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The Effect of Financial Liberalisation on Financial Sector Development in The Gambia

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ABSTRACT
The Gambia started its financial liberalisation policies in the mid-1980s with a number of structural and institutional reforms resulting to a marked improvement in the financial sector. The study attempts to establish whether the reforms undertaken have increased financial intermediation thus impacting on financial deepening in the country. The methodology made use of various variables and macro-economic indicators to test the relationship between financial intermediation and financial deepening in an economy, applying stepwise least squares regression method. The study found that The Gambian financial system though shallow, has reported significant improvements over the years compared to the commencement of the reforms in the 80s. Results revealed that improvements in the rule of law, structural reforms, legal enforcements, regulatory reforms and diversification have increased intermediation and help boost the banking and financial system in The Gambia. The economy performed better after these improvements with diversified financial systems including microfinance, licensed bureaus, expansion in insurance companies including Islamic insurance – Takaful.

Key Words: financial, liberalisation, Gambia, reforms, deepening
JEL Code:

INTRODUCTION

Financial liberalisation and the resulting relationship between financial sector development and economic growth led to a debate among development economist that finance leads growth that adopted the reforms. This is evident of developing Sub Sahara African (SSA) countries where financial sector is shallow and under-developed leading to retarded economic growth and development. The lack of innovative financial products and services coupled with low savings rate has hampered the continent's economic growth potentials. In short, the financial intermediation has not developed to a desired level to impact on socio-economic fundamentals. The attraction for commercial banks in the country is mainly attributed to the stable macro-economic fundamentals, the liberal financial policies, high interest rate spreads, peace and stability, protection of investments and other government schemes to promote the financial sector development. However from a strategic viewpoint, the increase in the number of banks (mainly regional bank expansion) was due to the anticipation of the monetary integration of the ECOWAS member states which has a population of over 300 million in sixteen countries.

Since the deregulation of the financial system in The Gambia by mid-1980s, a number of reforms have been carried out to improve the financial system[1]. Notable among these are the amendment of the CBG Act in 2005, enactment of the Banking Law 2009, Non-Bank Financial

[1] As in most SSA countries that of The Gambia was a gradual process. See Appendix I for the process stages.

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Institutions Act, 2016 and the improvement in the regulation of the semi-formal sector of the unlicensed forex bureaux, the setting up of the Credit Reference Bureaux (CBR), Collateral Registry and the newly enacted National Payment System Act, 2016 being implemented.

As The Gambia does not have a stock exchange[2] and other well-developed financial markets, the intermediation is still dominated by the banking industry. With the importance of a good financial system in the country and the high number of banks that have entered The Gambian financial system in recent years, it is important to carry out a study to examine how deep the financial system is in relation to the number of banks in the country and the liberal financial policies. In short, the impact of liberalisation on the financial system and its depth is what is being investigated. Deregulation was meant to do away with repressive policies such as interest rate controls, credit ceilings and control of foreign exchange rates among others.

The study covers the period 1985 to 2010 to determine how deep the system is with the deregulation and the subsequent increase in the number of commercial banks. The rest of the chapter is organised as follows: it presents the objectives of the study, the Methodology used, the limitations and the study's structure in the last section.

The objectives of the study examine the impact of financial liberalisation and reforms on sustained and effective financial intermediation in The Gambia from July 1985 and December 2010 in areas such as funds mobilisation, credit allocation by banks and the level of monetisation. Also examine how financial reforms led to financial sector deepening in The Gambia using the stepwise least squares regression method championed by Nzotta & Okereke (2009).

This paper is arranged into six parts. Section 1 introduces the paper followed by a background of the study. Section 3 shows the methodology adopted in answering the research objectives. Section 4 outlines the detailed literature review on financial liberalisation in developing countries. Section 5 presents the results of findings and the paper ends with summary of conclusions and recommendations.

Background of the Study

The Gambian financial system is dominated by the banking industry. It comprised the Central Bank of The Gambia (CBG) at the apex and twelve commercial banks[3] including one Islamic bank, a post office, eleven insurance companies[4], three financial companies, sixty-five village savings and credit associations (VISACAs), fifty-four credit unions and ninety-seven foreign exchange bureaux in 2018. The number of banks was five in 2004 rising to seven in 2007 and thirteen in 2010 with Zenith Bank (G) Limited being the latest entrant.

Despite the banking sector's dominance, it remains shallow, lacking merchant banks, development banks and a stock exchange. The banking industry is highly concentrated, with three banks controlling 49.0% of total loans and 62.6% of the deposits in 2009[5]. The percentages shifted slightly in 2010 to 50.99% on total loans controlled and 59.53% of total deposits (CBG, 2010). Factors responsible for the changes in percentages could be that the bigger banks are gradually losing their market shares, partly due to growth in other banks and the entrance of new banks.

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[2] Though preliminary efforts I terms of traing are being made to house one at Central Bank of Gambia
[3] The term Commercial Banks is generic and includes one Islamic Bank in the Country
[4] The Insurance companies too include one Islamic Insurance company – Takaful
[5] Sourced from the Central Bank of The Gambia's publications and authorised papers presented at official forums

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With the need to develop the country's economy and lay the basis for sustainable growth, The Gambia adopted the Economic Recovery Programme (ERP) with the help of the IMF and the World Bank in August 1985. The ERP was primarily directed to regain control of credit expansion by the banking system especially to the government and among other measures in the package was the liberalisation of the economy.

One notable development of the liberalisation adopted is the increase in the number of banks in the country. This has increased the competition but intermediation level did not match the increase as most are cautious of the build-up up of non-performing loans. However with the establishment of a Credit Reference Bureau, which facilitates access to borrowers' database by banks, has markedly reduced information asymmetry and improved the loan review process in banks, where bad debtors are denied financing by other banks.

It is shallow even for a developing economy; some of the causes are the size of the economy, the population and lack of resources. The overview will cover the apex institution - central bank, commercial banks, and financial institutions.

The Central Bank of The Gambia (CBG) is the regulatory institution for all the commercial banks, insurance companies, foreign exchange bureaux and microfinance institutions in the country. It issues licenses and can revoke them if the institution does not conform to prudential and regulatory guidelines under which the licence was issued. The Bank played a crucial role in the financial liberalisation process by amending financial laws relating to banking, microfinance, insurance, electronic money transfer, money laundering and terrorist financing Acts, among others. The liberalisation also led to considerable legal and structural reforms including the establishment of commercial court to enforce contracts timely. The financial sector had gradually deepened as the ratio of M2/GDP has more than double since 1986 from 25% to 52% in 2007 (Sriram, 2009).

The financial system is dominated by banks and at end 2010 there were thirteen banks, including one Islamic Bank. All banks are privately owned and foreign participation is high with seven from the sub-region. Though banks dominate the financial system, the level of financial intermediation is low and banking is highly concentrated.

Other than the banks there is a postal office which, like the banks do take deposits though small as do the Village Savings and Credit Associations (VISACAs). These are spread over the country and in the rural areas in particular. Most of the funds they collect are invested in the commercial banks or in treasury bills which is now common as the awareness level has increased since their inception in January 1986. Other forms of institutions are the registered foreign exchange bureaux. With tighter regulations on them after the amendment of the Central Bank Act of 2005, the bureaux funds channelled through the commercial banks have since improved.

Other financial institutions that exist are the insurance companies, whose activities are not as strong as the banks. Presently, there are eleven of them, including an Islamic-compliant "Takaful". There are 65 village savings and credit association (VISACAs), 80 credit unions and 3 finance companies mobilising deposits at the lower end of the market and revolving these funds as credit to promote the financing of micro and small enterprises in both rural and urban areas.

METHODOLOGY

The source of data to conduct this study were accessed from the Central Bank of The Gambia and The Gambia Bureau of Statistics (GBOS) such as interest rates, prudential regulation and other macro-economic indicators that will best predict the relationship between financial sector liberalisation, financial intermediation and deepening in The Gambian economy. The methodology employed by (Nzotta & Okereke, 2009) using the stepwise least squares regression with additional variables incorporated in the equation.

Model Formulation

In the model, financial deepening, defined as the ratio of Broad Money Supply to Gross Domestic Product (M2/GDP), depends on the ratios of Financial Savings to GDP (FS/GDP), Private Sector Credit to GDP (PSC/GDP), the rate of Inflation (INFLA), Prime Lending Rates (PLRA), Currency held Outside Banks to Money Supply (COB/MS2) and a Dummy as follows:

$Y = f(X_1, X_2, X_3, X_4, X_5, X_6, dummy)$

M_2/GDPit = f (COB/M_2 INFLAit, PLRAit), FS/GDPit, PSC/GDPit, DMBAit, + DUM

Where Y = Broad Money Supply/ Gross Domestic Product (M_2/GDP)
COB/M2 = Currency Held Outside Banks to Money Supply
INFLA = Inflation
PLRA = Prima lender rates
FS/GDP= Financial Savings/ Gross Domestic Product
PSC/GDP = Private Sector Credit/ Gross Domestic Product
DMB = Deposit Money Banks

The relationship between liberalisation and financial deepening is examined by a regression of the financial depth variable on financial savings, private sector credit, and value of cheques cleared, the inflation rate, the lending rate and currency held outside banks. The reason for this, is financial liberalisation is meant to improve or impact positively on the above variables. In other words, the research question will answer whether financial liberalisation affects positively or negatively financial sector development.

Specification of Variables

i. Financial deepening Index (M2/GDP) – explain the relationship between the reforms and financial depth. If the level of deepening has increased then it indicates that the financial institutions have increased the level of intermediation. The liberalisation policy is meant to improve the financial sector therefore if it impacts positively then we should expect this ratio to increase.
ii. Financial savings ratio - Its inclusion is meant to capture the impact of liberalisation of savings rates on financial deepening. With rates determined by market forces and the financial institutions competing for funds from savers, the rates are likely to change, especially if intermediation is happening. If savings rates are favourable to savers, then we expect the savings to increase and this in turn will increase the bank deposits and loanable funds to productive sectors of the economy.
iii. Inflation - The inclusion of inflation will enable the capture of the impact of inflation on the various components of money, as it can adversely affect all forms of money.
iv. Lending Rates - Lending rates have an impact on financial intermediation and deepening. With high rates, the borrowers' demand will fall as the cost of funds will keep them away. Increased competition can help to lower rates. For deepening to be improved borrowers need to be able to get access to the funds they need at reasonable cost.

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v. Deposit Money Banks - The introduction of ATMs may also play a part as people will prefer to have their cash in banks from which they can withdraw with ease. The ATM introduction will be examined to see whether it did play a part. With easy access to cash the need to keep bulk cash at home especially by traders decreased. An increase in this variable is an indication that the economy, to some extent is becoming less cash intensive and the awareness of banking is increasing.

vi. Private Sector Credit - With a deepened financial system, we should expect to see private sector credit increase with expanding intermediation process. PSC/GDP ratio will help to determine the strength of financial intermediation. An increase of this ratio will be an indication that funds are being channelled to the private sector and this is the role of the financial intermediaries. They should mobilise funds and channel them to meet needs of borrowers.

vii. Currency outside Banks - If the financial system is deepened then the level of currency outside banks should be low as there will be financial products to capture the funds from those with surplus through the various means of financial instruments that are available in a developed financial system for short to medium and long term investors.

Hypotheses Formation

In order to find out the impact of liberalisation and whether it has enabled banks and other financial institutions to improve financial intermediation and thereby influence financial deepening in the country, the hypotheses for the study are:

i. Levels of financial savings, and deposit money banks deposits levels have a significant and positive relationship with the level of financial deepening in The Gambia;
ii. Is there any significant relationship between the financial deepening ratio (M2/GDP) and lending rates and private sector credit;
iii. Does financial deepening has a significant relationship with the level of currency outside banks.

The Gambia financial system was deregulated like most Sub Saharan African (SSA) countries in the 1980s. The model accurately tests for effectiveness of intermediation process and financial sector deepening during the period of liberalisation up to 2010.

Financial liberalisation entails various measures, such as interest rate reforms, bank denationalisation, prudential regulation, abolishing directed credit and free entry into banking. Analysing just the impact of interest rates reforms on the financial deepening of The Gambia may be narrow as financial liberalisation and its impact on financial development and economic growth entail more than interest rate reforms.

LITERATURE REVIEW

Financial liberalisation does entail different policies such as bank denationalisation and restructuring, interest rate liberalisation, prudential regulation, directed credit abolition and free entry to banking (Fowowe, 2008). Liberalisation is a key instrument for financial sector development and this has over the years attracted much research into the study of the relationships between financial sector development, financial deepening and economic growth (Levine 1997; Djankov et al. 2007; Demetriades & Hussein, 1996; Demirguc-kunt 2007, Demirguc-kunt & Levine, 2008).Though the theory of financial liberalisation was pioneered by (McKinnon, 1973) and (Shaw, 1973), several studies including (King & Levine, 1993a, 1993b; Odhiambo, 2009; Schumpeter, 1911) have argued that finance leads economic growth.

There has been consensus among many development economists, including Becks, Demirguc-Kunt, Laeven & Levine (2005); Levine (1997); Demirguc-kunt (2008) and Hussein &

Demetriades (1996) that financial sector development relieves constrains on enterprise financing obstacles. Accordingly, Levine (1997:688-726) argued that financial sector development is an important ingredient as it makes credit available for SME financing, thus enhancing economic growth. Enterprises' lack of access to credit has been identified as one of the factors that not only engender poverty and income inequality (Demirguc-Kunt & Levine, 2008) but also constrain economic growth and development (see Flessig, 1996) . There is general consensus among many researchers on a positive finance-growth nexus and substantial empirical evidence exists that supports this trajectory (Levine, 1997, Hussein & Demetriades, 1996, Demirguc-Kunt, 2008).

The theoretical and empirical research on financial development and economic growth is reviewed with the evidence suggesting that both financial sector development and markets matter for enterprise finance and growth under conditions of stable macroeconomic environment. The theory further shows that financial sector development relaxes external financing obstacles facing SMEs which confirms that financial development influences economic growth (Levine & Demirguc-Kunt, 2008; King & Levine, 1997; Rajan & Zingales, 1996).

The policy arguments of McKinnon/Shaw school was that policy restrictions in the financial sector regarding setting interest rate ceilings, raising reserve requirements and directing credit allocations by governments, may reduce lending to SMEs and distort the pattern and speed of financial development, hence constraining economic growth (Levine, 1997; King & Levine, 1993b and Beck et al, 2005). Such policies may reduce banks' liquidity, slow down competition and set in inefficiencies in the banking sector. However, doubts were expressed by some economists, such as Lucas (1988) and Chandavarkar (1992) on the role of financial system in economic growth and development. Despite contrary views, the works of Levine (1997) on cross-country case studies at industry and enterprise levels and Rocca et al. (2009, 2011) showed empirically the lack of financial development crucially affects enterprise financing and the speed and patterns of economic development. The study of Love (2003) also found strong negative nexus between sensitivity of investment and financial market development and found that financial development decreases the effects of financing constraints on investment and relaxes small-sized enterprises financing bottlenecks (Laeven, 2003; King & Levine, 1993b).

The works of Hussein & Demetriades (1996) and Levine & Demirguc-kunt (2008) are indeed robust on financial sector development – financial deepening nexus, (also see Jaabi, 2014). This is evident in most developing economies like SSA where financial sector is shallow and underdeveloped with commercial banks failing to show much presence in financing small enterprise market. This coupled with market imperfections; institutional weaknesses and poor infrastructure make enterprise financing a huge challenge in LDCs of SSA. Much collaboration, adoption of technologies in financial products delivery, addressing collective action problems and crucial role of public sector agencies can be viable way forward in increasing SMEs' financial access.

Acceleration of economic growth was the reason for adopting financial liberalisation which enables financial deepening which in turn leads to economic growth. This argument can be found in (Shaw, 1973) in which he argued; "Financial deepening is one technique for attaining income, savings, investment, and distribution effects that can assist to escape from underdevelopment".

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The “finance leads growth” hypothesis is the most popular among the proponents of financial liberalisation as they argue that growth in the financial sector does lead to real sector growth; but, in recent studies, other causation patterns, though not strong and significant have been exhibited by the works of critics of this hypothesis.

The debate on the causality patterns had widened but what is certain is that the relationship between financial development and economic growth is country specific and to some extent depends on the strengths of components and variables used to examine the nexus. With the development of financial infrastructures and the development of financial services with a wider choice, financial deepening takes place.

Financial deepening has several different measurements but this paper relied on broad money to Gross Domestic Product (GDP), expressed as M2/GDP, inflation, financial savings to GDP, private sector credit to GDP, deposit money banks to GDP. The rational for this, according to (Nzotta and Okereke, 2009), is that the more money is in the economy– liquidity, the more the opportunities exist for continued growth in the economy. The non-availability of data on financial assets such as value of shares due to lack or low developed stock markets in SSA countries is yet additional reason.

In a study to determine the long-run link between finance and growth,(King and Levine, 1993b), have showed that financial sector development can lead to economic growth. They argued that a more developed financial system can foster productivity as a better financial system can stimulate economic growth by accelerating the rate of productivity enhancement. Their findings suggest that government policies may have an important causal effect on long-run growth. This is in line with the conclusions on the financial liberalisation policies and economic growth in the SSA countries by (Fowowe, 2008), who suggested that the financial reforms in the SSA countries did not yield better results but instead resulted in financial crisis; the reforms should be seen as long-term solutions that need the political will on the part of governments to put in the right structures and policies.

On the works on interest rate reforms in Kenya and financial deepening, (Odhiambo, 2009) found that finance leads growth causality predominates in Kenya. His approach was two-fold: first he examined the impact of interest rate reforms on financial deepening in Kenya and secondly the causal relationship between financial depth and economic growth using regression analysis of the financial depth variable on real income, deposit rate, expected inflation and a lagged value of financial depth. His findings concluded that interest rate reforms did have a positive impact on financial depth in Kenya and that the supply leading hypothesis exists.

In a study of interest rate liberalisation in five African countries, namely Ghana, The Gambia, Kenya, Nigeria and Malawi in a working paper for the International Monetary Fund (IMF), (Turtelboom , 2006) examined the impact of financial liberalisation carried out in these countries in the mid-1980s to 1991. He advanced reasons such as excess liquidity and non-performing loans as the causes of high interest rate spreads as well as a lack of sound structural features. Findings in this report indicated that financial deepening did not take place in these countries, though marginal improvements were recorded post-implementation of reforms. Structural features, like having credit reference bureaux, could have curbed the high number of non-performing loans, (Oduor et al., 2011)

In the case of Tanzania (Odhiambo, 2010b), examination of the relationship between interest rate reforms and economic growth revealed that there exists a positive relationship between

the two, but the test failed to reveal a finance led growth. Instead, the real sector drove financial sector development. The reasons for this may be due to the repressive policies adopted by the country after independence, such as control of banks by the state and the slow pace of liberalisation. The slow pace may be the most important factor as although the country started liberalisation in the 1980s, it was only in the 1990s that fully fledged financial reforms were implemented; (Akinboade, 2000). In a study of the relationship between financial deepening and economic growth, (Akinboade, 2000), found that financial development and economic growth are independent of each other. This may be due to the lack of industrialisation in the SSA countries.

The investigation of causality between financial development and economic growth in Turkey in March 2011,(Demirhan et al., 2011), using bank credit to the private sector and total market capitalisation chosen as proxies for financial development, the findings revealed that financial development contributes to economic growth in the long run. (Demirhan et al., 2011) summed it up in their conclusion that the direction of causality remains unresolved in both theory and practice as the relationship between financial development and economic growth is country-specific.

In a study of five Latin American countries, (Argentina, Brazil, Chile, Colombia and Mexico), (Nazmi, 2005) examines the impact of banking and financial deregulation, financial deepening on capital accumulation and growth and found that from the panel data of the five countries, financial development had played a positive and significant role in fostering investment and economic growth in Latin America. The findings agreed with earlier work of (Bencivenga and Smith, 1991) in that the role played by financial intermediaries especially banks, in the mobilisation of savings and investments as liquidity needs can be addressed by the banks. Without financial intermediaries, those with surplus funds may have to maintain the liquidity needs and keep unproductive assets, thus the need for governments to cease financial repression and legislate financial institutions and structures that will enable liberal financial systems.

An empirical study using causality tests to investigate the validity of “the two competing but mutually exclusive hypotheses” in the context of ECOWAS countries (Atindéhou et al., 2005), found a weak causal relationship between finance and economic development in West African countries. Economic development impacts on finance in Burkina-Faso, Mauritania, Niger, Nigeria, Sierra Leone and Togo while financial variables seem to explain economic development in Ivory Coast, Mali, The Gambia, Mauritania and Sierra Leone. The study found the evidence that the banks dominated the financial intermediation, but the credit allocated by them did not impact significantly in the economic development of these countries. This agrees with the report of the (NEPAD-OECD Secretariat, 2009) on the lack of depth of the African banks.

The failures of the financial liberalisation are not only to be found in West African bloc but in all SSA countries. Financial liberalisation in Africa, after the change of the policies on controls of their economies and the focus on building and sustaining development banks to encourage economic development; was intended to make African economies more efficient and attractive for foreign capital and investment. According to (Mkandawire, 1999), African countries policies have placed greater emphasis on stabilisation and debt management aspects of financial policy than on the resource mobilisation and allocation aspects.

With the lack of consensus on finance-growth nexus, it is clear that the causality patterns are country-specific, and that there is no prescription that fits all countries; clearly more studies

need to be carried out on the subject, this paper examining financial liberalisation and growth nexus.

The reasons why the liberalisation did not induce high growth in SSA countries when compared with others are the same for most developing countries that did not realised high growth. They range from inadequate regulatory frameworks, underdeveloped financial and capital markets and a lack of financial products that can enable them to carry out proper intermediation. A lack of industrialisation and productive sectors that can raise demand for funds also played a part. Finally, the reforms were not thorough enough as the regulatory institutions took far too long to be setup by the authorities.

FINDINGS

The findings are presented in three broad areas: performance of the variables selected, macroeconomic indicators and regression results. The findings revealed that the variables that were used to determine the level of financial deepening and explore the depth of intermediation in The Gambia have less performed. The financial system had remained shallow throughout most of the period covered despite the fact that a lot of reforms took place during the period of study. Overall the variables improved except the interest rates and Currency Outside banks in the latter period.

Performance of Variables and Macroeconomic Indicators

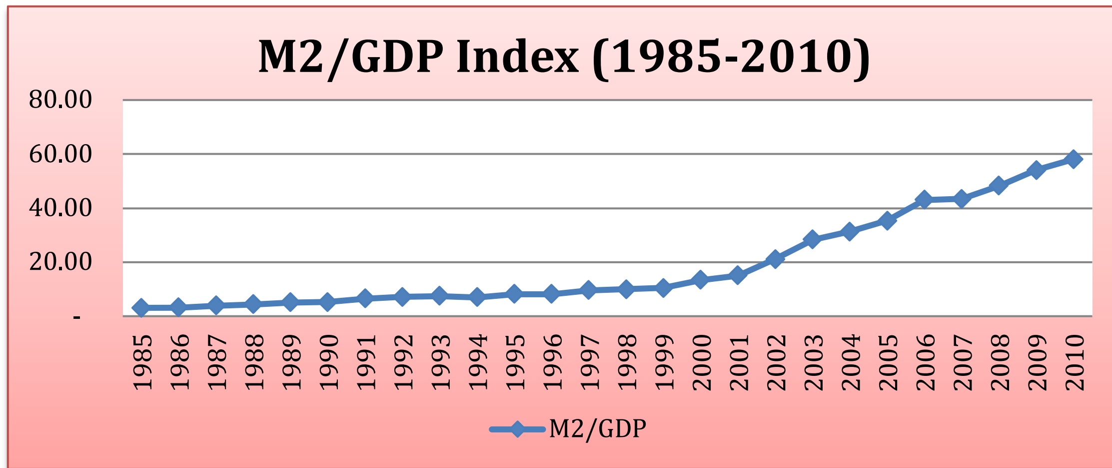
The rise in the Money Supply slowed down but the reforms led to increase of commercial banks as well as diversification of the financial sector to include VISACAs, credit unions, financial bureaus and finance companies. This is coupled with the expansion and sophistication of banking sector manifested by broad money (M_2) showing a steep rise from 2000 onwards.

This is explained by an indication that financial deepening and economic growth accelerated in post liberalisation though slow and steady in the first decade until 1994 when it dropped associated with the military takeover but picked-up in the following year. With the increase in the number of banks, coupled with the vigorous drive on reforms from 1999 to date, the ratios of growth rate did accelerate from year to year increase of 1% to 3-7%. This was a proof that increased financial intermediation did have an impact in the economy.

Money Supply to GDP Ratio

The financial deepening index (M2/GDP) has moved from 3.09 in 1985 and grew gradually to 7.49 in 1993 and it is worth to note that this was preceded by the enactment of the CBG Act, 1992 and Financial Institutions Act (FIA) 1992 to incorporate Islamic banking. The index dropped in 1994 to 6.47 as a result of the change of government but quickly picked up in the following year. With the increase in the number of banks and the pace of reforms the index continues to grow. Though the growth looks impressive, it should be noted that the index is small and unstable compared to those in the sub-region such as Nigeria (Nzotta, 2009). However, The Gambia's ratio is compares favourably with countries in the sub-region except Nigeria. Overall the index did show that financial deepening has improved but the real impact took a decade as it was in the 2000s that the ratio improved significantly explained by stable macro-economic indicators, consolidation of reforms, diversification of financial sector, among others increase confidence in banking sector..

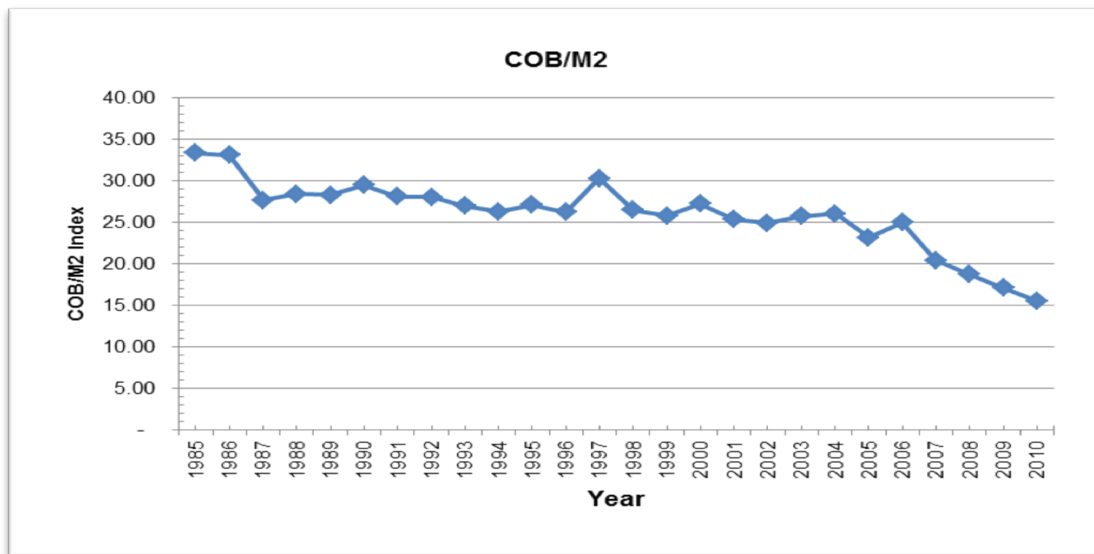
Figure 1: M2/GDP Performance



Currency Held Outside Banks To Money Supply Ratio

The ratio of currency held outside banks to GDP has shown a decline from 1985 when it was 33.34 and declined by close to half, to 15.53, in 2010. The decline has not been smooth as it fluctuates over the twenty-five year period. It starts to have a steady decline in 2000 which is an indication of the confidence in the banking system boosted by the expansion of bank branches and the introduction of internet banking, cash collection, increase in the number of ATMs, swift exchange. With the payment system being implemented the index is likely to further reduce in the coming years.

Figure 2: COB/M2 Performance



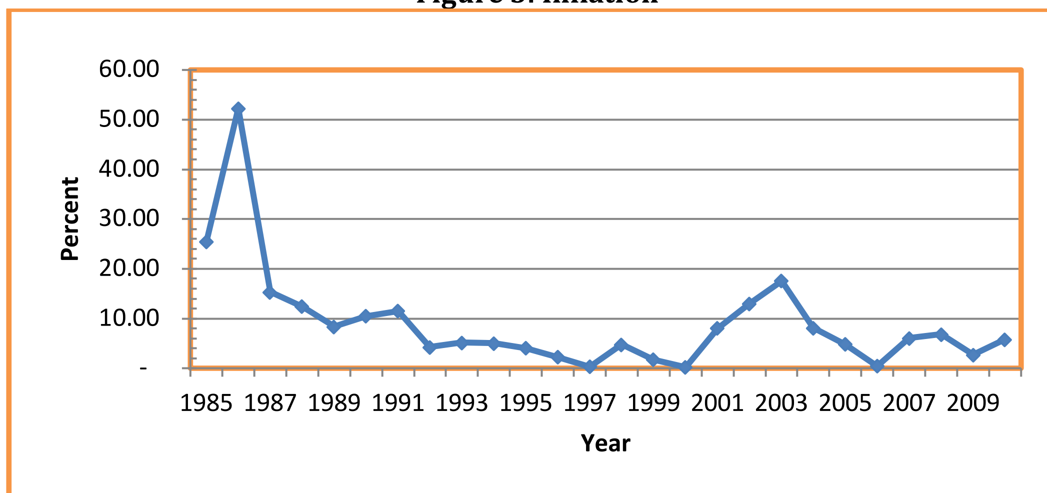
Lending Rates

Lending rates, as in most SSA countries after liberalisation, continued to increase which was due to the high cost of doing business and high information asymmetric. The increase in non-performing loans, increased cost of capital, adverse business environment have led to the high cost of lending to cover the high risk profile. The rates started to decline in 2005 and this was partly due to the implementation stage of the CRB in The Gambia and the introduction of the Tax Identification Number (TIN) to identify persons in transacting business. The CRB implementation process had helped in the reduction of information asymmetric and improved the loan review process in banks, where bad debtors are denied financing by other bankers. Rates however, have remained high at 27% since 2008 inclusive of credit insurance premiums.

Inflation Variable

Inflation rose sharply from 18.3% at the beginning of reform and stabilisation programme to 56.6% in 1986. This was due to the commencement of the IMF and World Bank directives under the macroeconomic and stabilisation programme. With stabilisation achieved in 1988 (Turtelboom 1991), inflation continued to decline with the central Bank's and WAMZ objectives, among others of keeping inflation rate under "single digit" has maintained until the 2002/2003. It thereafter remained a single digit through to 2010.

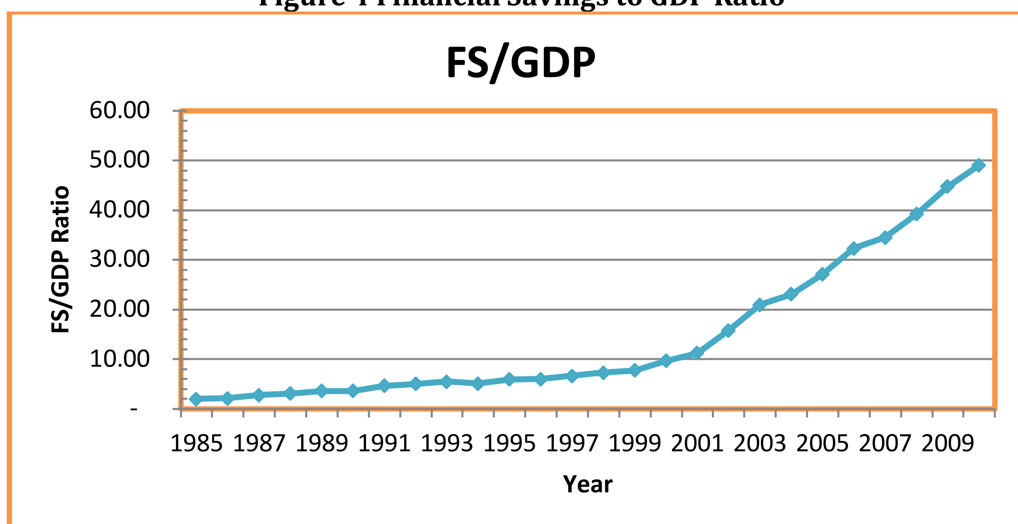
Figure 3: Inflation



Financial Savings To GDP Ratio

The FS/GDP growth index reported a marginal increase until 2001 when growth rates increased significantly. Like the other indicators, this was the time of improved financial sector development in the country and the confidence of the banking system improved. The savings levels of the MFIs, such as Financial Companies and VISACAs increased from D32.0m to D389.9m in 2010.

Figure 4 Financial Savings to GDP Ratio

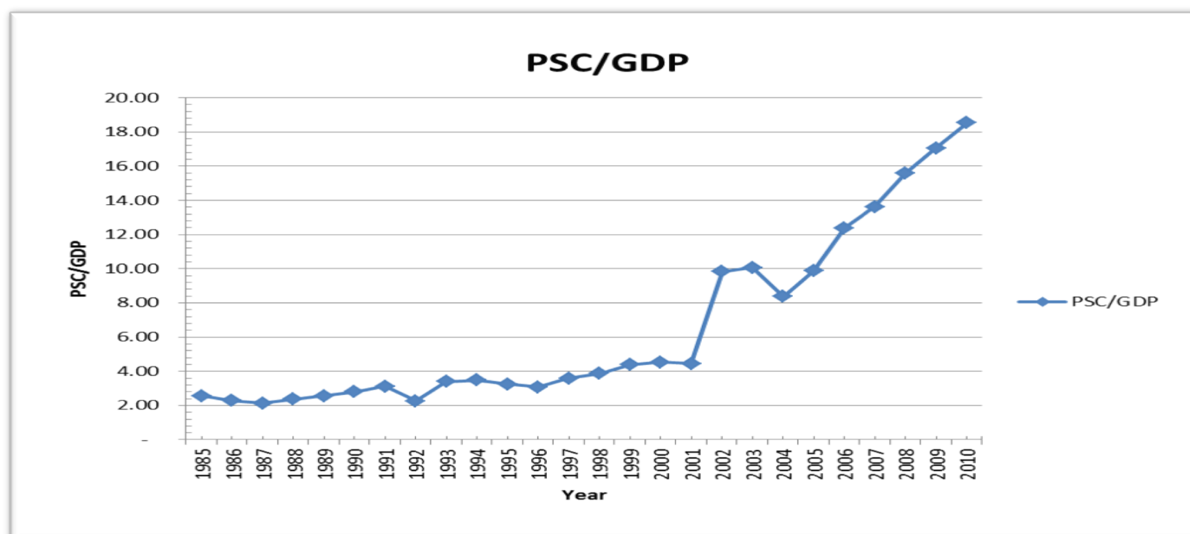


Private Sector Credit To GDP

Private Sector Credit to GDP ratio was quite low in 1985 through to 1992, indicating the reluctance of the financial intermediaries especially banks to lend to the private sector, particularly under periods of unstable macro-economic conditions - high interest rates and increasing non-performing loans. Due to effective risk management measures and the strong

stance of regulatory authorities on resources, the rate fell as banks were to meet strict regulatory requirements. It rose thereafter to 10.06 in 2003, the highest since the commencement of the reforms. With the structural reforms, particularly the CRB, the index has shown an upward trend in recent years reaching 18.53 by 2010.

Figure 5: Private Sector Credit To GDP Index



Deposits in Money Banks To GDP

The banks' balance sheets continued to rise and the index has shown a sharp upward trend due to financial sector diversification, inclusive financial services capturing remotest areas through the MFIs, VISACAs and credit unions inculcating the habit of savings and investments in members. This coupled with increases in bank branches and agencies have resulted to expansion in savings and lending by banks and other financial institutions.

Regression Results

Regression results suggest a very strong relationship between the variables (R^2 = 0.998), adjusted - R^2 = 0.998, and F540.902, indicating that the estimated coefficients are statistically significant. Each of the individual estimated coefficients, with the exception of X_6, is statistically significant at 1% and 10% levels, so that all variables except X_6 (Deposit Money Banks to GDP) are contributing to the explanation of Y.

The explanatory power of the multiple regressions is measured by the coefficient of correlation R and coefficient R^2. The implications are that 99.8% of the variables used in the equation explained the relationship between financial liberalisation and financial deepening during the period. Correlations coefficients measure the degree of relationship between two variables. The signs of the coefficients (+/-) help to explain the direction of the relationship.

COB, PSLR, FS, PSC and DBM are positively related to the financial deepening ratio while the INFL is negatively related. From the data used, the signs are expected as inflation has been decreasing and kept under single digit while the other ratios increase over the period of study.

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Table 1: Summary of Coefficient Signs

Independent Variable	Expected Coefficient	Actual Coefficient	Comments
COB/M2	Positive	Positive	Expected, as financial intermediation increases, M2 is expected to rise
INFLA	Negative	Negative	Expected, inflation needs to slow down or fall for M2 to increase
PLRA	Negative	Positive	Not expected due to high interest rates
FS/GDP	Positive	Positive	Expected, financial savings ratio growing over the years
PSC/GDP	Positive	Positive	Expected, private sector credit rises with financial sector development
DMB/GDP	Positive	Positive	Expected, level of intermediation process rises with financial sector development.

Table 2: Regression Analysis

	Coefficient	Standard Error	Probability
Constant	-14.821	3.189	0.0002***
X1	0.4078	0.1	0.0006***
X2	-0.0649	0.0477	0.0016***
X3	0.1527	0.0432	0.0022***
X4	0.9931	0.2385	0.0005***
X5	0.4490	0.2234	0.0589*
X6	0.1053	0.179	0.5634
R Square	99.9%		
R Square (adjusted)	99.8%		
F-ratio	2.5403		

Source: Author's Survey 2011. Note * and * refer to statistical significance at 1% and 10%**

All the independent variables show a significant relationship with the dependent variable (M_2/GDP- financial deepening proxied here as financial sector development) except X_6 (DMB/GDP) while X_2 (INFLA) shows a negative and significant relationship with financial sector development at 1%. X_6 reported a positive relationship though not significant but X_5 (PSC/GDP) showed a positive and significant relationship at 10%, all others X_1-X_4 show significant relationship at 1%. With the above, we accept hypotheses i, ii and iii as there is a positive and significant relationship with M_2/GDP.

Use is made of Pearson correlation to test for relationship between each independent variables and dependent variable. The matrix indicates that there is a strong positive correlation between the dependent variable (M_2/GDP) and FS/GDP, PSC/GDP and DMB/GDP while a strong negative correlation exists between M_2/GDP and COB/ME and a weak negative on INFL. It is expected that the performance of GDP will impact on all the variables that have a relationship with financial deepening. If GDP performs well it is likely to cushion the variables that exhibit strong positive correlation.

COB/M_2 (X_1) exhibits strong negative correlations with all other independent variables expect INFLA and a weak negative one with PSC (X_3). For INFL, it exhibits a weak negative correlation on all independent variables ranging from 10% to 27%. Overall the matrix exhibits what is expected i.e. the FS/GDP, PSC/GDP and DMB have a strong correlations to the M_2/GDP.

The macroeconomic variables selected did reveal that The Gambia's financial sector was shallow, as it did not have all the sophisticated products and services to significantly mobilise funds and offer loans at competitive rates. Neither savers nor borrowers were better served with high interest rates and low investment alternatives. Due to the fact that majority of the

population are found in the informal sector with micro and small-sized enterprises, often non-registered coupled with weak effective demand for loans and adverse business environment, it becomes difficult for financial intermediaries, particularly banks to extend loans to these groups at lower rates. However, with these challenges, banks and other financial institutions must exploit introducing innovative financial products and services to boost savings mobilisation and lending for growth. The mobile banking, mobile phone platform, agency banking, POS terminal, internet banking, among other have made considerable differences in financial inclusion drive in many parts of the globe including Safaricom, MTN in Eastern Africa, South America and some parts of Asian region.

CONCLUSIONS AND IMPLICATIONS

From the analysis carried out it can be seen that the level of financial deepening had remained relatively low in The Gambia for most of the years in the period of the study due to a number of factors that are common to the SSA and ECOWAS countries. The selected macroeconomic indicators for the period covered has revealed that financial reforms have helped to improve financial deepening to an extent which has been greatly augmented by the increase in the number of intermediaries which were attracted by the liberal policies adopted by the regulatory authorities.

Due to the importance of the banking industry and the entire financial sector to the economy of the country, it is important for policies to be adopted to further strengthen and improve the financial sector. Such policies include the continuation of the reforms and strengthening of the structural and institutional framework. A lot has been achieved over the years but still more needs to be done.

Policy Implications on Possible Solutions

Policy issues discussed here are based on three broad areas ranging from the Institutional and Regulatory Framework, Banking System Reforms and Innovation Issues that can help to improve financial depth based on the issues that are peculiar to the country.

Institutional and Regulatory Framework

Though a number of reforms have been carried out since 1985 relating to the strengthening of the financial and regulatory framework, the country needs to establish strong and effective commercial courts where contracts can be speedily settled. This is in line with the recommendations of the NEPAD-OECD on African Initiative (NEPAD-OECD Secretariat November 2009). These measures should be accompanied by good corporate governance regimes and ensure that property rights are protected. Setting up measures such as a simple and transparent property registration system, and facilitating bankruptcy proceedings by the commercial courts among others will improve the business environment and thereby improve financial depth. Where the rule of law is strong, financial intermediation is likely to improve, as alluded to by (McNulty, et al. 2007) in the study which examined the financial intermediation of the former Soviet and non-Soviet transitional economies. According to (Tressel & Detragiache, 2008), countries that have institutions that put checks and balances on political power do show evidence of financial deepening after financial reforms.

Given that one of the reasons for the lack of credit is the lack of collateral, in order to enable the financial intermediaries, especially banks, to lower the cost of screening and other factors that make them reluctant to lend, especially to the SME and given that most of the businesses are in the distributive trade and small in size, a well organised registration system for chattels, and immovable properties should be put in place. Improvement of the cadastre system containing information on ownership, location, dimension and value of properties and the availability of

such information at minimal cost with easy accessibility will reduce the cost of borrowing and enable more borrowing and thereby improve intermediation as potential borrowers will not be starve of funds to invest in productive sectors.

Banking System Reforms

The reforms in the banking sector have improved a lot and therefore the regulators and all stakeholders need to ensure that gains made are maintained and be proactive to any future challenges. Good corporate governance should be put in place to ensure that all stakeholders' interests in the industry are safeguarded and disputes and litigation proceedings are addressed within a reasonable time frame. Banking is based on trust, and the more the bankable population have it, the better for intermediation. Banks should be encouraged to come up with more innovative products to the market that is suitable and attractive to the country's need.

Innovative Issues

Banks should be encouraged through the Bankers' Forum (a meeting of commercial banks representatives in which the Director of Banking Services of the Central Bank is observer) meetings and other means to come up with new products and services that can help improve the financial system. Innovations of the extension of the banking hours, the backing of the CRB, had been applauded.

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