

Financial Sector Growth And Poverty Reduction: Evidence From Nigeria .

Adesanya, Teniola Aboosedo & Ajala, Olufunmilayo Adekemi
Department of Banking & Finance
The Polytechnic, Ibadan,
Oyo State, Nigeria

E-mail: tennytone@yahoo.com, adekemiajala@gmail.com
Phone:08034335938, 08033752838

ABSTRACT

The paper examines the contribution of financial sector growth to poverty reduction in Nigeria. Building on earlier research which had established links between financial development and economic growth, and economic growth and poverty reduction, the paper employs a regression analysis of Ordinary Least Square to investigate the link between financial sector growth and poverty reduction in Nigeria. The empirical analysis shows that financial sector growth had not contributed to poverty reduction in Nigeria. This could be due to the high interest rate on lending or because financial institutions find it difficult to give out loans to owners of small scale businesses due to their inability to provide adequate collateral. The paper suggests more policy measures in the financial sector that will help to reduce poverty in Nigeria.

Keywords: Financial Sector, Growth, Poverty Reduction, Nigeria and Investigation

1. INTRODUCTION

The concept of poverty is a multifaceted which manifests itself in different forms depending on the nature and extent of human deprivation. In absolute terms, poverty suggests insufficient or the total lack of basic necessities like food, housing and medical cares (Olaniyan and Bankole, 2005). It involves the inadequacy of education and environmental services, consumer goods, recreational opportunities, neighborhood amenities and transport facilities. In relative terms, people are poverty-stricken when their incomes fall radically below the community average (World Bank 2000). This implies that such people cannot have what the larger society regard as the minimum necessity for a decent living.

Poverty reduction has been an important challenge to the development of Nigeria over the decades (Ebimobowei et al. 2012). This is because according to Akinlo et al. (2012), the level of poverty has continued to increase over the years. For example, the number of those in poverty increased from 27 per cent in 1980 to 46 per cent in 1985; it declined slightly to 42 per cent in 1992 and increased very sharply to 67 percent in 1996. The figure has consistently hovered around 70 per cent between 2000 and 2007 (NBS, 2008). Hence, part of the problems facing the poor is lack of access to formal sector funds to enable them to take advantage of economic opportunities to increase their level of output and move out of poverty. According to Dhrifi (2013), issues around finance development and poverty had been discussed in the theoretical literature that showed the relationship between financial development and social welfare. The majority of these studies are unified almost on the existence of a significant positive effect of financial development on growth.

Researchers in this subject suggest the idea that a high growth rate, induced by financial development contributes automatically to poverty reduction (trickle-down theory). The researchers are harnessed to study the effects of financial development on poverty reduction through the fruits of growth and neglect the direct effects that could affect poverty reduction through the channel of credit, savings, insurance services and income inequality (Dhrifi, 2013).

In the same vein, financial sector is the set of institutions, instruments, markets and regulatory framework that permit transactions to be made through the extension of credit. According to Wikipedia, financial sector development takes place when financial instruments, markets, and intermediaries work together to reduce the costs of information, enforcement and transactions. A solid and well-functioning financial sector is a powerful engine behind economic growth. It generates local savings, which in turn lead to productive investments in local business. Furthermore, effective banks can channel international streams of private remittances. The financial sector therefore provides the rudiments for income-growth and job creation. In developing countries, economic or income inequalities highlights the gap between individuals or households. This shows the different between individuals or population in the distribution of their assets, wealth or income.

More so, the financial system constitutes one of the major systems which income is being channeled into the economy. This comprises of financial institutions and financial markets. The financial institutions include the banking system - central bank, banking institutions (commercial banks, merchant/investment banks, other deposit-taking institutions) and non-bank financial institutions (provident/pension funds,

insurance, development finance institutions (DFIs), others). Financial markets comprise money and foreign exchange markets; capital markets - equity markets, bond markets, public debt securities, private debt securities – and derivatives markets (Mordi, 2012). However, policy makers want to make policies that will ameliorate level of poverty among people in the nation. Therefore, having the understanding of impacts of financial development on poverty reduction would have assisted them in their policy making. Therefore, in this study, the following questions are very important. Does the growth rate of financial system has an impact on poverty reduction? Is there a link between the financial sector development and poverty

2. LITERATURE REVIEW

The relationship between financial development and economic growth has been examined extensively in the literature, but with conflicting results (Dhrifi, 2013). According to Dhrifi, (2013), there are three existing views in the literature regarding the relationship between financial development, economic growth and level of poverty. The first view argues that financial development lead to economic growths which increase the standard of living and reduce the level of poverty. The second view maintains that it is economic growth that drives the development of the financial sector, while the third-view contends that there is a bi-directional causality between financial development and economic growth.

On this note, quite numbers of papers have made attempts to investigate the relationship between financial development, economic growth and level of poverty. The impact can be direct or indirect. Few studies examine empirically the impact of financial development and economic growth on poverty reduction. Hence, it is important to study links between financial development and social welfare. Jalilian et al. (2001) stated that theoretical predictions advocate that financial development contributes directly to poverty reduction: first, in a direct way through savings, insurance services and access to credits that can enhance the productivity of assets the poor by allowing them to invest in new technologies, or investing in education and health. Financial development can improve opportunities for the poor to have access to formal finance.

Second, financial system enables the poor to access financial services, particularly credit and insurance risk, enhancing the productive assets of the poor, by improving productivity and increasing the potential to achieve sustainable gains. Indeed, the direct relationship between financial development and poverty reduction depends on financial instruments, services and institutions available for poor. However, the economic literature developed from this perspective shows that the poor are often constrained in their access to financial services and emphasizes that the central issue in finance is how to provide financial services to poor households on a sustainable basis (Dhrifi, 2013).

In terms of indirect effects, financial development can reduce poverty through its impact on economic growth. According to World Bank, (2001), once economic growth takes place, it would automatically lead to reduction of poverty. Most of the work done in this perspective point out that the evolution of the formal financial system has no direct effect on income of the poor, that these have no access to financial services, other than that through growth. Bank credits may be hindered by high unit costs of small loans,

2.1 Poverty in Nigeria: Causes and Effects

Poverty in Nigeria has been a long standing issue and its reality is manifested in worsening incidence and severity over the years, despite the vast human and natural resources, economic and development potentials that is blessed with the country. In Nigeria, HNLSS (2009) described poverty profile in Nigeria to consist of relative, abject and absolute poverty. Relative poverty is the condition in which people lack the minimum amount of income needed in order to maintain the average standard of living in the society in which they live while, absolute poverty is a condition characterized by severe deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health, shelter, education and information. It depends not only on income but also on access to social services.

Poverty in Nigeria is caused by numerous factors. The economic crisis of 1980's as a result of shocks, high interest rate and poor term of trade, external debt crisis, instability and misallocation of scarce foreign exchange, fiscal indiscipline, corruption and weak external demand on domestic industrialized goods was so severe, thus causing an increase in poverty (Ijaiya, 1998). High birth rate has contributed to overpopulation in developing countries. Overpopulation can also be identified as one of the causes of poverty in Nigeria. This is the situation where large numbers of people are with few resources and too little space. Overpopulation can result from either a high population density (the ratio of people to land area) or from low amounts of resources, or from both.

The lack of income and productive resources are causes of poverty in developing country. World Bank, (1995), states that insufficient income cannot ensure sustainable livelihoods; its causality are hunger and malnutrition, ill-health, limited or lack of access to education and other basic services which increases morbidity and mortality from illness. Homelessness, inadequate housing, unsafe and depredated environment, social discrimination against women and minority tribes, and exclusion are also causes of poverty in the country. Urbanization posed some problems, such as overcrowding, congestion, contamination of water, bad sanitation, crime and additional social problems. For instance, According to Ijaiya (1998), in 1991, only about 46 percent of the total population had access to safe water while only about 67 percent had access to basic health care; and where available they were in low quality (World Bank 1995).

Ijaiya (1998) state that the poor state of the country's education also has its turn on the poor people. Over the years, the country's educational system has fallen, shortage of funds continued to be a constraint to educational development at all levels. At the primary school level, the shortage of funds resulted to delays in the payment of teacher's salaries, and inadequate supply of books and teaching aids. Worst hit are girls whose parents never want to send to school because they are usually seen as household help. Poor women, because of their lack of education, often have too many children, and poor health conditions, frequently suffer from hunger and malnutrition and related illness which often undermine their productivity. Thus, this extends poverty in Nigeria.

2.2 Economic Cause of Poverty

Changes in labor markets in developing countries have also contributed to increased poverty levels. For instance, the number of relatively high-paying manufacturing jobs has declined, while the demand for workers in service- and technology-related industries has increased. Hence, people have learned the skills required for jobs that involve manual labor, such as those in manufacturing, either on the job or through easily accessible school vocational programs. As these jobs are replaced by service- and technology-related jobs—jobs that usually require skills taught at the college level—people who cannot afford a college education find it increasingly difficult to obtain well-paying work.

In many developing nations the number of people living in poverty has increased due to rising disparities in the distribution of resources within these countries. Parts of these problems are high rate of unemployment, unfair trade, corruption and poor governance can create poor impacts of financial development on poverty. Global financial crisis has ravaged the world's economy has unemployment increased. With a higher number of unemployed people, crime rates in the cities increases as people grow desperate to survive. In addition, lack of subsidies and high tariffs, and neglect for mechanized agriculture in the developing world drains the taxed money and increases prices for consumers in Nigeria, decreasing competition and efficiency and preventing exports by more competitive agricultural and other sectors in the developed world due to retaliatory trade barriers and undermining the very type of industry in which developing countries do. Not only that, under-utilization of resources, inflation, poor and inability to access loans from banks, bad financial structures in the country affects the economy. Corruption, both in government and business, places heavy cost on society. It occurs at all levels of society, from local and national governments, civil society, judiciary functions, large and small businesses, military and other services its effects are: unequal trade agreements, bad structural adjustment policies etc.

2.3 Methodological Review

Dhrifi (2013) study the direct and indirect effects of financial development on poverty reduction, taking into account the simultaneous effects on growth and on inequality. The study employed simultaneous equation model and found out that while the indirect effect of financial development on poverty is not robust and ambiguous, the direct effect of financial development, through the channels of insurance, access to credit services and savings, is robust to reducing poverty. Also, effect depends on the magnitude and sign of the effects of financial development on inequality and growth.

Beck et al. (2004) examines the relationship between financial development and both changes in the distribution of income and changes in the level of poverty. The study made use of descriptive statistics and correlation. The findings revealed that financial development reduces income inequality by disproportionately boosting the incomes of the poor. Countries with better-developed financial intermediaries experience faster declines in measures of both poverty and income inequality.

3. METHODS OF ANALYSIS

This study takes idea from Dhrifi (2013) and Ravailon et al. (1992). This study employs a regression analysis of Ordinary Least Square Method (OLS) to investigate the impact of financial development on poverty reduction in Nigeria. The study tests for unit root using Augmented Dickey-Fuller at 2nd difference to test for error and error correction.

3.1 Model Specification

Therefore the model is specified below as:

$GDPC =$

Where GDPC is the index of poverty, it is measured by household final consumption expenditure. RGDP represent Real GDP. FD is an index measuring financial development. FD comprises of Deposit money bank assets (DMB), Commercial bank credits (CC). Water source is (WS). (SAN) is Sanitation facilities. is the error term.

3.2 Data Sources

The data used in the study are obtained from World Bank and International Financial Statistics.

4. RESULTS AND DISCUSSION

The tables below present the results for this study. Table 4.1 to 4.6 show the unit root test for the dependent and independent variable used for the study. For the unit root test, the study performed Augmented Dickey-fuller test statistics at 2nd difference. Table 4.1 show the unit root test for the dependent variable Gross Domestic Product per capital (GDPC). This variable is used to measure social welfare and control for poverty index in the model. It is stationary at 2nd difference (0.000).

Table 4.1: Unit Root Test For Gross Domestic Product Per Capital

Null Hypothesis: D(GDPC,2) has a unit root

Exogenous: Constant

Lag Length: 1 (Automatic - based on SIC, maxlag=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-5.817778	0.0002
Test critical values:		
1% level	-3.831511	
5% level	-3.029970	
10% level	-2.655194	

*MacKinnon (1996) one-sided p-values.

Warning: Probabilities and critical values calculated for 20 observations and may not be accurate for a sample size of 19

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(GDPC,3)

Method: Least Squares

Date: 06/23/14 Time: 22:39

Sample (adjusted): 1993 2011

Included observations: 19 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(GDPC(-1),2)	-1.750548	0.300896	-5.817778	0.0000
D(GDPC(-1),3)	0.529693	0.199541	2.654564	0.0173
C	227.9168	313.3038	0.727463	0.4775
R-squared	0.712839	Mean dependent var		34.20775
Adjusted R-squared	0.676944	S.D. dependent var		2390.646
S.E. of regression	1358.796	Akaike info criterion		17.41052
Sum squared resid	29541211	Schwarz criterion		17.55965
Log likelihood	-162.4000	Hannan-Quinn criter.		17.43576
F-statistic	19.85894	Durbin-Watson stat		1.804395
Prob(F-statistic)	0.000046			

Table 4.2 below is the unit root test for the exogenous variable Real Gross Domestic Product (RGDP). This is the total monetary value of all goods and services produced in the country for a year. It is stationary at 2nd difference (0.000)

Table 4.2 : Unit Root Test For Real Gross Domestic Product

Null Hypothesis: D(RGDP,2) has a unit root

Exogenous: Constant

Lag Length: 1 (Automatic - based on SIC, maxlag=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-5.766226	0.0002
Test critical values: 1% level	-3.831511	
5% level	-3.029970	
10% level	-2.655194	

*MacKinnon (1996) one-sided p-values.

Warning: Probabilities and critical values calculated for 20 observations
and may not be accurate for a sample size of 19

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(RGDP,3)

Method: Least Squares

Date: 06/23/14 Time: 22:43

Sample (adjusted): 1993 2011

Included observations: 19 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(RGDP(-1),2)	-1.749355	0.303380	-5.766226	0.0000
D(RGDP(-1),3)	0.545624	0.203286	2.684016	0.0163
C	5.89E+10	4.12E+10	1.427862	0.1726
R-squared	0.708594	Mean dependent var		4.42E+09
Adjusted R-squared	0.672168	S.D. dependent var		3.07E+11
S.E. of regression	1.76E+11	Akaike info criterion		54.76384
Sum squared resid	4.93E+23	Schwarz criterion		54.91296
Log likelihood	-517.2565	Hannan-Quinn criter.		54.78908
F-statistic	19.45310	Durbin-Watson stat		1.749440
Prob(F-statistic)	0.000052			

Table 4.3: Unit Root Test For Commercial Banks Credit

Null Hypothesis: D(CC,2) has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic - based on SIC, maxlag=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-5.332777	0.0004
Test critical values:		
1% level	-3.808546	
5% level	-3.020686	
10% level	-2.650413	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(CC,3)

Method: Least Squares

Date: 06/24/14 Time: 08:22

Sample (adjusted): 1992 2011

Included observations: 20 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(CC(-1),2)	-1.210020	0.226902	-5.332777	0.0000
C	0.117697	0.964616	0.122015	0.9042
R-squared	0.612391	Mean dependent var		0.275000
Adjusted R-squared	0.590857	S.D. dependent var		6.741066
S.E. of regression	4.311876	Akaike info criterion		5.855263
Sum squared resid	334.6609	Schwarz criterion		5.954836
Log likelihood	-56.55263	Hannan-Quinn criter.		5.874700
F-statistic	28.43851	Durbin-Watson stat		2.066520
Prob(F-statistic)	0.000045			

Table 4.4: Unit Root Test For Deposit Money Bank Assets To GDP

Null Hypothesis: D(DMB,2) has a unit root

Exogenous: Constant

Lag Length: 1 (Automatic - based on SIC, maxlag=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-6.058365	0.0001
Test critical values:		
1% level	-3.831511	
5% level	-3.029970	
10% level	-2.655194	

*MacKinnon (1996) one-sided p-values.

Warning: Probabilities and critical values calculated for 20 observations and may not be accurate for a sample size of 19

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(DMB,3)

Method: Least Squares

Date: 06/24/14 Time: 08:23
Sample (adjusted): 1993 2011
Included observations: 19 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(DMB(-1),2)	-1.903179	0.314141	-6.058365	0.0000
D(DMB(-1),3)	0.719924	0.207398	3.471217	0.0031
C	-0.148881	0.978254	-0.152191	0.8809
R-squared	0.717500	Mean dependent var		0.152632
Adjusted R-squared	0.682188	S.D. dependent var		7.538152
S.E. of regression	4.249620	Akaike info criterion		5.875476
Sum squared resid	288.9484	Schwarz criterion		6.024597
Log likelihood	-52.81702	Hannan-Quinn criter.		5.900713
F-statistic	20.31862	Durbin-Watson stat		1.987491
Prob(F-statistic)	0.000041			

Table 4.5: Unit Root Test For Sanitation Facilities

Null Hypothesis: D(SAN,2) has a unit root
Exogenous: Constant
Lag Length: 2 (Automatic - based on SIC, maxlag=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-6.660519	0.0000
Test critical values:		
1% level	-3.857386	
5% level	-3.040391	
10% level	-2.660551	

*MacKinnon (1996) one-sided p-values.

Warning: Probabilities and critical values calculated for 20 observations and may not be accurate for a sample size of 18

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(SAN,3); Method: Least Squares; Date: 06/24/14 Time: 08:26

Sample (adjusted): 1994 2011; Included observations: 18 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(SAN(-1),2)	-3.868707	0.580842	-6.660519	0.0000
D(SAN(-1),3)	1.704837	0.431607	3.949975	0.0015
D(SAN(-2),3)	0.655761	0.210497	3.115304	0.0076
C	-0.033705	0.115352	-0.292190	0.7744
R-squared	0.899002	Mean dependent var		-0.055556
Adjusted R-squared	0.877360	S.D. dependent var		1.392088
S.E. of regression	0.487509	Akaike info criterion		1.594116
Sum squared resid	3.327316	Schwarz criterion		1.791976
Log likelihood	-10.34704	Hannan-Quinn criter.		1.621398
F-statistic	41.53896	Durbin-Watson stat		1.968691
Prob(F-statistic)	0.000000			

Table 4.6: Unit Root Test for Water Source

Null Hypothesis: D(WS,2) has a unit root
Exogenous: Constant
Lag Length: 4 (Automatic - based on SIC, maxlag=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-4.683120	0.0023
Test critical values:		
1% level	-3.920350	
5% level	-3.065585	
10% level	-2.673459	

*MacKinnon (1996) one-sided p-values.
Warning: Probabilities and critical values calculated for 20 observations
and may not be accurate for a sample size of 16

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(WS,3)
Method: Least Squares
Date: 06/24/14 Time: 08:28
Sample (adjusted): 1996 2011
Included observations: 16 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(WS(-1),2)	-7.325132	1.564156	-4.683120	0.0009
D(WS(-1),3)	4.770492	1.363641	3.498348	0.0057
D(WS(-2),3)	2.898989	1.016445	2.852086	0.0172
D(WS(-3),3)	1.416405	0.578108	2.450070	0.0343
D(WS(-4),3)	0.495059	0.237317	2.086068	0.0635
C	-0.057996	0.129510	-0.447814	0.6638
R-squared	0.949411	Mean dependent var		-0.125000
Adjusted R-squared	0.924116	S.D. dependent var		1.857418
S.E. of regression	0.511663	Akaike info criterion		1.777697
Sum squared resid	2.617995	Schwarz criterion		2.067418
Log likelihood	-8.221578	Hannan-Quinn criter.		1.792533
F-statistic	37.53407	Durbin-Watson stat		1.956276
Prob(F-statistic)	0.000004			

Table 4.7 below shows the regression results for this study. The results contain estimation of ordinary least square method and a unit root test. From the result, variables such as real gross domestic product (RGDP), sanitation facilities percentage of population and water source percentage of population with access are significant at (0.000), (0.28) and (0.05) respectively. The model has a very robust coefficient of determination at 90%. This shows a good fitness of the model.

Table 4.7: REGRESSION RESULT

Dependent Variable: GDCP
Method: Least Squares
Date: 06/24/14 Time: 08:30
Sample: 1989 2011
Included observations: 23

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	30539.19	35122.24	0.869511	0.3967
RGDP	4.99E-09	3.58E-10	13.95759	0.0000
CC	31.69617	107.5415	0.294734	0.7718
DMB	-11.14688	102.0839	-0.109193	0.9143
SAN	660.1771	599.0806	1.101984	0.2858
WS	-586.6313	287.7688	-2.038551	0.0574
R-squared	0.993650	Mean dependent var		60613.60
Adjusted R-squared	0.991782	S.D. dependent var		9871.825
S.E. of regression	894.8865	Akaike info criterion		16.65073
Sum squared resid	13613971	Schwarz criterion		16.94694
Log likelihood	-185.4834	Hannan-Quinn criter.		16.72523
F-statistic	532.0411	Durbin-Watson stat		1.015537
Prob(F-statistic)	0.000000			

The coefficient of Real Gross Domestic product (4.99) shows that it has a positive relationship with the dependent variable Gross Domestic Product per Capital. Since the dependent variable measure social welfare, it implies that an increase in national income has no impact on the reduction of poverty in Nigeria. This is because, the higher the Real Gross Domestic Product the higher the level of poverty. The coefficient of sanitation facilities percentage of population is 660.1. This shows that there is a positive relationship between sanitation facilities and the measure of poverty (Gross Domestic Product per Capital). It implies that the more poverty grows among society the more the sanitation among people gone worse and poor. In the same vein, the coefficient of water source percentage of population with access is -586.6.

This has shown that there is a negative relationship between the measure of welfare and water source. The implication is that as poverty rise among people, accessibility to portable water reduces. This means that people will have to depend on poor water sources (well water, spring water source) to survive. This might create health problem which will eventually make poverty worse. Nevertheless, other exogenous variables such commercial banks credit (CC) and Deposit money bank assets to GDP (DMB) which measure financial development are not significant in the regression result. These are (0.77) and (0.91) respectively. This implies that the loan which commercial banks created to finance small and medium entrepreneur business (microfinance) and improve welfare have no impact on the reduction of poverty.

5. CONCLUSION

This study looks at the impact of financial development on poverty reduction in Nigeria. In this study, it shows the links between financial development and poverty in Nigeria. Also, the study exposes the causes and effects of poverty in Nigeria. This study employed Ordinary Least Square method and test for unit root. In our results which have been discussed earlier, it can be concluded that there are no impacts of financial development on the reduction of poverty in Nigeria. Therefore, this study suggests more policy measures to improve financial system in other to reduce poverty in Nigeria.

5.1 Recommendations

The paper recommends that the lending rate should be reduced to most a single digit so that small scale business owners can access fund easily. Also banks should look for other ways of securing the loans to be given out, instead of asking this customers to bring collaterals which is obviously impossible. Lastly, the Central Bank should instruct the Banks to set aside a certain percentage of money to be given out as loan to the small scale business owners.

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