Digitization and Economic Growth in Africa: The Role of Financial Sector Development

Authors : Abdul Ganiyu Iddrisu, Bei Chen

Abstract : Digitization is the process of transforming analog material into digital form, especially for storage and use in a computer. Significant development of information and communication technology (ICT) over the past years has encouraged many researchers to investigate its contribution to promoting economic growth and reducing poverty. Yet the compelling empirical evidence on the effects of digitization on economic growth remains weak, particularly in Africa. This is because extant studies that explicitly evaluate digitization and economic growth nexus are mostly reports and desk reviews. This points out an empirical knowledge gap in the literature. Hypothetically, digitization influences financial sector development which in turn influences economic growth. Digitization has changed the financial sector and its operating environment. Obstacles to access to financing, for instance, physical distance, minimum balance requirements, and low-income flows, among others can be circumvented. Savings have increased, micro-savers have opened bank accounts, and banks are now able to price short-term loans. This has the potential to develop the financial sector. However, empirical evidence on the digitization-financial development nexus is dearth. On the other hand, a number of studies maintained that financial sector development greatly influences growth of economies. We, therefore, argue that financial sector development is one of the transmission mechanisms through which digitization affects economic growth. Employing macro-country-level data from African countries and using fixed effects, random effects and Hausman-Taylor estimation approaches, this paper contributes to the literature by analysing economic growth in Africa, focusing on the role of digitization and financial sector development. First, we assess how digitization influences financial sector development in Africa. From an economic policy perspective, it is important to identify digitization determinants of financial sector development so that action can be taken to reduce the economic shocks associated with financial sector distortions. This nexus is rarely examined empirically in the literature. Secondly, we examine the effect of domestic credit to the private sector and stock market capitalization as a percentage of GDP as used to proxy for financial sector development on economic growth. Digitization is represented by the volume of digital/ICT equipment imported and GDP growth is used to proxy economic growth. Finally, we examine the effect of digitization on economic growth in the light of financial sector development. The following key results were found; first, digitalization propels financial sector development in Africa. Second, financial sector development enhances economic growth. Finally, contrary to our expectation, the results also indicate that digitalization conditioned on financial sector development tends to reduce economic growth in Africa. However, results of the net effects suggest that digitalization, overall, improve economic growth in Africa. We, therefore, conclude that, digitalization in Africa does not only develop the financial sector but unconditionally contributes the growth of the continent's economies.

Keywords : digitalization, financial sector development, Africa, economic growth
Conference Title : ICCIPED 2023 : International Conference on Culture, Institutions, Politics and Economic Development
Conference Location : Miami, United States
Conference Dates : March 16-17, 2023