

1 IMPACT OF FINANCIAL SECTOR REFORMS ON AGRICULTURAL GROWTH IN 2 NIGERIA: A VECTOR AUTOREGRESSIVE (VAR) APPROACH

3 4 5 **Abstract:**

6 *The study assessed the impact of financial sector reforms on agricultural growth in Nigeria.*
7 *Secondary data was collected from Central Bank of Nigeria covering the period from 1970-2009*
8 *and analyzed using long-term time-series techniques and the vector error correction model*
9 *(VECM) approach. The result revealed that financial sector reforms (LNFSRGDP) in the base-*
10 *line and sensitivity model (LNPSC) significantly impact on agricultural growth both in the long*
11 *and short-run. However, the impact of financial sector reforms shock (proxied by LNPSC) on*
12 *agricultural output growth was lower with 0.60 percent when compared with 78.85 percent*
13 *(proxy by LNFSRGDP) in the base line model. This implied that financial sector reforms play a*
14 *significant role in the growth of the agricultural sector by increasing its productive level and*
15 *independently generate positive investments in the sector than in the sensitivity result. It is*
16 *therefore recommended that government should adopt strong macroeconomic policies targeted*
17 *to kick-start meaningful growth in the agricultural and financial sectors as well as providing the*
18 *enabling environment conducive for farming as a business through concessionary interest rates,*
19 *tax free and import duty concessions. These financial and fiscal incentives when provided would*
20 *encourage further output growth in the agricultural sector of the country.*
21

22 **Key Words:** Agricultural Growth. Financial Sector Reforms. Vector Autoregressive Approach.
23

24 **Introduction**

25 The issue of financial sector reforms has taken the centre stage in the world's economy. Both
26 developed and developing countries have tried to bring about reforms in their financial sectors in
27 order to impact on the growth of either the entire economy or a sub-sector of the economy such
28 as agriculture. Financial sector reforms constitute that aspect of economic reforms which focuses
29 mainly on restructuring the financial institutions (regulators and operators) via institutional and
30 policy reforms (Balogun, 2007). It has also been described as deliberate measures and policies
31 made by the relevant authorities to bring the needed changes in the financial institutions over a
32 period of time. These changes are expected to ultimately result in economic growth. Economic
33 growth is defined in economic literature as the incremental outcome of productive activities,
34 which can be assessed by observing the behavior of real Gross Domestic Product (GDP) or
35 Gross National Product (GNP) per capita year by year (Eyo, 2005).
36

The financial system has been acknowledged to play an important role in economic growth and development. Several theoretical and empirical studies at the international, national and provincial levels demonstrate that the financial sector could be a catalyst of economic growth if it is developed and healthy (Mckinnon, 1973 & Shaw, 1973; Chen & Feng, 2000; Chow & Li, 2002). Marjit (2004) opines that economic growth is significantly related to growth in agriculture. This confirmed the works of Johnston and Mellor (1961), who stated that agriculture has important linkages and interrelationship with the rest of the economy. This interaction is highly vulnerable to changes in other sector especially macroeconomic policies not specially targeted at agriculture (Oyejide, 1986). World Bank (1989) also reported that in most other developing countries where agriculture is a large sector of the economy, no other sector of the economy is large enough to serve as an engine of economic growth in the next decade. This is because a large proportion of the Gross Domestic Product (GDP) comes from the agricultural sector.

In Sub-Saharan Africa (SSA), the international recessions, debt crises and political instability adversely affected savings and investment ratio in the region. This was occasioned by a decline in the domestic resource mobilization and narrow tax base, which further depressed investment and economic growth (Kasekende & Atingi-Ego, 2003). The unfavourable conditions in SSA relating to the deterioration in economic performance alongside financial repression in the 1970s gave rise to the adoption of structural adjustment programme under the auspices of the Washington Consensus (World Bank, 2007).

In Nigeria, before the comprehensive financial sector reforms of 1987, the existing financial institutions could not adequately support the process of industrialization and agricultural modernization that was needed to move the country into the forefront of development. These financial institutions were foreign owned; local farmers and entrepreneurs had difficulties borrowing from them. The informal financial sector provided the little loans they were capable of at high interest rates. There were few sources of equity and long term finance for long term borrowers. On the other hand, creditors actually demonstrated a reluctance to provide long-term funds for a number of reasons. Investment was considered risky as production was in the new sectors and used technologies were unfamiliar to the work force. Both entrepreneurs and

managers were relatively inexperienced (Okorie & Uwaleke, 2010). These situations coupled with repression in the financial sector occasioned by excruciating external debt burden, falling terms of trade in the international market, slow growth of output, high rate of unemployment posed serious concern to the government who needed to channel cheap credit towards the sectors in the economy that were believed to be at the forefront of development by the Central Bank of Nigeria. These scenarios caused a shift in the economic development paradigm from government-led development (public driven economy) to private sector-led development (Adegbite, 2005). Thus, were compelled to use the financial sector to finance investment projects for the purposes of allocating resources to projects with high social returns, distribution of incomes and to revamp high economic growth. This gave rise to financial sector reforms as a component of the Structural Adjustment Programme in August, 1987 with the deregulation of interest rates.

The elements of the financial sector reforms are financial structure reforms, monetary policy reforms, foreign exchange reforms, liberalization of capital movement reforms, capital market reforms and banking reforms (recapitalization and consolidation). The main objective of the financial sector reforms was to create strong financial institutions that would take advantage of the benefits of increase in size, improve the efficiency and raise the diversity of the financial system of the economy. This objective was to be attained through financial liberalization, which could be viewed as the process of moving towards market determined interest rates, as well as market-determined prices on all classes of financial products, a banking system characterized by symmetric entry and exit conditions to all participants, increasing internationalization or the opening up of domestic markets to international competition, and limited barrier to the introduction of new products. The major policy variables adopted during this period were interest rate and exchange rate (CBN, 2009).

In spite of several reform measures such as deregulation of interest rates, removal of sectoral credit allocation, exchange rate, establishment of the Nigeria Deposit Insurance Cooperation (NDIC) and introduction of monetary policy instruments (2005) in the financial system, there is still a knowledge gap regarding financial sector reforms and agricultural growth because research effort in this regard have been minimal, when compared to efforts the other components of the

economic reforms such as trade liberalization and exchange rate reforms. Even where research is available, emphasis has tended to be placed on the institutional aspects of the reform that is banking sub-sector (Soyibo & Adekanye, 1992; Ojo, 1993; Ikhide & Alawode, 1994; Balogun, 2007). Mentions are only on the potential effects of the reforms on agriculture with no empirical evidence with efforts geared towards the investigation of current account and government deficits as well as their implication for saving and growth imbalances. Apart from this, many similar studies have failed to or not sufficiently document empirically the effect of reforms on agricultural growth. This paper attempts to fill in this gap.

Using long-term time-series data and the vector autoregressive (VAR) method of analysis, this study attempts to empirically examine the channels through which financial sector reforms affect long-term agricultural growth in Nigeria. In addition to the stated objectives, it builds on the existing literature in two important ways. First, financial sector GDP or RGDP (value added) is used as a measure of financial sector reforms. This is a major departure from the commonly used bank related measures such as: monetary aggregates like M2, liquid liabilities of the financial system, or bank credit to the private sector which are regarded as poor indicators of financial sector reforms (Levine, Loayza & Beck, 2000; Arestis & Luintel, 2001; Liang & Teng, 2006 & Ghirmay, 2009) as compared to financial sector Gross Domestic Product (GDP) or Real Gross Domestic Product (RGDP) which is by far a better indicator of financial sector reforms in a number of ways; one of which is that, it represents a broader measure of financial reforms. Consequently, unlike the other measures, it does not underestimate the level of financial sector in Nigeria's economy, where significant financial development, Investment, Productivity and economic growth or innovation occurs in the real sector. Second, it uses a Granger causality testing procedure to conduct causality analysis. It is against this backdrop that it becomes necessary to assess the impact of financial sector reforms on agricultural growth in Nigeria. The specific objective is to examine the effect of financial sector reforms on agricultural output growth in Nigeria.

129

130 **Literature Review**

131 The importance of the financial system to economic development is not a clear-cut issue.
132 Researchers like Robinson (1952) are of the view that economic development creates demand for
133 certain financial instruments while others like Hicks (1969) holds a contrary view and argues that
134 the financial system plays a crucial role in the mobilization of capital for industrialization. Thus,
135 the financial system only responds to the demand created as a result of economic development. It
136 is however known that countries with better developed financial systems, that is financial
137 markets and institutions with more effective way of channeling society's savings to its most
138 productive use, tend to experience faster economic growth compared to those with less
139 developed financial systems (Beck, Levine, & Loayza, 2000). This is because financial sector
140 development helps economic growth through more efficient resource allocation and productivity
141 growth rather than through the scale of investment or saving mobilization. In addition,
142 availability of finance helps to foster economic development by widening access to external
143 finance and helping those industries and firms to rely most on financial resources (Demirguc-
144 Kunt & Maksimovic, 1998; Rajan & Zingales, 1995). It also helps to improve resource allocation
145 and increases the efficiency with which investment funds are reallocated across industries as
146 demand changes. Financial development also plays an important role in dampening the impact of
147 external shocks on the domestic economy.

148

149 Haslag and Koo (1999) opined that financial repression and economic growth are related. There
150 is also a relationship between growth and gross real return on household assets. Assuming an
151 economy where household preferences exhibit a constant elasticity of inter-temporal substitution,
152 the rate of per-capita output growth is positively related to the gross real return on a household's
153 assets. As such the argument focuses on the negative effect of repression on growth rate of per-
154 capita output. Aizenman (2005) opines that the clamour for developing countries to embark on
155 capital and financial market liberalization is born out of the desire to achieve economic growth.

156

157 According to Asamoah (2008), the financial sector reforms can affect economic growth by
158 altering the saving rates. In this case, the sign of the relationship is not obvious, because

financial sector development may also reduce savings and thereby growth. It is observed that real rate of interest exerts a positive influence on the ratio of savings to the Gross National Product (GNP) while the main function of the financial markets is to channel funds from savers to investors. Households and firms save their money in banks for future. These banks lend those funds to investors. However, savers consider the interest rate or what they will gain from saving their money at the bank before they make decision to save. Lower interest rate discourages savers and hence reduces funds available for investors. On the contrary, if there are many financial institutions competing for savings, the interest rate will be high for savings, savers will save more, making more capital available for investors.

Several theoretical perspective and early studies of Schumpeter (1911), McKinnon (1973), Shaw (1973), Pagano (1993), Greenwood and Jovanovic (1990) and Arestis and Demetriades (1997) among others show the relationship between financial sector and economic growth, although there is no consensus over the direction of causality. Various aspects of this relationship have been analyzed extensively in both theoretical and empirical studies for a single country, cross-nations, industry and firms level through cross-sectional, time-series and dynamic panel techniques. Goldsmith (1969) documented a positive correlation between economic and financial development for a sample of 35 countries and attributed the problems in the field of finance to the effect that financial structure and development have on economic growth. Quite a number of empirical studies have been carried out to examine the effect of financial reforms on economic growth. The results confirm that there is a positive correlation between the two. However, Caprio and Klingebiel (1995) reported that many banking systems witnessed problems subsequent to liberalization. For instance, Chile experienced some banking problems right after the financial sector was regulated. Thus, empirical works of King and Levine (1993) and Levine, Loayza and Beck, (2000) find a positive effect of financial development on economic growth. On the other hand, literature in financial sector points to a destabilizing effect of financial liberalization. Only in South Korea was financial reform adjudged to be a success. Others have also examined the link between economic growth and how financial sector development broadly supports the view that both intermediaries as well as markets play a key role in supporting high economic growth. Moreover, numerous studies have found that better developed financial systems ease the financing constraint faced by enterprises, particularly small firms. Some studies have

190 increasingly found financial development to have a causal effect in stimulating economic and
191 productivity growth (Moore, Green, & Murinde, 2006; Das & Ghosh, 2006; Limi, 2004; Spiegel
192 & Yamori, 2003; Honda, 2003). For example, Moore *et al.*, (2006) applied stochastic simulation
193 methods to a system-wide flow of funds model for India for 1951-1994 to examine two issues.
194 The first concerned was the impact of financial reforms on interest rates and loan-able funds. The
195 second was to assess the robustness of policy if there was uncertainty about the true model. The
196 results of their studies showed considerable variations in policy risk depending on the policy
197 instrument and the policy regime. Interest rate risks were found to be greater in the controlled
198 policy regime, while quantity risks were greater in the liberalized policy regime. The results of
199 their studies also revealed that outcomes depended much on controls on intermediaries: more
200 heavily controlled banks responded differently from other less heavily controlled financial
201 intermediaries.

202
203 Working with large cross-section of countries (developed and developing) and using the method
204 of pure cross-country regression, or dynamic panel data methods such as the generalized
205 methods of moments (GMM), several studies have examined the channels through which
206 financial development affects economic growth (De Gregorio & Guidotti, 1995; Levine &
207 Zervos, 1998; Beck *et al.*, 2000, and Benhabib & Spiegel, 2000, among others). However, many
208 criticisms have been expressed against these studies with respect to the data and estimation
209 methods used. The predominant is cross-country/multi-country panel regression estimates “mask
210 important cross country differences” (Darlau, 2001). That is, the slope coefficient is taken to be
211 identical across the countries included in the panel, which implies that financial development
212 generates equivalent investment and productivity increases across countries. However,
213 heterogeneity across countries in terms of their institutional and financial structures which plays
214 a crucial role in determining the finance-growth relationship has been documented in the
215 literature (Edwards & Fisher, 1994; La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1997;
216 Shleifer & Vishny, 1998; Stulz, 2001). For example, as alluded to earlier, there is a rich diversity
217 of opinion in the existing literature on the relationship between the financial structure (that is, the
218 degree to which the financial system is bank or market-based) and long-term economic growth
219 (Levine, 2002).

All of these raise the possibility that the relationship between financial development and economic growth is country-specific, hence, the cross-country/multi-country panel estimates may not correspond to country specific estimates. Consequently, generalization based on cross-country or multi-country panels may provide incorrect inference for several countries included in the panel; thereby, seriously impairing their policy significance. The shortcomings of the cross-country/panel estimators have prompted a number of researchers to rely on time-series method to examine the finance-growth nexus based on the data of individual countries (Neusser & Kugler 1998; Rousseau & Watchtel, 1998; Arestis & Luintel, 2001). As argued by Arestis and Luintel (2001) ‘time series methods can provide useful insights into differences of this [financial development and economic growth] relationship across countries and may illuminate important details that are hidden in averaged-out results’.

Materials and Methods

Study Area

The study was carried out in Nigeria. Nigeria has a total area of 923,768 square kilometers constituting land area of 910768 square kilometers and water area of 13000 square kilometers respectively. It has coaster lines of 853 square kilometers and is located on the Gulf of the Guinea in West Africa. It lies within the tropical zone between latitudes $4^{\circ} 1^1$ and $13^{\circ} 9^1\text{N}$ and longitudes $2^{\circ} 21^1$ and $14^{\circ} 30^1$ E. It is bounded on the West by the Republics of Benin and Niger; on the East by the Republic of Cameroon; on the North by Niger and Chad Republics and on the South by Atlantic ocean on the Gulf of Guinea. It is one of the eight most populous countries in the world with a population of about 140 million (National Population Commission, 2006) with six geopolitical zones: North-East, North-West, North-Central, South-East, South-West and South-South.

Nigeria has financial service sector comprising of the banking system, financial institutions and financial markets with the Central Bank of Nigeria (CBN) as the apex bank. The CBN has responsibility for the promotion of a sound financial system that would ensure effective conduct of monetary policy. This is necessary for mobilization of resources for investment, economic growth and development (CBN, 2009). This mobilization covers all sectors including agriculture which depends on the financial intermediation for growth because of the large proportion of the

Gross Domestic Product (GDP) that comes from agriculture. The climate varies with Equatorial in South, Tropical in Centre and in the North. There are two seasons – the wet season (April-October) and the dry season (November-March). The type of vegetation is grassland savannah in the North and forest in the south. This vegetation has made agriculture the major employer of labour in the country.

Data Collection: The study made use of data from secondary sources obtained from Central Bank of Nigeria (CBN), Statistical Bulletin, Annual Report and Statements of Account of Central Bank of Nigeria (CBN), Federal Ministry of Agriculture and Natural Resources, National Bureau of Statistics (NBS), National Population Commission and Food and Agriculture Organization (FAO). The data covered the period of 1970-2009 because of long-term time-series data.

Analytical Techniques

The study was carried out using econometric model which expresses: (i) Agricultural investments as dependent on financial sector reforms (ii) Agricultural growth as dependent on financial sector reforms. The relationships were specified as follows:

$$AGINV = f(FSRGDP1) \quad 1$$

$$AGR GDP1 = f(FSRGDP) \quad 2$$

Where:

AGRINV = Agricultural Investments (represented by Foreign Investment plus Domestic Investment. The Foreign Investment was proxied for Foreign Private Investment (FPI) in agricultural sector while Domestic Investment was proxied for Credit to agriculture).

AGR GDP1 = Agricultural Growth (proxy for Growth Rate of Agricultural Sector Real Gross Domestic Product).

FSRGDP = Financial Sector Real Gross Domestic Product

From economic theory, other policy variables such as savings, income, output, interest rate and exchange rate also affect agricultural investments while agricultural investment, labour in agriculture, exchange rate and interest rate also affect agricultural growth. Therefore, we have:

$$LNAGINV = f(LNFSRGDP, LNSAV, LNAGR GDP1, LNPCI, LNER, LNIR) \quad 3$$

$$LNAGR GDP1 = f(LNFSRGDP, LNAGINV, LNLFA, LNER, LNIR) \quad 4$$

283 $LNSAV$ = Log of Total Savings

284 $LNPCI$ = Log of Per Capita Income

285 $LNLFA$ = Log of Labour Force in Agriculture

286 $LNER$ = log of Exchange Rate

287 $LNIR$ = log of Interest Rate

288 $(AGINV, AGRGDP1, FSRGDP)$ are as defined in equations 1 and 2.

289 Given the various theories on the relationship between financial sector reforms and economic
 290 growth, various variables of interest such as
 291 $(LNAGINV, LNAGRGDP1, LNFSRGDP, LNSAV, LNPCI, LNLFA, LNER, LNIR)$ were jointly
 292 determined. The empirical investigation into the relationships among these variables was carried
 293 out in a vector autoregressive (VAR) model and Granger causality test. A unique advantage of
 294 the VAR technique of analysis is that it treats all variables as potentially endogenous and also
 295 facilitates investigation of the related concept of causality in the Granger's sense of it (Granger,
 296 1969). Causality in Granger's sense is inferred when values of a variable say X_t have
 297 explanatory power in a regression of Y_t on lagged values of Y_t and X_t . The vector autoregression
 298 (VAR) model has become one of the leading approaches employed in the analysis of dynamic
 299 economic relationships (Barsky & Kilian, 2004; Killian, 2009; Ozlale & Pekkurnaz, 2010;
 300 Chuku, Effiong, & Sam, 2010) like the ones specified in equations 3 and 4 respectively. This
 301 study follows suit by specifying a VAR model that examined the short and long-run relationship
 302 of the impact of financial sector reforms on agricultural investment and growth in Nigeria.

303

304 The VAR representation of the model with lag order k is thus:

305

$$Y_t = C_0 + \sum_{i=1}^k A_i Y_{t-i} + \mu_t \quad 5$$

306 Where:

307 $Y_t = (LNAGINV, LNACRGDP1, LNFSRGDP, LNSAV, LNPCI, LNLFA, LNER, LNIR)$ is a 8X1
 308 vector of endogenous variables or Integrated Variables 6

309 $C_0 = (C_1, C_2 \dots C_n)$ the C intercept vector of the VAR model.

310 A_i = matrix coefficients estimated of autoregressive coefficient

311 vector Y_{t-i} , for $i = 1, 2 \dots k$. Thus, A_i is 8×8 coefficient matrices.

312 $\mu_t = (\mu_{1t}, \mu_{2t}, \dots, \mu_{8t})$ vector of independent and identically distributed error terms (I.I.D).

313 k = the number of lagged terms.

314 The VAR estimations are very sensitive to structure of lag variables and sufficient lag length
 315 does help to reflect the long term impact of variables on others. However, including longer lag
 316 lengths will lead to multicollinearity problems and will increase the degrees of freedom (DOF)
 317 (Wooldridge, 2006). From equation (6), it was expanded as follows:

$$\begin{aligned} \Delta \text{LNAGINV} = & \varphi_0 + \varphi_1 \sum_{i=1}^k \Delta \text{LNAGRGDP1}_{q,t-i} + \varphi_2 \sum_{i=1}^k \Delta \text{LNFSRGDP}_{q,t-i} + \\ & \varphi_3 \sum_{i=1}^k \Delta \text{LNSAV}_{q,t-i} + \varphi_4 \sum_{i=1}^k \Delta \text{LNPCI}_{q,t-i} + \varphi_5 \sum_{i=1}^k \Delta \text{LNLFA}_{q,t-i} + \\ & \varphi_6 \sum_{i=1}^k \Delta \text{LNER}_{q,t-i} + \varphi_7 \sum_{i=1}^k \Delta \text{LNIR}_{q,t-i} + \\ & \mu_{1t} \end{aligned} \quad 7$$

$$\begin{aligned} \Delta \text{LNAGRGDP1} = & \theta_0 + \theta_1 \sum_{i=1}^k \Delta \text{LNAGINV}_{q,t-i} + \theta_2 \sum_{i=1}^k \Delta \text{LNFSRGDP}_{q,t-i} + \theta_3 \sum_{i=1}^k \Delta \text{LNSAV}_{q,t-i} + \\ & \theta_4 \sum_{i=1}^k \Delta \text{LNPCI}_{q,t-i} + \theta_5 \sum_{i=1}^k \Delta \text{LNLFA}_{q,t-i} + \theta_6 \sum_{i=1}^k \Delta \text{LNER}_{q,t-i} + \theta_7 \sum_{i=1}^k \Delta \text{LNIR}_{q,t-i} + \\ & \mu_{2t} \end{aligned} \quad 8$$

$$\begin{aligned} \Delta \text{LNFSRGDP} = & \lambda_0 + \lambda_1 \sum_{i=1}^k \Delta \text{LNAGINV}_{q,t-i} + \lambda_2 \sum_{i=1}^k \Delta \text{LNAGRGDP1}_{q,t-i} + \lambda_3 \sum_{i=1}^k \Delta \text{LNSAV}_{q,t-i} + \\ & \lambda_4 \sum_{i=1}^k \Delta \text{LNPCI}_{q,t-i} + \lambda_5 \sum_{i=1}^k \Delta \text{LNLFA}_{q,t-i} + \lambda_6 \sum_{i=1}^k \Delta \text{LNER}_{q,t-i} + \lambda_7 \sum_{i=1}^k \Delta \text{LNIR}_{q,t-i} + \\ & \mu_{3t} \end{aligned} \quad 9$$

$$\begin{aligned} \Delta \text{LNSAV} = & \beta_0 + \beta_1 \sum_{i=1}^k \Delta \text{LNAGINV}_{q,t-i} + \beta_2 \sum_{i=1}^k \Delta \text{LNAGRGDP1}_{q,t-i} + \beta_3 \sum_{i=1}^k \Delta \text{LNFSRGDP}_{q,t-i} + \\ & \beta_4 \sum_{i=1}^k \Delta \text{LNPCI}_{q,t-i} + \beta_5 \sum_{i=1}^k \Delta \text{LNLFA}_{q,t-i} + \beta_6 \sum_{i=1}^k \Delta \text{LNER}_{q,t-i} + \beta_7 \sum_{i=1}^k \Delta \text{LNIR}_{q,t-i} + \\ & \mu_{4t} \end{aligned} \quad 10$$

$$\begin{aligned} \Delta \text{LNPCI} = & \gamma_0 + \gamma_1 \sum_{i=1}^k \Delta \text{LNAGINV}_{q,t-i} + \gamma_2 \sum_{i=1}^k \Delta \text{LNAGRGDP1}_{q,t-i} + \gamma_3 \sum_{i=1}^k \Delta \text{LNFSRGDP}_{q,t-i} + \\ & \gamma_4 \sum_{i=1}^k \Delta \text{LNSAV}_{q,t-i} + \gamma_5 \sum_{i=1}^k \Delta \text{LNLFA}_{q,t-i} + \gamma_6 \sum_{i=1}^k \Delta \text{LNER}_{q,t-i} + \gamma_7 \sum_{i=1}^k \Delta \text{LNIR}_{q,t-i} + \\ & \mu_{5t} \end{aligned} \quad 11$$

$$\begin{aligned} \Delta \text{LNLFA} = & \psi_0 + \psi_1 \sum_{i=1}^k \Delta \text{LNAGINV}_{q,t-i} + \psi_2 \sum_{i=1}^k \Delta \text{LNAGRGDP1}_{q,t-i} + \psi_3 \sum_{i=1}^k \Delta \text{LNFSRGDP}_{q,t-i} + \\ & \psi_4 \sum_{i=1}^k \Delta \text{LNSAV}_{q,t-i} + \psi_5 \sum_{i=1}^k \Delta \text{LNPCI}_{q,t-i} + \psi_6 \sum_{i=1}^k \Delta \text{LNER}_{q,t-i} + \psi_7 \sum_{i=1}^k \Delta \text{LNIR}_{q,t-i} + \\ & \mu_{6t} \end{aligned} \quad 12$$

$$\begin{aligned} \Delta \text{LNER} = & \sigma_0 + \sigma_1 \sum_{i=1}^k \Delta \text{LNAGINV}_{q,t-i} + \sigma_2 \sum_{i=1}^k \Delta \text{LNAGRGDP1}_{q,t-i} + \sigma_3 \sum_{i=1}^k \Delta \text{LNFSRGDP}_{q,t-i} + \end{aligned}$$

$$\sigma_4 \sum_{i=1}^k \Delta \text{LNSAV}_{q,t-i} + \sigma_5 \sum_{i=1}^k \Delta \text{LNPCI}_{q,t-i} + \sigma_6 \sum_{i=1}^k \Delta \text{LNLFA}_{q,t-i} + \sigma_7 \sum_{i=1}^k \Delta \text{LNIR}_{q,t-i} + \mu_{7t} \quad 13$$

$$\begin{aligned} \Delta \text{LNIR} = & \phi_0 + \phi_1 \sum_{i=1}^k \Delta \text{LNAGINV}_{q,t-i} + \phi_2 \sum_{i=1}^k \Delta \text{LNAGRGDP1}_{q,t-i} + \phi_3 \sum_{i=1}^k \Delta \text{LNFSRGDP}_{q,t-i} + \\ & \phi_4 \sum_{i=1}^k \Delta \text{LNSAV}_{q,t-i} + \phi_5 \sum_{i=1}^k \Delta \text{LNPCI}_{q,t-i} + \phi_6 \sum_{i=1}^k \Delta \text{LNLFA}_{q,t-i} + \\ & \phi_7 \sum_{i=1}^k \Delta \text{LNER}_{q,t-i} + \mu_{8t} \end{aligned} \quad 14$$

351

352 It is important to note that while it is easier to measure other variables described above,
 353 measuring financial sector reforms often poses a challenge to researchers in their effort to assess
 354 the impact of financial intermediation on real economic activity. The reason is because
 355 commonly used bank measures such as the ratio of monetary aggregates (like M2) to GDP, the
 356 ratio of liquidity liabilities to GDP and the ratio of bank credit to the private sector to GDP are
 357 considered as poor indicators of financial sector reforms (Levine *et al.*, 2000; Arestis & Luintel,
 358 2001; Liang & Teng, 2006 and Ghirmay, 2009). As such, financial sector RGDP or GDP is
 359 regarded by far a better measure of financial sector reforms in that: (i) it represents a broader
 360 measure of financial reforms. (ii) it represents all the activities of a financial system; that is, all
 361 financial transactions “involving the creation, liquidation, or change in ownership of financial
 362 assets and/or facilitating financial transactions”.(iii) it is invariant to the structural changes
 363 within the financial sector.(iv) it does not underestimate the level of financial sector in Nigeria’s
 364 economy, where a significant financial development, Investment, Productivity and economic
 365 growth or innovation occurs in the real sector. Based on the above assertions, financial sector
 366 RGDP (Real Gross Domestic Product) was utilized as indicator for financial sector reforms.

367

368 The *a priori* expectations for vector autoregressive models are suited to track and identify
 369 structural shocks within a system of equations, with respect to underlying economic theory. Our
 370 focus in this study is on the relationship between the impacts of financial sector reforms on
 371 agricultural investment and growth in Nigeria’s economy, thus, we concentrate on the expected
 372 theoretical relationships that should hold in equation (9). The parameter for λ_1 is expected to be
 373 positively related. Financial constraint is one of the problems in agricultural production; an
 374 efficient financial sector should ensure the channeling of funds to agricultural sector. Thus, as the
 375 financial sector becomes more efficient, more saving will be mobilized and this provides an

376 opportunity for funds to be extended to provide investment opportunities in the agricultural sub-
377 sector.

378 The parameter for λ_2 is expected to have direct positive influence on income, interest rate,
379 financial sector gross domestic product, financial sector reform and agricultural output growth.
380 This implies that investment from the financial sector would greatly enhance agricultural output
381 growth. The parameter for λ_3 is expected to be positively related. Generally, financial sector
382 reform is expected to have positive impact on saving mobilization in the economy. However,
383 depending on the measure of the financial sector reform, a priori sign could be negative. The
384 parameter λ_4 is expected to have a positive sign. Per capita income is very crucial for economic
385 growth and it may increase savings, which may in turn help in boosting the financial system. The
386 parameter λ_5 is expected to be positively related. The positive sign is to reflect the quality of
387 manpower being produced by the agricultural sector of the economy.

388 The parameter λ_6 is expected to have a positive sign. This is because a lower interest rate will
389 induce private economic agents to undertake investment activities at the lower levels of interest
390 rate. However, in an environment characterized by severe financial repression as been the case in
391 developing countries over the years, investment funds may not be readily available to potential
392 investors (Afangideh, 2009). In this case, the only way to induce people to mobilize investment
393 funds through saving is high interest rate. This implies that the higher the financial
394 intermediaries, the more the availability of investment funds through savings and hence the
395 higher level of investment in agriculture. This is the premise of the argument of Mckinnon-Shaw
396 hypothesis which postulated a positive relationship between financial liberalization and real
397 interest rate. The parameter λ_7 is expected to have a negative sign since the exchange rate is
398 negatively related to the agricultural production. At a favourable exchange rate, more agricultural
399 outputs would be produced. Also, with good macroeconomic policies that enhance favourable
400 exchange rates, agricultural funds can be widely available at low interest rate.

401 The VAR model is known in establishing the relationship among variables, which is conditional
402 on the assumption of stationarity of the variables that make up the VAR. If the time series are
403 non-stationary at levels, the stability condition of VAR is not met; this implies that the usual
404 statistical techniques of coefficient evaluation will not be valid. In such condition, the
405 cointegration and vector error correction (VECM) techniques are recommended to investigate

the relationship among non-stationary variables (Wooldridge, 2006). Therefore, it was imperative to first conduct preliminary diagnostics on the time series properties of the variables before further evaluation.

To ascertain the order of integration of the variables, a preliminary step analysis was carried to test for the presence of unit-roots using two specifications of the augmented Dickey-Fuller (ADF) test: (i) Intercept (ii) trend and intercept. The later was used for confirmation test. The essence of the test was to show whether the time series have a stationary trend and if non-stationary, to show the order of integration at which they become stationary.

The hypothesis for the unit root test is:

- $H_0: \rho = 1$
- $H_1: \rho < 1$

To ensure that the results obtained was not spurious (Maddala, 2002), cointegration test was carried out. Economically speaking, two variables are co-integrated if they have a long-term or equilibrium relationship (Gujarati, 2003). To test for the presence of a long-run relationship, the maximum likelihood method developed by Johansen (1988 and 1991) was utilized. Using the Johansen approach, two test statistics can be used in testing the number of cointegrating vectors: the Trace and the Maximum Eigenvalue statistics. The null hypothesis for the trace test was that there are at most r cointegrating vectors, while for the Max Eigenvalue test, the null of $r = 0$ was tested against the alternative that $r = 1$; $r = 1$ was tested against the alternative that $r = 2$ and so on. The Schwarz Information Criterion (SIC) was used to select the optimal lag length for the cointegration test.

After estimating the cointegrated VAR, innovation accounting was conducted to determine the dynamic responses of the variables to one-standard deviation shocks in other variables in the system. This was done by generating the impulse response functions from the system. Impulse Response Functions (IRF), trace the responsiveness of the dependent variable in the VAR (VECM) to a unit shock in the error terms. For each variable from each equation, a unit shock was applied in the error term and the effects upon the VAR (VECM) to a unit shock in error terms are observed over a period of time. If there are K endogenous variables in the model, then a total of K^2 impulse responses can be generated. In this study, the analysis was confined to the

435 responses of AGRINV, AGRGDP, FSRGDP, SAV, PCI, LA, IR and ER to the shocks in
436 FSRGDP.

437 To further to obtain information concerning the relative importance of each innovation towards
438 explaining the behaviour of the endogenous variables, variance decomposition analysis (VDC)
439 was conducted. The generalized forecast error variance decomposition technique attributed to
440 Koop, Pesaran and Potter (1996) and Pesaran & Shin (1998) was used. This technique has the
441 advantage that its results are not sensitive to the ordering of the variables in the VAR (VECM).

442 To examine the short-run impacts of financial sector reforms on agricultural investments and
443 growth in Nigeria, the Granger-casualty test developed by Granger (1969) was adopted. This test
444 seeks to ascertain whether or not the inclusion of past values of a variable say Y_{t-p} do or do not
445 help in the prediction of present values of another variable X . If X is better predicted by including
446 past values of Y , than by not including them, then Y is said to Granger-cause X (Gujarati, 2003).
447 Several alternative methods of testing for Causality in Cointegrated VAR have emerged in
448 literature. The popular approach has been to re-parameterize the model into the equivalent vector
449 error correction model (VECM) and to conduct Causality tests following either the residual-
450 based Engle-Granger two-stage method or the Johansen-Type Error.

451 Finally, to ensure that the conclusions arrived at from the baseline models (equations 7 to 14) are
452 not spurious or outcomes of chance, sensitivity analysis and robustness checks on the results was
453 carried out. This was done by replacing a variable in the baseline model. The basic difference
454 between the models used for sensitivity analysis and the baseline model was the introduction of
455 Private Sector Credit (PSC) as a measure (or proxy) for Financial Sector Reforms in sensitivity
456 analysis and robustness analysis while Financial Sector Gross Domestic Product (FSGDP) was
457 use as a proxy for Financial Sector Reforms in the baseline equation.

458 The reduced form representation of the VAR is thus:

$$X_t = C_0 + \sum_{i=1}^k \delta_i X_{t-i} + \mu_t \quad 15$$

459

460

461
462
463 Where:
464 $X_t = (LNAGINV, LNAGR GDP1, LNPSC, LNSAV, LNPCI, LNLFA, LNER, LNIR)$ is a 8×1 vector
465 of five endogenous variables, while X_{t-i} is the corresponding lag term for each of the
466 variables. A_i is the 8×8 matrix of autoregressive coefficient vector X_{t-i} , for $i = 1, 2, \dots, k$.
467 $C_0 = (C_1, C_2, \dots, C_n)$ is the C intercept vector of the VAR model.
468 $\mu_t = (\mu_{1t}, \mu_{2t}, \dots, \mu_{nt})$ is the 8×1 vector of independent and identically distributed error terms
469 (I.I.D).
470 K = the number of lagged terms.
471 $LNPSC$ = Log of Private Sector Credit
472 $(LNAGINV, LNAGR GDP1, LNSAV, LNPCI, LNLFA, LNER, LNIR)$ = are as earlier defined.

473
474 **Effect of Financial Sector Reforms on Agricultural Output**
475 Table 1 shows the results of unit root test. Augmented Dicker-Fuller (ADF) unit root test was
476 applied on all the data series in their log forms. Schwarz Information Criterion (SIC) was used
477 for the selection of the optimal lag length to a maximum of 9. For robustness checks,
478 specification of the ADF model was varied. Specifically, the test was run under two different
479 assumptions: (i) with intercept and (ii) with trend and intercept. The results indicated that all the
480 variables possessed unit-roots at one percent level of significance and became stationary only
481 after transforming them to their first differences for both intercept and when trend specification
482 was included except for agricultural output growth that suggested that the series were stationary
483 at level, that is, $I(0)$. The unit-root test results provided us with a reliable guide on how to
484 incorporate the variables into the vector error correction model (VECM) analysis. Following the
485 results, agricultural investments (LNAGINV), financial sector reforms (LNFSRGDP), total
486 savings (LNSAV), per capita income (LNPCI), labour force in agriculture (LNLFA), exchange
487 rate (LNER) and interest rate (LNIR) were fed into the model at their first-differences, while
488 agricultural growth (LNAGR GDP1) enters at its level.

Table 1 Result of ADF Unit root test

	Levels		1 st Difference		
Variable	Intercept	Trend	Intercept	Trend	Conclusion
	+ Intercept		+ Intercept		
LNAGINV	-1.701[0]	-1.157[0]	-5.890[0]***	-6.161[0]***	<i>I(1)</i>
LNAGRGP1	-6.039[0]***	-5.972[0]***	_____	_____	<i>I(0)</i>
LNFSRGDP	-2.819[0]	-2.392[0]	-5.935[0]***	-4.157[0]***	<i>I(1)</i>
LNSAV	1.130[0]	-0.771[0]	-4.661[0]***	-4.735[0]***	<i>I(1)</i>
LNPCI	-2.492[0]	-1.962[0]	-5.702[0]***	-6.046[0]***	<i>I(1)</i>
LNLFA	0.613[0]	-1.371[0]	-5.650[0]***	-5.856[0]***	<i>I(1)</i>
LNER	0.125[0]	-2.163[0]	-5.023[0]***	-4.995[0]***	<i>I(1)</i>
LNIR	-2.189[0]	-2.929[0]	-9.239[0]***	-9.162[0]***	<i>I(1)</i>

Source: computed by Author. Notes: *** indicates significance at 1% level. The values in bracket [] for the ADF test shows the optimal lag length selected by the SIC within a maximum lag of 9 .Variables are in log forms.

Given the fact that most of the variables became stationary after first differencing, another test was conducted to examine whether the non-stationary variables were co-integrated. In other words, we tested the hypotheses about the rank of the cointegrating relationships that existed among the variables. The results from the Johansen cointegration tests are presented in Tables 2 and 3 respectively. The test assumption specified allowed for a linear deterministic trend in the data series and an intercept in the cointegrating equation. From Tables 2 and 3, it was observed that both the Trace and the Maximum Eigenvalue tests indicated the presence of two (2) and one (1) cointegrating vectors respectively. Thus, there were evidence of the existence of a long-run relationship among financial sector reforms, agricultural investment, output growth and other policy variables in Nigeria. Consequently, applying the vector error correction model (VECM) would enable us to track the long-run relationship among the variables and tie it to deviation that may occur in the short-run (Lorde, Jackson & Thomas, 2009).

506 **Table 2 Johansen Cointegration Trace Test**

Null Hypothesis	Alternative Hypothesis	Test Statistic	Critical Value
			0.05
r = 0	r = < 1	198.682	159.530***
r = 1	r = < 2	134.750	125.615**
r = 2	r = < 3	91.215	95.754
r = 3	r = < 4	62.088	69.819
r = 4	r = < 5	38.263	47.856
r = 5	r = < 6	23.603	29.797
r = 6	r = < 7	10.765	15.494
r = 7	r = < 8	1.447	3.842

507 Source: Computed by Author. Notes: r indicates the number of co-integrating vector. *** is the
 508 significance level at 1%. P-values are obtained using response surfaces in Mackinnon *et al.*,
 509 (1999).

510 **Table 3 Johansen Cointegration Maximum Eigenvalue Test**

Null Hypothesis	Alternative Hypothesis	Test Statistic	Critical Value
			0.05
r = 0	r = 1	63.932	52.363***
r = 1	r = 2	43.535	46.231
r = 2	r = 3	29.128	40.078
r = 3	r = 4	23.825	33.877
r = 4	r = 5	14.659	27.584
r = 5	r = 6	12.839	21.132
r = 6	r = 7	9.318	14.265
r = 7	r = 8	1.447	3.842

511 Source: Computed by Author. Notes: r indicates the number of co-integrating vector. *** is the
 512 significance level at 1%. P-values are obtained using response surfaces in Mackinnon *et al.*,
 513 (1999).

From the Johansen cointegration results, a VECM (2) with at least two cointegrating vectors was estimated and to ensure that the estimated VECM was not spurious, the residual auto correlation and correlogram tests were also conducted. The results showed that the residuals of the estimated VECM were appropriately uncorrelated, indicating that the estimated VECM was correctly specified or unbiased and the parameters estimated were consistent. This was because the spikes from the correlograms revealed the relative correlation of the error terms in the VECM equations and the closer the spikes are to the zero line, the more uncorrelated the error terms. The coefficients from the estimated VECM were not of primary interest in this empirical work. Instead, focused was on the impulse response function (IRFs) and variance decomposition (VDC) generated from the VECM.

The impulse response functions traced out the responsiveness of the dependent variable in the VECM to shocks on each of the variables using the Cholesky one standard deviation innovations (Choleskey one Standard deviations examine the dynamic interactions among variables). This implies that impulse responses showed the path of LNAGRDP1 (agricultural growth) when there were innovations in the financial policy variables. For each equation, a unit shock was applied to the error, and the effects upon the VECM system over 30 periods were examined. The VECM system has eight variables, thus a total of 64 impulses could be generated. But the primary objective was to examine the impact of financial sector reforms shocks on the other seven macroeconomic or endogenous variables. Thus, only the responsiveness of the financial sector reforms on the macroeconomic variables (LNAGINV, LNAGRDP1, LNSAV, LNPCI, LNLFA, LNER and LNIR) was traced out.

Figure 1, presented seven panels of impulse response graphs indicating how innovations in financial sector reforms variable affected agricultural investments; growth and other policy variables in Nigeria over a period of 30 periods. Each panel illustrated the response of the policy variables to a one standard deviation innovation (corresponding to a positive shock) in the policy variable. A value of zero means that financial sector reforms shock has no effect on the financial policy variables and the variables continued on the same path it would have followed had there been no financial sector reforms shock. A positive or negative value indicated that the shock

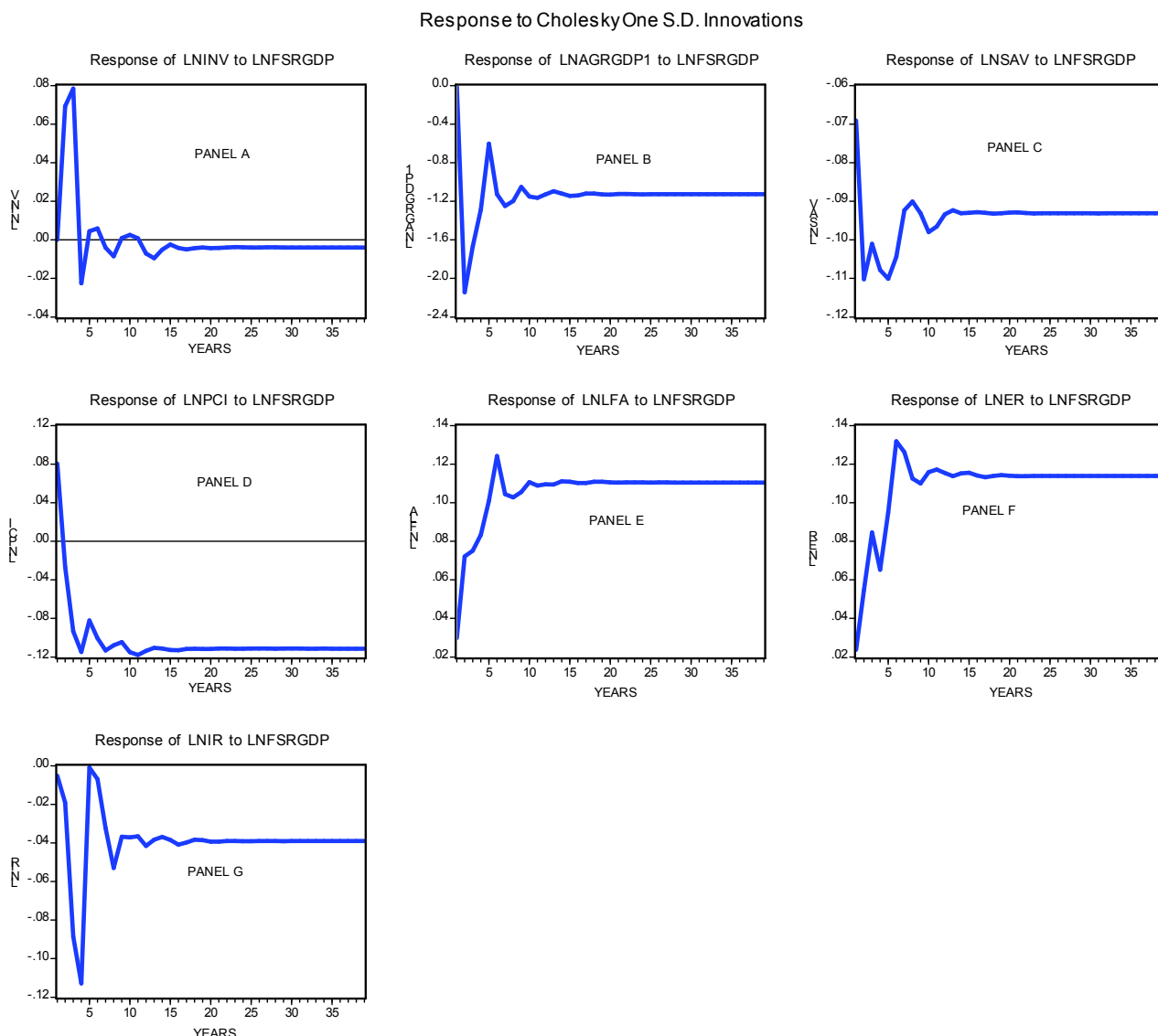
caused the variable to be above or below its ‘natural’ path as the case may be. The solid lines depict the estimated effects of the shock.

Panels A, B, C and G displayed the impulse responses of agricultural investments, agricultural growth, total savings and interest rate respectively to the one time shock in the financial sector reforms as presented in Figure 1. These four financial policy variables are falling below equilibrium or responded negatively in an undulating but significant manner before stabilizing over the period reviewed to the positive shock in the financial sector reforms. This implies that there is a negative response among agricultural investments, savings and interest rate to the positive shock in financial sector reforms in Nigeria financial system. This would initially retard growth in agricultural sector as shown in panel B in the first two periods. However, in the long-run, it settles at a period below equilibrium level. That is, it leads to a long-run disequilibrium solution since the impulse response function does not return to the zero line. This is in line with the economic postulation that the higher the interest rate, the higher the savings and the greater the investments opportunities and vice versa. However, this was not consistent with our *apriori* expectations since economic agents are expected to adjust their spending and investment habits moderately and gradually in response to the increased supply of funds rather than immediately. The result correlated with that of Hasan *et al.*, (1996) which reveals that low interest ceiling is noted to unduly restrict the real flow of loan-able funds, thus depressing the quality of productive investment during financial sector reforms while Mckinnon (1973) and Shaw (1973) agree that economic growth is severely hindered in a repressed financial system by the low level of savings rather than by the lack of investment opportunities. However, investment is negatively related to the effective real rate of interest on loans, but positively related to the growth rate of the economy. They also opined that savings in many developing countries were barely sufficient to maintain the existing capital stock hence, could not permit enough investment to sustain economic growth.

The negative but significant effect of the financial sector reforms shock on these monetary variables displayed on Figure 1 was not consistent with theoretical expectations and this confirms the weak and unstable nature of credit markets in the Nigeria economy but agree with Asamoah (2008) who stated that the financial sector reforms can affect economic growth by altering the saving rates. In this case, the sign of the relationship was not obvious, because

financial sector development may also reduce savings and thereby growth while Fry (1998) affirms that the use of interest rate ceilings in a repressed system, distorts the economy in four critical ways: (i) Current consumption is favoured compared to future consumption (ii) financial institutions are favoured instead of lending via deposits and engage potential investors in relatively low-yielding investments (iii) the low level of interest rates would cause borrowers to favour capital-intensive projects (iv) the pool of potential borrowers is dominated by entrepreneurs who possess low-yielding projects.

Panel D indicated that per-capita income was consistently falling below equilibrium over the time period though exhibited rising trend at the beginning of the period. This is plausible because of the argument that focuses on the negative effect of repression on the rate of per-capita income contrary to the McKinnon-Shaw premise. Financial researchers argued that the increase in the real interest rate may not necessarily lead to improved private savings. In very poor countries for instance, the level of income would be so low that households spend very high proportion of their earnings on basic needs. In such a case, even with high real interest rates, very little proportion of income would be saved. This implies that McKinnon-Shaw's proposition would therefore be more relevant in rich countries. In Panel E, labour force in agriculture increased consistently in a positive manner over time. This implies that labour force is skewed to the shock in the reform with a positive future expectation. This is consistent with theoretical postulation reflecting the quality of manpower being produced by the agricultural sector of the economy. Panel F revealed that exchange rate responded positively over a period of the thirty years. This shows that financial sector reforms have a positive impact on monetary policy (exchange rate) in Nigeria. This is contrary to the negative theoretical postulation considering the seasonal nature of agricultural production in a country with an open economy having many trading partners.



600

601 Figure 1: Response of LNAGINV, LNAGRGDP1, LNSAV, LNPCI, LNLFA, LNER, and LNIR
 602 to LNFSRGDP shock in choleskey one standard deviation (Choleskey one Standard deviations
 603 examine the dynamic interactions among variables).

604

605 The Variance Decomposition Analysis (VDC) provides a means of analysis to determine the
 606 relative importance of the dependent variable in explaining the variations in the explanatory
 607 variables. The result of variance decomposition over a 30-year time period is displayed in Table
 608 4. The values in the table confirmed the results obtained from the Impulse response analysis
 609 (IRFs). On the average, 3.84 percent of most of the variation in the forecast error for financial
 610 sector reforms was explained by the shocks to itself. Agricultural growth shock had a value of

78.84 percent of the variation in financial sector reforms over the 30-year period while the impact of financial sector reforms shock on agricultural investments was 0.34 percent over the 30 year period.

The influence of the shocks on total savings was marginal at the onset with values less than one percent up to the fifteen periods but later increased to 1.37 percent over the thirtieth year period.

The average contributions of LNPCI, LNLFA, LNER and LNIR were 2.49 percent, 10.53 percent, 5.19 percent and 0.08 percent respectively. The higher contributions of agricultural growth to the shocks in financial sector reforms indicate that financial sector reforms significantly affected agricultural out than other monetary variables which were mild and persistent. This correlated with the empirical works of King and Levine (1993) and Levine *et al.*, (2000) which confirms that financial development has a positive effect on economic growth. The implication of this is that policy makers will be faced with less uncertainty in planning for the long-term.

Table 4 Variance Decomposition of FSRGDP

Period	S.E	LNINV	LNAGRGP1	LNFSRGDP	LNSAV	LNPCI	LNLFA	LNER	LNIR
1	0.396	88.336	10.223	0.000	0.000	0.000	0.000	0.000	0.000
5	0.725	0.582	81.492	5.078	0.300	0.702	6.676	5.108	0.062
10	0.946	0.426	79.893	4.080	0.599	1.821	9.341	3.763	0.077
15	1.124	0.341	78.846	3.838	0.951	2.493	10.530	2.917	0.083
20	1.279	0.286	78.328	3.688	1.163	2.839	11.169	2.443	0.0869
25	1.417	0.251	78.022	3.585	1.289	3.047	11.567	2.151	0.089
30	1.542	0.226	77.812	3.515	1.374	3.189	11.841	1.952	0.091

Source: Computed by Author. Note: S.E (Standard Error), LNINV (log of Agric. Investment), LNAGRGP1 (log of Agric. Growth), LNFSRGDP (Log of Financial Sector RGDP), LNSAV (log of total savings), LNPCI (Log of Per Capita Income), LNLFA (Log of Labour Force in Agric.), LNER (Log of Exchange Rate) and LNIR (log of Interest Rate).

However, comparing the VDC analysis for agricultural output growth in Tables 5 revealed that agricultural output shocks on financial sector reforms was lower with an average contribution of 33.35 percent respectively than the shocks of financial sector reforms on agricultural output with an average of 78.84 percent as shown in Table 4. This implies that an increase in the financial sector through effective reforms would enhance growth in the agriculture sector of the country. On the other hand, agricultural output shocks on other policy variables showed a positive impact indicating a positive interaction among variables. The low values recorded in interest rates are good signals to the agricultural investments which would consequently impact positively on output growth in agriculture as it would attract investors to come and invest into the sector.

Table 5 Variance Decomposition of LNAGRDP1

Period	S.E	LNINV	LNAGRDP1	LNFSRGDP	LNSAV	LNPCI	LNLFA	LNER	LNIR
1	0.396	88.336	10.223	0.000	0.000	0.000	0.000	0.000	0.000
5	0.725	0.582	81.492	5.078	0.300	0.702	6.676	5.108	0.062
10	0.946	0.426	79.893	4.080	0.599	1.821	9.341	3.763	0.077
15	1.124	0.341	78.846	3.838	0.951	2.493	10.530	2.917	0.083
20	1.279	0.286	78.328	3.688	1.163	2.839	11.169	2.443	0.0869
25	1.417	0.251	78.022	3.585	1.289	3.047	11.567	2.151	0.089
30	1.542	0.226	77.812	3.515	1.374	3.189	11.841	1.952	0.091

Source: Computed by Author. Note: S.E (Standard Error), LNINV (log of Agric. Investment), LNAGRDP1 (log of Agric. Growth), LNFSRGDP (Log of Financial Sector RGDP), LNSAV (log of total savings), LNPCI (Log of Per Capita Income), LNLFA (Log of Labour Force in Agric.), LNER (Log of Exchange Rate) and LNIR (log of Interest Rate).

To examine if a significant short-run relationship existed between financial sector reforms and the macroeconomic variables, an error correction modeling (ECM) analysis was conducted as shown in Table 6. The results of the final parsimonious estimate revealed that R^2 value of 0.97 shows that all the variables can explain about 97% of agricultural output growth. F-statistic of 31.62 ($P < 0.01$) shows that they are jointly significantly and the Durbin Watson Statistic value of

2.05 implies that the model does not suffer from autocorrelation problem thus, has a very good fit. In term of significance of the variables, it was observed that financial sector reforms (LNFSRGDP), past value of financial sector reforms (proxy by LNFSRGDP), per capital income (LNPCI), labour force in agriculture (LNLFA) and interest rate (LNIR) were the significant determinants of agricultural output growth in Nigeria for the period of analysis. From the result, the past financial sector reforms, per capital income, labour force in agriculture and interest rate significantly raises the current financial sector reforms, per capital income, labour force in agriculture and interest rate. The result further reveals that the coefficients of other three variables (savings, exchange rate and agricultural investments) were not significantly different from zero. This implies that past financial sector reforms, per capital income, labour force in agriculture and interest rate positively determine the current flow of financial sector reforms, per capital income, labour force in agriculture and interest rate in Nigeria while the previous savings, exchange rate and agricultural investments do not significantly affect the present savings, exchange rate and agricultural investments in Nigeria. Thus, an increase in the previous volume of financial sector reforms, per capital income, labour force in agriculture and interest rate would result in an increase in the present level of financial sector reforms, per capital income, labour force in agriculture and interest rate to agricultural output in Nigeria. The result further reveals that the coefficient of the error correction term which measures the speed of adjustment towards long-run equilibrium was both correctly signed (negative) and statistically significant at 1% percent meaning that about 75% of the error are corrected yearly with a different adjustment speeds to long-run equilibrium. Therefore, correcting any deviations from the long-run equilibrium. This implies that financial sector reforms had impact on agricultural growth in the short-run.

Table 6 Vector Error Correction Model for Short-run Impact

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.695538	0.842285	-2.013022	0.0613
D(LNAGRDP1(-2))	0.160707	0.099081	1.621968	0.1243
D(LNFSRGDP)	9.746098	1.774025	5.493778	0.0000
D(LNFSRGDP(-2))	-5.517377	1.671753	-3.300354	0.0045
D(LNSAV)	3.561411	2.476003	1.438371	0.1696
D(LNSAV(-1))	1.763468	2.343236	0.752578	0.4626
D(LNPCI)	2.854077	1.655964	1.723514	0.1041
D(LNPCI(-1))	-5.845329	1.326259	-4.407382	0.0004

D(LNPCI(-2))	1.599045	1.586716	1.007770	0.3286
D(LNLFA)	2.912682	1.724201	1.689294	0.1106
D(LNLFA(-2))	-2.028902	1.127346	-1.799715	0.0908
D(LNER)	-1.863357	1.486112	-1.253846	0.2279
D(LNER(-1))	-1.678422	1.090944	-1.538505	0.1435
D(LNIR)	-1.206719	1.174977	-1.027015	0.3197
D(LNIR(-1))	-1.982491	1.023264	-1.937418	0.0706
D(LNIR(-2))	-0.642033	0.764057	-0.840295	0.4131
D(LNINV)	0.828225	0.687123	1.205352	0.2456
D(LNINV(-1))	1.108967	0.642909	1.724920	0.1038
D(LNINV(-2))	1.006459	0.688385	1.462058	0.1631
ECM(-1)	-0.751859	0.140136	-5.365209	0.0001
R-squared	0.974060	Mean dependent var	0.024444	
Adjusted R-squared	0.943257	S.D. dependent var	5.895698	
S.E. of regression	1.404400	Akaike info criterion	3.817279	
Sum squared resid	31.55744	Schwarz criterion	4.697011	
Log likelihood	-48.71101	Hannan-Quinn criter.	4.124329	
F-statistic	31.62198	Durbin-Watson stat	2.050879	
Prob(F-statistic)	0.000000			

677 Source: Computed by Author. Note: ***, ** =1% and 5% significant levels respectively.

678 Finally, a sensitivity analysis/ robustness check was carried out on VECM equation (15) to
679 ascertain that the model was not spurious or outcome of chance. The results indicated that private
680 sector credit (LNPSR) which replaced financial sector real gross domestic product as a proxy for
681 financial sector reforms was stationary at first difference in Augmented Dickey-Fuller (ADF) for
682 both intercept and when trend specification was added. The Johansen cointegration results of
683 LNPSR and other variables (LNINV, LNAGRDP1, LNSAV, LNPCI, LNLFA, LNER, LNIR)
684 earlier specified indicated the presence of two and one cointegrating vectors in the system at 1
685 percent significant level for both Trace and Maximum Eigenvalues vectors as displayed in tables
686 8 and 9 respectively. This confirms the existence of a long-run relationship between financial
687 sector reforms and the policy variables in Nigeria.

688
689 The impulse response function analysis in robustness test showed that variables responded in a
690 similar pattern to the one time shock of financial sector reforms (LNPSR) as that of the baseline
691 model (LNFSRGDP). This could probably be due to the order of integration of LNPSR which
692 was stationary at first difference at 1 percent significance as earlier reported. The Variance
693 Decomposition Analysis (VDC) results revealed that the average values of 5.41 percent, 0.60
694 percent, 2.50 percent, 0.67 percent, 5.66 percent, 1.09 percent, 0.30 percent of LNAGINV,
695 LNAGRDP1, LNSAV, LNPCI, LNLFA, LNER and LNIR respectively contributed to the

variations in financial sector reforms (83.82 percent) over the 30-years. The impact of financial sector reforms shock (proxy by LNPSC) on agricultural output growth was lower with 0.60 percent when compared with 78.85 percent of table 4 (baseline Table). This is because a well structured, effective and efficient financial sector reforms is expected to impact more on agricultural growth at a lower value of 3.84 percent which is the case of financial sector reforms (LNFSRGDP) in the baseline model than the higher value of 83.82 percent LNPSC obtained in sensitivity analysis with agricultural growth value of 0.60 percent. This implies that the financial sector reform was not strong, effective and efficient to cause an astronomical growth in the agricultural sector. This result is in line with several theoretical and the empirical studies of Chen and Feng, 2000; Chow and Li, 2002 at the international, national and provincial levels who affirmed that the financial sector could be a catalyst of economic growth if it is well developed and healthy. The result further agrees with the theoretical argument and is consistent with the results of VAR model; Cross-country/panel empirical studies of Ghirmay (2009), Levine and Zervos (1998); Benhabid and Spiegel (2000) which provided evidence that financial sector real gross domestic product used as proxy in financial sector reforms or financial development has greater significance and positive effect on long-term growth through its investment and productivity effects than proxies used in monetary aggregates such as private sector credit (PSC). This implies that financial sector reforms played a significant role in the growth of agricultural sector by increasing its productivity level and independently generated positive investments in the sector which was a converse of the sensitivity result (PSC). Similar trend were experienced for per capita income (0.67 percent), labour force in agriculture (5.57 percent) and exchange rate (1.09 percent) were lower in sensitivity test except for savings (2.46 percent) and interest rates (0.30 percent) that were higher in sensitivity test than that of the baseline test.

Furthermore, the shock of LNAGRDP1 on LNPSC was lower in sensitivity analysis with 14.25 percent than 33.35 percent shocks on LNFSRGDP recorded in tables 5 (baseline table) respectively. From the above results, it could be deduced that financial sector reforms shocks greatly influenced microeconomic policy variables in the baseline model especially agricultural output growth than those financial sector reforms shocks in sensitivity analysis in the long-run during the period under review. In the short-run, the coefficient of the error correction term was statistically significant and correctly signed (negative) indicating a different adjustment speeds to

727 long-run equilibrium. Thus, correcting any deviations from the long-run equilibrium. This
 728 affirms that financial sector reforms positively impacted on agricultural growth in the short-run
 729 just as in the base line analysis.

730

731 **Table 8 Johansen Cointegration Trace Test**

Null Hypothesis	Alternative Hypothesis	Test Statistic	Critical Value
			0.05
r = 0	r = < 1	216.539	159.530***
r = 1	r = < 2	130.879	125.615**
r = 2	r = < 3	86.672	95.754
r = 3	r = < 4	55.859	69.819
r = 4	r = < 5	34.548	47.856
r = 5	r = < 6	20.901	29.797
r = 6	r = < 7	9.524	15.495
r = 7	r = < 8	0.773	3.841

732 Source: Computed by Author. Notes: r indicates the number of co-integrating vector. *** is the
 733 significance level at 1%. P-values are obtained using response surfaces in Mackinnon *et al.*,
 734 (1999).

735 **Table 9 Johansen Cointegration Maximum Eigenvalue Test**

736 Source: Computed by Author. Notes: r indicates the number of co-integrating vector. *** is the
 737 significance level at 1%. P-values are obtained using response surfaces in Mackinnon *et al.*,
 738 (1999).

Null Hypothesis	Alternative Hypothesis	Test Statistic	Critical Value
			0.05

739

740

741

r = 0	r = 1	85.660	52.363***
r = 1	r = 2	44.207	46.231**
r = 2	r = 3	30.813	40.078
r = 3	r = 4	21.311	33.877
r = 4	r = 5	13.647	27.584
r = 5	r = 6	11.376	21.132
r = 6	r = 7	8.752	14.265
r = 7	r = 8	0.773	3.842

Conclusion and Recommendations

The vector error correction model (VECM) result revealed that financial sector reforms had significant effects on agricultural output growth in Nigeria both in the long and short-run in the base line model and the sensitivity analysis/robustness check respectively. Also, it was discovered that financial sector reforms in the baseline test impacted more on microeconomic policy variables especially growth in agricultural output than those in the sensitivity test in the long-run. Based on the outcome of this work, it is concluded that the assertions made by Ghirmay, 2009; Liang and Teng, 2006; Watchel, 2000; Neussar and kugler, 1998 regarding the use of financial sector real gross domestic product as a better indicator of financial sector reforms than monetary aggregates such as private sector credit commonly used as proxy for financial sector reforms is true since it impacted more positively on agricultural investments and growth in Nigeria.

It is therefore recommended that Government should adopt strong macroeconomic policies targeted to bring meaningful growth in the agricultural and financial sector against foreign-based economic policies since the results confirmed the significant impact of financial sector reforms on agricultural growth in Nigeria in the long and short-run. This could be done by creating a well secured bank-based financial system through strong financial regulation, good supervision, regular and sustainable institutional reforms. The current restructuring in the financial institutions should be seriously addressed with appropriate regulatory frameworks instituted to prevent future recurrence. The empirical results revealed financial sector drives agricultural growth both in the long and short-run. As such, more attention should be focused on financial

sector development in order to foster more agricultural growth in the economy since financial sector enhances agricultural performance in Nigeria in the long-run and in the short-run.

There should be proper formulation of an appropriate and harmonized regulatory framework that will support a level playing field in a liberalized economy. A liberalized macroeconomic environment would foster the growth and expansion of competitive economic entities, which would in turn encourage growth and competition within the financial sector, develop a strong, transparent institutional and legal framework for financial sector activities. Government and corporate individual should jointly improve and provide enabling environment in the country such as economic, institutional and social infrastructures that will create incentives for growth of business opportunities on a sustainable basis and allow financial institutions to expand.

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