Dissertation By

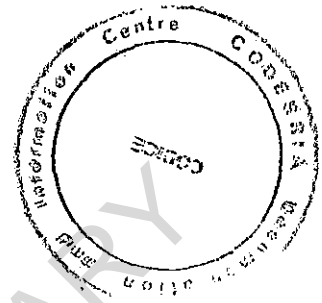
DAUDA OLALEKAN YINUSA

SCIENCE IN ECONOMICS OF OBAFEMI AWOLOWO UNIVERSITY, ILE-IFE.

Financial Sector Reforms, Stock Market Development and Economic growth in Nigeria: 1970-1993

JULY, 1998

FINANCIAL SECTOR REFORMS, STOCK MARKET DEVELOPMENT AND ECONOMIC GROWTH IN NIGERIA (1970-1993)



BY

DAUDA OLALEKAN YINUSA.
B.Sc (ECONS) O.A.U IFE, 1992

A THESIS SUBMITTED IN PARTIAL FULFILMENT OF AWARD OF THE DEGREE OF MASTER OF SCIENCE IN ECONOMICS OF OBAFEMI AWOLOWO UNIVERSITY, ILE-IFE.
NIGERIA

JULY, 1998

DEDICATION

This thesis is dedicated to my wife Mrs. Morenike C. Yinusa and my loving Son, Oluwadamilare Olalekan (Jnr) Yinusa for their unflinching and unalloyed support throughout the preparation of this thesis.

CERTIFICATION

This is to certify that this research project was conducted under my supervision by D.O Yinusa and is being approved for the Department of Economics, Obafemi Awolowo University, Ile-Ife.

Anthony E. Akinlo (Ph. D)
(Supervisor)

27/7/98
Date

Dr. S.I. Oladeji
(Head of Department(Economics))

28/7/98
Date

HEAD
Department of Economics
Obafemi Awolowo University
ILE-IFE, NIGERIA

ACKNOWLEDGEMENT

To God be the glory. I benefited from the wealth of knowledge possessed by a lot of people too numerous to mention in this limited space. However, I wish to express my appreciation to the following special people.

First and foremost, my sincere thanks go to my supervisor, Dr A.E. Akinlo, who took up the challenge of supervising this thesis after the departure of my former supervisor, Mr P.C. Mutambuka from the department. Aside from contributing immensely to my intellectual development in the field of Economics, Dr Akinlo's moral support and other contributions towards the successful completion of the thesis is greatly appreciated. Indeed, I have enjoyed conducting a rigorous research of this nature under his supervision.

I also want to use this medium to thank my lecturers in the Department of Economics for their very useful contributions. Dr S.I. Ikhide taught me International Trade Theory and International Finance at the Postgraduate Level. In fact, I received motivation from him in designing this research topic. Apart from volunteering all his research works and other materials in this area of study to me, I had full and unrestricted access to his library. Therefore, aside from being my lecturer, Dr. Ikhide is a trusted confidant and father. He stood by me through the troubled period. May the heavenly father reward him abundantly.

My special thanks go to Dr. S.I. Oladeji who is not only my lecturer but also my Head of Department. He taught me econometrics at the Postgraduate level and also took particular interest in my thesis. May the Almigty God be with him.

I also wish to thank Mr A.O Olaloye, Dr. J.A. Fabayo, Dr. (Mrs) Agnes Odejide, Dr. (Mrs) R.O. Soetan, Dr. (Mrs) Olusi and my other colleagues in the Department for

their moral and intellectual support. You have all produced yet another "Economist".

The financial assistance towards data collection and the preparation of this thesis provided by the Council for the Development of Economic and Social Research in Africa (CODESRIA) is gratefully acknowledged and appreciated.

Finally, I am gratful to my parents, uncles, brothers, sisters and friends for their moral support during the period of this study.

TABLE OF CONTENTS

LIST OF TABLES

ABSTRACT

This study provided an empirical analysis of the impact of financial sector reforms on Stock Market Development in Nigeria. The study also verified the relevance of Stock Market for economic growth. To achieve the above stated objectives, three equations were formulated and using time series quarterly data, Two Stage Least Squares(2SLS) estimation technique was employed to estimate the parameters of our variables for the period 1970-1993.

The results of the Stock Market Equation show that financial sector reforms had contributed significantly to Stock Market Development in Nigeria. For the growth equation, Stock Market index indicates a positive and significant association with economic growth.

The policy implication of the findings are, first, government should avoid financial repression and lean more towards the side of carefully designed and consistently implemented policy of deregulation since financial reform affects Stock Market development positively. Particular attention should be given to exchange rate and financial structure policies because of their possible destabilizing effects if not well managed. Second, policy makers should endeavour to encourage Stock Market development so as to actualise their vision of sustained and real growth in the future.

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND TO THE STUDY:-

Many factors determine the level and the rate of development of a given economy, namely, natural resources endowment, labour supply, and of course capital. An economy blessed with precious minerals, valuable agricultural land and suitable land - water mix, is in a better position to develop than another economy without these, other things being equal. In the same manner, a country that does not have adequate supply of requisite manpower is at a disadvantage. Although, other factors are quite important in the development of a modern economy, it is no use denying the importance of financial markets in general and the capital market in particular(CBN, 1982).

However, the recognition of the important role which financial markets could play in the developmental aspirations of most African economies is a recent phenomenon. For example, before the 1960s, the Nigerian economy was basically agrarian. It depended largely on agricultural products for its foreign exchange earnings. Indeed, characterised by a centralised marketing boards system, the ultimate pricing and purchase of agricultural products within the domestic economy in Nigeria was highly centralised in and controlled by the government. The argument then was that international market price volatility in a decentralised marketing arrangement for agricultural products may have destabilising effects on the economy. Hence, to promote domestic price stability, steady foreign exchange earnings for the government and also to insulate domestic producers of these products from the risks inherent in world market price instability, a regulated marketing arrangement was adopted. As a monopsony within the domestic economy, the marketing

board dictates the price and as a monopoly in the export sector for agricultural products, it was the ultimate source of foreign exchange earnings for the economy. During this period, the financial markets necessary for the finance of agricultural production and marketing was close to non-existence and the demand for credits therein was grossly seasonal. To be specific, the domestic financial markets in general and capital market in particular was undeveloped and visibly unorganised since the entire financial system was predominantly foreign owned. What existed was linked to the London market which in effect meant that short-term and long-term funds of the financial institutions operating in the country were usually transferred overseas for investment in foreign financial assets. This culminated in a net export of capital at a time when the country needed all the funds it could lay hands upon for development. Nigeria's farmers, businessmen and industrialists had no organised formal market where they could raise short - and especially long - term funds for the running of their businesses, and the country, particularly the government, had no effective and organised machinery for mobilizing its resources for planned development; nor was there any effective machinery for monetary policy and control. In short, many benefits of financial markets especially the capital market, eluded the country(Nwankwo, 1991). Therefore, because of the seasonality in credit demands and the unorganised nature of the financial markets in Nigeria, the capital market did not respond adequately to the developments in the real sector, hence, the motivation for the current financial sector reforms becomes evident.

With the discovery of crude petroleum in commercial quantities in the 1970s, Nigeria witnessed an unprecedented improvement in the Balance of payments (BOP) in terms of foreign exchange earnings. This led to an increase in demand for imported goods by individuals and government, firms also relied heavily on imported inputs for their

production. There was rural urban migration of people especially during this period, thereby resulting in over crowding in cities and loss of labour in the rural areas. This over-dependence on crude petroleum export earnings made the economy more vulnerable to the uncertainties and vagaries in the world economy. Therefore, it could be said that the features of Nigerian economy in the 1970s were dictated largely by the growing importance of crude petroleum, the expanding role of the public sector in the economy and an unsustainable dependence on the external sector.

Following the large increase in foreign exchange earnings from oil, which was largely monetised, the public sector involvement in direct economic activities escalated. Fiscal deficits especially after 1974 soared, and because of the increasing over - dependence on external sector, external equilibrium which was quite visible early in the period had virtually disappeared by the end of the decade. Inflationary pressures mounted while monetary management began to experience serious difficulties. Although, the industrial performance appeared to be relatively satisfactory, the dominance of the oil sector in this performance was rather disturbing, while the over - dependence of manufacturing production on imported raw materials made its achieved performance rather unsustainable. Also, the dominance of the public sector in economic activities was promoted by the strategy to utilise the large public resources to expand infrastructural facilities and build up the country's industrial base. The increasing role of public expenditure in determining the course of economic development was boosted by the rapid growth rate of government owned institutions especially financial. Under government pressure, banks did lend to state enterprises and priority sectors at below - market interest rates. Private industrialists also patronised this cheap source of finance thereby leading to high debt/equity ratio in most companies (public and private). Indeed, the

inability or unwillingness of borrowers to repay their loans in recent years has become a serious problem. It has led to a preponderance of bad and doubtful debts in the banking sectors and hence hasten the insolvency of banks. Although, Nigeria had started to develop a market for short-term debt towards the end of 1970s, a system for long-term finance remained unorganised, undeveloped or underdeveloped at best. Therefore, it could be argued that the interventionist approach was much less successful in promoting financial development in this country. Hence, in order to promote equity rather than debt finance, (so that the development aspirations of the country could be achieved) financial sector reforms becomes necessary.

Moreover, the balance of payments position in the 1970s presented a picture of large surpluses in the early part of the period followed by reduced surpluses and the emergence of deficits from the middle part of the period. These trends were determined by developments in the oil sector as well as changes in government policies. This was reflected in the increased shared of the oil sector in the export trade from under 60 percent in 1970 to over 90 percent starting from 1973. While non-oil exports declined proportionately from 30 percent of aggregate exports in 1970 to less than 10 percent at the end of the decade. However, it should be observed that an important factor in this development was the ban imposed by government during the second half of the period on the exports of non - oil commodities in order to satisfy the excess demand for these commodities in the domestic market (import substitution strategy). Another factor responsible for the deteriorating external payments position was the mounting public expenditure by reason of its high import content and also due to the stimulus it gave to private sector imports. It could be argued in particular, that the structure of world demand combined with oligopolistic pricing policies in the industrial economies resulted into a

long-term tendency for the commodity term of trade of Less Developed Countries (or of primary product exporters) to deteriorate (Killick and Sharpley, 1984). Additionally, deficits induced by adverse movements in the commodity terms of trade, towards the tail-end of 1970s, necessarily imposed negative distribution of the gains from trade. The real income effect of this adverse trend in relative prices was equivalent to the transfer of resources from poor nations to rich(Killick and Sharpley, 1984; P.30) . Such an adverse trend tends to accelerate what some (e.g. Balassa, 1964) have argued to be a secular trend in the terms of trade, and the greater instability of LDCs export prices are the destabilising factors.

Also, with huge increases in government expenditure, occasioned by the increased role and direct involvement of the government in production and distribution and the urge of the government to provide social amenities and job opportunities for the teaming population, the financial sector experienced rapid monetary expansion in the 1970s because these expenditures stemmed from the monetization of huge oil revenues. There was also significant expansion of bank credit as another stimulus to monetary growth during the period. Under these circumstances, especially in a situation of increased aggregate demand when output response to domestic requirements was not sufficiently elastic, inflationary pressures intensified in the 1970s. A vivid illustration of the general attitude of the government was its decision to award large salary increases with retrospective effects to its workers in 1975. Private sector enterprises took similar action. Consequently, inflationary pressures worsened while further erosion of external stability was encouraged. However, with the collapse by the international oil market in the 1980s specifically in 1981, foreign exchange earnings of the country fell markedly and the uncontrolled taste for imported goods and services exacerbated the balance of payments

problems. Indeed, government resulted to excessive borrowing and money creation in order to finance its deficits, hence, the financial system was overheated thereby leading to high inflation. But, in periods of inflation, standard economic principle predicts that portfolio investments tend to be discouraged while investment in physical assets is encouraged hence the growth and/or development of the financial markets is undermined. Therefore, it could be stated that the recent financial sector reforms in this country is not misplaced if the potential roles of these markets (especially the capital market) in alleviating the financing problems of the country is considered.

Also the wave of instability passed through the financial sector. Indeed, the financial sectors of most African economies in the 1970s and early 1980s was repressed and highly regulated. The World Bank (1989) observed that:

> Most developing countries have periodically held their interest rates below market-clearing levels. These artificially low interest rates have "repressed" their financial systems, shrinking financial assets in real terms especially at times of high inflation. If financial depth promotes economic growth, artificially low real interest rates may be an obstacle to development(P.32).

Specifically, a major indicator of financial repression is wide spread prevalence of negative real interest rates in the organised financial markets - that is nominal interest rates which are lower than the current rate of inflation. In most LDCs, nominal interest rates on financial assets are regulated below the equilibrium levels that market forces would dictate (see table 1.1 below). Sequel to this, a disequilibrium state of excess demand prevailed in both the financial markets, where the demand for loans exceeds the funds available, and in the real sector where desired investment exceeds mobilised savings. This has often resulted in credit rationing(Wong, 1977) and the perpetuation of price instability(Leff and Sato, 1980). Although, government administrative rules and

regulations of the financial sector tended to vary in intensity and types across countries, there existed certain elements which were common to the regulated structure. Among these are ceilings on credit expansion and interest rates, which encouraged capital flight, nationalization of the entire financial system, restrictions on both inflow and outflow of capital, high liquidity and reserve ratios as well as out-dated laws and accounting procedure.

Credit ceilings reduces efficiency in two ways: first, they limit all banks equally, even those that are most efficient at lending or those that have the most dynamic entrepreneurs as clients. Hence, credit ceiling imposes an uneven rationing criterion because of the customer - market nature of bank credit. Second, credit ceiling reduces efficiency by destroying

TABLE 1.1
NOMINAL AND REAL INTEREST RATES IN SELECTED AFRICAN COUNTRIES

	NIGERIA			KENYA			BURKINA FASO			COTE D'IVIORE			NIGER		
YEAR	NOMINAL RATE	INFLATION RATE	REAL RATE	NOMINAL RATE	INFLATION RATE	REAL RATE	NOMINAL RATE	INFLATION RATE	REAL RATE	NOMINAL RATE	INFLATION RATE	REAL RATE	NOMINAL RATE	INFLATION RATE	REAL RATE
1970	3.00	13.8	-10.8	3.50	1.94	1.56	3.00	1.66	1.34	3.00	9.84	-6.84	3.00	1.43	1.57
1971	3.00	15.6	-12.6	3.50	3.81	-0.31	3.00	1.96	1.04	3.00	-1.49	4.49	3.00	3.87	-0.87
1972	3.00	3.2	-1.16	3.50	6.42	-2.92	3.00	-2.89	5.89	3.00	0.00	3.00	3.00	9.83	-6.83
1973	3.00	5.4	-2.4	3.50	9.48	-5.98	5.75	7.59	-1.84	5.75	11.11	-5.36	5.75	11.73	-6.73
1974	3.00	13.4	-10.4	4.32	17.32	-13.00	5.75	8.90	-3.15	5.75	17.73	-11.98	5.75	3.59	2.16
1975	3.00	33.9	-30.9	5.13	19.46	-18.33	5.88	18.59	-12.71	5.88	11.20	-5.32	5.88	9.00	-3.19
1976	2.67	21.2	-18.53	5.13	11.24	-6.11	6.00	-8.31	14.31	6.00	12.15	-6.15	6.00	23.47	-17.47
1977	2.83	15.4	-12.57	5.13	14.65	-9.52	6.00	30.05	-24.05	6.00	27.24	-21.24	6.00	23.37	-17.37
1978	4.15	16.6	-12.45	5.13	14.98	-9.85	6.00	7.77	-1.77	6.00	13.14	-7.14	6.00	9.31	-3.31
1979	4.47	11.8	-7.33	5.13	9.96	-4.83	6.00	15.34	-9.34	6.00	16.56	-10.56	6.00	15.27	-9.27
1980	5.27	9.9	-4.63	5.75	13.94	-8.19	6.19	12.34	-6.15	6.19	14.76	-8.57	6.19	3.31	2.88
1981	5.72	20.9	-15.18	8.85	11.62	-2.77	6.25	7.10	-0.85	6.25	8.68	-2.43	6.25	22.93	-16.68
1982	7.60	7.7	-0.1	12.20	20.55	-8.35	7.75	11.94	-4.19	7.75	7.40	0.35	7.75	11.63	-3.88
1983	7.41	23.2	-15.79	13.27	11.36	1.91	7.50	8.41	-0.91	7.50	5.92	1.58	7.50	-2.52	10.02
1984	8.25	39.6	-31.35	11.77	10.20	1.57	7.25	4.81	2.44	7.25	4.29	2.96	7.25	8.39	-1.14
1985	9.12	5.5	3.62	11.25	12.96	-1.71	7.25	6.88	0.37	7.25	1.87	5.38	7.25	-0.94	8.19
1986	9.24	5.4	3.84	11.25	4.75	6.50	6.08	-2.54	8.62	6.08	6.73	-0.65	6.08	-3.18	9.26
1987	13.09	10.2	2.89	10.31	7.66	2.65	5.25	-2.70	7.95	5.25	7.00	-1.75	5.25	-6.74	11.99
1988	12.95	13.3	-25.35	10.33	11.18	-0.85	5.25	4.01	1.24	5.25	7.00	-1.75	5.25	-1.43	6.68
1989	14.68	40.9	-26.22	12.00	12.92	-0.92	6.42	-0.30	6.70	6.44	1.00	5.42	6.42	-2.80	9.22
1990	19.78	7.5	12.28	13.67	15.61	-1.94	7.00	-0.79	7.79	7.00	-0.79	7.79	7.00	-0.79	7.79
1991	14.92	13.0	1.92	-	1.98		7.00	2.50	4.50	7.00	1.70	5.30	7.00	-7.08	14.80
1992	18.04	44.5	-26.1	-	29.55		7.75	-1.95	9.70	7.75	3.54	4.21	7.75	-4.45	12.20
1993	23.24	57.2	-33.96	-	-		-	0.50	-	-	2.85	-	-	-1.25	-

- not available

Source: IFS YEAR BOOK, IMF, 1994

competition for deposits. Once the ceiling is reached, extra deposits represent idle cash reserves and so are not wanted. Banks will then stop making efforts to attract deposits and to provide good services to existing depositors. Alternatively, they may reduce deposit rate of interest. Needless to say that reduced deposit rate interest may discourage aggregate savings and hence limit the amount of investible funds available in the economy, it may even lead to a misallocation of resources since a substantial amount of a nation's financial resources will be outside the financial super structure thereby favouring the purchase of physical assets which are largely consumables and predominantly unproductive. However, the overall effects of credit ceiling is to increase the spread between gross cost of borrowing and net returns to lenders (Tables 1.2). Indeed, credit ceiling deliberately reduce financial intermediation.

Although, the need for social equity, income redistribution, maximization of scale economies, avoidance of externalities and the quest for timely dissemination of information has been the arguments for setting up state - owned enterprises in less developed countries, nationalization of predominantly state - owned financial system are beset with many problems. Among which are proliferation of unviable financial institutions, low resource mobilization, risky priority sector lending, low capitalization ratios, reduced flexibility of banks to undertake discretionary lending, increasing administrative requirements for loan processing, reduced scope of financial institutions to allocate credit on the basis of economic criteria, poor quality of field staff and weak management and supervision. Therefore, it could be argued that complete nationalization of financial institutions as we have witnessed in most African countries reduces financial sector efficiency and flexibility as their performance has been observed to be highly correlated with general Civil Service performance(Morris, 1985).

TABLE 1.2

SPREAD BETWEEN GROSS COST OF BORROWING AND NET RETURNS TO LENDERS IN NIGERIA (1970-1993)

YEAR	DEPOSIT RATE SAVINGS (NOMINAL) (1)	LENDING RATE FIRST CLASS ADVANCES (NOMINAL) (2)	SPREAD (2 - 1)
1970	3.00	7.00	4.00
1971	3.00	7.00	4.00
1972	3.04	7.00	3.96
1973	3.00	7.00	4.00
1974	3.00	7.00	4.00
1975	3.00	6.25	3.25
1976	2.67	6.50	3.83
1977	2.83	6.00	3.17
1978	4.11	6.11	2.00
1979	4.47	7.79	3.32
1980	5.27	8.43	3.16
1981	5.72	8.92	3.20
1982	7.60	9.54	2.13
1983	7.41	9.98	2.57
1984	8.25	10.24	1.99
1985	9.12	9.43	0.31
1986	9.24	9.96	0.72
1987	13.09	13.96	0.87
1988	12.95	16.62	3.67
1989	14.68	20.44	5.76
1990	19.78	25.30	5.52
1991	14.92	20.04	5.12
1992	18.04	24.76	6.72
1993	23.24	31.65	8.41

SOURCE :IFS YEAR BOOK, IMF, 1994

Also, in most countries, apart from inadequate regulation and supervision which have permitted risky lending, virtually all banks in most African countries experienced the incidence of non - performing loans. Worse still, most economies in Africa are afflicted with rapid and persistently high inflation. Under such an environment, as argued above, physical assets tend to be more attractive as investment outlets than portfolio investments. Hence, as investment in physical assets assumes increasingly large proportions as a result of inflation, financial disintegration resulted thereby frustrating the overall objective of the system in terms of resource mobilization and allocation.

The capital market also came under the pervading influence of the government. By assuming the role of the major supplier and users of capital funds, the government determines the pace and course of activity in the market. Rates and yields in the capital market were also largely administered and kept below the scarcity value of loanable funds in the market by official policy. With respect to government stocks, low rates were maintained to minimise government debt burden. The volume and price of private securities in the capital market were also influenced by the government. Hence, resources mobilization and allocation is less than optimal (Ikhide, 1993). Financial reforms, financial liberalization or increased financial intermediation, is thus advocated to help surmount these problems (Shaw, 1973, McKinnon 1973, McKinnon, 1976).

Indeed, the purpose of organised financial markets is to allocate savings efficiently for investment in real assets. But inappropriate macro-economic policies have prevented effective and efficient domestic resources mobilization and allocation through the financial markets of many developing countries over the past two decades(Fry, 1988). High and volatile inflation in developing countries has been accompanied by increased financial instability and crash. Hence, given the experience of financial repression followed by

financial crash, advice on macro economic and financial sector has changed rather rapidly as experience grew(Fry, 1988; P.345). The realization that financial crash occasioned by financial repression, inhibits economic growth by obstructing efficient savings, investment and capital market development underlined the introduction of a comprehensive financial reform under SAP. Hence, the restructuring of the financial system to provide a framework that would assure and promote the structural realignment of the entire economy became inevitable. Specifically, in 1987, the authorities in Nigeria commenced an extensive reform of the financial system as part of a structural adjustment programme. Reforms involved the liberalization of interest rate, promotion of market based system of credit allocation, enhancing competition and efficiency in the regulatory and supervisory framework. It could be argued that a liberalised financial system would stimulate the capital market development through the proper functioning of the price mechanism thereby raising domestic savings, attracting foreign investors (capital Inflow), promoting efficient financial intermediation, increasing capital formation (investment) and accelerating the rate of growth of productive capacity. This argument is premised upon the fact that high interest rates that is expected to follow financial reforms would encourage investment in securities thereby developing the domestic capital market and thus permitting more efficient use of open market operations. To support the above argument, TunWai and Patric (1973) submitted that financial reforms will create a conducive environment for capital market development in LDCs. In their own words,

> *An essential condition for an effective capital market development is that prices be determined freely by interaction of forces determining demand and supply. Yet, the low interest rate policy pursued by governments in many LDCs conflict with the principle and practice of freely determined market prices for securities, notably for bonds. The moral is that the development of capital market requires freedom from government attempts to control interest rates in that market (P.283).*

In addition financial reforms are also expected to generate healthy competition in the financial sector. Competition will lead to financial innovation which bring about vast array of financial instruments new product design and delivery. To take advantage of these, a well developed capital market must exist According to Hang - Sheng cheng(1980, P.45)

> *... a well - developed secondary market pre-supposes a high degree of financial sophistication, based on ..., knowledgeable investment - advisory services, efficient communication networks and reasonable regulatory authorities to enforce the rules of the game.*

Indeed, research attempts have been made at evaluating the impact of this programme on the banking subsector(Ikhide and Alawode, 1993; 1994 and Ojo, 1993). However scanty and unsatisfactory attempts has been made at evaluating the success or failure of this programme as it affects the capitals market. First, there is the need to find out the extent to which reform measures aimed at the capital market have yielded the desired results. Second, most of the attempts at evaluating the impact of financial reforms in Nigeria have reported performances that are less than desired result (see for example, Ikhide and Alawode, 1994) To what extent is this related to the reforms or lack of it in the capital market (Cho, 1986)?

This study therefore, focuses on the impact of financial liberalization on this crucial segment of the Nigerian financial system - The capital market and economic growth.

1.2 JUSTIFICATION FOR THE STUDY:-

The Nigerian financial system is in a dire state. The existing financial structure no longer appears adequate to achieve the goals and developmental priorities of the country.

This has motivated the quest for financial reform. However, financial liberalization has further exposed the inherent weakness in our financial system that is disposed towards debt financing as against equity financing. In the face of asymmetric information, leading to adverse selection, insolvency has becomes a common feature in the banking system as bad and doubtful debts have been on the increases. For instance, out of about 150 banks and 800 non-bank financial institutions which operated in Nigeria at the wake of liberalization, 80 and 700 respectively had become insolvent. This poses serious risk for our economy.

Aside from this, a well developed capital market has a lot of roles to play in achieving the development aspirations of any economy. For concreteness, the role of a well functioning capital market in economic development involves: mobilization of domestic savings for productive investment; promotion of the growth of financial services and various forms of institutional savings such as insurances and pension funds; facilitation of overall efficiency of investment by encouraging higher standard of accounting, financial planning and public disclosure and the facilitation of the entry of domestic enterprises into international capital market. Other roles include improvement in the gearing of the domestic corporate sector by promoting equity financing, thus reducing dependence on borrowing and making the financial system more solvent; provision, through equity financing, of a cushion for business against variable cash flows and possible losses; and the facilitation of institutional development and of the establishment of venture capital companies (VCCS), Unit Trusts, country funds and foreign mutual funds.

From the above, it follows that a clear understanding of the linkage between financial sector reform and stock market as it affects investment, savings, capital flows

and institutional development would help policy makers to designs and implement financial policies consistent with the developmental aspirations of their economies. Therefore, by investigating the linkages between stock market development and financial reforms, we would be in a position to profer useful policy recommendation aimed at improving the efficiency, stability and globalization of Nigeria's capital market for the overall development of the economy. Needless to say that a programme of reforms need to be evaluated and re-evaluated from time to time in an attempt to monitor the effectiveness and overall relevance of the policy prescriptions emanating from the implementation of the programme as regards achieving its desired impacts on the target macroeconomic variables, the study will also complement the research efforts that have been made in measuring the impact of financial reforms with regards to other sectors of the economy. In addition, the study will provide empirical evidence on the pessimism that still exist in the literature as regard the relevance of stock markets for long-run economic growth in less developed countries(Singh, 1991).

1.3 STATEMENT OF OBJECTIVES:-

In the context of efforts to improve the efficacy of financial markets in resource mobilization, allocation and at the same time maintain macroeconomic stability for economic growth, the broad objective of this study is to examine the impact of financial sector reforms on stock market development and consequently, empirically investigate the impact of stock market development on economic growth in Nigeria. To ensure conformity with the broad objectives of this study, we focus on the following specific objectives:-

i. To provide a comprehensive appraisal of the structure of the Nigerian financial system.

ii. To empirically investigate the impact of financial sector reform measures on the growth of stock market in Nigeria.

iii. To examine the impact of stock market development on economic growth.

iv. To suggest policy guidelines that will aid the on-going liberalization efforts in Nigeria towards enhancing sustained economic growth.

1.4 RESEARCH HYPOTHESES

The hypothesis to be tested include:-

1. That there is a positive relationship between financial sector reforms and stock market development in Nigeria.
2. That there is a positive correlation between stock market development and economic growth.

1.5 SCOPE OF STUDY

The origin and early growth of the Nigeria's capital market could be traced to 1946 when the first development stock was issued. From this period through 1960s and until the early 1970s, the market was characterised by limited financial institutions and assets - long -term securities. For concreteness, by the end of 1971, there were 17 commercial, one merchant and two development banks in the country with few other non-bank financial institutions e.g insurance houses, mortgage institutions etc. Besides, transactions in the market consisted mainly of government stocks. The use of corporate finance by business organisations was a strange idea to most entrepreneurs at that time. Direct borrowing was favoured as against equity finance. However, since these loans cannot be capitalised, alternative sources of finance must be sought . Hence, the search for a more

permanent source of finance coupled with the need to keep pace with the financial developments in the global society called for a more efficient means of finance. But, during this period, the financial system was beset with so many institutional and structural problems which made it practically impossible for it to efficiently and effectively satisfy the needs of the modern investors. There is then the need for a total reorganisation of the system to achieve increased efficiency. Indeed, it is evident that a comprehensive measure directed towards restructuring the financial sector in Nigeria was as a result of the structural and institutional problems which culminated into financial crisis in the early 1980s. Since then, efforts have been directed towards studying the effects of various financial policies instituted on macro economic variables. However, scanty literature exists on the effects of financial sector reforms on the capital market. Therefore, the scope of this study is to examine the effects of financial sector reforms on growth of capital market in Nigeria and the effect of stock market development on economic growth using the data base of 1970 - 1993. This period is further sub - divided into two i.e 1970 - 1985 and 1986 - 1993. Prior to 1970, the effect of Nigeria's capital market on macroeconomic variables such as investment or capital formation, was insignificant. Even in 1970, the value of government stocks stood at N16.4 million while the industrial ones is estimated to be ₦0.2 million. This ₦0.2 million represent about 1.2 percent of the value of total stocks outstanding in the Nigeria's securities market. Although, the number of deals in industrial stocks (331) was higher than the number of deals in government stocks (303), the value of government stocks was obviously dominating. However, it need be stated that monies raised through the capital market then were largely used to finance infrastructural facilities with little or no multiplier effect on real total output of the nation. Also, 1970 marked the beginning of an era of strict economic regulation in Nigeria, as this represents

the beginning of oil boom period when government dominated all sectors of the economy including the financial sector. Hence, the choice of that year as the lower limit of our data base. Also, we close the period of our analysis at 1993 because, the beginning of 1994 witnessed the reawakening of another form of economic regulation which we do not intend to study now because its impact on the economy is too early to study.

The partitioning is informed by the introduction of financial reforms in 1986 which we expect to have impact on our estimates. It will also enable us to compare the impact of reform measures on the capital market and the effect of stock market development on economic growth under different regulatory environments.

Besides, it is expected that the time frame selected will adequately reflect the impact of the fast - changing economic atmosphere on financial markets in general and capital market in particular. This expectation is premised upon the fact that the period under consideration witnessed considerable changes in the history of Nigerian economy. For example, between 1970 and 1985, the financial system was under a strict regulation; interest rates were administratively fixed, exchange rates were fixed by administrative fiat; and the growth rate of the banking sub-sector were constrained by various regulatory frameworks. But as the economic recession reached its peak in 1985, the picture changed dramatically and up to 1993, a regime of financial liberalization prevailed. Thus, the period selected displays enough diversity for us to make meaningful deductions from our study of the impact of financial reforms on the capital market on the one hand and stock market development and economic growth on the other.

1.6 PLAN OF STUDY:-

This study is divided into six chapters. Chapter one provided a background to the study. In Chapter Two, Literature Review and Theoretical framework for the study is

lucidly discussed. Chapter Three appraises the Nigerian Financial System while Chapter Four contains the research methods. In Chapter Five, we present our analysis of result while Chapter Six contains Summary, Recommendations and Conclusion.

CHAPTER TWO

LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1 LITERATURE REVIEW

2.1.1 INTRODUCTION:-

Here, we review the existing literature on the effects of financial reforms on the economics of LDCs. Indeed, discussions in this area of macroeconomic adjustment and management have taken four major dimensions in the literature. It ranges from those that sought to diagnose factors that led to financial restructuring in most reforming economics (Suzuki, 1987; freedman, 1987 and Silber, 1983), those that sought to understand what the goals of financial deregulation ought to be (Tobin, 1987, Roberts, 1987; Corrigan, 1987; and Khan and Sundararajan 1992); those that sought to suggest a feasible sequence of financial liberalization program (Smith and Spooner, 1992; Chapple, 1990; Villanueva and Mirakhor, 1990; Ikhide and Alawode, 1994; etc); to those that sought to provide empirical evidence on the linkages between financial deregulation and the economies of LDCs (Fernandez, 1985; Diaz Alejandro, 1985; Demelo and Tybout, 1986; Cho, 1986; Corbo, 1985; Ikhide and Alawode, 1993, 1994 and Ikhide, 1995). In what follows, we will take a closer look at each of these issues with a view to identifying a research gap calling for further investigations.

2.1.2 THE NEED FOR FINANCIAL SECTOR REFORMS:-

The financial system of a country, regardless of time and place, is maintained to meet the economic conditions of that country. In the process of economic development,

however, there occur new economic or technological conditions that foster change of the financial system: the coherence between the old financial system and the new conditions breaks down; internal inconsistencies develop; and the financial needs of the economy are not met sufficiently. In this situation, private financial institutions tend to develop innovation within the old financial system and circumvent old regulations in order to conform to the new conditions. These result in political and economic pressure for relaxation or abolition of all regulations. In this way, the driving forces of financial reform are the emergence of contradictions between the old financial system and the new technological or economic conditions and the reactions of both public and private sectors to these contradictions.

Suzuki (1987) attributed the need for financial sector reform in Japan to four major factors. The first was the large - scale flotations of government bonds that accompanied the shift to low growth and the consequent expansion of free -rate, and open financial markets in both long- and short maturity assets. A second major reason, according to him, was the new sensitivity of corporations and individuals to free interest rates. The third factor was the integration of domestic and foreign financial markets after new incentives brought about by the shift to floating exchange rates and the revision of the foreign exchange and foreign Trade Control Law in 1980 that made capital transactions free in principle. The fourth incentive for financial restructuring was the active introduction of new telecommunications technology and computers by financial institutions which improved efficiency of portfolio management and reduced costs.

Fry (1988) found that in Korea and Taiwan, like in most other less developed countries (LDCs), bank deposit and loan rates have always been set below their free - market equilibrium levels. However, it is widely recognised that such policies particular

below - market interest rates and selective allocation of credit, are not without cost. One view associated with Mckinnon (1973), is that these policies lead to financial repression: without a market allocation mechanism, savings and credit will be misallocated. Therefore, the need for financial liberalization in Korea and Taiwan was basically informed by the desire to ameliorate the costs associated with financial repression. Specifically, it was argued that the desire for financial reform in most economies was a result of the pressure for the removal of interest rate ceilings, credits controls and other quantitative restrictions.

Freedman (1987) noted that unlike the case in most countries, the drive for financial restructuring in Canada was totally unrelated to pressures for the removal of interest rate ceilings, credit controls, or other such quantitative restrictions. According to him, the motivation for financial sector reform was basically to provide a clear-cut separation of functions among different types of institutions and also to checkmate the spread of the conglomerate movement to the financial sector. This is because, according to him, there has been a blurring of functions as institutions penetrated each other's area. Although, the changing structure sketched out above provided the initial pressure for a major legislative restructuring of the financial sector, other factors come to play an important role over time in intensifying the perceived necessity for a change. Freedman (1987; pp.66-7) identified four major factors that drove the process. First, there was a need to modernise the legislation of trust and mortgage loan companies and of life insurance companies and to deal with the question of the business powers available to each of these groups. Second, in the light of the spread of closely - held ownership, commercial - financial links, and common ownership of firms in different industries, there was a need to re-examine potential problems of self-dealing, conflicts of interest, and broader question

of the desirability of financial - Commercial links. Third, given the recent failure of a number of financial institutions, including two small western Canadian banks, questions were raised about the incentives created by the system of deposit insurance in Canada, and about the adequacy of the supervisory structure. Fourth, as the process developed, there was increasing attention paid to the on-going globalization of financial markets and the need for Canadian financial institutions to able to compete effectively both at home and abroad.

Therefore, we can conclude that across all countries, there seem to be some similarities in the conditions or factors that led to financial restructuring in most reforming economies. The instabilities in the financial system, the need to remove arbitrary legal constraints on financial organisations, the mass failure of most banking institutions of the financial system to cater for the developmental goals and priorities of the country; the need to internationalise the domestic financial markets; and the desire to remove, replace or modify obsolete legal constraints concerning the financial sector served as a motivator for financial liberalization. In what follows, we take a look at the views of different authors concerning the goals of financial liberalization.

2.1.3 GOALS OF FINANCIAL SECTOR REFORMS:-

For a long time, bankers, businessmen regulators and lawmakers have all, from their varied perspectives been aware of problems developing in the structure of most financial systems. But often, entrenched economic power, diverse views of history, and differences in regulatory philosophy have led to disagreement on what the goals of financial sector reform should be. Looking at several of the proposals, one can see bits and pieces of various sets of goals of reforms but there exists only limited uniformity of what

the goals of financial deregulation ought to be in today's environment. In all these, there are similarities and differences, but no consensus.

Tobin (1987) observed that the existing financial structure no longer appear adequate to achieve the goals and developmental aspirations of most countries. He therefore, proposed that the goals of financial reforms should be:

> *... to protect the system of monetary payments, assure the availability of safe and convenient media of exchange and other assets to the general public, preserve effective macroeconomic monetary control..., and maintain the sovereign power and responsibility of the federal government...(P. 168)*

In addition, he observed that:

> *The system of depositories is drifting towards oligopoly of giant nation wide banks and bankholding companies, and to conglomerates engaged in a host of financial and non financial business. An unfortunate byproduct of this drift would be that government would be so fearful of the consequences of a failure of these giants that their survival would be guaranteed - whatever the nature of their difficulties...(P. 170)*

Hence, another goal of financial reforms would be to "reduce the oligopolistic tendencies" of the big financial institutions in the economy thereby encouraging competition in the market place.

Commenting on the fundamental goals of financial reforms and on the nature of government intervention that is needed to achieve these goals, Edward (1987; P.15) proposed a set of goals. In his view, identifying these goals is essential to designing a new system and to defining the proper scope of government involvement. He therefore, outlined four goals that any new financial structure should satisfy: (1) A sound and stable financial system; (2) The most competitive system consistent with soundness and stability

(3) Equal (or fair) treatment of all customers (4) protection for the small and unsophisticated depositor.

Khan and Sundararajan (1992) and Corbo (1985) argued that the goals of financial reforms are to achieve greater independence for central banks in macroeconomic stabilization and adjustment efforts, enhanced competition in the banking system, stronger balance sheets and a higher quality of bank portfolios, an effective banking supervision system, and an efficient clearing and settlement system for payment.

Meanwhile, while agreeing with other authors on the goals of financial reforms, Corrigan (1987) noted that one goal often goes unstated. The goal relates to what he called "systemic risk". It involves trying to protect the system as a whole against the possibility of a highly destabilizing "accident" that could undermine prospects not just in the banking or financial arena, but in the economy as a whole.

In the final analysis, Roberts (1987) summarized the goals of financial reforms in five sentences: To ensure access to capital and credit, to all types of participants in financial markets; to balance competition with safety and soundness, recognizing the quasi - public character of financial institutions; to enhance the efficiency of the market system by preventing conflict of interest and concentration of financial resources, ensuring impartiality in credit decisions, and a large number of participants; to ensure that the financial system exercises its fiduciary responsibility, particularly by channeling funds into productive uses and by being a catalyst for economic growth; and to protect customers by ensuring integrity of institutions and markets and by cushioning the impact of failures. However, he admitted that although, these identified goals may not be a perfect set, but one can argue that they constitute the acknowledged ones in the literature. These same set of goals should be used in looking for any necessary modifications of the current financial

structure so that the realization of the desired financial system and its associated benefits will not be an illusion. In the next section, we look at the appropriate sequencing of financial sector policies.

2.1.4 APPROPRIATE SEQUENCING OF A FINANCIAL LIBERALIZATION PROGRAM.

The issue of sequencing stabilization policies vis-a-vis structural policies has received a lot of attention in the literature. Smith and Spooner (1992) identified a number of reasons why stabilization measures are expected to precede supply - side measures in an adjustment program. First, it is argued that the results of supply-side measures take time to be realized and without demand restraint, the initial increase in balance of payments deficits that accompany demand -side measures may become explosive and uncontainable especially where there is a constraint on external inflows. Second, stabilization measures are required to bring about a substantial improvement in the balance of payments. This is made possible by a drastic depreciation of the exchange rate to promote exports in order to provide funds for the importation of essential imports. In order to sustain the exchange rate adjustment, appropriate monetary, fiscal and income policy have to be put in place as a pre-requisite to the expansionary supply-side policies. Thirdly, to enhance the growth of savings and hence investment, it is necessary that inflation be controlled. The initial impact of a devaluation and restrictive monetary policies is in most cases an increase in the level of prices(Crockett, 1981). More often that not, when these policies are combined with huge fiscal deficits which are inevitably financed by borrowing from the central Banks, the result is often destabilizing.

Chapple (1990) dwelt on the timing of financial liberalization within an overall

adjustment program. He outlined an economic liberalization framework with the following sequence:-

a) Reduce fiscal deficits

b) Liberalize the financial system

c) Liberalize the trade account

d) Liberalize the capital account.

According to him, financial liberalization can only be successful if implemented after monetary stability has been attained. In developing countries, fiscal deficits constitute the major source of monetary expansion. Hence, particular attention should be paid to achieving a significant reduction in the size of the public sector deficit prior to the introduction of a financial liberalization program. Chapple further argued that unless this is done, liberalizing interest rates in an unstable macroeconomic environment would lead to explosive increase in both deposit and loan rates. It is only after monetary stability has been achieved and financial reforms well under way that the trade and capital accounts can be liberalized in that order..

The timing of the deregulation of interest rates has also received a lot of attention in recent times in reform measures in most LDCs. Villanueva and Mirakhor (1990) proposed the following strategies for successful financial reform:

a) Countries with an unstable economy and weak bank supervision should achieve macrostability and strengthen the supervisory framework before liberalizing interest rates.

b) Unstable economies having adequate bank supervision should stabilize while maintaining firm supervision. Gradual deregulation could then be attempted.

c) Stable economics with inadequate supervision should maintain stability while boosting regulation and supervision. Interest rates should be temporarily regulated.

d) Only countries that can boast of macro-stability plus adequate bank supervision should proceed directly with financial liberalization.

Based on the study by Villanueva and Mirakhor (1990), Ikhide and Alawode (1994) proposed a "feasible sequence" of financial liberalization, summarized under four steps. Step 1 underscores the need to restore macroeconomic and financial stability before the commencement of large-scale financial liberalization. Step 2 involves the introduction of indirect monetary instrument and a reinforcement of the regulatory framework and prudential bank supervision while step 3 has to do with the enhancement of competition among Banks. Finally, step 4 involves the abolition of all direct controls on interest rates and credit ceilings.

From the studies reviewed so far, it was noted that the importance of stabilization prior to liberalization has been given a particular attention by almost all the contributors probably because of its implications for the success or otherwise of large - scale financial reforms. It could be concluded therefore, that before a successful financial sector reforms could be carried out, a stable macroeconomic environment is a pre-requisite while proper sequencing of financial sector policies itself is a necessity.

2.1.5. EMPIRICAL EVIDENCES ON THE LINKAGES BETWEEN FINANCIAL SECTOR REFORMS, THE STOCK MARKET AND ECONOMIC GROWTH.

Here, we review empirical findings on the effects of financial sector reforms on the economies of LDCs with special reference to economic growth and capital market development in the reforming economics. Fernandez (1985) examined the role of financial

reforms as part of the expectation management approach to stabilization in Argentina during 1976 - 82. The aim of the study was to investigate whether reform measures can help to open the economy to foreign trade and/or reduce inflation. Relying on the use of financial crisis model, based on Fernandez (1983), it was found that the financial system expanded considerably at the initial period of deregulation thereby encouraging international trade. But, he reported that this was later followed by crisis.

Diaz-Alejandro (1984) seeks to understand why financial reforms carried out in several Latin American Countries during the 1970s, aimed at ending financial repression and also to free domestic capital markets from Usury laws and other alleged government - induced distortions, led to unintended consequences. The paper reviewed dilemmas posed by intrinsic imperfections of any financial market and examined the legal pre-requisites for the reasonably efficient operation of those markets. Alternative ways of organizing domestic capital markets under Latin American conditions were discussed while policies regarding the links between domestic and international financial markets were also considered. Relying on intuitive deductions based on the review of the experiences of the Latin American countries before and after liberalization, "Good by - financial repression, Hellow financial Crash" were the conclusions of Diaz - Alejandro (1984; P. 1). Searching for the possible explanations of these unintended developments, he discovered that very low credibility of the government commitment to a truly laissez - faire domestic financial system, lack of appropriate political environment, presence of interlocking directorates among financial and non- financial firms, volatile and indiscriminate international financial inflow, the use of market forces alone in exchange rate management, and inappropriate sequencing of reform measures were responsible for the financial crash that followed liberalization.

Hanson and de Melo (1985) evaluated Uruguay's reforms emphasizing the outcome of financial reforms and attempts to bring down inflation. Using a simple model of uncovered interest parity to examine the adjustments in asset holdings after liberalization, it was reported that financial reforms did not lower nominal pero interest rates in Uruguay. This was attributed to a simultaneous increase in world interest rate.

In a similar study for the same economy, de Melo and Tybout (1986) investigated whether financial market deregulation affects resource allocation and growth. They found that the financial reform of Uruguayan economy promoted financial deepening as Uruguayans shifted their wealth towards financial assets in domestic banks. They also discovered that savings behavior exhibited a clear shift with financial liberalization and private savings shifted upwards with the implementation of financial reforms.

Cho (1986) studied the effects of financial liberalization on the Korean economy. He found that financial reforms led to a more equalized access to, and cost of, borrowing among different sectors of the economy. He also discovered that the increased competition among financial institutions led to a much more integrated financial system in terms of access and cost of capital among various sectors.

Corbo (1985) studied the effect of reform and macro economic adjustments in Chile. The author provided a background on the main macroeconomic developments of the reform period. He used a modified - standard macro - model such as the Dornbusch and Fischer (1984) to study the effect of liberalization on the position of interest rates, foreign exchange rates, the competitive nature of the banking industry and the degree of capital flows. It was found that unemployment and high interest rates that followed liberalization was due to the lack of adequate supervisions for the financial system. Also, the use of the exchange rate to stabilize the economy created not only a temporary short

-term peso appreciation, it also encouraged external borrowing when restrictions on capital flows were being lifted. In a similar manner, it was found that the deregulation of domestic financial markets gave commercial banks and other financial institutions too much freedom. Consequently, financial intermediaries in difficulties increase interest rates just to attract new deposits and make up for the short-fall on interest payments to depositors created by their non-performing loans. Hence, an environment in which returns to investment assets are much higher than returns to investment in equity capital prevailed which according to the author is not conducive to the intended objective of financial sector reforms (reallocation of resources) in Chile.

Ikhide and Alawode (1993,1994) and Ojo (1993) investigated the impact of financial reforms in Nigeria on the banking subsectors. It was found that the number of distressed banks in the economy has soared after liberalization. This was attributed to inadequate and inappropriate sequencing of policy measures.

The major shortcoming of all the literature reviewed so far is that none of them specifically discussed the direct linkage between financial sector reforms and the growth of the capital market. Indeed, this constitute a gap in the flow of knowledge.

King and Levine (1993)investigated the relationship between financial intermediation and economic development. The objective of the study was to provide a link between financial intermediation and economic growth and also to link historical differences in growth during the post world war II period to the measures of the extent and quality of financial intermediation in the countries considered. To achieve the said objectives, the authors conducted two kinds of empirical exercise: First, a bivariate analysis, which provides correlations of each growth variable with each financial indicator, then a multivariate analysis, which includes a financial indicator along with the

"usual list of suspect" variable in a cross - sectional growth regression. The objective of the multivariate analysis is to control for the influence of factors other than financial variables that might influence growth. From the analysis, two main conclusions arise: first, the bivariate analysis reveals a strong correlation between financial indicators and growth, Second, in the multivatiate analysis, financial variables remain significant even after the inclusion of variables that normally enter as statistically significant predictors of growth. In their words, they argued that "our theoretical and empirical analysis suggest that financial sector reform can importantly promote economic growth ... by improving the efficient allocation of resources ... (King and Levine (1993, p.157).

While the results of King and Levine on this subject of research suggest that financial development is good for economic development and that financial repression has serious negative effects on economic growth, a number of cautionary caveats are required. First, Roubini (1993) noted that the effects of policies of financial repression on growth is mixed. He argued that the experience of several high - growth countries shows that they were characterised by highly repressed financial sectors and negative returns to savings. In countries such as Korea, Taiwan, Thailand and other successful developers, financial markets were heavily regulated, the government had a fundamental role in the allocation of savings to particular investment purposes and several capital controls were maintained for long periods of time. Therefore, he suggested that rather than taking the conclusions of King and Levine as conclusive, one should look more carefully at specific government policies in financial markets and their effects on investment and productivity growth. This underscores our present research attempt at investigating the impact of financial sector reforms on the capital market and as a consequence, economic growth. The second issue has to do with possible biases involved in lumping developed countries with less developed

countries which more often than not have different financial structures and stages of economic development. Developed countries are not the fastest growing, but one might expect that they have the deepest financial system. Thus, it could be argued that, owing to structural differences, the coefficient estimates might differ between developing and developed countries. For example, the impact of inflation on growth in a financially repressed economy may be different from its effect in a financially sophisticated economy. Also, as argued by Gertler (1993) , one might expect diminishing returns to financial development as financial markets edge towards being perfect. If so, he argued further that the marginal impact of financial conditions on growth might be stronger in less developed countries than in highly developed countries. Any conclusion therefore from this kind of analysis tends to be biased. Hence, our present study is justified on the ground that, we present empirical evidence for a developing country (Nigeria) using time series predictions.

Montiel (1995) provided a survey of studies on the impact of financial policies on economic growth not to provide new results but to motivate additional research. Although, the paper was to encourage an examination of the potential role of financial sector policies in the reactivation of economic growth in sub- Saharan African, it provided a theoretical linkage between financial development and growth. He argued that innovations in financial development can alter the growth of an economy through three channels: improved efficiency of intermediation: improved efficiency of capital stock and an increase in the saving rate. The author noted that because of the mutual interdependence between financial development and growth, the identification of innovations in financial development is not a trivial matter. According to him, changes in financial sector policies are an identifiable source of such innovations. Hence, to him, the adoption of policies to facilitate financial

intermediation (financial liberalization), can be regarded as a form of "innovation" in financial development. Indeed, with improved financial intermediation occasioned by financial sector reforms, the proportion of national savings that is diverted by the financial system into "non productive" uses falls and the rate of capital accumulation consequently increases. He therefore concluded that financial development may exert positive effects on economic growth by increasing the efficiency of capital stock as well as reducing the cost of operating the financial system by removing financial repression through a judicious financial liberalization.

Sarmiento (1988) investigated the behaviour of capital market in Latin America following liberalization. Focusing on evidence from Columbia, the author empirically analyzed the liberalization of certain Latin American capital markets with a view to identifying the causes of the failure experienced in such economies. He attributed the failures of financial markets to the characteristics of the economies and to institutional factors. Therefore, he reported that financial liberalization of economies that have been subject to controls for several years results in greater saving the development of more efficient activities and a rise in the growth rate.

Building on the recent study by Atje and Jovanovic (1993), Levine and Zervos (1996) examines whether there is a strong empirical association between stock market development and long-run economic growth. Using pool cross -country data on forty-one countries over the period 1976 - 1993, the relationship between stock market development and economic growth was investigated through time series regressions. It was found that stock market development is positively associated with economic growth. However, they cautioned that, although their study implied a strong link between stock market development and economic growth, the results should be view as "suggestive partial

correlation that stimulates additional research rather than as conclusive findings". Indeed, the authors admitted that their method of analysis (cross-country growth regressions) suffers from measurement, statistical and conceptual problems. In terms of measurement problems, country officials sometimes define, collect, and measure variables inconsistently across countries. Further, people with detailed country knowledge frequently find discrepancies between published data and what they know happened. In terms of statistical problems, regression analysis assumes that the observations are drawn from the same population; yet vastly different countries appear in cross-country regressions. Many countries may be sufficiently different to warrant separate analyses. Conceptually, coefficients from cross - country regressions should be interpreted with caution. When averaging over long periods, many changes are occurring simultaneously: countries change policies, economies experience business cycles, and governments rise and fall. Thus, aggregation may blur important events and differences across countries. In view of this, they suggested that analysts should extend this line of research by examining country - specific time series relationship between stock market development and economic growth. Hence, our current research effort is justified on this ground.

However, the pioneering study on the linkages between financial reforms and the growth of capital market in Nigeria was conducted by Ikhide (1995) . Using "before and after method" of analysis, relying on ratios and percentages summarised in tables, he found that aside from the substantial growth in the area of capital mobilization witnessed by the Nigerian capital market during the period of liberalization, the stock market has also helped to attract the inflow of both portfolio and direct investment. In addition, it was found that there was an appreciable decline in the debt - equity ratios of firms quoted on the stock exchange during the period of reforms. From the Japanese experience, it was

deduced that there is the need for the intervention of the state in fostering the growth of the institutions in the financial system as well as setting guidelines for the operations of such institutions. He noted also that the growth of a virile capital market ought not in any way hinder the role of banks in the economy. He however concluded that the successes recorded under liberalization programme have been short-lived.

Interesting as this study looks, it suffers from a fundamental defect especially the method of analysis employed thereby making the conclusions from the study to become mere tentative deductions wanting further empirical investigations. Aside from being essentially historical, making most of the conclusions flowing from the subjective judgment of the author, the study is devoid of any scientific base and diagnostic tests upon which the conclusions can be evaluated. Indeed, he admitted that by using "before and after approach", it will be difficult to determine whether observed changes in our variables of interest can be ascribed to the policies under observation or to other factors implicitly held fixed or not considered in the analysis. Also, the approach fails to answer the question as to whether observable changes would have occurred even without the policies under observation.

To rectify the problems of the study by Ikhide (1995) and to provide further empirical evidence in this area of macroeconomic management and adjustment, we have resulted to the use of an econometric approach. This approach allows estimates to be made for the marginal contributions of programs for given initial conditions and exogenous shocks, since the approach allows for the recognition of other factors unrelated to programs, that also affect performance (Elbadawi, *et al*, 1994).

It is hoped that this study will fill a gap and provide useful support for the ongoing liberalization efforts in most developing countries. It will also help to shed more light on

the pessimism that still exists in the literature concerning the relevance of stock market for economic development in less developed countries.

2.2 THEORETICAL FRAMEWORK

2.2.1 INTRODUCTION

The significance of financial markets (that is , the complex of institutions and instruments which brings together lenders and borrowers) to a country's economic development derives from three widely held conceptions. In the first place, it is argued that these markets can play an important role in mobilising voluntary saving and diverting these savings into development outlets. In the second place, it is frequently asserted that such a role is not played to the full in the less developed countries or else is discharged ineffectively. Finally, it is contended that in a country such as Nigeria, that is largely agricultural economy and more recently crude oil dependent (as from the early 1970s), there exists distortions in the structure of financial system which impede progress towards industrialisation and diversification - the economic course the country has apparently set for itself.

In this section, we will focus our attention on the discussion of the nature of the connection between the entire financial system, financial markets and development planning and endeavour in the light of this discussion, develop a theoretical framework for development planning strategy in the area of financial economics designed to facilitate and to speed up the rate of growth of capital market thereby accelerating the overall economic growth and in fact, development in Nigeria.

There is some relationship between a country's financial structure and its stage of economic growth(Ojo, 1984). Any definition whether formal or operational of a stage in the development of a country's economy includes some mention of the money and capital

markets and of financial institutions. In general, more complex and hence, more developed financial markets are associated with higher stages of growth(Rozental, 1970; P. 293). But such an association is by no means either clear or unambiguous. It begs the rigorous definition of both financial structures and stages of economic growth which is capable of furnishing even a weak ordering relation. For conciseness, very poor countries will usually have very simple financial structures while very rich countries will show a converse relation. Therefore, if indeed, financial structure is simply a fortuitous reflection of a level of economic development already reached by a country, then, the study of this structure becomes of paramount importance. If however, it is true that financial institutions and instruments can serve as catalysts, if not out right determinants, of economic growth, then, such a study acquires operational significance. This is so because if one understands the ways and means by which a financial structure accelerates or impedes the growth of capital markets, one can, in principle, devise a structure which enhances the acceleration of growth while minimising the impediments(Cameron, 1967).

In addition, the process of economic growth is associated with industrialisation (Cameron, 1967; P. 3). This, in turn, suggests the growing requirement for outside funds both because of increasing needs for mixed capital and because of the spread of the corporate form of business organisation. Thus, the importance of an efficient mechanism to transfer funds from the surplus to the deficit units becomes apparent.

In principle, the increasing need of corporations and government could be satisfied not only by financial intermediation such as those provided by banks, but also by instrumentalities of direct finance whereby claims against business and government are sold directly to households through the organised capital markets. The role which is unique to the capital market is that of providing equity capital as against debt which is

crucial for industrialisation and long term growth. As a source of funds with no repayment obligation, equity capital provides enterprises with a cushion against bad times. For investors, equity represents risk capital, since they bear the risk of losing these funds if the enterprises in which they invest fail. When the enterprise performs well investors gain substantially, which serves as incentive for bearing risks. Equity, therefore, provides a degree of stability and strength to the financial structure of enterprises (Ikhide, 1995). But the thinness of capital markets in less developed countries together with the whole complex of social forces militating against this type of finance, make this extremely difficult. Indeed, the role which an efficient financial system could play in the channelling of investible funds into a more productive mix has long been recognised in the literature on economic growth. Kindleberger (1958) observed that:

> *one of the major tasks of the monetary authorities in development is to support the gradual expansion and proliferation of the machinery - Commercial banks, saving banks, investment banking, Insurance companies, private bond and share markets, etc. - which link surplus and deficit spending units(P. 191).*

Therefore, it could be argued, in particular, that financial markets and capital market to be specific, could play a positive role in development planning. Far from being merely mirror images for a given stage of economic growth, they can contribute significantly both to the level of voluntary saving and to the more efficient allocation of savings. From this position, principles and techniques can be evolved whereby the structure of the financial system is better adapted thereby contributing to the growth of the capital market in Nigeria. The literature is replete with proposals for the establishment of a financial system capable of improving the mobilisation and allocation of investment, augment the flow of voluntary saving and accelerate capital formation. (Goldsmith, 1961,

Gertler, 1988; Buckle and Thompson, 1992; Ojo, 1984; Patrick, 1966; etc.). But these proposals are usually not rooted in any clear-cut concepts of the ways in which the financial sector should be structured so as to achieve a higher rate of growth in the capital market and hence economic development. We therefore present in what follows, a theoretical framework capable of explaining the need for financial reforms in Nigeria as well as the linkages between stock market development and economic growth.

2.2.2 A THEORETICAL FRAMEWORK

A theoretical framework capable of supporting a structure of the financial sector designed to speed up the rate of growth of Nigeria's capital market and hence economic development can be constructed in three layers. The first of these layers is composed of those criteria of economic efficiency which have to do with optimum allocation of resources, full utilisation of these resources, and reduction of constraints to competition. Classical economic theory enables one to detect deviations from economic efficiency. But to the policy makers bent on accelerating the rate of growth, improvements in the efficiency of existing institutions and instruments of the financial sector may not be of overriding importance. In fact, such improvement may actually be counter productive in those cases where the market arrangements facilitate the flow of funds into channels which have very low priority from the stand point of developmental strategy. Hence, the second layer of the theoretical framework should include an explicit statement of the developmental goals and priorities against which it can be structured. Finally, and this is particularly true in the developing countries, only a portion of the financial markets is actually or potentially amenable to developmental guidance. Many of the financial flows take place outside the purview and the scrutiny of developmental authorities, who, even

when armed with knowledge required to reform the financial sector and the power to do so, may still not be able to influence the vast volume of financing which flows through the informal markets. The last section on this theoretical issue will take a look at the linkages between stock market development and economic growth. Each of these theoretical layers is discussed below:-

2.2.2.1 THE FINANCIAL REPRESSION HYPOTHESIS: ISSUE OF ECONOMIC EFFICIENCY

The seminal work on financial liberalization was produced separately by Mckinnon (1973) and Shaw (1973). The basis of Mckinnon-Shaw's financial repression hypothesis arises principally from artificially low interest rate ceilings. Following classical economic theory, interest rates provide the reward for waiting, or postponing consumption. Also, interest rates are not a reflection of supply and demand for money, but rather the equilibrium between savings and investment. If at any time, savings is more than investment, the rate of interest falls, investment increases and savings decline till the two are equal at the new interest rate. In contrast, when savings is less than investment, a rise in the rate of interest brings about a decline in investment and increase in savings till savings equals investment. Hence, it was argued by the classicals that higher real rates increase the flow of savings by removing excess demand thereby enlarging the quantity of investible funds. In addition, there will be a commensurate increase in the quantity of investment:

> *By paying a rate of interest on financial assets that is significantly above the marginal efficiency of investment in existing technique, one can induce some entrepreneurs to disinvest from inferior processes to permit lending for investments in improved technology and increased scales in other enterprises.. .The release of resource from inferior uses in the underdeveloped environment is as important as new net savings per se (Mckinnon, 1973; P. 15).*

In a similar manner, credit rationing by the government also reduces the quantity

and quality of intermediation, with a commensurate impact on investment:

> *Rationing is expensive to administer. It is vulnerable to corruption and conspiracy in dividing between borrowers and officers of the intermediary the monopoly rent that arises from the difference between low, regulated loan rate and the market- clearing rate. It can be frustrated by borrowers who simply do not repay loans and keep their place in the ration queue by extending maturities. The rationing process discriminates poorly among investment opportunities ... and the social cost of this misallocation is suggested by the high incremental ratios of investment to output that lagging economies report (Shaw, 1973; P. 86).*

In contrast, increased competition, private bank ownership, efficient foreign exchange market, appropriate monetary policy regime and sound foreign capital movement strategies can reduce the emphasis on debt finance, allowing optimal agreements between suppliers and users of investible funds, thereby increasing the overall stock market development and efficiency of intermediation:

> *Optimal monetary policy seeks equilibrium on the markets for money and savings that minimizes the gap between loan and deposit rates while it allows supply prices for equity in banking. One counts upon competitive pressures to bring about agreements between bank and depositors regarding efficient substitution between payment services and deposit rate as well as between banks and borrowers concerning substitution between allocative services and loan rates. The rate gap would be minimised for the quality of product upon which buyers and seller agree under competitive circumstances and subject to specifications in insurance programs for deposits and loans (Shaw, 1973; P. 134).*

In a nutshell, a synthesis of the Mckinnon-Shaw hypothesis by Long (1984) views the financial sector as an intermediate service input sector in the production process. To enhance the growth of real output, more of this input must be produced. However, in many developing countries, government intervention in the financial system, particularly in the form of interest rate controls in the face of inflation, has repressed the size of the

financial system. Thus, the financial sector in most of these countries had become too small, in the sense that the services provided are less than optimal. The consequences of financial repression have been analysed by Lanyi and Saracoglu (1983) and Fry (1988) and summarised by Dornbusch and Reynoso (1993) as follows. First, savings vehicles are underdeveloped or the returns on savings is negative and unstable, or both. Thus, the savings rate is depressed and money that is saved tends to go into self financed, relatively unproductive assets, e.g. Inflation hedges, or foreign exchange. Second, financial intermediaries that collect savings do not allocate these savings efficiently among competing uses. Since interest rates on loans are regulated, rationing occurs and this tends to reduce the productivity of investment. Third, firms are discouraged from investing, because poor financial policies reduce their returns or make them excessively unstable. Where this is accompanied by high and unstable inflation, price controls, and an overvalued exchange, rate, they add to the risk of doing business and as such depress investment in productive assets. Aside from depressing investment, an unstable financial system also induces wasteful use of resources for rent seeking (Krueger, 1974) as firms lobby to secure large transfers from the government. Hence, inefficiency pervades the financial system. The financial repression hypothesis and its policy implications were an important components of structural adjustment programme aimed at achieving economic efficiency in financial markets. Indeed, efficiency in financial markets can take three meanings: Operational efficiency, allocative efficiency and informational efficiency. The first type of efficiency is concerned with whether the market operates at the lowest level of cost or whether excessive resources are allocated to the operation of the market. In this connection, absence of price competition and presence of cartels will lead to economic inefficiency. Certainly, the financial markets in the less developed countries have their

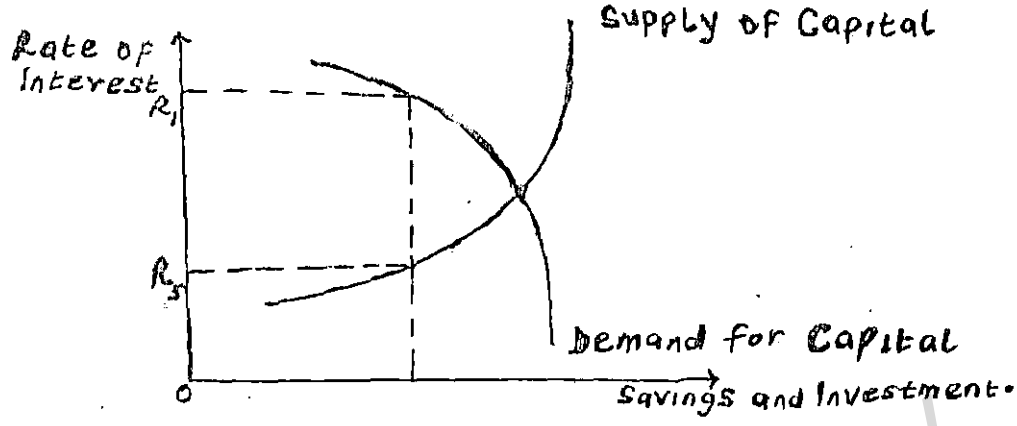
share and more of the inefficiencies brought about by monopolistic practices, by under utilization of resources, by lack of knowledge and skill and by all the other circumstances which causes institutions to operate below the optimum.

The Second facet of efficiency refers to the role of the market in the allocation of resources. The third aspect deals with the question of whether prices reflects all available information (Buckle and Thompson, 1992)

One of the convenient indices of the extent of these inefficiencies is the discrepancy between the reward offered to the savers and the costs to be borne by investors. While these rewards and costs need not be confined to the purely financial, they tend to be reflected in the rates of return, on the one hand, the cost of capital, on the other. Given the demand and supply curves for loanable funds, it is seen that the market clears at the points of equality between demand and supply because the extra returns R_1R_s does not accrue to the savers. Thus, not only is the flow of savings less than it would be in the absence of the "gap", but also the cost of investment is greater than it would otherwise be . A gap measured by the distance R_1R_s probably exists in all countries but is said to be particularly great in the less developed countries (Rozental, 1970). This follows from the contention that in these countries, not only are financial markets imperfect, but in addition, non-pecuniary factors affect the costs and rewards such that inefficiencies result in the mobilizational, operational and allocative roles of the financial markets.

Consider the diagram below:-

Costs and Rewards Expressed as a Rate of Interest.*



**The diagram is adapted from Rozental (1970), p.13.*

The diagram shows the demand and supply of capital in less developed countries. Since most of these economies are characterised by financial repression, the demand and supply of capital is, more often than not, out of equilibrium. Specifically, since the demand for capital will always be greater than supply of capital, rationing will result in a rate of interest other than the one determined by the market forces. Hence, distortion will follow as a consequence and allocation of capital will be less than optimal. That is, the actual interest rate will exhibit some deviation from the desired.

Moreover, in the underdeveloped countries, the variance in the distribution of interest rates is larger than in the advanced countries. In many countries, the rates of interest prevailing in the money market for certain limited purposes compare favourably with those obtaining in much more advanced countries (World Bank, 1989). On the other hand, capital for other purposes, particularly those connected with the acquisition of durable assets, is either completely unavailable or available only at prohibitive terms. Furthermore, the interest rates announced by the governments obscure the existence of much higher rates prevailing outside the organised financial system (Montiel, et al, 1993)

One possible strategy, then, which pertains both to the efficiency of the market

structure and to developmental objectives would be to reduce the spread between the reward to the saver and the cost to the investor, particularly for investors interested in obtaining long-term finance. This is one of the reasons for the call and the drive towards the liberalization of the financial sector in recent years.

Another measure of the extent of the inefficiencies is the existence of asymmetric information in the financial sector. Indeed, classical microeconomic theory assumes that people always have full knowledge of the goods and services they require, or that they can always get the assistance of some agents. However, experience shows that this is not always the case. Very often, markets are characterised by asymmetric information i.e. it is impossible for an individual to determine the quality of a good acquired and it is also impossible or very costly to monitor the actions of an agent. When asymmetric information exists, market equilibria will in general depart from their first best value. Indeed, several theoretical approaches to the existence of the banking firm focus upon various information problems and how banks are able to handle them more efficiently than the capital market and bilateral transactions between savers and borrowers (Llewellyn, 1993). Three aspects of information problems are highlighted: non-availability, asymmetric supply of information, and situations where the borrowers chooses for competitive reasons not to make relevant information publicly available but is willing to share it with a bank.

Therefore, it could be argued that one of the roles of banks is to overcome asymmetric information problems by screening devices, and to exploit inside information gained through the banker - customer relationship which the borrower chooses not to make publicly available. Some of the bank's information advantages derives from economies of scope whereby information is produced as a by product of other banking business.

However, banks have been loosing some of their traditional advantages vis-a-vis the capital market for corporate sector business. This could produce a further loss of share of the corporate financing business. For concreteness, it could be argued that the growth of securitisation implies a potential decline in the demand for services traditionally provided by banks, especially for the corporate sector. Leland and Pyle (1977) argued that bank lending to borrowers signals a rating to the capital market and may therefore increase the availability and lower the cost of capital market finance. This explains why those who have access to the capital market nevertheless also borrow from banks. A central problem is the lack of adequate, credible and reliable information on the quality of projects for which finance is sought. This explains the reason for the establishment of capital markets in most developing countries thereby contributing to the reduction of the "Moral Hazards" and adverse selection problems involved with asymmetric information.

However, financial markets are also characterised by the existence of asymmetric information. Analogous to what happens in the credit market where firms may find limits on their ability to obtain loans and may therefore forego some profitable investment opportunity, it is possible that a firm will both undertake projects with a positive net present value because of the excessive cost of raising equity capital. According to Mattesini (1993), when asymmetric Information is taken into account, a firm will usually find it costly to finance investments by issuing equities since an equity issue is usually perceived as a negative signal, either because it is interpreted by the market as an indicator of the low level of assets of the firm (as suggested by Myers and Majluf (1984)) or because it indicates that a firm is more likely to go bankrupt (as suggested by Greenwald, Stiglitz and Weiss (1984). When such problems arise, firms may find it profitable to forego some profitable investments that would otherwise be undertaken.

However, asymmetric information is likely to be more present in banks than in capital markets. Indeed, banks have a comparative advantage over capital markets when information on enterprises and their projects are not easily transferred to the open markets, when problems arise over monitoring borrowers" behaviour when for competitive reasons firms do not wish to make information publicly available, and when borrowers do not wish to be subject to the discipline of continuous pubic scrutiny. However, in the recent years, such roles are declining progressively. First, technological developments have reduced the costs of acquiring and assessing information. Secondly, rating agencies have developed both to make information more wisely available and accessible to assess information on behalf of potential investors. Thirdly, disclosure laws have been extended such that companies now disclose more information which was previously a private advantage to the bank, has become more of a "public good". In each of these ways, bank's information advantages have been eroded. Therefore, it could be argued in particular, that the impact of technology in reducing transactions, monitoring and information costs, the emergence of rating agencies, new disclosure laws applicable to companies and financial innovations widening the range of capital market options all have the effect of increasing the relative efficiency of capital markets vis-a-vis banking in information gathering thereby ameliorating the problem of asymmetric information grossly present in banks.

As argued above, asymmetric information leads to second best equilibria in the credit and financial market which create distortions in the allocative mechanism and are not socially optimal. In most developing countries, it was thought that government intervention could improve on such equilibria. Indeed, it was argued that asymmetric information represents a source of market failure and implies a need for government

intervention (Stiglitz, 1993). Hence, the widespread use of government direct loans and loan guarantees in almost all developing economies to sectors that are considered more important from the stand point of the monetary authorities. However, in order to produce an improvement in social welfare, the intervention of the government must rely on a different information set than the other participants of the market or must exploit some extra information not available to others or gather enough political will aimed at removing the existing impediments again effective intermediation of financial resources in the economy through liberalization. However, since these conditions are not always met in most cases, government intervention often induce distortions that are not necessarily less harmful than the one that government policy intends to correct (Mattesini, 1993; PP. 68-9). Hence, the current drive towards financial liberalization aimed at reducing asymmetric information and hence enhancing effective allocation in financial resources in the reforming countries.

Indeed, financial liberalization aimed at removing the lid on interest rate ceilings, enhancing competition in the financial sector, improving the functioning of securities markets, increasing the transparency of financial transactions and harmonizing and simplifying standards of prudential supervision, will no doubt help to reduce the consequences or occurrence of asymmetric information in countries under going economic reforms (Ikhide, 1995; P. 1).

2.2.2.2 DEVELOPMENTAL GOALS AND PRIORITIES

The developmental bias towards the accumulation of capital assets and, hence towards long- term finance is firmly established in the literature and often find expression in the dictum that capital formation is a necessary if not a sufficient condition for economic growth (Jhingan, 1986; Meier, 1961; Handler, and Steinherr,1993 etc.). This helps but little in devising an order of goals and priorities. It tells nothing about which segment of the economy should have first claim on resources - whether public infrastructure, agriculture, or manufacturing - or what should be the emphasis within each of the segments. More importantly, it tells nothing about the requisite shift in priorities, both sectoral and structural, which corresponds to the stages of growth of the entire economy. At early stages of development in Nigeria, the country relied on the export of primary produce for foreign exchange. But with the discovery of oil in commercial quantities, there was an agrarian change leading to a change of focus towards crude oil development as a backbone of the economy. With the collapse of the international oil market in 1981, foreign exchange earnings from oil declined markedly and economic management in the country suffered an unprecedented set back. As a result of this, priorities of development planners shifted away from crude oil dependent strategy to the development of manufacturing and agricultural sectors. It was argued that these two sectors were accorded these recognition because agriculture will produce food, employment and raw materials for economy while manufacturing for export will provide the desired foreign exchange to finance imports of machineries necessary for industrial take-off. Hence, Nigeria's former reliance, on exports of crude oil as a primary vehicle of growth will have to be decreased in favour of greater emphasis on manufacturing capacity, particularly manufacturing for export if the country is to continue to grow in the future.

Indeed, those concerned with the country's development strategy think that increased emphasis on manufacturing ,which relies more on local entrepreneurship and local resources and less on imported skills and equipment describes the best path for Nigeria's development to follow. It need be stated that if we are to reach the industrial take-off stage in the foreseeable future, inducement must be provided to shift the emphasis from investment for short term commercial gains to the growth of investment in long term activities where the capital market serve as a vehicle. That is to say, the government will encourage only the type of capital outlay which is based on long-term profit involving the establishment of permanent undertaking with an eye towards future expansion. Indeed, a basic theoretical framework for capital market analysis is the provision of equity as against debt financing. Our development objectives must therefore focus on the role and advantages of equity (long-term) as against debt (short term) financing. Needles to say that the ongoing debt crisis tends to emphasis the importance of equity rather than debt, particularly in the financing of risky projects with long gestation period, heavy reliance on debt has adverse macroeconnomic and microeconomic consequences. At the macro level, it has caused severe debt-servicing implications. More importantly, it has contributed to the occurrence of bank insolvencies. Increasing interest rates in the face of moral hazard and adverse incentive effects, has led to the blooming of bad and doubtful debts in the portfolio of banks as bank customers who have got bank loans at high interest rate are not necessarily those who can pay such loans. High interest rates will tend to force firms to go to the capital markets to raise equity finance rather than borrow from banks and thus provide long term debt financing and risk capital through the issue of bonds and shares. This is indispensable for long term economic growth (Ikhide, 1995; P. 42). For

these desires to be realisable, financial sector needs to be restructured so as to provide a conducive environment necessary for the growth of the capital market which will be able to efficiently and effectively mobilise and allocate financial resources to developmental goals and priorities of this country and thereby accelerate the overall economic growth.

2.2.2.3 FORMAL AND INFORMAL FINANCIAL MARKETS:

Armed with a set of developmental priorities which in the case of Nigeria, emphasize the formation of small and medium scale manufacturing plants which produce for export those goods and services in which the country has a comparative cost advantage, the planning authorities can begin to improve the efficiency of the financial markets and to attempt reforms and modifications of these markets so as to make them more responsive to those developmental needs. But the effectiveness of these modifications and reforms is restricted by the fact that in most of the developing countries, a large number of financial transactions are conducted outside the formally organised markets. In many sectors of the economy the financing of enterprises is outside the purview and scrutiny of developmental authorities. In fact, it may be convenient to consider these markets over which the authorities do not exercise supervision to be conterminous with the informal ones. In as much as the informal markets tends to be amorphous, unorganised and unofficial, there is little legislation and regulation which covers their operations; hence, not much is known about the institutions and instruments making up the informal markets beyond the wide spread conviction that their scope and importance is indeed wide (Rozental, 1970; Agenor, 1990; and Montiel, et al , 1993). Given the size of the informal credit and foreign exchange markets in many developing countries, their presence will have important macroeconomic effects. Such markets can be expected to

play important roles in determining the manner in which exogenous and policy shocks are disseminated throughout the economy, especially the capital market which is responsible for the mobilization and allocation of productive resources in the economy. Failing to integrate them in the short-run macroeconomics of developing countries may therefore result in inadequate analysis and misleading policy advice.

The terms "informal" "parallel" "black", "unorganised", "fragmented", "underground". "segmented", and "curb" markets have all been used interchangeably in the literature to describe various forms of economic activities lying outside the officially regulated or monitored realm. In this manner, all activities that lie beyond the pale of official regulation or control is considered to be informal in nature. For concreteness, informal credit and foreign exchange markets consist of a large number of diverse activities encompassing all forms of unregulated transactions. The informal credit market includes the lending and borrowing transactions of very varied types of individuals and intermediaries, such as professional and non-professional money lenders, private finance firms, indigenous bankers, rotating saving and credit association, traders, landlords and households. To be specific, it could be argued that the economies of most less developed countries are dominated by the informal sector, mostly financial. In this case, capital markets more often than not focus on the large equity based firms. Small scale enterprises which form the core of the informal sector find it difficult to enjoy the advantages of equity based developmental framework because of the inability of these firms to meet the stock exchange listing and other requirements in the capital market which are considered stringent, as well as the enormous cost of going public. However, financial liberalization by encouraging equity as against debt financing (which form the main source of fund for small and medium-scale enterprises) may further mar the growth of small and medium

scale enterprises and thus squeeze them out of existence thus further marginalising the small scale investor. Since banks or debt financing tends to be skewed in favour of the informal sector, financial liberalization which deemphasises debt financing to the advantage by equity financing may impact negatively on the informal sector. Therefore, the formal financial sector should be restructured so as to accommodate the small and medium scale enterprises which constitute the engine of growth in the developmental efforts of this country.

Although the choice by the small and medium scale enterprises to operate in the informal sector or more importantly to rely more on debt finance may essentially be informed by the desire of most entrepreneurs to keep their businesses away from public scrutiny and also by complicated entry and listing requirement which discriminates against them. But , it is perhaps beyond dispute that with liberalization, all these prohibitive listing requirements, which hitherto, serve as a barrier to entry, will be remove thereby encouraging the small and medium scales enterprises to raise equity capital from the organised capital market.

On the other hand, the parallel currency market is a mechanism through which foreign exchange is offered for sale at a rate different from the one officially fixed by the authorities. It includes the activities of the road-side foreign exchange dealers and other unofficial transactors.

However, informal financial markets seem to perform a useful economic functions in developing countries. Needless to say that they allow access to a credit, although at high interest rates determined by the market forces, to the small borrowers, who will otherwise be unable to borrow because of the prohibitive collateral securities required by banks, in some cases, they also allow small savers to obtain high interest rates on this

savings and hence could be an inducement to save. But, at the macro economic level, concern have been expressed for the efficacy of monetary and fiscal policy in an economy where such markets are large. To the extent that transactions in the informal markets tend to be based primarily on currency, the large currency holdings that are accumulated therefore have the potential of reducing the authorities' control of the money supply. Attempts at monetary creation, for instance, may be frustrated by a flight of currency from the banking sector into the informal sector, hence, limiting the bankers' ability to create deposits.

On the fiscal side, the government may find that the informal market frustrates its effort at revenue collection as the bulk of informal transactions are officially unrecorded. Government revenue collection effects in most developing countries, characterised by the existence of informal markets, must therefore, be concentrated on the formal sector. However, attempts to increase revenue in that sector by means of increased taxation, say on the interest earnings of that sector, induces a switch to and therefore, an increase in activity in the informal sector. Consequently, the tax base of the government becomes smaller and more unstable as informal markets grow in size (Montiel, *et al*, 1993; P. 26).

Similarly, the existence of a large parallel currency market has important consequences for the functioning of a developing economy. The major arguments that have been advanced in favour of these markets are the following: first, by allowing financing of parallel market activities, parallel currency markets make available commodities (food, intermediate inputs, durable goods, etc) which would not have otherwise been forthcoming, due to the existence of rationing in the official market for foreign exchange and/ or trade restriction. second, the existence of informal markets for foreign exchange provides employment and income opportunities to many small traders.

There are however, a variety of distortions created by the existence of parallel currency markets. First, the expansion of a parallel market for foreign exchange weakens the effectiveness of capital controls impose by the central bank. Formally, it has effects similar to increase in capital mobility which may help accelerate capital flight and may lead to an increase in the degree of substitution between domestic and foreign currencies. The potential for currency substitution becomes an effective way of avoiding the inflation tax on the holdings of domestic cash balances. Second, parallel foreign exchange rates, domestic prices are likely to display a significant degree of instability, which may adversely affect economic decision making. Third, since there are two prices at which foreign exchange can be bought and sold, exports whose proceeds are repatriated at the official exchange rate are taxed relatively to other exports. Consequently, the parallel market premium may be seen as an implicit tax on exports (Pinto, 1989; 1991)

More summarily, there is a cost of enforcement, of counteracting parallel market activities somewhat and punishing offenders. Needless to say that parallel foreign exchange market promotes a loss of tariff revenue (due to smuggling and under invoicing), a loss in income tax and domestic indirect taxes and a reduced flow of foreign exchange to the central bank, which lowers the capacity to import of the government, parallel markets encourage rent - seeking activities (corruption of government officials, for instance), which lead to a sub-optional allocation of scarce resources.

The foregoing analysis suggests that exchange restrictions are often largely inoperative. Instead of increasing the foreign exchange reserves at their disposal, the controls imposed by the authorities often only succeed in diverting a substantial part of the foreign exchange underground, implying that they not only fail to solve the problem, but they actually worsen it. The logical and obvious implication is that if parallel markets

emerge in response to the imposition of controls, the most effective way to reduce their size is to eliminate these restrictions and let prices reflect the full scarcity of foreign exchange. Hence, the move by most developing countries to financial sector reforms aimed at reducing the various bottlenecks in the formal financial sector that are counter productive to optimal allocation of economic resources.

2.2.3 A THEORETICAL NOTE ON THE LINKAGES BETWEEN STOCK MARKET DEVELOPMENT AND ECONOMIC GROWTH.

The relevance of financial system for economic growth especially in the developing countries has been a subject of controversy in both the theoretical and empirical literature. One line of research argues that the financial system is unimportant for economic growth(Sterm, 1989; Lucas, 1988; etc.), while another line of research provides a conceptual description of how and empirical evidences of when, the financial system affects economic growth(Bagehot, 1962; Schumpeter, 1932; Cameron, *et al*, 1967; Goldsmith, 1969; Mckinnon, 1973 and Shaw, 1973). Building on these seminal contributions by those who ascribed important role to the financial system in accelerating economic growth, King and Levine (1993a; 1993b), DeGregorio and Guidotti (1995) and Levine and Zervos (1996) show that measures of banking and stock market development are strongly correlated with economic growth in a broad cross-section of countries. According to this line of research a well-functioning financial system is crucial for sustained economic growth.

Indeed, a burgeoning theoretical literature provides evidence concerning the specific role of stock markets in economic growth (Levine and Zervos, 1996; P.323). According to them functioning of equity markets affects liquidity, risk diversification, acquisition of information about firms, corporate control, and savings mobilization. By

altering the quality of these services via financial liberalization, the efficient functioning of stock markets can alter the rate of economic growth in the positive direction.

To be specific, stock markets may affect economic activity through their liquidity. Many high-return projects require a long-term commitment of capital. Investors however, are generally reluctant to relinquish control of their savings for long periods. Therefore, without liquid stock markets, or other financial arrangements that promote liquidity, less investment may occur in the high-return projects. Levine (1991) and Bencivenga, Smith and Starr (1996) show that stock markets may arise to provide liquidity. That is, savers have liquid assets (such as equities) while firms have permanent use of the capital raised by issuing equities. Liquid stock markets reduce the downside risk and costs of investing in projects that do not pay-off for a long time. With a liquid equity market, the initial investors do not loose access to their savings for the duration of the investment projects because they can cheaply, quickly and confidently sell their stake in the company. Therefore, more liquid stock markets ease investment in the long-run, potentially more profitable projects, thereby improving the allocation of capital and enhancing prospect for long-term growth.

Risk diversification through globalised stock markets is another vehicle by which stock market development may influence economic growth. Many authors have shown that stock markets provide a vehicle for diversifying risk(See for example, Saint-Paul, 1992 and Deveux and Smith, 1994). These models also show that greater risk diversification can influence growth by shifting investment into higher - return projects. Intuitively, because projects with high expected returns also tend to be comparatively risky, better risk diversification through internationally integrated stock markets will foster investment in projects with higher returns.

In terms of raising capital, it is argued that large, liquid and efficient stock markets can ease savings mobilisation. By mobilizing savings, stock markets enlarge the set of feasible investment projects. Since some worthy projects requires large capital injections and some enjoy economies of scale, stock markets that ease resource mobilization can boost economic efficiency and accelerate long- run economic growth. Mayer (1988) presented a contrary view on the importance of stock markets for raising capital. He argued that new equity issues account for a very small fraction of corporate investment.

In the final analysis, stock market development may influence corporate control. Diamond and Verrvecchia (1982) and Jensen and Murphy (1990) show that efficient stock markets make it easier to tie manager's compensation to stock performance. A closer link helps to align the interests of managers and owners. Laffont and Tirole (1988) and Scharfstein (1988) further argued that takeover threats induce managers to maximize a firm's equity price. Therefore, well-functioning stock markets that ease corporate takeovers can mitigate the principal agent problem and promote efficient resource allocation and growth.

CHAPTER THREE

THE NIGERIAN FINANCIAL SYSTEM

3.1 OVERVIEW OF THE FINANCIAL SYSTEM:

The Nigerian financial system is made up of a wide array of institutions and entities which can be classified into a number of ways. It consists of both the organised and the unorganised sectors.

The organised financial system in Nigeria comprises of a large number of institutions and instruments which are under the purview of the regulatory authorities. It consists of the Central Bank of Nigeria (CBN) which is the apex financial institution, Commercial and Merchant banks, Development finance institutions, Thrift and Insurance organisations, a Stock Exchange and a Securities and Exchange Commission.

Prior to the establishment of the CBN in 1959, the main banks in Nigeria were local branches of banks of the metropolitan countries whose lending and related activities were largely confined to the financing of expatriate businesses which consisted largely of the export of primary products and import of manufactures. The banks as such, were enclave institutions that had little to do with economic developments' effort of the country. Indigenous merchants were deprived of credit from these enclave financial institutions. However, to ensure that resources are allocated in accordance with the development strategies, the government decided to remodel this financial system. Towards this end, new financial institutions were created to provide funding at low interest rates to the sectors that were to be at the forefront of industrial development and /or directed the existing institutions to do so. The government themselves borrowed heavily from the financial system to finance budget deficits and the needs of state-owned enterprises. Banks were also directed to open rural branches in order to mobilise deposits and provide credit. to widely dispersed small holders.

The interventionist approach was much less successful in promoting financial

development. Under government pressures, banks did lend to state enterprises and priority sectors at below - market interest rate, but spreads were often too small to cover the banks' costs(Ojo and Adewumi, 1992). Many of the directed loans were never repaid, interest rate controls discouraged savers and holding domestic financial assets and discouraged institutions from lending longer-term. In Nigeria, Public borrowing from Commercial Banks displaced lending to the private sector. In short, government have made control over finance an important tool of their development strategies. It was believed that without intervention, the financial system would not be cooperative partners in the development effort(CBN, 1989; p.28).

However, during the past one decade, the structure of Nigerian financial system changed substantially under the combined impact of profound changes in the economic environment, market forces, technology and alterations in official regulations governing the banking and securities market. Indeed, there has been remarkable changes in terms of the number and variety of financial intermediaries, the depth and breadth of institutions as well as the structure of its capital and ownership. The same observation holds for the regulatory framework within which the system operates. Nevertheless. it has been observed that the Nigerian financial system remains relatively under - developed as it is yet to acquire that degree of financial intermediation which the economy requires for rapid development(CBN, 1989; p.28)

By 1960, the 12 commercial banks operating in the country had a total asset of N235.8 million and about 190 branches throughout the country. The only merchant bank, Phillip Hill (Nigeria) Limited (which later merged with the Nigerian Acceptances Limited (NAL)), did very little business. There was no specialised development banks but there were a few non-bank financial intermediaries operating on a very modest scale. They included a few insurance companies, regional government - owned corporations and loan boards, cooperative societies and thrift institutions, the Lagos Building Society (Later

reconstructed into the Federal Mortgage Bank) and the Post Office Savings Bank. The Post Office Saving Bank was the single largest non-bank financial intermediary at that time with over 160 branches spread all over the country. However, it made limited impact on the economy because its funds were invested largely in London, a practice which negated one of the most important aims of setting up savings institutions in less developed countries namely, the mobilization of capital for domestic investment.

At the end of 1993, there were 66 commercial banks with a branch network of 2275. Merchant banks at the end of 1993 numbered 54, with a total of 116 branches. The five development bankers, viz: Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI), Federal Mortgage Bank (FMB), Nigerian Agricultural and Cooperative Bank (NACB) and Nigeria Export - Import Bank (NEXIM) also operated in Nigeria as at the end of 1993. These are Development finance institutions charged with the responsibility of providing loan and industrial finance by attracting foreign resources, mobilising domestic savings and allocating investment funds efficiently. Additional Institutions have been established with the structural Adjustment Programme to meet up with the ever increasing credit needs of segments of the society who are not adequately catered for by the existing institutions. These are the Community Banks whose capital requirement are provided by the communities in which they are located and the Peoples' Banks which are supposed to provide for the needs of small- and medium - scale entrepreneurs in the society.

Thrift institutions have also achieved some prominence in the financial system. These comprises mainly insurance companies, pension funds and the savings banks. The main pension Institution in Nigeria is the National Provident Fund (NPF), which was established in 1961 as a compulsory savings scheme with the objective of running as a social security program by providing protection to contributors in their old age, invalidity or temporary loss of employment. The Federal Savings Bank (FSB), was established in

1974 with the aim of providing a ready means for the deposit of savings to encourage thrift.

Aside from these major financial institutions, the financial system is also inundated with a collection of young and small institutions who play a major role in the intermediation process. These include finance companies, leasing companies, mortgage, savings and loan associations and ventures capital companies. Most of these have come into prominence in the wake of the financial innovation that pervaded the system with the onset of financial liberalization. In 1992 alone, more than 47 finance companies were granted licenses to operate. As of that date, about 618 finance houses were in operation.

The Nigerian Deposit Insurance Corporation (NDIC) came into existence in 1989. It was set up majorly to provide deposit Insurance and related services for banks with the objective of promoting confidence in the banking industry.

Other institutions in the financial system include (i) The Urban Development Bank set up in 1992 to provide financial resources to both the public and private sectors of the economy for the development of urban dwellings, mass transportation and public utilities (ii) the discount houses which are special non-bank financial institutions aimed at providing discounting/rediscounting facilities in government short-term securities. In particular, discount houses are to promote the growth and efficiency of the money market, enhance the implementation of open market operations by facilitating the issue and sale of short-term government debt instruments by tender and also accommodate banks short-term financial need. Their main source of finance is equity (paid - up capital and reserves), money on call and overnight advances from the CBN. By September 1992, approval - in - principle had been granted to three discount houses. (iii) The bureau de change which were set up in 1989 to act as dealers in the spot market for foreign exchange. Indeed, the need to broaden the foreign exchange market at the onset of SAP and improve the access of small transactors to foreign exchange necessitated their

establishment. (iv) The National Economic Reconstruction Fund (NERFUND) was set up in 1989. It is a funding mechanism aimed at bridging the gap in the provision of local or foreign funds to small - and medium scale enterprises. It is jointly owned by the Federal government of Nigeria, the CBN and other foreign partners.

The financial markets is the other segment of the financial system. It consists of the money and the capital market. The money market has been developed with two main objectives in mind: to provide the public and private sectors with means of raising short-term money and invest cash and to serve as a conduit for the management of liquidity and money by the monetary authorities. The major institutions operating in the market are the Central Bank, Commercial banks and private companies dealing mainly in commercial papers. The interbank market has also become more prominent with the SAP. The size of the money market has increased substantially both in terms of the number and heterogeneity of instruments traded since 1987 when SAP began(Ikhide, 1997). Today, Mutual funds, Unit Trusts, Investment Companies operate both in the money and capital markets(Ikhide, 1993).

Unit trust Scheme are institutions established mainly for the mobilization of the financial resources of small and big savers and management of such funds to achieve relatively high returns with minimum risks through efficient portfolio diversification. The first Unit trust Scheme was launched in December 1990 and by the end of 1992, ten units schemes had been launched. Hence, the Nigerian financial system over the years has become increasingly deep, broad and sophisticated in structure and well protected as a catalyst in the process of economic growth and development. The main environmental factors over the 1970s and 1980s which brought about changes in the financial system can be summarised as follows:-

(a) there was a strong trend over this period particularly the 1980s, towards deregulation of the financial system. The aim here was to introduce greater competition

into the financial system with a view to increasing efficiency. Alongside this deregulation was a parallel trend to tighten up prudential regulation of the financial system, with the aim of protecting the user of financial intermediation services. So, the late 1980s saw deregulation as far as pricing of services was concerned accompanied by increased regulation for purposes of prudential control and investor protection.

(b) The economic environment particularly in 1970s and 1980s, was very volatile. High and volatile inflation and interest rates led to great uncertainty in financial decision making. This led to changes in the development of new financial instruments to manage the greater risks.

(c) A substantial rise in domestic and international imbalances led to a greater demand for financial intermediation services. International imbalances on a large scale occurred following the oil price increases of 1973/74, which led to OPEC countries' surpluses and balances of payments Deficits for many non-oil exporting developing countries.

A review of the Nigerian financial system will not be complete without a reference to the informal financial sector in Nigeria. The informal financial sector plays an important macroeconomic role in Nigeria. As a result of financial repression, unorganised credit and foreign currency markets have become an essential part of the financial intermediation process. These markets are informal because they have no legal standing and are not subject to regulations by the government. However, given the size of informal credit and foreign exchange markets in many developing countries like Nigeria, their presence will have important macroeconomic effects to the extent that failing to integrate them into the short-run macro economics of Nigeria may result in inadequate analysis and misleading policy advice.

The informal credit market consists of a large number of diverse activities encompassing all forms of unregulated transactions. It includes the lending and borrowing transactions of very varied types of individuals and intermediaries such as professional

and non - professional money lenders, private finance firms, indigenous bankers, rotating saving and credit associations, pawn shops, trades, landlords and households(Horsch, 1989a). Their characteristic low information and transaction costs coupled with the easy access that they provide to low income groups who may not have access to formal finance are some of the factors that have continued to ensure their survival even in a very competitive environment.

3.2 THE NIGERIAN CAPITAL MARKET:-

This study focuses on financial liberalization, stock market development and economic growth. In view of this, a little more attention is devoted to the treatment of capital market in this section. Indeed, the development of a capital market in Nigeria actually began with the establishment of the Lagos Stock Exchange (Now Nigerian Stock Exchange) in 1960. Broadly, the Nigerian capital market can be divided into two- the non-securities segment and the securities segment. The non-securities segment consists of savings bank, mortgage banks, Development banks and insurance companies.

The capital market proper consist of the securities segment. The major participants in this market are the governments, public companies, institutional investors and individuals. There are about 20 stock brokerage firms dealings on the stock exchange on behalf of their clients as of 1985. The figure rose to 21 in 1986 and as of 1992, the number has risen to 140. Yet, transactions on the stock Exchange continue to be relatively few in number and low in value compared with more developed markets(CBN, 1993) because of the paucity of securities available for trading in the Nigerian capital market. Federal Government development stocks dominate the market in terms of value while private sector securities are more in number (see table 3.1). This observed trend was due to the fact that during this period, government was investing more in the economy. Most of these investment are principally on infrastructural development aimed at creating a

conducieve environment for sustained economic developments. However, private individual's investment was minimal in value since government was involved in virtually all economic activities in the country.

In terms of institutions, the capital market consists of a primary market which is dominated by the investment (merchant) Banks, brokers and dealers and ventures capitalists and a secondary market dominated by the stock Exchange. While the primary markets main concern is with the primary issues, the secondary market handles already existing issues. In what follows, we take a look at the organs of the Nigerian capital market.

TABLE 3.1
NIGERIAN STOCK EXCHANGE TRANSACTIONS

YEAR	NUMBER OF DEALS			VALUE (₦MILLION)		
	GOVT	INDUSTRIAL	TOTAL	GOVT	INDUSTRIAL	TOTAL
1970	303	331	634	16.4	0.2	16.6
1971	204	748	952	32.7	3.5	36.6
1972	258	640	898	26.2	1.0	27.2
1973	285	537	822	91.9	0.5	92.4
1974	256	2,807	3,063	49.4	1.3	50.7
1975	203	501	704	62.8	0.9	63.7
1976	321	696	1,017	111.3	0.6	111.9
1977	337	1,314	1,651	178.8	1.2	180.0
1978	243	2,230	2,473	187.2	2.5	189.7
1979	124	3,099	3,223	249.7	4.7	254.4
1980	220	6,918	7,138	380.8	7.9	388.7
1981	118	10,081	10,199	298.7	6.1	304.8
1982	184	9,830	10,014	207.0	8.0	215
1983	292	11,633	11,925	384.8	13.1	397.9
1984	194	17,250	17,444	240.9	15.6	256.5
1985	340	23,231	32,571	295.3	213.3	318.9
1986	270	27,448	27,718	477.6	20.3	497.9
1987	238	20,401	20,639	340.0	42.4	382.4
1988	96	21,465	21,561	99.4	33.0	132
1989	174	33,273	33,447	507	63	570
1990	102	25,828	25,930	155.0	83	238
1991	45	44,235	44,280	43.0	94	137
1992	71	48,958	49,029	78.0	239	317
1993	39	40,359	40,398	50.0	353	403

SOURCE: CBN, STATISTICAL BULLETIN, VOL 5, JUNE, 1994.

3.2.1 ORGAN OF THE NIGERIAN CAPITAL MARKET:-

The major organs of capital market in Nigeria include the Nigerian Stock Exchange and the Securities and Exchange Commission.

3.2.1.1. THE NIGERIAN STOCK EXCHANGE:-

The secondary market is generally called the Stock Exchange and it is the prime operational institution in the capital market. Established in 1961 by the Lagos State Exchange Act, the Lagos Stock Exchange was reconstituted into the Nigerian Stock Exchange in 1977 and today has six trading floors in Lagos, Kaduna, Port Harcourt, Kano, Onitsha and Ibadan,

In terms of organisation, the Nigerian Stock Exchange comprises the following:-

i. Council members responsible for the day to day management of the Exchange and

ii. Dealing members who are the Stock Brokers licensed by the Councils to deal in government and industrial securities quoted on the Exchange and whose conduct are guided by the Exchange rules and regulations.

The Nigerian Stock Exchange was established to perform the following functions:

1. To promote the machinery for mobilizing private and public savings and making them available to productive investment through Stocks and Shares
2. To provide a meeting place for dealing members to buy and sell existing stocks and shares, as well as provide opportunities for raising new capital
3. To facilitate the purchase and sale of securities
4. To facilitate dealings in government securities and thus provide government with funds for development purposes.
5. To cooperate with associations of stock brokers and stock Exchanges in other countries and to obtain and make available to members information and facilities likely to be of advantage to them to their clients

6. To protect the public from shady deals and practices in quoted securities through its rules, regulations and operating codes with the objective of operating fair dealing and

7. To investigate any irregularities or alleged irregularities in the dealings of members and their clients, any complaints made against members by other members or any other parties provided that such differences, dispute or complaints shall relate to or touch on the Stock broking business or activities of such members and to deal with and decide upon such irregularities, differences, dispute, or complaints and to make necessary steps for the enforcement of its decisions and awards (Nwankwo,1980; Alile and Anao, 1986).

3.2.1.2 SECURITIES AND EXCHANGE COMMISSION (SEC):-

Formerly called the Capital Issues Commission (CIC), the SEC was established by the SEC ACT 71 of 27th September 1979, which was re-enacted by the SEC Decree 29 of 1988. The SEC as an apex regulatory organ of the capital market has the objectives of promoting an orderly and efficient capital market in Nigeria by providing a conducive climate for savings and investment necessary for economic development; ensuring fair and appropriate prices for stocks and shares; and ensuring adequate protection of the investing public.

Before deregulation, SEC's function included the determination of the price and time at which companies' securities are to be sold; approving the amount of such securities' registering all securities dealers, investment advisers, registers and establishing market places in the industry such as stock exchange branches with a view to maintaining proper standards of conduct and professionalism in the securities business, giving approval in respect of mergers, acquisitions and all forms of business combination; ensuring capital market development and maintaining overall surveillance of the market.

With deregulation however, SEC's function is restricted to regulatory and developmental roles. Under the current dispensation, SEC is to ensure that rules and regulations guiding professional conduct in the market are followed to the letter and also to provide an environment for the development of the capital market through the various enlightenment campaign embarked upon in recent years.

However, from inception, the capital market had apparently not succeeded in generating sufficient securities from companies and institutions - a situation that has tended to give rise to a shortage of securities, particularly equities. One reason for this is the inability of small - and medium - scale enterprises to meet the stock Exchange listing requirements which are considered stringent, as well as the enormous cost of going public. The second - tier securities market (SSM) was thus launched on April 30, 1985 majorly to serve the interest of small - and medium - scale enterprises in raising long-term funds for expansion and modernization. As at the end of 1993, there were 28 companies listed in the sector. Five of these companies have already graduated into the First - Tier securities market. The basic distinction between the first - tier and second - tier is the relaxation of conditions for enlistment. The relaxed entry requirement for enlistment in the Stock market enjoyed by those who got listed as potential members are:

i. Companies should have 3 years trading record instead of 5 years for the first - tier.

ii. At least 10% or 350,000 of equity capital must be made available to the public as against 25% or 3125,000 required in the first - tier.

iii. Companies must have not less than 100 shareholders instead of 300.

iv. Companies must submit audited half year and annual statements instead of quarterly statement required in the first-tier

v. A flat annual quotation fee of 32,000. In the first - tier, fees are based on the share capital of companies(Onyindo, 1986).

While the amount to be raised by companies in the first - tier market is limitless and depend on their borrowing capacity, the amount that could be raised in the SSM is limited to N5 million. However for both the First-Tier and the SSM, enterprises must be registered as public limited companies.

3.3 FINANCIAL SECTOR REFORMS IN NIGERIA*

Finance sector reforms in Nigeria has taken five major dimensions: reform of the financial structure, monetary policy reforms, foreign exchange reforms, liberalization of capital movement and capital market reform.

(a) Reform of the Financial Structure:- Measures undertaken here are majorly designed to increase competition, strengthen the supervisory role of the regulatory authorities and strengthen public sector relationship with the financial sector. Some of the measures undertaken include:

i. Granting of licenses to more banks:- More banks were granted licenses to operate in the economy. This is to enhance banks' efficiency through increased competition. Hence conditions for the licensing of new banks were relaxed. In response, the number of banks increased markedly from 40 in 1986 to 120 in 1992. A comparable increase in the number of non-bank financial institutions occurred.

ii. Strengthening supervision of banks and increasing their viability through adequate regulations regarding minimum capital requirements, specifying the range of assets and liabilities they can acquire, introduction of uniform accounting standards for banks to ensure accuracy, reliability and comparability. Two banking laws were promulgated with effect from June 1991, the CBN Decree no 24 of 1991 and the

---

* This section benefited greatly from the studies of Ojo, M.O. (1993) and Ikhide, S.I. (1997).

Banks and other Financial Institutions Decree (BOFID), No 25, 1991. In addition, the Nigerian Deposit Insurance Corporation (NDIC) was established, with the responsibility of insuring banks deposits against bank failures and ensuring safe and sound banking practices through effective monitoring and supervision of banks in collaboration with the CBN.

iii. Defining the role of the financial sector:- In this case, all government accounts in commercial banks were to be transferred to the central bank with the intent to discourage unhealthy competition in savings mobilization, prohibition of the practice whereby banks granted domestic loans on the security of foreign exchange deposits held abroad or on domiciliary accounts. There was also the introduction of an auction - based system for the issuance of treasury certificates aimed at promoting a greater reliance on market forces in the determination of yields on government debt instruments through market - determined interest rates and the decision by the Federal Government to sell its share holdings in some commercial and merchant banks thereby reverting such banks to private ownership.

(b) Monetary policy reforms:- These are policies primarily designed to stabilize the economy in the short-run and to induce the emergency of a market - oriented financial sector. They include the following:

i. Rationalization of credit controls:- Although credit ceilings on banks are not completely removed, the sectoral credit allocations targets were compressed from 18 in 1985 to 2 in 1987, i.e. priority (agriculture and manufacturing) and non-priority (others). Other credit measures put in place were the elimination of exceptions within the ceiling on bank credit expansion, giving similar treatment to commercial and merchant banks in relation to required liquidity ratios and credit ceiling, the modification of cash reserve requirements which is now based on the total deposits, (demand, savings, and time deposits), rather than on the time

deposit only, and the re-introduction of stabilization securities. These are non-negotiable and non-transferable debt instrument of the central bank which banks are mandated to purchase at intervals in order to control their excess reserves. It was designed to mop - up the excess liquidity in the banking system.

ii. Deregulation of interest rates:- In January 1987, a partial deregulation of interest rates was attempted, but by August, all rates became market - determined. The central bank adopted the system of fixing only its minimum rediscount rate to indicate the desired direction of interest rate changes. Interest rate liberalization was aimed at enhancing the ability of banks to change market -based loan rates and also guarantee the efficient allocation of scarce resources. In 1989, banks were encouraged to pay interest on demand deposits. However, the rates to be paid was to be negotiated between banks and their customers.

iii. The shift from direct to indirect system of monetary control:- In June 1993, Open-Market Operation (OMO) were introduced. Under this scheme, OMO was to be conducted exclusively through licensed discount houses which are supposed to constitute the open market for government securities. The introduction of OMO was meant to replace the use of direct controls for managing liquidity in the economy.

c) Foreign Exchange market Reforms:- Previously the sale and purchase of foreign exchange was rigidly controlled through the use of import licenses and the exchange rate was fixed by administrative fiat. This culminated into an overvaluation of the Naira. In order to restore appropriate exchange rates and correct the overvaluation of the Naira, the authorities began the auction sales of foreign exchange to licensed Dealers. A first- Tier market was retained to take care of transactions related to government debt - servicing, contributions to international organisations and transfers to Nigerian missions abroad. In 1988, the

government permitted the establishment of private foreign exchange bureaux. This was aimed at absorbing some of the demand pressures for foreign exchange and to accord recognition to small dealers in foreign exchange.

(d) Liberalization of Capital Movement:- All existing restrictions on capital transfer were abolished with the deregulation of the foreign exchange market. Hence, all applications for capital transfer abroad were to be backed by appropriate documents and settled at the prevailing exchange rates.

i. The reconstitution of the securities and exchange commission.

ii. Tax policies:- The reduction of the withholding tax on dividend, and the reduction of the fiscal burden with respect to the proceeds and yields from debt and equity.

iii. Regulatory Measures:- These include measures aimed principally at alleviating the difficulties involved in listing, Disclosures and checking insider trading.

Other measures that impacted on the capital market include:

i. Privatization: The privatization of public institutions which started under the reform programs made a lot of impact on the market.

ii. Debt conversion program: Debt swap were first developed as part of the restricting program of Nigeria's external debt which reached a crisis proportion with the Structural Adjustment Programme. Debt to equity swap has had some impact on the capital market since they are a form of securitisation.

3.4 APPRAISAL OF FINANCIAL SECTOR REFORMS IN NIGERIA:-

An appraisal of financial sector reforms in Nigeria can be carried out from four major perspectives which form the basis of their adoption. They include improved financial efficiency, monetary stability, globalization of the financial system and consequently expanded real economic activities. The reforms were expected to produce

positive effects on the financial sector regarding its organic growth, innovations and competition, financial savings, as well as the quality of bank portfolio and management. Monetary stability was to improve through moderate growth in liquidity and domestic prices, sustainable interest and exchange rate regimes and increased and diversified foreign asset earnings. In alignment with other economic policies and as a direct consequence of the financial reform policies, real economic activity would be enhanced through higher investment, output and employment, and reasonable stability in the external sector.

Following financial sector reforms, increased structural growth has been witnessed in the number of financial institutions operating in the country. This was due to the reduced administrative constraints towards the establishment of banks and other non-bank financial institutions as one of the components of financial liberalization. In addition to this, other institution such as the community bank, the people's banks, mortgage finance houses, the Nigerian Export - Import Bank (NEXIM) and special funds have emerged to fill gaps in the financial sector especially in the areas of financing small - and medium - scale enterprises and specific sectors which could not be effectively catered for by the traditional banking sector. As a result of consequent competition for financial savings, following liberalization, many institutions have successfully launched financial products to attract savers.

Yet, the structure of the sector is still lopsided. For example, the ten largest commercial banks control over 60 percent of total deposits in the sub-sector. With the fragility of new entrants and distress in some existing ones, an oligopolistic structure has emerged whereby movements in critical variables such as interest rates have not been consistent with the observed trends in domestic liquidity. This caused the CBN to prescribe interest rate mark-up standards since 1989.

Another important objective of financial reform is improved financial conditions of institutions. The Nigerian experience with financial reform and liberalization clearly

shows that the initial stages of the programme was characterised by greater financial distress, but it is good that the financial reform process helps to identify this problem and reduced it to the barest minimum level.

As the core of financial sector reforms, monetary policy reforms was aimed at supporting the entire financial system through the promotion of a competitive system and in particular through the development of a market-based system of financial control. It was expected that relative macro- economic stability would be achieved. However the reality of monetary management in Nigeria revealed that while a market- based financial sector has visibly emerged, macro- economic instability has been on the increase. Observed movements in domestic liquidity, inflation, credit allocation, interest and exchange rates volatility have engendered macro-economic instability. Indeed, increased excess liquidity in the economy and the associated inflationary pressures led to the issurance of stabilization securities to banks to sterilize the excess liquidity (Ojo, 1993).

The liberalization of interest rates in 1987 induced an immediate rise in all interest rates, which was sustained up to 1992 with the levels of real interest rates turning positive most of the period (Table 3.2). Regulation of interest rates was restored in 1991 but was quickly reversed early in 1992 as the ceiling on lending rates in particular failed to achieve intended purpose. Apart from this, the attempt by the CBN to mop up excess liquidity through the issuance of stabilization securities increased the tempo of increases in all interest rates. The continued presence of insolvent banks which engaged in distress borrowing for survival accentuated the increases in interest rates especially in the inter-bank funds market in which a few large banks, having control of deposits, were able to dictate the rates.

In the foreign exchange market, the distortions in exchange rates have been reduced to a large extent while foreign exchange allocation procedure involving active participation of banks has been installed. However, exchange rates have been volatile and

TABLE 3.2
SELECTED PRECOMIANT INTEREST RATES (PER CENT)

Rates	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Minimum Rediscount Rate	6.0	6.0	8.0	8.0	10.0	10.0	10.0	12.8	12.8	18.5	18.5	15.5	17.5
Treasury Bills Rates	5.0	5.0	7.0	7.0	8.5	8.5	8.5	11.8	11.8	17.5	18.5	14.5	21.0
Treasury certificates rates													
(a) One-year maturity	5.5	5.5	7.5	7.5	9.0	9.0	9.0	12.3	12.3	16.4	18.2	15.5	22.0
(b) Two-year maturity	6.0	6.0	8.0	8.0	9.5	9.5	9.5	12.8	12.8	17.8	18.5	15.5	22.5
A. COMMERCIAL BANKS													
1. DEPOSIT RATES													
(a) Time (i) 3 months	5.8	5.5	7.3	7.3	9.8	9.3	9.3	14.9	13.4	18.9	19.8	15.7	20.8
(ii) 3-6 Months	6.0	6.0	7.5	7.5	9.5	9.5	9.5	15.3	12.1	21.6	20.4	16.1	22.3
(iii) 6-12 Months	6.3	6.5	7.8	7.8	9.8	9.8	9.8	15.8	14.3	21.4	20.9	16.5	22.1
(iv) Over 12 Months	6.5	6.5	8.0	8.0	10.0	10.0	10.0	15.8	14.3	21.2	20.9	16.5	20.5
(b) Savings Rates	6.0	6.0	7.5	7.5	9.5	9.5	9.5	14.0	14.5	16.4	17.8	14.7	16.1
2. LENDING RATES													
(a) First Class Advances	7.5	7.8	10.3	10.0	12.5	9.3	10.5	17.5	16.5	26.8	26.8	20.2	29.8
(b) Produce Advances	8.5	9.8	7.8	9.8	7.0	8.5	10.5	19.0	17.3	25.9	n.a.	n.a.	n.a.
(c) Other Advances	9.5	10.0	11.8	11.5	13.0	11.8	12.0	19.2	17.6	24.6	26.5	21.0	31.2
B. MERCHANT BANKS													
1. DEPOSIT RATES	-	-	-	-	-	-	-	-	14.5	22.0	23.5	18.0	38.0
(a) Time (i) 3 months	-	-	-	-	-	-	-	-	15.0	24.0	22.5	18.4	38.2
(ii) 3-6 months	-	-	-	-	-	-	-	-	15.5	25.0	23.9	18.4	37.0
(iii) 6-12 months	-	-	-	-	-	-	-	-	15.5	28.0	24.1	18.9	35.5
(iv) Over 12 months													
2. LENDING RATES													
(a) First Class Advances	-	-	-	-	-	-	-	-	16.0	30.0	26.5	21.4	46.2
(b) Produce Advances	-	-	-	-	-	-	-	-	17.0	15.0	26.7	21.0	48.7
(c) Other Advances	-	-	-	-	-	-	-	-	17.0	30.0	29.0	21.0	50.6
FEDERAL SAVINGS BANK 1/	6.0	6.0	8.0	7.7	9.5	9.5	9.5	14.0	14.5	16.4	17.8	14.7	n.a.

1/ Federal saving bank started full commercial banking operation in 1988; n.a. = not available
Source: CBN, Economic and Financial review; Statistical Bulletin, Various issues.

persistently depreciating (Table 3.3). This has been due to the inadequate foreign exchange supply in the face of excessive demand pressures induces by the rapid liquidity growth. The country's huge external debt burden has also limited the supply of foreign allocations of foreign exchange to the foreign exchange market since 1989 have been more them 80 percent short of demand, resulting in large and persistent depreciation of the naira exchange rate, as well as an enlarged resort to the parallel market with the attendant widening premium and malpractices by operators.

Therefore, the appraisal of the monetary effect of financial sector reforms in Nigeria reveals considerable pressures and instability of the financial environment. The major factor in this respect was the adverse effects of government fiscal operations characterised by imbalances and bulding public debt service (Table 3.4, 3.5, 3.6).

Capital movement liberalization is another crucial aspect of financial sector reforms in Nigeria. Prior to liberalization, there was no data on portfolio investment in Nigeria, although data exists on direct foreign investment. With the reduction or outright elimination of constraints to capital inflow following liberalization, the Nigerian stock market has recieved a boost. However, caution has been exercised on the free movement of captial. This is because, portfolio investment constitute a mobile capital. When the environment is good, they comes in, and when the reverse obtains they migrate. And because of the danger their exit might pose for the economy, a lot of supervisory networks and surveilance has been put in place to checkmate any adverse effect of capital outflow. Specifically, portfolio investment are only allowed out of the Nigerian stock market on conditions. Shortly after

TABLE 3.3

FOREIGN EXCHANGE BUDGET AND DISBURSEMENT AND EXCHANGE RATES

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
FOREIGN EXCHANGE ALLOCATION ($ Million)													
Budget	11,656.20	20,667.50	14,261.80	9,951.80	10,468.00	8,964.80	6,844.30	4,974.00	7,140.00	6,479.00	7,789.00	11,855.00	7,936.00
Disbursement	17,325.30	25,315.00	18,879.20	15,094.50	11,656.90	11,724.80	6,481.90	5,270.30	6,306.80	6,729.50	9,076.90	11,347.50	8,038.30
Change Between Budget & Disbursement 1/	-5,669.10	-4,648.50	-4,617.40	-5,142.70	-1,188.90	-2,760.00	362.40	-296.30	833.20	-250.50	-1,287.90	507.50	-102.30
EXCHANGE RATES (N/$)													
Official	0.6052	0.6052	0.6733	0.7506	0.7672	0.8924	1.7323	3.9691	4.5367	7.3651	8.0378	9.8650	21.848
Parallel Market	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	4.6008	6.0484	10.7000	9.4990	12.8142	22.243
Buraau de Change	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	10.13000	9.55400	12.81040	22.802
RATE OF DEPRECIATION (OFFICIAL) (+)/APPRECIATION (-)	3.26	0.00	-10.08	-10.32	-2.17	-14.03	-48.48	-56.36	-12.50	-38.38	-8.39	-18.57	-54.90

1/(+) when Budget exceeds Disbursement and (-) when it falls short of it.
n.a. = Not Available
Source: Adapted from Ojo, M.O. (1993), P.43.

TABLE 3.4
SUMMARY OF FEDERAL GOVERNMENT FINANCIES (₦ MILLION)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
REVENUE:													
Oil Revenue	12353.8	8564.4	7814.9	7253.0	8269.2	10923.7	8107.3	19027.0	19831.7	39130.5	55215.9	6315.5	115382.6
Non-Oil Revenue	2880.2	3615.8	3949.5	3255.7	2922.0	3765.4	4194.7	6027.8	7763.3	8667.8	13362.2	18325.2	23224.4
Total Fed. Collected Revenue	15234.0	12180.2	11764.4	10508.7	11191.2	14689.1	12302.0	25099.8	2759.0	47798.3	68578.1	78640.7	138617.0
Total Fed. Retained Revenue	12138.7	7269.6	7506.0	6234.1	6996.0	9723.3	7969.4	16129.0	15525.0	25893.6	39033.0	31774.5	51774.2
EXPENDITURE:													
Total	23695.7	21238.8	15368.2	11525.0	11686.7	12680.0	16756.8	22018.7	27749.5	41028.9	61149.1	67530.4	107723.3
Recurrent	15300.1	15541.9	7417.9	5656.5	6275.7	7215.3	7680.0	15646.2	19409.4	25994.2	36219.6	38243.5	69270.3
Debt Service	839.6					5621.1	8902.1	7509.2	11345.5	19307.7	39545.1	46014.4	67359.5
Capital	8395.6	5696.9	7950.3	5868.5	5412.0	5464.7	9076.8	6372.5	8340.2	15034.0	24929.5	29286.2	38453.0
BUDGET BALANCE													
Overall Deficit (-)/ Surplus(+)	-1975.2	-3708.5	-6104.1	-5070.0	-2615.1	-3039.7	-8254.3	-5889.1	-12224.5	-15134.3	-22116.1	-35755.9	-55949.1
FINANCING													
External Loans	255.3	464.4	263.5	1106.9	1184.5	1045.9	708.1	832.7	1918.7	5719.0	1563.8	278.0	
Intenal Loans	636.2	352.7	340.2	7376.8	3450.2	2277.0	499.2	8339.4	10240.5	10020.0	27042.0	32107.1	57090.5
Banking System	872.6	2363.6	2989.2	5616.1	289.2	2491.4	498.9	4617.2	7773.9	6581.4	23677.1	31101.8	55802.0
Central Bank	310.1	3187.3	1975.9	3324.9	-646.0	820.5	6199.7	1475.6	9156.7	10708.6	18172.8	32848.5	56784.9
Comm. Bank	562.5	-823.7	1013.3	2291.2	353.8	1670.9	5700.8	3141.6	-1335.3	-4043.4	5246.7	-2070.3	-1311.9
Non-banking System	-236.4	1163.4	412.8	1760.7	558.2	-214.4	-0.3	3591.6	2466.6	3438.6	3364.9	1005.3	1281.5
Other Funding /2	1083.7	-282.9	2438.6	-3413.7	-2019.6	-283.2	7047.0	-3283.0	1.7	-1390.4	-6923.9	2921.8	-1134.4
Total Rev. /GDP (%)	30.5	25.5	24.8	19.9	19.2	22.2	19.3	23.1	19.0	21.3	25.4	34.4	30.8
Total Oil Rev. /GDP (%)	24.7	18.3	16.4	13.8	14.2	16.5	12.7	17.5	13.6	17.4	20.5	20.9	25.6
Total Non oil Rev. /GDP (%)	5.8	7.2	8.4	6.1	5.0	5.7	6.6	5.6	5.4	3.9	4.9	13.5	5.2
Total Expenditure/GDP	47.6	45.0	32.4	21.8	20.0	19.2	26.3	20.2	19.1	18.9	22.7	23.4	23.9
Total Debt Service/GDP	1.6					1.5	13.9	6.9	7.8	8.6	14.6	15.9	15.0
Overall Deficit/GDP	4.0	7.9	12.8	9.7	4.5	4.5	10.4	5.4	8.4	6.7	8.2	12.4	9.8

Sources: CBN, Statistical Bulletin (various issues).

TABLE 3.5
DOMESTIC PUBLIC DEBT OUTSTANDING (N MILLION)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
1. COMPOSITION OF DEBT													
i. Treasury Bond										11,350.0	20,000.0	20,000.0	20,000.0
ii. Treasury Bills	2119.0	5782.0	9619.0	13,476.0	15,476.0	16,976.0	16,976.0	25,226.0	35,476.0	34,126.0	25,476.0	57,763.1	103,317.5
iii. Treasury Certificates	2,727.6	2,307.6	1,668.6	4,894.4	6,413.1	6,654.1	6,664.7	6,664.1	6,794.6	6,944.6	34,214.6	34,214.6	34,214.6
iv. Development Stocks	3,069.0	3,353.0	3,557.0	3,851.0	3,783.0	4,314.0	4,809.0	4,909.0	4,759.0	4,629.0	4,401.0	4,221.0	3,961.0
v. Others	2.9	2.9	2.9	2.9	2.9	2.9	1.5	1.5	1.5	1.5	1.5	1.5	n.a.
2. HOLDERS													
i. Banking System	5,838.2	8,181.8	11,191.0	16,807.1	19,699.6	22,191.0	22,689.9	27,597.6	35,578.7	42,160.1	65,837.2	96,939.0	140,950.4
a. Central Bank	2,859.3	6,046.6	8,022.5	11,347.4	10,701.4	11,521.9	17,721.6	19,197.2	27,682.7	38,391.3	56,564.1	89,412.6	134,406.9
b. Commercial Banks	2,978.9	2,135.2	3,168.5	5,459.7	8,998.2	10,669.1	4,968.3	8,109.9	7,714.5	3,670.6	8,917.3	6,847.0	5,535.1
c. Merchant Banks								290.5	181.5	98.2	355.8	679.4	1,008.4
ii. Non-Bank Public	2,080.3	3,263.1	3,656.5	5,417.2	5,975.4	5,761.0	5,761.3	9,193.0	11,452.4	14,891.0	18,255.9	19,261.2	20,542.7
3. TOTAL DEBT OUTSTANDING	10,399.0	11,436.51	14,847.5	22,224.3	25,675.3	27,952.0	28,451.2	36,790.6	47,031.1	57,051.1	84,093.1	116,200.2	161,943.1
i. Loans on-lent to State 1/													
Government and Public Agencies	2,446.6	2,746.6	3,046.6	3,346.6	3,346.6	3,613.3	3,495.4	3,495.4	3,495.4	3,495.4	n.a.	n.a.	n.a.
ii. Federal Govt. Domestic Debt net of Loans on-Lent	7,952.4	8,689.9	11,800.9	18,877.7	22,328.7	24,338.7	24,955.8	33,295.2	43,535.7	53,555.7	84,093.1	116,200.2	161,493.1

n.a. = Not Available
Source: CBN, Economic and Financial Review (Various issues); Research Department Occasional Papers, No. 8, 1993.

TABLE 3.6
EXTERNAL PUBLIC DEBT OUTSTANDING

YEAR	TOTAL DEBT		DEBT SERVICE (N'Million)	TOTAL DEBT AS PROPORTION OF		DEBT SERVICE/EXPORT RATIO (%)
	(N'Million)	($' Million)		GDP (%)	EXPORTS (%)	
1980	1,866.8	3,444.8	101.6	4.71	13.3	0.7
1981	1,331.2	3,667.7	513.6	5.23	12.7	4.9
1982	8,819.4	13,124.1	775.2	18.74	101.1	8.9
1983	10,577.7	14,130.7	1,335.2	21.40	141.0	17.8
1984	14,536.6	18,034.1	2,640.5	28.60	160.0	29.1
1985	17,290.6	17,297.5	3,718.0	25.05	154.2	33.2
1986	41,451.9	18,631.3	2,502.2	26.23	186.9	29.4
1987	100,787.6	23,445.1	3,590.6	33.02	333.3	11.9
1988	133,956.3	29,725.1	8,140.7	38.11	429.4	26.1
1989	240,393.6	31,424.0	15,577.7	37.40	414.7	26.9
1990	297,894.3	33,179.0	30,855.8	36.70	242.1	26.8
1991	328,590.4	33,364.5	35,291.8	35.49	275.0	29.0
1992	544,264.1	27,564.8	45,053.4	34.40	231.9	20.0

Source: Adapted from Ojo, M.O. (1993), P. 42.

liberalization, capital proceds arising from subsequent disposal of investment may be repatrated after a minimum of 10 years at the rate of 20 percent a year. Specifically, guidelines for repatration of proceeds from sale of shares include:

(i) Instalmental repatration as follows:

(a) amount not exceeding ₦300,000 shall on approval be transfered.

(b) The excess over ₦300,000 shall be transfered at the rate of ₦300,000 every six months.

(ii) Evidence of "Approved status" or importation of capital.

With the March 5, 1993 deregulation of foreign exchange market, existing restrictions on capital transfer as outlined above were abolished. However, evidence of importation and exportation has to be provided to the Federal Ministry of Finance before repatration could be effected. In additon, all applications for capital transfer abroad must be backed by appropriate documents and settled at the foreign exchange market rate. In all, portfolio investment inflow has increased with capital movement liberalization.

To be sustained in a positive way, financial sector reforms must be accompanied by an improved level of real economic activity reflected in positive changes in domestic output, investment and employment, as well as external trade and payments. Available data indicate that real economic activity has expanded in the reform period. Economic growth in the first two years of the reform was inadequate as the positive increase in output in 1986 (2.2 percent) turn negative in 1987 (-0.3 percent). This development was in response to the shock of a sudden depreciation of the naira exchange rate which increased production costs particularly in the manufacturing sub-sector. After this initial decline, the economy picked up in 1988 when a 7.0 percent increase in output was achieved. Between 1989 and 1992, domestic output increased at an average rate of 6.1 percent per annum. In spite of the moderate growth in domestic output, employment generation has been inadequate resulting in larger numbers of unemployed persons

particularly graduates of secondary and tertiary institutions.

In the final analysis, developments in Nigeria's external sector have been mixed, but have been generally more favourable than in the pre-reform period. The balance of payments position which was rather weak up to 1988 turned strongly positive between 1989 and 1991 (Table 3.7). But a larger deficit in the balance of payments was recorded in 1992 due to mounting political and economic pressures in the domestic economy which are unfavourable to external trade.

TABLE 3.7
BALANCE OF PAYMENTS
(₦' Million)

DESCRIPTION	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Current Account	2,355.3	-3998.4	-4,879.5	-3,137.9	44.1	2,215.4	-2,999.1	-295.3	-965.7	8,232.3	44,731.2	12,655.4	39,422.0
Merchandise:													
Visible Trade	6,132.7	-703.5	-1,810.2	-781.4	2,299.8	5,065.1	3,443.9	13,968.1	11,425.0	30,770.3	70,114.9	44,677.9	81,1000.4
Services	-3,462.2	-2,948.4	-2,779.9	-2,070.7	-2,001.9	-2,617.7	-6,222.6	-14,167.7	-12,786.0	-24,714.0	-28,998.3	-3,934.4	-54,258.5
Unrequitted Transfers	-315.2	-346.5	-289.4	-285.8	-253.8	-232.0	-240.4	-96.2	385.3	1,140.8	3,614.6	7,291.9	12,680.1
Capital Account	97.4	929.5	3,470.9	2,737.7	171.9	2,555.0	-1,900.9	-16,743.3	-18,447.3	-30,221.9	-49,245.3	-27,482.9	-138,755.6
Errors and Omissions	50.5	48.1	10.3	100.9	138.9	-94.3	-767.7	-1,226.2	-1,382.0	-1,003.9	-1,247.8	-969.1	-2,072.1
Overall Balance Surplus (+) Deficit (-)	2,402.2	-3,020.8	-1,398.3	-301.3	354.9	349.1	-784.0	159.2	-2,294.1	8,727.8	18,498.2	5,959.2	-65,272.6

Source: Adapted from Ojo, M.O. (1993), P.47.

4.2 ANALYTICAL TECHNIQUES AND SOURCES OF DATA

This study will utilize secondary data on variables such as GDP growth rate, market capitalization, real interest rate, exchange rate, number of banks, portfolio investment, credit to the private sector and broad money. Data on these variables was sourced essentially from the publications of the securities and exchange commission, the Nigerian Stock Exchange and the Central Bank of Nigeria. We also made use of publications of the International Finance Corporation (IFC) and Federal office of statistics of Nigeria.

Two methods of analysis was employed: bivariate and multivariate analysis. The bivariate analysis is to examine the degree of association between each of the explanatory variables in this study and the dependent variables. The multivariate analysis is essentially an econometric regression method. Indeed, in choosing the estimation technique employed in this study, we took into consideration the nature of the equation and the suitability of the various estimating techniques. For an interacting model such as ours, the method of ordinary least squares (OLS) cannot be employed. Indeed, despite the obvious advantages of optimal properties (which include unbiasedness, least variances, efficiency, Best linear unbiasedness (Blu), Least Mean - square -error (MSE) and sufficiency) over other technique such as the two stage least square (2SLS), three stage Least Square (3SLS), indirect Least Square (ILS) maximum likelihood estimator (MLE), the application of OLS to an equation belonging to a system of simultaneous equation, will yield biased and inconsistent estimates(Pindyck and Rubinfeld, 1976). This precludes the use of OLS in our study. Since our equations are of the simultaneous nature, this study employs the two stage least squares estimation technique to estimate models fitted to the time series data for the Nigerian economy.

The two stage Least Square (2SLS) method is a single - equation method being applied to one equation of the system at a time. The method provides a very useful

estimation procedure for obtaining the values of structural parameters in over-identified equations(Wonnacott and Wonnacott, 1979). It utilizes the information available from the specification of an equation systems to obtain a unique estimate for each structural parameters. In short, 2SLS method involves two things: one, the application of OLS to the reduced form equation in order to obtain an estimate of the exact and the random components of the endogenous variables. Two, replacement of the endogenous variables of the equation with their estimated values after which ordinary least squares is applied to the transformed original equation to obtain estimates of the structural parameters(Pindyck and Rubinfeld, 1976).

Indeed, 2SLS eliminates the problem of an over supply of instruments by using combinations of pre-determined variables to create new instruments. Although, in small sample, the transformation does not eliminate the simultaneous equation bias, in large sample such as ours, however, and as the sample size becomes larger, the bias tends towards zero. That is, the 2SLS estimates are asymptotically unbiased. Also, in large samples, the estimates of 2SLS are consistent and asymptotically efficient(Wonnacott and Wonnacott, 1979).

The estimation of the equations gave summary statistics of the coefficient of multiple determination (R^2) and t-value of coefficients. The Durbin - Watson statistics was used to test for auto-correlation in our systems of equations while the F-statistic was used for testing the overall explanatory power of the model.

However, it has been suggested that the conventional t-test of significance of parameter estimates of a simultaneous equations model may not be a valid test but can only be taken as suggestive for two main reasons. In the first place, not much is known about the finite sample properties of 2SLS (Kmenta, 1971; P. 583) . Secondly, available evidence suggest that 2SLS tends to yield somewhat conservative t-value, meaning that the method tends to understate the significance of a particular coefficient. Hence, much

emphasis cannot be placed on the notion of significance. Instead, greater attention are often attached to *a priori* specification such as signs of coefficients in evaluating 2SLS results.

Other statistical tests often used in assessing results of 2SLS are the coefficient of multiple determination (R^2) and the sampling error of estimates. The R^2 is a measure of the degree of variation in the dependent variable that are explained by the independent variables. The higher the R^2, the more useful the model will be for both policy design and predictive purposes. Most of these tests are utilised in this study.

To compliment the above multivariate analysis, a bivariate analysis was also conducted using information from the correlation matrix generated by the computer. The intention here, is to be able to determine the degree of association existing between each of the explanatory variables and the dependent variables. This, we believe will make our study more robust.

In the final analysis, we can summarise the usual regression criteria employed to evaluate our 2SLS estimates:

(1) The theoretical criteria with regards to the signs and magnitude of the estimated coefficients.

(2) Statistical criteria regarding the explanatory power of the model as measured by the following:-

   (i) R^2, which is the adjusted coefficient of multiple determination. The coefficient of multiple determination (R^2) is a measure of the degree of variation in the dependent variable that is explained by the independent variables. The higher the R^2, the more useful the model will be for policy and predictive purposes.

(ii) The standard errors of the estimates used in judging the reliability or significance of the regression coefficients.

(iii) The F-statistics, used to test the overall explanatory power of the model

(iv) The student 't' statistics which enables us to examine the relative significance of each independent variable.

(v) The Beta coefficient which enables us to examine the relative importance of the explanatory variables.

3. Other econometric criteria such as the Durbin-watson statistic which measures the degree to which the regression residuals exhibit serial correlation.

In what follows, we hereby present our model specification.

4.3 MODEL SPECIFICATION:-

Attempts at reforming the financial sector in Nigeria have fallen under five major headings - reforms of the financial structure, monetary policy reforms, foreign exchange reforms, liberalization of capital movement and capital market reforms(Ikhide, 1995; P. 33). We therefore present our model specification along this path.

4.3.1 FINANCIAL REFORMS AND STOCK MARKET DEVELOPMENT

Hanson and de Melo(1985), used competitive interest rate as a measure of competition in the uruguaying economy, we included instead, the number of banks (NB) as a measure of the competitive nature of the Nigeria's financial system. In Nigeria, before liberalization of the financial sector, interest rates were fixed by administrative fiat and as such financial institutions were not allowed to manipulate it and in such an environment such as ours, the number of banks rather than the interest rates would be a better measure of competition in the financial system. As more banks are chartered as a result of financial structure reforms, there tends to be more operators in the stock market and as such

activities going on in this market will be enhanced. Hence, we expect a positive relationship between financial structure reform and stock market development in Nigeria. This will allow us to capture the impact of financial structure reforms on the stock market development.

Real interest rate (r*) was included as one of our explanatory variables to capture the effect of monetary policy reforms on the capital market. Real interest rate as opposed to nominal interest rate, which do not account for the inflation rate in the economy, serves as an equilibrating agent for the various sources and uses of investible funds. Hence, for our purpose in this study, we shall use the modified Mckinnon's proxy for real rate of interest. The relevant rate of interest (r*) as used by Mckinnon is the real yield on money, i.e the real deposit rate of interest. This he measured by subtracting expected inflation (Π^e) from the twelve - month time deposit rate of interest (d) such that

$$r^* = d - \Pi^e$$

Lagged inflation rate (Π_{t-1}) is used as a proxy for expected inflation rate because this is more relevant for intertemporal decision making. Hence we write that

$$\Pi^e = \Pi_{t-1}$$

It is expected that real interest rate will impact positively on the growth of the capital market.

Also, the exchange rate, as a measure of foreign exchange market reforms, constitutes an important aspect of financial sector reforms in Nigeria (Montiel, *et al*, 1993 ; Ikhide, 1995). It is one of the key linkages between a small, open economy and the rest of the world. It connects individual countries through the micro - and macro - economic channels of the goods and the asset markets(Dornbusch, 1985). Since the domestic wealth holders must choose how to hold their wealth either in domestic financial assets or in a range of foreign assets, exchange rate links the domestic economy to the world payment system. Therefore, the nominal exchange rate (e_R) was included in our model as a measure

of the extent to which the Nigerian financial sector (especially the capital market) is integrated with the world's financial system. If domestic returns on financial assets traded in the capital market fall short of returns from foreign assets, capital flight will take place thereby reducing the growth of the domestic capital market. Therefore, the e_R was included as a policy instrument in the model mainly to say something about the extent to which foreign exchange policy in Nigeria encouraged or discouraged capital flight in the country and also to measure the international competitiveness of Nigeria financial assets (and by implication, the Nigerian capital market).

The ease with which foreign banks and securities dealers have access into the Nigeria securities market determines its growth rate. Hence, portfolio investment (Pinv) was included as an index of capital movement liberalization in Nigeria. Therefore, reduction of constraints to capital inflow (e.g removal of information asymmetry), will no doubt impact positively on the growth of capital market.

Another important reform measure that affect the Nigerian capital market is the privatization programme. This involves the transfer of ownership of erstwhile public institutions to the private individuals. Indeed, privatization requires the creation of a mechanism to reassign ownership rights over assets from the state sector to private parties. In market economies or those aspiring to be one, the reallocation of property rights is normally carried out through free buying and selling in markets(Erunza, 1985a). Privatization programme is expected to affect positively the activities taking place in the capital market. However, since this policy measure may be difficult to quantify (measured empirically), we have decided to include a dummy (DpR) to capture the impact of privatization on the growth of capital market in Nigeria. DpR is equal to one during the reform era and zero elsewhere (pre - reform period).

4.3.2 STOCK MARKET DEVELOPMENT AND ECONOMIC GROWTH:-

Each theoretical model in the literature focusses on one characteristic of the functioning of stock markets, such as size, liquidity or integration. Consequently, one line of research is to evaluate empirically characteristic by characteristic, the predictions from each model. For our purpose, we focus on the size of the market. This index reflects the issue capacity of the market over time. Therefore, we measure the size of stock market using market capitalization. Theory suggests that the size of stock market is positively correlated with the ability to mobilize investible capital and diversify risk and hence economic growth.

Another variable included in our growth equation is the money supply broadly defined to evaluate whether financial depth is significantly correlated with economic growth. King and Levine (1993a, 1993b) and De Gregoria and Guidotti (1995) identified a significant correlation between financial depth and log-run economic growth rates in broad cross - country samples. To measure financial depth, these authors use money supply broadly defined such as M_2. We also adopt this measure of financial depth. M_2 is defined as liquid liabilities of the financial system. Liquid liabilities consist of currency held outside the banking plus demand and interest - bearing liabilities of banks and non banks financial intermediaries. It is hoped that this measure of financial depth will impact positively on economic growth.

In the final analysis, another financial variable included in our model is credit to the private sector. Theory suggests a positive correlation between an active investing private sector in an economy and economic growth. Hence, when more credits are supplied to the private sector, it boosts economic activities thereby enhancing economic growth.

We have decided to exclude other determinants of economic growth such as labour force, capital and technological progress, not to under state their importance in enhancing

economic growth, but rather the choice is informed by our desire to isolate the role of financial factors in economic growth. Consequently, we summarise the model equations:-

(a) Market capitalization:-

$$\Delta MC = f(r^*, e_R, NB, Pinv, DPR, CPS, M_2, GDP) \text{ explicitly,}$$

$$\Delta MC = \beta_o + \beta_1\Delta r^* + \beta_2\Delta e_R + \beta_3\Delta NB + \beta_4\Delta Pinv + \beta_5 DPR + \beta_6\Delta CPS + \beta_7\Delta M_2 + \beta_8\Delta GDP + e_t \quad \ldots\ldots(1)$$

consequently,

(b) $$EMC = f(r^*, e_R, NB, Pinv, DPR)$$

explicitly,

$$EMC = \beta_o + \beta_1\Delta r^* + \beta_2\Delta e_R + \beta_3\Delta NB + \beta_4\Delta Pinv + \beta_5 DPR + e_t \quad \ldots\ldots(2)$$

(c) Economic Growth measured by GDP growth:

$$\Delta GDP = f(EMC, \Delta CPS, \Delta M_2)$$

explicitly,

$$\Delta GDP = \beta_o + \beta_1 EMC + \beta_2 CPS + \beta_3\Delta M_2 + e_t \quad \ldots\ldots(3)$$

such that

$$\Delta x_t = x_t - x_{t-1}$$

The functional relationship adopted here was informed by both statistical and economic theory. Equation (1) relates market capitalization to real interest rate, exchange rate, number of banks, portfolio investment, credit to the private sector, broad money, Gross domestic product and a dummy to capture the effect of privatization on stock market development. In equation (2), estimated market capitalization is specified to depend on the reform variables alone (i.e real interest rate, exchange rate, number of banks, portfolio investment and a dummy). Equation (3) regresses GDP on estimated market capitalization, credit to the private sector and money supply (broadly defined).

Our *a priori* expectation in the equation (2) and (3) in the model above are:-

$\beta_1, \beta_2, \beta_3, \beta_4$ and $\beta_5 > o$

where

MC = Market capitalization

EMC = Estimated market capitalization

GDP = GDP growth rate which measured economic growth

r* = Real interest rate proxied by d - Π^e

d = Twelve - month noninal deposit rate

Π^e = Expected inflation rate measured as lagged inflation rate (Π_{t-1}).

e_R = Nominal exchange rate

NB = Number of Banks

Pinv = Portfolio investment

CPS = Credit to the private sector

M_2 = Money supply (broadly defined)

e_t = Error or the disturbance term

Δ = Denotes first differencing operator to eliminate the effects of trend and seasonal variations which are typical of economic variables especially financial.

CHAPTER FIVE

EMPIRICAL ANALYSIS

5.1 INTRODUCTION

The results of the estimated equations are presented in tables 5.1, 5.2A and 5.2B below. The R^2 is the adjusted value of the coefficient of multiple determination ; D-W stands for the Durbin - watson, d, statistics; the F is the conventional F - statistic (that tests the overall explanatory power of the model or put differently, it tests jointly the overall significance of the estimated equations' parameters), while the figures in the parenthesis are the t - values.

Equation (1, 1′, 1″) in tables 5.1, 5.2A and 5.2B, represents the first stage of the regression in the pool - data, pre-reform and the reform periods of our analysis respectively.

In what follows, we present specific data analysis of the second stage of the regression results which constitute the core of our study.

5.2 FINANCIAL LIBERALIZATION AND STOCK MARKET DEVELOPMENT IN NIGERIA: AN EMPIRICAL ANALYSIS.

To investigate the impact of financial liberalization on the Nigeria stock market, a model was formulated in which estimated market capitalization was regressed on reform variables, the results of which are summarised in equations (3, 3′ and 3″) of Tables (5.1, 5.2A and 5.2B). The summary statistics show that R^2 and R^2 are generally high. It ranges from 0.6993 for the reform period to 0.7597 for the pre-reform period, thus indicating that about 69.93 per cent to 75.97 per cent variation in the market capitalization are explained by the policy variables i.e interest rates, exchange rate, Number of banks, portfolio investment and privatization, leaving about 31-25 percent unexplained. The Durbin -

Watson statistics are quite good showing 2.05 for the pre-reform equation, 2.16 for the reform period and 2.15 for the pool - data period . This indicates absence of autocorrelation in our analysis.

The calculated F - statistics in all the periods, (47.49 for the pool-data period, 62.19, for the pre-reform period and 15.70 for the reform period) are greater than the theoretical F, thus indicating the good explanatory power of our models. Hence, predictions from our analysis could be looked at as very reliable from the statistical sense.

Contrary to our *a priori* specification, the regression result shows that the real rate of interest is negatively related to market capitalization, but as expected, significant at 5 per cent levels. This means that as real interest increases, market capitalization falls. This can be interpreted to mean that despite high interest rate following deregulation which ought to discourage debt financing and favour equity finance, which can only be got in the stock market, debt financing was also patronised at the expense of equity financing in Nigeria. Two reasons can be adduced for this. One, the complex procedure and stringent conditions required for participating in the Nigerian stock market could be a major disincentive for investors wishing to patronise stock market. Two, inadequate publicity and poor public enlightenment on the parts of the supervisory authorities concerning the activities going on in the Nigerian stock market could be another factor.

The conclusion that can readily flow from the above analysis points to the fact that market capitalization and in fact, stock market development is insensitive to interest rates in a developing economy such as Nigeria but in the negative direction. This assertion is supported by Friend (1963) who argued that in a developing economy, " ...the net impact of real interest rate movement is either negative or insignificant."(P. 672)

TABLE 5.1
2SLS REGRESSION RESULTS FOR THE POOLED DATA: 1970(2) - 1993(4)

	REGRESSION EQUATION	DEPENDENT VARIABLE	CON-STANT	INDEPENDENT VARIABLES									SUMMARY STATISTICS			
				Δr^*	Δe_R	ΔN_B	ΔPinv.	Dp_R	ΔCPS	ΔM_2	ΔGDP	EMC	R^2	$\bar{R}^2$	F	D-W
1st stage	1	ΔMC	-1.71 (0.026)[a]	-18.38 (3.18)	98.37 (1.03)	112.90 (6.41)	0.11 (5.19)	-131.56 (0.85)	0.25 (9.66)	0.002 (0.093)	0.047 (4.22)		0.9242	0.9180	131.14	2.20
2nd stage	2	ΔGDP	33.49 (0.060)						0.4479 (1.39)	-0.0188 (0.157)		2.3702 (3.186)	0.6007	0.5919	45.63	2.35
2nd stage	3	EMC	63.103 (0.5336)	-21.25 (2.15)	928.45 (6.63)	110.59 (3.63)	0.0785 (2.13)	125.80 (0.5685)					0.7274	0.7152	47.49	2.15

* Figures in parenthesis are the t-values.

TABLE 5.2A
2SLS REGRESSION RESULTS FOR THE PRE-REFORM PERIOD: 1970(2) - 1985(4)

	REGRESSION EQUATION	DEPENDENT VARIABLE	CON-STANT	INDEPENDENT VARIABLES									SUMMARY STATISTICS			
				Δr^*	Δe_R	ΔN_B	ΔPinv	Dp_R	ΔCPS	ΔM_2	ΔGDP	EMC_t	R^2	$\bar{R}^2$	F	D-W
1st stage	1^1	ΔMC_t	103.433 (1.49)	-13.998 (2.043)	3033.309 (1.43)	-70.539 (1.093)	-	-	0.156 (1.88)	-0.0169 (0.1935)	-0.0164 (0.3756)	-	0.2291	0.1603	2.77	2.20
2nd stage	2^1	ΔGDP	33.49 (0.060)	-	-	-	-	-	0.0798 (0.213)	0.0315 (0.117)	-	0.042 (0.033)	0.026	-0.031	0.05	1.67
2nd stage	3^1	EMC_t	125.02 (9.21)	-18.69 (11.36)	3401.27 (6.31)	-71.29 (4.37)	-	-	-	-	-	-	0.7597	0.7516	62.19	2.05

Figures in parenthesis are the t-values.

TABLE 5.2B
2SLS REGRESSION RESULTS FOR THE REFORM PERIOD: 1986(1) - 1993(4)

	REGRESSION EQUATION	DEPENDENT VARIABLE	CON-STANT	INDEPENDENT VARIABLES									SUMMARY STATISTICS			
				Δr^*	Δe_R	ΔN_B	ΔPinv.	Dp_R	ΔCPS	ΔM_2	ΔGDP	EMC_2	R^2	$\bar{R}^2$	F	D-W
1st stage	1"	ΔMC	-63.36 (0.298)	-32.65 (2.929)	0.3838 (0.0027)	107.73 (4.19)	0.1267 (4.123)	-	0.2459 (6.7177)	-0.0068 (0.2899)	0.049 (3.103)	-	0.9535	0.9419	70.38	2.05
2nd stage	2"	ΔGDP	314.69 (0.149)	-	-	-	-	-	0.5592 (0.997)	-0.0487 (0.0727)	-	2.12 (1.64)	0.5873	0.5578	13.28	2.23
2nd stage	3"	EMC_2	198.95 (0.5605)	-30.32 (1.243)	868.52 (3.191)	111.42 (1.9437)	0.090 (1.307)	-	-	-	-	-	0.6993	0.6659	15.70	2.16

Figures in parenthesis are the t-values.

As such, in an underdeveloped financial system where the capital market is shallow compared with the banking sector, monetary policy and in fact, high rates of interest will not be an appropriate instrument for encouraging stock market development.

Another policy variable examined in our study is the exchange rate (e_R). As expected, the coefficient of the exchange rate, used here as an index of foreign exchange market reforms, came out with the correct positive signs in the three periods of our analysis. Aside from having the right signs, they are all significant at the 5 per cent levels meaning that as the exchange rate improves, capital inflow takes place thereby impacting positively on the growth of stock market. Another conclusion that flows from this is the fact that one can argue with high level of confidence that the Nigeria's stock market has the potential of being able to compete favourably well with more developed stock markets, if the right foreign exchange rate policy is put in place. Hence, we can conclude that the foreign exchange policy in Nigeria has encouraged capital inflow to the economy and as a consequence encouraged stock market development.

The next independent variable considered in our analysis is the number of banks used as an index of financial structure reforms in Nigeria. The result confirms our *a priori* specification in terms of signs of coefficients in the equation for the three periods covered by our analysis except for the pre-reform period where a negative sign was exhibited contrary to expectation. However, the coefficients in all these periods are significant at 5 percent levels indicating that in general, number of banks and in fact, financial structure reforms is an important variable in explaining stock market development in Nigeria. From the above, it follows that a favourable domestic financial structure that encourages more and more banks to be chartered will lead to increased financial intermediation in the

economy. Since they also have to decide on the term structure of their investment, more operators, occasioned by increased number of banks, tend to participate in the stock market thereby contributing to its development. However, for the pre - reform period, where the number of banks coefficient exhibit a wrong sign, the result confirms our practical knowledge of the Nigerian financial system characterised by widespread repression. Indeed, during this period, the banking sector was dominated by government banks with their civil servant orientation characterised by gross inefficiency. Since the government through credit guidelines dictates where, how and in what direction the investible funds mobilised through the banks should be targeted (short or long-term), their participation in the capital market was therefore minimal. Hence, one can conclude that during the pre-reform period characterised by a repressed financial system, stock market development is not responding adequately to the number of banks operating in the country.

We also investigated the effects of capital movement liberalization on the growth of the capital market in Nigeria via its index, portfolio investment. As argued earlier, the ease with which foreign banks and securities dealers have access into the Nigeria's securities market determines its rate of growth. Our result shows that the coefficient of portfolio investment is significant at 5% level for the pool data, insignificant for the reform period and in both cases, it has the expected positive signs. For the pre-reform period, we are unable to generate any estimate for portfolio investment because there was no data for portfolio investment in Nigeria prior to liberalization.

A major conclusion from this analysis is that capital movement liberalization has impacted positively on stock market development in Nigeria. Hence, reduction or absolute elimination of constraints to capital inflow, following liberalization, has improved economic activities and the growth of the stock market in Nigeria.

Another reform measure captured by our analysis is the effect of privatization on stock market development. Using a zero-one dummy function as a proxy for this variable (since it cannot be measured empirically), we found that for the pool data, it exhibits the right positive sign as expected but it is insignificant at 5 percent level. The positive association indicates that with privatization many formally government owned institutions (especially banks) are sold to private individuals via the stock market thereby promoting its growth. Hence, it could be asserted that with sustained and uninterrupted regime of privatization that encourages increased private participation in the economic activities of the country, stock market are likely to witness an increased boom in the future.

However, for the pre-reform and reform periods, estimates cannot be got for the measure of privatization. This is because the data used here are essentially constants.

To test for structural shift in our estimates, we computed the chow - test. Since our calculated F(2.81) is greater than the tabulated $F_{6,83}$.(2.25), we conclude that estimated market capitalization has changed overtime. During the reform period, market capitalization has witnessed a tremendous growth than what existed pre-reform. Hence, this discovery is in consonance with the main theme of this study. It also reinforce what Ikhide (1997; P. 75)) found that "The capital market witnessed.. substantial growth ... during the period of liberalization." In all the major reason for the good results observed for the pooled-data period (1970-1993) and the reform period (1986-1993) is that the positive effects of liberalization has outweighed the negative effects of financial repression in Nigeria.

The relative importance of our policy variables is also examined using the β-coefficient estimates summarised in table 5.3. Figures in parenthesis are the ranks for each of the variables. The ranking however shows that in the pool-data period, an exchange rate

and by implication foreign exchange policy reform is the most important measure determining stock market development in Nigeria while privatization exercise takes the second position. While the measure of financial structure reform (NB) takes the 3rd position, an index of monetary policy reform (r*) and portfolio investment (measure of capital movement liberalization) takes the 4th and the fifth positions respectively. From the above, it is very clear that foreign exchange market reform should be given special attention in the liberalization process before privatization, financial structure, monetary policy and capital movement reforms are considered in that order.

TABLE 5.3

RELATIVE IMPORTANCE OF THE EXPLANATORY VARIABLES IN THE STOCK MARKET DEVELOPMENT EQUATION

DEPENDENT VARIABLE	INDEPENDENT VARIABLE					PERIOD OF ANALYSIS
	Δr^*	Δe_R	ΔNB	$\Delta Pinv$	DPR	
EMC	0.2251 (4)	139.4336 (1)	3.6081 (3)	3.097X10-6 (5)	29.8436 (2)	1970(2)-1993(iv)
EMC	0.3274 (3)	19,521.064 (1)	12.3641 (2)	-*	-**	1970(2)-1985(iv)
EMC	0.4347 (3)	138.9971 (1)	3.7557 (2)	3.554X10-6 (4)	-**	1986(1)-1993(iv)

$$\beta\text{-coefficient} = \frac{\text{Coefficient of Xi times standard deviation of Xi}}{\text{Standard deviation of Y}}$$

Xi = explanatory variable

Y = dependent variable

-* = portfolio investment in Nigeria was nil pre-reform period

-** = we used a Dummy (represented by a zero-one function) to capture the effect of privatization and the dummy is equal to zero pre-reform and one-during the reform period.

For the pre-reform period, foreign exchange policy reform also maintains the leading position followed by financial structure reform and monetary policy reforms in explaining stock market development.

The same picture is got for the reform period as exchange rate, number of banks, real interest rate and portfolio investment takes position 1,2,3 and 4 respectively.

In addition to the multivariate analysis interpreted above, we also conduct a bivariate analysis between each of the policy variables and stock market development the result of which is summarised in Table 5.4. Interest rate is consistently negatively correlated with market capitalization in all the periods of our analysis. However, the degree of association is only strong during the pre-reform periods. In other periods, the correlation is weak. For the exchange rate, the correlation coefficient indicates strong and positive association between foreign exchange policy and stock market development in all the periods of our analysis except the pre-reform period. The correlation coefficients are generally low for the measure of financial structure reforms in the three periods of our analysis. Dummy for privatization is weakly but positively correlated with market capitalization. Finally, the correlation between portfolio investment and index of stock market development is strong and positive.

TABLE 5.4

EMC RESULT FROM BIVARIATE ANALYSIS

DEPENDENT VARIABLE	CORRELATION COEFFICIENTS					PERIOD OF ANALYSIS
	Δr^*	Δe_R	ΔNB	ΔP_{inv}	DPR	
EMC	-0.3949	0.7670	0.3382	0.5893	0.2893	1970(2)-1993(4)
EMC	-0.7442	0.4743	0.2075	-	-	1970(2)-1985(4)
EMC	-0.4648	0.7772	0.2913	0.6003	-	1986(1)-1993(4)

5.3 STOCK MARKET DEVELOPMENT AND ECONOMIC GROWTH IN NIGERIA: AN EMPIRICAL RESULTS.

To assess whether stock market in Nigeria is merely a burgeoning casino where more and more players are coming to play bets, or whether stock markets are importantly linked to economic growth, this study formulated a model to investigate the relationship between stock market development and economic growth. The result of the regression is summarised in equations (2, 2′, and 2″) of Tables 5.1, 5.2A and 5.2B. For these equations which regress GDP on Estimated Market Capitalization, Credit to the Private Sector and Money Supply broadly defined, the R^2 are found to be generally low especially for equation 2 in the pre-reform period (0.026). The value of R^2 in the pool-data and the reform periods are 0.6007 and 0.5873 respectively. For the pool-data, this value of R^2 show that about 60.07 percent of the variation in economic growth in Nigeria is explained by stock market development, credit to the private sector and money supply broadly defined leaving about 40 percent unexplained. For the reform period, R^2 value of 0.5873 indicates that 58.73 percent of the changes in GDP are explained by the independent variables leaving about 42 percent unexplained. However, for the pre-reform period, it means that about 2.6 percent of the changes in economic growth are explained by credit to the private sector, money supply broadly defined and stock market development leaving about 97 percent unexplained. This result suggests that identified financial variables are grossly unimportant for economic development during the repressed period. Hence, other factors influencing growth such as labour force, capital and effect of technological progress which are excluded from our analysis would have been responsible for the low R^2 during the pre-reform period. Therefore, it could be argued that financial

factors became relevant for economic growth only after liberalization.

The Durbin-Watson statistics ranges between 1.67 in the pre-reform period to 2.35 in the pool-data. It is 2.23 for the reform period. All these indicates absence of autocorrelation in our analysis.

To test for the overall explanatory power of our model, the F-statistic computed for the pool-data is significant. This is because the calculated $F_{0.05\%}$ (45.63) is greater than the tabulated $F_{4,85}$ (2.53), thus indicating that all the estimated coefficients are jointly significant. For the reform period, the picture is the same since the calculated F(13.28) is greater than the theoretical $F_{4,28}$ (2.71). However, for the pre-reform period, the computed F-statistics (0.05) is smaller than the theoretical $F_{4,59}$(2.53), meaning that the coefficients in the equation for this period are jointly insignificant. This reveals that for predictive purposes, the equation for the pre-reform period cannot be relied upon while equations for the other two periods are judged to be statistically good for forecasting purposes.

Aside from the above summary statistics discussed above, the effects of some financial variables on economic growth are also considered. In these growth equations we found that positive relationship exists between economic growth and the credit to the private sector in all the periods of our analysis. This is as expected. When credits are provided to the private sector for purposes of profitable investment, increased general economic activities tend to promote economic growth. This positive association is consistent in all the periods of our analysis.

The second explanatory variable whose effect on economic growth was examined was money supply broadly defined. Contrary to our expectation, it exhibits a negative relationship meaning that as more money are supplied to the economy, it dampens

economic activities and hence, economic growth. Our knowledge of the Nigerian economy shows that this result is justifiable on the ground that in the past years, money supply narrowly or broadly defined, are used essentially either to finance deficits in government budgets or that they are spent on white-elephant projects with low marginal contribution to economic growth. Therefore , we are not too surprised that money supply exhibits this kind of behaviour.

The sterling and in fact one of the major discoveries of this study is the positive relationship between market capitalization (which is a measure of stock market development) and economic growth in the three periods of our analysis. Aside from this positive relationship, the coefficient estimates are significant at 5 percent levels except for the pre reform period that is insignificant at 5 percent level. Although , it must be acknowledged that stock market became significant only during the reform period, but insignificant pre-reform, the potential relevance of the stock market pre-reform can in fact be gauged by the positive sign exhibited by the coefficient of market capitalization. This discovery confirms the recent empirical study by Levine and Zervos (1996; P. 333) conducted for a cross-section of countries and a descriptive study conducted by Ikhide (1997; P. 92) for the Nigeria economy. They posited that "stock market is positively and robustly associated with long-run economic growth". Hence, we can conclude that capital market is significantly relevant for economic growth in Nigeria. In view of this, the various ongoing reform policies directed towards the development of Nigeria's capital market is a right step in the right direction.

To test for structural shift in our estimates, we computed the chow-test. Our test indicates that there has been a shift in our estimates post liberalization, since our calculated F(2.61) is greater than the theoretical $F_{4,85}(2.53)$. Specifically, there has been a shift in

economic growth post reform. This shift in economic growth, for our purpose is attributed to the various financial sector reform policies and the development of stock market in Nigeria. However, the structure of this growth is not readily clear from this present study.

The relative importance of the explanatory variables in our model was examined by computing the Beta-coefficient for the various co-efficient estimates (see Table 5.5). The rank for each of the explanatory variables is presented in parenthesis. The ranking shows that in determining economic growth, market capitalization, an index of stock market development, consistently remain the most important variable in our model followed by credit to the private sector and broad money takes the last position. In view of this discovery, it is consistent to state that efforts should be directed more than ever before on how to develop the capital market so as to accelerate economic growth in this country. This is definitely to compliment the role expected of other predictors of growth.

TABLE 5.5

RELATIVE IMPORTANCE OF EXPLANATORY VARIABLES IN THE GROWTH EQUATION

DEPENDENT VARIABLE	INDEPENDENT VARIABLES			PERIOD OF ANALYSIS
	ΔCPS	ΔM_2	EMC	
ΔGDP	2.99×10^{-5} (2)	4.67×10^{-7} (3)	3.66×10^{-4} (1)	1970(2)-1993(4)
ΔGDP	2.68×10^{-5} (2)	7.60×10^{-6} (3)	4.63×10^{-5} (1)	1970(2)-1985(4)
ΔGDP	3.69×10^{-5} (2)	1.30×10^{-6} (3)	3.21×10^{-4}	1986(1)-1993(4)

The figures in parenthesis are the rank for each coefficient in the model

$$\beta\text{-coefficient} = \frac{\text{Coefficient of Xi times standard deviation of Xi}}{\text{Standard deviation of Y}}$$

Xi = explanatory variable

Y = dependent variable

Our bivariate analysis between each of the explanatory variables and economic growth is summarised in Table 5.6. The analysis shows that stock market development indicator is strongly and positively correlated with economic growth for all the periods of our analysis except the pre-reform period which has a weak though positive correlation with economic growth. Credit to the private sector displays the same behaviour while the correlation coefficient between money supply variable and economic growth is generally low for all periods although positively correlated. This analysis reinforces our earlier discussions on the association between economic growth and the identified financial factors.

TABLE 5.6

GDP RESULTS FROM BIVARIATE ANALYSIS

DEPENDENT VARIABLE	CORRELATION CEFFICIENTS			PERIOD OF ANALYSIS
	ΔCPS	ΔM_2	EMC	
ΔGDP	0.7457	0.1496	0.7695	1970(2)-1993(4)
ΔGDP	0.0481	0.0044	0.0404	1970(2)-1985(4)
ΔGDP	0.7395	0.0198	0.7566	1986(1)-1993(4)

CHAPTER SIX

SUMMARY, RECOMM0ENDATIONS AND CONCLUSION

6.1 SUMMARY AND RECOMMENDATIONS:

In this chapter, we present the summary and policy recommendations which is followed by conclusion of our study. The last section of the chapter contains the suggestions for future research. Since the objective of this study is to investigate the impact of financial sector reforms on stock market development on the one hand and stock market development and economic growth on the other, we started by reviewing the basic macro-economic environment existing in the country that motivated the need for financial liberalization. It was found that the inability of the financial system to be responsive to developmental goals and aspirations of the country in terms of efficient resource mobilization and allocation motivated the urge for liberalization. Also, both internal and external distortions were found to be contributory factors to the inefficiencies in the Nigerian financial system. Following liberalization however, the inherent weakness of Nigeria's financial system was further exposed as many of the financial institutions that started operation at the wake of liberalization became insolvent.

In Chapter Two, we present a comprehensive appraisal of the Nigerian financial system. It was found that following liberalization, the number of institutions operating in the financial sector has increased significantly, and the financial system became more competitive than ever before. This was found to be a consequence of the reform exercise which led to the removal of unnecessary constraints and other usury laws that inhibit efficient financial intermediation and competition. As such the roles of all regulatory institutions in the financial systems are redefined to be in line with the new financial environment that now prevails in the economy.

Chapter Three contains the literature review and the theoretical framework of our analysis follows immediately in this chapter. Our study is situated in the Neoclassical financial repression hypothesis which attributed the failure of the financial system to widespread controls and regulation of all prices in the sector thereby leading to inefficient allocation of resources. To get around this problem, this school of thought recommended financial liberalization in which all controls are removed and prices are allowed to be determined by the market forces.

In Chapter Four, we present our models and Chapter Five contains the results therefrom. Specifically, we empirically investigate the impact of financial sector reforms on stock market development and also examine the contribution of stock market development to economic growth. To be able to do this, we employed both bivariate and multivariate methods of analysis. The results from both the bivariate and multivariate analysis indicate many interesting discoveries. We can summarize our major findings as follows:-

(1) In general, financial sector reforms have enhanced stock market development in Nigeria. This confirms our first hypothesis earlier stated in this study that there is a positive relationship between financial sector reforms and stock market development.

(2) To measure the specific impact of each of the reform variables on stock market development, we found that exchange rate liberalization has encouraged stock market development by attracting foreign capital inflow to the economy. Aside from this, our data suggest that the Nigeria's stock market has the potential of being able to compete favourably well with more developed stock markets, if the right foreign exchange policy is put in place.

(3) It was found that a repressed financial structure will be a disincentive to stock market development. This is because, during the pre-reform period, characterised by a repressed financial system, stock market development was found to be insensitive to the measure of financial structure reforms (number of banks). However, for the pooled-data and the reform periods, the result indicates positive and significant association between stock market development and financial structure reforms.

(4) Reduction or absolute elimination of constraints to capital movement (capital inflow) following liberalization has improved economic activities and stock market development in Nigeria. This position is justified by the significance of coefficient of portfolio investment in our model.

(5) Our result shows that sustained and uninterrupted regime of privatization which encourages increased private participation in economic activities of this country are likely to boost stock market development in the future.

(6) Another conclusion that can be drawn from our study is that monetary policy (i.e. interest rate manipulation) may be an inappropriate policy instrument for encouraging stock market development especially in an underdeveloped financial system characterised by a shallow capital market compared with the banking sector. This is because, its net effect will either be negative or insignificant after all.

(7) Prior to liberalization (pre-1986 period), financial factors are insignificant determinants of economic growth. This is informed by the low value of R^2 (0.026) for this period. However, financial factors became important determinants of economic growth only after the commencement of liberalization programme in 1986.

(8) In the final analysis, another major discovery of this study is the significant and positive correlation between stock market development and economic growth in all the three periods of our analysis. Hence, LDCs wishing to achieve rapid economic growth and development should direct all efforts towards the development of domestic equity markets in view of the potential role it can play in long-run economic growth.

From the above, two policy issues stands out clearly. The first has to do with the role of a well coordinated macro-econimic programmes in ensuring the success of financial liberalization. The second is concerned with the role of the regulatory bodies in directing policies during the process of reform towards the actualization of the desired goals.

For financial liberalization to be successful, a precondition is macro-economic stability. If the macro-economic conditions of an economy is right, financial liberalization would be successful and the possible instabilities that often follow deregulation would be easily contained or avoided. But if macro-economic environment is not right, the economy is likely to move from instability to deeper instability. Hence, policy markers are adviced to ensure macro-economic stability before attempting financial liberalization.

When financial liberalization is to be implemented however, the first responsibility of the authorities is the promulgation of relevant laws to guide the conduct of the operators in the system, otherwise, the profit- motivated capitalists (operators) will frustrate the aims of the government through illegal dealings.

Aside from this, some aspects of financial liberalization should be given special attention to avoid instability in the system. Specifically, exchange rate policies should be well concieved and carefully implemented. This is because of the role it plays in linking the domestic economy with the world payment system. Any inappropriate foreign

exchange policy may frustrate other financial policies introduced in the system. Also, capital movement policies especially as it affects portfolio investment, should be specially monitored and supervised. This is to avoid the demise which Asian economies are experiencing now. In these economies, they were busy liberalizing the economy without puting in place adequate regulatory measures to avoid the negative effects of portfolio investment inflow into their economies.

In the final analysis, specific policies should be designed aimed at encouraging stock market development in less developed countries so as to achieve sustained and accellerated economic growth in the future.

6.2 CONCLUSION:

The major conclusion that can be drawn from our study is that financial sector reform measures have contributed immensely to stock market development in Nigeria. This presupposes that financial repression is counter productive and should be avoided. Also, our empirical study reveals that stock markets can play a frontline role in achieving sustained and acclerated economic growth in any economy (especially less developed countries) if stock markets are developed, globalised and properly monitored to avoid sharp practices of the operators under a deregulated environment.

6.3 AGENDA FOR FUTURE RESEARCH:

The study has been able to confirm that financial sector reforms has encouraged stock market development in Nigeria and more importantly, stock market has impacted positively on economic growth in Nigeria. However, the structure of this growth cannot be determined from this current study. This should constitute an area of concern for future

research. There is the need for future research to take a closer look at the contributions of each of the sectors of the economy to this percieved growth.

In the growth equation, we only focused on financial factors i.e Estimated Market Capitalization, credit to the private sector and money supply broadly defined (M2). This is not to undermine the important roles which other predictors of growth such as labour force, technological progress, and of course capital stock (capital formation) can play in determining economic growth, but rather the choice was informed by the desire to isolate the impact of financial factors on economic growth. Future research may want to take a look at this area in which case both financial and non-financial factors or predictors of growth will be included in the analysis.

REFERENCES

Agenor, Pierre - Richard (1990), "Stabilization Policies in Developing Countries with a Parallel Market for Foreign Exchange: A Formal Framework", IMF Staff papers, Vol. 37 (September) pp. 560 - 92.

Alile, H. I. and Anao, A. A. (1986), The Nigerian Stock Market in Operation, Nigeria Stock Exchange, Lagos.

Atje, R. and B. Jovanovic (1993), "Stock Markets and Development", European Economic Review, Vol. 37. No. 2/3 (April) pp. 632-40.

Bagehor, W. (1962), Lonbard Street. Homewood, Ill, : Richard D. Irwin.

Balassa, B. A. (1964), Trade Prospects for Developing Countries, Homewood, Ill,Irwin.

Bencivenga, V. R., B. D. Smith, and R. M. Starr (1996), "Equity Markets, Transactions Costs and Capital Accumulation: An Illustration", The World Bank Economic Review, Vol. 10 No. 2 pp. 241-65.

Blinder, A. S. (1987), "Credit Rationing and Effective Supply Failures", Economic Journal, 97, (June) pp. 327-52.

Blommesterin, H. J. (1993), "Financial Sector reform and Monetary Policy in Central and Eastern Europe", in Fair, D. E. and Raymond, R. J. (eds.) The New Europe: Evolving Economic and Financial System in East and West, Kluwer Academic Publisher, Netherlands, pp. 363-89.

Bird, G. (1984), "Balance of payments Policy in Developing Countries", In Tony Killick (ed): The Quest for Economic Stabilization: The IMF and the Third world, Heinemann Educational Books, pp. 85-127.

Bruno, Micheal (1979), "Stabilization and Stagflation in a semi-industrialised economy". In Dornbusch, R. and Frenkel, J. A. (eds): International Economic Policy: Theory and Evidence, Baltimore, John Hopins University Press, Baltimore.

Buckle, M. and J.L. Thompson (1992), The United Kingdom Financial System in Transition- Theory and Practice, Manchester University Press, Oxford, U.K.

Cameron, Rando (1967), Banking in the Early Stages of Industrialization, Oxford University Press, Oxford. pp 1-9.

CBN, (1982), "The Financial Markets in Nigeria", Bullion, Vol. 7, No. 3 (July September) pp. 22-29.

CBN, (1989), Economic and Financial Review, Vol. 28, No. 1, Lagos, p. 28.

_____, (1990), "Structural Adjustment and the Role of the Central Bank: The NigerianExperience and Future Directions: Economic and Financial Review, Vol. 28, No. 1 (March).

_____, (1992), "The Role of Regulatory Bodies in Capital Market Development: The Nigerian Experience, " Bullion, Vol. 16, No. 4., Oct/Dec.

_____, (1992), "Monetary Policy in Nigeria in the 1980s And Prospects in the 1990s", Economic and Financial Review, Vol. 30, No. 1 (March).

_____, (1993), "The Nigerian macroeconomic Environment and Development of the Capital Market:, Bullion, Vol. 17, No. 3 July/September.

Chapple, S. (1990), "A Sequence of Errors? Some Notes on the Sequence of Liberalization in Developing Countries", UNCTAD Discussion papers, No. 31.

Cho, Y. J. (1986), "The Effects of Financial Liberalization on the Development of the Financial Markets and the Allocation of Credits to Corporate Sectors: the korean Case", Discussion Paper, Development Research Department, Economics and Research Staff, World Bank.

Chow, G. C. (1960), "Test of Equality Between Sets of Coefficients in two Linear Regressions", Econometrica Vol. 28, pp. 591-605.

Corbo, V. (1985), "Reforms and Macroeconomic Adjustments in Chile during 1974 - 84, "World Development, 13(8), August.

Corrigan, E. G. (1987), "Financial Restructuring An Overview" in Wyoming, J. H. (ed.) Restructuring The Financial System, Federal Reserve Bank of Kansas City pp. 207-14.

Cottani, J. and D. Cavallo (1993), "Financial Reform and Liberalization", in Policy making in the open Economy, Concepts and Studies in Economic Performance; Rudiger Dornbusch (ed), EDI series in Economic Development.

Crockett, Andrew D. (1981), "Stabilization Policies in Developing Countries: Some Policy Considerations", IMF Staff Papers, 28(1), March, pp. 54-79.

De Gregorio, J. and P. E. Guidotti (1995), "Financial Development and Economic Growth" World Development, Vol. 23, No. 3 pp. 433-48.

de Melo, J. and J. Tybout (1986), "The Effects of Financial Liberalization on Savings and Investment in Uruguay". Economic Development and Cultural Change, 24(3).

Dembinski, P. and Schoenenberger, A. (1993), Financial Markets: Impossible Mission?, The Foundation Pour le progres de l'Homme (FPH), Sept.

Devereux, M. B. and G. W. Smith (1994), "International Risk Sharing and Economic Growth, International Economic Review, Vol. 35, No. 4 (Aug.) pp. 535-50.

Diamond, D. W and R. E. Verrecchia (1982) "Optimum Managerial Contracts and Equilibrium Security Prices". Journal of Finance, Vol. 37 (May) pp. 275-87.

Diaz - Alejandro, Carlos (1985), "Good-Bye Financial Repression, Hello Financial Crash", Journal of Development Economics, 19(1-2) Sept/Oct. pp. 1-24.

Dornbusch, R. (1985), Special Exchange Rates for Capital Account Transactions, Working Paper 1659, Cambridge, Mass: National Bureau of Economic Research.

Dornbusch, R. and A. Reynoso (1993), "Financial Factors in Economic Development", In R. Dornbusch (ed.) Policy Making in the Open Economy: Concept and Case Studies in Economic Performance, Oxford University Press.

Dornbusch, R. and S. Fischer (1984), Macroeconomics, Third Edition, McGraw Hill, New York.

Dougal, H. E. (1965), Capital Markets and Institutions, Prentice-Hall, Inc. New Jersey, pp. 10-45.

Eastmand B. D. (1984), Interpreting Mathematical Economics and Econometrics, Macmillan, London, pp. 59-106.

Edwards S. (1987), "Sequencing Economics liberalization in Developing Countries, Finance and Development, (March).

Elbadaw, I G. D. and G. Uwujaren (1994) Why Structural and Adjustment has not Succeeded in Sub-Saharan African. Policy Research Working Papers, WPS 1000, World Bank.

Erunza, V. and E. Losq (1985a) "The Behaviour of Stock Prices on LDC Markets", Journal of Banking and Finance, Vol. 9. pp. 561-75.

Fair, D. E. and R. J. Raymond (1992), The New Europe: Evolving Economic and Financial System in East and West, Kluwer Academic Publisher, Netherlands, pp. 1-20.

Falegan, S. B. (1987), Redesigning Nigeria's Financial System: A Study of Nigeria at Financial Cross - road in applied fiannncial Intermediation, University Press Limited, Ibadan, Nigeria.

Fernandez, R. B. (1985), "The Expectations Management Approach to Stabilization in Argentina during 1975-82", World Development, Vol. 13. No. 8. pp. 871-92.

_____, (1983), "La Crisis Financieva Argentina: 1980-1982", Desarrollo Economico, Vol. 89. pp. 79-97

Freedman, C. (1987), "Financial Restructuring: The Canadian Experience', in Wyoming, J. H. (ed.) Restructuring the Financial System. Federal Reserve Bank of Kansas City, pp. 63-79.

Frenkel, J. (1982), "The Order of Economic Liberalization: A Comment", in K. Brunner and A. Meltzer (eds) Economic Policy in a World of Change, Amsterdam, North Holland.

Friend, irwin (1963), "Determinants of the Volume and Consumption of Saving with special reference to the influence of Monetary Policy" in Impacts of Monetary Policy Commission on Money and Credit. Englewood Cliffs, N.J. Prentice Hall. pp 671-73.

Fry, Maxwell J. (1982b), "Model of Financial Repressed Developing Economics", World Development, 10(9), Sept. pp. 731-750.

_____, (1988), Money, Interest, and Banking in Economic Development, The Johns Hopkins University Press, Baltimore.

Gadziala, Marry Ann (1993), "Globalization of Securities Markets and Comprehensive Financial Services Reform in the United States", in Mikdashi, Z. (ed.), Financial Strategies and Public Policies: Banking, Insurance and Industry, the Macmillan Press Ltd. pp. 72-9.

Gertler, M. (1988), "Financial Structure and aggregate Economic activity", Journal of Money, Credit and Banking, part 2, (August) pp. 559-88.

Gertler, M. (1993), "Commentary on Financial Intermediation and Economic Development", In C. Mayer and X. Vives (eds) Capital Markets and Financial Intermediation, Cambridge University Press, N. Y.

Goldsmith, R. (1969), Financial Structure and Development, New Haven, Conn. Yale University Press.

Good hart, C. E. A. (1975), Money, Information and Uncertainty, the Macmillan Press LTD. London.

Greenwald, B., Stiglitz, J. E. and Weiss, A. (1984), "Informational Imperfections in the Capital Market and Macro-economic Fluctuations", American Economic Review, 74, (May), pp. 194-200.

Gurley, J. G. and E. Shaw (1955), "Financial aspects of Economic development", American Economic Review, 45, September, 515-38.

Handler, H. and Steinherr, A. (1993), "Capital needs and Investment Financing in Eastern Countries", In Fair, D. E. and Raymond, R. J. (ed.), The New Europe: Evolving Economic and Financial System in East and West, Kluwer Academic Publishers, Netherlands, pp. 363-89.

Hang - Sheng Cheng (1980), "Financial Deepening in Pacific Basin Countries", Federal Reserve Bank of San-Fransisco Economic Review, Summer, pp. 43-56.

Hans - Jorg Rudloff (1993), "International Capital Market Evolution and Prospects", In Mikdeshi, Z. (ed), Financial Strategies and Public Policies pp. 157-162.

Hansen, J. A. and de Melo, J. (1985), "External Shocks, Financial Reforms, and Stabilization Attempts in Uruguay during 1974-83, World Development, (1398), August, pp. 917-939.

Hellman, T. K. M. and J. Stiglitz (1994), Financial Restraint: Towards a New Paradigm, Preliminary Draft of a World Bank EDI Workshop.

Hess, I. D. (1984), "Imperfect Information and Credit Rationing: Comment", Quarterly Journal of Economics, 99, (November), pp. 865-68.

Horsch, H. (1989a), "Securities Market Development in Korea", EDI Working paper series, Finance Industry and Energy Division. The World Bank.

Horsch, H. (1989b), Policies for Developing Financial Markets, EDI working papers: Economic Development Institute of the World Bank.

IFC, (1988), The Development of Capital Markets, Capital Markets Department, Washington, D. C. IFC, March.

____, (1989) Purposes, Issues, and Approaches in Capital Market Development, Working Draft, Washington, D.C. IFC, Capital Market Department. October.

Jhingan, M. L. (1986), The Economic of Development and Planning, 25th Revised Edition, Konark Publisher, PVT LTD, pp. 319-33.

Ikhide, S. (1997), Financial Sector Reform and the Growth of Capital Market in Nigeria, IDE, V.R.F. Series No. 291 (Feb.).

Ikhide, S. and A. Alawode (1993), "Impact of Stabilization programmes on the Growth of the Money Market in Nigeria", The Developing Economics, Vol. 31, No. 2 (June).

_____, (1994), "Financial Sector Reforms, Macroeconomic Instability and the Order of Economic Liberalization; The Evidence from Nigeria", African Economic Research Consortium, Nairobi, Final Project Report (Dec.).

Ikhide, S. I. (1993), "Financial Liberalization and the Inflationary Developing: Is There a Link in Adjusting Developing Countries? "International Review of Economics and Business, Vol. XL, N.2 - February.

Ikhide, S. I. (1995), "Financial Liberalization and the Growth of the Capital Market in Nigeria", Final Report of a research project submitted to the Institute of Developing Economies, Tokyo, Japan, (September Chapters 1, 3 and 4.

Jensen, M. C. and K. J. Murphy (1990), "Performance Pay and Top-Management Incentives', Journal of Political Economy, Vol. 98. (April) pp. 225-64.

Kapur, B. K. (1976), "Alternative Stabilization Policies for Less Developing Countries", Journal of Political Economy, August.

Keller, Peter (1980), "Implications of Credit Policies for Output and the balance of payments, IMF Staff papers, 27(3), Sept.

Khan, M. S. and V. Sundararajan (1992), "Financial Sector Reforms and Monetary Policy" In Structural Adjustment and Macroeconomic Policy Issues: Moderator: V.A. Jarfarey, IMF, Pakistan Adm. Staff College, Washington.

Khan, M. S. and Knight, M.D. (1982), "Some Theoretical and Empirical Issues relating to economic stabilization in developing countries," World Development, (Sept).

Killick, T. and Sharpley J. (1984), "Extent, Causes and Consequences of Disequilibria in Developing Countries", in Tony Killick (ed), The Quest for Economic Stabilization: The IMF and the Third World. pp. 15-54.

Kindleberger, C. P. (1958), Economic Development, McGraw-Hill, New York, pp. 190-195.

_____, (1993), "Financial Intermediation and Economic development" in C. Mayer and Z. Vives (ed.) Capital Markets and Financial Intermediation, Cambridge University Press Ltd.

King, R. G. and R. Levine (1993a), "Financial, Entrepreneurship, and Growth: Theory and Evidence." Journal of Monetary Economics, Vol. 32, No. 3 (Dec.) pp. 513-42.

_____, (1993b), "Finance and Growth: Schumpeter Might Be Right", Quarterly Journal of Economics, Vol. 108, No.3 (Aug.) pp. 717-38.

Kinsela, R. (1992), New issues in Financial Services, Blackwell Publisher, Oxford. U.K. Chapter 1.

Kmenta, J. (1971) Elements of Econometrics, Macmillan Press, New York p..583.

Koutsoyiannis, A. (1977) Theory of Econometrics, 2nd Edition, Macmillan Press Limited, pp. 101-104.

Krueger, A. (1974), 'The Political Economics of the Rent-Seeking Society", American Economic Review, Vol. 64 No. 3.

Kuznets, Simon (1958), "Capital Formation and Economic Growth: A conference of the Universities", Princeton University Press Princeton, pp. 1-21.

Laffont, J. and J. Tirole (1988), "Repeated Auctions of Incentive Contracts, Investment, and Bidding Parity with an Application to Takeowners", RAND Journal of Economics, Vol. 19 (Winter) pp. 516-37.

Lanyi A. and R. Saracoglu (1983), "Interest rate Policies in Developing Countries", IMF Occasional Paper 22, Washington, D.C. IMF.

Leff, N. H. and Sato, K. (1980), "Macroeconomic adjustment in developing countries: Instability, Short - run growth, and external dependency", Review of Economics and Statistics, Vol. 24, No. 63 (May).

Leland, H. E. and D. H. Pyle (1977), "Information Asymmetries, Financial Structure, and Financial Intermediation, Journal of Finance, (May). pp. 371-87.

Levine, R. (1991), "Stock Market, Growth and Tax Policy", Journal of Finance. Vol. 46, NO.4 (Sept.) pp. 1445-65.

Levine, R. and S. Zervos (1996), 'Stock Markets Development and Long-Run Growth" The World Bank Economic Review, Vol. 10. No. 2. (May) pp. 323-40.

Llewellyn, D. T. (1993) 'Secular Pressures on banking in developed Financial System: Is traditional banking an Industry in Secular Decline?' in Fair, D.E. and R.J. Raymond (ed.), The new Europe: Evolving Economic and Financial System in East and West. Kluwer Academics Publication, Netherlands. pp. 169-92.

Long, M. (1984), "A Note On Financial Theory and Economic Development' in D. Adams, G. Douglas and Von Pischke (eds.) Understanding Rural Development with Cheap Credit, West View Press.

Lucas, R. E. (1988), "On the Mechanics of Economic Development", Journal of Monetary Economics, Vol. 22, No. 1 (July). pp. 3-42.

Manuel, Guitian (1993), "From the plan to the Market: banking an Financial Reform aspects", in Fair, D. E. and R. J. Raymond (ed), The New Europe: Evolving Economic and Financial Systems in East and West. Kluwer Academics Publishers, Netherlands.

Mattesini, F. (1993), Financial Markets, Asymmetric Information and Macroeconomic Equilibrium, Dartmouth Publishing Company LTD, U.S.A. Chapters, 1, 2 and 3.

Mathieson, D. J. (1979), "Financial Reform and Capital Flight in a Developing Economy", IMF Staff paper, Vol. 26. No. 3 (Sept).

_____, D. J. (1980a), "Financial Reforms and Stabilization Policy in a Developing Economy, Journal of Development Economics, 7(3) Sept. pp. 359-359.

Mayer, C. (1988), "New Issues in Corporate Finance", European Economic Review, Vol. 32 pp. 1167-88.

Mayer, S. C. and Vives, X. (1993), Capital Markets and Financial Intermediation, Cambridge University Press, U. K. pp. 150-60.

Mayers, S. C. and N. S. Mayluf, (1984), "Corporate Financing and Investment Decision When Inventory Have Information that Investors Do Not Have", Journal of Financial Economics, Vol. 13, No. 2. (June) pp. 187-221.

Mckinnon, Ronald, I. (1973), Money and Capital in Economic Development (Washington, D. C.), Brookings Institutions).

_____, (ed) (1976), Money and Finance in Economic Growth and Development: Essays in Honour of Edwards S. Shaw (New York: Mancel Dekker).

Meier, G. M. (1961) Leading Issues in Economic Development, New York, Oxford University Press.

Mikdashi, Z. (1993), Financial Strategies and Public Policies - Banking, Insurance and Industry, The Macmillan LTD. U.K.

Modigliani, F. and Miller, M. H. (1958), "The Cost of Capital, Corporation Finance and the Theory of Investment," American Eocnomic Review, (June) pp. 261-97.

Montiel, P. J. (1995), Financial Policies and Economic Growth: Theory, Evidence and Country - Specific Experiences from Sub-Saharan Africa. AERC Special Paper Eighteen, Kenya.

Montiel, P. J., Agenor, P. R. and U.I. Haque N. (1993), Informal Financial Markets in Developing Countries; A Macroeconomic Analysis, Blackwell, Oxford U.K, pp. 1-44.

Morris, Felipe (1985), "India's Financial System: An Overview of its principal structural features", (Washington, D.C., World Bank Staff Working paper, No. 739).

Myers, Margaret G. (1970), A Financial History of the United States, Columbia University Press, New York.

Nwankwo, G. O. (1991), Money and Capital Market in Nigeria Today, University press, Nigeria.

Obstfeld, M. (1994), "Risk - taking, Global Diversification, and Growth", American Economic Review, Vol. 84. No. 5. (Dec.) pp. 1310-29.

Ojo, M.O. (1993), "A Review and Appraisal of Nigeria's Experience with Financial Sector Reforms" Central Bank of Nigeria Research Department , Occasional paper No. 8 (August).

Ojo, O. O. (1984), "Financial Intermediation and Growth", Inaugural Lecture Series 68, University of Ife press, University of Ife, Nigeria.

Oyindo, B. (1986), "Promoting Money Market Development in Nigeria", CBN, Economic and Financial Review, Vol. 28, No. 2 (June).

Partington, (1989) Applied Economics in Banking and Finance, Oxford University Press, Fourth Edition, Chapters 1 & 2.

Patrick, H. T. (1966), "Financial Development and Economic Growth in Under-developed Countries," Economic Development and Cultural Change, Vol. 14, No. 2 (January).

Pindyck, R. S. and D. L. Rubinfeld (1976), Econometric Models and Economic Forecasts, McGraw Hill, 2nd Edition.

Pinto, B. (1989), "Black Market Premia, Exchange Rate Unification and Inflation in Sub-Saharan Africa", World Bank Economic Review, Vol. 3 (September) pp. 321-38.

_____, (1991), "Black Markets For Foreign Exchange, Real Exchange Rates, and Inflation, "Journal of International Economics, Vol. 30 (January) pp. 121-35.

Popiel, P. (1985) Development of Money of Capital Market, EDI working paper series, Finance, Industry and Energy Division, EDI, World Bank.

_____, (1991), "Developing Financial Market in Sub-saharan Africa," in Popiel, P. (ed), Financial System and Development in Africa, EDI Series, World Bank, pp. 201-224.

Roberts, S. M. (1987), "Commentary on Proposals for Financial Restructuring in Wyoming J. H. (ed.) Restructuring The Financial System. Federal Reserve Bank of Kansas City, pp. 193-205.

Roubini, N. (1993), "Commentary of Financial Intermediation and Economic Development" In C. Mayer and X. Vives (eds.) Capital Markets and Financial intermediation, Cambridge University Press, N. Y.

Rozental, A. A. (1970), Finance and Development in Thailand, Preager Publisher, Inc. U.S.A Chapters, 1, 3 and 8.

Saint - Paul, G. (1992), "Technological Choice, Financial Markets and Economic Development", European Economic Review, Vol. 36. No. 4 (May) pp. 763-81.

Santomero, A. (1984), "Modeling the Banking Firm", Journal of Money, Credit and Banking, Vol. 16, No. 4, (November).

Sarmiento, E. (1988), "The Failure of the Capital Market: A Latin American View". in Urrutia, M. (ed.) Financial Liberalization and the Internal Structure of Capital Markets, The United Nations University, pp. 82-109.

Scharfstein, D. (1988), "The Disciplinary Role of Takeovers", Review of Economic Studies, Vol. 55 (April) pp 185 - 99.

Schumpeter, J. A. (1932) The Theory of Economic Development. Translated by Redvers Opie. Harvard University Press, Cambridge.

Schydlowsky, D. M. (1979), Containing the cost of stabilization in semi Industrialized LDCs - a Marshallian Approach, Boston University Centre for Latin American Studies, Discussion paper series No. 32, (Dec.).

Sharpley, J. (1984), "The Potential of Domestic Stabilization Measures in Developing Countries", In Tony Killicks (ed): The Quest for Economic Stabilization: The IMF and the Third World, pp. 55-85.

Shaw, Edwards (1973), Financial Development in Economic Development (New York Oxford University Press).

Silber, W. M. L. (1983), "The Process of Financial Innovation, AER, Vol. 73, No. 2 (May).

Smith, L and N. Spooner (1992), "The Sequence of Structural Adjustment Policy Instruments in the Agricultural Sector", In Chris Milner and A. Rayner (eds.); Policy Instruments in Africa, Macmillan, London.

Stein, H. and P. Lewis (1996), "Banking deregulation in Nigeria: The Genesis of a Financial Black Hole." Paper Presented on the seventeenth International Conference on Socio-Economics, Washington, D. C: (April).

Stern, N. (1989), "The Economics of Development: A Survey" Economics Journal, Vol. 99, No. 3, (Sept.) pp. 685.

Stiglitz, I. E. (1993), "The Role of the State in Financial Markets, Proceedings of the World Bank, Annual Conference, On Development Economics, 1993, pp. 19-52.

Suzuki, Y. (1987), "Financial Restructuring: The Japanese Experience", In Wyoming, J H. (ed.) Restructuring the Financial System. Federal Reserve Bank of Kansa City, pp. 103-119.

Tobin, J. (1965), "Money and Economic Growth" Econometrica, Vol. 33, No.4 (Oct.).

_____, (1987), "The Case for Preserving Regulatory Distinctions", Federal Reserve Bank of Kansas City. pp. 167-83.

Tunwai, U. and Patrick, H. T. (1973), "Stock and Bound issues and Capital Markets in Less Developed Countries", IMF Staff paper, 20(2). July pp. 283-284.

Van Horne, J. (1985), 'Of Financial Innovation and Excesses", Journal of Finance, (July) pp. 621-31.

_____, (1978), Financial Market Rates and Flows, Prentice - Hall, Inc. London. Verstuysen, E. (1988), "Financial Deregulation and the Globalization of Capital Markets", PPR Working papers WPS 40, World Bank.

Villanueva, D. and Mirakhor, A. (1990), "Strategies for Financial Reforms" IMF papers, Vol. 37. Sept.

Wong, G. H. (1977), "Demand for Money in Developing countries:, Journal of Monetary Economics pp. 59-86.

Wonnacott, R. J. and Wonnacott, T. H. (1979), Econometrics, John Wiley & Sons, New York.

World Bank, (1981), World Development Report 1981, New York: Oxford University Press for the World Bank, August.

_____, (1989), "Financial System and Development", World Development Report 1989, Oxford University Press, for the World Bank.