Empirical Analysis of the Impact of Capital Market on Economic Growth in Nigeria (1980-2010)

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Abstract
The Nigerian capital market had not been performing effectively in terms of providing long term capital needed by firms to finance capital projects. This cast doubts on its ability to meaningfully enhance the growth of the economy against the apriori expectations amidst different reforms that were introduced by the government .This study examines the effectiveness of the Nigerian capital market in stimulating economic growth in Nigeria using secondary data relating to GDP[Gross Domestic Product] as well as new issues, volume of transactions and market capitalization of the Nigerian Stock Exchange between 1980-2010 which were formulated into an over parameterized error correction models (ECM_1) and ECM_2) and analysed using residual plots, Granger causality test, Johansen co-integration test and Augmented Dickey-Fuller unit root test. The study reveals that the capital market enhances capital formation with a positive impact on Nigerian economic growth and recommends that the regulatory authority should initiate policies that will facilitate more access to the market and remove impediments to trading by improving surveillance in order to prevent sharp practices that may erode the market's integrity and investors' confidence.

Keywords: Economic Growth, Capital Market, Gross Domestic Product

Introduction

Economic development generally refers to the sustained, concerted actions of policymakers and communities that promote the standard of living and economic health of a specific area. This development

is usually evidenced by increase in the Gross Domestic Product (GDP) of a country, decrease in poverty rate and increase in disposable income (Ranis, Dan and Tavneet, 2004).

The role of capital in the production process and economic performance of a nation has long been recognised as it provides the impetus for the effective and efficient combination of factors of production to ensure sustainable economic growth. (Babalola and Adegbite, 2011). The capital market is a "complex of institution and mechanism through which intermediate and long term funds are pooled and made available to business, government and individuals and instruments already outstanding are transferred" (Dougall and Gaumnitz, 1975). These institutions which traditionally play one role or the other in transfer of funds from savers to users include Nigerian Stock Exchange, Stock Registrars, Issuing Houses, Stock Brokers and Underwriters as well as Securities and Exchange Commission.

In 2005, the capital market was able to help banks meet the 25 billion naira capital base requirement of the recapitalization programme embarked on by the CBN. This amount to One Hundred and Fifty Six Million, Two Hundred and fifty thousand US Dollars: ($ 156, 250,000). It has also helped government and corporate bodies in raising long term funds for modernization and expansionary projects (Nwankwo, 1990). However, Ariyo and Adelegan (2005) posit that although liberalization of the Nigerian capital market led to its growth, yet, it has little impact on the macro-economic level.
All businesses need long term funds in order to effectively carry out their operations, seek expansion, modernization and execute long term projects. There is however evidence to the fact that long term funds are not readily available to most businesses in Nigeria and where available, it is inadequate. Therefore most businesses in Nigeria depend on short term financing to execute long term projects which is a very risky and at variance with the maturity matching concept. All such firms therefore need to raise an appropriate mix of short and long term capital (Dermigue-kunt and Levine, 1996).

The failure of several firms in Nigeria can be linked to the low capital formation which led to the cessation of several companies and the merger of others especially during the recapitalization exercise of 2004. This problem can be linked to the illiquidity of the Nigerian Stock Market which relates to the degree of access that investors have when buying and selling stocks in the market.

The ease with which investors are able to carry out their transaction in the market determines how interested they will be in trading in the market. Since it is from these trading activities that capital are made available, it goes without saying that it is desirable that the market be kept liquid. An average ratio of 2% per year, the turnover ratio, which is a measure of the value of traded shares relative to the local market capitalization, is very low in Nigeria as a result of ownership structure in comparison with those of Botwana, Zimbabawe and Mauritius which are 10%, 9% and 4.6% respectively.

Prior to 1995, when the Nigerian Investment Promotion Commission Decree 16 and the Foreign Exchange (Monitoring and Miscellaneous) Act were promulgated, the Nigerian Stock

Exchange was restricted to mainly local investors. Thus, new foreign capital had little or no access to the market. Another complication is the fact that most Nigerians hold on to their securities rather than trade with them leaving only a proportion available for trading activities on the floor of the Exchange. This often limits the liquidity of the market.

Despite the media coverage of the landmark improvements recently recorded by the capital market and the tremendous boost in its performance, the pivotal role played by the Nigerian capital market in economic growth and development of Nigeria have not been adequately investigated. More so that the management team of the capital market have been accused of gross misconduct and fund mismanagement while the global economic crisis is biting high, these incidents might have downplayed the expected economic growth reinforcement expected of the capital market. Thus, this study is undertaken to examine the operations of the Nigerian capital market and its effectiveness in contributing to the growth of the Nigerian economy. The prevalence of social, political and institutional factors inhibiting the Nigerian economy notwithstanding, the constraints placed by the lack of adequate long term finance is an anathema to the growth of the Nigerian economy.

With new issue to gross fixed capital averaging only 16%, capital formation in terms of long term fund raised from the market through the issue of new securities to GDP standing at just 1.36%, it is necessary to evaluate the operations of the Nigerian capital market vis-a-vis economic growth in Nigeria.

Literature Review

Jhingan (2004) defined the capital market as a market which deals in long term loans. It supplies industries with fixed and working capital and finance medium term and long term borrowings of the central, states and local governments. The capital market has been identified as an institution that contributes to the socio-economic growth and development of emerging and developed economies and a veritable tool in the mobilization and allocation of savings among competitive uses which are critical to the growth and efficiency of the economy (Pat and James, 2010). In principle, the capital (stock) market is expected to accelerate economic growth, by providing a boost to domestic savings and increasing the quantity and the quality of investment. By these, it is able to positively influence economic growth through encouraging savings among individuals and providing avenues for firm financing (Charles and Charles, 2007).

Thus it is argued that for capital market to contribute or impact on the economic growth in Nigeria, it must operate efficiently with a view to create confidence in the minds of the public and investors for them to part with their hard earned funds and invest them in securities with the hope that in future they will recoup their investment (Ewah *et al*, 2009). The efficient market theory (EMH) describes an efficient market as one where the securities prices fully and speedily reflect available information. The relevance of the efficient market theory with respect to quoted companies is that the hypothesis hold true when the company's "real" financial position is reflected in its share price.

The Nigerian capital market is however

deemed informationally inefficient as the market's stock prices do not reflect available information and do not exhibit random walk. Nwosa and Oseni (2011). Many attempts have been made by previous researchers to establish a relationship between the capital market development and economic growth. In Nigeria, Osinubi and Amaghionyeodiwe (2003), Adam and Sanni (2005), Abu (2009) and Ezeoha *et al* (2009) as well as Ogwumike and Omole (1996) and Ojo (1998), have used different models and different variables to determine the relationship between stock market development economic growth in Nigeria. Their studies showed that stock market development increases economic growth.

Outside of Nigeria, several attempts had also been made by researchers to establish the relationship between stock market development and economic growth. Such studies are Nieuwerbugh *et al* (2005) in Belgium, Chee *et al* (2003) in Malaysia, and Bolbo *et al* (2005) in Egypt. Others in support of the positive impact capital market has on economic growth include Liu and Hsu (2006), Francia et al (2007, Levine and Zervos (1996), Demirguc-Kunt and Levine (1996), Pedro and Erwan (2004), Agarwal (2001), Thornton (1995), Beckaert *et al* (2005), Rousseau and sylla (2001); Calderon and Liu (2002) supported the view that financial system development promotes economic growth.

In contrast with the above studies, Ted *et al* (2005) examined the empirical association between stock market development and economic growth in India. Whereas the authors found support for the relevance of stock market development to economic development during pre-liberalization, they discovered a negative relationship between stock market development and economic development for the post liberalization period. Ewah *et al* (2009) appraised the impact of capital market efficiency on economic growth in Nigeria revealing that the capital market in Nigeria has the potential to induce growth, but it has not contributed meaningfully to the economic growth of Nigeria because of low market capitalization, low absorptive capacity, illiquidity, misappropriation of funds among others. Also, Gursoy and Muslumov (1999) and Luintel and Khan (1999) and Hondroyiannis *et al* (2005 confirmed the existence of a bidirectional causal relationship between stock market development and economic growth.

In a nutshell, empirical evidence before now corroborates a positive relationship between capital market and economic growth. However, the economic crisis that rocked the financial sector had changed the terrain and as such a reassessment of the relationship between capital market and economic growth in the post crisis is not an academic exercise in futility but a desirable and timely one instead of relying on a rule of thumb.

Methodology

Data Sources, Description and Method of Analysis

This study made use of secondary data that spans between 1980 to 2010 which were obtained from the Capital Market Statistical Bulletin of 2010, a publication of the Nigerian Security and Exchange Commission

Model Specification

The model of the study is based on the improvement suggested by Dermiguekunt and Levine (1996), Levine and Zervos (1996) and Ewah *et al* (2009) who have investigated the linkage between stock

market and economic growth. To examine the long run relationship, this study co-opted the use of Johansen co-integration test and developed an over parameterized error correction model (ECM_1) and a parsimonious error correction model (ECM_2). ECM_1 involves leading and lagging of the variables in the regression equation while ECM_2 introduces dynamism into the model.

The functional equation for the econometric model is based on the following equation:

$$Y = f(x_1, x_2, x_3, x_4) \ldots\ldots\ldots\ldots\ldots\ldots (i)$$

Where Y = Economic growth proxied by constant value of GDP at 1990 prices and; x_1-x_4 are independent capital market performance variables: market capitalization (MCAP), total new issue (TNI), value of transactions (VLT) and total listed equities and government stocks (LEGS).

The apriori expectations of the coefficient of the model: $\beta_1, \beta_2, \beta_3$, and $\beta_4 > 0$.

Thus,

$$GDP = f(MCAP, TNI, VLT, LEGS) \ldots\ldots\ldots\ldots (ii)$$

The explicit form of the equation is represented as:

$$GDP = \beta_0 + \beta_1 MCAP + \beta_2 TNI + \beta_3 VLT + \beta_4 LEGS + \varepsilon \ldots\ldots\ldots (iii)$$

Where β_0 = intercept of the relationship in the model/constant and β_1-β_4 are coefficients of each of the independent variables and ε = stochastic/ error terms. By stating the variables in logs, equation (iii) becomes:

$$LogGDP = \beta_0 + \beta_1 \log(MCAP) + \beta_2 \log(TNI) + \beta_3 \log(VLT) + \beta_4 \log(LEGS) + \varepsilon \ldots\ldots (iv)$$

Where log = natural log. From equation (iv), the model can be stated in time series form as

$$Log(GDP)_t = \beta_0 + \beta_1 \log(MCAP)_t + \beta_2 \log(TNI)_t + \beta_3 \log(VLT)_t + \beta_4 \log(LEGS)_t + \varepsilon \ldots\ldots (v)$$

By stating the error correction model (ECM) from equation (v), the model becomes:

$$\Delta \log(GDP) = \beta_0 + \sum_{i=0}^{n} \beta_1 \log(MCAP)_{t-1} + \beta_0 + \sum_{i=0}^{n} \beta_2 \log(TNI)_{t-1} + \beta_0 + \sum_{i=0}^{n} \beta_3 \log(VLT)_{t-1} +$$

$$\beta_0 + \sum_{i=0}^{n} \beta_4 \log(LEGS)_{t-1} + \beta_0 + \sum_{i=0}^{n} (ECM)_{t-1} + \sum_{i=0}^{n} \beta_0 t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (vi)$$

Where:
GDP = Real Gross Domestic Product
TNI = total new issues of the Nigerian capital market;
VLT = value of all transactions;
MCAP = Market capitalization of the Nigerian Stock Exchange;
LEGS = listing of Equities and Government Stock; and

$\Sigma^{n}_{i=0}(ECM)_{t-1}$, the error correction term, t-1 meaning the variables were lagged by one period and $\Sigma\beta_0 t$ is the white noise residual.

The hypothesis of the test is thus formulated as follows:

$H_0: B_1 = B_2 = B_3 = B_4 = 0$ (no long run relationship i.e. no co-integration)
$H_1: B_1 \neq B_2 \neq B_3 \neq B_4 \neq 0$ (presence of long run relationship i.e. co-integration exist).

For valid estimation and inference the set of non-stationary data was first co-integrated. This was done to verify that a linear combination of these variables that is stationary exists. To determine if the time-series data are stationary, the unit root test was carried out which resulted in a linear combination of series called co-integration equation. This, however, may be interpreted as a stable long-run (equilibrium) relationship among non-stationary times series variable. It also ignores the short run dynamics that might cause the relationship not to hold in the short run.

The tests used are the Granger causality test which was used to establish the presence(or absence) of causation and Augmented Dickey-Fuller unit root test which was used to test for stationarity of the time series in order to prevent spurious result. The Johansen co-integration test was then used to test for long run relationship between the variables. These tests were carried out using the Econometric View 5.0) and the results are presented as follows:

Results Presentation and Discussion of Findings

The result from analysis are presented in tables as follows and discussed accordingly:

Table 4.1: Augmented Dickey -Fuller Unit Root Test

Variables	ADF Stat.	Critical value @0.05 Confidence Level	Order of integration	Remark
GDP	-7.4901	-2.9678	I(1)	Stationary
TNI	-6.7622	-2.9677	I(1)	Stationary
VLT	-5.0829	-2.9677	I(1)	Stationary
MCAP	-5.5756	-2.9677	I(1)	Stationary
LEGS	-5.8032	-2.9677	I(1)	Stationary

Source: Eviews Output

The result of the unit root test as shown in table 4.1 reveals that all the variables did not achieve stationarity until first difference. The analysis employed a de-trended series. While Nelson and Plosser (1982) showed the existent of unit roots in most macro economic variables, Perron(1987) was able to show that when series are de-trended and structural breaks in data factored in(the 1929 Crash and 1970s

world oil decline in their own case), it was possible to reject the null hypothesis of presence of unit root in nine (9) series out of the thirteen (13) series explored by Nelson and Plosser.

Thus, these structural breaks in the case of this study may be the 1986 market liberalization, with the adoption of the (International Monetary Fund) IMF's Structural Adjustment Policy (SAP), its subsequent abandonment in 1994, Universal banking of 2001, Banks Recapitalization Exercise of 2004 as well as the global financial meltdown of 2008 among others. The differenced data along with these structural breaks might account for the lack of unit roots in the variables used in this study.

Correlation Test

The correlation test was carried out to examine the relationship between the proxies used and economic growth (Table 4.2(a) and 4.2(b).

Table 4.2 (a) Correlation Test Results

	LEGS	MCAP	TNI	VLT
GDP	0.656640	0.848062	0.852632	0.699284

Table 4.2 (b): Pairwise Correlation Test Result

Pairwise Correlation Matrix

	GDP	LEGS	MCAP	TNI	VLT
GDP	1.000000	0.656640	0.848062	0.852632	0.699284
LEGS	0.656640	1.000000	0.502254	0.444035	0.493800
MCAP	0.848062	0.502254	1.000000	0.975333	0.913173
TNI	0.852632	0.444035	0.975333	1.000000	0.855012
VLT	0.699284	0.493800	0.913173	0.855012	1.000000

Table 4.2 (a) which was extracted from Table 4.2 (b) reveals a strong positive correlation between GDP and the selected capital market indicators. Both total new issues and market capitalization show a very strong positive relationship at a correlation coefficient of 0.85 (85%) each. Furthermore, the listings of equities and government stocks as well as the value of transaction also exhibited a strong positive relationship with coefficients of 0.66 (66%) and 0.70 (70%) respectively. Thus, the selected capital market proxies had positive impact on the Gross Domestic Product, this impact by inference may be adjudged to be strong since the relationships (85%, 70% and 66%) exceed an average of 50% in all the cases. However, since the correlation coefficient of both total new issues and market capitalization is higher than 0.80, there is suggestion of autocorrelation between total new issues, market capitalization and GDP.

Pairwise Granger Causality Test

The Granger causality test is used to determine the predictive power of one variable in relation to another variable. It indicates the level of independence of one variable to another and may be an indication of autocorrelation. Using this test, if the F-statistics critical value is less than

those which are obtained from pairwise granger analysis, causality (causation) is established. A unidirectional causality is established when only one of the calculated F-statistics in the Pairwise test is greater than the critical value while bi-directional causation is indicated when both of the F-statistics are greater than the critical or table value. If the two are however lower than the critical value, then, there is absence of causation.

Table 4.3: Pairwise Granger Causality Test Result.

Pairwise Granger Causality Test
Date: 03/12/13 Time: 19:44
Sample: 1980 2010
Lags: 2

Null Hypothesis:	Obs	F-Statistic	Probability
LOG(MCAP) does not Granger Cause LOG(G	29	0.70421	0.50443
LOG(GDP) does not Granger Cause LOG(MCAP)		2.01226	0.15562
LOG(TNI) does not Granger Cause LOG(GD	29	0.62316	0.54470
LOG(GDP) does not Granger Cause LOG(TNI)		8.28438	0.00184
LOG(VLT) does not Granger Cause LOG(GD	29	1.12580	0.34093
LOG(GDP) does not Granger Cause LOG(VLT)		1.35343	0.27737
LOG(LEGS) does not Granger Cause LOG(G	29	0.24829	0.78211
LOG(GDP) does not Granger Cause LOG(LEGS)		0.37377	0.69207

Table 4.3 shows that there exists a unidirectional causality from GDP to total new issue (logGDP→ logTNI) but not vice versa. This is evident from the F-value of 8.284 been greater than the critical value of 2.76 (25,4 degree of freedom) leading to the rejection of the null hypothesis for GDP→ TNI. There was however no "reverse causation" from TNI→ GDP since the F-value of 0.623 is less than 2.76. Furthermore, there is independence (no causation) between GDP and MCAP as well as VLT and LEGS.

Johansen Cointegration Test

The Johansen cointegration test shows that the null hypothesis of no long run equilibrium was rejected at three cointegrating equations and 5% level of significance. At that point, as reflected in table 4.4 the trace statistics was 9.5414 which was less than the critical value of 15.49. This shows that a long run relationship exists between the economic growth and capital market proxies.

The trace test in table 4.4 shows that at 0.05 level of significance, and a level of difference 2, the null hypothesis is rejected indicating that there is co-integration among the data used.

Table 4.4: Johansen Cointegration Test

Johansen Cointegration Test

Date: 03/12/13 Time: 19:47
Sample (adjusted): 1998 2010
Included observations: 28 after adjustments
Trend assumption: Linear deterministic trend
Series: LOG(GDP(-1)) LOG(MCAP(-1)) LOG(TNI(-1)) LOG(VLT(-1)) LOG(LEGS(-1))
Lags interval (in first differences): 1 to 1

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.760702	100.9360	69.81889	0.0000
At most 1 *	0.627252	60.89466	47.85613	0.0019
At most 2 *	0.571382	33.26276	29.79707	0.0192
At most 3	0.264346	9.541482	15.49471	0.3177
At most 4	0.033208	0.945604	3.841466	0.3308

Trace test indicates 3 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Estimation Command:
==========
LS LOG(GDP(-1)) LOG(LEGS(-1)) LOG(MCAP(-1)) LOG(TNI(-1)) LOG(VLT(-1)) C

Estimation Equation:
==========
LOG(GDP(-1)) = C(1)*LOG(LEGS(-1)) + C(2)*LOG(MCAP(-1)) + C(3)*LOG(TNI(-1)) + C(4)*LOG(VLT(-1)) + C(5)

Substituted Coefficients:
==========
LOG(GDP(-1)) = 1.148440396*LOG(LEGS(-1)) + 0.1060627012*LOG(MCAP(-1)) + 0.1040905008*LOG(TNI(-1))-0.081 99662775*LOG(VLT(-1)) - 1.314635586

Ordinary Least Square Analysis Results

As shown in table 4.5, the R-squared of the series was 0.746 while the adjusted R-squared was 0.706. This means that 74% of the changes in GDP can be explained by the capital market variables employed. The non-substantially low Durbin-Watson (DW) of 1.4 might suggest the presence of serial correlation. However, the existence of such serial correlation was subjected to further confirmatory test visually displayed in the form of residual plots and the result reveals that the residuals are uncorrelated with past inputs. Hence, there is no fear of relevant statistics being inflated or possibility of deriving incorrect estimation.

The result of the ordinary least squares analysis as shown in table 4.5 showed that market capitalization (MCAP), listing of equities and government stocks (LEGS) and total new issues (TNI) were positively signed against GDP with coefficients of 0.1061, 1.1484 and 0.1041 respectively. However,

Table 4.5: Ordinary Least Squares analysis result

Dependent Variable: LOG(GDP(-1))
Method: Least Squares
Date: 03/12/13 Time: 19:56
Sample (adjusted): 1981 2010
Included observations: 30 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(MCAP(-1))	0.106063	0.132691	0.799323	0.4316
LOG(TNI(-1))	0.104091	0.085304	1.220226	0.2338
LOG(VLT(-1))	-0.061997	0.093665	-0.661898	0.5141
LOG(LEGS(-1))	1.148440	0.928454	1.236939	0.2276
C	-1.314636	4.818733	-0.272818	0.7872

R-squared	-0.746309	Mean dependent var	5.676381
Adjusted R-squared	0.705718	S.D. dependent var	0.588632
S.E. of regression	0.319320	Akaike info criterion	0.705765
Sum squared resid	2.549129	Schwarz criterion	0.939298
Log likelihood	-5.586473	F-statistic	18.38625
Durbin-Watson stat	1.397054	Prob(F-statistic)	0.000000

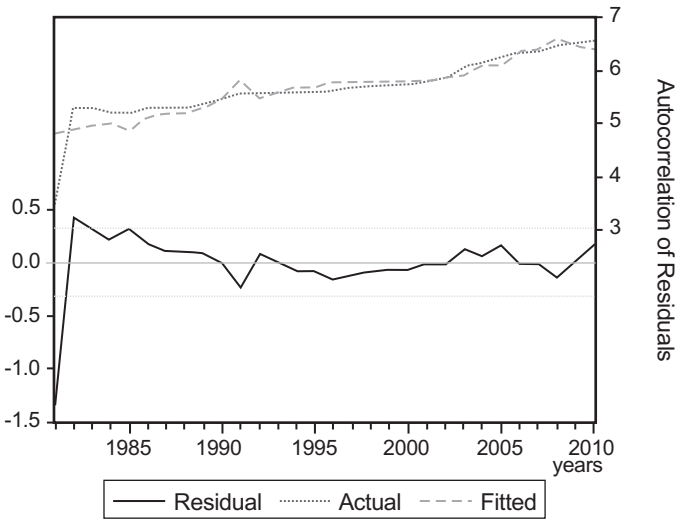
value of transactions (VLT) was negatively signed. The t-statistics however shows that none of the coefficient is significant at 0.05 level of significance.

This indicates that a million units increase/decrease in Market Capitalization, Total New Issues and Listing of Equities and Government Stock will amount to 0.1061, 0.1041 and 1.1484 million units increase/decrease in Gross Domestic Product respectively. Conversely, an increase/decrease of a million unit in Value of Transactions will lead to a decrease/increase of 0.062 million unit in Gross Domestic Product in the long run. The constant coefficient, which is negatively signed, indicates that there will be a constant decline of about 1.315 million if the capital market proxies were constant or equated to zero.

Thus, all the independent variables conform to the *a priori* expectation except the Value of Transactions which was negatively signed against GDP. Also, all the variables were significant using the standard error test. This affirms the impact that the variables used to proxy the capital market have on the economy. This is further buttressed by the residual plot of the model in figure 4.1. Residuals are differences between the one-step-predicted output from the model and the measured output from the validation data set.

The vertical scale of the residual plot shows the autocorrelation of residuals for the output (Whiteness test). The horizontal scale is the number of lags, which is the time difference (in samples) between the signals at which the correlation is estimated. Since a good model should have residuals uncorrelated with past inputs (independence test), the model passes the independence test, having residuals uncorrelated with past inputs.

Figure 4.1: The Residual Plot.



Conclusion and Recommendations

The analysis of the result shows that Gross Domestic Product, Market Capitalization, Total New Issue, Volume of Transaction and Listing of Equities as well as Government Stock did not achieve stationarity until after the first difference. Furthermore, the result of co-integration test indicated that the variables were co-integrated thus implying that a long run relationship exists between them. Furthermore, only the Market Capitalization, Total New Issue and Listing of Equities and Government Stock proved to have positive impact on the growth of the economy with Value of Transaction having a negative impact. This negative impact of the value of transaction on economic growth was at variance with expectation.

The findings of the study align with those of Ewah *et al* (2009), Osinubi and Amaghionyeodiwe (2003) and Nyong (1997) who found that the capital market has the potential to positively stimulate economic growth though it has not contributed much due to low market capitalization, small market size, illiquidity among others. Also, the result was in agreement with the studies of Dermigue-Kunt and Levine (1996) as well as that of Harris (1997) who established a strong positive relationship between capital market and economic growth.

The findings of the study indicated that the capital market has a positive (although very low) impact on the growth of the Nigerian economy. It is therefore recommended that more private limited liability companies and small and medium scale enterprises (SMEs) should be encouraged to access the market for fresh capital while the Security and Exchange Commission should be more proactive in its surveillance roles in order to curb sharp practices

which may undermine the integrity of the market and erode investors' confidence.

Furthermore, impediments to trading such as high transaction costs and multiple- taxation should be addressed and eliminated in order to encourage more trading on the capital market. This is because more trading is expected to enhance the performance of the study variables which is expected to bring about a progressive turnaround in terms positive multiplier effect on economic growth.

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