Nigerian Economy under Democratic Rule and the Impact of Capital Market on its Growth

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Abstract

This study seeks to examine the impact of capital market on the growth of the Nigerian economy under a democratic rule. Despite the popular belief that democracy promotes investments friendly environment, the Nigerian capital market seems not to have lived up to expectation in terms of its contribution to economic growth. The study relies on time series data, multivariate regression method was used to analyze the data. The result shows that while total market capitalization and all share indexes exert positive influence on the GDP growth rate, the total value of stock has a negative effect on the GDP growth rate, and none is significant. The study therefore recommends that government should depict concerted effort and sincerity of purpose in the capital market development.

Key words: capital market, democracy, and market capitalization.

Introduction

Capital market is a network of financial institutions and infrastructure that interact to mobilize and allocate long-term funds in the economy. The market affords business firms and governments the opportunity to sell stocks and bonds, to raise long-term funds from the savings of other economic agents. The capital market is a highly specialized and organized financial market and indeed an essential agent of economic growth because of its ability to facilitate and mobilize savings and investment.

Sourcing of long-term finance through the capital market is essential for self-sustained economic growth, which is consistent with external adjustment and rapid economic growth (Iyola, 2004). The capital market effectively started operations in Nigeria on 5th June, 1961 under the provision of the Lagos Stock Exchange Act 1961, which transformed into the Nigerian Stock Exchange in December 1977 as a result of the review of the Nigerian financial system (CBN, 2007). The Securities and Exchange Commission (SEC) was established in 1979 through the SEC Act 1979, to regulate the capital market, but it commenced actual operation in 1980. It took over regulatory functions from Capital Issues Commission, which was established in 1973. Since then, various forms of financial instruments have been issued in the capital market by new and existing business to finance product development, new projects or general business expansion.

The capital market, no doubt, is pivotal to the level of growth and development of the economy. Chinwuba and Amos (2011) note that capital market is one of the major institutions that acts in propelling a prostrate economy for growth and development. Nyong (1997), sees it as a complex institution imbued with inherent Mechanism through which long-term funds of the surplus sectors of the economy are mobilized, harnessed and made available to deficit sectors of the economy.

Osaze and Anao (1999), assert that capital market is the cornerstone of any financial system since it provides the funds needed for financing, not only business and other economic institutions, but also the programs of government as a whole. Ilaboya and Ibrahim (2004), stress that capital market functions as an economic barometer for galvanizing economic activities. The journey to the present democratic experience in Nigeria commenced on may 29, 1999, when the military government returned power to civilian administration. The agitation for the exit of the military was embarked upon because of the popular belief among the stakeholders in the economy that, democracy, among other things, promotes economic growth. Supporters of democracy also argue that the motivation of citizens to work and invest, the effective allocation of resources in the market place,

and profit-maximizing private activity can all be maintained in a climate of liberty, free-flowing information and secured control of property (North, 1990) In the light of the above background, the question that would readily come to mind is whether or not capital market has significantly impacted on the growth of the Nigerian economy, given the enabling environment provided by the supportive democratic structure. Indeed, this is one question that past related empirical work have failed to answer. This study is then undertaken to satisfy this "curiosity" and hence fill the existing gap.

Despite the popular belief that democracy promotes economic activities which in turn engenders economic growth, the growth of the capital market in Nigeria is still very small in relation to the size of the economy. CBN (2007) has it that a comparative analysis of equity market capitalization of the Nigerian capital market with some countries in North and South America,

Asia, Europe and Africa shows that the Nigerian market is relatively very small. Worse still is the attendant ugly consequences of the capital market meltdown, characterized by the crash of the market capitalization from a high record of N13.5 trillion in early 2008 to less than N4.5 trillion in the corresponding period of 2009. This development necessitated an investigation by the House of Representatives, through its committee on Nigerian capital market, of the circumstances surrounding the 2009 crash of the Nigerian capital market, and this investigation is otherwise known as the capital market probes

However, given these scenario, one begin to wonder if the Nigerian capital market has really fared well in terms of its impact on the growth of the Nigerian economy since the return to civilian administration in Nigeria. Suffice it to re-state here that no past focused on this very important period (beginning from 1999), which this study intend to cover. What is seen in other related works is a combination, in varying degrees, of periods of military and civilian rule.

Objective of the Study

The broad objective of this study is to assess the impact of capital market on economic growth in Nigeria.

To achieve this, the study will empirically analyze the effects of market capitalization, all share index and total value of transaction on the gross domestic product during the period under review.

Hypothesis of the Study

Ho: capital market has no significant impact on economic growth in Nigeria.

Review of Related Literature

The major concept that dominates discussions is efficiency. The concept of efficiency is central to any segment of the financial market. It refers to any one of the three types namely. Operational efficiency, allocation efficiency and pricing efficiency. However, the theoretical explanation on the nexus between capital market and economic growth is well expanciated using the Efficient Market Hypothesis (EMH). The Efficient Market Hypothesis, according to Fama (1965) is an academic concept which provides a framework for examining the efficiency of the capital market.

According to the EMH, financial markets are efficient or prices on traded assets, have already reflected all known information and therefore are unbiased because they represent the collective beliefs of all investors about future prospects Olawoye (2011).

In other words the EMH states that all relevant information are immediately and fully reflected in a security's market price. Previous test of the EMH have relied on long range dependence of equity returns. It shows that past information has been found to be useful in improving predictive accuracy. This assertion tends to invalidate the EMH in most developing countries.

Using Egyptian data, Mecagni and Sourial (1999), applied the GARCH estimating methodology to show that four of the popular stock market indices did not conform with the efficient market hypothesis. Osei (2002), using Ghanaian data, explored the character of asset pricing and the response to earning announcement on the Stock Exchange. He found that abnormal and cumulative abnormal returns of selected securities were not efficient with respect to annual earnings. Working with Nigerian data covering 1981 to 1992, Olowe (1999), employed correlation analysis to show that the Nigerian stock market was weak form efficient.

The first comprehensive study on the relationship between capital market development and economic growth, according to Levine (1997), was undertaken by the World Bank Research Group. They investigated the compatibility of stock market development with financial intermediaries and economic growth and concluded that stock market development is positively correlated with the development of financial intermediaries and long term economic growth. Levine (1997) confirms that capital markets can boost economic activity through the creation of liquidity, while Obstfeld (1995) identifies risk diversification, through internationally integrated stock markets, as another vehicle through which stock markets can raise resources and affect growth.

In France, Vazakidis and Adamopoulos, (2009), employed Cointegration, Granger Causality test and Vector Error Correction model, to examine the causal nexus between stock market development and economic growth for period of 1965 to 2007. They found that there exists a significant positive association between economic growth and stock markets development. Mishra, et al (2010) examine the impact of capital market efficiency on economic growth of India using the time series data on market capitalization, total market turnover and stock price index over the period spanning from the first quarter of 1991 to the first quarter of 2010. Their study reveals that there is a linkage between capital market efficiency and economic growth in Indian.

In Romania Brasoveanu, et al (2008), study the correlation between capital market development and economic growth for the period 2000 to 2006. The result indicates that capital market development is positively correlated with economic growth by way of feed-beck effect. Bolbol et al (2005), indicates that capital market development has contributed to the economic growth of Egypt.

The World Bank (1994) found that stock market development does not merely follow economic development, but provides the means to predict future rates of growth in capital, productivity and per capita GDP. Tharavaniji (2007), observes that countries with deeper capital market face less severe business cycle output contraction and lower chances of economic downturn compared to those with less developed capital market.

Adamu and Sanni (2005), examine the roles of the stock market on Nigeria's economic growth, using Granger-causality test and regression analysis. They discovered a one-way causality between GDP growth and market turn over. They also observed a positive and significant relationship between GPD growth and market turnover ratios. The authors advised that government should encourage the development of capital market since it has a positive effect on economic growth. Chinwuba and Amos, (2011), examine the impact of the Nigerian capital market performance on the economic development of Nigeria by using the Ordinary least Square regression model. The result indicates that the performance of the capital market impact positively on the economic growth of Nigeria.

Osinubi and Amaghionyeodiwe (2003) examine the relationship between Nigeria stock market and economic growth during the period 1980 to 2000, using Ordinary least square regression. The results show that there is a positive relationship between the stock market development and economic growth. They therefore suggested that government should pursue polices that are geared toward rapid development of the stock market. Abu (2009), examines whether stock market development raises economic growth in Nigeria, by employing the Error Correction Approach. The econometric results indicate that stock market development raises

economic growth. He however encouraged SEC to facilitate the growth of the market, restore the confidence of stock market participants and safeguard the interest of shareholders by checking sharp practices of market operators.

Ewah et al (2009), appraise the impact of the capital market efficiency on economic growth of Nigeria using time series data from 1963 to 2004. They found that the capital market in Nigeria has potential of growth-inducing, but it has not contributed meaningfully because of low market capitalization, low absorptive capitalization, illiquidity, misappropriation of funds among others. Obamiro (2005), investigates the role of the Nigeria stock market in the light of economic growth. He reported a significant positive effect of stock market on economic growth.

Moreover, Agarwal (2001) argues that financial sector development facilitates capital market development, and in turn raises real growth of the economy. Similarly, kolapo and Adaromola (2012), found that Nigerian capital market development has significant relationship with economic growth, just as Abdullahi (2005), agrees that capital market development in Nigeria is an engine to her economic growth.

Methodology

The data used for this study are basically time series data covering 1999 to 2011. The data were sourced from the central bank of Nigeria statistical bulletin, and annual reports and accounts of the Nigerian stock exchange.

In measuring the impact of the capital market on economic growth, we adopted the convectional method of using their proxies. Thus capital was proxied by the Total Market Capitalization (TMC), All Share Index (ASI) and Total Value of Stock (TVS), while economic growth was proxied by real Gross Domestic Product Growth Rate (GDPGR)

Model Specification

In this study, we adopted the statistical method of multiple regression approach in line with that applied by Olawoye (2011) and Ewah et al (2009). Their studies infer that economic growth is significantly influenced by capital market indices. We have, however, made some adaptations to suit our study.

The functional relation of the model is given as:

GDPGR= f(TMC, ASI, TVS)…….(1)

The model is specified as follows:

$GDPGR=\beta_0+ \beta_1 TMC+ \beta_2 ASI+ \beta_3 TVS+\mu$…….(2)

Where: GDPGR=Gross Domestic product Growth Rate

TMC=Total Market Capitalization

ASI=All Share Index

TVS=Total value of stock

β_0, β_1, β_2 and β_3= constant parameters and μ = the error term

Method of Data Analysis

The procedure in the analysis was multiple regression econometric procedure. The study commenced its analysis with Dickey-Fuller test, to verify, the stationary variables so as to avoid spuriousness of empirical result. The t-test was employed to ascertain the significance of each of the constant parameters, while the diagnostic test based on the coefficient of determination (R^2) was used to check for the goodness of fit of the model.

Data Analysis and Results

Unit Root Test

The unit root test adopted here is the Augmented Dickey Fuller Test and the results are shown in Table 1 below;

Table 1. The ADF unit Root Test for the series of GDPR, TMC, ASI and TVS

VARIABLES	**Deterministic Term**	**Lags**	**t-statistic**	**5% critical value**	**Remarks**
GDPGR	C	0	-3.103646	-2.975224	Stationary
	C,t	0	-3.307104	-3.602202	Not stationary
TMC	C	0	-8.351772	-2.87225	Stationary
	C,t	0	-8.208022	-3.505501	Stationary
ASI	C	0	-0.382663	-2.886225	Not stationary
	C,t	4	-4.160643	-3.544853	Stationary
TVS	C	0	-2.451165	-2.875224	Not stationary
	C,t	1	-4.227342	-3.512188	stationary

Source: Computer output (E-view 7.2)

The Table 1 above shows that the first difference of the natural logarithm of the total market capitalization (TMC) is stationary when deterministic term contains both constant and constant and trend. The first difference of natural logarithm of Gross Domestic Product growth rate (Gdpgr) is stationary when deterministic term contains a constant. Also the natural logarithm of the all share index (ASI) and total value of stock (TVS) are stationary when deterministic term contains constant and trends.

Model Analysis

The multivariate regression analysis is shown in Table 2 below.

Table 2: Analysis of the effect of TMC, ASI and TVS on GDPGR

Predictor	**Coefficient**	**St. Dev**	**t-statistic**	**Probabilities**
onstant	0.2728	0.2772	0.98	0.339
TMC	0.04554	0.03215	1.42	0.172
ASI	0.1161	0.5454	0.21	0.834
TVS	-0.0148	0.5301	-0.03	0.978

S = 1.075 R-Sq = 14.8% R-Sq (adj) = 0.0%

Source: Author's Computation, 2019.

The result in Table 2 above shows that total market capitalization and all share index have positive effect on GDP growth rate, while total value of stock has negative effect on GDP growth rate, but none of these effects is significant (P-values > α). The coefficient of determination R^2 shows how well the model fits the sample data, and about 15% has been accounted by the model.

Discussion of Findings

Our findings show that total market capitalization all share index and total value of stock are all joint predictor of economic growth provided by GDP, though insignificantly. The total market capitalization and all share index exert insignificant positive influence on GDP growth rate while the total value of stock has insignificant negative effect on economic growth.

The implication of the result is that an increase in market capitalization and all share index will insignificantly increase GDP, and this is supported by Osinubi and Amaghionyeodiwe (2003), Abu (2009), Agarwal (2001), Chinwuba and Amos (2011) and Ewah et al (2009), who in their different studies, found that capital market has positive impact on

economics growth in Nigeria. Ewah etal (2009) made it abundantly clear that although capital market exerts positive influence on economic growth, it has not contributed meaningfully (significantly) to the growth of the Nigerian economy.

This position, conversely, slightly disagrees with Obamiro (2005) and kolapo and Adaramola (2012), who argue that the positive impact of capital market on economic growth is significant. However the positive coefficients (0.04554 and 0.1161), show that total market capitalization and all share index respectively if increased, have the capacity to trigger economic growth. Another implication of our result is that the total value of stock exert an insignificant negative influence on GDP growth rate. This confirms the position of Ilaboya and Ibrahim, (2004), that the insignificant effect suggest that majority of key investor prefer to invest in other sectors of the economy other than the capital market.

Furthermore, the coefficient of determination (R^2) of 14.8%shows that about 15% variation in GDP growth rate are explained by change in capital market variables, while about 85%are accounted for by variables outside our model. Therefore, the model is not a good fit for the relationship.

The result of the hypothesis shows that the effect of capital market on economic growth, whether negative or positives, is not significant (p_values: 0.172, 0.834,0.978>α) hence we accept the null hypothesis and therefore conclude that capital market has no significant impact on economic growth in Nigeria.

Recommendations

i. Government should restore confidence in the capital market by showing true commitment and sincerity of purpose in the capital market probe. The findings recommendation of the investigation panel should be fully implemented to restore sanity and confidence in the market.

ii. There is need for a diversified investment instruments in the capital market whereby debt and derivative instruments will assume as much prominence as ownership instruments.
ii. Government should do everything possible to provide a safe and conducive investment climate by nipping in the bud, the prevalent activities of terrorist and kidnappers. This will not only encourage the Nigerian investors, but also attract foreign investors into the Nigerian capital market.

Conclusion

This study examined the impact of capital market on the growth of the Nigerian economy under a democratic rule. Capital market was proxied by total market capitalization, all share index, and total value of stock, while economic growth was proxied by the growth rate of gross domestic product.

The ADF unit root was adopted to test the level of integration of the variables, and all the variables attained stationarity. The method of multivariate regression was employed in the analysis, and the results showed the following: total market capitalization and all share index have positive effects on GDP growth rate; and total value of stock has negative effect on the GDP growth rate, but none is significant. Hence we conclude that capital market has not significantly impacted on economic growth in Nigeria

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