POLICY BRIEF

Inclusive Growth in sub-Saharan Africa: Do Financial Depth and Inclusion Matter?

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Abstract

This study attempts to contribute to the existing literature by exploring the effect of financial inclusion and depth on inclusive growth for 26 sub-Saharan Africa countries. Using the random effects panel regressions, the results suggest that financial inclusion positively affects inclusive growth in the sub-Saharan region, while financial depth variable does not. At very high levels of financial inclusion, however, the results portray decreasing marginal effects of financial inclusion on inclusive growth. Evidence from this study, however, shows weak transmission channel from financial deepening indicators to inclusive growth.

The study recommends more financial inclusion drives, particularly that the levels of financial inclusion are still low and significant to inclusive growth.

Introduction

This paper attempts to investigate whether financial inclusion matter for inclusive growth in sub-Saharan African (SSA) countries. Until recently, the key arguments in the finance-growth literature were on whether finance leads to economic growth or vice versa. As clearly summarized by Murinde (2012), the literature is oversupplied with literature either in support or indeed opposing the role of finance in economic growth. For example, in support of the role of finance to economic growth includes the works of Lucas (1988: 6) who registered serious misgivings about the finance-growth nexus and suggested that finance was an overrated determinant of economic growth. Other economists with similar views include Robson (1952) and Miller (1998). On the other hand, economists that have recognized the importance of finance in economic growth include Bagehot (1873), Schumpeter (1912), Goldsmith (1969) and McKinnon (1973). However, recent evidence found by Law and Singh (2014) suggests that there is a threshold effect in the relationship between finance and economic growth. This evidence suggests that the level of financial development is beneficial to economic growth only up to a certain point or threshold beyond which additional financial development negatively affect economic growth.

Recent works in this area, however, are questioning the comprehensiveness of economic growth as a measure of national progress. The argument is that growth must be inclusive such that all segments of the society can benefit from economic expansion. It is claimed that economic growth has failed to trickle down to the poor and that high economic growth might be meaningless to most of a society if there are high levels of inequality. Perhaps this is the reason OECD (2018) defines inclusive growth as economic growth that creates opportunity for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms, fairly across society, and that inclusive growth is sustainable and effective in reducing poverty. While literature for the past century has focused on the relationship between financial development and GDP based economic growth, this study intends to depart from the previous studies by establishing whether finance influences inclusive growth—growth associated with equitable opportunities for economic participants during economic growth with benefits incurred by every section of society.

Specifically, this study contributes to the existing literature in two ways. Firstly, the study uses unified measures of inclusive growth to establish the existence of a relationship between finance and inclusive growth. Two alternative measures of inclusive growth are used in this study. The first measure uses suitable indicators of

inclusive growth, namely, growth, employment, economic infrastructure, income inequality and equity including gender equity human capabilities and governance to compute an inclusive growth index soliciting key insights from the World Bank, OECD, ADB and AfDB. The study also uses the United Nations' Human Development Index as an alternative measure of inclusive growth to check if the results will still be consistent. Clearly, the use of broader measures of inclusive growth—unlike single indicator measure—will provide a relevant addition to the literature on how other important elements of wellbeing are influenced by inclusive finance. Secondly, the study will establish whether too much finance is problematic to inclusive growth. Specifically, the study will establish whether there is a threshold beyond which additional financing would be detrimental to inclusive growth in sub-Saharan Africa, motivated by Law and Singh (2014) who—in a related but different study—found that there is a threshold effect in the relationship between finance and economic growth.

Data

The literature is not reaching an outright consensus on how inclusive growth should be measured. The jury is still out on which components should constitute inclusive growth. We have noted different views by international institutions like UNDP, OECD, ADB, AfDB and the World Bank on what inclusive growth should include. It is an endless debate. This study has reviewed these proposals and selected key elements that will be used to construct an inclusive growth index using a methodology proposed by Asian Development Bank Working Paper by McKinley (2010).

Conclusion and policy implications

This study was set out to establish whether financial inclusion and depth are important for inclusive growth in the SSA region. The evidence shows that financial inclusion is one of the determinants of inclusive growth. This study has shown that, while financial services must be available or accessible in a country or region, this availability alone could be inconsequential to inclusive growth if individuals and institutions do not use such services. More importantly, the people should, not only be encouraged to use the financial services, but also there should be deliberate policies to minimize impediments to extensive use of financial services. The study has, however, failed to find evidence of a robust link between financial depth and inclusive growth in the SSA region.

The study has established diminishing marginal effects of financial inclusion on inclusive growth. The results are like those of Law and Singh (2014) who found out that the level of financial development is beneficial to growth only up to a certain threshold; beyond the threshold level, further development of finance tends to

adversely affect growth. In fact, Sahay et al. (2015) found evidence suggesting that financial stability risks may increase when access to credit is expanded without proper supervision. Their findings claim that financial buffers decline with broader access to credit, other things being equal, and in countries with weaker supervision, the erosion of buffers is larger. A report by European Investment Bank of 2013 revealed that bank supervisory capacity is weak in many SSA countries, reflecting both under-resourcing of supervision activities and deficient legislative arrangements. SSA region, however, still has financial inclusion at relatively low level, with account ownership at 43%, way below an average of 63% for developing countries, together. It suggests that at the current level of financial inclusion, the region has ample space for financial inclusion to impact on inclusive growth at an increasing rate.

Given the results from this study, financial inclusion needs to be promoted—particularly at a time when coverage of inclusion remains low in the region. One of the ways of encouraging financial inclusion in this regard may include, but not limited to, minimization of tariffs on both bank and mobile money transactions to allow many people—including the marginalized—to be taken on board. People in the lowest income bracket make serious consideration before opening a bank account and mobile money account and often, they fail to register or exit quickly after registration because of some tariffs and transactional charges as these charges matter to a low-income individual. Another way of encouraging financial inclusion is to promote financial literacy. The people need to understand the advantages of having an account at a financial institution or making some savings. In most developing countries, including the SSA region, the task of financial literacy promotion has remained the responsibility of central banks. Perhaps, there is need for more players in this area, including ministry of education and other non-governmental agencies.

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