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Financial Inclusion and Economic Growth in the Context of Financial Liberalization

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Abstract
Financial incusion and economic growth are closely linked, particularly in the context of financial liberalization. This paper examines the impact of financial inclusion on economic growth, emphasizing the role of financial liberalization in fostering accessibility and efficiency in financial markets. The study explores into theoretical frameworks, empirical evidence, and policy implications to assess how financial liberalization enhances or hinders financial inclusion and economic growth.

I. Introduction

Financial inclusion, defined as the availability and accessibility of financial services to all individuals and businesses, is a key driver of economic development. Financial liberalization, which involves liberalizing financial markets and reducing restrictions on capital flows, is often viewed as a catalyst for financial inclusion and economic expansion. However, the relationship between these variables is complex and multifaceted. This paper examines the interaction between financial inclusion and economic growth in the broader framework of financial liberalization. Financial Inclusion has become a focal point of development policies worldwide, particularly developing economies, such as Nigeria. Financial Inclusion is defined as the provision of financial services at affordable rates to disadvantaged and low-income segments of the population, in contrast to financial exclusion, in which such services are inaccessible or unaffordable (Nwanne, 2015). Onaolapo (2015) describes financial inclusion as a process aimed at ensuring easy access to, and utilization of, formal financial services by all members of the economy. This involves facilitating the opening of bank accounts, enabling access to credit, and ensuring continous usage of financial products and services. Stephen et al. (2009), cited in the Central Bank of Nigeria (CBN) (2013), defined financial inclusion as a state in which all individuals have access to banking and insurance services coupled with financial literacy and capabilities. Sanusi (2011) highlights the essential role of the financial system in driving economic development by enabling savings mobilization, efficient monetary administration, and liquidity management. A robust financial system secured by banks fosters linkages across various sectors, promotes specialization, and provides a favorable environment for implementing government policies aimed at achieving non-inflationary growth, exchange rate stability, balance of payments equilibrium, and full employment. The concept of financial inclusion originated in the early 2000s in response to research findings that highlight the negative effects of financial exclusion on poverty and economic growth. The overarching aim of financial inclusion is to ensure that all adult members of society have easy access to a comprehensive range of financial products fitted to their needs and offered at reasonable costs encompassing payments, savings, credit, insurance, and pensions (Onaolapo, 2015).

Theoretical Framework

The nexus between financial inclusion and economic growth is explained through various economic theories:

Endogenous Growth Theory: Suggests that financial inclusion foaster capital accumulation and productivity, fostering long-term growth.

Financial Intermediation Theory: Argues that effective financial markets allocate resources

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effectively, promoting economic activities and entrepreneurship.

Liberalization Hypothesis: Posits that financial liberalization leads to increased competition, efficiency, and access to financial services, thus supporting economic growth.

The Concept of Financial Inclusion

Financial inclusion has been interpreted differently by analysts, stakeholders, researchers, and scholars, leading to a lack of uniformity in standard comparisons. It is defined as a process that ensures universal access, availability, and utilization of the formal financial system by all members of an economy. According to Martinez (2011), financial access serves as a vital policy tool utilized by governments and non-governmental organizations to foster aggressive and stimulating economic growth, enabling the efficient allocation of productive resources and reducing capital costs. This inclusive financing system significantly enhances day-to-day financial management and curbs the spread of unfair informal credit sources such as money lenders (Martinez, 2011). Consequently, an inclusive financial system is recognized as a pivotal policy initiative in many countries, with contributions from financial regulators, government bodies, and the banking industry. Legislative efforts have been undertaken in certain countries to establish monitoring frameworks, exemplified by initiatives in the United States, France, the United Kingdom, and South Africa. Many of these regulatory frameworks aim to enhance the economic welfare of marginalized groups, enabling rural women to purchase sewing machines and start small businesses, granting artisans access to a broader range of financial services to augment income and enhance resilience to economic shocks. A well-functioning financial system steer economic growth through sustainable development and facilitates financial intermediation by offering savings, credit, payment, and risk-management products tailored to the diverse needs of individuals. Financially inclusive systems ensure broad-based access to financial services by providing customized products at affordable rates without strict documentation requirements, particularly benefiting the poor and other vulnerable groups within the economy. Onaolapo (2015) contends that without financially inclusive systems, the poor would rely solely on limited savings for future investments, while micro and small businesses would struggle to pursue growth opportunities, perpetuate income disparities, and hinder economic growth in many developing countries.

Empirical Evidence

Several studies have explored the impact of financial inclusion and liberalization on economic growth:

According to Khan (2011), rural families would benefit from more economic activity and job prospects because of having access to basic banking services. As more people engage in the economy, rural households' disposable income will increase, resulting in more savings and a stronger base of deposits for the bank. This will drive economic growth, which inevitably leads to inclusive growth.

According to Hariharan and Marktanner (2012), Financial Inclusion can support economic development and growth. They discover a significant positive association between a nation's total factor productivity (TFP) and its Financial Inclusion, suggesting that it has the capacity to generate capital. The research findings indicate that financial inclusion has the capacity to augment the savings portfolio of the financial sector, improve the effectiveness of intermediation, and stimulate entrepreneurial endeavours. Using the index of financial inclusion (IFI) technique, which he developed in accordance with UNDD within the 94 nations of study,

Sarma (2012) assessed the degree of financial inclusion for 94 countries globally between 2004 and 2010. Even Nigeria and Ghana were absent from the list of very few African nations, and his selection of them was predicated on the data that was available in the IMF's financial access survey (FAS) database. According to the results, among the 91 nations that were eventually tested in 2009, Cyprus had the highest ranking as the most financially inclusive nation, with an IFI value of 0.996, while Chad had the lowest, with an IFI value as low as 0.016. Afghanistan came in worst in 2010 with an IFI rating of 0.052, while Luxembourg came in first place with a value of 0.996. The study's conclusion is based on the discovery that financial inclusion and exclusion vary widely among nations. Because it is a reliable predictor of economic progress, he advises using a multidimensional method consistently to track the degree of financial inclusion and exclusion in different nations.

Aina and Oluyombo (2014) look at Nigeria's financial inclusion economy. According to the report, most respondents had savings accounts even though there is a high level of access to bank accounts. Even with dormant accounts, adults have antremendously low bank account

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Policy Implications

For financial inclusion to translate into economic growth within a liberalized financial system, policymakers must consider:

- **Strengthening Financial Regulations:** Ensuring that liberalization does not lead to financial crises due to excessive risk-taking.
- **Promoting Digital Financial Services:** Leveraging technology to expand access to banking services in underserved areas.
- **Enhancing Financial Literacy:** Educating individuals and small businesses on financial management to maximize the benefits of financial inclusion.

II. METHODOLOGY

Following Onaolapo (2015) and Evans and Adeoye (2016), this study adapts the models established by Wadkok (2018), Emmanuel and M-Ember (2022), and Ukoh and Okeke (2023) to probe the effect of financial inclusion on economic growth in Nigeria from to 1981- 2022. Theevaluation of financial inclusion used in this study includes money supply, which represents the size of the banking sector, while credit to the private sector measures the size and financial depth of the banking sector. Others include the loan-to-deposit ratio, liquidity ratio, and total savings ratio, while economic growth is measured using gross domestic product per capita. Data sources encompassed a range of publications, including the Central Bank of Nigeria Statistical Bulletins (2023) and the World Development Indicators (2023). The adapted model that examines the influence of financial inclusion on economic growth in Nigeria is presented below.

$LGDPPC_t = (\alpha_0 + \beta_1 CPS_t + \beta_2 BM_t + \beta_3 LDR_t + \beta_4 LQR_t + \beta_5 TSR_t + \dots \dots . U_t)$ (1)

Where: $LGDPPCt$: is the natural log of gross domestic product per capita at time t

BMt : Ratio of road money to GDP (M2/GDP) at time t

$CPSt$: Ratio of Credit to Private Sector by bank to GDP (CPS/GDP) at time t

$LDRt$: Loan-to-deposit ratio of commercial banks at time t

$LQRt$: Liquidity ratio of commercial banks at time t

$TSRt$: Total Savings ratio of commercial banks at time t

α0 = Intercept $\beta 1$– $\beta 5$ = Coefficient of the Independent Variables.

U_t = Disturbance Term at time t

III. RESULTS & DISCUSSION

Table 1
Descriptive Statistics

	LNGDP	CPS	BM	LDR	LQR	TSR
Mean	7.148496	9.355944	16.80191	67.34447	49.20652	8.049396
Median	7.416375	8.194985	13.88719	66.90000	46.36736	6.645847
Maximum	8.071204	19.60353	27.37879	96.81702	104.2024	14.94330
Minimum	6.162171	4.948032	9.063329	37.55947	26.39276	3.291754
Std. Dev.	0.614723	3.505756	6.060746	13.37272	14.51636	3.464103
Skewness	-0.271039	1.026327	0.449879 -	0.181231	1.446075	0.547543

Source: Authors Compilation (2024), based on data from WDI (2023)*

The descriptive statistics above depict the characteristics of the study variables and ascertain their suitability. The average value of all the variables is positive, with loan to deposit ratio (67.34%) having the highest mean value. This implies that Nigerian banks' financial intervention function of funding the deficient sector with excess surplus sector is quite meritorious. The banks liquidity ratio is alo found to be about 49% which is above the 30% liquidity ratio recommended by the CBN 293th Monetary Policy Committee meeting (CBN, 2024). This implies that Nigerian banks have an adequate ability to cover all immediate debt obligations. Furthermore, the median of the variables suggests that all the variables are symmetrically distributed, given that their values are close to the mean value, while the maximum and minimum values ascertain that the values of the variables studied range from positive to positive in all cases, suggesting that there are fewer outliers in the dataset used for this study. The standard deviation values were also quite low compared with the mean values, suggesting that the data were distributed. Similarly, some of the variables are negatively distorted (LNGDPPC and LDR), while LNGDPPC, BM, LDR, and TSR are platykurtic, implying that the variables produce fewer and less extreme outliers than those of the normal

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distribution, while others are greater than three, thus, leptokurtic. The unit-root test is described in the next section.

Table 2
Unit Root Test

	Level	1 st Difference	Decision
LNGDP	-1.4904 0.5284	-5.2315 0.0001*	I(1)
CPS	-2.2771 0.1840	-5.9441 0.0000*	I(1)
LDR		-4.8608 0.0003*	I(0)
BM	-0.8849 0.7830	-5.2266 0.0001*	I(1)
TSR	-0.2970 0.9166	-4.9630 0.0002*	I(1)

Source: Authors Compilation (2024)

The Augmented Dickey Fuller (ADF) test was used to ascertain the stationarity of the variables. The results in Table 2 confirm that LDR is stationary at the level, while LNGDPPC, CPS, BM, and TSR became stationary at the first difference. This affirms that the variable exhibited multilevel stationarity; hence, the study conducts the ARDL approach to cointegration to yield the short-run dynamic relationship, long-run relationship, and equilibrium parameter. Pesaran and Shin (1999) and Pesaran et al. (2001) confirm that the ARDL cointegration technique is used to determine the long-run relationship between series with different orders of integration. The bound test is as follows.

Table 3
ARDL Bound Test

ARDL Bounds Test		
Null Hypothesis: No long-run relationships exist		
Test Statistic	Value	K
F-statistic	4.4731	5
Critical Value Bounds		
Significance	I0 Bound	I1 Bound
10%	2.26	3.35
5%	2.62	3.79

Source: Authors Compilation (2025)

The bound cointegration test was performed for the linear specifications, and the results are listed in Table 3. The computed value of the F-statistic is 4.4731, which is higher than the upper bounds, implying that there exists a long-run linear association between financial inclusion and economic growth in Nigeria. This finding is similar to that of Sethi and Acharya (2018), who revealed that a long-run relationship exists between financial inclusion and economic growth. In Nigeria, Ogiriki and Andabai (2014) confirmed a long-run equilibrium relationship between economic growth and financial intermediation.

Table 4
ARDL Cointegrating And Long Run Form

Dependent Variable: LNGDPPC				
Cointegrating Form				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LNGDPPC(-1))	-0.0354	0.1942	-0.1822	0.8576
D(LNGDPPC(-2))	0.2724	0.1944	1.4014	0.1791
D(LNGDPPC(-3))	0.4124	0.1830	2.2538	0.0377*

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D(BM)	0.0812	0.0456	1.7805	0.0929**
D(BM(-1))	-0.1166	0.0584	-1.9959	0.0622**
D(BM(-2))	-0.0662	0.0411	-1.6093	0.1260
D(CPS)	-0.1096	0.0796	-1.3765	0.1865
D(CPS(-1))	0.0194	0.0486	0.3999	0.6942
D(CPS(-2))	-0.1185	0.0441	-2.6904	0.0155*
D(LDR)	0.0234	0.0075	3.1310	0.0061*
D(LQR)	-0.0068	0.0046	-1.5007	0.1518
D(TSR)	0.0468	0.0784	0.5970	0.5584
D(TSR(-1))	0.1719	0.1112	1.5457	0.1406
D(TSR(-2))	0.2137	0.1058	2.0196	0.0595**
CointEq(-1)	-0.8747	0.1799	-4.8616	0.0001*
Cointeq = LNGDPPC - (0.4326*BM -0.1708*CPS + 0.0430*LDR -0.0201*LQR -0.4747*TSR + 3.3606)				
Long Run Coefficients				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
BM	0.4326	0.1182	3.6614	0.0019*
CPS	-0.1708	0.0929	-1.8383	0.0836**
LDR	0.0430	0.0113	3.7991	0.0014*
LQR	-0.0201	0.0078	-2.5746	0.0197*
TSR	-0.4747	0.1418	-3.3477	0.0038*
C	3.3606	0.5933	5.6640	0.0000*

Source: Authors Compilation (2025)
NB: * 5% and ** 10% probability value respectively

Table 4 shows the short- and long-run effects of financial inclusion on economic growth. The results show that the error correction model (ECM) parameter represented by COINTEQ (-1) is significant at 5%, with a coefficient of -0.8747; hence, the altered parameter is significant and it has the correct theoretical sign. This implies that about 87% of any disequilibrium in the relationship between financial inclusion and economic growth, represented using gross domestic GDP per capita, can be restored within one year. This result is like that obtained by Wadkok (2018), who found that a short-run relationship exists between financial inclusion and economic growth. In terms of the long-run effect of financial inclusion on economic growth, the findings revealed that broad money supply (BM) and loan-to-deposit ratio (LDR) have a significant positive effect on economic growth as a measure of financial inclusion. This implies that a 1%increase in money supply by the federal government through the CBN to support the driver for financial inclusion will result in betterement in the lives of the citizens, as measured using gross domestic product per capita. Similarly, a 1% increase in LDR will result in 4.3% increase in economic growth. Barajas et al. (2016) and Nwafor and Yomi (2018) revealed that financial inclusion has a great impact on economic growth. Makina and Walle (2019) also reveal that financial inclusion has a positive and statistically significant effect on economic growth in Africa. Shittu (2012) and Azege (2004) report that financial deepening drives economic growth. On the other hand, credit to the private sector (CPS), liquidity ratio (LQR), and Total Saving ratio (TSR) show significant negative coefficients, implying that these measures of financial inclusion do not propel economic growth in Nigeria. This means that an increase in credit to private sector, liquidity rate, and total savings rate will result in 17%, 2 %, and 47% decline in growth in the economy respectively. Between 1986 and 2007, Nzotta and Okereke (2009) opined that financial inclusion did not support economic growth in Nigeria. Furthermore. Bhattarai (2015) opined that overfinancing has reduced the level of growth in some developed countries with high financial development ratios, while a more prudent financial deepening method supports higher economic growth in emerging economies.

IV. Conclusion

Financial inclusion plays a crucial role in driving economic growth, particularly when facilitated by well-managed financial liberalization. While financial liberalization can enhance accessibility and efficiency in financial markets, it requires balanced regulatory oversight to prevent economic turbulence. Policymakers must adopt a

comprehensive approach that integrates financial inclusion strategies with sustainable economic policies to ensure equitable and long-term economic growth. This study underscores the critical interplay between financial inclusion and economic development in Nigeria, supported by an extensive review of relevant literature and empirical evidence. The findings reveal a subtle understanding of the multifaceted relationship between financial inclusion and economic growth, shedding light on both the positive and negative aspects. Using data from to 1981-2022 and employing the ARDL Bound Test, it was revealed that a short- and long-run relationship exists between financial inclusion and economic growth in Nigeria measured using gross domestic product per capita. there is a need for more loans from banks in closing the wide gap between the total accumulated savings and the loans allocated, especially to rural dwellers, business owners, and small and medium-sized enterprises who are in critical need of financial support, which will ultimately result in inclusiveness. Furthermore, the financial sector needs to adopt technological innovations and enhance financial literacy programs that can facilitate greater participation in the formal financial system, thereby fostering inclusive economic growth and sustainable development in Nigeria. This study underscores the significance of advancing financial inclusion as a catalyst for driving economic development, empowering individuals, and building a more resilient and inclusive economy in Nigeria. By leveraging the insights gleaned from this research, stakeholders can chart a course toward a more prosperous and equitable future for all Nigerians.

References