

An Assessment of the Banking Sector Development in Economic Performance: A Case of Selected Countries

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ABSTRACT

Purpose: The study examines economic growth and banking sector development in some G8 countries (United States, United Kingdom, Canada, Japan, and Germany) and three African countries (Nigeria, Ghana, and South Africa).

Approach/Methodology/Design: Study objectives include filling the gap occasioned by a lack of literature on this topic, especially as it concerns the selected countries. As a check for stationarity, we used the Levin-Lin-Chu and Im-Peseran-Shun unit root tests. In addition to Pedroni, long-run relationships between variables are also tested. Because the study is a cross-country study, it was necessary to perform the Hausman test to determine if random effect panel analysis is consistent and effective and to test long-run cointegration using the ARDL Bound test.

Findings: According to the results, banking sector development, and exchange rate contribute positively to economic growth while CPI contributes negatively. In contrast, the results indicate a long-run relationship between economic growth, banking, and other determinants.

Originality/value: The study recommends that G8 countries and most African countries consider improving their banking sector and incorporating it into their economic development as one of the determinants.

INTRODUCTION

Banking is an important part of an economy because it generates employment, offers investments to investors, and provides financial services to its customers. Developing economies require capital, which is provided by the financial service industries (Berger, Rebecca, and Philip, 1999; Beckett, Paul, and Barry, 2000). An economic institution's performance can be measured by its profitability and stability. Profitability of a bank is continuously increasing when its performance is improving. In order to satisfy human desire, the development process needs prerequisite requirements, such as financing for investments and production. Economic problems like unemployment, poverty, low living standards, and inflation are common in developing countries. In order to increase their living standards,

these countries always seek economic growth to increase national incomes and create more jobs. Financial and banking sectors play an important role in economic development. In addition, the banking sector leads to increased economic growth. There have been numerous empirical studies that confirm the argument (Afangideh, 2008).

Economic growth theory considers financial institutions, specifically banks, as useful tools for improving the productive capacity of an economy, and as important sources of funding for any country, particularly at the beginning of economic development. Economic growth relies on the banking system's ability to collect and attract deposits from savers. Its role in providing loans to encourage production and investment is its ability to create an economic expansion in agricultural, industrial, and trade sectors. Furthermore, it intermediaries' savers with borrowers Investment projects start with capital provided by the banking industry.

Two functions are crucial for banks. The payments system is essential for a modern economy to function. Paying via check, credit card, and online banking is common. Most money is bank money, while government coins and Federal Reserve Notes serve as legal tender. Because we can exchange bank money for legal tender at our local bank or ATM, we are confident in it. For these exchanges, banks must have legal tender reserves (Sotto, 2014). Financial intermediation is the second function of banking, which includes lending, investing, and creating credit. This is the business side of banking. Bank shareholders provide equity capital to the business in return for profit. In order to keep money in a bank, banks charge depositors more than they charge borrowers. As a result of banks' intermediation function, the American economy survives thanks to generations of entrepreneurs (Lynch, 1996).

As a crucial part of the country's economy, the banking sector is currently facing the worst crisis it has ever experienced. Dollar rate increases daily. As a result of insufficient reserves in our central bank, our currency devalued in foreign markets. Due to political instability and economic crisis which is affecting Nigeria and other selected African countries (Ghana and South Africa) under study, our banking sector is suffering from a great disaster which is affecting its financial performance. As merger and acquisition activities increase in our country, the economic situation also becomes a barrier to the growth of our banking sector. Banking sector declined due to worst energy crisis. Several African countries face energy crises. A lack of energy is the primary cause of our economic collapse (Hamza & Khan, 2014).

A measure of agents' ability to utilize financial markets to make savings and investment decisions, the depth of financial development is closely related to long-term economic growth when it comes to firms' and businesses' ability to make long-term and risky investments. Financial penetration also remains low in Africa. There are a high number of unbanked people in Sub-Saharan Africa. A review of the data indicates two things: (i) the level of financial inclusion is low, especially among low-income communities, and (ii) private individuals do not have access to banking services. The lowest financial penetration is in sub-Saharan Africa, with only 21% of adults having a bank account. The average is 90% in OECD countries, compared with 34% in other developing regions. Nearly 14% of West African adults reportedly have an official bank account. In this subregion, the share is the lowest. The banking system reaches relatively well into the Southern African economies (Nyantakyi & SY2, 2015). Across the continent, manual banking systems gave way to digital services in the 1980s and 1990s. Investments have taken place in online banking and electronic transactions in recent years. Nyantakyi & SY2 (2015) demonstrate how digital infrastructures have not only allowed domestic banks to reach a greater number of clients but also reduced operations costs, which in turn improved banks' margins.

Hicks (2009) argue that the financial system boosts the economy's growth. According to the theory, financial institutions should be providing more funds for economic activities, which will result in an increase in banking credits as a result. Economic growth is facilitated by financial development, according to King and Levine (1993) and Miller (1998). The growth of the financial sector is positive. Nevertheless, Goldsmith (1969) showed that economic growth is the foundation for the development of financial institutions. The objective of this paper is to examine the impact of banking sector development on economic performance in the selected G8 countries (The United States, the United Kingdom, Canada, Japan, and Germany) and three African countries between 1996 and 2022, using a panel Autoregressive Distributed Lag (ARDL) model.

Banking System and Economic Performance

An economy's financial system is based on its banking system. Researchers have been investigating the relationship between financial development and economic performance for many decades (Nguyen, 2022). As Levine (1997) points out, financial development, including the development of the banking system, will assist companies in mobilizing and allocating capital, managing risks, promoting the sale of goods and services, stimulating capital accumulation, technology development, and economic growth. In the same way, Giovannini, Maurizio & Raoul (2012) see financial development as a means of reducing information costs, promoting innovation, and reducing risks. As a result, this improves the allocation of resources and investment activities, thereby improving performance. SME growth can be stimulated by financial sector development. Large firms typically have fewer jobs than SMEs. Economic development is especially important in emerging economies. Financial intermediaries and infrastructure are just the beginning of the financial sector. All key entities need to be regulated and supervised by policies that are robust to ensure their success.

In 2011, sub-Saharan African banks accounted for 22% of all cross-border FDI and 7 % of all greenfield FDI in the region (UNCTAD, 2015). During the period 2003 to 2014, around 50% of intra-African Greenfield investment projects have been focused on financial services, 38% on retail banking, and 5% on insurance. Despite the fact that African banks have established a pan-African ambition and have changed the face of the banking landscape, global banks remain a significant force in the industry. A number of regional African banks operate in many countries across Africa, including Ecobank Transnational (from Togo), which operates in thirty countries across West Africa, Central Africa, and East Africa. Banks such as Standard Bank and others have started to invest abroad, opening branches and subsidiaries in developed and emerging markets (Pelletier, 2014).

In comparison to African countries, advanced countries have a banking sector where the assets of UK-owned banks represent 48% of the total assets. The proportion of UK-owned banks in the UK banking sector has increased since 2004. Banks are being converted into building societies, the banking industry is consolidating, and non-financial firms are entering the financial services market. A significant portion of the UK economy is generated by the banking sector, which accounts for approximately 3.7% of its Gross Domestic Product (British Bankers Association, 2004). A total of 16.7 trillion U.S. dollars was held by banks in 2021, compared to 16.8 trillion in 2020. There were 21.1 trillion dollars in bank assets in 2008, which is a record high. UK financial services were fourth in the OECD as a percentage of national economic output in 2021. The financial services industry accounted for 25% of Luxembourg's economic output, making it the largest in the OECD. According to data provided by the UK government for Q1 2022, there were 1.08 million jobs in financial services, which accounted for 3.0% of all jobs in the country. As a result of the UK financial

services exporting £61.3 billion and importing £16.6 billion in 2021, the industry generated a surplus of £44.7 billion (UK statistics, 2022).

It is estimated that at the end of 2018, the U.S. banking system had \$17.9 trillion in assets and \$236.8 billion in net income, and that the banking system supports the world's largest economy with its most diverse banking institutions and the highest concentration of private credit anywhere in the world. Throughout 2002-2021, American banks' assets consistently increased. Approximately 30.2 trillion dollars' worth of assets was held by U.S. banks in 2021. Since 2002, all banking institutions' assets in Germany fluctuated considerably. German banks held 10.51 trillion U.S. dollars in 2021. Germany's banking institutions held assets in excess of 12.14 trillion US dollars in 2008, the highest value recorded during the period under study. The value of assets of banks in Canada steadily increased from 2002 to 2021. Over the past decade, Canadian banks have accrued assets totaling approximately 4.9 trillion U.S. dollars. The Japanese banks held a total of 19.6 trillion dollars in 2021. More than five trillion dollars have been added to the assets of Japanese banks since 2021 (Statistia Research Department, 2023).

Objective of the Study

The objective of this study is to examine the impact of banking sector development in the economic performance of the selected countries. Evaluate the relationship between banking sector development and economic performance in the selected countries.

REVIEW OF LITERATURE

Theoretical Literature

Acemoglu, Johnson, and Robinson (2001) developed the settler mortality hypothesis as part of their endowment theory. Institutions and geography have a significant influence on the financial sector. The paper argued that disease environments and geographic factors shaped colonisers' creation of institutions. Acemoglu et al. (2001) observe that colonization experience influences institutions in former colonies. According to endowment theory, initial endowments influenced early institutions, which impacted property rights protection and financial sector growth (Beck, Demirguc, & Levine, 2003b). According to La Porta et al., 1997, and La Porta et al., 1998, law plays a significant role in the development of the financial sector. Two parts to the theory. A discussion of legal systems begins the essay. A higher level of financial sector development is evident in countries where creditor rights have been prioritized and contracts are enforced effectively (Levine, 1998, Levine, 1999, and Levine et al., 2000). A second part of the study asserts that differences in the development of the financial services industry are due to legal traditions/origins. It is argued in the article that common law countries are more financially developed than civil law countries. As Rajan and Zingales (2003) explain, the simultaneous openness hypothesis is often called the interest group theory of financial development. The growth of the financial sector can be affected by a number of factors, such as interest groups, international trade, and capital inflows. In order to assist in the development of the financial sector, it is necessary to encourage openness and trade in the industry in order to help it develop.

Empirical Literature

In a study conducted by Obiora, Zeng, Li, Liu, Adjei & Csordas (2022), economic growth effects on bank performance were examined in 23 sub-Saharan African economies and 14 developed economies. A study shows that SSA's economic development increases lending rates, increases domestic credit to the private sector (DCPS), and has a positive impact on

commercial banking lending (CBCL). Economic development has a positive effect on NPLs in developed countries. Vietnamese banking system was studied by Nguyen (2022). Multivariate regression was conducted using the ARDL approach based on ARDL data. As a result of economic transition, the results demonstrate a positive long-term effect-based financial system for mobilizing capital. As well, Hshin-Yu & Alan (2006) examined how the financial sector contributes to economic growth. As Granger causality and Odedokun suggest, aggregate output drives financial system development. According to Granger causality tests, income and education levels increase when a "demand-following" relationship becomes the driving force.

An analysis of financial inclusion indices, development variables, and infrastructural development was conducted by Cicchiello, Kazemikhasragh, Monferra & Giron (2021). A pooled panel regression was used to study 42 countries, from 2000-2019. Financial inclusion is associated with economic growth. A similar analysis was carried out by Eyuboglu (2016) using the TOPSIS method between 2009 and 2013. Argentine and Turkey's banking sectors are the least successful, while South Africa and Turkey's are the most. Bist (2018) investigated in 16 low-income countries the long-run relationship between financial development and economic growth using panel unit root, co-integration analysis, and fully modified and dynamic OLS techniques. Cross-sectional dependence is observed across the countries. Several countries have experienced economic growth due to financial development. Dhawan & Mehta (2022) used data envelopment analysis (DEA) for relative efficiency, and Malmquist productivity index (MPI) for assessing average total factor productivity (TFP). SE exhibited better performance in the Canadian market, whereas TE, ME, CE, and AE showed better performance in the American market. It has been revealed that Germany, France, and the UK have seen positive growth in terms of productivity in the last few years.

According to Akinlo & Egbetunde (2010), economic growth in ten countries within sub-Saharan Africa is explained by long-run causal relationships and economic development. An analysis of the vector error correction model (VECM) in sub-Saharan Africa finds that financial development is closely related to economic growth. A causal relationship between banking development and economic growth was examined using VECM by Egbetunde & Mobolaji (2010) in ten countries in sub-Saharan Africa. There is a close correlation between financial development and economic growth in all ten countries evaluated. To examine Nigerian economic growth, Afangideh and Olofin (2008) used aggregate annual data for 1970-2005. Our study resulted in the development of a small macroeconomic model that illustrates the interrelationships between aggregate bank credit activity, investment behavior, and economic growth. Bank credit and investment activities are not directly linked to output growth, but are rather supported by a well-developed financial structure.

METHODOLOGY AND PROCEDURES

Through its research design, this study adopts an ex post facto approach. Through the use of a research design guide, a researcher can conduct the necessary investigation and analysis. By incorporating all its essential elements, the scientific method can be applied to investigate and solve the set research problems (Onwumere, 2009). To examine the cointegration (long run) relationship between the banking sector and economic growth as well as the short-run dynamics, we used the autoregressive distributed lag (ARDL) bound testing procedure. An OLS estimator is used to compute the bound test for the autoregressive distributed lag (ARDL) model estimates.

Model Specification

$$GDP = f(DCPS, MCAP, CAB, EXR, INF) \tag{1}$$

Where

GDP = Gross Domestic Product

DCPS = Domestic Credit to Private sector proxy of banking sector development

MCAP = Market Capitalization

CAB = Current Account Balance

EXR = Exchange Rate

INF = Inflation

Equation (2) will be transformed into ARDL mode

$$GDP_t = \alpha_0 + \sum_{t=i}^p \alpha_{1i} \cdot \Delta GDP_{t-1} + \sum_{t=i}^p \alpha_{2i} \cdot MCAP_{t-1} + \sum_{t=i}^p \alpha_{3i} \cdot \Delta CAB_{t-1} + \sum_{t=i}^p \alpha_{4i} \cdot \Delta EXR_{t-1} + \sum_{t=i}^p \alpha_{5i} \cdot \Delta INF_{t-1} + \beta_1 GDP_{t-1} + \beta_2 MCAP_{t-1} + \beta_3 CAB_{t-1} + \beta_4 EXR_{t-1} + \beta_5 INF_{t-1} + \varepsilon_t \tag{2}$$

The equation two (2) will be used to capture objective 1

Panel Data Analysis

As part of this study, a linear model was used to analyze cross-sectional and time series data in order to isolate banking performance as well as the determinants of bank performance in selected African countries (Nigeria, Ghana, and South Africa) across the G-8. Based on the Hausman specification test approach, a panel data analysis was used to determine the factors that are important for achieving improved performance in the banking sector by applying panel data analysis.

$$GDP_{it} = \alpha_i + \beta_1 DCPS_{it} + \beta_2 MCAP_{it} + \beta_3 CAB_{it} + \beta_4 EXR_{it} + \beta_5 INF_{it} + \mu_{it} \tag{3}$$

Hauseman Test

The hausman test use the following test statistic:

$$H = (\hat{\beta}^{FE} - \hat{\beta}^{RE})' [Var(\hat{\beta}^{FE}) - Var(\hat{\beta}^{RE})]^{-1} (\hat{\beta}^{FE} - \hat{\beta}^{RE}) \chi^2(k) \tag{4}$$

Fixed Effect Model

The fixed effect estimator is a method of estimation that allows the regressors to be correlated with the individual particular effects of individuals in order to correct for endogenous effects, but it still assumes that idiosyncratic errors μ_{it} cannot be correlated with the regressors.

$$Y_{it} = \alpha_i + \beta_1 X_{1it} + \beta_2 X_{2it} + \dots + \beta_k X_{kit} + \varepsilon_{it} \tag{5}$$

Random Effect Model

Based on the Random Effects Model, the error term is assumed to differ for each country, and it also includes a stochastic variable that is non-measurable, which helps differentiate individuals from one another.

$$Y_{it} = \alpha_i + \beta_1 X_{1it} + \beta_2 X_{2it} + \dots + \beta_K X_{kit} + \mu_i + \varepsilon_{it} \tag{6}$$

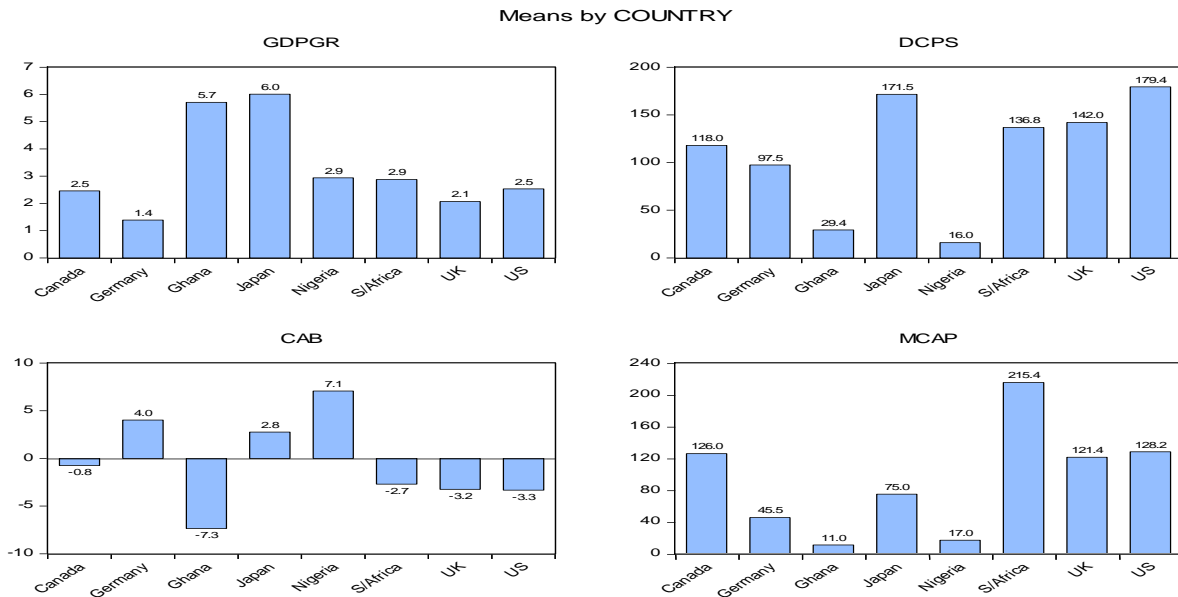
RESULTS AND DISCUSSION

Descriptive Statistics

Table 1

Var	GDPgr	DCPS	MCAP	CAB	EXR	CPI
Mean	3.247559	111.4772	94.82231	-0.439497	32.80625	77.17923
Max	33.73578	221.2885	412.2541	32.54303	253.4923	158.9435
Min	-5.618860	9.013525	3.723800	-12.49198	0.095568	8.726837
Std Dev	3.317629	61.30282	70.92527	5.941841	52.24549	32.08892
JB	12164.57	12.24828	60.28335	439.1560	90.33490	16.02663
Prob	0.000000	0.002189	0.000000	0.000000	0.000000	0.000331

Fig 1



The chart illustrates the comparison of variables between the G-8 countries and African countries. In the G-8 countries, the United States has the highest domestic credit to provide (Banking sector performance) followed by Japan, the United Kingdom, and Canada, Germany has the lowest, and South Africa has the highest in the selected African countries.

Panel Unit Root

The Levin, Lin, and Chu, 2002 method, and the Im, Pesaran, and Shin (IPS) method, will be used to conduct the unit root test, to know whether or not the variables are stationary, by conducting the unit root test.

Var	LCC		IPS	
	Level	First Diff	Level	First Diff
GDPgr	-3.75963 (0.0001)**		-2.22880 (0.0129)**	
DCPS	-0.02701 (0.4892)*		-0.65671 (0.2557)*	-3.24068 (0.0006)**
MCAP	-2.62029 (0.044)**		-2.05760 (0.0198)**	
CAB	-1.69326 (0.0452)*	-4.71847 (0.0000)**	-1.39795 (0.0811)*	-3.80945 (0.0001)**
EXR	1.22828 (0.04650)*	-4.20795 (0.0000)**	0.24195 (0.5956)*	-2.61340 (0.0045)**
CPI	-0.25287 (0.4002)*	-2.93853 (0.0016)**	-0.33113 (0.3703)*	-2.39081 (0.0084)**

Specification levels are noted as * unit root present and ** no unit root presence. Using Levin, Lin & Chu (LLC) and Im, Peasaran & Shin (IPS) for unit root testing, Gross domestic product growth rate (GDPgr) and Market capitalization are integrated at zero I(0) meaning they are stationary at level difference, while other variables such as Current Account Balance

(CAB), Exchange Rate (EXR), Private Credit to the Private Sector (DCPS) and Inflation (CPI) are integrated with order one I(1) meaning they are stationary at first difference.

Co-integration Test Using Pedroni Panel Co-integration Test

Table 2
Alternative hypothesis: common AR coefs. (within-dimension)

	Statistic	Probability	Weighted Stat	Probability
Panel v-Statistic	-3.229948	0.9994	-2.637440	0.9958
Panel rho-Statistic	-0.009385	0.4963	1.045557	0.8521
Panel PP-Statistic	-9.232425	0.0000	-9.372156	0.0000
Panel ADF-Statistics	-2.827509	0.0023	-3.575873	0.0002

Alternative hypothesis: individual AR coefs. (between-dimension)

	Statistics	Prob
Group rho-Statistics	1.922411	0.9727
Group PP-Statistic	-15.56837	0.0000
Group ADF-Statistics	-4.210374	0.0000

Since ADF and PP statistics are less than 5% we reject the null hypothesis and accept the alternative hypothesis, saying that there exists a long run relationship among the variables.

The Hausman Test

Table 3
Correlated Random Effects – Hausman Test

TTest Summary	Chi-Sq Statistic	Chi-Sq. d.f	Prob
Cross-section random	9.453623	5	0.0923

Using the Hausman test described above, we can deduce that the null hypothesis can be accepted since the probability is 0.0923 and is greater than 5% (0.05), which means that we accept the null hypothesis as the random effect is consistent and effective in analyzing the data.

Examine the impact of banking sector in the economic growth of the selected countries

Table 4.
In General Dependent Variable: GDPGR

Variables	Coefficient	Std.Error	t-Stat	Prob
C	4.772778	0.738368	6.463952	0.0000
DCPS	0.011712	0.005643	2.075624	0.0396
MCAP	-0.003726	0.004336	-0.859176	0.3916
CAB	-0.040975	0.048860	-0.838618	0.4030
EXR	0.021114	0.005641	3.743151	0.0003
CPI	-0.040995	0.010137	-4.043623	0.0001
UHAT(-1)	0.271495	0.080504	3.372424	0.0009
Adjusted	0.199291			
DW	2.087200			

Dependent Variable: GDPGR

Method: Panel Least Squares

G8-Countries	African Countries
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Variables	Co-efficient (Std. Error)	T-Statistic	Co-efficient (Std Error)	t-Statistic (Prob)
C	4.297889 (3.651253)	1.177100 (0.2419)	5.424233 (0.622726)	8.710459 (0.0000)
DCPS	-0.004590 (0.009984)	-0.459739 (0.6467)	0.006805 (0.014257)	0.477272 (0.6352)
MCAP	0.023780 (0.0023780)	2.132752 (0.0353)	-0.007614 (0.008299)	-0.917462 (0.3632)
CAB	0.133644 (0.127062)	1.051803 (0.2954)	-0.049021 (0.045099)	-1.086966 (0.2822)
EXR	0.043658 (0.010233)	4.266209 (0.0000)	0.005105 (0.009743)	0.523928 (0.6026)
CPI	-0.044032 (-0.044032)	-1.374291 (0.1724)	-0.0031304 (0.012691)	-2.466625 (0.0170)
UHAT(-1)			0.477007 (0.196116)	2.432267 (0.0186)
Adjusted R-Square	0.233353		0.298149	
DW	1.843997		1.725806	

Based on the above panel general regression, domestic credit to the private sector (banking sector development) (DCPS) and exchange (EXR) are positive and statistically significant for economic growth, whereas consumer prices are negative and statistically significant. Besides market capitalization and current account balance, other variables are insignificant. Changes in domestic credit to the private sector (banking sector development) and in the exchange rate will lead to increases of 0.11% and 0.2% in economic growth, respectively, and increases in the consumer price index will lead to decreases of about 0.4%. 20 percent of the variables have a good fit. In a different panel regression, in the G-8 countries, market capitalization and exchange rate are positive and significant while other variables are insignificant to economic growth. That is one percent change in market capitalization and exchange rate will bring about an increase of 0.2% and 0.4% to economic growth and its goodness of fit is about 23%. In the selected African countries, only the consumer price index is negative and significant while other variables are insignificant to economic growth. That is one percent change in consumer price index will bring about a decrease of 0.3% to economic growth and its goodness of fit is about 30%.

Evaluate the relationship between banking sector development and economic growth in the selected countries

Table 5
Wald Test

Test Statistic	Value	df	Probability
F-statistic	8.886417	(6, 140)	0.0000
Chi-square	53.31850	6	0.0000

Table 4.7: F-statistics for testing the existence of long-run relationship

Model	F-statistic
GDP=f(DCPS,MCAP, CAB, EXR, CPI)	8.8.886417

Critical Value	Lower Bound	Upper Bound
1%	3.725	5.163
5%	2.787	4.015
10%	2.458	3.647

From the above tables, the F-Statistical >Critical upper bound in both 10%, 5% and 1% significant level, therefore there exist a long run co-integration relationship among Banking sector development, other variables and economic growth.

Findings were interesting in this study. Domestic credit to the private sector (banking sector development) (DCPS) and exchange (EXR) are statistically significant economic growth indicators, whereas consumer price index is negatively significant. Economic growth is not affected by variables such as market capitalization or current account balance. Different panel regressions found market capitalization and exchange rate significantly correlated with economic growth in the G-8 countries. There is only one negative and significant variable on economic growth in the selected African countries. Among the selected countries, growth and development of the banking sector have long run relationships. This result conform to the works of other past researchers such as Obiora, Zeng, Li, Liu, Adjei & Csordas (2022), Nguyen (2022), Akinlo & Egbetunde (2010), Cicchiello, Kazemikhasragh, Monferra & Giron (2021) and Bist (2018).

CONCLUSION AND SUGGESTION

Based on the findings, the study recommends the following: This study suggests that policymakers in the selected G8 countries and particularly the three selected African countries should consider improving their banking sectors. As a determinant and an important component of economic growth, the development of the banking sector is also an important factor. In addition, it is recommended that all countries improve their financial sector reform to ensure that the financial sector, especially commercial banks, raises interest rates to encourage savers and reduces interest rates for lenders so investors can invest more. Based on the findings of this study, a long-term economic policy is needed to promote the development and development of a well-functioning banking sector and financial system especially in selected African countries to boost economic growth.

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