Financial Inclusion and the Size of the Informal Sector in Sub-Saharan Africa: Does the Quality of Institutions Matter?

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Abstract: This article examines the role of institutional quality in the relationship between financial inclusion and the informal sector's size in sub-Saharan Africa. The analysis is based on a panel of 32 countries covering the period 2002-2017, with data from the IMF, the World Bank (WDI, WGI), and Medina and Schneider (2019). The double least squares (DLS) method is used as the main estimation technique, supplemented by IV-GMM as a robustness test. Results confirm that financial inclusion contributes to reducing the size of the informal sector, but its effectiveness depends on the quality of institutions. More specifically, it is economic institutions (corruption control, government efficiency, rule of law) that play the most significant role as amplifiers, reinforcing the impact of financial inclusion. Political institutions (political stability, voice and accountability, regulatory quality) have a more limited effect. Thus, beyond the expansion of financial services, better economic governance appears crucial to formalizing African economies. Recommendations therefore focus on fighting corruption, strengthening administrative efficiency, and consolidating rule of law to create an institutional environment conducive to formalization and inclusive growth.

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