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Trade Finance and Economic Growth in Nigeria: A Fully Modified OLS Approach

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Abstract

The study examined trade financing and economic growth in Nigeria from 1981 to 2024. The World Development Indicators and the Statistical Bulletin of the Central Bank of Nigeria were the primary sources of secondary data applied in the research. Real GDP serves as the dependent variable, with Nigeria's export credit, import credit, and letter of credit serving as the explanatory factors in the study. Full Modified Ordinary Least Squares (FMOLS) is an econometric technique that was applied to examine the data. The results showed that real GDP is positively affected by a rise in export trade credit. The same holds true for import trade credit; it boosts real GDP. Real GDP is negatively impacted by the issue of the letter of credit. The research found that trade financing helped Nigeria's economy grow over the studied period. The study consequently recommends that, import trade should be more on capital-intensive goods where Nigeria has a disadvantage in either production or expertise, credit to the private sector should be channeled into the production of capital goods and services which will attract more foreign exchange into the country.

Keywords:

Export credit, Import credit, Letter of credit, Real GDP, Trade finance.

1. Introduction

Trade finance, which includes funding exports and imports, provides financial assistance to individuals and businesses to trade both locally and globally. Export financing, on the other hand, assists individuals and businesses in selling their goods and services internationally by giving an

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advance or guaranteed payment. On the other side, import finance assists individuals and businesses in selling their goods and services locally. Trade credit, cash advances, purchase order finance, receivables discounting, term loans, and export finance are some examples of foreign trade financing. Many financial organisations, such as deposit money banks, insurance firms, export credit agencies, and other associated companies, finance both imports and exports to promote economic growth.

Meanwhile, in terms of economic growth, the Nigerian economy has been seen to have performed well behind expectations in relation to its vast natural endowment and similar African and global nations. Despite possessing abundant solid natural resources, a population of over 200 million people, and one of the world's biggest gas and crude oil reserves. For example, the country's economic performance has been judged lacklustre when compared to growing Asian nations such as India, Thailand, Malaysia, China, and Indonesia. In terms of GDP per capita, these countries trailed Nigeria substantially in 1970, but they were finally able to change their economies and become major players in the global economy (Chinda & Nyeche, 2024).

Commerce finance has a substantial influence on the growth of the Nigerian economy because it facilitates international commerce through tools such as letters of credit, which decrease risk for exporters and ensure payment. Nonetheless, Nigeria's trade finance system has flaws, including an overreliance on oil, which makes the economy vulnerable to price fluctuations and limits diversification into other areas that drive development, such as manufacturing and agriculture. Policies should focus on expanding the export base, increasing security, strengthening the business climate, and continuing banking sector reforms to funnel more capital towards successful businesses in order to generate substantial growth.

Given the lack of appropriate financing to the external trade sector at a time when the demand to extend the nation's trade border is growing, Nigeria's economic development has remained below expectations. As a result, there is a need to better understand the impact of foreign trade finance on Nigerian economic growth. This study differs from previous studies in that it considers credit to export trade, credit to import trade, and letters of credit as trade finance proxies, as well as real GDP as a proxy for Nigeria's economic development.

2. Literature Review

Trade finance, in its broadest sense, refers to the practice of directing investment, loan, or credit capital towards businesses and individuals who would make the most use of it (CBN, 2023). When it comes to investment, production, and export, NEXIM (1997) defined export financing as the availability of money to the exporter at favourable conditions. Financing, then, is the process of providing and allocating capital for a specific commercial enterprise with the goal of generating economic growth over time. Growth in the economy, as measured by GDP, occurs when an economy's production rises over a long period of time, often a year. Therefore, a letter of credit or other type of trade financing is necessary to encourage economic growth.

Endogenous economic development theory, upon which the study is based, holds that both public and private institutions should work to foster an environment conducive to innovation by offering financial incentives to businesses and individuals who take creative risks. There are favourable externalities that may be capitalised on, in congruent with proponents of endogenous growth theory, when a knowledge economy with high value-added capabilities develops and maintains a competitive advantage in the global economy. They believe that investments in human capital are crucial to long-term prosperity and that new capital investment, together with private sector investment, is a major driver of technological advancement.

Using the ARDL model, Chinda and Nyeche (2024) empirically studied the effect of foreign trade finance on GDP per capita in Nigeria from 1981 to 2022. Based on the results, we know that NEXIMC bank credit boosts GDP temporarily but has a negative long-term impact, that deposit money bank credit to import trade boosts GDP per capita, that letter of credit issuance hurts GDP per capita, and that an appreciation of the exchange rate hurts GDP per capita. In addition, Obieche and Onuabi (2024) applied multiple regressions and the Granger causality test to look at export financing and Nigeria's growth from 1990 to 2023. Our research showed that export financing factors accounted for 56.8% of the variance in GDP growth. Exchange rates have a detrimental impact on economic growth in Nigeria, although export grants, microcredit, commercial bank loans, and import-export banks all contribute positively.

Using multiple regressions and the Granger causality test, Erickson and Miftahu (2023) looked at how export trading affected economic development in Nigeria from 1996 to 2021. In the time frame considered, the results showed that oil export had a favourable and substantial effect on the expansion of Nigeria's economy. The outcome also demonstrated that exports of non-oil commodities substantially and positively affect GDP. There is a one-way causal relationship between oil exports and GDP, in congruent with the granger causality test.

From 2000 to 2020, Itah and Obayori (2022) applied the ARDL and ECM to study non-oil export financing and economic development in Nigeria. The results showed that interest rates substantially reduce real GDP in the long and medium term, whereas financing for non-oil exports had a considerably beneficial effect on real GDP. Another study that looks at export promotion schemes and the rise of agricultural output in Nigeria is Okunlola and Akinlo (2021). utilising the ARDL model, ECM, impulse response function, and variance decomposition, yearly time-series data from 198-0 to 2014 were estimated. This research employed the following export promotion schemes: the ACGSF, government capital spending on agriculture, FDI in the agricultural sector, and the government. Government export promotion policies boost agricultural output, in congruent with the results.

Arikpo and Adebisi (2017) applied the Vector Error Correction Mechanism (VECM) to study the impact of deposit money bank funding on real sector production in Nigeria. The results showed that in Nigeria, the trade sector is substantially impacted by deposit money bank financing over the long run, while the agricultural sector is unaffected. Similarly, interest rate spread has a favourable effect on agricultural sector output, but a negative effect on trade sector output.

From 1986 to 2016, Hsiao (2017) applied an ARDL bounds testing technique to analyse the effect of deposit money bank credit on the growth of Nigeria's exports. The empirical results shown that, in the long run, deposit money bank credit at lags one and two has a direct and substantial influence on the Nigerian export sector, however, in the short run, there is an inverse but substantial link between the two. The report suggests that the Nigerian government lower interest rates so that export-related investors can more easily access loanable funds, and that the central bank implement sufficient policies to deepen the banking sector, which would increase supply and decrease the cost of credit for export-related businesses.

3. Methodology

From 1981 to 2024, secondary data on trade finance, credits to import trade, and letters of credit were culled from the CBN statistics bulletin and the NEXIM archive. Real GDP was applied as a proxy for economic growth in Nigeria. For this investigation, the analysts applied the Fully Modified Ordinary Least Square (OLS) method to find out how the independent variables affected the dependent one. The time series data was further checked for stationarity utilising the ADF unit root test (Dickey & Fuller, 1979). Because it can estimate long-run relations between two or more variables following stationarity, the FMOLS approach was chosen.

Based on empirical evidence, the following is the FMOLS non-linear representation of the calculated econometric model:

$$LnRGDP = b_0 + b_1LnEXPC + b_2LnIMPC + b_2LnLOC + U \quad (1)$$

Where;

RGDP = Real Gross Domestic Product

EXPC = Export Credit

IMPC = Import Credit

LOC = Letter of Credit

b_0 = Constant Term

b1-b3 = Slope parameters or short dynamic coefficients of the regressors

4. Results and Discussion

The results of the unit root test is presented in Table 1 below;

Table 1: Augmented Dickey Fuller Unit Root Test for the Estimated Model

Variables	**Level**		**First Difference**		**Order of Integration**
	ADF Statistic	**Critical Value**	**ADF Statistic**	**Critical Value**	
Ln(RGDP)	-2.023960	-3.297558	-4.952043	-3.297558	I(1)
Ln(EXPC)	-2.065694	-3.297558	-3.896340	-3.297558	I(1)
Ln(IMPC)	-1.901343	-3.297558	-6.071713	-3.297558	I(1)
Ln(LOC)	-3.00012	-3.297558	-6.152858	-3.297558	I(1)

Source: E Views Output

The time series data utilised to analyse trade financing and economic growth in Nigeria meet the criterion of stationarity or stability, as shown in Table 1. None of the variables were stationary at the level when looking at the output closely. After the first differencing, though, they became immobile.

Table 2: Fully Modified Ordinary Least Square for the Estimated Model

Dependent Variable: LOG(RGDP)				
Method: Fully Modified Least Squares (FMOLS)				
Date: 09/19/25 Time: 11:48				
Sample (adjusted): 1981 2024				
Included observations: 44 after adjustments				
Cointegrating equation deterministics: C				
Long-run covariance estimate (Bartlett kernel, Newey-West fixed				
bandwidth = 4.0000)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(EXPC)	0.910576	0.4198470	2.168828	0.0023
LOG(IMPC)	0.658316	0.3065445	2.147538	0.0474
LOG(LOC)	-0.233414	0.0076125	-3.066187	0.0009
C	4.284680	2.9759682	1.439760	0.2013
R-squared	0.897228	Mean dependent var		16.30006
Adjusted R-squared	0.837034	S.D. dependent var		0.602149
S.E. of regression	0.202989	Sum squared resid		1.096411
Long-run variance	0.711020			

Source: E Views Output

Table 2 shows the long-run estimate of the FMOLS cointegrating equation. Evidence from the regression analysis revealed that credit to export commerce (EXPC) has a favourable connection

with real GDP that is statistically substantial at 5%. As a result, a percentage increase in lending to export commerce leads to a 91% rise in real GDP over time. This debate is compatible with economic theory or judgement, and it demonstrates how the long-term effects of continuing to give funding to Nigerian exporters would strengthen the Nigerian economy. The results are consistent with the study of Obieche and Onuabi (2024) on export financing and Nigerian development from 1990 to 2023. Our research revealed that commercial bank credit, export import banks, microcredit export credit, and export grants all had a favourable impact on Nigeria's economic growth.

Similarly, the credit to import trade (IMPC) coefficient has a favourable association with real GDP and is statistically substantial at 5%. As a result, an increase in bank credit to import transactions in Nigeria produces an approximately 65.8 percent boost in economic growth. This means that when economic expansion continues, credit and loans are offered to people active in import commerce. The study validates Chinda and Nyeche's (2024) empirical analysis on the influence of international trade finance on per capita GDP in Nigeria from 1981 to 2022, which showed that increasing import trade credit had a favourable effect on per capita GDP.

Meanwhile, the coefficient of letter of credit (LOC) has a negative and substantial impact on the dependent variable. The conclusion backs with Chinda and Nyeche's (2024) findings that export-import bank credit has a negative long-run effect on per capita GDP. Based on the findings' coefficient of determination (Adjusted R-Squared), the three trade finance variables explained about 83.7 percent of the variation in economic growth. Thus, the predicted model provides an excellent match.

Table 3: Normality Result of Post Estimation Test

Normally Test	Skewness	Probability	Kurtosis value
0.1156613	0.116446	0.22099	2.99688

Source: E Views Output

The post-estimation outcome of Nigeria's trade finance and economic development was displayed in Table 3. The likelihood number is higher than the five percent crucial value, in congruent with the outcome. Consequently, it was determined that the estimate series adheres to the normal distribution.

Table 4: Breusch-Godfrey Serial Correlation LM Test

F-statistic	3.728462	Prob. F(2,19)
Obs*R-squared	9.00590	Prob. Chi-Square (2) 0.0607

Source: E Views Output

The serial correlation analysis indicated that there is no indication of serial correlation in the calculated residuals. This claim is predicated on the observation that the probability values of the serial correlation test exceed 0.05. Consequently, the model is applicable for policy execution.

5. Conclusion and Recommendations

From 1981 to 2024, the research looked at trade financing and GDP growth in Nigeria. The study relied heavily on secondary data culled from the World Development Indicators and the Central Bank of Nigeria's Statistical Bulletin. With real GDP as the dependent variable, the study used Nigeria's export credit, import credit, and letter of credit as explanatory factors. All of the data was examined using the econometric technique known as FMOLS. The results showed that real GDP is positively affected by a rise in export trade credit. Similarly, real GDP is positively impacted by import trade credit. The actual GDP takes a hit because the letter of credit is issued. Over the time period under consideration, the study found that trade financing had a favourable effect on economic growth in Nigeria. The study concludes that capital-intensive items, for which Nigeria does not have the necessary production capacity or knowledge, should be prioritised for import. In order to increase the country's foreign exchange inflow, it also recommends that private sector loans be used to produce capital goods and services.

The findings suggest that import trade should focus on capital-intensive goods where Nigeria lacks production capabilities or expertise. Additionally, credit to the private sector should be directed towards the production of capital goods and services to enhance foreign exchange inflow into the country. The Nigerian government should enhance export commerce by developing sustainable social infrastructure, including trade facilities, railways, airports, energy supplies, and other utilities. Emerging industries should be permitted to confront rivalry with their counterparts to facilitate the enhancement of export product quality in the near future.