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## Financial Reforms and the Finance-Growth Relationship in the Southern African Development Community (SADC) Region

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The role of finance in economic growth in SADC has been downplayed in most literature and policy initiatives given that financial sectors of SADC countries are regarded as less developed with the exception of South Africa. This notwithstanding, the role of finance in development of the region is gradually regaining importance amid a gradual shift from wholesale to retail finance in support of development of SMEs. Furthermore, there has been substantial progress over the past two decades in terms of financial inclusion, financial innovation, and cross-border banking in Africa's banking systems. In SADC, innovation in financial services has driven efficient financial transfers and increases the volume of trade. Most SADC countries introduced financial reforms in the 80s and 90s to facilitate development of the financial sectors, and studies acknowledge the role of financial reforms in enhancing financial development and growth in SADC countries. Southern Africa region has been registering significant growth rates in the last decade with growth being more widespread across countries, including non-resource-rich countries. The increasing role of finance in economic activity in the region justifies the need to look on the finance –growth nexus in SADC.

This study determines the causality relationship between financial development and economic growth in the SADC countries, extending the analysis to cover the effects of financial reforms. This study contributes to policy research on regional economic development from a financial perspective, especially in respect of the current drive towards regional financial integration among SADC countries.
Literature reviewed show that development of a financial system is crucially important in stimulating economic growth. Financial markets play a vital role in the economic growth process by channelling funds to the most efficient investors and by fostering entrepreneurial innovation on the relationship between finance and economic growth. Empirical evidence shows that a more developed financial system is associated with higher rates of economic growth. Although literature acknowledges the relationship between finance and growth, the debate on direction of remains inconclusive. There are three possible relationships between financial development and economic growth 1) the supply-leading or finance-led growth; 2) the demand-following or growth-driven finance and 3) the two-way causal relationship. The positive role of financial development in economic growth has, however, been questioned and not all researchers are convinced about the importance of financial systems. The role played by financial reforms, in particular financial liberalisation  in enhancing financial development in SADC region, is acknowledge in this study. The study included a dummy on financial reforms in the finance-growth nexus.

Using GMM and Dynamic Panel Estimations, the study establishes that in SADC financial development does not support or is adverse to economic growth. The two have an inverse relationship suggesting that financial development has a detrimental effect on economic growth in SADC. The results are consistent with findings by some studies whilst contrasting others. Possible explanations to this study's findings are threefold.

a. The under developed financial sectors of most SADC countries results in low credit levels, poor institutional structure and lack of depth and broader access to finance which retards growth.
b. The structure and distribution of credit in some SADC countries where in government borrowing crowds-out private sector credit. As such, credit in these countries goes towards non-productive sectors.
c. Though not empirically tested, the results could have been affected by strong country heterogeneity factors despite use of models that controls for country heterogeneity.

The financial reforms dummy, though negative, when interacted with financial development variables, however, causes coefficients for two of these to be positive. The implication is that the post liberalisation period financial development had a positive impact on growth in SADC. The deduction from the result could be that financial reforms managed to enhance development of financial systems of SADC countries and cause them to have a positive impact on their growth. The interacted dummy variables, however, remain insignificant implying possibly that the impact of financial reforms, though positive, remains minimal.

Panel Granger causality shows bidirectional causality between financial development and economic growth. Causality is, however, strong when running from economic growth to financial development and weak when running in the opposite direction suggesting that in SADC demand-following financial development is more pronounced to supply leading.

SADC countries should address the underlying structural issues in their financial systems by strengthening weak financial systems and enhancing performance of the financial sectors. There is need for strengthening financial regulation and improve on financial and regulatory infrastructure. The region should also promote financial integration in order to enhance development of underdeveloped financial systems through enhanced interconnectedness and spill-overs. Countries needs to constantly improve their financial sectors through continuous reforms. Pro-growth policies should be intensified so that growth subsequently pulls with it financial development given a strong demand-following causality.

**Lessons for the South African Economy:**

a. South Africa remains a dominant economic in the region and has opportunity of expanding its own credit market by developing credit market for other SADC countries.
b. Financial integration is important for the SADC region, but more importantly for the South African Economy as it anchors financial development in the region
c. South Africa needs to drive region financial integration agenda as it may strength its own economy and has opportunity of using its own currency in the region.
d. Increased Government borrowing form the financial sector may crowd out private sector borrowings.
e. South Africa can strengthen its dominance in the region by driving structural realignment of financial sector of other SADC countries through supporting regulatory and infrastructure development as well as further reforms.
f. Growth drives financial development in the region. However, for growth to occur there is need for financial resources. As such, South Africa could utilise its developed financial

systems and integration with global markets to source credit and investment from the global market and redistribute it in the region through financial structures around primary commodities abundant in may SADC countries.