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Impact of Islamic Financial Inclusion on Economic Growth in Nigeria

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Abstract

Although the connection between finance and growth is well deliberated in literature, attentions are now geared to non interest inclusive finance with understanding the deficiency of traditional inclusive finance. However, the impact of interest free inclusive finance on growth still is partly examined. This research work dealt with Islamic inclusive finance - growth nexus. The research employed a quarterly data spanning from (2010-2020). In this work, a novel index of Islamic financial inclusivity was constructed using the (PCA) and a recently developed Bootstrap ARDL (BARDL) Cointegration technique was used in analyzing the data. The finding indicates a number of results. First, the results of BARDL demonstrates a robust association among Islamic Inclusive finance and Growth. As such, it demonstrates the presence of positive and statistically significant nexus between Islamic inclusivity finance and growth. Moreover, findings also reveal presence of cointegration among Islamic inclusivity finance and growth. As such, interest free finance can be used as a tool to help nations to exit from economic recession and other macroeconomic challenges.

Keywords: Financial Inclusion, Economic Growth, Linear Causality

1. Introduction

A ccomplishing an inclusive economic growth has been a major macroeconomic objective of several countries across the world (Torruam, Chiawa & Abur, 2013; Ibrahim & Aliero,2020). Inclusive growth can facilitate the reduction of the rate of poverty, unemployment, ensures improved public services and most importantly, attracts foreign investment (Usman, 2010). Contrary to this, according to Ajakaiye (2009), poor economic growth may have a negative effect on the economy such as decreasing output level, low per capita income, low level of savings and investments, decreasing foreign direct investment, increasing unemployment etc. Economic growth has been defined as condition through which national income is increases (Todaro, 1990).

This improvement in economic performance can only encourage an increase in welfare if it enshrines inclusivity. Hence, inclusive economic growth has just been well-thought-out as a prime objective of national economic policy of all nations. In

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this way, the recent worldwide development agenda of Sustainable Development Goals (SDGs) stresses the accomplishment of social inclusion in a sustainable way (Ibrahim & Aliero,2020).

The principal economic objective of the Nigerian government of accomplishing sustainable economic growth has strained the yawn of scholars and those responsible for enacting policies in the country to essentially examine the causes of economic growth among which financial inclusion was acknowledged and was clearly counted a policy objective in the nation in April, 2005 (Ibrahim & Aliero, 2020; CBN, 2020). Economic growth captured by percentage rise in (G.D.P) though rest on to a large extent on many variables, yet, financial inclusion in this veneration is topmost (Conroy, 2005). Levin & Zervos (2004) contended that, provision of sufficient and reasonable financial products and services to the unbanked populace impacts positively on growth. Hence, the development of inclusive finance is perilous in accomplishing inclusive growth. Furthermore, empirical result has discovered that, the rate of financial inclusivity in the economy determines the level of growth, capital and technology (Levin & Zervos, 2004; Conroy, 2005).

According to Babajide, Adegboye, and Omankhalen (2014); Sarma (2015); Jisha and Varghese (2016), growth will be realized sustainably if the adult population is financially inclusive. This corroborates Kam and Adign (2012), Babajde, (2014) and Andrianvo and Kpoda (201). Explicitly, more access to deposits undoubtedly improves inclusivity. Ajkaye and Olowkere (2019) similarly acknowledged that, inclusivity stimulates growth. Therefore, inclusivity has capacities to stimulate all-encompassing growth.

In acknowledgement of the position of financial inclusivity as apparatus of propelling progress in the economy, varying plans and strategies to encourage inclusive finance in line with the peculiarities of the local features of the economy along with homegrown population characteristics were put in place. The enactment of bucolic banking system in 1970s was one of the chief strategies and programs put in place by Nigerian administration towards inspiring inclusivity (Ibrahim, 2019). Explicitly, the system was inaugurated by the Central Monetary Authority in 1975 mainly to attain at least one branch of commercial bank in all local governments in Nigeria (Central Bank, 2015).

Furthermore, (N.A.C.R.D) was constituted by Federal Government of Nigeria in October, 2000 precisely to make credit facilities available to the poor populace. It collects savings and provides a room for self-employment in rural communities. With all the efforts and commitments put in place, the influence of inclusivity in driving growth has since been unsatisfactory in the economy despite the fact that Nigeria is among the number of nations that struggle to achieve the targeted financial inclusion rate of 95% by the year 2024. In response to this, the Central Monetary Authority

(C.B.N) approved the creation of Islamic Banks (IBs) which are sharia - based in 2012 to serve as an alternative to the prolonged conventional banks (Ibrahim, 2019). Such sharia- based finances provided by Islamic Banks include Musharakah (sharia- based partnership), Mudarabah, Ijarah and Sukuk among others. Jaiz Bank Plc has been the pioneer Islamic operating under the Nigeria's Islamic Banking and Finance since 2012 with outstanding performance since its inception. Meanwhile, Taj Bank, another developed Islamic Bank emerged recently in Nigeria and started operation in 2020. Furthermore, research has shown that, some secular Banks in Nigeria that earlier had an Islamic gap are now making all that are essential to migrate in to a fully sharia-based Islamic Banks (Ibrahim, 2022). This undoubtedly shows the success and prospects of Islamic Banking industry in Nigeria.

It is therefore, in the rouse of this background that this study set to study influence of Islamic inclusivity in finance from Islamic point of view on growth within Nigeria by employing a quarterly data spanning from 2016-2022.

1.1 Research Aims

The prime aim the study set to accomplish will be exploring the influence of Islamic financial inclusivity on growth. It also aims to study the presence of cointegration among non interest financial inclusivity- growth nexus.

2. Review of related literatures

2.1 Conceptualization

According to United Nation (UN, 2010); financial inclusivity is the procedure of guaranteeing comfort of entree, convenience and practice of formal monetary system among the individuals which will enhance their wellbeing economically and socially. World Bank (2018) opined financial inclusivity as chains where people and corporate ventures get suitable and reasonable financial goods and facilities to meet their wants; and such facilities provided in a decent and sustainable manner. However, in this study, the researcher allied with United Nations (UN, 2010) by adopting their definition as a working definition in this study. The crux of choosing United Nations's meaning researcher's operational meaning is due to its strong emphasis on principal gages of inclusivity. These gages comprise accessibility of services, obtainability and utilization. The combination of the gages along with commercial banks/ micro finances corporations acting as doorway undoubtedly paves way for inclusivity.

From Islamic viewpoint, inclusive finance entails access to finances in risk-apportionment agreements by delivering truthful and non interest finance by devising a revenue redistribution procedure for eradicating poverty (Ibrahim, 2022). Mushaarakah (sharia- based partnership), Mudarabah, Murabaha, Istisnah, Salam, Ijarah and Sukuk among others are samples of a sharia- based and risk-apportionment indentures which are usually available under the umbrella of Islamic Banking and finance.

In Musharakah method of financing, it contains a risk- sharing contract in line with sharia in which two or more partners mutually agree to provide a capital to run a business such that, the profits and rewards earned is apportioned

Among the partners based on the ratio agreed at the time of the bond, whereas the losses incurred are borne according to the capital invested (Ibrahim & Aliero, 2020). Scholars stress that, this method of Islamic financing, due to its characteristic of risk and loss distribution, it promotes financial system stability, effectiveness and most importantly, encourages economic growth Arshed, Yasmin & Gulzar (2020). Mudarabah on the other hand deals with a profit and loss sharing contract between two partners where by one partner (capital provider) provides the capital to the other partner (Entrepreneur) who provides his skills and exertions to operate a business venture such that the profits or capital gains earned are shared between both partners based on agreed ratio Arshed, Yasmin & Gulzar (2020). However, all the loses are totally borne by the Rab ul maal while the liability of the Mudaarib will be limited to the loss of his time and exertions. In contemporary days, the exercise of this contract has been extended to cover various businesses. The above is the most commonly practiced type of Mudarabah. There is another system of Mudarabah which comprises investment accounts and project financing. In this respect, it serves as an exciting device to eradicate interest from the society as it offers interest free financing by using the mudaarib as manager of the resources of the economy Arshed, Yasmin & Gulzar (2020).

Murabaha Islamic financing mean on the other hand is an extraordinary sharia-based alternative of debt financing by the orthodox banking system. It is a type of sale contract where the product traded for cost plus profit, the seller reveals the cost of getting a stated commodity required by the buyer along with the profit margin Arshed, Yasmin & Gulzar (2020). The entire price which comprises the cost and profit margin is usually paid in lumps. Therefore, Murabaha is non-interest-based loan which is forbidden in Islam, but rather, it is a type of financing to buy a commodity which is sharia- based. Istisnaa is an extraordinary type of sale, at a price accepted by the parties involved, where by the purchaser orders to produce, accumulate, and build anything to be provided or supplied at an impending time. In istisna, the product must be identified and stated to eliminate any vagueness concerning its conditions with its color, nature, worth and number. The selling cost of the commodity to be produced must be fixed in unqualified and explicitly. The price may be paid wholly or in parts in the stock commonly agreed by the parties. In Ijarah (Leasing) mode of financing, the quantity of hired commodity or property stays in the possession of the owner and only its use is shifted to the renter. A commodity which cannot be used deprived using the same cannot be rented out such as currency, foods, fuel etc. only properties which are possessed by the original owner can be rented out.

2.2 Empirical works

Here, the researcher reviews critically several scholastic works done on the nexus between inclusivity and growth across the globe. The studies are classified in to country specific and cross-country studies.

2.3 Country Specific Studies:

Burgess and Pandey (2007) studied the influence of financial inclusivity on growth. The scholars utilized a data spanning (1982-2015) O.L.S. Method was hired in analyzing the data. The conclusions from the result indicated that, inclusivity is positively and significantly impacting on growth in the sampled area during the passé covered by the study. Ibrahim and Aliero (2020) studied the influence of Islamic inclusive finance on the growth of the economy. The researcher utilized a quarterly data spanning from (2010-2014) and Fully Modified O.L.S. was hired in evaluating the data. The results showed that inclusivity is a significant cause of economic growth through the study passé. Ibrahim (2012) also studied the causality between Islamic financial inclusivity and economic growth in Nigeria over the period 2000-2011. The scholar found a causal relation from growth to Islamic financial inclusivity and gages like Sukuk, Ijara and Salam. These results lend an empirical support for the the association among Islamic banking financing and economic growth.

Kazeem and Akinyele (2006) investigated the influence of Islamic financial inclusivity and financial literacy growth in Nigeria from 1990-2003. The study employed Ordinary least squared method of estimation. The findings from the analyses conducted reveal among others; Islamic financial inclusivity possess a negative influence on growth in Nigeria. Nzotta and Okereke (2009) studied the influence of financial literacy and innovation on growth in Nigeria (1986-2007). The analyses were done using stepwise L.S regression technique and the findings indicated that financial innovation and financial literacy have a moderately low level of deepening influence on economic growth through the passé of the study.

Kennedy and Samuelson (2010) studied the influence of financial inclusivity on poverty eradication in Nigeria. The scholar employed data for (1987- 2014) and O.L.S. was hired in analyzing the data. The findings showed that, Nigerian rural financing programs have a positive impact on poverty elimination among the poor households.

Hassa & Sanhez (2011) also investigated an association of Inclusivity and growth of the economy by utilizing panel data spanning 1980-2006. From the results, it showed a robust positive nexus among inclusive finance and growth. Meanwhile domestic credit is negatively associated with growth. Similarly, Law and Singh (2014) studied the connotation among finance and economic growth by using panel cointegration method. The study sample comprised of 87 advanced and emerging nations. The findings disclosed that there was a threshold effect in the finance-growth relationship.

3. Empirical methodology

This part of the study comprises a wary synthesis of the methods adopted to accomplish the research objectives. An index of inclusivity was generated using (P.C.A) using the following gages to capture its dimensions; Musharakah (MUS), Mudarabah (MUD), Murabaha (MUR) and Iarah (IJA) by following the work of Aliero & Ibrahim, (2020), with slight modification. A series as Islamic Financial Inclusion Index (IFII) was generated which was regressed against economic growth with Sukuk (SUK), Salam (SAL) and Istisna (IST) as control variables.

3.1 Model Description

The theoretical model of financial inclusion is stated as follows by following Aliero & Ibrahim, (2022):

$$\text{Economic growth} = f\ (\text{Islamic Financial Inclusion})$$

$$\text{GDP} = f\ (\text{IFII})$$

Thus, to achieve the first objective of this study, this model is specified:

$$lnGDP_t = \beta_0 + \beta_1 IFII_t + \beta_2 SUK_t + \beta_3 SAL_t + \beta_4 IST_t + \mu_t$$

- $GDPt$ – Growth proxy.
- IFII- represent Islamic Financial Inclusion Index
- SUK-represent Sukuk.
- SAL-represent Salam
- IST-represent Istisna
- μ - error term with the usual stochastic assumptions.

3.2 Data

Researcher sourced quarterly data for the variables selected. The data was sourced from (WDI) Data base and IFSB.

3.3 Bootstrap ARDL Cointegration Test

To detect cointegration among the dependent and independent variables, cointegration tests are employed. The researcher checked the existence of long run connotation among Islamic financial inclusivity and growth by employing bootstrap ARDL cointegration approach. Bootstrap ARDL method was introduced by Mcknown, (2019). This test is known to have advantages over the conventional ARDL approach.

Thus, following MacNon et al. (2018), the BARDL procedure for the above model Islamic financial inclusion was specified below:

$$\Delta lnGDP_t = \beta_0 + \sum^{p} \beta_{1i}\, \Delta lnGDP_{t-i} + \sum^{q} \beta_{2i}\, \Delta IFII_{t-i} + \sum^{r} \beta_{3i}\, \Delta lnSUK_{t-} + \sum_{l=0}^{s} \beta_{4i}\, \Delta lnSAL_{t-i} + \sum_{m=0}^{t} \beta_5\, lnIJA_{5i} + \alpha_1 lnGDP_{t-1}\ \alpha_2 IFII_{t-1} + \alpha_3 lnSUK_{t-1} + \alpha_4 lnSAL_{t-1} + \alpha_4 lnIJA_{t-1} + \varepsilon_{1t} \qquad 3.2)$$

After establishing long run relationship among the variables, and estimating the long-run parameters of the ARDL models, the short-run parameters were gotten by an error correction model (ECM). The error correction model is:

$$\Delta lnGDP_t = \beta_0 + \sum^{p} \beta_{1i}\, \Delta lnGDP_{t-i} + \sum^{q} \beta_{2i}\, \Delta IFII_{t-i} + \sum^{r} \beta_{3i}\, \Delta lnSUK_{t-} + \sum_{i=0}^{s} \beta_{4i}\, \Delta lnSAL_{t-i} + \sum_{k=0}^{t} \beta_4\, lnIJA_4 + \theta_1 ECT_{t-1} + \varepsilon_{1t} \qquad (3.3)$$

4. Results and discussion

This section presents the results and discussions of the analyses conducted on the data generated.

4.1 Stationarity

Two techniques of checking unitroot were adopted by the researcher namely; ADF and P-P. the results indicated a combination of I(0) and I(1) series. This provided a solid justification for the application of ARDL model.

Table 4.4: Stationarity Tests Results

	A.D. F		P-P		
Series	**Level**	**1st difference**	**Level**	**1st difference**	**Stationarity**
LGDP	-1.3975	-4.2564 **	-2.7856	-13.3646***	I1

MUS	-3.5125*	-	-	-	I0
MUD	-2.4568	-6.6453***	-2.3816	-6.7508***	I1
MUR	-1.6702	-4.8757***	-1.8086	-4.7973***	I1
IJA	-1.8969	-6.3190***	-2.0454	-6.3230***	I1
IFII	-2.5147	-5.0870***	-2.5528	-6.5809***	I1

Dep. variable| Ind. variables	**Lag Specification**	**F-stat.**	**Critical values**			**P-Value**	**Cointegration Status**
			1%	**5%**	**10%**		
$(\boldsymbol{lnGDP}\|\boldsymbol{IFII}$	(1, 0,)	5.620	5.431	4.272	3.399	0.009	Cointegration
$(\boldsymbol{lnGDP}\| \boldsymbol{MUS}, \boldsymbol{MUD}, \boldsymbol{MUR}, \boldsymbol{IJA})$	((1 ,1, 1, 0, 0)	6.047	5.431	4.272	3.399	0.007	Cointegration

Table 4.5: Bootstrap Co-integration Test

Note: F-stat. is the Bootstrap test statistics, critical values are the bootstrap tabulated value and p-value is the Bootstrap probability value.

The outcomes above indicates the cointegration status in both aggregated and disaggregated models. The result showed the presence of cointegration association between real GDP as dependent variable and Islamic Financial Inclusion Index (IFII) as independent variable under the aggregated model. This is because, the Bootstrap F-statistics (5.620) is bigger than the bootstrap t- value (4.272) at 5%. This is further established by the bootstrap probability value (0.009) . Thus, the finding satisfied the expectation of the study.

Tab. 4.6: Estimated Coefficients

PAN. A: LR Coefficients - DV is RGDP				
Series	Coef.	S. E	t-Statistic	Prob.
FII	0.1727	0.0538	3.2068	0.0033
SUK	-0.0603	0.0341	-1.7652	0.0884
SAL	0.0592	0.0269	2.2024	0.0360
IST	0.5905	0.4880	1.2101	0.2364
PAN. B: SR Coefficients - DV is ΔRGDP				
C	3.6927	0.4921	7.5036	0.0000
LGDP (-1) *	-0.4297	0.1078	-3.9857	0.0004
IFII **	0.0742	0.0333	2.2289	0.0340
SUK***	-0.0259	0.0142	1.8239	0.0788
SAL**	0.0255	0.0113	2.2575	0.0320
IST	0.2538	0.2109	1.2036	0.2388

ECT_{t-1}	-0.4298	0.0577	-7.4433	0.0000
R^2	0.72663			
F-stat.	5.9115			0.0001
D.W-stat.	1.8203			

Notes: ***, ** and * signify L signifies logarithm length of lag has been chosen based on SIC.

Source: Researcher's computation, (2023).

The results as presented indicates that, marginal impact of Islamic inclusivity remains 3.69% approximately. From the estimates, the result reveals that, holding other factors constant, Islamic financial inclusivity positively and significantly influences growth in Nigeria. Specifically, 1unit change rise in Islamic financial inclusion causes about 0.173% rise in growth. Therefore, Islamic financial inclusion represented in this study by the index encourages the growth of Nigeria's economy.

Furthermore, from short run findings, the coef. Of ECT l is less than one, it is negative and significant (-0.4298); P-Value (0.0000), therefore, meets the Apriori anticipation. This outcome establishes that, 42.98% of aberrations from the short run balance will be adjusted over the long term within one quarter.

The outcome also discloses that, jointly, regressors in the model adequately explained the variations in the dependent variable (LGDP) in Nigeria. This is indicated by the high R-square (0.72663) which implies that, 72.66% of the variations in LGDP, over the period (1983 to 2019), have been explained by financial inclusion. This also signifies that, less than 27% of the total discrepancy in the dv was explicated by other factors not captured (error terms).

The F-statistics from this model is (5.91) approximately with a P-value (0.0001). This implies that, the inclusivity determinants used in the index are jointly significant in determining variation in GDP.

5. Conclusion

Islamic financial inclusivity is a a tool that can be used to fuel inclusive growth. The growth and development of Islamic finance is inspired by the recognition of the faintness of the orthodox financial system equally in scope and effect. This study explored Islamic financial inclusivity- growth nexus in Nigeria by creating Islamic financial inclusivity index regressed to growth. As projected, the findings from the regression analysis discovered that, Islamic financial inclusivity has a strong positive influence on growth in Nigeria. The findings also discovered that, cointegration exists among inclusivity and growth. Hence, the outcome from the variables modelled buttresses that, Islamic financial inclusivity strongly influences growth. Therefore, considering the results from the analyses and the methodology employed, the researcher reiterates the positive influence of Islamic inclusive finance in the growth process as being deliberated in literature across the globe. In this respect, Islamic inclusivity could be utilized in combating economic recession in Nigeria which has been a serious menace in the economy. The conclusion is also applicable in other nations with economic growth challenges.

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