

Relationship between the Capital Markets and Economic Growth in Nigeria

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Abstract: *This paper examines the role of the capital market in stimulating economic growth and development. Financial sector stability and economic prosperity are inseparable variables in all economies across the world. The Nigeria capital market is performing well compared to some capital markets within the continent.*

Keywords: *Credit Availability, Investments, Economic Growth*

Background to the Study

The capital market is a subset of the financial system that is involved in the provision of long-term funds for productive use. The capital market drives any economy's economic growth and development because it is necessary for long term growth capital formation (Osaze, 2000) but evidences from past studies have revealed a growing concern and controversies on the role of the capital markets on economic growth and development. While some (Atje & Jovanovic, 1993; Demirguc-Kunt & Levine, 1996; Levine & Zervos, 1996) supported a positive link, some 497

others (Harris, 1997; Levine & Zervos, 1998; Ariyo & Adelegan, 2005; Ewah, Esang & Basse, 2009; Donwa & Odia, 2010) do not find any empirical evidence to support such conclusion. Nyong (1997) found a negative link but Sudharshan and Rakesh (2011) saw, instead, economic growth playing a role in stock market development.

The neoclassical growth model made three important predictions:

1. Increasing capital relative to labour creates economic growth, because people can be more productive given more capital.
2. Poor countries with less capital per person will grow faster because each investment in capital will produce a higher return than rich countries with ample capital.
3. As a result of diminishing return to capital, an economy will eventually reach a point at which any increase in capital will no longer create economic growth. However, it can overcome this steady state and grow by investing on new technology

Solow (1956) explains that if there were no technological progress, then the effects of diminishing returns would finally cause economic growth to die down, however, economies that achieve large increases in output over extended periods of time, not only enable rapid increases in standards of living, but also have serious changes in their economic, political and social landscape. Therefore, for a country to attain a sustainable economic growth and development, it requires both local and foreign capitals made available by the opportunities provided by the capital market (Ekundayo, 2002). However, non-availability of long-term funds for investment

financing has constituted a barrier to the development and growth of most African countries, particularly in many developing countries such as Nigeria, wherein capital has become a major constraint to economic development.

Despite the significant financial reforms experienced in the financial sector over the years, there has been an underdevelopment of the real sector as a result of lack of funds from the financial sector (Oluwole, 2014). The Nigeria capital market has grown to being capable of providing facilities both to the private and public sectors to raise long term capital used in executing development programmes as well as finance the expansion and modernization of projects. However, how these reforms have influenced economic growth over the years still remains unexplored by previous studies. Any economy that is financially underdeveloped is usually characterized by under-employment of resources. Zuvekas (1978) puts it that development is a progress towards the reduction of the incidence of poverty, unemployment and income inequalities (cited in Oluwole, 2014, p.232) but these incidences are still evident in the Nigerian economy.

LITERATURE REVIEW

There has been considerable interest in the development of capital markets in many developing countries in the last twenty years or so. In a study on emerging stock markets performance and economic growth in Iran, Seyyed (2010) presented a systematic investigation of the relationship between the two variables within the Vector Autoregressive (VAR) model and deduced that macroeconomic activity was a main cause for the movement of stock prices in the long run and that the stock market plays a role as a leading economic indicator of future economic growth in the short run. Relative to Nigeria, Atoyebi, Ishola, Kadiri, Adekunjo and Ogundeji (2013) study the impact of the capital market on economic growth using annual data of 1981 to 2010. Employing the Ordinary Least Square test and Vector Auto Regression technique, a percentage increase in the market index and market capitalization was found to bring about respectively, an average of 33.7% and 44.8% increase in real GDP. Kolapo and Adaramola (2012), applying Johansen co-integration and Granger causality tests, also examined the impact of the Nigerian capital market on its economic growth but from 1990 to 2010. Results show that a long-run relationship exists between capital market (measured by market capitalization, total new issues, value of transactions, and total listed equities and government stocks) and economic growth (proxy by GDP) in Nigeria. The evidences from these studies reveal that the activities of the capital market tend to impact positively on the Nigerian economy. Similarly, Abu (2009) utilized the error correction approach to examine whether stock market development increases economic growth in Nigeria and it was found to be true. However, Donwa and Odia (2010) empirically analyzed the impact of the Nigeria's capital market on her socio-economic development from the period of 1981 to 2008 and it was discovered that capital market indices (market capitalization, total new issues, volume of transactions, total listed equities and government stock) have no significant impact on socio-economic growth.

To a great extent, the positive relationship between capital market activities and real economic growth has long been affirmed in previous empirical studies but in country-specific studies, the structural variations among economies may not have been adequately accounted for. Success in capital accumulation and mobilization for economic growth and development varies among nations and is largely dependent on domestic savings and inflows of foreign capital but

the omission of these core variables that accounts for country-specific differences in the specification of the growth models possibly could have introduced some bias and inconclusiveness in the result of these previous studies. In a bid to fill this gap in the literature, this study incorporates these vital variables in the investigation of both the short-run and long-run relationship between capital market development and economic growth in Nigeria., therefore contributes to the body of existing knowledge by evaluating the contribution of the Nigerian capital market to the growth of its economy but specifically looking at the relationships between capital market development indicators such as deposit mobilization, capital accumulation, labour supply, total listed stock market securities with economic growth in Nigeria. A cocountry-specific study that incorporates the effect of these structural differences that characterize the development of the capital market among economies was provided, as well as the dynamic nature of capital market in developing countries, such as Nigeria where the financial system is still highly undeveloped.

THE NIGERIAN CAPITAL MARKET

The capital market is the complex of institutions and mechanisms through which economic units desirous to invest their surplus fund, interact directly or through financial intermediaries with those who wish to procure funds for their businesses. Okereke (2000) describes the capital market as constituting of market and institutions that facilitate the issuance and secondary trading of long-term financial instruments. Unlike the money market which represents the short-end of the financial system that provides facilities for claims and obligations with maturity varying from one day to a year, the capital market provides government at all levels an effective way of financing public projects; thus playing a vital role in stimulating industrial as well as economic growth and development.

Assuming the role of the major supplier and user of capital market funds, the government has a lot of pervading influence on the capital market. In Nigerian, the government influences the capital market through the Nigerian Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE). SEC has the primary objective of being in charge of the overall regulation of the entire capital market while NSE supervises the operations of the formal quoted market (as a self-regulatory organization). However, the Nigerian financial markets are experiencing challenges such as poor infrastructural facilities, low level of public awareness as to the benefits derivable from the operation of the capital market, inadequacy of supply of securities, stringent stock exchange listing requirements limiting mostly the smaller companies, illiquid market and unfavorable government policies.

Structure of the Nigerian Capital Market The capital market operations are structured into three broad categories: the primary, secondary and derivatives markets.

The Primary Market: it is responsible for the issue of new shares through the stock exchange or by private placement. Their operations are conducted through the following methods: offer for subscription, offer for sale, right issue, private placing and listing by introduction.

The Secondary Market: also referred to as the stock market, it provides the forum for capital market activities (trading in stock and shares, bonds, debentures and other long-term securities) and is usually accessible to all category of investors – small or big, government institution or

individuals. The major participant in the Nigerian capital market includes development banks, private firms, the treasury and the CBN while the minor ones includes commercial and merchant banks, individuals, states and local governments. This market comprises of the organized stock exchange and the over-the-counter (OTC) market but presently, there is no organized OTC market in Nigeria. Secondary market transactions are carried out by licensed stock brokers on the seven trading floors of the Nigerian Stock Exchange located in Lagos, Kaduna, Benin, Port Harcourt, Kano, Onitsha, Ibadan, Yola, and Abuja.

The Derivatives Market: This is the market that trades, not in the issued securities, but on the right to title on the underlying security or on the basis of the future title to the security. The derivatives market in Nigeria is still in its infancy and the only derivative presently being actively traded on the Nigerian Stock Exchange is right offer issue options.

Nigeria, like many countries, has a formal capital market symbolized by the existence of a stock exchange and an active new issues market. According to Okereke (2000) the Nigerian capital market constituencies can be broadly classified into four categories:

1. Providers of funds (Individuals, Unit Trusts, Pension Trust, Insurance Companies)
2. Users of funds (Companies, Government at all tiers, etc)
3. Intermediaries (Stock broking Firms, Issuing houses, Registrars, Auditing Firms)
4. Regulators (SEC, NSE, CBN)

Similarly, the financial instruments in use can broadly be classified into the following:

1. Equity (Ordinary shares, Preference shares)
2. Debt (Government bonds such as federal, state and local government bonds, Industrial loans/debenture stock and bonds)
3. Derivatives (Options rights, swaps, Futures, etc)

In addition, the NSE has upgraded its stock market towards the internationalization of its operations and one of such development, that has increased the appeal of the Nigerian stock market internationally, is the establishment of the Central Security Clearing System limited (CSCS), which started operations in April 1997. The CSCS operates an automated clearing and settlement system, i.e. the transfers of stock ownership from one shareholder to another and the transfer of sales proceeds from the buying shareholder to the selling shareholder. The transfer of shares is now done on a T + 3 (Trading day + three working days) time frames under the automated CSCS, while transactions are executed on the basis of delivery versus payment.

THE ROLE OF THE CAPITAL MARKET IN ECONOMIC DEVELOPMENT

The capital market is an essential agent for economic growth because of its ability to facilitate and mobilize savings and investment. However economic growth relates to increases over time in a country's real output of goods and services or more appropriately real output per capita (usually measured with GNP/GDP). It has been argued that the yardstick of measuring economic growth, as well as development, is inadequate because the widely accepted national income indicators – GNP, GDP, and NNI tend to be inappropriate due to the differing computation and parameters used. Consequently, it is difficult to make any generalization by comparing the per

capita income figure, as it is a basis for classifying a country as developed or underdeveloped may be misleading.

Following the attainment of political independence, developing countries were preoccupied with development strategies. Initially, the development plans focused on the provision of necessary infrastructure with a view to ensuring a smooth industrial take-off in the respective countries. However, McKinnon (1973) argued that developing countries may achieve better economic development via a viable financial system rather than through inefficient and counterproductive state invention. Accordingly, he concluded that a vigorous capital market, centered on the monetary system, can be a more efficient engine of economic development. A financial system provides an intermediation mechanism for transferring savings from savers to investors for capital accumulation through a network of institutions known as financial intermediaries or institutions. These institutions serve as catalysts for economic growth and development by way of mobilizing savings, from the surplus sector for economic progress. The characteristic difference between the financial institutions and capital markets lies in the premise that the latter unlike the former cannot create additional financial assets or liabilities apart from what is supplied to it by the savers and investors. The capital market provides an avenue for the sale and purchase of new financial assets or instruments, as well as an exchange floor for 'second-hand' securities.

Methodology and Methods

Model Specification

The notion of growth as increased stocks of capital goods (means of production) involved a series of equations which showed the relationship between labour-time, capital goods, output, and investment. Therefore, economic growth (measured by real gross domestic product) is estimated as a function of savings by deposit mobilization, capital accumulation, labour supply, total listed stock market securities and the contribution of the stock market. These were measured respectively by deposit money banks, gross fixed capital formation, active labor force participation, total listed assets and stock market capitalization.

$$RGDP = f(MCAP, SAV, GFCF, LABF, TLA) \dots\dots\dots (1)$$

Where:

RGDP = Real Gross Domestic Product at constant factor cost

MCAP = Stock Market Capitalization SAV = Savings Accumulation

GFCF = Gross Fixed Capital Formation LABF = Labour Force

TLA = Total Listed Securities

Given that equation (1) is a non-linear, its logarithmic form is indicated below

$$\begin{aligned} \text{Log}(RGDP) = & a_0 + a_1 * \text{log}(MCAP) + a_2 * \text{Log}(SAV) + \\ & a_3 * \text{Log}(GFCF) + a_4 * \text{log}(LABF) + a_5 * \text{log}(TLA) + U_t \end{aligned}$$

-----(2)

Where

a_i are the parameters to be estimated ($i = 0, 1, 2, 3,$

4, 5)

U_t is the error term, assumed to be normally distributed with the zero mean and constant variance.

Source of Data

Secondary data was collected on each of the above-stated variables, covering the period from 1981 to 2014. The choice of this period is to make room for broad coverage of the capital market indicators, as well as the investigation of both the short run and long-run relationship between capital market development and economic growth in Nigeria. These annual data series were collected majorly from the CBN Statistical Bulletin of 2014, the CBN Annual Report and Statement of Accounts (various issues), NSE books, and SEC Market Bulletins.

In order to ensure variables used in this study are not spurious, the stationarity of variables was initially tested using the Phillip Perron (PP) test. This was followed with a co-integration test after the stationarity of variables have been established. The estimation technique used, drawn from developments in the co-integration theory, is the Vector Error Correction Mechanism (VECM). Granger and Newbold (1974) and Engle & Granger (1987) have proved that co-integration is a sufficient condition for an ECM formulation. The estimation was done with the aid of the E-views 7.0.

EMPIRICAL ANALYSIS AND RESULTS

Variables	1 st Difference		Levels	
	PP-Statistic	Critical Value at 5%	PP-Statistic	Critical Value at 5%
LRGDP	-5.394077*	-2.957110	-0.183246	-2.954021
LMCAP	-4.395043*	-2.957110	0.056414	-2.954021
LSAV	-4.136575*	-2.957110	0.417036	-2.954021
LGFCF	-5.247791*	-2.957110	1.880315	-2.954021
LLABFP	-3.399938**	-2.957110	-1.570106	-2.954021
LTLA	-4.901126*	-2.957110	-0.329174	-2.954021

* Stationary at 1% significance level

** Stationary at 5% significance level

Source: Author’s Compilation from E-views 7.0

A variable is stationary when PP value is greater than the critical value. In table 1 above, the test statistics for the log levels of real gross domestic product, market capitalization, saving deposit, gross fixed capital formation, labour force participation rate, and total listed assets indicate that these variables are statistically insignificant.

Table 2: Unrestricted Co-integration Rank test

Hypothesized No. of CE(s)	Eigen Value	Trace Statistics	0.05 Critical Value	Prob.**	Hypothesized No. of CE(s)	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.787811	143.0374	117.7082	0.0005	None *	49.60885	44.49720	0.0128
At most 1 *	0.664050	93.42852	88.80380	0.0222	At most 1	34.90534	38.33101	0.1175
At most 2	0.605809	58.52318	63.87610	0.1299	At most 2	29.78946	32.11832	0.0937
At most 3	0.317318	28.73372	42.91525	0.5780	At most 3	12.21526	25.82321	0.8591
At most 4	0.284519	16.51847	25.87211	0.4516	At most 4	10.71359	19.38704	0.5431
At most 5	0.165900	5.804872	12.51798	0.4855	At most 5	5.804872	12.51798	0.4855

Source: Author’s Compilation from E-views 7.0

The test for the co-integration relationship was verified using Johansen co-integration. In determining whether there is co-integration or not among the variables included in the growth model, the maximum Eigenvalue and trace statistics are compared with their corresponding critical values. An Eigenvalue or trace statistics greater than the critical value indicates a co-integrated series and the identification of the presence of at least one co-integrated equation signifies that there is a long-run equilibrium relationship among the variables. In other words, Granger causality exists among the variables in at least one way (Engle & Granger, 1987). A detailed analysis of the co-integration result in table 2 above indicates the maximum Eigenvalues of 49.60885 and trace statistics of 143.0374 and 93.42852; suggesting the existence of a co-integrating equation at a 1 percent significance level for the maximum Eigenvalues and trace statistics respectively. This further reveals the existence of a long-run equilibrium relationship among the variables captured in the economic growth model.

ERROR CORRECTION MODEL

The Vector Error Correction Model was employed to determine the error correction mechanism in the co-integration relationship, as well as to test for long and short-run causality among co-integrated variables. The error correction process within the system is obtained by the mean of the Error Correction Term (ECT).

Table 3: LONG RUN COEFFICIENT ESTIMATES

Normalized co-integrating coefficients (Standard error in parenthesis)					
LRGDP	LMCAP	LSAV(-1)	LGFCF(-1)	LLABFP	LTLA
C	0.451389	0.503318	0.329890	-47.39522	-2.023221
202.0478	(0.17367) [2.59911]	(0.16150) [3.11643]	(0.04368) [7.55298]	(3.05476) [-15.5152]	(0.31337) [-6.45643]

Note: Standard error and t-statistics are stated in parenthesis () and [] respectively

Source: Author’s Compilation from E-views 7.0

Table 4: Vector Error Correction Estimates

Variable	D(LRGDP1)	D(LMCAP(1))	D(LSAV)	D(LGFCF)	D(LLABFP(1))	D(LTLA(1))
ECM (-1)	-0.524164	-0.266008	0.023304	-0.741225	0.013039	0.162446
Standard Error	0.17685	0.33865	0.13312	0.62581	0.00594	0.23285
t-Statistic	-2.96394	-0.78549	0.17506	-1.18443	2.19627	0.69765

Source: Author’s Compilation from E-views 7.0

Table 3 shows the result of the normalized cointegration coefficients of the variables for the case of a cointegrated equation with respect to the standard error and t-statistic result associated with each variable. The value of the t-statistic is used to indicate the significance or otherwise of the independent variable in the long run. Generally using the rule of thumb, if the t-Statistics is 2 or greater than two, the variable is considered to be significant but if otherwise, it is insignificant.

Thus the result of the normalized co integrated relationship reveals a significant relationship between market capitalization, savings deposit, gross fixed capital formation, labour force, total listed asset and real economic growth in Nigeria. A significant relationship between market capitalization and economic growth was found at 5 percent level of significance and furthermore reveals that, a percentage change in market capitalization results to a corresponding 0.451 percent change in real GDP holding other variables at a constant. The elasticity estimate reveals that the degree of responsiveness of economic growth to the change per time in marketcapitalization is less than one and therefore inelastic. This shows that market capitalization plays a significant role in economic growth in Nigeria.

Similarly, saving deposit mobilization with deposit money banks was found to have asignificant long run relationship with economic growth at 5 percent level of significance. A percentage change in savings deposit indicates 0.503 percentage change in real economic growth. The above evidence further implies that the degree of the responsiveness of economic growth to thelagged effects of the variations in savings withNigerian deposit money bank is less than a unit elasticity and thus inelastic. Likewise for capital formation and economic growth; a detailed analysis of the cumulative effect of capitalformation shows that the variations in previous year capital accumulation still accounted for significant changes in economic growth in thecurrent period over the period under consideration. Hence, capital accumulation could be considered a significant determinant of the variations in economic growth within this period. A significant relationship was also seen betweenactive labour force and economic growth, with apercentage change in active labour force bringingabout a 47.39 percentage change in economic growth holding other variables at constant. The estimated elasticity suggests a higher elasticity greater than 1, thus the degree of responsiveness of economic growth to the variations in activelabour force is seen to be strongly elastic. However, labour force participation rate apparently appears to have significantly retarded the growth process within the economy. In the same vein, the results show significant support for the existence of a relationship between total listed assets incapital market and economic growth.

Also, a percentage change in listed assets reveals 2.023 percent change in economic growth. Therefore, the degree of responsiveness of economic growth to total listed market securities is observed to be elastic and statistically significant. However, economically the listed securities appear not to be growth supportive as expected.

In table 4, the result shows that the coefficient of the normalized growth model has the right sign (-) and magnitude (between zero and one) at 5 percent significance level. It is therefore statistically significant. The significance of the error correction model provides further confirmation to the cointegration evidence, giving the impression of a long run movement between economic growth and the explanatory variables. Implying that in the incidence of the presence of external shock resulting to disequilibrium of the system, the model can still converge with time to its normal state with a relatively average speed of adjustment of 52.41 percent per time. growth in Nigeria while that of labor force participation and total listed securities in the market is inverse. This signifies that higher stock market capitalization increases the ability of firms to raise capital in order to increase investment spending and expand production of goods and services and this translates to higher growth rate in the long run. Similarly, increase in savings accumulation will significantly increase the volume of credit availability and further facilitate easy access to funds and investment. Therefore, the higher the physical capital made available for investors, the greater the likelihood of attracting prospective local and international investors that will boost capital investments within the economy. The negative impact of total value traded ratio on economic growth may be due to the difficulties involved in trading shares such as high transaction costs, delay in the issuance of shares certificate to mention just a few and that of labor force participation can be attributed to the high level of low skilled and semi-skilled labor that dominated the informal sector which actually account for a larger proportion of economic activities in Nigeria.

IMPLICATIONS OF THIS ANALYSIS

This study examined the contribution of the capital market to economic growth and it was found to be positive. This suggests that for significant growth to be achieved in an economy, the main focus of policymakers should be on measures to promote growth in the stock market. This is a very pertinent and prerequisite consideration for any economy desiring to increase rapid economic growth.

The findings from this study raise the following policy issues and recommendations. In order to enhance the development of the Nigerian capital market as the engine of economic growth, it is recommended that government should remove impediments to stock market development in the form of tax, legal and regulatory barriers because they are sometimes disincentives to investment.

In order to increase the ease with which investors can purchase and sell shares, thus guaranteeing liquidity on the stock market, the Nigerian Security and Exchange Commission should improve on the trading system.

Given that the stock market operates in a macroeconomic environment, it is therefore necessary that the environment must be an enabling one that will promote and encourage investment opportunities for local and international investors.

To significantly enhance labor force participation, especially in capital market activities, more priority should be accorded to human capital development through more educational funding, scholarship programmes and educational grants. Other programmes such as vocational training and skill acquisition could also be built into the educational system to improve on the quality of the labor force and professionals.

The value of the total traded securities and equities revealed no direct relationship with the economic growth indicator-gross domestic product growth rate. This suggests that companies listed on the Stock Exchange should be mandated to provide timely electronic information on their operations such as quarterly and annual financial statements, in order to enable the market to learn, absorb and act on information quickly leading to market efficiency and precise pricing of securities. With the existence of a positive relationship between stock market development and economic growth, it is pertinent to recommend that there should be a sustained effort to stimulate productivity in both the public and private sectors. The Nigerian government should employ appropriate trade policies that promote the inflow of international capital and foreign investment, so as to enhance the production capacity of the nation.

Capital Market regulators especially the Securities and Exchange Commission should be more open to innovations and be flexible without jeopardizing the interest and protection of investors as well as the efficiency of the market. The Commission needs to encourage more companies to list in the market so as to expand it and give investors better options for investment. Recent experience has shown that the confidence of many shareholders is waning due to the declining fortune of the stock market and many are reluctant to invest in shares and other securities

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