African Development Review
Revue africaine de développement

African Development Review, Vol. 31, No. 4, 2019, 434–447

Economic Union, Finance and Growth: A Prognosis in West Africa

Kizito Uyi Ehigiamusoe and Hooi Hooi Lean*

***Abstract*:** This paper compares the impact of financial development on economic growth in the Union Économique et Monetaire Ouest Africaine (UEMOA) and non-UEMOA countries. It also examines the finance-growth nexus before and after the formation of UEMOA, as well as the indirect effect of economic union on economic growth through the financial sector. The study reveals a significant difference in the finance-growth nexus between UEMOA and non-UEMOA countries. Specifically, financial development has a robust positive impact on growth in UEMOA countries, while the impact is tenuous in non-UEMOA countries. However, we find no remarkable difference in the finance-growth nexus before and after the formation of UEMOA. We also reveal that economic union has no robust indirect effect on economic growth via the financial sector. The economic implication is that UEMOA could have economic benefits, but financial development is not a channel through which it influences growth. Therefore, it is necessary to reposition the union so that it can enhance the impact of finance on growth.

1. Introduction

The recent vote for the exit of Britain from the European Union (EU) and the political pressures or debates in some member countries to quit the EU calls for reassessment of the role of economic union in promoting economic growth and development. The fundamental issue is whether economic union is beneficial to member countries. The shortcomings of the economic and institutional arrangements of economic union include absence of fiscal and financial union, limited powers of the Union's Central Bank, productivity gaps and widening trade imbalances across countries (Shambaugh, 2012). However, theoretical evidence contends that economic union has the potentials to accelerate productivity growth, capital accumulation and economic growth. The possible channels through which economic union could influence economic growth include promotion of international trade, enhancement of sound institutions and strong macroeconomic stability, promotion of international financial integration and financial market development (Conti, 2014).

However, empirical literature on the link between economic union or integration and economic growth present mixed findings. Integration spurs economic growth by easing capital flow to capital-scarce nations and promoting the functioning of domestic financial systems via competition and importation of financial services (Klein and Olivei, 2008). Kamau (2010) noted that economic integration and trade have positive effects on economic growth. Similarly, Anyanwu (2003) and Bun and Klaassen (2007) found a significant positive impact of economic union on trade and output. However, the benefits of integration in developing countries depends on the quality of institutions, strong macroeconomic framework, prudent policies, human capital and financial markets development.

Moreover, some empirical studies conclude that economic growth can be stimulated through improvements in the operations of the financial system (Beck *et al.*, 2000; Levine *et al.*, 2000). A more developed financial sector enhances financial deepening, access and efficiency which boost economic growth. Besides, a liquid and deep financial system has the capacity to mobilize savings, allocate resources, reduce information and enforcement costs, diversify and manage risks,

*Hooi Hooi Lean (corresponding author), Economics Program, School of Social Sciences, Universiti Sains Malaysia, 11800 USM, Penang, Malaysia; e-mail: hooilean@usm.my. Kizito Uyi Ehigiamusoe, School of Finance and Economics, Taylor's University, Subang Jaya, Selangor, Malaysia. Hooi Hooi Lean, Economics Program, School of Social Sciences, Universiti Sains Malaysia, Gelugor, Penang, Malaysia; e-mail: ehiuyikizexcel@yahoo.com