

LAWS, POLITICS AND BANKING SECTOR DEVELOPMENT: A COMPARATIVE ANALYSIS OF SELECTED G-7 GROUP AND ECOWAS COUNTRIES

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Abstract: *he study investigated the relationship between law, politics and banking sector development in selected G-7 group and ECOWAS countries. The panel ARDL approach suggested by Peseran et al. (2001) was adopted for the estimation, and quarterly time series data for the period 1970 - 2019 were used. Law is measured with rule of law, voice and accountability, government effectiveness and regulatory quality, while politics is captured by corruption control and, political stability and absence of violence. The ratio of bank credit to private sector is used to represent banking sector development. The results from the estimated panel ARDL model revealed that a significant relationship exists among the measures of law, politics and banking sector development in the panel. However, it was observed that the legal system in the G7 group is more viable than that of ECOWAS countries. In addition, law and politics in both groups exert strong and significant influences on banking sector development. The Pedroni Cointegration test results led to the rejection of H_0 of no cointegration. Further evidence shows a significant long-run relationship between law, politics and banking sector development, while the significant lagged error correction term (ECT), both within the panel and in the individual groups that make up the panel revealed granger causality in the relationship. Finally, the interactive effects of the measures of law, politics and macroeconomic environment significantly affect banking sector development. Thus, we conclude that viable legal systems and stable political environments promote banking sector development.*

Keywords: *Laws, Politics, Banking Sector Development*

1. INTRODUCTION

The role of banks in economic growth has been extensively documented in economic literature. A well-developed banking sector accelerates the process of economic growth by identifying and financing credit-worthy firms, mobilizing savings, pooling risks, and facilitating transactions, to mention but a few (Levine, 2003). These in turn engender increased economic activities, impact significantly on the level of income per capita, employment and the magnitude of cyclical fluctuation, and thus, promote long-run economic growth (Levine, 2003). A well-functioning



banking system is usually an important policy focus of most governments across the globe. Consequently, banking sector reforms play an integral role in promoting the economy, especially the small businesses. These reforms have led to more effective oversight functions in the financial system; and in particular, resulted in the consolidation of the structure of banks through the establishment of new laws for the protection of customers and investors. A healthy banking culture has been created which has necessitated the imposition of higher standards of conduct in the banking industry as well as the institution of criminal sanctions for reckless misconducts that could lead to bank failures. Ultimately, customers have been provided with greater choice through incentivized innovation and competition within the banking sector (Levine, 2003).

Despite numerous ongoing reforms in their banking systems, the slow pace of banking sector development in third world economies such as the West African economies has been a cause for serious concern for analysts. In contrast, many developed and developing economies have complex banking systems, and this anomaly has raised fundamental questions as to the reasons for the disparity in the levels of banking development in various economies. Efforts to address the above question have shown that the existence of viable institutions or a set of laws is essential in achieving development of the banking system and the financial system in general (Manasseh, Mathew & Ogbuabor, 2017; Demetriades & Andrianova, 2003; La Porta et al. 1997; Levine, 1998; Demirguc-Kunt & Detragiache, 1999; Demirguc-Kunt & Detragiache, 1999). While some economies have achieved measurable advancement in their banking systems, others are still struggling with developmental challenges. Past studies (Girma & Shorthand, 2004; Levine, 2003) have shown that financial institutions hardly succeed where the quality of institutions is poor or non-existent. Hence, they argued that financial institutions flourish in an environment where contracts are enforced without any form of hindrances, and market actors provided with greater incentives. In a study on law and finance, Levine (2003) demonstrated that a country's legal system creates a suitable environment for investments to thrive. He further argued that the enactment of laws, which adequately protect investor's rights, encourage financial innovations and ensure stability in the system. In this regard, countries where the legal system guarantees the rights of credits, meticulously enforce laws and contracts, have better developed banks than countries (Levine, 2003).

Furthermore, the political system adopted by different countries has been recognized globally as a major influence for many economies, but its negative effects seem to be more apparent in African countries than the western world. The ugly trend in African politics for example, political unrest, insecurity of lives and properties, corruption and poor investor's confidence, not only affects the banking system, but also the entire economy. As a result, political elites may be inclined to adopt selfish policies that could interfere with the market in order to protect their interests, for instance, state ownership of banks to facilitate favorable terms in credit markets. Even advanced financial systems such as the United States and the Eurozone are not completely exempt from the contagion effect of political influence, as the 2007/2008 global financial crisis revealed (Song & Thakor, 2012; Girma & Shorthand, 2004; and Acemoglu et al., 2001). Studies have shown that financial development occurs at a faster pace in economies with progressive democratic practices, and is slower in economies with less tolerant or non-existent democratic systems (Bordo & Rousseau, 2006; Girma & Shortland, 2008). One reason adduced for this phenomenon is that the democratic process creates opportunities for mass participation and therefore, limits the degree of control over economic resources by the political elites (North, 1990; Roe & Siegel, 2011). Many countries have therefore made concerted efforts to initiate best practices that promote financial and economic stability. Accordingly, many measures have been recommended by the World Bank and International Monetary Fund (IMF) as ideal ways to achieve financial system viability. These have culminated in diverse reforms in Africa and other emerging economies, such as structural adjustment programs (SAP), liberalization of interest rates and credit markets, restructuring of banks, privatization, consolidation and post-consolidation activities for banks, among others (see table 1 below).

Table 1: Financial Sector Reforms in Africa

Reforms	SAP	Interest Rates Liberalization of rates & credit market	Banks Restructure	Privatization of Banks	Bank Consolidation	Post Consolidation	Stock Exchanges Establishment
Benin	-	1989	-	-	-	-	-
Botswana	1991	1991	-	-	-	-	1989
Cameroon	-	1990	-	1998	-	-	-
Cote d'Ivoire	-	1989	-	1999	-	-	1776
The Gambia	-	1986	-	-	-	-	-
Ghana	1983	1988	1989	1997	-	-	1996
Kenya	1989	1991	-	1989	-	-	1954
Madagascar	-	1994	-	1999	-	-	-
Malawi	1987	1988	1990	-	-	-	1996
Mauritania	-	1990	-	-	-	-	-
Mauritius	1983	1993	-	-	-	-	1988
Namibia	1992	1991	-	-	-	-	1992
Nigeria	1986	1986	1990	1992	2004	2006	1960
Tanzania	1985	1991	1991	1994	-	-	1998
Uganda	1987	1988	-	1996	-	-	1998
Zambia	1991	1992	-	-	-	-	1994
Zimbabwe	1991	1991	-	1997	-	-	1946

Source: Senbet and Otchere (2005), Mkandawire, (1999); SAP; Structural Adjustment Program.

The purpose of the reforms is basically for the stabilization of the African financial system. In recent times, many African countries have extended their policy reforms to the restructuring and promotion of viable legal systems for the enforcement of law and order (Senbet & Otchere). For the G7 group, their approach was to strengthen their financial systems with greater emphasis on improving openness and transparency, maintaining best practice codes and strengthening official assistance to developing countries to fortify their economic and financial infrastructures. Thus, while reforms in African financial systems were inward looking, G7 reforms incorporated developing nations with the aim of promoting surveillance in the international financial system.

These reforms were undertaken in many African countries to fast-track their predominantly bank-based financial systems. The restructuring was aimed at promoting greater private sector participation or investment in the sector, and reducing state or government control over banks, often perceived to be a barrier to growth. Many economic experts have acknowledged the positive effects of these reforms, and encouraged various apex banks to adopt policies that lead to the emergence of more efficient private deposit money banks that can finance the productive sector, facilitate risk sharing, as well as support private sector development (Nyantakyi & Sy, 2015). Notwithstanding these reforms, a review of relevant performance indicators shows that African banks are still struggling with developmental challenges when compared to their peers in developed countries. Accordingly, Global Financial Development (GFD, 2017) argued that financial services provision has shown greater improvement in developed economies than in the transiting economies. For example, between 2010 and 2015, the ratio of domestic credit to the private sector from banks (BCPS) averaged 186.5% in the USA, 177.5% in Japan, 82.5% in Germany, 95.94% in France, 158.8% in UK, while the combined ratio of BCPS for Nigeria, Cote d'Ivoire, Ghana, Senegal and Cape Verde averaged 141.18%, which is far below the indicators for USA, Japan and UK. Individually, Nigeria, Cote d'Ivoire, Ghana, Senegal and Cape Verde recorded an insignificant ratio of BCPS which

averaged 13.5%, 18.5%, 17.23%, 30.4% and 61.55% respectively, within the same period (GFD, 2017). In terms of operational depth, this indicates the likely shallowness of banking development in Africa compared to G-7 countries. Further analysis shows that African banks displayed little or no value when compared to their developed counterparts, in terms of access and efficiency in operations. A review of bank overhead cost to total asset revealed the following for each country: USA (2.7%), Japan (2.7%), France (0.81%) and UK (1.34), compared to Nigeria (5.57%), Cote d'Ivoire (4.97%), Ghana (6.94%) and Senegal (4.91%) respectively, and suggests that African banks were relatively low value and inefficient (GFD, 2017). A possible reason may be limitations in bank lending schemes, low financial inclusion and weak legal protection for creditors (Nyantakyi & Sy, 2015). Thus, weak legal and institutional environment, among other business environment measures (see table 2 below) are likely to expose lending agents to high risk.

Table 2: Ease of Doing Business (EDB) Ranking for Selected Countries

S/ N	Africa			America & Europe				
	Economy	EDB	S/N	Economy	EDB	S/N	Economy	EDB
1	Mauritius	25*	18	Nigeria	145***	35	United Kingdom	7*
2	Rwanda	41*	19	Gambia	146***	36	Japan	34*
3	Kenya	80**	20	Burkina Faso	148***	37	Germany	20*
4	Botswana	81**	21	Mauritania	150***	38	United States	6*
5	South Africa	82**	22	Benin	151***	39	Canada	18*
6	Lesotho	104***	23	Guinea	153***	40	France	31*
7	Namibia	106***	24	Togo	156***	41	Italy	46*
8	Malawi	110***	25	Comoros	158***	42	Netherlands	32*
9	Swaziland	112***	26	Zimbabwe	159***	43	Switzerland	33*
10	Ghana	120***	27	Sierra Leone	160***	44	New Zealand	1*
11	Uganda	122***	28	Ethiopia	161***	45	Denmark	3*
12	Cape Verde	127***	29	Madagascar	162***	46	Korea, Rep.	4*
13	Tanzania	137***	30	Cameroon	163***	47	Norway	8*
14	Mozambique	138***	31	Burundi	164***	48	Sweden	10*
15	Côte d'Ivoire	139***	32	Gabon	167***	49	Georgia	9*
16	Senegal	140***	33	Sudan	170***	50	Macedonia, FYR	11*
17	Mali	143***	34	Liberia	172***	51	Lithuania	16*

Source: World Bank Ease of Doing Business (2017). ***, **, & * indicated countries with sound, relative and bad ease of doing business environment respectively.

High ranking ease of doing business is indicated by low numerical value. Countries with the lowest values identified as ($0 \leq * \leq 50$), ideally have sound business environments. In addition, countries whose rating values are identified as ($50 < ** < 100$) have relatively good business environments, while countries with rating values ($100 < *** < 180$) are estranged with poor business environments. However, countries with good business environments seem to have viable regulatory systems for businesses to thrive, and such countries have high investor confidence. Issues of credit assessment, resolving insolvency, protecting minority investors and enforcement of contracts are properly taken care of in these countries, unlike those countries with poor ease of doing business rating (***). This may be a likely reason for the difficulty often encountered comparing the banking systems of African countries with those USA, UK, Japan and Canada, etc.

In addition, the protection of property rights of economic agents, and the provision of an enabling macroeconomic environment, which are often inadequate in transiting economies, can promote investor confidence and business activities. The positive effects include: increase in the level of investment in the financial sector and bank accessibility, increase in the size and branches of banks, reduction in the cost of operation, and improved banking efficiency. Other issues such as



political instability, corruption, unlimited government power, irregular power supply, insecurity and poor road network also pose a strong challenge to the development of banks, especially in developing countries. These challenges have in one way or the other affected the operating costs and performance of the banking system (Manasseh et al. 2017; Nyantakyi & Sy, 2015). However, considering the vital role of the banking sector, various governments in Africa have expressed concern over the dismal performance of their banks, and consequently, adopted measures to meet the standards of their counterparts in western countries. Among these measures are: institutional reforms to advance transparency and accountability, enforcement of strict regulations and prudential guidelines for a viable business environment that deepen banking operations and protect investors (Manasseh et al. 2014). Other reforms include the establishment of the Independent Corrupt Practices and Other Related Crimes Commission, Transparency International corruption perception rating, Certified Anti-Money Laundering Specialists and Financial Crimes Commission (Manasseh et al., 2017). These reform programs led to a period of improved sanity in the legal environment, improved bank capital base, and relative political stability, which helped reduce corruption in the system. Consequently, a thriving banking system emerged, and attracted attention from the global financial system. Using capital adequacy ratio (CAR) or capital-to-risk weighted assets ratio (CRAR) as an indicator of depositors' protection as well as the stability and efficiency of the financial system, African banks may not be too far behind their peers in the developed countries. For instance, between 2010 and 2015, USA, Japan, Germany, France and UK recorded average CAR of about 14.48%, 14.61%, 17.63%, 14.72% and 17.73% respectively, while Nigeria, Ghana and Senegal recorded about 14.72%, 18.22% and 16.51% respectively.

Considering the discussed reforms that have been undertaken to stabilize the regulatory and political environments in order to strengthen the banking sector in Africa, we set out to empirically establish the relationship between law, politics and banking sector development in G-7 group and selected Economic Community of West African (ECOWAS) countries. A comparative analysis was also performed to assess if there were differences in the associated relationship between law, politics and banking sector development, due to changes in government and policy implementation in these countries. Further investigation was carried out on the interactive effect of measures of law and politics on the macroeconomic environment, and its impact on banking sector development. The results from the study offer useful policy choices that promote viable legal systems and political environments and thus, ensure transparency, reduce information asymmetry, promote property right protection, control corruption, and lead to increased investor confidence in the banking sector. The paper is organized as follows: Section two discusses the legal system and banking sector development while the relationship between politics and banking sector development is presented in section three. In section four, related literature on the topic is reviewed, while section five describes the research method and data sources. Finally, results from the analysis are reported and discussed in section six, while section seven presents the summary, conclusion and policy suggestions of the study.

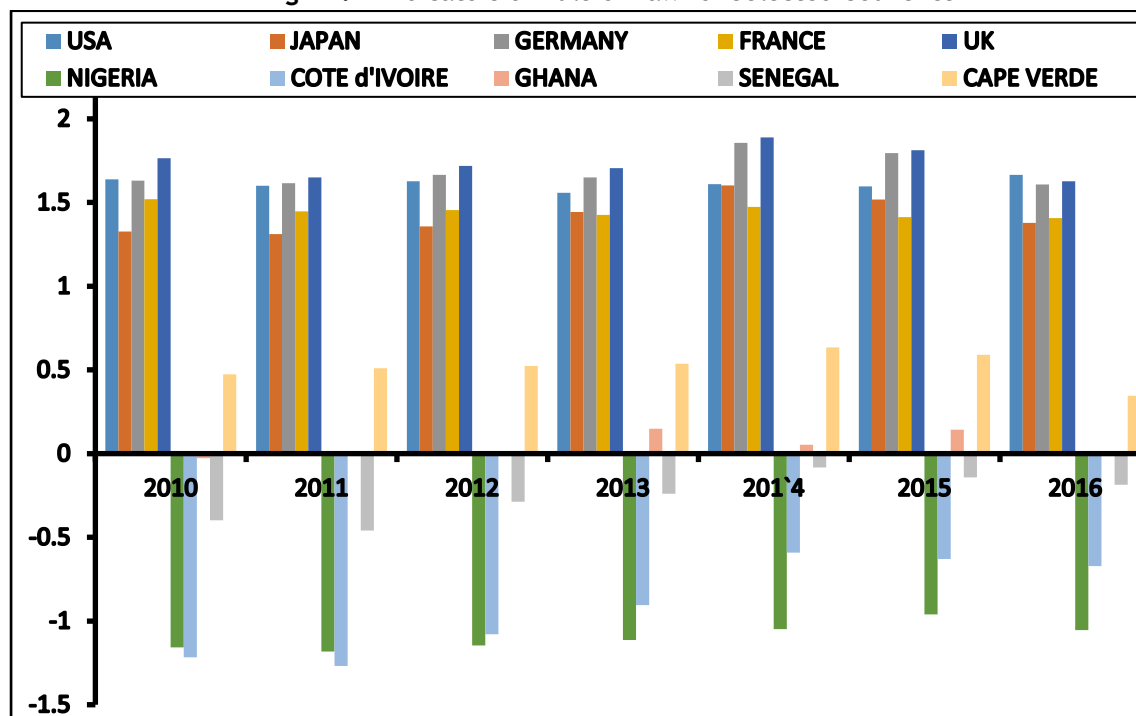
2. LEGAL SYSTEM AND BANKING SECTOR DEVELOPMENT.

The legal system is often seen as a critical factor that shapes the relationship among economic agents. Typically, there exist legal and supervisory bodies that provide cohesion and order in business activities. Thus, a strong and efficient legal system reduces uncertainty in investment decision-making by lowering transaction and agency costs, which can increase returns to shareholders. The legal system reflects the ability and willingness of an economy to protect investor rights and enforce contracts. These systems boost investors' confidence and motivate them to hold financial assets, which in turn facilitate financial deepening through capital accumulation (Levine, 2002). The reverse is usually the case in a system where the legal system is too weak to protect property rights and enforce contracts adequately. This may be due to an inactive rule of law, which ordinarily should promote quality of contract enforcement, property rights, the police and the courts (see figure 1 below). A weak legal system creates business uncertainty and confers undue advantage to rent seekers. Furthermore, a viable legal system may enforce discipline in

financial transactions and corruption control - which is often the source of insider-dealing, and constitutes a serious impediment to the development of the market. In addition, such a legal system reduces political risk thereby encouraging consistent inflow of external finance into the market. Consequently, this could result in a deepened operation and greater integration with world financial markets. Furthermore, the business environment has been a key factor in long term investment. In Africa however, the highly risky and volatile environment has adversely affected credit mobilization and the level of investment. This anomaly has been linked to an inefficient judicial system.

The vulnerability of the legal systems of many third world countries has constrained the ability of the banking sector to mobilize domestic savings and accumulate capital for long-term financing. Unlike the western countries, the effect of poor corporate governance, unethical practices by some market participants, and the weak market regulation commonly found in most developing economies were more damaging than the global financial crisis, and likely resulted in the loss of investors' confidence and poor property right protection. Weak legal systems and poor enforcement agency have been argued by many analysts as the key factors responsible for share price manipulation, insider information abuse, weak disciplinary procedures, questionable financial reports and large provisions for margin loans in many African countries. These unethical practices by some market gladiators, undertaken to deceive the investing public, adversely affect market activities, profits, dividends, share prices and banking sector performance in general (Igbatayo, 2011). To mitigate the effects of these irregularities, many African countries, just like other countries in the world especially in Europe and America, have implemented many reforms to improve their business environments, promote economic activities and banking operations. These reform policies adopted by most of African countries include the enactment of laws such as money laundry (prohibition) Act, banking recapitalization and others previously mentioned. The outcome of these reforms include: larger capital bases, better risk management, liberalization of the sector by reducing the role of state-owned banks and reorientation along commercial lines thereby strengthening their operational basis, relative political stability, as well as improved sanity in the legal environment.

Figure: 1 Indicators of Rule of Law for Selected Countries



Source: Worldwide Governance Indicators -WDI (2017).



Rule of law shows peoples' opinions of the extent of agents' confidence, and the degree to which they abide by the rules and regulations of society. The rule of law particularly looks at the quality of contract enforcement, property rights, the police and the courts, as well as the likelihood of crime and violence in the society (WDI, 2017). Thus, higher values ranging from 0 to 100 correspond to better outcomes. From the reports, Cape Verde was the only African country that had relatively viable agent's confidence where as other selected African countries were poorly rated. This implies that in these countries there was poor quality of contract enforcement, property rights and high level of crime and violence, thereby constraining investment inflow.

3 POLITICS AND BANKING SECTOR DEVELOPMENT

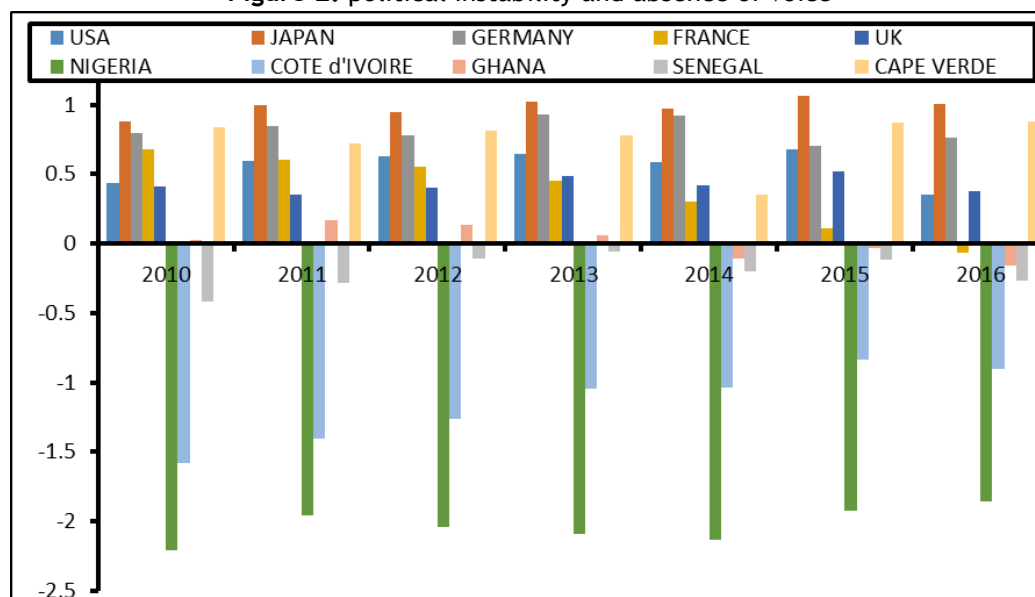
The role of the banking system in economic growth has been greatly influenced by politics, particularly in Africa. To a large extent, the performance of their predominantly bank-based financial systems depends on the political environment. Therefore, political stability, controlled political power, political accountability and democratic practices are argued to be key determinants of financial development (Ashraf, 2017; Manasseh et al. 2017). Usually, the financial system thrives more in a healthy political environment than a weak one. Since banks and other financial institutions are not insulated from political influence, many nations (particular in Africa) enact laws to protect banks from political control by proscribing politicians from holding management positions or serving as board members of banks, as well as prohibiting bank managers and directors from holding political offices. This is to prevent the tendency of banks to unduly favor their former directors turned politicians after retirement, who may be in possession of a large percentage of the bank shares. This also applies when politicians become bank director (a very common occurrence in many African countries). Political influence thus poses a serious challenge to the development the banking sector. Most of the challenges arise from the existing relationship with the incumbents (i.e. politician turned manager or director), who may exploit his/her political experience/connection to attract political favors to the banks which reciprocate the gestures by providing financial support to politicians (Aburime, 2009). In developing countries (Africa in particular), many political office holders would always like to retain power. Sometimes, in partnership with the "politician-turned-manager/director", unwarranted credit facilities may be extended to potential voters to improve their chances of getting re-elected. In addition, these politicians may also utilize strategies such as capital subsidies to banks in exchange for government ownership. The banks, on the other hand, leveraging on such capital infusion are inclined or mandated to extend credit facilities to a higher number of borrowers, including riskier borrowers.

The politicians' motive for influencing the financial system to expand its lending scope has been an issue of interest in some developing countries. Banks may be negatively affected when rules and regulations are enacted to favor some set of individuals. Thus, banks could be compelled to extend credit to some individuals, groups or sectors that may expose these banks to a high risk of incurring losses. Further, the threat of the loss of their operating licenses should they refuse to adhere to such regulations could force the management of these banks to comply, especially when they have healthy profit margin. These situations are all likely scenarios in a politically unstable and violence prone country, and could be one of the reasons why confidence in the African banking sector has been eroded. This is usually not the case in well developed financial systems (Song & Thakor, 2012). Calomiris and Haber (2014) demonstrated that the extent of political influence in the banking sector of various countries depends on differences in their political institutions. A survey by the Centre for the Study of Financial Innovations (CSFI) and PriceWater house Coopers (PWC) rated "political interference" in banking as the most important risk in 2010 (cited in Liu & Ngo, 2014). Hence, Asfrac (2017) stressed the tendency for bank risk to be higher where political institutions encourage government expropriation risk, adverse selection and moral hazard problems, as well as unhealthy competition in credit markets. He therefore concluded that bank risk is lower in an environment with lower government expropriation, improved information environment and better political institutions. In such situations, information asymmetries between

banks and borrowers are reduced, giving everyone the opportunity to access information that could enrich and promote their businesses in a timely manner.

Furthermore, while investor protection is a key factor in banking development, an unstable political environment due to a weak legal system may undermine investor's confidence. Thus, weak legal systems sometimes result in recurring political instability and absence of voice - more common among African countries (see fig. 3 below). This is fundamental problem which creates uncertainty within the business environment. Accordingly, investor confidence is weakened resulting in delays/falls in investment decisions, entrepreneurial activities and private sector development, and in turn affects bank deposits as well as the supply of funds. Consequently, there will be significant reduction in financial assets holdings (Bordo & Rousseau, 2006). Therefore, viable institutions act as checks on executive authority thus creating an environment suitable for competition among political and economic participants which enhances investor protection (Roe & Siegel, 2011). Increase in political participation under a democratic dispensation for instance, will constrain the power of the state to exact undue pressure on the financial system through acts of control and repression (Haber et al., 2007).

Figure 2: political instability and absence of voice



Source: WDI (2017)

Higher values depict countries with political stability and free from violence/terrorism. Countries whose values are negative have more volatile and risky business environment than others whose values are very insignificant but remain positive (e.g. Nigeria, Senegal and Cote d'Ivoire). The plot shows that Africa is yet to achieve an ideal state that can enforce confidence in the minds of investors and thus, strengthen the operations of banks in the continent. The poor ranking of African countries also indicates constraints to entrepreneurial activities, and this may explain the high cost of doing business, which is evident in bank overhead cost to total asset ratio and results in low supply and demand for financial assets.

4 REVIEW OF RELATED LITERATURE.

The neoclassical inter-temporal theory of consumption and investment assumes (though implicitly) that there is a "perfect capital market" in which economic agents can borrow or lend as much as they wish to maximize their respective objective functions (Demetriades & Andrianova, 2003). This assumption suggests a unified interest rate at which future transactions are discounted at the present time. It is equally assumed that the costs of finance are the same irrespective of the asset type - bank loans, bonds, retained earnings or stock issues. However, this assumption may not hold in modern market economies where different interest rates exist, and borrowing applications are



rejected without compensation for the transaction costs (application fees and time). The neoclassical theory has been criticized based on allocation decisions which may be altered if the assumption of perfect capital market is relaxed. Thus, if a consumer is refused credit or a firm is unable to raise capital for an identified investment opportunity, the consumer's intention to purchase a commodity or product is affected due to insufficiency of fund. This may affect the firm's investment opportunity which may be exploited by a foreign competitor. However, when the domestic firm is able to exploit this investment opportunity from its savings, it may no longer be viable. Hence, this weakens the neoclassical theory's assumption of "neutrality of finance" and may also explain why some countries' economies grow faster than others.

The underlying cause of imperfect markets can be linked to the issue of transaction costs and information asymmetry which give rise to the problem of adverse selection and moral hazard in the market. This justifies government intervention by way of laws that guarantee the regulation and supervision of the financial system. According to Demetriades and Andrianova, (2003), an economy where information asymmetry and other constraints in the financial system are properly managed is likely to experience: (a) high investment rates, (b) high levels of certainty in the business environment, (c) high investment productivity and growth, as well as stability in the financial system, and ultimately, sustained economic growth. However, the reverse is the case in an economy where these constraints are not properly addressed. The problem of imperfect markets has therefore necessitated the establishment of laws and institutions that shape human interactions and facilitate the development of markets. These laws are meant to provide stable rules, ensure transparency and monitor the activities of both government and other market participants, reduce transaction costs in the market, and improve the business environment (North, 1990). Over the past decades, the relevance of legal systems for financial development has been well documented in the literature. The foremost work in this area has been that of La Porta, Lopez-de-Silanes, Shleifer and Vishny (LLSSV, 1997), who used cross-sectional data from 49 countries to investigate how legal rules (emphasis on shareholders' protection - minority investors and creditors, and enforcement quality) effect financial intermediary development.

Drawing inspiration from Demetriades and Andrianova (2003) work which classified national legal systems into two broad legal traditions - civil law and common law, La Porta et al. (1997), further divided the legal systems into four namely: English common law, French, German and Scandinavian civil laws. They discovered that legal and regulatory treatment of creditors; enforcing contracts and accounting standards of countries were key determinants of the size and extent of a country's capital markets (Law & Azman-Saini, 2008). Thus, they argued that significant differences in legal rules protecting investors and contract enforcement in various countries explain the differences in external financing of the sampled countries. Hence, a legal tradition that protects investors against expropriation by entrepreneurs will attract more external financing since such investors are motivated to surrender their funds in exchange for security, and this will further deepen the operations of such economies' capital markets. La Porta et al. (1997) also pointed out that common-law countries generally have the strongest shareholder protection, while civil law countries have the weakest. Furthermore, they found that viable legal systems were important for the enforcement of law and order. Their findings revealed that Common law and Scandinavian civil law countries ranked higher than French civil law countries in terms of law enforcement.

Levine (1998) considered the relationship between legal system and banking development, and how the legal aspect of banking development affects long-run economic growth. Specifically, the study investigated whether differences at the cross-country level of banking development could be explained by cross-country differences in the legal rights of creditors, contract enforcement, and the origin of legal system of a country. The findings show that legal and regulatory environment are important determinants of banking development. He therefore asserted that countries which prioritized creditors' rights in their laws and regulations will have better functioning and well developed banks and financial intermediaries than countries with weak legal systems. Also, his work shows that countries whose legal and regulatory environments ensure high compliance with



contract enforcement, including government contracts, tend to have much better developed banks than countries where the level of enforcement is poor. Thus, he concluded that contract enforcement is significant for banking development. It should be noted that while La Porta et al. (1997) examined the financial system and included banks, debt and equity markets, Levine (1998), complemented the above by focusing specifically on the relationship between legal systems and banking development. In like manner, Demirguc-Kunt and Detragiache (1999), using indicators such as law and order, bureaucratic delay, contract enforcement, quality of bureaucracy and corruption, found that viable institutions are key determinants of investors' property rights protection. They therefore confirmed that viable institutions were crucial in determining investor confidence in the financial system.

Acemoglu et al. (2001) focused on endowment theory as the determinant of financial development. He argued that the environmental endowment of a country may explain differences in financial development other than the legal system. According to the endowment theory, countries with high levels of settler mortality during the earlier colonization era tend to have substantially lower levels of financial development, than countries with less settler mortality (Law & Azman-Saini, 2008). This theory argued that countries with high mortality rates were narrowly set up to serve the immediate economic interest (extracting precious raw materials) of the colonizers, and subsequently, the political/economic interest of the small group of elites who took over when the colonizers left. On the other hand, countries where the environment was more conducive and less life-threatening for the colonizers saw the establishment of more functional institutional frameworks to serve their long-run economic interest, and this laid the foundation for advanced financial development post colonization. The endowment theory was applied by Beck et al (2003) to provide empirical evidence that institutional endowment is important for financial development. Using a sample of 129 countries, Djankov et al (2007) reported that contract rights and enforcement institutions play a big role in the development of financial markets. Their results also showed that improvements in credit rights or the introduction of credit registries (or information sharing institutions) lead to an increase in the private credit to GDP ratio, which is a measure of banking development. Also, they reported that legal origins were an important determinant of both creditor rights and information sharing institution. However, Rajan and Zingales (2003) argued that the absence of political will by incumbents to protect their economic interest (not necessarily the legal system), is the bane of financial development for poor countries, and is equally responsible for the variability in levels of financial development in advanced countries. They argued that financial development is accelerated only when the ruling elite welcomes it. Rajan and Zingales proposed trade openness as a fast track for financial development since international trade breeds competition and will open up countries to accommodate the economic interests of other groups in the society.

Chinn and Ito (2006) studied the link between capital account liberalization, legal and institutional and financial development. The study adopted panel data analysis techniques, and covered 108 countries for the period 1980 to 2000. Their findings show that higher levels of financial openness contribute to the development of financial markets when viable legal systems and institutions are attained. For emerging market countries, their findings show that higher levels of bureaucratic quality, law and order, and lower levels of corruption, enhance the effect of financial opening on the development of equity markets. Similarly, Bordo and Rousseau (2006) carried out a cross-sectional study of 17 countries, covering the period 1880 to 1997 and showed that political variables were strongly related to financial development. In like manner, Girma and Shortland (2008) studied the impact of the political system and legal origin on financial development. With the aid of panel model techniques and time series data on developed and developing countries from 1975 to 2000, the degree of democracy and political stability were found to impact significantly on financial development. Habibulla (2009) examined the determinants of financial development, law and institutional quality, with evidence from 27 countries for the period 1980 to 2001. Findings revealed that the legal and institutional quality is a statistically significant determinant of banking sector and capital market development.



Adopting asset pricing models, Hooper et al. (2009) studied the link between quality of institutions and performance of stock markets. Their findings show a positive and significant relationship between stock market performance and institutional quality. Further inquiry revealed that stock market total risk factors were negatively associated with the institutional environment. This suggests that countries with better-developed institutional structures have stock markets with higher returns on equity and lower levels of risk. North (1990) contends that those in power will favor policies that enrich them and sustain their hold on political and economic power. Political economy hypothesis states that financial development may be inhibited by the presence of narrow political/industrial elite who may not be favorably disposed to developing financial markets that give access to finance to their competitors, but would rather maintain a restricted market that serves their interests through relationship banking. Thus, there is a belief that financial underdevelopment is the outcome of a deliberate attempt by the ruling elites who make policies that perpetuate their political and economic interest. Such elites may take advantage of policies that undermine financial market development and therefore, restrict access to finance for new firms or potential competitors. To explore the relevance of politics in the development process, Roe and Siegel (2011) in a cross country study using cross-sectional regressions, country fixed effects and instrumental variable regressions, established that differences in political stability are significant, consistent, and substantial determinant of differences in financial development across the world. Their assertion is that political instability is harmful to financial markets and does so after controlling for the level of a nation's economic development. The study revealed that military coups, political assassinations and violence are robust predictors of financial outcomes thus validating the findings of Acemoglu et al (2001), and Rajan and Zingales (2003) that legal system and trade openness are prerequisites for financial development. Aluko and Ajayi (2017) applied the Generalized Method of Moments (GMM) dynamic panel model estimator and discovered that institutional quality is important for banking sector development while law and trade openness are important determinants of banking sector efficiency and stability, all important indicators of banking sector development.

5. METHODOLOGY OF THE STUDY

The theoretical underpinning of this study is based on the work of La Porta et al. (1997), who argued that an effective legal system facilitates financial development by protecting the legal rights of creditors and shareholders, and ensures the enforcement of contracts. Other studies such as Williamson (1985) and Levine (1998), stressed the need for viable institutions, as these reduce transaction costs and guard against defaults in investments. In addition, they assert that viable institutions produce stable rules which are key factors for the success of new investments. Levine (1998) strengthens the argument by showing that these factors are crucial for the efficient working of the banking sector, suggesting that viable institutions promote banking sector development. Thus, this study is interested in extending the investigation by determining whether the rule of law and political environment promote or discourage banking sector development in the selected countries.

5.1 Data and Method of Analysis:

This study used quarterly time series data generated from the World Development Indicator (WDI, 2020), and World Governance Indicator (WGI, 2020) data bases. The data span the periods 1970 to 2019. The model adopted for the estimation is Panel autoregressive distributed lag approach - PARDL. The variables of interest include banking sector development as the dependent variable, rule of law, voice and accountability, government effectiveness, corruption control, regulatory quality, and political stability and absence of violence/terrorism as measures of law and politics. According to Gries and Meierrieks (2010), these explanatory variables are important in the study of the banking sector and financial system development in general. Though there are many suggested measures of banking sector development, the choice of relevant measures for individual countries depends on their policy targets. For the bank-based financial system typical of developing ECOWAS countries, banking sector development can be measured by considering the extent to



which economic agents are able to use their savings and investment instruments to make economic decisions. For example, financial deepening captures the size or depth of the financial system, and describes the ability of the banks to pool resources and channel same to profitable investments. Banking depth, measured by the domestic credit to the private sector as a percentage of GDP, could be used as a proxy for banking sector development. This reveals how financial institutions, through their services, enhance or boost economic activities. Other measures include the degree of individuals' access to financial institutions, bank efficiency, and the stability of financial institutions (Čihák et al., 2012).

In this study, banking sector development is proxied with the ratio of bank credit to the private sector, while rule of law, voice and accountability, government effectiveness and regulatory quality are proxies for law. Stability and absence of violence/terrorism, as well as corruption control are proxies for politics. Rule of law captures the extent of an agent's confidence in the market and their respect for existing laws. It establishes the quality of contract enforcement, property rights, police, courts, as well as crime and violence. Voice and accountability account for the influence of citizens' freedom of expression, freedom of association, media, and citizens' ability to participate in selecting their government. On the other hand, government effectiveness measures the extent of public service quality, civil service quality and the extent of independence from political pressures in policy formulation, implementation and reliability of government's commitment. Regulatory quality measures the strength of the government in devising and implementing quality policies and regulations that promote private sector development. This is necessary because it is generally recognized that the private sector drives the economy. In addition, political stability and absence of violence/terrorism captures the influence of politically-motivated violence such as terrorism, while corruption control measures the degree to which public power is used for private gain. It also measures the impact of petty and grand forms of corruption. We also controlled for macroeconomic volatility proxied with the standard deviation of real GDP, to account for the effect of vulnerability to external shocks that may decrease the prospects for banking sector development and financial system in general. Thus, PARDL is specified as shown in equations 4 and 5 below.

5.2 Model Specification:

Given the above premise, this paper adopted panel autoregressive distributed lag (PARDL), a time series econometric approach, to determine if law and politics are significantly associated with banking sector development. The ARDL approach is based on the ordinary least square (OLS) estimation of a conditional unrestricted error correction model (UECM) for cointegration as developed by Pesaran et al. (2001). While traditional bivariate cointegration techniques (Engle & Granger, 1987; Johansen, 1988; Johansen & Juselius, 1990) specify that cointegration only exists among variables with the same order of integration, the ARDL (as demonstrated by Choong et al., 2005; and Rahman & Salahudin, 2012) is predicated on some fundamental advantages including; first, the ARDL model can be estimated by ordinary least square (OLS) once the model lag order is identified. Second, the long-run and short-run parameters of the model can be estimated simultaneously, thus capturing the long-run and short-run impacts of the variables. Third, pre-testing for unit roots may not be required as the bounds test can be applied irrespective of the order of integration of the regressors, be it purely $I(0)$, purely $I(1)$ or fractionally integrated; however, no variable should be integrated of order two, $I(2)$. Fourth, the efficiency of the test is further enhanced particularly with small sample sizes. Another advantage of the ARDL method is that estimation is possible when explanatory variables are endogenous because it includes lags of dependent and independent variables (Pesaran et al., 1999). Furthermore, the error correction model (ECM) can be derived from ARDL through simple linear transformation, which integrates short-run adjustments with long-run equilibrium without losing long-run information (Pesaran & Shin, 1999).

The Panel ARDL is a dynamic technique that possesses certain advantages over static panel models. Static standard panel models such as pooled OLS, fixed effects and random effects have been adjudged to possess certain limitations. The pooled OLS imposes common intercept and slope

coefficients across cross-sections, thereby ignoring individual heterogeneity and is regarded to be a highly restrictive model. Fixed effects models however, allow intercepts to vary across sections but assume a common slope and variance. If dummy variables are introduced to observe cross sectional and time effects, the problem of loss of degree of freedom arises. Also, when endogenous regressors are correlated with error terms, parameter estimates produced by fixed effect models are biased (Samargandi et al., 2013). The assumption of strict exogeneity (Arellano, 2003), is a limitation in Random effects models. The model assumes an invariant model, meaning that the error at any period is uncorrelated with the past, present and future values, which is illogical in real life. However, it assumes common intercepts and therefore, is less problematic in terms of the degree of freedom. Other limitations of static panel estimators include inability to distinguish between short- and long-run relationships, and assumption of homogeneity of coefficients of the lagged dependent variable which leads to serious bias estimators, considering that data dynamics are heterogeneous across the cross sectional units. Their restrictive characteristics impose homogeneity on the slope coefficients thus neglecting possible variations across countries.

In light of these shortcomings in static models, Pesaran, Shin and Smith (1999) suggested a more dynamic approach that allows for heterogeneity and variations in coefficients across countries, both in the long-run and short-run. It does not also impose any restrictions as stated earlier. Based on Pesaran et al. (1999), the dynamic panel regression can be incorporated into an error correction model using the autoregressive distributed lag ARDL (p,q) model as stated by Loayza and Ranciere (2006), Samargandi et al. (2013), and Rafindadi and Yosuf (2013).

$$Y_{i,t} = \sum_{j=1}^{p-1} \psi_{i,t} (y_i)_{t-j} + \sum_{j=0}^q \gamma_{i,t} (x_i)_{t-j} + \mu_i + \varepsilon_{i,t} \quad (4)$$

where number of cross sections $i = 1, 2, \dots, N$; and time $t = 1, 2, 3, \dots, T$. $X_{i,t}$ is a vector of $K \times 1$ explanatory variables, $\psi_{i,t}$ is a scalar. In equation 1, p and q may vary across countries. Following Rafindadi and Yosuf (2013), eqn.4 may be re-parameterized as a VECM system shown in eqn.5 below.

$$\Delta Y_{i,t} = Z_i (y_{i,t-1} - \beta_i X_{i,t-1}) + \sum_{j=1}^{p-1} \psi_{i,t} \Delta y_{i,t-j} + \sum_{j=0}^{q-1} \gamma_{i,t} \Delta x_{i,t-j} + \mu_i + \varepsilon_{i,t} \quad (5)$$

where Δ is the first-difference operator, Y is the dependent variable, while X represents the vectors of independent variables. ψ and γ represent the short-run coefficients of lagged dependent and independent variables respectively, β measures long-run coefficients, and Z_i measures the coefficient of speed of adjustment to the long-run equilibrium. If $Z_i = 0$, then there is no evidence that variables have long run association. It is expected that Z_i is negative and statistically significant under the prior supposition that variables indicate a convergence to long run equilibrium in case of any disturbance. Thus, i and t are subscripts for individual country and time respectively. Once a cointegrating relationship between the variables is established, an estimate of the long-run equilibrium relationship between the variables is stated as:

$$Y_{i,t} = \sum_{i=1}^p \beta_{1i} Y_{i,t-j} + \sum_{i=0}^p \beta_{2i} X_{i,t-j} + \mu_i + \varepsilon_t \quad (6)$$

The final step involves the estimation of an error correction model (ECM) which measures the speed of adjustment to restore equilibrium in the dynamic model (Manasseh et al. 2018) as:

$$\Delta Y_{i,t} = \sum_{i=1}^p \delta_i \Delta Y_{i,t-j} + \sum_{i=0}^p \delta_i \Delta X_{i,t-j} + \varpi ECT_{i,t-j} + \mu_i + \varepsilon_{i,t} \quad (7)$$

With equations (6) and (7), the long-run and short-run impacts of law and politics on banking sector development is also established, and eqns. 2 and 3, as well as the Dynamic Fixed Effects (DFE) estimator are all possible estimators of eqn. 7 above (Samargandi et al., 2013). However, before applying the ARDL test in this study, the order of integration of the variables were examined using the unit root test. The rationale behind the test of stationarity is to ensure that the ARDL assumption of the order of integration of the variables is met. The ARDL approach is based on the assumption that the variables are $I(0)$ or $I(1)$ series, and that none is integrated of order two, $I(2)$. Therefore, pretesting for stationarity is of critical importance in the ARDL analysis. This study applied Lin and Chu (LLC), and Im, Pesaran and Shin (IPS) unit root tests to check for stationarity of

the variables. Also, other ARDL assumptions were tested to ensure that the model is suitable for the study.

6. RESULTS PRESENTATION AND ANALYSIS

This section presents the regression results obtained from the models for the study. First, the descriptive statistics were carried out to ascertain if the variables deviated largely from the mean. Second, following the ARDL (p, q) assumptions, pre and post-estimation tests were performed. Ensuring that we satisfy ARDL (p, q) assumptions as stipulated by Pesaran et al. (2001), tests such as; Levine, Lin and Chun (LLC) and Im, Pessaran and Shin (IPS) unit root tests, cross sectional dependence test, normality test, heteroscedasticity and serial correlation tests were carried out. Also, cointegration tests using Pedroni and Kao were performed. Prior to model estimation, the Hausman test was also conducted to determine the suitable technique for estimating the panel ARDL (p, q). From the results, fixed effects (p-value < 5%) is the most suitable for the estimation.

6.1. Descriptive Statistics

From the results presented in table 3 below, we observed that the minimum and maximum coefficients were -142.25 and 2448.83 respectively, that is, the least and highest values in the series. The skewness and kurtosis revealed that the series are not symmetrically distributed, indicating that the variables are not normally distributed. This may reflect differences in the macroeconomic environments of the selected countries.

Table 3: Summary Statistics

	BCPS	ROL	VAC	GEF	REQ	MEV	DCPS
Mean	2.5117	1.6220	1.8397	1.4859	1.5954	30.329	3.0547
Median	2.1549	1.7976	3.2365	1.5133	2.3087	17.6527	2.7229
Maximum	7.8976	5.1574	5.4057	5.1644	5.9891	2448.8	8.8481
Minimum	0.1664	-4.0359	-5.0339	-3.4344	-3.9552	-142.247	0.1749
Std. Dev.	1.9327	2.8469	2.8724	2.7454	2.7691	123.023	2.4806
Skewness	0.6975	-0.4858	-0.8251	-0.2116	-0.1820	14.4807	0.5761
Kurtosis	2.6697	1.9219	2.2395	1.5099	1.5392	237.286	2.0518
Jarque-Bera	93.519	95.845	150.206	109.18	103.13	25.3569	101.314


Source: Author's Conception

6.2. Unit Root Tests

In this section, the stationarity properties of the series were examined using Levine, Lin and Chun (LLC) and Im, Pessaran and Shin (IPS) unit root tests. LLC and IPS permit for heterogeneity of the specific deterministic effects and presume homogeneous autoregression for the series, while IPS accounts for residual serial correlation and heterogeneity of the dynamics and error variances across groups. This is to ensure that none of the variables are integrated of order two ($I \sim I(2)$), this being the main condition for the application of a panel cointegration test. Therefore, panel ARDL appears to be a more suitable technique for the estimation. The unit test result is presented in table 4 below:

Table 4: Panel Unit Root Tests Result

Var	LLC	Order of Integration		IPS	Order of Integration	
		Level	1 st Diff		Level	1 st Diff
BCPS	-2.97789**	I(0)	-	-4.07195**	I(0)	-
ROL	-1.32300*	I(0)	-	-2.13672***	I(0)	-
VAC	-18.2771***	-	I(1)	-3.08050***	-	I(1)
GEF	-6.81931***	I(0)	-	-2.7748***	I(0)	-



REQ	-4.09342***	I(0)	-	-2.20985***	I(0)
MEV	-11.8680***	-`	I(1)	-9.89110***	- I(1)
DCPS	-7.20225***	I(0)		-1.99337**	I(0) -

Source: Author's Conception; LLC denotes Levin, Lin & Chu t while IPS denotes IM, Pesaran & Shin. ***, ** and * represent 1%, 5% and 10% level of significance respectively.

The results of the LLC and IPS unit root tests show no evidence of unit root. Thus, none of the variables are integrated of order two ($I \sim I(2)$), confirming the suitability of the model for long-run estimation. The LLC test was estimated based on the assumption of persistent parameters common across cross-sections, while the IPS is based on the assumption that the persistent parameters freely move across sections (Hossain, 2010). The findings of the panel unit root test result show that BCPS, ROL, GEF, REQ and DCPS are integrated of order zero ($I \sim I(0)$), while VAC, and MEV are integrated of order one ($I \sim I(1)$). Therefore, the null hypothesis ($H_0: \alpha = 0$) of unit root is rejected, while the alternative hypothesis ($H_1: \alpha < 0$) of no unit root is accepted.

6.3. Cross Sectional Dependence:

Test for cross sectional dependence enables us determine if a cointegration test is necessary in this study. There are several reasons that make this test necessary including omitted observed common factors, unobserved common factors, spatial spillover effects, or general residual interdependences. The case of spatial spillover effects can arise due to possible cross country dependence, for example, of the ECOWAS or G7 industrialized countries due to increasing economic integration. Thus, these possible interdependences between cross sectional units may be a pointer to a long run relationship among variables of interest (Arouri & Rault, 2013; De Hoyos & Saraidis, 2006). Therefore, the determination of cross sectional dependence in the panel is important to avoid bloated and inefficient estimators (Phillips & Sul, 2003). Thus, Breusch and Pagan LM test (1980), Pesaran scaled LM test (2004), Pesaran CD test (2004), and Baltagi et al. bias-corrected scaled LM test (2012), were utilized. The results are presented in table 5 below.

Table 5: Summary of Cross Section Dependency Tests Results

Variables	BCPS	ROL	VAC	GEF	REQ	MEV	DCPS
Breusch-Pagan LM	(2331.6) [0.000]	(1683.4) [0.000]	(1325.9) [0.000]	(507.26) [0.000]	(1337.2) [0.000]	(577.98) [0.000]	(2076.9) [0.000]
Pesaran scaled LM	(180.43) [0.000]	(128.54) [0.000]	(99.916) [0.000]	(114.43) [0.000]	(100.82) [0.000]	(40.030) [0.000]	(160.04) [0.000]
Bias-corrected scaled LM	(180.35) [0.000]	(180.35) [0.000]	(99.838) [0.000]	(114.35) [0.000]	(100.74) [0.000]	(39.952) [0.000]	(159.96) [0.000]
Pesaran CD	30.137 8 (0.0000	(1.8491)) [0.064]	(0.8559)) [0.392]	(5.1115)) [0.000]	(-0.6140) [0.539]	(6.1236) [0.000]	(26.236) [0.000]

Source: Author's Conception. ***, ** and * represent 1%, 5% and 10% level of significance respectively (.) and [.] is t-statistic and the probability values respectively

To test for the presence of cross sectional dependence in the series, we employed the Breusch - Pagan LM test applied when $T > N$ in a balanced or unbalanced panel. The result in table 5 shows that we cannot accept the null hypothesis (H_0) of no cross sectional dependence at the 5% level of significance. Other tests like the Pesaran scaled LM test, Bias-Corrected scaled LM and Pesera CD test also support the rejection of the null hypothesis (H_0) of no cross-sectional dependence. We conclude therefore, that a cross-sectional dependency exists in the data series.

6.4. Cointegration Tests:

Since the test for cross sectional dependence indicates that the variables are cross-sectionally dependent, we proceed to conduct a panel cointegration test for countries in the panel to ascertain the existence of long run relationship in the model. Many tests have been proposed for panel cointegration. These tests include Pedroni (1999; 2004), Kao (1999) and a Fisher-type test - combined Johansen test for a time series. The Pedroni and Kao tests are based on Engle-Granger (1987) two-step residual-based cointegration tests (Maddala & Wu, 1999). Hence, since Pedroni proposes several tests for cointegration that allow for heterogeneous intercepts and trend coefficients across cross-sections unlike others, it was adopted to ascertain the existence of a long-run relationship in the series. This is because it is a more comprehensive test for panel cointegration. The results are presented in table 6 below.

Table 6: Panel Pedroni Residual Cointegration Results

Within-Dimension			Between-Dimension	
	Stat	W - Stat		Stat
Panel v-Statistic	-3.3178	-2.8898	Group rho-Statistic	-11.5609***
Panel rho-Statistic	-5.4437***	-11.293***	Group PP-Statistic	-11.2209***
Panel PP-Statistic	-5.7167***	-11.069***	Group ADF-Statistic	2.90684
Panel ADF-Statistic	7.5633	2.8376	-	-

Source: Author's Conception. ***, ** and * represent 1%, 5% and 10% level of significance respectively. Null Hypothesis: No cointegration; Trend Assumption: No deterministic trend; Automatic lag length selection based on AI. W-Stat is Weighted Statistic

This test has two different dimensions with eleven outputs (see table 6). Within dimension tests include; Panel-v statistic, Panel rho-statistic, Panel PP-statistic and Panel ADF-statistic have eight outputs, while between dimension tests comprise Group rho-statistic, Group PP-statistic and Group ADF-statistic, with three outputs. Generally, there are seven tests which yield a total of eleven outputs - statistics (stat) and w-statistics (W-stat). From the results, four out of eight within dimension tests were significant at 1%, while two out of three between-dimensions tests were also significant at 1% level. The majority of the tests are significant at the 1% level for within and between dimensions, suggesting a long-run relationship within the variables, as well as between the panels. Therefore, the null hypothesis (H_0) of no cointegration is rejected.

6.5. ARDL Estimated Results:

Before estimating the panel ARDL approach, it was necessary to investigate the most suitable estimation method. To do this, the Hausman test was adopted as suggested by Green (2008) to determine if the unique errors (μ_i) are correlated with the regressors. The result shows that the Chi-Sq. Statistic (18.837036) and its probability value (0.0044) are significant at 5% level. Therefore, the null hypothesis (H_0) which states that the preferred model is random effects, indicating that unique errors (u_i) are not correlated with the regressors is rejected, while the alternative hypothesis is accepted. This is because the P-value from the Hausman test is statistically significant, showing that the fixed effect method is the most appropriate for the estimations. However, the panel ARDL estimated results were presented in two forms. First, we estimated the relationship between law and banking sector development (see table 7 below), followed by the estimation of politics and banking sector development (see table 8 below). Second, we estimated the group panel regressing ECOWAS and G7 separately as summarized in table 8 below, to enable us carry out a comparative analysis between the two economic blocks. Finally, the results on the interactive effects on banking sector development are presented in table 9 below.

6.5.1 Law and Banking Sector Development:

Having established the existence of a long run relationship among the variables, we apply panel ARDL techniques to estimate the long run coefficients and identify the effects of law on banking sector development. Law is proxied with the components of the legal system such as Rule of law (ROL), Voice and accountability (VAC), government effectiveness (GEF) and Regulatory quality

(REQ). It has been argued that a viable legal system is critical for an effective banking system because it ensures investors' rights protection and contract enforcement. Therefore, countries whose laws and regulations give precedence to creditors' rights tend to have more efficient and developed banking systems (La Porta et al. 1997; Levine, 1998; Levine, 2002; Djankov et al., 2007; Habibulla, 2009). Table 7 shows the results of the relationship between law and banking sector development, the interactive effect of law on the macroeconomic environment as well as its impact on the banking sector development.

Table 7: Panel Estimation: Law and Banking Sector Development

Regressors	(1)	(2)	(3)	(4)	(5)
ROL	0.1578***	0.3114***	0.7128**	0.0508*	0.1171*
VAC	0.2736***	0.1125**	0.3603**	0.6107***	0.3113***
GEF	0.1723***	0.5231*	0.2310***	0.3231**	0.0713**
REQ	0.1163***	0.4311**	0.1013**	0.1616***	0.1835**
MEV	-0.0226***	-0.0623***	-0.0461***	-0.4216***	-0.1723*
DCPS	0.4207***	0.2475**	0.2077**	0.5001**	0.3097***
ROL*MEV		-0.0063***			
ROL*DCPS		0.2575***			
REQ*MEV			0.0540***		
REQ*DCPS			-0.5969***		
GEF*MEV				-0.0009**	
GEF*DCPS				0.1098***	
VAC*MEV					0.0011*
VAC*DCPS					0.2101***
ECT	-0.5782**	-0.16132	-0.24961	-0.20521	-0.3954**
Constant	-0.2000	-0.165652	0.124543	-0.07151	0.0934
Hausman Test	18.837***	16.111***	40.42348***	13.4773***	19.7501***
Normality Test	3.08056	2.1282	0.82988	1.45414	1.9881
Serial Correlation Test	0.6387	0.3886	1.4270	2.9454	0.9239
Heteroscedasticity Test	2.9539	0.8576	0.97087	1.3544	2.6428

Source: Author's Conception. Dependent Variable: Bank Credit to Private Sector - BCPS (% of GDP) is a proxy for Banking Sector Development. ***, ** and * represent 1%, 5% and 10% level of significance respectively.

As stated earlier, the models (1 - 5) were subjected to diagnostic tests following the assumptions of ARDL model. The reported tests include; Jacque-Bera test which is adopted to determine if the series are normally distributed, while Breusch-Godfrey LM test evaluates the presence of serial correlation. In addition, we conducted the White test for heteroscedasticity to find out if the divergences of error terms are equal or not. From the results, there is no evidence of autocorrelation, and the variables are homoscedastic (i.e. equal means).

In this study, law is measured with rule of law (ROL), voice and accountability (VAC), government effectiveness (GEF) and Regulatory quality (REQ) as stated earlier, while banking sector development is proxied with bank credit to private sector, BCPS (% of GDP). From the results presented in column (1) in table 7 above, ROL is positively and statistically associated with BCPS. This suggests that the extent of investor's confidence and quality of contract enforcement, including property rights protection determine banking sector development. We also observed that VAC, which represents the influence of investor's freedom in expressing their concern on government policies, also has a positive and significant relationship with BCPS. Hence, controlling for the influence of political interference and ability of the government in implementing quality policies, we found that GEF and REQ respectively exhibit positive and significant influence on BCPS.



This confirms the relevance of the legal environment in determining banking development. The outcome implies that an improvement in ROL, VAC, GEF and REQ account for about 0.158, 0.274, 0.172 and 0.116 increase in banking sector development respectively. This finding supports the postulate of La Porta et al. (1997), which viewed the legal system as a vital instrument to accelerate financial development. They pointed out that the effective enforcement of contracts and protection of legal rights of creditors and shareholders were vital for financial system development. Also, our findings concur with studies by Levine (1998, 2002) and Djankov et al. (2007), who argued that countries that give precedence to creditors' rights by way of laws and regulations tend to have better developed banking systems. In addition, our findings are also consistent with past studies, which stressed the relevance of a viable legal system/environment, and institutional quality on the development of banks, stock markets and the financial system in general. Such studies include: Williamson (1985), Chinn and Ito (2006), Manasseh et al. (2017), Habibulla (2009), Hooper et al. (2009), North (1990), and Aluko and Ajayi (2017).

We examined the influence of financial system development and the macroeconomic environment on banking sector development, by controlling for domestic credit to the private sector (DCPS) and macroeconomic volatility (MEV), proxied with the standard deviation of RGDP. The findings show that DCPS is positive and significantly related to BCPS, while MEV is negative and significantly associated with BCPS. This implies that an increase in DCPS will improve banking sector development by 0.423, while a rise in MEV worsens banking sector development by 0.0026. Government authorities should implement policies that ensure stability in the macroeconomic environment in order to gain from inherent benefits in bank sector development. Since the variables move together in the long-run, indicating significant long-run equilibrium relationship at 5% critical value, the regular unrestricted error correction term (ECT) with no constant and trend was fitted to obtain the coefficient of one-lagged level of the ECT as shown in table 7, column (1). Hence, deviation from the long-run equilibrium in the panel is corrected at the 57% adjustment speed. Thus, there is a short-run causality effect of the coefficient of the explanatory variables on the dependent variable, as expressed by the significance of the coefficient value of ECT. The results on the interactive effect of law on macroeconomic environment (proxy, MEV) and its impact on banking sector development as reported in table 7 above, (columns 2, 3, 4 and 5) also support the claim that the macroeconomic environment is vital for growth in an economy.

In column (2), the rule of law (ROL) is interacted with MEV and DCPS respectively. From the results, ROL*MEV has a negative and significant relationship with banking sector development (BCPS), while ROL*DCPS exerts significant positive influence on BCPS. Thus, suggesting that the influence of law on the macroeconomic environment (MEV) impacts negatively and positively on BCPS respectively. This means that the deterioration of ROL, especially when there are insufficient corrective measures for its restoration, partly explains the decay of the macroeconomic environment (MEV) because in such situations, people tend to behave the way they like and government, in most cases, becomes undemocratic and tyrannical. This in turn may result in a decline in investor's confidence, and deterioration in banking sector development. In addition, in column (3), we observed that regulatory quality (REQ) is a key determinant of the macroeconomic environment since REQ*MEV results in a significant and positive impact on banking sector development (BCPS). Interacting REQ and DCPS yielded a negative but significant relationship with BCPS which contradicts our expectations. This finding implies that the ability of government to formulate and implement sound policies which address vital macroeconomic issues such as unfair competitive practices and discriminatory taxes, as well as initiate effective anti-monopoly policy, investment freedom and ease of starting business (for example, a stable exchange and interest rates environment, etc.) will reduce the volatility of the macroeconomic environment (MEV) and in turn, promote the development of the banking sector and the private sector.

The result of the interactive effect of GEF*MEV in column (4) shows a negative relationship with banking sector development (BCPS). One may therefore argue that proper enforcement of law promotes a stable macroeconomic environment. A stable macroeconomic environment may be


achieved through effective public and civil services, high degree of freedom of political pressures in policy formation and implementation, and credible government policies. These will in turn, lead to improvements in the legal system which may facilitate banking sector development. Also, evidence from VAC*MEV in column (5) shows a positive relationship with banking sector development (BCPS). Hence, investors' freedom of expression as regards their opinions about government policies or actions without any form of undue punishment can benefit the macroeconomic environment and enhance investor's confidence in the sector as well as promote banking sector development. In like manner, the interactive effect of GEF*DCPS and VAC*DCPS shows a positive and significant relationship with BCPS. Thus, government effectiveness and, voice and accountability are significant in improving the macroeconomic environment, and also have the ability to hinder the development of banks and the economies of the selected countries in general. Hence, the inability of government to adequately promote the enforcement of law and enhance investors' freedom of expression may inhibit banking sector development.

6.5.2. Politics and Banking Sector Development

In this section, the relationship between politics and bank development was established. The influence of politics on bank development was determined by investigating the effect of measures such as corruption control (COC) and, political stability and absence of violence (PSAV). While COC captures the extent to which public power influences private gain, PSAV encapsulates the effect of politically motivated violence (e.g. terrorism). The political environment is a two sided coin that may either advance or limit financial development. Hence, Girma and Shortland (2008), Huang (2010), and Ashraf (2017) argued that a democratic and politically stable environment is a key determinant of financial development. They suggested that democracy promotes institutional quality, which facilitates civil liberties, creates societies where contract enforcement and property rights protection are entrenched, and discourages corruption and lawlessness. However, where the democratic system and consequently, political institutions are weak and grossly immature, such systems become a disincentive to financial development due to poor policies and corruption (Blanchard & Shleifer, 2000; Persson & Trabelini, 1992). From the results reported in table 8 as presented in column (1) below, political stability and absence of violence (PSAV), and corruption control (COC) are positively related to banking sector development. This suggests that PSAV and COC significantly influence banking sector development, thus supporting the evidence from Roe and Siegel (2011), Bordo and Rousseau (2006), and Girma and Shortland (2008). Given the above findings, a high level of corruption control - including petty and grand forms, the extent of public power for private gain, as well as political stability and absence of violence, would promote banking development by 0.49 and 0.05 respectively. In addition, after controlling for the influence of the macroeconomic environment (MEV), we discovered that it relates negatively with banking sector development (BCPS) which is found to be consistent with our initial findings previously reported in table 7 above - though not significant.

Table 8: Panel Estimation: Politics and Banking Sector Development

Regressors	(1)	(2)	(3)	(4)
PSAV	0.0545**	0.51165**	0.1741**	0.2861**
COC	0.4895***	0.3951***	0.5015***	0.5117***
MEV	-0.0010	-0.2013	-0.0816	-0.3119
DCPS	0.52338***	0.07621***	0.61356***	0.1891***
PSAV*MEV	-0.00241			
PSAV*DCPS		0.1663***		
COC*MEV			-0.00163*	
COC*DCPS				-0.19619***
ECT	-0.4234**	-0.5213***	-0.32624	-0.51641
Constant	-0.061064	-0.018331	-0.05685	-0.03164
Hausman Test	52.1368***	61.0374***	33.5701***	24.061***



Normality Test	1.86011	2.14012	1.24612	3.1317
Serial Correlation Test	1.06836	2.00345	0.72189	0.5328
Heteroscedasticity Test	2.4495	1.27141	2.11101	2.3371

Source: Author's Conception. Dependent Variable: Bank Credit to Private Sector (BCPS) used a measure of Banking Sector Development. ***, ** and * represent 1%, 5% and 10% level of significance respectively.

For models (1 - 4), the Jacque-Bera test is adopted to determine if the series are normally distributed, while Breusch-Godfrey LM test evaluates the presence of serial correlation. Also, White test for heteroscedasticity was carried out to determine if the divergences of error terms are equal or not. More so, there is no evidence of the presence of autocorrelation, and the variables are homoscedastic. The Fixed effect technique was adopted for the estimation as suggested by the Hausman test.


Furthermore, in assessing the influence of financial system development (proxy, direct credit to the private sector - DCPS) on banking sector development (BCPS), shown in column (1) of table 8 above, we discovered a positive relationship which exerts significant influence on BCPS. This suggests that policies that improve the development of the financial system will also benefit the banking system. Therefore, the development of the financial system is critical for the development of banking sector. In addition, interacting political stability and absence of violence (PSAV) and corruption control (COC) with the macroeconomic environment (MEV) respectively (i.e. PSAV*MEV and COC*MEV), to evaluate the influence of politics on MEV and its impact on BCPS (see columns 2 and 3), it was observed that improvement in PSAV and COC reduces macroeconomic volatility. Invariably, this implies that a volatile macroeconomic environment could deter banking sector development. Hence, a stable political environment is important in promoting banking development as pointed out by Girma and Shortland (2008), Huang (2010) and Ashraf (2017). Moreover, there exists a short-run causality effect indicated by the significance of the coefficient value of ECT in column (1). Hence, the coefficients of the explanatory variables significantly affect the dependent variable, and the speed of adjustment to equilibrium is 42%. Finally, a review of the interactive effect of PSAV*DCPS and COC*DCPS shown in columns (2) and (3), reveals that PSAV*DCPS is positively related to banking sector development (BCPS), while COC*DCPS has a negative effect on BCPS. Hence, improvement in political stability and absence of violence (PSAV), and corruption control (COC) may promote credit to the private sector and in turn, the banking sector through increase in bank deposits. Thus, the political environment is a significant determinant of banking sector development, *ceteris paribus*.

6.5.3. Comparative Analyses of selected ECOWAS countries and the G7 group

Evidence from the reviewed literature has shown that countries with viable legal and stable political systems are more likely to have well-functioning and developed banking sectors (Girma & Shorthand, 2004; La Porta et al., 2002; Chinn & Ito, 2006; Aluko & Ajayi, 2017; Habibulla, 2009; and Hooper et al., 2009). Such systems promote political participation and competition, and limit the power of the state to control and repress the financial system. Hence, it reduces opportunities for predatory and unscrupulous behaviors, leading to a more competitive and efficient banking system (Haber et al., 2007). In this section, the individual groups that make up the panel - ECOWAS and G7 were investigated. The results obtained from the panel estimation using the fixed effects technique, as suggested by the Hausman test outcome, were compared. The objective was to examine the influence of law and politics on the banking sector development of each group in the panel, and to draw an inference from the findings on the influence of law and politics in promoting banking sector development. Thus, the estimated results for the individual groups are presented in table 9 below.

Table 9: Panel Estimation: Law, Politics & Banking Sector Development

	Ecowas Countries		G-7 Group	
Regressors	(1)	(2)	(3)	(4)



ROL	0.67496**	0.31429**	0.15861***	0.5321***
VAC	0.06561	0.5117**	0.03061**	0.3327**
GEF	-0.44629*	-0.6421*	0.99149***	0.4917***
REQ	0.8506***	0.2716***	0.83446***	0.7147***
MEV	-0.00057**	-0.09153**	-0.02674***	-0.1661***
DCPS	0.84790***	0.7171***	0.91919***	0.1417***
PSAV		-0.01593***		0.28406***
COC		-0.01869***		0.95779***
ROL*MEV	-0.0017		-0.0026***	
REQ*MEV		0.0004***		-0.0268***
GEF*MEV		0.0030**		-0.0859***
VAC*MEV	-0.0171***		-0.0044***	
PSAV*MEV		-0.4142***		-0.0995***
COC*MEV		-0.2031***		0.3280
ECT	-0.54851	-0.3835	-0.65672	-0.5976
Constant	0.01216	0.00203	0.02567	-0.22941
Hausman Test	56.4123***	37.22036***	25.9154***	30.1190***
Normality Test	1.63427	0.79345	2.03391	1.62084
Serial Correlation Test	2.1767	1.90011	1.86511	0.82193
Heteroscedasticity Test	0.91143	0.77921	2.41416	1.50637

Source: Author's Conception. Dependent Variable: Bank Credit to Private Sector (BCPS) used a measure of Banking Sector Development. ***, ** and * represent 1%, 5% and 10% level of significance respectively. There was no evidence of the presence of autocorrelation, and the variables are homoscedastic. The Fixed effect technique was adopted for the estimation as suggested by the Hausman test.

In our earlier findings on the link between the measures of law, politics and banking sector development (BCPS) in the panel, it was discovered that ROL, VAC, GEF, REQ, PSAV and COC exert positive and significant effect on BCPS respectively, while the macroeconomic environment (MEV) is found to be significantly and inversely related to BCPS. However, the results obtained from the group that make up the panel (ECOWAS & G-7), presented in table 9 shows contradictory evidence, particularly from the measures of politics. The results obtained for ECOWAS show the measures of law such as ROL, VAC and REQ to be positively related to banking sector development (BCPS), while GEF influences BCPS negatively as indicated in columns 1 and 3. All the indicators exert significant influence on BCPS except VAC. The inverse relationship existing between government effectiveness (GEF) and BCPS likely suggests poor quality public and civil services, and the high degree of dependence on political pressures in policy formulation and implementation, common in many developing countries such as ECOWAS members. Comparing this outcome with the G7 group, we observed that all the measures of law (ROL, VAC, GEF and REQ) are statistically significant at 1% and 5% critical value, and have a positive relationship with banking sector development (BCPS), which is consistent with the viable law making process and stable political environment prevalent in G7 countries. This suggests that the quality of regulations established by the authorities of these countries, whether in the form of law making or custom, and their enforcement by the judicial system are important determinants of banking sector development. This is because the legal system of every country is enriched by its ability to incorporate individual or investor differences. However, the insignificant relationship existing between voice and accountability (VAC) and BCPS, as observed in the ECOWAS countries, may be as a result of the absence of the citizens' involvement in selecting their government, as well as the poor freedom of expression and association for individuals and media houses. Hence, our results on macroeconomic environment (MEV) are consistent with our earlier findings.



In addition, further investigation shows that measures of politics such as political stability and absence of voice (PSAV) and corruption control (COC) in ECOWAS countries are significant and inversely related to BCPS, while in the G7 group, PSAV and COC are directly related and significantly impact on BCPS. Furthermore, the inverse relationship between measures of politics and BCPS may be linked to the volatile political environment experienced in most of the ECOWAS member countries. Thus, this has constrained the growth of economic activities and development of the banking sector in these countries. Hence, the authorities of these countries must ensure a stable political system, avoid violent threats (terrorism) and reduce the high level of corruption in order to benefit from a developed and efficient banking system. Failure to address these challenges may affect the economy, undermine investors' confidence and their ability to invest in the sector, and thus, derail the development of the banking sector. Drawing from the above findings, we infer that law and politics promote banking sector development in ECOWAS and G7 countries, irrespective of the dissimilarities in their legal systems. These findings corroborate evidence from Girma and Shorthand (2004), La Porta et al. (2002), Chinn and Ito (2006), Aluko and Ajayi (2017), Habibulla (2009), Hooper et al. (2009), Haber et al. (2007), Girma and Shortland (2008), Huang (2010), Manasseh et al. (2017) and Ashraf (2017) in their respective studies on the relationship between institutions/institutional quality, legal system, banking system and the financial system. The unrestricted error correction term (ECT) with no constant and trend was fitted to obtain the coefficient of one-lagged level of the ECT as shown in table 9, columns 1 and 3. Hence, deviation from the long-run equilibrium in the groups is corrected at the 54% and 65% adjustment speed respectively. There is also evidence of a short-run causality effect of the explanatory variables on the dependent variable as revealed by the significance of the coefficient value of ECT.

Extending the investigation, we examine the interactive effect of law and politics on the macroeconomic environment (MEV), and their effects on banking sector development (BCPS). The results in table 9 (column 1) reveal that law and politics influence the macroeconomic environment (MEV) and impact on banking sector development. Hence, the interactive effects of $ROL*MEV$ and $VAC*MEV$ on banking sector development (BCPS) are negative and statistically significant in both ECOWAS and G7 group (see columns 1 and 3). This confirms the need to improve legal processes and their enforcement without preferential treatments for highly placed political personnel, and also ensure freedom of expression for the citizens to air their opinions on government policies without being punished. Consequently, macroeconomic environment (MEV) and investor's confidence will improve, with a corresponding development in the banking sector (BCPS). Further inspection shows that $REQ*MEV$ and $GEF*MEV$ are directly related with BCPS for ECOWAS countries, while they are inversely related with BCPS for the G7 group. The implication of these findings for ECOWAS member countries is that improvements in regulatory quality (REQ) and government effectiveness (GEF) have barely any influence on MEV. Ideally, it is expected that as REQ and GEF improve, there should be a significant reduction in macroeconomic volatility (MEV) just as was observed for the G7 group. However, as earlier pointed out, the ability of ECOWAS countries to control the influence of political interference in policy making and implementation, as well as ensure proper enforcement of law that affords every citizen/investors equal protection, will improve the macroeconomic environment and lead to banking sector development. On the interactive effect of political stability and absence of voice (PSAV) and corruption control (COC), we observed that $PSAV*MEV$ exerts a negative and significant influence on banking sector development (BCPS) in both groups that make up the panel. In addition, while $COC*MEV$ show significant and negative effect on BCPS for ECOWAS countries, there was evidence of a positive but insignificant impact of $COC*MEV$ on BCPS for the G7 group. This implies that effective control of corruption may improve macroeconomic volatility (MEV), and consequently impact significantly on the development of the banking sector. Hence, improved legal system and regulatory environment are vital in stabilizing the macroeconomic environment as well as promoting banking sector development.

7. Summary, Conclusion and Policy Suggestions



The study investigated the relationship between law, politics and banking sector development for a sample of thirteen countries from the G-7 group and ECOWAS region. Law is proxied with the rule of law (ROL), voice and accountability (VAC), government effectiveness (GEF) and regulatory quality (REQ), while politics is captured by corruption control (COC) and, political stability and absence of violence (PSAV). Banking sector development is measured with bank credit to private sector (BCPS as % of GDP). Following Pesaran et al. (2001), the study adopted the panel ARDL approach for the estimation. The quarterly time series data for the study spanned the period 1970 to 2019, and were obtained from the world development indicators (WDI) and world governance indicator (WGI) databases. All study variables were subjected to diagnostic tests following the ARDL assumptions. The panel cointegration test was performed using Pedroni (1999; 2004) technique which has seven outputs namely: Panel-v statistic, Panel rho-statistic, Panel PP-statistic, Panel ADF-statistic, Group rho-statistic, Group PP-statistic and Group ADF-statistic. Consequently, evidence of long-run relationship within the series as well as between the groups was investigated, and the null hypothesis (H_0) of no cointegration was rejected based on the result of the test.

The panel ARDL estimated results presented in tables 7 and 9 above, revealed a significant relationship between law, politics and banking sector development in the panel. This indicates that law and politics are vital determinants of banking sector development. Thus, a high level of investor's confidence, quality contract enforcement, property rights protection, investor's freedom of expression, avoidance of political interference in policy making and implementation, as well as stable political system and control of corruption could boost the development of the banking sector. We generated the residuals series for the models, fitted with the unrestricted ECT with no constant and trend, to obtain the coefficient of one-lagged level of error correction term (ECT) using the OLS estimator. Since the coefficient of the ECT obtained was negative and significant, there is evidence of long-run relationship between measures of law, politics and banking sector development in the panel. Moreover, the significant ECT revealed granger causality in the relationship. The short-run dynamic parameter from the error correction term (ECT) associated with the long-run estimates also shows short-run causality effects - implying that banking sector development is strongly affected by law and politics.

To evaluate the group that make up the panel - selected ECOWAS and G7 countries, we sought to ascertain the extent of the influence of law and politics on banking sector development, considering the fact that these economies are heterogeneous in nature. For ECOWAS member countries, measures of law such as ROL, VAC and REQ were discovered to be positively related to banking sector development (BCPS), while GEF exerts a negative influence on BCPS as indicated in table 9 (columns 1 and 3) above. Hence, all the indicators significantly influence BCPS except voice and accountability (VAC). But comparing this outcome with the G7 group, we observed that all the measures of law (ROL, VAC, GEF and REQ) were statistically significant, and impacted positively on banking sector development (BCPS). The existence of an inverse relationship between GEF and BCPS in ECOWAS countries may be attributed to poor quality public and civil services, as well as a high degree of dependence on political pressures in policy formulation. However, for the G7 group, the legal environment seems to be more viable. Furthermore, we observed that measures of politics such as political stability and absence of voice (PSAV) and corruption control (COC) in ECOWAS countries exerted significant and negative influence on BCPS, while in the G7 group, PSAV and COC were directly related and significantly impacted on BCPS. Thus, the observed inverse relation between PSAV, COC and BCPS may be due to the volatile political environments experienced in most ECOWAS countries.

However, despite the dissimilarities in the legal systems and political environments of both G7 and ECOWAS countries, we conclude that law and politics promote banking sector development in these countries. Also, we fit the ECT with no constant and trend to obtain one-lagged level coefficient of ECT shown in table 9, columns 1 and 3. Hence, the deviation from the long-run equilibrium in ECOWAS and G7 countries is corrected at 54% and 65% adjustment speeds respectively. We observed that law and politics had short run causality effect on banking sector development, indicated by the significant coefficient value of ECT in both groups. In like manner, interacted




measures of law and politics with macroeconomic environment (proxied with MEV), suggest that a viable legal system, improved regulatory quality and stable political environment are capable of controlling aggregate instability that may arise from external shocks, volatile macroeconomic policies, microeconomic rigidities and weak institutions. The interactive effect impacted significantly on banking sector development. In view of the findings, we infer that a viable legal system and stable political system are key determinants of banking sector development in the panel, and in the groups that make up the panel.


To benefit from the advantages inherent in a developed banking sector, both ECOWAS and G7 countries must not only improve their legal systems but also avoid instability in the political environment. Following our findings on the relationship between law, politics and banking development, we suggest that policies that strengthen the legal system should be the primary objective of these countries. Such policies encompass the generality, clarity, publicity, stability and perception of the norms that govern the countries, as well as the processes by which these norms are administered, including liberty and respect for private property right. Also, laws that protect citizens by providing opportunities for participation in the selection of their leaders, and equally afford them freedom of expression and association should be encouraged. This is more relevant for most ECOWAS countries than the G7 group, where human rights are respected. Since the credibility of government commitment in policy making and implementation partly depends on the quality of the public and civil service, a high degree of independence from political pressure is desirable and should be encouraged. Regrettably, this may be difficult to achieve in most ECOWAS countries due to the presence of duplication of functions, probably driven by political benefits. In addition, the private sector is the engine of growth in many countries and should be promoted. Government authorities, especially in Africa and ECOWAS countries in particular, should formulate sound policies that promote private sector participation and investment, such as: (a) tax incentive/holiday/exemption, (b) investor's rights protection, (c) improvement in the ease of doing business measures, and (d) property protection, among others. These will improve the economic activities of the countries, increase bank deposits and ultimately, encourage the development of the banking sector.

Concerted efforts should be made to discourage any form of political turbulence capable of causing politically-motivated violence and terrorism. Furthermore, corruption has been the greatest challenge facing most third world countries, and has deprived these economies the opportunity to develop vital infrastructural facilities due to the rampant diversion of public funds for private gain. Hence, following recommendations from the Transparency International as well as our findings, we suggest some stringent measures that could be adopted to reduce the effect, namely: (a) effective law enforcement to ensure that the corrupt are punished, (b) reformation of financial management and strengthening the role of auditing agencies, (c) disclosure of budget information to prevent waste and misappropriation of resources, (d) government openness and freedom of press, (e) closure of international loopholes to stop corrupt public officials from accessing the international financial system, and (f) complying with citizens' demand for anti-corruption laws. It is our belief that implementation of the suggested policies will promote the development of the banking sector and assist in transforming the economies of the sampled countries, especially those in the ECOWAS region, as well as other developing and emerging economies across the globe.

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