DO FINANCIAL DEVELOPMENT AND TRADE OPENNESS MATTER FOR ECONOMIC GROWTH? PANEL EVIDENCE FROM SELECTED WEST AFRICAN COUNTRIES

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Abstract
The study investigates the impact of financial development and openness to trade on economic growth in the selected West African West namely: Benin, Ghana, Niger, Nigeria, and Togo for the period of 2002 to 2023. The study employed cross-sectional dependence tests and the results from the panel unit root test found the mixture of I(0) and I(1). The Westerlund co-integration test confirms the existence of co-integration. After a Hausman test the Pooled Mean Group was utilized, and the result posits that foreign direct investment and financial development are significantly and positively impacted economic growth in the selected countries with coefficients 5.253and 2.600 and the probability values of 0.001 and 0.002 respectively. This suggests that the financial development and foreign direct investment has a significant impact on the economy, meaning that economic growth increase as financial development and foreign direct investment. While, trade openness on the hand, is negative -2.300 with probability values of 0.677, and statisticallyinsignificant, which indicates that increase in trade openness bring about a decrease in economic growth. The study recommends for appropriate financial reform that focuses on inclusive and efficient financial intermediation for economic growth. It also suggests that governments reform their institutions in order to liberalize the foreign sector, remove trade barriers, draw in investors, promote economic diversification for value-added exports, enhance trade partnerships with other countries, and reap the benefits of trade openness in West African countries.

Keywords: Economic growth, financial development, pmg, trade openness.

1.0 Introduction

In macroeconomics, the relationship between financial development, foreign direct investment and economic growth remains subject to debate.Financial development is thought to be the primary force behind economic expansion and is also a major factor in increasing productivity and capital

efficiency. By influencing the percentage of savings, it influences the rate of savings, which in turn influences the accumulation of capital (Pagano, 1993; Levine, 1997). In their pursuit of economic development, developing nations place a high priority on financial development and strengthening.

It is generally recognized that financial development plays a critical role in fostering economic expansion and, both directly by increasing access to financing and indirectly through growth, in reducing poverty. This is accomplished by stimulating the effective use of resources, facilitating trade and payments, and mobilizing savings (ADB, 2020).

Development aid has prioritized supporting the expansion of the financial sector over the last few decades. The ability that leads foreign direct investment toward establishing backward links with the rest of the economy, adopting advanced technology, attracting skilled labor, and making it easier for domestic businesses to access local funding that will allow them to buy new equipment are just a few advantages of a developed As a result, financial development promotes optimal resource allocation and offers more details about projects that have the potential to succeed. A sound financial system promotes the pooling of resources by generating lending possibilities and mobilizing savings. Furthermore, there is a direct correlation between financial development and economic growth in industrialized nations (Olohunlana and Dauda, 2019).It makes it easier for more private businesses to be established, which increases the amount of employment that are available. Giving impoverished people greater work possibilities lowers the economy's poverty rate (Omar and Inaba, 2020).

According to Panjaitan (2022) and Rashid and Intartaglia (2017), financial development helps the poor deal with issues in the financial system, such as asymmetric information and higher lending rates for small borrowers. It also makes formal funding more accessible, which helps people with low incomes manage their resources more efficiently. To put it another way, those with modest earnings will be able to borrow and save money for their enterprises. Financial development may have a cascading effect on poverty through avenues of economic growth.

Theoretically and empirically, financial expansion helps the poor both directly and indirectly by increasing their access to credit and basic financial services, which improves their ability to run businesses (Sehrawat and Giri, 2016). Indirectly, credit expansion helps the poor by creating jobs through expanding credit to businesses.

Research suggests that more affordable interest rates and easier access to loans may allow the impoverished to invest in health care, education, and insurance against unforeseen economic shocks. The economic case for free trade is predicated on the idea that trade liberalization will improve nations' economic development and well-being. Additionally, trade was recognized as a catalyst for inclusive economy growth and poverty alleviation in the 2030 Global Agenda for Sustainable Development (WTO, 2018).Openness of the domestic product to the global community, access to foreign goods not made in the nation, effective resource allocation, access to cutting-edge technologies not found in the domestic market, and the promotion of competition and specialization are just a few advantages of trade liberalization. In this regard, it is anticipated that trade openness will boost economic growth. Many nations, particularly developing nations, have long been concerned about trade openness (Zahonogo, 2016).

The main objective of this paper is to examine the relationship between financial development, trade openness and economic growth among selected West African countries.

2.0 Literature Review

Financial Development, Trade Openness and Economic Growth Relationship

Financial development renders it possible for various organizations to mobilize savings and reroute them toward lucrative investments. As a result, household consumption and private investment rates rise over time, boosting economic growth. The growth of the financial industry makes it possible for different organizations to mobilize savings and redirect them toward profitable endeavors. Over time, this leads to higher rates of private investment and household spending, this boosts economic growth. A well-developed financial system makes capital more accessible as investors have access to knowledge, which promotes economic growth (Strike, 2015).Financial sector operations also have a significant effect on private wealth, business and consumer behavior, and the overall economy's cyclical performance (IMF, 2016; Adusei 2017; Khan, Ahmed & Bibi, 2019). Furthermore, the level of development and management of the financial sector determines its role and impact on economic activity in every given economy.

The degree to which a country engages in international trade by reducing trade barriers such as tariffs, quotas, and regulations is known as trade openness. Economic theory states that there is a positive correlation between trade openness and economic growth. This is due to the fact that economies of scale, comparative advantage, and access to global markets and technologies are all advantages of open economies (Krugman & Obstfeld, 2009). By facilitating resource allocation based on market efficiency, trade openness can enhance economic performance and productivity. Empirical research has usually supported the positive impact of trade openness on economic growth, despite the fact that the strength and consistency of this effect vary among countries and circumstances.Through its impact on the efficient allocation of financial resources to productive sectors, trade openness has the potential to alter the connection between finance and growth. More openness increases the benefits of financial development on economic growth by encouraging competitiveness, technological transfer, and market access (Rajan & Zingales, 2003).However, in economies with weak institutions, trade openness may lessen the economic gains by exposing financial systems to external shocks (Beck, 2002). Thus, the depth of the financial system and the quality of institutions play a considerable role in the moderating effect of trade openness.

Theoretical Underpinning

The work of Schumpeter (1911), who was the first to argue that the growth of the financial sector stimulates economic growth and technical innovation, provides this theoretical framework (Agnes, 2009; James, 2011; Bah et al., 2016). Schumpeter asserts that innovation in the business sector is the primary driver of growing investments and business volatility. New concepts and useful applications for recently created materials, technologies, procedures, and energy sources could be examples of these innovations. The seminal works of McKinnon (1973) and Shaw (1973) later bolstered this, emphasizing that financial liberalization will increase savings, which will then accumulate capital that will be invested and drive economic growth. The Schumpeterian link highlights that innovation funded by financial institutions' credit allocation is what propels economic growth. The financial system facilitates the development of new goods, procedures, and technologies that boost productivity growth by directing capital to creative entrepreneurs (Schumpeter, 1911). By encouraging creative destruction, this credit-financed innovation enables more productive businesses to displace less productive ones. Research demonstrates that robust financial institutions reinforce this relationship between innovation and growth (Aghion et al., 2005).

The theoretical paradigm of Schumpeterian innovation is introduced as:

$$EG_t = A_t K_t^{\propto} H_t^{\beta} \quad (1)$$

Where technological progress is endogenized as

$$A_t = \emptyset(FD_{t,} R\&D_t) \quad (2)$$

Substituting:

$$ln(EC_t) = \beta_0 + \beta_1 \ln(FD_t) + \beta_2 \ln(R\&D_t) + \beta_3 \ln(HC_t) + \varepsilon_t \quad (3)$$

The Schumpeterian relationship is driven by innovation of credit-financed growth.

Empirical Literature

The relationships between financial development, trade openness, and economic growth, as well as their effects on growth, have been the subject of debate in the fields of development economics and finance due to a number of empirical studies that use different variables, analysis techniques, and sample sizes. On the question of whether increased financial development and trade openness promote economic growth, there is controversy.

Afolabi (2022) investigates the impact of financial liberalization and openness to trade on economic growth in Nigeria for the period of 1981 to 2018 using dynamic ordinary least square and granger causality techniques. The study found that financial development impacted economic growth in Nigeria, while, trade openness interaction effects with financial development does not influences economic growth in the country.Study by Olayiwola and Akinbobola (2022) determine the role of financial sector development in relation to inclusive growth and poverty in Sub-Saharan African countries using dynamic common correlated effects and annual time series data from 2000-2019. The study found a positive impact of on growth to poverty at both absolute and multidimensional poverty level in the Sub-Saharan African countries, while a very weak effects of financial sector to growth and poverty level in the West and Central African countries. The study further reveals that financial sector development does not influences inclusive growth in the East African sub-region.

Khatun and Bist (2019) in a similar empirical study found that financial development significantly and positively impacted economic growth, while trade openness to financial services favorably affects economic growth in BRICS countries. The study utilizes panel data for the period of 1990-2012 and dynamic panel data of FMOLS and DOLS estimatorsSin-Yu and Iyke, (2018) applied panel data from 1996 to 2014 of 43 sub-Saharan African countries and found that trade openness impacted financial development in the long-run, while the short-run result is negative and not clear. Moreover, trade openness in the low income countries influences financial development, but in the middle income countries the effects are detrimental, and suggest a non-linear relationship between trade openness and financial development. Oke, and Adegbite, (2018) applied Bayesian VAR (BVAR) approach to investigates the link between trade openness and financial development in Nigeria and the study found that the evidence of positive significant relationship between trade openness and financial development over the period under investigation. In a similar vein, Luo, Zhang and Zhu (2016) found that financial openness and trade openness significantly impacted financial openness, but negatively impacted financial development in both direct and indirect financial sectors. The findings validate an issue of mismatch between China's financial resource distribution and the types of trading enterprises that are distributed around the country.

Studies by Appiah et al., (2020); and Sehrawat & Giri, (2016) found a positive impact of financial development on poverty through growth-enhancing effect. Suleman & Julius (2022) and Nessa & Imai (2022) in their studies found that openness to trade enhances growth and also identified as an engine for poverty reduction in the countries. Gnangnon (2021) employed two –step generalized methods of moment (GMM) of 136 countries for both developed and developing countries for the period of 1995-2017 to investigate the effect of poverty on financial development: Does trade matters? The study discovered that the impact of poverty on financial development in the sample nations is significantly influenced by trade openness. Stated differently, greater trade openness reduces the adverse impact of poverty on financial growth, and for very high trade openness levels, this negative effect may prove useful.Furthermore, the growth of the financial industry is negatively impacted by rising poverty rates, and this effect is manifested in the development of human capital.In fact, higher rates of poverty along with a decreased accumulation of human capital are linked to countries with lower levels of financial growth.

Based on the reviewed literature, findings remain inconclusive, in similar studies reporting both positive and negative using different techniques of analysis such as GMM, BVAR, FMOLS and DOLS. But this study employ dynamic PMG model to examine both short-run and long-run dynamics to address the identified gaps in the literature.

3.0 Methodology

This study uses secondary data. Numerous sources, including publications from the National Bureau of Statistics (NBS), the International Monetary Fund (IMF), the World Development Indicators (WDI), and the International Financial Statistics (IFS), are used for collecting and verifying the data. The analysis is restricted to the variables that were employed, such as trade openness as (import + export)/GDP, GDP, and FDI, and financial development as proxy of domestic credit to the private sector as a percentage of GDP and M2.

The study uses dynamic panel data methodologies to examine the long-term relationship between trade openness, economic growth, and financial development in the selected West African nations between 2002 and 2023.A multivariate regression equation is built so as to empirically examine the nexus between financial development, trade openness and economic growth specified as:

$$LGDP_{it} = \beta_0 + \beta_1 LDCRDT_{it} + \beta_2 LM2_{it} + \beta_3 LOPEN_{it} + \beta_3 LFDI_{it} + \mu_i + \varepsilon_{it} \quad (4)$$

Where,

GDP	=	Economic Growth
DCRDT	=	Domestic credit to the private sector
M2	=	Money Supply
INFL	=	Inflation Rate
TOPEN	=	Trade Openness
FDI	=	Foreign Direct Investment

Hence, β_s are the unknown parameters to be estimated,i is the country cross-country dimension, t is the country's time series dimension and ε is random disturbance term.

i.e. i = 1, 2, 3..... t = 2002, 2003 ...2023,

Cross-sectional Dependence Test

First, the study uses the Cross-sectional Dependence (CD) test developed by Breusch & Pagan (1980), Pesaran (2004), and Baltagi et al. (2012) to see if innovations or shocks in one variable spread to other variables as part of the panel. When cross-sectional dependence is present, a first-

generation unit root test is used; otherwise, a second-generation unit root test is used (Mehmet, Akbas & Gokcen, 2014).

Panel Unit Root Tests

The Cross-Sectionally Augmented Dickey-Fuller (CADF) and CIPS tests (Pesaran, 2007) are used to evaluate the stationarity properties of the variables and determine whether each variable is integrated of order I(0), I(1), or mixture. This test will be used to make sure that the variables are appropriate for long-run modeling and that spurious problem with regression is avoided.

Panel Cointegration Tests

The existence of a long-term equilibrium relationship between the variables is confirmed using the Westerlund (2007) cointegration test, which takes into consideration any cross-sectional dependence. Financial development, trade openness, and economic growth have moved in together throughout time, according to confirmed cointegration.

Panel ARDL (PMG) Estimation

The study uses the Panel Autoregressive Distributed Lag (ARDL) model with Mean Group (MG) and Pooled Mean Group (PMG) estimators to capture both short-run dynamics and long-run connections between the dependent and independent variables. The Hausman test is used to choose the best estimator. This method imposes homogeneity on long-run coefficients while permitting differences in short-run coefficients between countries. The general PMG (Panel ARDL) specification can be written as:

$$y_{it} = \sum_{p=1}^{P} \pi_{i,p} y_{i,t-p} + \sum_{q=0}^{Q} \beta_{i,} X_{i,t-q} + \mu_i + \varepsilon_{it} \quad (5)$$

Where:

y_{it}= dependent variable for country *I* at time *t*); $X_{i,t-q}$= vector of explanatory variables; P and q = lag orders; μ_i= country- specific fixed effects; ε_{it}= error term. The Error correction form is expressed as:

$$\Delta y_{it} = \pi_i \left(y_{i,t-1} - \theta_i^{`} X_{i,t-1} \right) + \sum_{p=1}^{P-1} \partial_{i,p\Delta} y_{i,t-p} + \sum_{q=0}^{Q-1} \gamma_{i,q} \, \Delta X_{i,t-q} + \varepsilon_{it} \quad (6)$$

Where: Δ= first difference operator; $\theta_i^{`}$= captures the long-run impact between financial development, trade openness on economic growth; π_i= indicates how quickly deviations from the long-run equilibrium are corrected each year; $\partial_i and \gamma_i$= capture the country-specific short-run dynamics. To further verify that the MG or PMG estimators are suitable, a Hausman test was employed.

4.0 Results and Discussion

Descriptive Statistics

The descriptive statistics provide fundamental details about the distribution and correlations among the study variables and assist identify possible trends before econometric analysis.

Table 1:
Descriptive Statistics of the selected West African Countries

Variables	Mean	Standard Deviation	Minimum	Maximum	
DCRDT	14.26464	5.745093	3.874003	30.41711	
M2	24.5671	8.789759	6.556239	50.12151	
TOPN	2.872109	0 1.98e+10	.2158798	1.52e+11	
INFL	6.703726	6.773783	-2.489793	31.2559	
GDP	1144.797	715.7142	223.3524	3200.953	
FDI		9.73e+08	1.99e+09	-2.27e+08	8.84e+09

Source: Stata 17 Output.

From Table 1, the data for the sampled countries are normally and evenly distributed. DCRDT has a mean of 14.26 and a standard deviation of 5.74, indicating variations in commercial bank credit over time, with a maximum of USD 30.41 billion and a minimum of USD 3.87 billion. Trade openness (TOP) has a mean of 2.87 and a standard deviation of 1.98, ranging between USD 1.52 billion and USD 0.215 billion. FDI averages 9.73 with a standard deviation of 1.99, fluctuating from USD 8.84 billion to USD -2.27 billion due to economic shocks. Inflation averages 6.70 with notable variability, while GDP per capita averages USD 1,144.79, showing higher dispersion but remaining broadly normally distributed.

Cross Sectional Dependence Tests

The cross sectional dependence tests are presented in Table 2. The table reports all the four cross sectional dependence test employed the study.

Table 2:
Cross Sectional Dependence Tests

Variable	Breusch-Pagan LM	Pesaran scaled LM	Bias-corrected scaled LM	Pesaran CD
DCRDT	70.024 (0.0000)	13.421 (0.0000)	13.296 (0.0000)	7.5567 (0.0000)
M2	97.885 (0.0000)	19.651 (0.0000)	19.526 (0.0000)	5.7248 (0.0000)
TOPN	17.258 (0.0688)	1.6231 (0.1046)	1.4981 (0.1341)	-0.4384 (0.6611)
INFL	37.472 (0.0000)	6.1429 (0.0000)	6.0179 (0.0000)	4.8094 (0.0000)
GDP	169.21 (0.0000)	35.601 (0.0000)	35.476 (0.0000)	12.951 (0.0000)
FDI	44.57 (0.0000)	7.7321 (0.0000)	7.6071 (0.0000)	5.3748 (0.0000)

Source: EViews 10, 2026. Note. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels

From Table 2 shows that all the variables included in the study were found to be statistically significant in all four cross-sectional dependent tests, with the exception of trade openness. Therefore, we reject the null hypothesis and conclude that cross-section dependence is significant. Thus, the second generation unit root test would be used to assess the variables' level of stationarity.

Panel Unit Root Test Result

The panel unit root tests byCIPS and CADF are used to determine the stationarity of all the regressors is presented in Table 3. This is to make it possible to determine the stationarity of the various data for all the selected West African countries and at what level of stationarity.

Table 3:
Panel Unit Root Tests

	CADF Test	CIPS Test	Order of integration
Variables	**Statistics**	**Statistics**	
DCRDT	-1.731**	-3.840**	I(1)
M2	-1.058*	-4.366**	I(1)
INFL	-2.600**	-3.366**	I(0)
TOPN	0.370*	-3.028**	I(1)
GDP	-1.820*	-3.638**	I(0)
FDI	-3.237***	-4.412**	I(1)

Note: ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.
Source: Stata 17 Output.

The Table 3 revealed cross-sectional dependence; unit root tests of the second generation (CADF and CIPS) were used.The results reveal that inflation and gross domestic product are stationary at levels, while domestic credit, trade openness, money supply, and foreign direct investment are stationary at first difference. This suggests a mixture of I(0) and I(1) processes among the variables.

Table 4:
Westerlund Cointegration Test Results for the Variables

Statistic	Value	Z-value	P-value	Robust P-value
Gt	-4.504	-3.214	0.001	0.040
Ga	-2.935	4.223	0.005	0.032
Pt	-9.508	-2.918	0.002	0.020
Pa	-4.661	3.041	0.999	0.510

Source: Stata 17 Output.
Note. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

The Westerlund panel Cointegration result from Table 4 indicates a long-term link between the variables considered in the study.The values are statistically significant with a majority probability. This implies that the null hypothesis of no Cointegration is rejected and concludes that the variables are shown to be stable over the period of time.

Table 5:
Pooled Mean Group Estimation Results

Variables	Coefficient	Prob.
Long-Run		
Constant	630939	0.018
DCRDT	5.25302**	0.001
M2	5.63365*	0.673
TOPN	-2.30e-20*	0.677
FDI	2.60e-07	0.002
INFL	-52.54137**	0.011
Short-Run		
ΔDCRDT	0.0716802	0.433
ΔM2	-0.2851231	0.086
ΔTOPN	-0.0989663	0.102
ΔFDI	0.0319197	0.156
ΔINFL	0.0017399	0.440
ECT (t-1)	-0.0001408	0.029

Hausman Test: 1.0000

Multicollinearity (VIF): 3.00
Heteroscedasticity: 0.0995
Serial Correlation: 0.0762

Note. ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively.
Source: Stata 17 Output.

The results of the impacts of financial development, trade openness on economic growth are presented in Table 5. The result shows that, there exists a positive and statistically significant relationship at 1%level between financial development and economic growth in the long run. Therefore, by enhancing investment and productive activity in the selected West African countries, financial development raises economic growth. This is in line with both a priori expectations and the financial development theory. A healthy financial sector might raise sufficient funds and generate credit for the expansion of the private sector, which would boost economic growth.This study corroborates the finding of Khatun andBist (2019) and Afolabi (2022). The table reveals that there exist a positive and insignificant relationship between money supply and economic growth, suggesting that liquidity expansion does not strongly drive long-run growth. The coefficient of trade openness shows a negative and insignificant effect on the economic growth in the selected West African Countries at 10% level, contradicting a priori expectations and implying that openness may expose the economy to external shocks that dampen growth, suggesting that trade openness does not in any way influences economic growth due to technical and structural issues like poor infrastructure, ineffective trade agreements, brittle macroeconomic indicators, weak institutional quality, and slow technology development could be the cause of the lack of statistical significance. These limitations make it more difficult for the sampled economies' trade policies to successfully convert openness into long-term economic growth. Further limiting the growth-promoting effect of trade are comparatively lower trade ratios as compared to economies in Europe, Latin America, and Asia.

This is contrary with the findings ofSuleman & Julius (2022) and Nessa & Imai (2022) found that openness to trade enhances growth and poverty reduction in the West African Countries are related in the long-run.The table 5, further reveals that foreign capital inflows stimulate growth through knowledge transfer and capital accumulation is supported by the fact that foreign direct investment (FDI) has a positive and significant impact on economic growth in the long-run among selected economies. As foreign direct investment increase will lead to an increase in economic growth.Besides, in the long run, inflation has a negative and statistically significant effect on GDP, suggesting that rising price levels impede economic growth. In addition, a persistent inflation raises production costs, distorts investment decisions, erodes purchasing power, and creates macroeconomic uncertainty, which discourages long-term investment and lowers overall economic productivity.That means high inflation can also introduce high volatility in relative prices and make investment risky. The result of this reveals that some of the economies in WACs are facing macroeconomic problems in their economy due to unfavourablemacroeconomic environment.In addition, the short-run effect of financial development and trade openness on economic growth is, however different. None of the explanatory variables is statistically and economically significant at conventional levels. In the model, the error correction term meets all its condition, that is negative, less than one and statistically significant, it shows that there is a high speed of adjustment, if there is any disequilibrium in the system andconfirming convergence toward long-run equilibrium. This implies that deviations from long-run GDP growth are corrected over time.The Hausman test probability value is 1.0000, indicating the rejection of null hypothesis

and hence PMG is more appropriate than MG estimator. Lastly, the post-estimation test of serial correlation, Hetroscedasticity and multicollinearity are all found valid in the model.

5.0 Conclusion and Recommendations

The study examine the relationship between financial development, trade openness and economic growth in the selected West African Countries namely, Nigeria, Niger, Ghana, Benin and Togo for the periods of 2002-2023 using panel data analysis. The study also utilized both first generation panel unit root and Westerlund co-integration tests. The result posits a mixture of I(0) and I(1), and the panel co-integration test confirmed the long-run relationships among the variables under consideration. Moreover, the empirical result from the model indicates that financial development and foreign direct investment influences economic growth in the selected countries, while, openness to tradefound that there is no significant effect to economic growth in the long-run. Furthermore, high inflation rates resulted in high living costs that adversely affect the economy by stifling growth and redistributing real income and wealth.

Therefore, based on the findings this study recommends that policy makers need to focus on policies that spur the performance of the financial intermediaries and improving financial inclusion. Moreover, to promote financial deepeningthere is need for effective institutional integrity by bolstering property rights, regulatory frameworks, and contract enforcement. Improving openness and governance will increase the effectiveness of credit distribution. Increasing competition and financial inclusion will bolster investment-driven economic growth even further.In order to improve competitiveness and resilience in international markets, trade policies should also prioritize diversification and value-added exports.The respective governments should also initiate prudent macroeconomic policies can result in low inflation to sustain the macroeconomic environment stability. Because of the high inflation rate is a signal to macroeconomic instability that would increase the uncertainty in the selected West African Countries.

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