



Global Advanced Research Journal of of Management and Business Studies (ISSN: 2315-5086) Vol. 1(9) pp. 321-326, October, 2012  
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*Full Length Research Paper*

# Capital Market Liberalization and Globalisation: It's Impact on the Nigerian Economic Growth.

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Accepted 01 June 2012

**The paper examines the impact of capital market liberalization and trade openness in relation to the present global meltdown on Nigeria economic growth. The study takes a critical look at the important theoretical measure if capital market liberalization as well as measure of globalization in relation with global meltdown has significant effect on economic growth. A country – specific time series data were used to investigate the impact of capital market liberation and index of globalization on growth. The paper made use of simple linear regression and it was deduced that globalization is good for growth. Liberalization will enhance capital inflow, foreign domestic investment, and hence economic growth in Nigeria. Analysis of other related data indicates that Nigeria's restrictive policies on trade and payment have continued to discourage growth in the net capital flow. The current trend indicates highly restrictive capital movement, and Nigeria is still far from benefiting from trade openness due to its rigidities and protective policies. The Paper suggests that since the regression result indicates significant positive relationship between growth and capital market liberalization, Nigeria should strive to put in place trade policies that will enhance a complete liberalization of the Nigerian capital market.**

**Keywords:** Capital Market, Liberalization, Globalization and Economic Growth.

## INTRODUCTION

The Nigeria economy was characterized by low level of domestic savings, poor technological know-how and low level of foreign exchange earnings which had attendant effect of low level of domestic investment in the era before independence (1950 downward). This low level of domestic investment has its multiplier effects in form of all in the levels of output, income, employment and consumption. And owing to the fact that capital market provides means for investment makes it relevant to combat these problems.

The trade policy proposals of the 2002 Federal Government Budget follow the observed tradition of countries wishing to liberalize its trade regime. This tradition recommends three mechanisms, unilateral or

autonomous reforms, opening of market in the context of reciprocal regional trade agreements, and multilateral trade liberalization through negotiation under the auspices of the World Trade Organization (WTO).

The trade policy proposal includes first, the proposals to continue the general liberalization of the economy. Secondly, is proposal to protect domestic industries? Nigeria's trade liberalization policies appear to have been carried out predominantly within the unilateral or autonomous mechanism. This is evidenced by two major statement of the 2002 budget implying the direction in which liberalization will follow – reduction in the upper limit of the existing tariff regime and further reduction in duties on machinery, spare parts and raw materials. In

effect, these statements suggest that:

1. The range of tariffs will be further compressed; and
2. Average tariff rate for capital goods will be reduced below the then existing 16.1% level.

Central to the capital market liberalization debates is its impact on economic development. As Eichengreen (2001) observes, the case for international financial liberalization is the same as the case for domestic financial liberalization. This question is now put forth by him that: "if domestic financial markets can be counted on to deliver an efficient allocation of resources, why can't international financial markets.

The determination of the overall growth of an economy depends on how efficiently the stock market performs its allocative function of capital. As the stock market mobilizes savings concurrently it allocates a large proportion of it to firms with relatively high prospects as indicated by its rate of returns and level of risk. The importance of this function is that capital resources are channelled by the mechanism of the forces of demand and supply to those firms with relatively high and increasing productivity thus exchange economic expands and growth (ibid).

### Statement of the Problem

It is a well-known fact that results from the study of the impact of capital account liberalization on economic growth have not been clear and conclusive. The inconclusive nature of these results has been attributed to several reasons, including the difficulty of measuring policies of capital accounts liberalization, and the issue of distortions in the foreign capital transaction, as well as exchange rate restrictions, according to Biodun (2008), restrictions on current accounts transactions have negative effects on the ability of foreign direct investor to repatriate interest earnings and other profits thereby reducing the propensity to invest

Distortions in capital movement have been a major characteristic of developing countries. Several studies address the circumstances under which restrictions are prevalent. The most robust regularity in the literature is the negative association between per capita income and controls, where the per capita income is typically interpreted in this context as a measure of economic development. It follows that the more developed the country, the more likely that it would have removed restrictions on capital flows

The paper examines the major theoretical issues on the impact of trade liberalization on economic growth in general, and specifically, capital market liberalization on economic growth in Nigeria in line with the global meltdown. The paper is aimed at making significant contribution to the literature on financial liberalization, global meltdown and its economic impact.

### Literature Review

The review of globalization, capital market and the current global meltdown may look myopic and insufficient if their evolution and how they are conceptualized by both local and foreign scholars are not given cursory outfit. Globalization and global meltdown which had its way into the economic literature of Nigeria as a result of the introduction of Structural Adjustment Programme in 1986 This has generated controversies among various scholars. The ambiguity and vagueness of the concept make every attempt to define them (globalization, and Global meltdown) a subject of intense controversy among the experts.

### Conceptual Framework Of Globalisation: Global Meltdown

The concept of globalization has remained one of the most controversial subjects of our time. In defining the concept, ambiguity arises. Several scholars have reflected its different connotation and ideological applications (Spybee, 1996; Hoogrosveld, 1997; Kiely and Marlet, 1998, Culpeper, 1997; Weat, 2000; Woods, 2000; Mshomba, 2003; Scholte, 2000). Ogundele (2005) viewed globalization as; *the process of international integration of goods, technology, labour, capital, individuals, organization, institutions, that are implementing world wide strategies which link and coordinate their international activities on a global basis.*

Omoleye and Adewumi (2004), define globalization as; *The increasing integration of region and nations into world, mark, the overcoming borders and easing of transaction cost as frontiers barriers are eliminated.*

The above definitions presuppose that globalization motive is on economic resources gain for the actors in the world market. A major aspect of financial intermediation is globalization and internationalization of financial transaction. Improvement in technology brought in internet banking, which today, makes it possible to transfer funds and invest in financial securities within the same economy and internationally within seconds (Ogunseye, 2009)

The global financial and economic crisis was made popular in America in 2008, when the financial institution gave out mortgage loans and advances without collateral to back it up in the face of failure to pay back. This situation continues over time and it make the money in circulation to be too much (ibid)

In the specific case of Nigeria, it has been observed that the capital market is still in the process of being internationalized and integrated into the world capital market. The major challenge of financial liberalization in Nigeria is that of how to institute a regime of supervision that would be efficient, effective, up-to-date, and relevant to the changing complexities of modern banking and

**Table 1.** Flow Of Foreign Private Capital In Nigeria 1980-2008. (#' Million).

Year	Inflow (1)	Outflow (2)	Net flow (1-2) (3)	Annual growth in Net flow (%) (4)	TCF/GDP (%) (5)
1980	786.4	319.4	467.0	-	2.23
1981	584.9	447.1	137.8	-70.49	2.05
1982	2193.6	568.5	1624.9	1079.19	5.36
1983	1673.6	1116.9	556.7	-65.74	4.92
1984	1385.3	850.5	534.8	-3.93	3.55
1985	1423.5	1093.8	329.7	-38.35	3.53
1986	4024	1524.4	2499.6	658.14	7.69
1987	5110.8	4430.8	680.0	-72.80	8.93
1988	6236.7	4891.1	1345.6	97.88	7.880
1989	4692.7	5132.1	-439.4	-132.66	4.42
1990	10450.2	10914.5	-464.3	-5.67	8.29
1991	5610.2	3802.2	1808.0	-489.4	2.94
1992	11730.07	3461.5	8269.2	357.37	23.00
1993	42624.9	9630.5	32994.4	299.00	7.51
1994	7825.5	3918.3	3904.2	88.16	1.29
1995	55999.3	7322.3	48677.0	1145.57	4.43
1996	5672.9	2941.9	2731.0	-94.39	0.32
1997	10004.0	4273.0	5731.0	109.85	0.50
1998	32434.5	8355.6	24078.9	320.15	1.48
1999	4035.5	2256.4	1779.1	-92.61	0.19
2000	16453.6	13106.6	3347.0	-81.06	0.89
2001	4937.0	1560.0	3377.0	-0.90	1.37
2002	8988.5	781.7	8206.8	143.02	6.34
2003	13,531.2	475.1	13056.1	59.02	8.03
2004	20,064.4	155.7	19908.7	52.49	12.43
2005	26,083.7	202.4	25,881.3	30.00	18.41
2006	41,734.0	263.1	41470.8	60.23	26.34
2007	47,241.2	288.1	54783.2	65.12	29.48
2008	51,752.0	412.3	59318.5	69.46	42.46

Source: computed using data from CBN statistical bulletin Vol. 10 No 2, December 2008.

finance (Okonkwo and Afolabi 1998).

It has been suggested that capital market liberalization is more beneficial in more financially developed and strong economic. Quinn (2000) finds scant evidence that capital market liberalization had a positive impact on growth in the poorest countries but some strong positive evidence for middle-income countries, especially those that have characteristics, such as strong financial system, likely to make them attractive to foreign investors.

In an attempt to substantiate the view that countries with strong financial system, effective prudential supervision and quality policies and institutional likely to have positive effects of financial liberalization, Kraay (1998) tested directly the hypothesis that the effects of capital market liberalization depend on the strength of the financial system, the effectiveness of prudential supervision and regulation, and the quality of policy and institution with financial globalization is almost never positive and significant, and it is sometimes significantly negative.

It might suffice to say that the relationship between economic growth and capital market liberalization in face of the present global meltdown is a field of enquiry that

remain in its infancy at least for the developing African countries (Ogunseye, 2009).

The global and financial meltdown have a multiplier effect on Nigeria economy directly and indirectly due to the fact that many Nigerians of affluence acquired properties in America and other developed countries and established their businesses there. A good number of the multinationals which operate in Nigeria have their base in America and the rest of the world, so therefore any upheaval in the American economic and financial system have a multiplier effect in Nigeria financial system (Ogunseye, 2009).

The effect of global meltdown though does not really have much negative effect on Nigeria financial institution and capital market owing to the fact that before the crisis the then governor of central Bank of Nigeria implemented a policy on consolidation of the financial institution from #5billion to #25billion capital base, this makes the financial system a little immune from it (Ibid).

According to Wikipedia (2008), the immediate causes of the present financial crisis stems from "the failure of large financial institutions in the United States. It rapidly evolved into credit crisis, deflation and sharp reduction in

shipping, resulting in a number of European bank failures and decline in stock indexes and large reduction in the market value of equities and commodities worldwide. The situation continues and later turns to currency crisis at the end of October 2008, and investors in the glob transfer their capital resources into stronger currencies.

**Overview Of Capital Movement In Nigeria**

Table 1 below presents a time-series data on the flow of capital in Nigeria for the period of 1980-2006, of major interest is the net flow of capital in Nigeria; the difference between inflow and outflow of capital. The trend shows an irregular flow of capital in Nigeria. The net flow declined in 1981, picked up in 1982, and declined there after until 1986, when it rose to #2,499.6million. The trend can be attributed to economic and political instabilities. On the average, the net capital flow was about #6,912,41million. This average is comparatively low for a country of as high resources endowment as Nigeria.

Using the ratio of total capital flow (TCF) to the Gross Domestic Product (GDP) as proxy for capital market liberalization, table 1 shows an interesting trend. Nigeria has been slow in positive implementation of its capital market liberalization policies. This is reflect in the low average GDP share of total capital flow of barely 5percent for the period under study. It appears that capital market in Nigeria is still very far from been liberalized so as to encourage foreign domestic investments.

**Theoretical Framework And Empirical Methodology.**

**Theoretical Framework**

Many growth literatures emphasize a number of factors that intermediate between capital market liberalization and economic growth. Investment, financial development and the stability of macroeconomic policy among other variables, have been shown to be positively related to an economy’s rate of growth (Levine and Renelt, 1992; Levine, 1997; and Bairo, 1997), these variables create channels through which capital market liberalization can potentially affect economic growth, studying the impact of capital market liberalization policy on these intermediate variables, therefore away of inferring its implication for growth.

Several researchers have attempted to analyze the connections between capital market liberalization policies and domestic investment. Rodrik (2000) relates the investment GDP ratio to IMF’s measure of capital account openness, findings to relationship. Kraay (1998) similarly found no impact on gross domestic investment as a percentage of GDP, using the IMF’s index, the Quinn index, and gross capital inflows and outflows as

alternative measures of financial openness. Kraay considers the possibility that capital market liberalization positively affects investment only in countries where risk-adjusted returns exceed the world average, that is, where liberalization will lead to inflow of capital rather than outflow. Using the average balance on the financial account of the balance of payments as proxy for risk-adjusted returns, Kraay observe a positive impact on investment when this variable is regressed on capital account openness. The regression coefficient, however, differs significantly from zero for only one of kraay’s three measures of capital accounts openness, that is, the actual gross capital inflows and outflows.

Klein and Olivei (1999) found that capital market liberalization stimulates financial depth (measured variously as change in the ratios of liquid liabilities to GDP, claims on the non-financial private sector). But the correlation between capital market liberalization and financial depth has been found limited in less developed countries; the relationship fails when these countries are excluded from the stuffy sample.

It has been noted severally that the impact of capital market liberalization, globalization, and economic growth is indirect (for example, an open capital market encourages financial development, which in turn encourages growth) and contingent on a range of intervening factors. This may explain the difficulties in documenting a direct link between capital market liberalization and economic growth.

**Empirical Methodology**

The empirical methodology in this paper adopts Rodrik’s (1998) study of the relationship between growth and capital market liberalization, where he regressed the per capita GDP growth on the share of capital for years when the capital market was free of restrictions (or liberalized) for about 100 industrial and developing countries.

To better understand the foundation for the impact of capital market liberalization, on economic growth consider a neo-classic function.

$$Y = AHL \dots \dots \dots (i)$$

Where  
 A= Level of technology  
 H= Human capital  
 L= Labour.

It can be Re-written like this  
 $\infty \beta$

$$Y = AK H L - (\infty + \beta) \dots \dots \dots (ii)$$

Dividing equation (1) by L and totally differentiating with respect to time “t” yields the traditional Solow decomposition;

$$Y = A + \infty K + \beta h \dots$$

$$Y = A k h \dots \dots \dots (iii)$$

Where the lower case letters; y, k, and h, designate output per worker, physical capital per worker, and

human capital per worker, respectively.

It follows that the ultimate driver of per capita growth are technological growth. A and the per capita growth of human and physical capital, h and k, respectively, trade policies do affect either of these factors. The paper empirical methodology, therefore, consists of a growth equation involving the ration of total flow (TCF) to GDP, used as a proxy for capital market liberalization, and the ratio of total trade (Exports+Imports), TT to GDP, used as a proxy for trade openness or globalization. The effects of these ratios on growth will be examined.

Given the theoretical background, the model that will explain the relationship between economic growth and capital market liberalization, as well as globalization takes the form:

$$GDP_t = f(CML_t, OPENT_t)$$

Where  $GDP_t$  = GDP growth rate.

$CML_t$  = index of capital market liberalization, defined by;

$$\frac{\text{Total Capital Flow ratio}}{GDP}$$

$OPENT_t$  = index of openness, used as a proxy for globalization and defined by;

$$\frac{\text{Total Trade ratio}}{GDP}$$

The explanatory variables,  $CML_t$ ,  $OPENT_t$  serves as vector of trade liberalization indicators, as defined by Adenikinju and Olofin (2000), Kraay (1998), Swank, (1998).

The equivalent parameter from one of the model to be estimated is specific as follows:

$$GDP_t = \beta_0 + \beta_1 CML_t + \beta_2 OPENT_t + \mu_i, \dots \dots \dots (iv)$$

Where the variables are define above

The a priori theoretical expectations are that:  $\beta_1 > 0$ ,  $\beta_2 > 0$ . The data used for the estimation were obtained from various issues of the CBN Statistical Bulletin.

## Model Estimation and Analysis Of Results

The parameter estimate as in equation (v) below

$$DGP = 4.465 + 0.497 CML_t + 0.432 OPENT_t$$

$$(9.852) \quad (1.148) \quad (0.008)$$

$$T = (0.453) \quad (2.250) \quad (1.953) \quad 2$$

$$R = 0.527; F = 3.277; df = 2$$

The regression result shows that capital market liberalization and globalization with recent global meltdown explain about 53 percent of economic growth in Nigeria. The slope coefficient,  $\beta_1$  and  $\beta_2$  are significant at 3.8 percent and 6.7 percent respectively. The entire model is significant at about 6.3 percent.

The paper observes from the regression that capital market liberalization and globalization are significant determinants of growth in Nigeria since global meltdown is a fraction of globalization. The positive coefficient confirms the a priori theoretical assertion that capital

liberalization and globalization have positive effect on economic growth.

## Policy Implications and Conclusion

It is now a known fact that the paper's econometric evidence has shown that trade openness and capital market liberalization is good for growth, liberalization policies in Nigeria should be aimed at encouraging private foreign domestic investment for long-term growth. The policy makers should pedal down on policies aimed at protecting domestic producers.

Protective policies have been found to be detrimental to both capital inflow and foreign domestic investment, which in turn, has negative impact on growth. The fact that the regression coefficients are positive and significant implies that Nigeria should strive at complete openness in its trade policies. The so-called "policies on domestic industry protection" should be re-examined.

From the literature findings, as well as the results of the regression analysis, the following conclusions are in place. The driving forces of globalization in general including among other; widespread push toward trade and capital market openness; increasing intermediation of corporate production; technology; democracy; and implementation of outward-oriented policy reforms. In the area of capital market liberalization, Nigeria is still in the process of being internationalized and integrated into the world capital market. The major challenge of capital liberalization in Nigeria is how to institutes a regime of supervision that would be efficient, effective, up-to-date and relevant to the changing complexities of modern banking and finance services. Nigeria should re-examine its policies on capital movement restrictions. Such restrictions, whether direct or implied, affect the ability of the private sector to obtain foreign exchange for payments related to capital inflow and import of raw-materials. They also affect the ability of foreign direct investors to repatriate interest earnings and other profits, which are the major business objectives.

It can be deduced that Nigeria capital market is not totally affected by the recent global meltdown, due to the fact that the market is not fully integrated to the world capital market. But the study has shown that the Nigeria capital market respond to the global meltdown.

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