their financial system, much less progress was achieved in liberalizing capital account transaction. It was on this note that the study aim at examining Africa economic performance for financial sector development.

## **Literature Review**

### **Conceptual Review**

#### **Financial Sector Development**

Oluranke and Fatukasi (2012) pointed out that financial sector plays an indispensable part in a country's overall growth. The most important constituent of this sector is the financial institutions, which act as a conduit for shifting capital from net savers to net borrowers, that is, from those who spend less than their earnings to those who spend more than their earnings. Traditionally, the financial institutions have become the country's main source of long-term funds. Such institutions provide a range of financial products and services to meet commercial sector varied needs. However, they assist new businesses, small and medium-sized businesses and the industries developed in backward areas. By fostering widespread industrial growth, they also helped to reduce regional inequalities. Adel (2015) noted that when considering the accumulation of capital in the form of investments that require technological innovation to function, in the sense of creating economies of scale and increasing production capacity capable of causing profound changes in the productive structure. Unbalanced growth, in turn, releases driving forces which cause a sequence of inductive imbalances in the economic activities of an economy's various supply chains. In addition, the design of a financial savings creation pattern often changes overtime. In a first step of establishing a financial system, families and businesses and finding financial intermediaries only to boost their capital-money in the domain of financial movement. In the second phase, it is the financial intermediaries that pursue credit demanding customers and loans are granted on the basis of the parameters of profitability, liquidity and the risk of applications and not just their social or development ventures.

#### **Economic Performance**

Koontz and Donnell (2003) defined performance as the ability of any business enterprise to achieve objective of high profit, good quality product, large market share, good financial results and survival at pre-determined time using relevant strategy for action. Mihaela (2012) noted that the growth of an economic is measure from the pieces of information on gross domestic product calculated by statistical agencies of countries. Economic growth is acquired by a rise in a country's production capacity.

Ekpo (2015) assert that economic growth and rise in GDP is not enough for development to be sustainable. Economic development is more than a growth that is sustain, it has to be sharing, equity and fairness. This means that development has to rise in arithmetic or geometric progression. Once an economy shift forward with as step and then backwards with two steps, and rise in poverty, it is not developing. Development need to include all parts of a population bettering the standard of living of all people. James (2015) observed that even though a country has may resources it is rated low in performance in terms of economic development.

## Theoretical Framework

### Internationalization Theory (IT)

Buckley and Casson (1976) explain that the theory give details on the factors which propel organization to extend their operation further away from their environment and make decision on the mode of entry. The internationalization theory explain the relative benefits and cost of serving foreign country market internally through multinational corporation than making it externally. That the decision of an organization to enter foreign market or create an internal market depend on the presence of conditions like transaction cost.

The internationalization theory is base on the idea that an organization will choose the option of creating its internal market if the cost of business transaction is lower and it will like to go into a foreign market when it has a great competitive advantage over indigenous companies and could protect some unique specific advantages.

### Mundel-Fleming Model of Open Economy

This model is founded on one price basis. Obaseki and Ojo (1998) noted that once a nation open its economy, the economic growth will be high. The authors highlight that economy of a nation is fully opened and liberalized when it contains the following factors; competitiveness, the level of the exchange rate, domestic gross capital formation, among other things. Mundel-Fleming model of open economy is derived from growth rate of GDP. It is mathematically stated as follows:

$$Y = f(t/y, r, mg, f/y, In) \dots\dots\dots\text{equation (1)}$$

$$t/y > 0, r > 0, m > 0, f/y <, In < 0$$

Where

$Y = \text{GDP}$

$t/y = \text{Total trade /GDP}$

$r = \text{Measure of real exchange rate}$

$mg = \text{Measures of real growth rate of money supply}$

$f/y = \text{Ratio of fiscal deficit /surplus over GDP}$

$In = \text{Inflation}$

Obaseki and Ojo (1998) further conclude that a positive sign is expected to show in an index for openness variable and real exchange rate; while a negative sign is also expected for money supply variable, ratio of fiscal deficit /surplus over GDP and inflation. The outcomes are based on a priori expectation.

### Model of Closed Economy

Study of Obaseki and Ojo (1998) point that closed economy is one whose state of equilibrium is attained. The authors further stress that in such an economy the aggregate demand (Ad) must be equal to aggregate supply (As). Aggregate demand comprises of government fiscal operations such as, expenditure, marginal productivity of capital, income, consumption, capital stock, interest rates and among others.

The authors also note that, aggregate demand or supply has relationship with adsorption which is represented mathematically as:

$$A^d = A^s$$

$$A^d = A \dots \dots \dots \text{equation (2)}$$

$A^d$  = aggregate demand;  $A^s$  = aggregate supply;  $A$  = adsorption

According to Obaseki and Ojo (1998), equation (2), indicate that aggregate demand grows through absorption, and by implication it constitutes a major problem to that economy thus limiting the extent of its economic growth. The authors also point that, in an open economy, import from other countries helps in the production purposes. Apart from that, resources can also be exported to other countries to earn foreign currencies necessary for economic growth. This is further explained in equation (3) as follows; where

$$A^d = A = Cab \dots \dots \dots \text{equation (3)}$$

Where,  $Cab$  = Current account balance

In view of this, Obaseki and Ojo (1998), further stress that aggregate demand is also a function of current account balance. Current account balance comprises of several factors such as; domestic absorption, foreign absorption and real exchange.

Based on this assumption, equation (4) is formulated.

$$Y = A + Cab + Tr_{ft} \dots \dots \dots \text{equation (4)}$$

Where,  $Y$  = Aggregate growth rate of output or GDP

$Tr$  = Transfers

$N_{ft}$  = Net Foreign Indebtedness

This means that the growth rate of an economy depend on the functioning of the financial development. If the financial system functions in an efficient manner, that is, it proceeds from a good collection of savings of an optimal allocation of the resources. Nevertheless, the model has shown the channel through which the financial system promotes the economic performance of countries through savings intermediation and volume of investment. It has also presented a tenable leeway for other forms of technology to be generated to promote economic performance.

### Research Methodology

The study uses secondary data sourced from World Development Indicators (WDI) for the period of 37 years which span from 1980-2017. The study link Africa financial sector development and economic performance with emphasis on selected 46 African countries. Base on the United Nation Development Program, it listed 46 of Africa's 54 countries as "sub-Saharan", excluding Algeria, Djibouti, Egypt, Libya, Morocco, Somalia, Sudan and Tunisia.

### Data Analysis

Data obtained on broad money supply (BMS), number of commercial bank branches (NCBB), bank deposits (BD) interest rate spread (IRS) stock market capitalization (SMC), bank credit to private sector (BCPS), economic performance index (EPI), financial development (FD) and financial liberalization (FL) were analyzed using pair-wise correlation metrics and Arellano-Bond Dynamic Panel as presented below:

**Pair-wise Correlation Metrics**

	<b>BMS</b>	<b>NCBB</b>	<b>BD</b>	<b>BCPS</b>	<b>IRS</b>	<b>SMC</b>
<b>BMS</b>	1.0000					
<b>NCBB</b>	0.0004 0.9868	1.0000				
<b>BD</b>	0.0018 0.9380	0.5435 0.0000	1.0000			
<b>BCPS</b>	-0.0021 0.9305	0.3631 0.0000	0.5002 0.0000	1.0000		
<b>IRS</b>	0.0271 0.2530	-0.0357 0.1324	-0.0940 0.0001	-0.0955 0.0001	1.0000	
<b>SMC</b>	-0.0161 0.4971	0.0644 0.0067	0.2205 0.0000	0.2883 0.0000	-0.0034 0.8863	1.0000
<b>Source: Computed by Authors using Stata 13.0</b>						

The leading diagonals present correlation values of 1.000 showing that each of the variables in this paper is perfectly collinear to itself. The correlation between the explanatory variables are all less than 0.5 (except for bank deposits and bank branches) showing that the correlation amongst the explanatory variables is weak.

**Arellano-Bond Dynamic Panel**

(1)		(2)		(3)	
<b>ECP</b>		<b>FD</b>		<b>FL</b>	
<b>Variables</b>	<b>Coeff. (Std. Err.)</b>	<b>Variables</b>	<b>Coeff. (Std. Err.)</b>	<b>Variables</b>	<b>Coeff. (Std. Err.)</b>
L.ECP	-0.222*** (0.000702)	Fl	-0.00700** (0.00311)	ecp	-3.87e-05*** (1.85e-06)
L2.ECP	-0.173*** (0.000977)	L.f.d	0.887*** (0.0170)	L.fl	0.587*** (0.000855)
L3.ECP	-0.174*** (0.000905)	L2.f.d	-0.0721*** (0.00800)	L2.fl	-0.518*** (0.000536)
L4.ECP	-0.0907*** (0.000870)	L3.f.d	-0.0278*** (0.00871)	L3.fl	0.295*** (0.000974)
L5.ECP	-0.0716*** (0.000457)	L4.f.d	0.0692*** (0.00998)	L4.fl	-0.378*** (0.00123)
L6.ECP	0.313*** (0.000658)	L5.f.d	-0.0643*** (0.00758)	L5.fl	0.139*** (0.00137)
L7.ECP	-0.161*** (0.000533)	L6.f.d	-0.00101 (0.0165)	L6.fl	-0.255*** (0.00103)
L8.ECP	-0.138*** (0.000556)	L7.f.d	-0.0553*** (0.0181)	L7.fl	0.0588*** (0.00358)
FD	-3.135*** (0.290)	L8.f.d	0.0726*** (0.00934)	L8.fl	-0.220*** (0.000200)
FL	0.234 (0.220)	ecp	1.81e-06 (3.22e-06)	fd	-0.195*** (0.0120)
Constant	175.6*** (4.161)	Constant	0.00513 (0.00747)	Constant	0.0131 (0.0297)
Observation	1.344		1.344		1.344
Number of Id	48		48		48
WALD		Wald chi2(10)= 29437.74		Wald chi2(10)= 3.38e+08	
CHI2(10)=4.73E+10		Prob > chi2 = 0.0000		Prob > chi2 = 0.0000	
<b>PROB &gt; CHI2 = 0.0000; Source: Computed by Authors using Stata 13.0</b>					

### The Findings

The findings revealed that the maximum lags are based on Schwarz information criterion (SIC) automatically selected 8 lags which is less than one-third of the total time period. The lagged values for the economic performance index have the capacity to decrease economic performance of the current period except for the sixth lag of the economic performance index which has the capacity to increase the economic performance index. This can be explained by the fact that most of the sub-Saharan African countries had very low values for the economic performance index. Most of the countries had a score of less than 50 percent. The deteriorating situation has the capacity to retard the coming year economic performance index. This is significant at the 1 percent level of significance. Financial development index has the capacity to decrease the economic performance index of Sub-Saharan African countries by 3.135%, and it is significant at 1 percent level of significance. This finding is so because financial development through increase in number of commercial bank branches, broad money supply and bank deposits has the ability to reduce financial insecurity which will thereby cause a reduction in the aggregate savings level. A fall in total savings in Sub-Saharan Africa will decrease the volume of total investments and thus reducing gross domestic product. This channel therefore justifies that the economic performance index will decrease within the framework of financial development in Sub-Saharan Africa.

Financial liberalization in Sub-Saharan Africa has the capacity to improve the economic performance index by 0.234. This is in agreement with the findings of Obamuyi (2009) who examined the relationship between interest rates liberalization and economic growth in Nigeria. These findings of the economic performance model are globally significant at 1 percent given the probability value of the Wald Chi<sup>2</sup> (3) which is acting as the F-ratio in this case. At the same time, the first lag, fourth lag and eight lag value of financial development has the ability to improve the current period financial development, while the other lagged values of financial development has the ability to decrease the current period financial development in Sub-Saharan African countries. The findings are significant at the 1 percent level. The economic performance of the current period in Sub-Saharan Africa has the ability to cause financial development to increase by 1.81e-06, while surprisingly financial liberalization has the capacity to decrease economic performance by 0.007 may be because these policies reduce the government's interference in financial markets leading to the privatizing of state-owned banks.

These findings are statistically significant at the 1 percent level of significance except for the causal link between economic performance of the current period and financial development that is statistically insignificant. The financial development model is also globally significant at 1 percent level of significance given the probability value of the Wald Chi<sup>2</sup> (3) statistic which is acting as the F-ratio in this case. Within the ambits of the same period, the first lag, third lag, fifth lag and seventh lagged values of financial liberalization cause the current period financial liberalization to improve, while the second, fourth, sixth and eighth lagged values will decrease the current period financial liberalization. The current period economic performance in Sub-Saharan Africa will decrease financial liberalization by 3.87e-05 while financial development decreases financial liberalization of the current period in Sub-Saharan Africa by 0.195. These findings are so because liberalizing the financial system for when there are high rates of unemployment, high inflation rate and high level of deficit might likely retard financial development as more is captured by these economic problems. These findings are statistically significant at the 1 percent level of significance. The financial liberalization model is globally significant at the 1 percent level of significance given the probability value of the Wald Chi<sup>2</sup>(3) statistics.

### Conclusion and Recommendations

The deteriorating economic performance in Africa has the capacity to retard subsequent years economic performance. This justifies that Africa economic performance index will decrease within the framework of financial development. Therefore, there should be financial discipline in Africa financial sectors and this should be guided by financial liberalization practices as a spring board for successful economic performance. For emerging financial markets and economics access to international capital is dangerous in the best of times and nonexistent in the worst.

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