



Financial Development and Economic Growth Nexus in Nigeria

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ABSTRACT

This research work focuses on the effect of money and capital market on Financial Development and Economic Growth in Nigeria. It employs an Ordinary Least Square (OLS) method of analyzing the secondary data covering a period of 1981 to 2010. The Findings shows that Banking system Credit to the Domestic Economy, CDMB and Money Supply, M2 (money market variables) are significant having effect on the GDP(Economic Growth) while Value of Deals, VOD and Market Capitalization, MCAP (Capital Market variables) are not significant. The study thus concludes that: Government should ensure that there is strict compliance of all the Financial Institutions in giving short term loans and advances to their customers. Also the capital market should be built by raising new and flexible long term financial products to increase the supply of securities because it serves as the major source of long term financing for investment and development.

Key Words: Financial Development, Economic Growth, Market Capitalization, Money supply

1. INTRODUCTION

1.1 Background to the Study

The process of financial development may be defined as the expansion and elaboration overtime of the financial structure (institutions, instrument and activities). On the other hand, economic growth can be defined as a sustained increase in the output of the economy often termed the Gross Domestic Product (GDP). According to Shah and Shah (2011), economic development is subject to availability of the physical and human capital while financial resources are needed to ascertain the availability of these capitals. They argue that an economic system equipped with an effective and efficient financial system can mold this investment function in an optimal manner. The debate on the role of the financial sector in economic growth and development has been going on for over a century now. Schumpeter (1912) explains that the financial system plays an important role in economic growth by favouring innovation through financial services. According to supply-leading argument, the effect runs from financial development to economic growth (AL-Naif, 2012).

Financial development starts with the banking system and depends on the diffusion of scriptural money, which the banking system provides. As countries become highly developed, the share of the banking system in the assets of the financial sector declines, while that of newer and more specialized institutions – such as building societies, life insurance companies, retirement funds and finance assets of the banking system are of lesser value than the financial assets held by all other financial institutions, whereas the reverse is true in economically underdeveloped countries. Hence, Shah and Shah (2011) describe financial development as the process involving actions such as founding and expounding functions of financial institutions, developing new (innovative) financial products and developing markets for these products.

In Nigeria, there has been an underdevelopment of the real sector and it has been envisaged that the reason for this is the lack of funds from the financial sector to this sector. This ought not to be so because over long periods, there has been in most countries a rough but unmistakable parallel between economic growth and financial development. According to the statistics gleaned from Goldsmith (1969), and Gurley and Shaw (1967), there is clearly a positive correlation between levels of economic development and financial development.

Prior to 1986 in Nigeria, a common practice has been the support of certain economic projects considered to be essential part of development strategy. Government adopted policies aimed at accomplishing specified objectives, such as; interest rate ceilings and selective sectoral policies. Those policies were introduced with the intention of directing credit to priority sectors and securing “inexpensive” funding for their own activities (Fry, 1988). The ceiling on interest rate and quantity restriction on loanable funds for certain sectors ensures that a larger share of funds is made available for favoured sectors. Such a practice hinders financial intermediation since the financial markets will only be accommodating the credit demand of the government plan and ignoring risks. The practice has been disfavoured as a growth policy by the “repressionist school” led by McKinnon (1973) and Shaw (1973).

According to the McKinnon-Shaw financial repression paradigm, governments’ efforts to promote economic growth by such indiscriminate measures have repressed financial system. The financial policy, that fosters the role of financial sector, raises the rate of growth by increasing the quantity, and improving the structure, of real savings; improving the structure and average productivity of investment; and by providing entrepreneurial skills and financial guidance to the economy as a whole. This argument is based on the fact that investment opportunities in developing countries abound and that capital accumulation is limited by the availability of investable funds.

1.2 Statement of Problem

The fundamental question in economic growth that has preoccupied researchers is why countries grow at different rates. The empirical growth literature has come with numerous explanations of cross-country differences in growth, including factor accumulation, resource endowments, the degree of macroeconomic stability, educational attainment, institutional development, legal system effectiveness, international trade and ethnic and religious diversity. The list of possible factors continues to expand, apparently without limit.

One critical factor that has begun to receive considerable attention more recently is the role of financial development in the growth process especially in the wake of the recent global economic and financial meltdown. The positive link between the financial depth and economic growth is in one sense fairly obvious. That is, more developed countries, without exception, have more developed financial markets. Therefore, it would seem that policies to develop the financial sector would be to raise economic growth. Indeed, the role of financial development is considered by many to be the key to economic development and growth.

While economists have generally reached a consensus on the central role of financial development in economic development theoretically; empirical works supporting this concept are conflicting. One school of thought asserts that financial development plays a limited role in accompanying the development of real activity; the second school of thought accords a crucial role to financial development in boosting the processes of growth, innovation and economic development; while for another group of scholars, the financial market promotes growth, with growth, in turn, comes market formation (Nicet-Chenaf, 2012). This study intends to bridge the existing gap in the literature by empirically investigating the role of financial development in the economic growth of Nigeria.

1.3 Objectives of the Study

The main purpose of this study is to provide an empirical investigation of the theoretical concept that financial development often leads to economic growth and development. Specifically, the study intends to examine whether the activities of the money market do really have an impact on economic growth and development in Nigeria.

1.4 Research Questions

The following research questions shall be examined in the course of this study.

- (i) Does financial development actually lead to economic growth?
- (ii) What is the effect of money market activities on economic growth?
- (iii) To what extent has the Nigerian money market and capital market developed?

1.5 Research Hypotheses

The research hypotheses to be tested in this study are stated below:

1. Ho: Activities of the money market in Nigeria does not have a significance effect on economic growth and development
Hi: Activities of the money market in Nigeria have a significance effect on economic growth and development.
2. Ho: Activities of the money market in Nigeria does not have a significance effect on economic growth and development.
Hi: Activities of capital market in Nigeria have a significance effect on economic growth and development

1.6 Significance of the Study

Financial system is seen as vehicle for promoting economic growth. Financial institution identifies the most efficient investment ventures and channel resources from savers into investors. It also screens borrowers, manages risks and operates the payment and settlement system. Thus, development of an efficient and vibrant financial system is fundamental to macroeconomic stability. Existing literature has only discussed this relationship in theory. This study is significant and unique because it empirically investigates the relationship between financial market/development and economic growth thereby filling the existing gap in the literature as it relates to the subject matter.

2 LITERATURE REVIEW

2.1 Theoretical Frame Work

Growth and development has been a central issue in economics, and other related fields. According to Zuvekas, (1978) however, economic growth relates to increase overtime in a country's real output of goods and service or more appropriately, real output per capita (which is usually measured by GNP/GDP). In a similar view he viewed development, inter-alia, as a progress towards reducing the incidence of poverty, unemployment and income inequalities.

Thirlwall (1989) however, appreciates that the ultimate rationale of development must be to improve living standard and welfare. Beinstein (1957), points out that in most underdeveloped countries the inadequacy of resources and the inability to finance the necessary level of investment is the principal economic limitation on the rate of development certainly this presupposes that the traditional pre-take off societies were incapacitated by lack of sufficient finance for increase capital accumulation towards improved production vis-à-vis economic growth. Note worthy however, is that "...the mere creation of money cannot accelerate economic development of the basis pre-condition for it are lacking" (Chandavarkar, 1973:14). The preconditions include entrepreneurial skills and the willingness and ability to harness resources.

The pioneering works of Gurley and Shaw (1967) and Goldsmith (1969) on the relationship between financial development and economic development incidentally coincided with the period when most of the developing countries gained political independence. Following the attainment of political independence, developing countries government where pre-occupied with development strategies, particularly development planning aimed at higher sustainable growth rate and ultimately economic development. Initially, the development plans focused on the provision of a necessary infrastructure with a view to ensuring a smooth industrial take-off in the respective countries because development is widely considered as an offshoot of industrialization and hence capital formation. In some models, the structure of financial market is imposed exogenously, and attention is focused on financial development reinforces economic growth by increasing social marginal productivity of investment and/or by increasing the fraction of savings channeled to investment (Bencirenga & Smith, 1991), (Cooley and Smith, 1998).

In others, the approach has been to model financial development as an endogenous outcome of the growth process with consideration given to the co-evolution of real and financial activities (Bose and Cothren, 1997). Over the last

decade, a substantial volume of research has been devoted towards understanding the relationship between financial development and real economic activity. At the empirical level, evidence has been found of a strong positive correlation between the level of financial development and long-term growth (King and Levine 1993). Yet it has been widely recognized for some time that financial development is a multifaceted process that takes place through various distinct stages from the emergence and expansion of bank-intermediate debt finance to the materialization of stock market and the increasing use of the equity as an additional instrument by which firms are able to raise funds (Gurley and Shaw, 1955, 1960), and Goldsmith (1969). Levine (1996), are of this view that the level of financial development is a good predictor of future rates of economic growth, capital accumulation, and technological change. Accordingly, Patrick (1966) said that development of financial system induces growth, by generating incentives to savers to increase the rate of their saving, to entrepreneurs to invest more, and to producers to work harder.

In contrast, at the other extreme, there is what is often referred to as the casino hypothesis view, which has a disregard for the financial system as a catalyst for economic development. Its proponents believe that the financial system may have a retrogressive effect on development by inhibiting the growth and distribution of income hence they were of the opinion that the financial system should be suppressed or nationalized (Kitchen, 1986). They see financial system as a legitimate arena for the private sector to make money. Empirical research, however is yet to provide a consensus on the causal relationship between financial development and economic development, (Gupta, 1984 and Drake, 1980) it can however, be inferred from Patrick's "demand-following" and "supply-leading" phenomena that the direction of causation between financial and economic growth could be from either direction. He postulates that at the initial development stage, the development of financial institutions may accelerates a "take off stage, which as economic growth progresses this supply-leading phenomena would give way for financial innovations, demand-following phenomenon to prevail (Patrick 1966). He shows that the two phenomenons can simultaneously occur in the same economy according to the levels of sectoral development of the economy. Evidently, the supply-leading phenomenon however, seems to be more pervasive in the developing countries were legacies of their former colonial masters are followed.

Noteworthy, also, is that financial innovations had been very slow in the developing countries with few exceptions, e.g Hong-Kong; (Chandavarkar, 1973), however concludes that though finance is relevant for development it is more basic and casual links are not so much through a number and variety of financial institutions and instruments as in the adoption of appropriate Patrick's concept of demand-following and supply-leading hypothesis because the mere availability of financial institutions and service does not guarantee economic development since inappropriate policies may obstruct the linkage between financial development and economic development.

According to Levine (1996), a growing body of theoretical and empirical work would push even skeptics towards the belief that the development of financial markets and institution is critical to economic growth, rather than a sideshow or a passive response to growth. Levine argues that the preponderance of theoretical reasoning and empirical evidence suggests a positive, first-order relationship between financial development and economic growth. There is evidence that the level of financial development is a good predictor of future rate of economic, capital accumulation and technological changes.

The starting point for thinking about economic growth is invariably Solow's model in which the key determinants of growth are exogenous variables. In this model, sustained growth in output per head is only possible as a result of exogenous technical change. However, the resurgence of interest in growth theory over the last two decades has been inspired largely by the Romer-Lucas, paradigm of endogenous growth, in which the key determinants of output growth may be endogenous variables. In this paradigm, output per head can grow over time because of endogenous forces within the economy, particularly human capital and the knowledge base. A third tradition in the literature stemming from Goldsmith's work emphasizes the importance of financial markets in the growth process. Financial markets facilitate growth by enabling efficient intertemporal allocation of resources, although there remains some debate as to whether financial development causes economic growth or vice-versa.

2.2 Theories on Financial Development

2.2.1 Keynesian Approach

The Keynesian theory strongly suggests that high real interest rate raise the cost of borrowing and therefore discourage investment, growth and saving. In contrast, the influential work by Mc Kinnon (1973) and Shaw (1973) predict a positive growth effect arising from positive real interest rate. The financial policy, that fosters the role of financial sector, raises the rate of growth by increasing the quantity, and improving the structure, of real savings improving the structure and average productivity of investments; and by providing entrepreneurial skills and financial guidance to the economy as a whole. This argument is based on the fact that investment opportunities in developing countries abound and that capital accumulation is limited by the availability of investable funds.

2.2.2 Neoclassical Approach

By a simple "Neoclassical growth model" this mean that in which the state uses monetary policies to make sure that thriftiness does not lead to unemployment and aborting thrift, by making equity and loan funds available at lower interest and profit rates (and possibly by unorthodox credit policies that provide guarantee against risk and uncertainties). Such a managed system can contrive deepening of capital. The Neoclassical model can be interpreted as picturing the technology of an efficiently run collectivist society that never faces macroeconomics problem of unemployment or of inflation due to lack of proper effective demand. The Neoclassical output growth can be decomposed into three separate sources; growth in labour, growth in capital, growth in technical innovation, this in general according to the Neoclassicists, is what contributes to the general growth and development in an economy.

However, the neoclassical economists have advanced strong theoretical counter arguments on the same premises of the Liberalization hypothesis. The starting point of these views is the fact that the financial development literature is an example of the neoclassical view that, when left to them markets will be self-equilibrating. (Stiglitz and Weiss 1989),

argue that unequal or insufficient information give room for diverse risk selection particularly under conditions of macroeconomic instability. The efficiency of financial liberalization policy may be hindered by the preserve of curb markets (the structuralist hypothesis). Assuming that informal credits market are more efficient than the organised money market because of absence of restrictions, neo-structuralist models suggest that high real interest rate policy that shifts resources to the latter lower investment and growth rate. It can be summarised that the impact of interest rate or financial policy on the real sector depends on the stage of financial development in the country and the structure of the economy. High real interest rate may not, at the same time, serve both the stabilisation and growth objectives.

In particular, McKinnon (1988) noted that the full liberalization of the banks during a high and variable inflation is potentially dangerous. He suggests that in order to avoid financial crisis, stabilization should precede liberalization. Moreover, the very assumption that investment opportunities abound and that these are unused resources precludes concern with the price effects of high interest rate policy. If firms depend significantly on credit to finance short term or working capital they may be forced by rising interest rates to raise prices thereby leading to higher rates of inflation. In Nigeria, there may be a contradiction in the sense that high interest rate policy is expected to reduce inflation through aggregate demand cuts in addition to attracting increased foreign capital inflow to compensate for reduced domestic investment demand. It is therefore, necessary to determine empirically whether high interest rates and associated changes in foreign capital inflow, among other things are, in reality, agree with the economic policy objectives of Nigeria.

2.2.3 Classical Approach

The classicalist explains that it is practically impossible for modern economies to function without the use of money and other instruments for financial transaction. But in itself is the veil used to convey the goods and services, which it measured and which it helps to lubricate its dynamic motion. Any further explanation of the relationship is therefore likely to be complicated by the difficulty of distinguishing in this dynamic process between the effect of the monetary lubricant and the real forces behind the veil. However, a sound monetary theory must be raised to separate the monetary phenomenon from the fundamental factors that govern production, distribution and welfare in the development process. This will be achieved using a thorough process of recognition of the role of the money as a link between the economic past, present and future.

Monetary theory is generally associated with the macroeconomic behaviour that focuses on the various financial instruments used when considered as a store of value. They are therefore concerned with the short-term to medium term analysis as we know that the explanation of long-term changes in the behaviour of an economy would need to be sought in such more fundamental forces of structural, demographic, institutional and technological changes. To be more precise and logical a good monetary theory should articulate a model of how the financial system behaves in each broad institutional setting and how it reacts with its total economic system concerned in explaining such phenomenon as changes in the level of output, employment, wages, prices and the balance of payment, the size and distribution of national income, and the determination of interest rate and security prices.

However, according to Hermes, (1993), classifying the debate on the role of saving and investment in the economic growth process, he identifies three broad periods in terms of changes in perception in the first period christened 'the era of Keynesian supremacy', capital accumulation was assigned primacy and import-substituting industrialisation was advocated. The endogeneity of saving in the growth process was emphasised and economic development was overwhelmingly thought of in real terms and financial repression was the essence of financial sector policies. In the period of 'neo-classical resurgence', substantial empirical evidence indicated that rapid investment expansion does not necessarily bring about a favourable growth outcome and investment-centred growth was dismal.

Morrisset (1993) said that fiscal responsibility promotes both financial development and economic growth through two important channels: first, it limits the extent of crowding out of private investment by government borrowing; and second, it tends credibility to the government's undertaking to maintain macroeconomic stability, an essential condition for private investment. No doubt specific initial condition and underlying country characteristic facilitate the emergence of strong and fiscally sound government capable of enforcing the rule of law. According to Hermes (1993), the convergence in financial architecture among the front-runner countries is consistent with a view that suggests a link between the level of economic development and the design of financial system. He however said that countries that choose to jump-start the development of financial market have all reverted to more bank-oriented financial system. In a weak environment, depositors must be convinced that banks will not abscond with their money or become involved in excessively risky projects. Furthermore, Levine, (1992) emphasised that there is a greater recognition of gains from financial efficiency as an endogenous source of economic growth leading to the freeing of financial system from repression regime. Obstfeld and Taylor (2002) found that in the globalisation century, capital flow more freely from the core countries to the periphery than it has in recent revival of capital-market globalisation. They believe that core countries invest relatively more of the total international flow of capital in each other and relatively less in the periphery than they did a century ago. In their view, the importance of mature national financial system in attracting capital from foreign investors and the disadvantages of immature systems in doing the same.

2.3 Empirical Review

A substantial literature demonstrates a strong posture link between financial development and economic growth and also that financial development is a good predictor of future economic growth. King and Levine (1993) study 80 countries over the period of 1960- 1989 and control systematically for other factors affecting long-run growth. For measurement of the level of financial development and their results indicate that there is a strong positive correlation between each of the four financial development indicators and economic growth. In subsequent work of Levine et al (2000), they examine whether the exogenous component of financial intermediary development influences growth using a giving dynamic panel estimator as well as a cross sectional instrumental variable estimator. Birth results confirm a positive and robust relationship between financial intermediary development and economy growth. This is in line with

Beck et al (2000) whose result shows that the financial intermediaries exert a large positive impact on total factor productivity growth.

Greenwood and Jovic (1990) also observed that financial institution produce better information, improve resource allocation (through financial forms with the best technology) and thereby include growth. Following the line of argument of the previous research was cross (2001) who had growth models to examine the impact of financial intermediaries in economic growth. He state that economic growth is no longer believed to happen for exogenous reasons; noted governments through appropriation policies partially with regards to financial market can influence it.

Dogo (2003), used the panel estimation technique to assess the mechanism through which policy changes have influenced the growth performance of fifteen European Union economics also support the above postulations. Recent study by Habibullah and Eng (2006) using the Gmm techniques developed by Arellano & Bover (1995), Blundel & Bond (1998) and had causality testing analysis on the Asian developing countries whose result is in agreement with other causality studies by Calderon & Liu (2003), Fase & Abna (2003), Chrotopoulous and Tsionas (2004). They found that financial development promote growth.

The research work by Switson (2008) in the USA used a VAR containing two lags to conduct a model with variable such as nominal interest rate; yield on investment grade corporate bonds with remaining maturity of 5-10yrs to capture long-term interest rate, real GDP, oil prices equity returns and real effective exchange rate made positive contribution in that direction. He posited that credit availability proxied by survey result on lending standards is an important driver of the business cycle accounting for over 20% of the typical contribution of financial factors to grow. "A net tightening in lending standards of 20% basis points reduces economic activity by $\frac{3}{4}$ after one year and $1\frac{1}{4}$ after 2 years.

Deidda and Fatouh (2002) present a two period overlapping generation's model with risk adverse agents and costly financial transactions that establish a non-linear and possible non-monotonic relationship between financial development and economic growth using a threshold regression methodology to King and Levine data set to search for an endogenously determined threshold level of income per capital. They find a simple significant threshold level of income per capital, however, in the low-income countries there is no significant relationship between financial development and growth where is in high income countries this study, however seem to suggest that the relationship between financial development and economic growth is nonlinear.

Benhabib and Spiegel (2000) examine the relationship between an assortment of financial intermediary development indicators and economic growth, physical capital accumulation and total factor producing growth they use a panel estimator that allows for the endogeneity of the regressor and find that financial development indicators are correlated with both total factor productivity and physical human capital accumulation.

Working with a period of cross country and time series observations Loayza and Rancerc (2005) estimate a model encompassing both short and long-run effects through the use of a pooled means group estimator they conclude that a positive long-run relationship between financial intermediaries and output growth co-exist with a mostly negative short-run relationship.

Empirical works by Favara (2003) reveal that relationship between financial development and economic growth is at best weak. To him, there is no indication that finance spares economic growth, rather for some specifications that the relationship is positively negative. Therefore, the effect of financial development on economic growth is ambiguous and not robust to alternative dynamic specifications. This he attributed to the fact that financial development does not have a first order effect on economic growth, the link between them is not linear and if the dynamic specification and slope heterogeneity across content are taken into account, the effect is negative.

The study by Mushin and Eric (2000) on Turkey further lends credence to this postulation, on their study, when bank deposit, private sector credit or domestic credit ratios are alternatively used as proxy for financial development, causality runs from economic growth to financial development; therefore, concluded that growth seems to lead financial sector development.

There were other studies that shows a Bi-directional relationship between finance and growth Demetriaoles & Itusserion (1996) conducted a study of 16 less developed countries between 1960 and 1990 with the aid of time series techniques. They observed longrun relationship for indicators of financial development and per capital GDP in 13 countries. However, they found bi-directional causality in six countries and reverse causality in Six countries while South Africa showed no evidence of causation between the variables.

Odedokun (1998) used the ordinary least square method and reported varying degree of effect of finance on growth for both high and low income growth in the developing countries. He found that growth of financial aggregate in real terms have positive impacts in economic growth of developing countries irrespective of the level of economic development attained. This study also corresponds to that of Shan & Jianhong (2006) study of the Chinese economy where they found a two-way causality between finance and growth. With the aid of VAR technique and using five variable namely: GDP, total credit to the economy, labour investment and trade, the study observed that financial development was the second most important factor after the contribution from labour force growth in affecting economic growth. They also found that flooring economic growth in the last 20years has significant effect on financial development by providing solid saving base.

Luintel and Khan (1999) examined the long run relationship between financial development and economic growth using motivation revealed that there is a bi-directional causality between financial development and economic growth for all samples countries. Studies on individual countries include that of Odiambo (2004) who examined the relationship between financial development financial development and economic growth for South Africa using a revealed that the supply trading hypothesis is rejected for South Africa. There is a strong evidence of demand leading hypothesis for South Africa. This implies that the causality runs from economic growth to financial development and shows that economic growth drives financial development in South Africa.

Part of the bi-directional causality is that of Jung (1986) between developed and developing countries. The results showed that developing countries have a supply trading effect more frequently than demand leading pattern while the

developed countries have a demand leading causality which supports Patrick (1966) hypothesis of stage development, this is in line with Lurtel and Khan (1999), Calderon and Liu (2003), Apergis et al (2007) and Odiambo (2005).

Generally, the causal relationship between financial development and economic growth depends on the stage of economic development (Patrick 1966). In the early stages of economic development, supply leading view can stimulate real capital formation; the development of new financial series creates new opportunities for savers and investors and causes an increase in economic growth. The supply-leading view becomes less important as financial and economic development proceeds and gradually, the demand leading view starts to dominate. Particular states that one industry can be encouraged financially in the basis of supply leading view, and when it develops, its financing shifts to demand-leading view. Other industries that are still at a low level of development will remain in the supply leading phase.

Meanwhile this study tends to study this relationship between finance and growth in Nigeria, a part of developing countries to ascertain whether it is the demand following pattern or the supply leading pattern operating in Nigeria.

3.0 METHODOLOGY OF THE STUDY

3.1 Restatement of Research Hypothesis

The statement of hypothesis will be tested using the Null hypothesis (Ho) and alternative hypothesis (Hi)

1. Ho: Activities of the money market in Nigeria does not have a significant effect on economic growth and development

Hi: Activities of the money market in Nigeria have a significant effect on economic growth and development.

2. Ho: Activities of the money market in Nigeria does not have a significant effect on economic growth and development.

Hi: Activities of capital market in Nigeria have a significant effect on economic growth and development

3.2 Model specification

We adopt the model using by Allen and Ndikumama and Davis (2004). GDP is used as a proxy for economic growth while Banking systems credit to the domestic economy (CDMB), money supply measure by M2, MCAP market capitalization and value of deals (VOD) are proxies for financial developments. The proxy used for financial development essentially captures the constituents of financial system into money and capital market.

The model is stated as follows:

GDP = F(CDMB, MS, MCAP and VPD) stated in equation we have,

$$GDP = \alpha_0 + \alpha_1 CDMB + \alpha_2 MS + \alpha_3 MCAP + \alpha_4 VOD + U$$

The variables are defined as follows

DGP = Nigeria Gross Domestic product at 1990 Constant bank prices

CDMB = Bank system's credit to the domestic economy

MS = Money supply as proxied by M2

MCAP = Market capitalization of Nigeria stock exchange as at Dec of every year.

VOD = Value of deals to the Nigeria stock exchange

α_0 = is the constant

α_1 to α_4 are the coefficient of variables.

3.3 Method of Data Analysis

The ordinary least square method (OLS) of solving multiple regression equation using the SPSS: Statistical Package of Social Science will be used to analyze the model. The t statistics will be adopted to test for auto correlation.

Identification of variable

The variable identified for utilization is: the dependent variable is Gross Domestic product (GDP) and independent variables are Banking System Credit to the Domestic Economy (CDMB), Money supply (MS), Market capitalization (MCAP) and Value of deals (VOD).

Parameter for estimation

The following linear equation will be obtained from the model $GDP = \alpha_0 + \alpha_1 CDMB + \alpha_2 MS + \alpha_3 MCAP + \alpha_4 VOD + U \dots (V)$

The parameters for estimation from equation are α_0 , α_1 , α_2 , α_3 and α_4

Theoretical significance of the variables

In line with economic theory it is expected, that the level and to a large extent determine the level of economic growth of the country. It may be mathematically denoted as.

$$\frac{\alpha GDP > 0}{\alpha CDMB} > 0, \quad \frac{\alpha GDP > 0}{\alpha MS} > 0, \quad \frac{\alpha GDP > 0}{\alpha MCAP} > 0, \quad \frac{\alpha GDP > 0}{\alpha VOD} > 0,$$

Hence $\alpha_1 > 0$, $\alpha_2 > 0$, $\alpha_3 > 0$ and $\alpha_4 > 0$

The variable which is in the theory ought to be included and their expected behavior has been discussed in the empirical literature. The data are given a chance to prove their empirical relevance. This implies that the hypothesis exist in accordance with the expected signs of the variable in the equation specified above

3.4 Sampling Method and Source of Data

The Nigeria economic data will be used in the study i.e., economic data from 1981 to 2010. Secondary data mainly obtained from the central Bank of Nigeria. Statistical bulletin will be adopted as the major data source. The data will be showcase and the result of multiple regression analysis using the ordinary least square (OLS) method will be discussed in the next session. The variable will be tested for their significance and the test of hypothesis will be carried out.

4.0 EMPIRICAL ANALYSIS

4.1 Presentation of data and analysis

The data will be showcase and the result of multiple regression analysis using the ordinary least square (OLS) method will be discussed in this section. The variables will be tested for their significance and the test of hypothesis will be carried out which include: Gross Domestic product (GDP), Banking system's credit to the Domestic Economy (CDMB), Money supply (M₂) Market Capitalization (MCAP), and value of deals (VOD).

The data is presented below:

	GDP	CDMB	M2	MCAAP	VOD
1981	47619.66	8,5582.9	16161.7	5.0	304.8
1982	49069.28	10,275.3	18093.6	5.0	215.0
1983	53107.38	11,093.9	20879.1	5.7	397.9
1984	59622.53	11,503.6	23370	5.5	256.5
1985	67908.55	12,170.2	2677.6	6.6	316.6
1986	69146.99	15,701.6	27389.8	6.8	497.9
1987	105222.84	17,531.9	33667.4	8.2	382.4
1988	139085.3	19,561.2	45446.9	10.0	850.3
1989	216797.54	22,008.0	47055	12.8	610.3
1990	267549.99	26,000.1	68662.5	16.3	225.4
1991	312139.74	31,306.2	87499.8	23.1	242.1
1992	532613.83	42,736.8	129085.5	31.2	491.7
1993	683869.79	65,665.3	198479.2	47.5	80.44
1994	899863.22	94,183.9	266944.9	66.3	985.9
1995	1933211.55	144,569.6	318763.5	180.4	1,838.8
1996	2702719.13	169,437.1	370333.5	285.8	6,979.6
1997	2801972.58	385,550.5	429731.3	281.9	10,330.5
1998	2708430.86	272,895.5	525637.8	262.6	13,571.1
1999	3194914.97	322,764.9	699733.7	300.0	14,072.0
2000	4582127.29	508,302.2	1036079.5	472.3	28,153.1
2001	4725086	796,164.8	131589.1	662.5	57,683.1
2002	6912381.28	954,628.8	1599494.6	764.9	59,406.7
2003	8487031.57	1,210,033.1	19885191.8	1,359.3	120,402.6
2004	1141066.91	1,519,242.7	2263587.9	2,112.5	225,820.0
2005	14572239.12	1,976,711.2	2814846.1	2,900.1	262,935.8
2006	18564594.73	2,524,297.9	4027901.7	5,121.0	470,253.4
2007	20657317.67	4,813,488.8	5832488.5	9,563.0	1,076,020.4
2008	24296329.29	7,799,400.1	9208462.6	7,030.8	1,679,143.7
2009	24794238.96	8,912,143.1	10780627.1	9,918.2	685,717.3
2010	29205782.96	7,706,430.5	11525530.3		799,910.9

Source: the central bank of Nigeria Statistical Bulletin 2010

4.2 Analysis of results

The regression result is containing in appendix attached and summarized below:

Variable	Coefficient	Std error	Student t
Constant	1018391.9	439926.56	3.315
CDMB	-3.630	1.428	-2.543
M2	40499	1.050	4.285
MCAP	611.894	336.011	1.821
VOD	3.055	3.154	0.968

Durbin-Watson = 0.677

F= Statistics = 131.480

R² = 95.5 %

The estimated equation results is as presented bellow

$$GDP = \alpha_0 + \alpha_1 CDMB + \alpha_2 MS + \alpha_3 MCAP + \alpha_4 VOD + U$$

$$GDP = 1018391.9 + 3.630 CDMB + 4.99M2 + 611.894 MCAP + 3.055 VOD$$

(439926.56), (1.428), (1050) (336.011), (3152)

The models is constant at 1018391.9. The variables M2, MCAP and VOD are positive meaning for the every one naira N1 increase in M2, MCAP and VOD, there is an increase in GDP of 4.499, 611, 894, and 3.055 respectively.

Meanwhile the coefficient for CDMB has a negative sigh i.e. there is an inverse relationship between CDMB and GDP i.e for every n1 change in CDMB there is a reduction in GDP to the tune of 3.630

Model fit

The value R² at 95.5% means that 95.5% changes in the dependent variable [GDP]is accounted for by changes in the models independent variables [cdmb,m2,vod and MCAP]while 4.5 changes in the independent variable is accounted for by changes in variables outside the model.

4.3 Test of significance

We conduct A two tailed test of significance at 5% level of significant and n-1 = 30 -1 = 29

The table + and variable + calculated are as follows;

Variance	T-calculated	t-tabulated	Level of significance
CDMB	-2.543	2.05	Significant
M2	4.285	2.05	Significant
MCAP	1.821	2.05	Not Significant
VOD	0.968	2.05	Not Significant

Comparing the t-test calculated and T-tabulated, independent variables.;CDMB and M2 are significant while VOD and MCAP are not significant.

4.4 Test for hypothesis

The CDMB and M2 are representing the activities of the money market and they are significance i.e. considering the first hypothesis we accept the alternative and reject the Null hypothesis. Conversely, the VOD and MCAP representing capital market activities are not significance i.e considering the second hypothesis we accept the null and reject the alternative.

In summary the activities of the money market in Nigeria are significant and have a positive effect on the GDP while capital market activities do not have a significance effect on economy activities in Nigeria.

4.5 Summary and Implication of Findings

Since Goldsmith (1969) documented the relationship between financial development and economic growth 30 years ago, the profession has made important progress. Rigorous theoretical work carefully illustrates many of the channels through which the emergence of financial market effect and are affected by economic growth. Considering the various independent variables, i.e. (CDMB, M2 MCAP and VOD), the results show that the CDMB and M2 are significant in the development of financial institutions and this will ultimately sustained the economic growth in the country. The capital market which has VOD and MCAP as its variable are not significance and should be restructured and the level of funds raised should also be increase. The money market should be encouraged to give out more short term loans so that unemployment and other economic problems can be eradicated. More funds should be directed to the small medium enterprises (SMEs) so that more jobs opportunity can be provided to the youth

5. SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Economic growth is an adventurous process demanding financial pro-activity in converting short term funds into longer term growth propelling investments. Joseph Schumpeter (1911) argue that the service provided by financial intermediaries, mobilizing funds, evaluating project, managing risk, monitoring managers and financial transaction are essential for technological innovation and economic development. Empirical work by Gold smith (1969) and McKinnon (1973) illustrates the close ties between financial and economic development for few countries.

The overall objectives of this study are to examine the effect of financial development on economic growth using Nigeria as a case study. The objectives include; determining the effect of money and capital market activities on economic growth and financial development in Nigeria, to estimate the increase in economy's real national income and ascertain the Gross Domestic product (GDP) and other economic variables. The Nigeria economic data ranging from the Central Bank of Nigeria statistical bulletin (2010). The ordinary least square method of multiple regression equation using the statistical package for social Science (SPSS) was used to analyze the model.

Considering the various independent variable used; Banking System's Credit to the Domestic Economy (CDMB), Money Supply (M2), market capitalization (MCAP) and value of deals (VOD). GDP being the dependent variables, it was observed that the CDMB) and M2 re significance in the development of financial institutions and it will stimulate economic growth. The capital market which has VOD and MCAP as its variable are insignificant and should be restored.

The Securities and Exchange Commission and the Nigerian stock Exchange should formulate better and more aggressive enlightenment programmes, create new and flexible long term financial products, and encourage institutions to securities their assets.

5.2 Conclusion

This study has examined the relationship that exists between the financial institutions and economic growth in Nigeria. It has observed that the growth of the country. However the proxies for Domestic (CDMB) Money Market (M2), Market capilization (MCAP) and value of deals (VOD). They captured the constituents of the financial system i.e. Money and capital market in the multiple regression result.

The proxy for economic growth was Gross Domestic Product (GDP). The study finds out that the activities of the capital market do not have a significant effect on the economic growth. This possible implies that a good percentage of the credit introduced to the economy is placed on money market instrument thereby neglecting the capital market instruments.

It is relevant to state at the junction that short term loans and advances are important for driving financial development within the country but the government should encourage investment in capital markets instruments.

5.3. Recommendations

The Nigerian capital market is still slow in developing in relation to her counterparts elsewhere. The reasons for the slow pace include the following;

- The unstable macro-economic environment arising from high and rising inflation over the years.
- Exchange rate depreciation from US \$ 1:00 to 0:30 in 1961 to US \$ 1:00 to 154.00 in 2011.
- Poor quality, high cost and the limited range of financial services.
- Lack of confidence in the financial market form the prevalence of parallel foreign exchange markets.

- Shift of financial resources abroad and capital flight
- Dominance of the financial system by commercial banks resulting from too much incentive to use shorter term bank facilities at the expense of longer term capital market securities.

No doubt the Nigerian capital market which should be the main source of long –term financing for development investment has remained rather slugging in terms of growth efficiency, activity and funds mobilization. Although many of these problems are being tackled by the Securities and Exchange Commission and the Nigerian Stock Exchange, there are still quite a few policies and programmes that need to be pursued to build the market to the standard of other fast growing and developing markets. Some of the recommendations are listed below;

- Better and more aggression enlightenment programmes;
- Creation of new and flexible long-term financial products to increase the supply of securities;
- Compelling companies of a minimum size to seek quotations;
- Encouraging institutions to securitize their assets thus, improving access to long-term liquidity;
- Improving accounting and auditing standards to satisfy the information requirements of the financial markets investors and the international financial community.

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APPENDIX

DESCRIPTIVE MEAN STUDY CORR SIGN

MISSING LISTWISE

STATISTIC COEFF OUTS R ANOVA

CRITERIA= PIN (0.5) POUT (0.1)

NOORIGN

DEPENDENT VAR00001

METHOD = ENTER VAR00002 VAR00003 VAR00004 VAR00005

Regression

(Data Set 0)

Descriptive statistics

Variable	Mean	Std. deviation	N
GDP	6168405.4	8772782.8758	30
CDMB	1346812.7	2523335.4652	30
M2	1858109.7	3238823.2447	30
MCAP	1825.3300	3516.46148	30
VOD	183960.67	391113.45171	30

	GDP	CDMB	M2	MCAP	VOD
Pearson correlation					
GDP	1.000	.943	.961	.917	.869
CDMB	.943	1.000	.992	.891	.889
M2	.961	.992	1.000	.889	.863
MCAP	.971	.891	.889	1.000	.827
VOD	.869	.889	.863	1.927	1.000
Sign (1-taile)					
GDP		.000	.000	.000	.000
CDMB	.000		.000	.000	.000
M2	.000	.000		.000	.000
MCAP	.000	.000	.000		.000
VOD	.000	.000	.000	.000	
Sign (1-taile)					
GDP		.000	.000	.000	.000
CDMB	.000		.000	.000	.000
M2	.000	.000		.000	.000
MCAP	.000	.000	.000		.000
VOD	.000	.000	.000	.000	
N					
GDP	30	30	30	30	30
CDMB	30	30	30	30	30
M2	30	30	30	30	30
MCAP	30	30	30	30	30
VOD	30	30	30	30	30
	30	30	30	30	30

VARIABLES ENTERED /REMOVABLE

Model	Variables Entered	Variables Removed	Method
1	VOD, M@ MCAP CDMB		Enter

- All requested variables entered
- Dependent variable: GDP

MODEL SUMMARY^B

MODEL	R	R Square	Adjusted R Square	Std. Error the estimate	Durbin Waston
1	.977a	.955	.947	2012759.248	677

- a. Predictors: (constant). VOD, M2, MCAP, CDMB
b. Dependent variable GDP

ANOVA^b

MODEL	SUM OF SQUARES	DF	MEAN SQUARE	F	SIG
1. Regression	2.1E+015	4	5.327E+014	131.480	.000a
2. Residual	1.0E + 014	25	4.051E + 012		
3. Total	2.2E 015	29			

- c. Predictors: (constant). VOD, M2, MCAP, CDMB
d. Dependent variable GDP

COEFFICIENTS

Model	Unstandardized coefficients B	Std. Error	Standardized coefficients Std.	T	
1. Constant	1018391.9	439926.56	-1.044	2.315	
CDMB	-3.630	1.428	1.661	-2.543	
MCAP	4.499	1.050	245	4.285	
VOD	611.894	336.011	1.36	1.821	
	3.055	3.154		.968	

- a. Dependent variable
b.

RESIDUAL STATISTICS^A

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted value	1063942.3	33412688	6168405.4	8571423.7891	30
Residual	-4206906	5486878.5	.00000	1868800.0464	30
Std. predicted Value	-596	3.179	.000	1.000	30
Std. Residual	-2.090	2.726	.000	.928	30