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The Impact of Financial Inclusion on Economic Growth in the Democratic Republic of Congo

Ngandu Lushimbula Glory

First term assistant at The Higher Institute of Medical Techniques of Kindu Democratic Republic of the Congo

ABSTRACT: The recent financial crises have revived the debate on the interactions between the financial and real spheres. In both developed and developing countries, financial inclusion is becoming a major issue. It is perceived as a real tool for economic development and poverty alleviation. The analysis of the interactions between the financial and real spheres is therefore renewed. The purpose of this study is to analyze the impact of financial inclusion on economic growth in Congo, based on the Autoregressive Distributed Lag (ARDL) model and the descriptive analysis

The study shows that financial inclusion has a significant and positive influence on economic growth in the Congo, particularly on the growth of non-oil Gross Domestic Product (GDP).

KEYWORDS: financial inclusion, Non-oil GDP, Congo, ARDL: autoregressive distributed lag, incidence, economic growth, financial sphere, SME, banking, optimal allocation, financial liberalization

1. INTRODUCTION

The recent financial crises have revived the debate on the impact of the financial sphere on economic growth. However, since the beginning of the 1960s, several authors have been interested in the role of the financial sector, and more specifically, of banks, in developing countries.

2. It is in this context that Gurley and Shaw (1960) put forward the benefits of financial diversification, which accompanies the development of the financial sphere, on economic development while McKinnon and Shaw (1973), through the theory of financial liberalization, advocated financial freedom as a therapy against economic underdevelopment. McKinnon and Shaw (1973) advocated against all forms of financialrepression. **[1][1]**Financial repression materializes as a set of that impede financial development and slow down economic growth. They emphasized the role of the credit channel, and more specifically, the role of financial institutions in the supply of funds to finance real activity and showed that financial development implies a greater diversification of financial institutions and tools in order to promote competition and the optimal allocationof resources.

In addition, since the late 1980s, many developing countries have implemented diversification and financial policy reform programs.

3. In Africa, and in Congo in particular, the first financial reforms along these lines were undertaken at the end of the 1980s. They were continued and strengthened after thedevaluation of the CFA franc on 12 January 1994. These reforms, which helped to clean up and stabilise the financial systems, did not have a significant impact on improving the rate of bank penetration. Many people are still excluded from the formal banking system. In sub- Saharan Africa, the share of the population over 15 years old having opened a bank account in a formal financial institution stood at 24% in 2011. It is less than 10% in the Franc Zone (Guérineau and Jacolin, 2014, p. 59). Although there has been a catching up since the 1990s, the financial intermediation role played by banks in sub-Saharan Africa is still less pronounced than in other countries.

2. THE FINANCIAL INCLUSION IMPACT OF

Financial inclusion fosters economic development by enabling a growing share of households and SMEs to access a wide range of financial services at a reasonable cost. Financial inclusion appears to be lowest in sub-Saharan Africa (SSA), and in particular in the franc zone, in terms of bank penetration, intensity of use of bank accounts and access to credit. The prevalence of financial exclusion in SSA reflects structural factors stemming from supply-side shortcomings (cost, management of information asymmetries), demand for financial services (income and financial education, self- exclusion phenomena), as well as the regulatory environment and the business climate. Financial inclusion implies, like any development of financial activities, new risks for financial stability and therefore a strengthening of regulations and banking supervision so that public confidence and increasing access to financial services go hand in handwith stable and sustainable economic growth.

In countries where financial systems remain weak, financing is a major challenge for both the government and the private sector. To the extent that it promotes savings and capital accumulation and ensures optimal allocation of capital, financial development can

contribute to faster growth and poverty reduction. Numerous studies show that countries with sufficiently developed financial systems, for example in South-East Asia, enjoy higher long- term growth than countries where financial depth
In addition, the financial sector is weaker, especially in sub-Saharan Africa (SSA), notably in the Congo. By reducing the liquidity constraints of firms, facilitating long-term investmentand helping to offset the effects of exchange rate volatility, financial systems also help to reduce the instability of investment and thus of economic growth

2.1 The Reluctance of the Financial Sector

Financial development in developing countries (DCs) is itself a multi-faceted process, involving financial markets, the banking system and microfinance institutions. In developing countries where the level of banking coverage remains low, in the order of 10% to 20% in low-income countries (LICs), and where access to credit for SMEs is insufficient to finance their growth, financial inclusion, i.e. better access to and more intensive use of financial services, is an important dimension of financial deepening.
In order to address this financial exclusion, which affects the most vulnerable populations andbusinesses to varying degrees in both advanced and emerging and developing countries, the G20 countries decided to make financial inclusion a priority on the international development agenda. This decision has taken concrete form through the Global Partnership for Financial Inclusion and the promotion of national or regional financial inclusion strategies. Thesestrategies include regulatory reforms to facilitate access to innovative financial services and measures to strengthen financial education and consumer protection. Their objectives include strengthening public confidence in "formal" financial institutions in countries with largeinformal economies and finance and a strong preference for cash among economic agents.

3. SOLUTIONS AND PERSPECTIVE

The Congolese economy has experienced accelerated growth over the past decade. Most notably, it has shown signs of sustainability and financial stability despite the pressures caused by unforeseen external shocks such as the recent global crisis. However, despite this successful transition to a higher level of growth, the inclusiveness of this growth remains oneof the concerns and priorities in the government's policy agenda.
2. The key point made in this paper is that the state of financial inclusion in Congo is not as clear cut as is usually assumed, the evidence is mixed, and the situation is not as bad as somerecent analysis suggests. It appears that there is relatively healthy access to secure formalstructures for savings, but access to credit in rural areas has not progressed as much as might be expected. In particular, the use of informal sources of credit has increased to finance emergency needs and consumption. Thus, measures to achieve comprehensive financial inclusion need to be carefully tailored to meet the realities on the ground.

3.1. Planning and Financing Solution

First of all, the dividend distribution policy needs to be redefined. This policy requires taking into account the periods related to the different phases of the project life cycle. In this context, the distribution of additional dividends to capital providers is determined only by the achievement of cash flow allowing the financing of activities.
Secondly, companies must distinguish their "self-financing" sources in two options, the accounting option and the financial or cash flow option.
The first option generally concerns rationalisation or productivity projects, since self- financing includes depreciation and reserved profits. It should be noted that, on the one hand, depreciation allows for the replacement or outright renewal of machinery and, on the other hand, from the point of view of reducing production and/or marketing costs, reserved profits will reinforce depreciation in order to achieve this aim.
In a financial or cash flow option, for innovation and expansion projects, self-financingincludes cash on hand, and possibly cash investments and the recoverable value of divestments. It should be noted, however, that for these types of large-scale projects, self-financing will not suffice in view of the disadvantages posed by the poor use of this source. This requires recourse to external financing. The obligation for companies to produce a *Business Plan* becomes a sine qua non condition likely to better exploit the opportunities offered by banks in excess of liquidity

3.2 The Inclusion Perspective

Since the early 1970s, economic growth in Congo, has been supported by the oil sector.In 2017, the oil sector still accounted for 55% of GDP, 85% of exports and 80% of budget resources. After two successive years of contraction (-2.8% in 2016; -3.1% in 2017), real GDP growth, driven by the recovery of oil prices and the increase in national hydrocarbon production, was estimated at 2.0% in 2018 (African Development Bank, 2019, p. 161).

The dominance of the oil sector makes the economy vulnerable to external shocks. The non-oil sector contributes very little to overall GDP growth. However, this economic growth has never been inclusive; it has had little impact on poverty reduction and the achievement of the Millennium Development Goals.

27 The poverty rate in Congo remains a concern, with the 40% of the Congolese population living below the poverty line (African

Development Bank, 2019, p. 161) and effectively excluded from the

4. SPECIFICATION OF FINANCIAL INCLUSION

Financial inclusion, defined as better access to and more intensive use of financial services(Guérineau and Jacolin, 2014, p. 58), is still limited. The banking sector offers limited access to finance and therefore represents a brake on growth. Yet, a developed banking and financial sector is the essential component of an economy and, several studies have demonstrated the links between financial development and economic growth (Levine et al. , 2000; Beck et al. , 2000; Demirgüç-Kunt and Levine, 2008). In Sub-Saharan Africa, the issue of financing remains recurrent. To the extent that financing promotes savings and capital accumulation and ensures optimal allocation of capital, financial developments are likely to contribute to accelerated growth and substantial poverty reduction (Abessolo and Timbi, 2019).

Congo is part of one of the economic communities, CEMAC **[2][2]**CEMAC: Communauté Economique et Monétaire de l'Afrique..., where financial inclusion is the lowest. Even though the banking system has been strengthened with a significant increase in the number of banks(6 to 10 banks in operation between 2010 and 2014, 11 as of December 31, 2015) **[3][3]**Final report of the National Credit Council (CNC), 2015, p. 13.,

The rate of access to banking services remains low (12.5% in 2015). However, this rate risesto 26.4% if microfinance institutions are included. The financial and banking system istherefore still underdeveloped, resulting in low financial inclusion. The scope of practice of Congolese banks is still limited to large investors (World Bank, 2015). The lack of access to the formal financial sector and the scarcity of banking products expose the poorest populations to poverty (International Monetary Fund [IMF] Report, 2012). According to the same IMF report (2012), the Congolese banking sector represents 21% of GDP and loans are mostly short-term and highly concentrated on a few productive sectors. The depth of the sector remains very low (6.5%). This paper examines the impact of financial inclusion on economic growth in Congo. Does financial sector development promote growth in Congo? More specifically, what is the short- and long-term impact of financial inclusion on the growth rate, particularly the growth rate of non-oil gross domestic product (GDP)? Despite the fact that the challenges of financial inclusion remain paramount in the Franc zone countries, as bank penetration rates are among the lowest in the world (Benhamdane et al. , 2016, p. 93), very few empirical studies have been conducted, to our knowledge, on the impact of financial inclusion on economic growth in Congo. This article is structured as follows: the first section presents the literature review; the second section focuses on the methodology adopted; the third section is devoted to the presentation and interpretation of the results before concluding and making some policy recommendations.

5. FINANCIAL GAP

Despite the good economic performance, with a growth rate of 6%, above the averagefor the sub-Saharan African region, the Democratic Republic of Congo (DRC) still faces many challenges in terms of economic development and financial inclusion of women.

According to statistics from the African Development Bank (AfDB) Group, unveiled during the launch of the second edition of the AFAWA Finance Series DRC on Tuesday, September 27, 2022 in Kinshasa, the financing gap affecting women in the Democratic Republic of Congo is estimated at nearly US$2.8 billion.

"In the Democratic Republic of Congo, the financing gap for small and medium-sized enterprises is estimated at nearly USD 2.8 billion for micro, small and medium-sized enterprises.

This is the first time that the Bank has ever been involved in the development of the country's economy," said Mr. Solomane Koné, Deputy Managing Director of the African Development Bank and Country Representative for the DRC.

According to him, the development of women's entrepreneurship is an important lever to support strong growth and the achievement of sustainable development goals for a trueinclusive transformation of African economies.

In addition, Solomane Koné said that in recent years, the financial inclusion of women in the DRC has increased significantly, from 4% in 2011 to 26% in 2021 mainly through microfinance and financial services.

At the African level, the financing gap affecting women is estimated at more than 42 billion US dollars.

In its sustainable development strategy, the AfDB Board of Directors has approved the 2022- 2025 development strategy, placing women's empowerment at the heart of its development strategy.

With its Affirmative Finance Action for Women in Africa (AFAWA) program, a pan-African initiative to promote women's access to finance in Africa, the AfDB aims at bridging the financing gap affecting women in Africa.

In order to reduce this financing deficit of women, the involvement of banks is highly desired by both the Congolese authorities and these women in search of finances.

To this effect, Willy Mulamba, President of the Congolese Association of Banks reassured on the willingness of the country's banking institutions to boost female entrepreneurship.

"We are committed to supporting African women in entrepreneurship to foster wealth creationto support their families," he said.

The Minister of Finance of the Democratic Republic of Congo (DRC), Nicolas Kazadi, who took part in the meeting, in his speech, commended the AfDB's initiative, AFAWA, which, according to him, will boost women entrepreneurship in the country. He underscored the fact that the DRC is committed to accelerating financial inclusion through new strategies.
"*The DRC is strongly committed to accelerating financial inclusion. To date, the Government is in the process of developing the national strategy for financial inclusion which will be finalized by June 2023. This strategy will be accompanied by an ambitious and clear roadmap that will carry six (6) major strategic objectives: access to economic and financial services; more credit for households and SMEs; increased use of mobile money and other fin-tech services; consumer education and promotion; appropriate infrastructure and institutionsavailable; more insurance to individuals and businesses,*" he said.

5.1 Financing deficit is associated with a growth incentive deficit

The question of the ability of SMEs to become large is not onlya question of the availability of financing, even if the European Central Bank (ECB) surveys show that this factor has become more important since 2009. Recent work on French data (Fougère *et al.* 2012; Cabannes *et al.* , 2013) shows: (1) that the main problem in this area is that the crisis has slowed the growth of young firms; (2) that the crisis has affected subsidiaries of groups more than independent firms. These studies reveal two problems, in addition to the inadequacy of the resources deployed by banks: the problem of support structures for entrepreneurship and the problem of the transfer of businesses and the modes of governance of medium-sized enterprises.
This question of the capacity of SMEs to grow must therefore also be related to the strategy of financial independence of managers and the stakes of power. The concentration of power and ownership leads managers in many cases to limit recourse to external financing, in particular to funds external equity. Several studies on the financial behaviour of SMEs find that it corresponds to the hierarchical financing pattern, with priority given to self-financing, followed by (bank)debt financing and, lastly, recourse to external equity (Brav, 2009; La Rocca *et al.* , 2011). However, the traditional arguments explaining this hierarchy - information asymmetry leading to increasing costs - are not directly transposable to SMEs, unless the costs of financing with funds are included in the loss of the benefits of financial independence.

Financial independence is a powerful brake on the opening upof capital, the strengthening of equity by contributions from outside shareholders and growth (Hamelin, 2011). Many managers still adopt a cautious management approach that favours the relative security of family assets. This desire for financial independence, often associated with a relativeconfusion between family assets and corporate assets with its implications in terms of private monetary and non-monetary levies and profits, constitutes a major obstacle to opening up capital to third-party shareholders, both from the point of view ofmanagers and from that of investors fearing moral hazard. Thisinevitably leads to cutting off the companies concerned from external equity financing, which requires profitability and growth.
For shareholder managers who nevertheless decide to focus on the growth of their company and use external equity, *private equity* financing methods have proven their effectiveness and have certain comparative advantages over the stock market. Inparticular, through the use of hybrid financial instruments, thesetransactions offer a high degree of flexibility in the distribution ofpower and future capital development, as well as the establishmentof governance arrangements that suit both parties, thus reducing the occurrence of moral hazard (Mahieux, 2010). In contrast, organized financial markets are by nature trading venues for standardized products that cannot compete with such flexibility, and governance is more a matter of regulation. A close examination of the theoretical literature on the main costsand benefits of listing for shareholders of private companies (Zingales, 1995; Pagano and Roell, 1998; Stoughton and Zechner, 1998; Chemmanur and Fulghieri, 1999; Huyghebaert and VanHulle, 2006) does not show a clear advantage of market financing, especially if we take into account the fact that, even for large SMEs and SMIs, the liquidity of the securities is often low.

5.2 Funding Gap Associated with a Risk Deficiency in Financial Institutions

It is clear that in countries where banks have experienced a sharp rise in bad debts, such as Spain, Portugal or Ireland, the banks' appetite for risk has certainly decreased. But many other European countries, including France, have not experienced this situation. It Nevertheless, an important question is the possibility of better guaranteeing credits, notably by developing public guarantees. But, in fact, these solutions already exist in a country like France, and it is difficult to see how they can be extended without the risk of encouraging a form of moral hazard. Once again, the recognition of the advantages of diversification in loan portfolios and the expertise of bankers in controlling anti-selection behaviour of borrowers are likely to provide positive solutions to the financing deficit of SMEs, if the corresponding means are implemented
Can the cause of the lack of appetite of banks be found in the strengthening of banking regulations with Basel III? The Basel IIIrules provide for a strengthening of capital requirements, bothin terms of quality and quantity, and the introduction of new liquidity requirements, which were previously absent from the Basel II regulations. In general, regulators have paid particular attention to SME customers, who now benefit from more favourable measures than other companies. Although the Europeanregulations (CRR - *Capital Requirements Regulation*), like those of Basel, make no distinction between SMEs, very small businesses and microenterprises, which are grouped together inthe SME category, in practice, given their size and the small unit amount of the loans granted to them, exposures to very small businesses are mostly classified as retail customers and are treated more favourably than those of other companies in terms of solvency. Moreover, at the initiative of the European Parliament,the CRR Regulation substantially

reduced the capital requirements for loans to SMEs [4][3].CRR regulation provides for application.... But the question maybe whether additional arrangements are possible for SMEs

On the one hand, work shows that regulatory formulas can overestimate credit risk in bank portfolios as firm size decreases.On the other hand, it is verified (Brun *et al.,* 2013) that banks' credit decisions are sensitive to the amount of capital required. This measure therefore creates a favourable context for SME financing. But in terms of credit supply, the key point is that SME loan portfolios are the source of important diversification effects for lending institutions, as discussed above. A morecomplete measurement of these effects should allow banks to ease the constraints on borrowers.

In terms of liquidity, European regulations provide for the introduction of two new ratios: a one-month *liquidity coverage ratio* (LCR), which requires the creation of a liquidity cushion to cover the shortfall that a bank might incur in the event of a liquidity crisis, and a one-year *net stable funding* ratio (NSFR) designed to limit banks' transformation risk. As in the case of solvency, MSEs are treated relatively favourably compared withother companies in terms of the LCR, as long as they meet the criteria for classification as retail customers. Deposits of SMEs are considered more stable than those of large firms and therefore benefit from a lower weighting (reflecting their potential "leakage" in the event of a crisis) than deposits of large firms. Inaddition, undrawn credit and liquidity lines to SMEs are weighted more favourably, as they are In the event of a crisis, these credit lines are less likely to be called upon. As regards liquidity outflows, loans to SMEs receivethe same treatment as loans to large companies. As far as the NSFR is concerned, the regulations do not currently provide for preferential treatment for SMEs, which are therefore not specifically penalised by this new ratio. All in all, this measure appears to be neutral, provided that it takes into account the specificity of French banks, which have relatively few resources inthe form of deposits (see *below*).

.Another serious obstacle for external equity is the profitability ofSMEs. Unlike the lender, the shareholder has requirements for a high return on his investment. Many SMEs have low profitability,real or perceived, and are therefore unlikely to be attractive to outside shareholders. In this case, all the obstacles combine andreinforce each other to rule out external equity financing: poor prospects of profitability (adjusted for risk), lack of liquidity, moral hazard, etc. As a result, only a small fraction of SMEs are eligible for external equity financing and, for the majority of them, the only external financing potentially available is bank financing. Stock exchanges The difficulty of market firms in financing SMEs is obvious, atleast as far as continental Europe and France in particular are concerned (Giami and Rameix, 2011). Euronext has been repeatedly criticised for its alleged lackof interest in mid caps. The objective reasons are well known: low capitalisation,low liquidity and trading volume, and a lack of interest in this asset class on the part of institutional managers. Although market operators are probably partly responsible for this situation, it should be remembered that over the past thirty years there have been many attempts to create and maintain stock markets for large SMEs and growth stocks, in France as in other European countries.

With the exception of London's Alternative Investment Market (AIM), the record is largely negative in relation to the stated ambitions, despite the resources and efforts made by market firms and public authorities (Vismara *et al.* , 2012). This contrasts with the rapid development, since the mid-1980s, of *private equity*, including in the segment of large SMEs considered as predestined for the markets.

6. PHYSIOGNOMY OF THE FINANCIAL SYSTEM IN THE DRC

The Congolese financial system, although in turmoil and in its infancy, has progressed over time, and the financial development indicators illustrate this dynamic. The ratio of bank creditto the private sector and the ratio of money supply show this increased dynamic since the 2000s, combined with an increase in the number of loans.

Generally, the DRC's financial sector provides an analysis of the impact of reforms initiated inrecent years and identifies reforms to be pursued to better contribute to the financing of the economy.

The Congolese financial sector, both banking and insurance, has experienced a decade of strong growth and major changes in the regulatory and supervisory framework. Despite this rapid and steady development, the financial sector is limited and does not meet the financial services needs of the economy. Today, the outlook suggests that this growth will accelerate. The challenge for regulators is more than ever to continue to adapt the regulatory framework to ensure that the sector continues to grow and improve.

6.1 Strength of the Congolese Financial System

The Congolese financial system includes banks, securities markets, pension and mutual funds, insurers, market infrastructure, the central bank, and regulatory and supervisory bodies. These institutions and markets provide the framework for economic transactions and monetary policy and help to efficiently channel savings into investment, thereby contributing to economic growth. The problems of In addition to disrupting financial intermediation, financial system shocks can undermine the effectiveness of monetary policy, exacerbate economic recessions, cause capital flight and put pressure on the exchange rate or place a heavy burden on the budget by bailing out troubled financial institutions. Moreover, given the connections between financial institutions and the closer financial and trade links between countries, financial shocks in one country can quickly spread across financial sectors and beyond borders. Thus, resilient financial systems that are well-regulated and well-supervised are essential to ensure economic and financial stability at both the national and international levels.

IMF technical assistance helps member countries implement reforms specifically designed to develop and strengthen their financial systems. This assistance can include training and advice on monetary and macro prudential policy frameworks, debt management, foreign exchange and capital market development, the design of payments and deposit insurance systems, regulatory and supervisory frameworks governing the activities of financial institutions,and strategies for crisis prediction and management and bank resolution

7. FINANCIAL IMPACT FALLOUT

A well-functioning financial system contributes to economic growth and stability. It is therefore important to keep a close eye on it because of the role it plays in the economic life of a country.

The financial repression did not allow the financial sector to develop. It is from the work of MC Kino (1973) and Shaw (1973) who have established economic policy recommendations to denounce the control of the financial sector by the state. Hence the importance of financial liberalization in the emergence of an economy.

The objective of this work is to verify if financial liberalization in the DRC has allowed the financial system to fully play its role in the economy of the DRC. To achieve this objective we used the econometric method more precisely the error correction model so as result the financial liberalization has no impact on the growth in DRC.

8. CONCLUSION

This paper aimed to measure, financial inclusion has a significant and positive influence on non-oil GDP. In other words, there is a non-inverse relationship between financial inclusion and non-oil GDP in Congo in the short and long run.But the impact of financial inclusion in the long run is stronger than in the short run. The level of financial inclusion therefore deserves to be improved by implementing a number of measures and initiatives such as lowering bank fees, popularizing financial culture, strengthening the regulatory framework by focusing on depositor protection, and promoting and developing new technologies.

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