THE CHARACTER OF THE STATE IN
FINANCIAL DEVELOPMENT AND ECONOMIC
GROWTH

BY

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ABSTRACT
This article proposes a framework for conceptualizing the finance-growth theory in developing economies. The study investigates how the influence of the character of a state may inadvertently define the trajectory of financial development of the state and its resultant effect on economic growth. To analyse this assertion, a developing economy (Nigeria) which had experienced decades of autocratic military governance was studied using a vector co-integration analysis. A historical case review was conducted using secondary data. The historical review revealed evidence of three major characters while the econometric analysis revealed the presence of macroeconomic structures identifying at least five co-integrating vectors.

KEY WORDS: Financial Development, Economic Growth, Ethnicity, Civil War, Military Government, Character of the State.
1.0 INTRODUCTION

“One of the most important problems in the field of Finance, if not the single most important one, almost everyone would agree, is the effect that financial structure and development have on economic growth” Goldsmith (1969:390).

Following Goldsmith (1969), this research focused on studying how the character of a state could define the pace and direction of financial development and economic growth. This study therefore focused on examining the financial and economic structures of the Nigerian economy which has a very different set of residual socio-economic and socio-political identity characters from developed economies, the characters of whom the theory is based upon. These broad characters include properly functioning democracies, free markets and largely mono ethnic societies. Numerous empirical and theoretical studies have shown that ethnicity does have a negative impact on economic growth (Montalvo and Reynal-Querol 2005, Collier, 2008 and Baggio and Papyrakis, 2010).

While it may be argued however that several studies have been carried out to demonstrate the existence of the impact of social and political instability on economic growth, most of all the studies such as Levine and Zervos (1996), Barro (1996) etc utilise cross-sectional data while Asteriou and Price (2001) utilise time series data but look at the effect of political uncertainty on investment growth and hence economic growth using Gross Domestic Product (GDP) as a proxy for economic growth in the United Kingdom and Collier (2008) shows precisely how political instabilities have contributed to African governments abdicating their responsibilities towards the provision of public goods for the benefit of their citizens. No known study has carried out an analysis of the impact of the character of the state leading to political instability and uncertainty on the causal relationship of financial development on economic growth in Nigeria. Asteriou and Price (2001) further indicate that in a ‘polarised society’, a change in the government may create political uncertainty with its attendant effect on economic growth; in the Nigerian context, polarity can be clearly seen by the deep stratification in ethnic groups.
from the North to the South and the vicious contest to control the Federal Government (Osaghae 1998). Asteriou and Price in their study of the UK economy give further insight as to why military takeovers of government in Nigeria was always welcome, they stress that if the current government was perceived to be untrustworthy, news of their ousting could lead to an increase in investment. However in the Nigerian case where there is a track record of the outcome of military governance, can this premise necessarily be true? The result of this study proved otherwise. This study is further unique due to the fact that it studied a developing economy with a unique set of endogenous characters.

The Finance-Growth theory’s main drive is that developments in the financial system help ameliorate inadequacies in information exchange between investors and providers of capital. Banks are thought to be in better control of information flow due to the personal contact they have with their clients while a different school of thought believes that markets are in place to counteract the rent seeking and monopoly prone attitude of banks thereby presenting a more investor friendly platform (Beck and Levine, 2004). This assumes that ceteris paribus the political economy of the country is in a state of tranquillity. In Nigeria however and a large number of African countries, evidence from literature (Brown 1995, Collier 2008) suggests that this may not be the case as these countries in addition to experiencing a constant state of flux in their body polity are riddled with decadent infrastructure that could further foster information asymmetry such as poor road networks, poor communication systems and even huge threats to the movement of factors of production due largely to ethnic strife between competing politico-ethnic groups (Madiebo 1980, Osaghae 1998, Falola and Heaton 2008).

2.0 THEORETICAL PERSPECTIVES
A vast amount of literature exists relating financial development indicators to economic growth from two varied points of view. Some economists are of the view that financial development leads to economic growth while others are of the view that economic growth brings about financial development. Early
pioneers of the literature like Bagehot (1873), Schumpeter (1911), Gurley and Shaw (1955) and Goldsmith (1969) strongly believe that the former is the case while more recent researchers like Robinson (1952) and Lucas (1988) queue behind the latter opinion, Lucas indicating that the entire dialogue has received far too much attention. McKinnon (1973) presents an economic development hypothesis that upholds the use of domestic capital markets as drivers of economic development in developing economies rather than inflow of foreign capital. His analysis details the need to use interest rates as an indicator of the actual volume of capital available in an economy for investment, implying an inverse relationship between interest rate and volume of capital. Levine (2004) further cites the views of other researchers such as Bagehot (1873), Gurley and Shaw (1955) and Goldsmith (1969) supportive of the fact that financial development leads to economic growth. Lucas (1988:41) clearly stands out in his position that different economies require different patterns of growth thereby implying that either of the two views above could be applicable to different economies. Greenwood and Smith (1997) are of the view that financial development spurs economic growth and economic growth leads to further financial development. Miller (1998) warns of the dangers inherent in depending on traditional bank loans to finance growth due to depositor’s free will to draw on their bank balances; he cites the example of financial crisis in Southeast Asia as an under-dependence on financial markets to fund growth initiatives against a preference for bank funds. This view of Miller’s incidentally constitutes another key division in the literature; some proponents strongly believe that a banking sector based financial system is superior to a financial market based system while others such as Alam and Hassan (2003) unequivocally uphold the reverse, arguing that stock market development granger causes growth in GDP (a proxy for economic growth). The United States and The United Kingdom due to properly dispersed and efficiently run financial markets it can be argued are able to manage pockets of financial crisis in their financial systems due to the alternative role markets play relative to traditional bank capital.

Advances in research skills and data such as are evidenced in Demirguc-Kunt and Levine (2001) has created contrary schools of thought as to which
financial system drives economic growth and to what extent. The general view of the finance-growth literature (Demirguc-Kunt and Levine, 2001) suggests that economic growth is primarily driven by financial development and not necessarily by financial structure (bank or market based). Evidence of this view was drawn from the case of Germany and Japan, bank based systems versus the United States of America and the United Kingdom, market based systems. All four countries have experienced similar magnitude of long run growth in GDP. They further indicate that the size of the banking sector as well as the size and liquidity of the stock market exert a causal drive on economic growth using Gross Domestic Product per Capita as a proxy for economic growth.

Goldsmith (1969) employed a three tier approach to investigate the relationship between financial structure and economic development. Goldsmith’s first case was to establish the potential of change in nature of financial instruments, markets and institutions in a country as the country experiences economic growth; evidence from his research demonstrates that banks had the tendency to grow much faster than other non-banking financial institutions and the stock market. Secondly Goldsmith attempted with limited success to show that financial development imposes a causal effect on economic growth. To demonstrate this relationship he employed a graphical method to show that the movement of indicators representing these two variables (using time series data from thirty five countries) were indeed positively correlated. Due to a lack of data, he was unable to draw a strong conclusion on his third case which was to establish how the nature of a country’s financial structure affects the speed of economic growth; Goldsmith sought to use direct evidence from Germany and the United Kingdom, The United States and Japan to argue that increased financial development had a positive impact on the speed of economic growth. Loayza and Ranciere (2004) however argue that financial development has the tendency to impede economic growth by bringing with it the propensity for financial crisis. He draws his argument from existing literature such as Caprio and Klingebiel (2003) amongst others to show that financial development in the short term leads to negative consequences of volatility and crisis resulting in stunted and
often negative growth but as the system further matures in terms of credit control and management, faster and more rapid economic growth may be experienced.

From the foregoing, the question of financial development leading to economic growth has long since been debated but perhaps not completely resolved (Spratt 2009). The intention of this section in general is not to prove that financial development definitely leads to economic growth but to highlight pockets of evidence as a framework to examine how the character of a state could possibly alter the relationship to a minor or significant degree.

3.0 FRAMEWORK AND HYPOTHESIS

3.1 Research Framework

This study adopted a historical case review of the Nigerian political economy from 1960 to 2007 in a bid to identify landmarks and themes that may be conglomerated into characters of the State under review. Data sources used were secondary (from existing literature). The purpose of adopting a historical case review was to unearth historic information relating to the determinants of the development of the financial system in Nigeria with a view to understanding the present situation as a leverage to predict or control future policy determinants suitable for development of the financial system. To achieve this aim, the research looked at the causes, effects and trends associated with these determinants. Of particular importance was country data on Nigeria relating to the long years under autocratic military governance. The qualitative data set was logically and critically analysed with a view to maintaining objectivity.

The endogenous determinants of financial system development in Nigeria were analysed using the Johansen Co-integration test. Levine, Loayza and Beck (2000) using traditional instrumental cross-section, instrumental variable techniques and dynamic panel techniques have shown that a positive relationship does exist between the endogenous components of financial development and economic growth as well as determine that a country’s legal
and accounting system play a strong positive and/or negative role in the growth pattern and magnitude of capital markets. Following their methodology, this research established the validity between the variables under question for Nigeria.

The co-integration method is used to study the relationship between two non-stationary variables, one believed to have a dependence on the other; the hypothesis is then tested for a statistically significant relationship between the endogenous components of financial development and the proxy for economic growth. Evidence of co-integration suggests the presence of economic structures.

Similar studies have been carried out by Aka-Brou (2004) where he analysed time series data for 26 countries to determine the causal effect of financial intermediaries and financial markets on economic growth in these countries. Aka-Brou tested for causality using advanced econometric tests such as the Error Correction Model (ECM) test, Johansen Co-integration test, Vector Auto-Regression (VAR) tests etc. Afonso et al (2002) adopted a Panel technique to investigate the causal effect in 24 developed and underdeveloped countries. King and Levine (1993) in providing further evidence for the Finance-Growth relationship defined financial development and economic growth indicators using similar time series data.

This research adopted the definitions of the indicators used in Demirguc-Kunt and Levine (2001) modifying them as the need arose. Other studies which used similar definitions include Kormendi and Meguire (1985), Barro (1991), Levine and Renelt (1992) and Mankiw, Romer and Weil (1992).

3.2 Statement of Problem and Model Specification

Given the short run Error Correction Model (ECM)

\[ Y_t = a_0 + a_1Y_{t-1} + \gamma_0X_t + \gamma_1X_{t-1} + \varepsilon_0ET + \varepsilon_0CV + m_0MG + u_t \]  

(1)
If a series of negative shocks occur in the economy represented by the character of the state (ethnicity, prebendalism, civil war and military intervention/governance) captured by the dummy variables ET, CV and MG then we may likely have a situation whereby $Y_t$ increases at a slower rate than its lagged value $Y_{t-1}$. In future periods, $Y_{t-1}$ will therefore be located below its long-run steady-state growth path.

If we successfully eliminate these characteristic factors (ethnicity, prebendalism, civil war and military governance/intervention), how fast, or what will be the speed of adjustment of $\Delta Y_t$ back to its steady state long-run equilibrium.

If the analysis shows that characteristic factors represented by dummy variables slow down the increase of $Y_t$ then we can conclude that in the case of the Nigerian Economy, the causal relationship between financial development and economic growth is truncated by the character of the state.

**4.0 DATA AND EMPIRICAL FINDINGS**

The study uses financial intermediary data from the International Financial Statistics (IFS) and financial market data from the Nigerian Stock Exchange. The specified model was analyzed using cointegration analysis to investigate the degree of correlation between the dependent and independent variables under review. Cointegration analysis provides a basic framework for testing, estimating and modelling the long-run macroeconomic relationships amongst time series variables. In the relevant literature, several approaches exist to carry out a cointegration test but the concept was first introduced by Engle and Granger in 1987 (Hendry 2003, Asteriou and Hall 2007). This study adopts the Johansen Full Information Maximum Likelihood (FIML) Test to model the relationship between the independent variables and the dependent variable. The preference for the FIML test over the Engle-Granger (EG) test is due to the EG test not being able to accommodate multiple independent variables such as this study adopts.
4.1 The Augmented Dickey Fuller Test (ADF Test)

The Augmented Dickey Fuller Test was conducted to investigate the stationary properties of the time series data employed in this study. The test was formulated as shown below:

\[
\Delta X_t = \gamma X_{t-1} + \sum \beta_i \Delta X_{t-j} + \alpha + \delta t + u_t
\]  

(2)

Where \( \Delta X_j \) are the first differences of the series and t is the time. Stationarity is sought to ensure that the possibility of spurious regressions is eliminated and the entire series is of the same stationary order. The following results were obtained.

**Table 1: Unit Root Test Results**

| VARIABLES     | TEST STATISTICS & CRITICAL VALUE | INTEGRATION LEVEL | LAG |
|---------------|----------------------------------|-------------------|-----|
|               | LEVEL                            | 1ST DIFFERENCE    |     |
|               | DF/ADF C.V (5%)                  | DF/ADF C.V (5%)   |     |
| DLGDP         | -1.865 -3.5162                   | -5.0013 -2.9320   | 1st Difference 0 |
| DLSIZMKT      | -0.17511 -3.5189                 | -4.1680 -2.9339   | 1st Difference 0 |
| DLACTSMKT     | -0.74763 -3.5189                 | -6.1809 -2.9339   | 1st Difference 0 |
| DLEFFSMKT     | -2.1783 -3.5189                  | -7.5272 -2.9339   | 1st Difference 1 |
| DLSIZFINT     | -2.3713 -3.5162                  | -5.1736 -2.9320   | 1st Difference 0 |
| DLACTFINT     | -2.0470 -3.5162                  | -6.2293 -2.9320   | 1st Difference 0 |
| DLEFFFINT     | -1.1779 -3.5162                  | -5.3436 -2.9320   | 1st Difference 0 |

From the table above, we observe that all the series were stationary at first difference. The corresponding critical values at 5% significance are given by the test (Microfit 4.0) consistent with Mackinnon (1991). It is also observed that all the series required zero augmentation to secure lack of autocorrelation of the error terms related to the variables except for the case of the efficiency of stock market series which required one augmentation. In order to select the appropriate test statistics for comparism with the 5% critical values, the Schwartz Bayesian Criterion (SBC) was chosen.
4.2 The Test for Co-integration

This test was employed to explore the existence of a long-run relationship between the proxy for economic growth and proxies for financial development in the Nigerian economy given the effect of characters of the Nigerian State represented in the test equation by dummy variables.

Table 2: Long Run Relationship between Variables

| DEPENDENT VARIABLE DLGDP | EXPLANATORY VARIABLES | COEFFICIENT | PROBABILITY |
|--------------------------|-----------------------|-------------|-------------|
|                          | C                     | -0.079070   | 0.491       |
|                          | DLSIZSMK              | 0.25005     | 0.177       |
|                          | DLACTSMKT             | -0.29554    | 0.093       |
|                          | DLEFFSMK              | 0.30817     | 0.059       |
|                          | DLSIZFINT             | -0.18484    | 0.245       |
|                          | DLACTFINT             | -0.56699    | 0.001       |
|                          | DLEFFFINT             | 0.65884     | 0.004       |
|                          | ETHNIC                | 0.11465     | 0.222       |
|                          | CIVWAR                | -0.11358    | 0.235       |
|                          | MILGOV                | 0.96167     | 0.293       |
|                          | T                     | 0.0046290   | 0.009       |
|                          | R²                    | 0.77362     |             |
|                          | R² BAR                | 0.70704     |             |
|                          | DW STAT               | 2.0699      |             |
|                          | S.E. OF REGRESSION    | 0.10518     |             |

COINTEGRATION REGRESSION | R² | R² BAR | DW STAT. | CALCULATED ADF RESIDUAL | 95% CRITICAL VALUE
GDP VS C, SMKT, FINT, DUMMIES AND T | 0.77362 | 0.70704 | 2.0699 | -6.7462 (0) | -3.5162 |

The reported critical value was obtained from Mackinnon (1991) and reported by Microfit 4.0. The number in parentheses indicates the number of lags chosen by the Schwarz Bayesian Criterion. This means that no augmentation was necessary to secure autocorrelation of the error terms for the relevant cointegration regressions. We therefore confirm a long run relationship between the variables.
This test confirmed the existence of a long run relationship between the independent variables of financial development and the dependent variable of economic growth indicating that in the long run, financial development (either intermediary or market) has a potential to grow the Nigerian economy irrespective of the adverse characters of the state highlighted in the historical analysis. The interpretation of this long run relationship is that error terms constituted by disturbances such as ethnically motivated civil unrest and public policy interventions occasioned by unexpected regime change (as shown by the value of the DW statistics greater than “2”) has the propensity to affect economic growth in the long run. This may no doubt be reflected in the steady decline of public goods prevalent in the country in spite of renewed attempts at reform and reorganization of the financial and real sectors of the economy as highlighted in Ayadi, Adegbite and Ayadi (2008) and Nzotta and Okereke (2009). If these reforms are seen through, the vast body of literature in finance and growth clearly tells us that the dividends of financial liberalization such as increased efficiency and liquidity of the financial system (Fitzgerald 2006) channelled to the real sector of the economy will result in significant levels of economic growth and poverty reduction (Nzotta and Okereke 2009). What the literature however fails to clearly highlight with the exception of certain literature in political economics such as Collier (2008) is the impact ethnicity, civil unrest and military governance may have in effectively hindering this growth process from taking shape.

4.3 The Error Correction Mechanism Test

The error correction model has the advantage that it can estimate the correction from a previous period state of disequilibrium in the variables under study as a means of determining the existence of a short run relationship between the variables under study (Asteriou and Hall, 2007). Error Correction Mechanisms (ECM’s) further provide the advantage of enabling the researcher generate the best model that fits the data set or better still confirms how well the data set fits the model under estimation (Asteriou and Hall, 2007:310).
The ECM specification according to Asteriou and Hall (2007) for \( Y_t \) and \( X_t \) that are co-integrated is given by:

\[
\Delta Y = a_0 + b_1 \Delta X_t - p u_{t-1} + Y_{t+1}
\]

(3)

Where \( u_t = Y_t - \beta_1 - \beta_2 X_t \)

(4)

\( b_1 = \) the short run impact multiplier effect that a change in \( X_t \) will have on \( Y_t \)

\( u_{t-1} = Y_{t-1} - \beta_1 - \beta_2 X_{t-1} \)

\( p = \) the feedback/adjustment effect that measures the correction rate of the disequilibrium.

The test revealed that in the short run, successive readings did resemble each other as shown by the value of the DW statistics of 1.7192 significantly less than “2” implying that the characters of the state highlighted in the historical analysis do have an impact on the short run growth mechanism of the Nigerian economy. These results are further supported by an \( R^2 \) value of 0.86280.

Table 3: Short Run Relationship between Variables

| EXPLANATORY VARIABLES | COEFFICIENT | PROBABILITY |
|------------------------|-------------|-------------|
| C                      | -0.054963   | 0.160       |
| ECT(-1)                | -1.1253     | 0.000       |
| DDLSIZSMK              | 0.46207     | 0.015       |
| DDLACTSMKT             | -0.47219    | 0.010       |
| DDLEFFSMK              | 0.43180     | 0.014       |
| DDLSIZFIN              | -0.37206    | 0.002       |
| DDLACTFIN              | -0.40366    | 0.000       |
| DDLEFFFIN              | 0.50811     | 0.008       |
| DETHNIC                | 0.030894    | 0.756       |
| DCIVWAR                | -0.020667   | 0.827       |
| DMILGOV                | -0.10285    | 0.341       |
| T                      | 0.0020794   | 0.121       |
| R²                     | 0.86280     |             |
| R² BAR                 | 0.81564     |             |
| DW STAT                | 1.7192      |             |
| S.E. OF REGRESSION     | 0.10337     |             |
4.4 The Johansen Full Information Maximum Likelihood Test

Two tests (Eigen Value Vector test and Trace Statistics Test) were employed here to test for a significant co-integrating relationship from the proxies of financial development to the proxy of economic growth. From the tables below, we see that for both tests, at least five of the six series (size, activity and efficiency of both stock market and financial intermediary) are co-integrated with the GDP series as a result of the test statistic exceeding the critical value at 95% significance. Two deductions can be immediately made here, the first being that both financial intermediaries and financial markets can contribute to economic growth in Nigeria in the appropriate policy environment and the second being that financial structure is irrelevant in Nigeria at its current growth stage. The second deduction conforms with Allen and Gale (2000), Demirguc-Kunt and Levine (2001) and Levine (2002) who argue that financial structure is irrelevant, what is of importance is the development of intermediaries and markets.

Table 4: Johansen Full Information Maximum Likelyhood Test

| Cointegration Regression | H₀  | H₁  | λ_max | C.V (5%) | λ_trace | C.V (5%) |
|-------------------------|-----|-----|-------|----------|---------|----------|
| MODEL                   |     |     |       |          |         |          |
| r = 0                   | r = 1 | 155.4325 | 64.1100 | 567.7492 | 245.6900 |
| r < = 1                 | r = 2 | 138.6547 | 57.9700 | 412.3167 | 203.9600 |
| r < = 2                 | r = 3 | 82.3911 | 52.0600 | 273.6620 | 166.1200 |
| r < = 3                 | r = 4 | 61.2874 | 46.4700 | 191.2709 | 132.4500 |
| r < = 4                 | r = 5 | 51.6111 | 40.5300 | 129.9835 | 102.5600 |
| r < = 5                 | r = 6 | -     | -     | 78.3724 | 75.9800 |

5.0 ANALYSIS AND INTERPRETATION OF RESULTS

This section is divided into two parts; the first part discusses the results of the empirical analysis and interprets the findings while the second part discusses the relevance of these results explaining the linkages between financial market development and economic growth in Nigeria.

5.1 Evaluation and Interpretation of Results

The Unit root test revealed that the data series for Real GDP Per Capita as
well as those for size, efficiency and activity of financial markets and intermediaries were all stationary at first difference and therefore contained only one unit root.

When the ADF Co-integration test was carried out to determine the long run relationship amongst the variables, the results showed the presence of long-run economic structures amongst the variables with statistically significant coefficients and an R-Squared value of 77.36% an indication that the regression line was closely fitted to the data set. The DW-Statistic showed a weakly negative autocorrelation indicating that future values of the series cannot be predicted by its past values. The fact that the coefficients generated for the variables of the long run relationship mostly showed small standard error terms, an indication of small standard deviations around the mean value, imply small variances in investor behaviour in the long term possibly as a result of stabilized long run conditions resulting from elimination of the highlighted characters of the state. A further implication of the presence of negative autocorrelation is that on the long run the retrogressive characters highlighted, become entrenched in the society, government and hence the economy. Looking more closely at the impact each of the co-integrating variables has on GDP the proxy for economic growth, it is observed from the probability figures displayed from the test results that the variables had varying levels of impact on economic growth both in the short and long run. A probability of 0.001 implies that in every 1000 samples, the independent variable will have an impact on the dependent variable in only one sample. For the long run relationship between stock market development and economic growth, we observe that the size of the stock market is the most significant variable in relation to economic growth with a probability of 177 in 1000 followed by the activity of the stock market (93 in 1000) and efficiency of the stock market (59 in 1000). Looking at the long run impact of financial intermediaries on economic growth, there is a clear indication that the size of financial intermediaries is a strongly significant variable relative to stock market variables with a probability of 245 in 1000 followed by the efficiency of financial intermediaries (4 in 1000) and the activity of the financial intermediaries (1 in 1000). Ethnicity, Civil War and Military Government clearly
have substantial long term effects on financial development considering their probabilities relative to those of the other independent variables of 222, 235 and 293 respectively with the long term effect of military government being the most significant long run relationship with economic growth. The good news here is that even though the most significant long run relationship, at a probability of 293 in 1000 samples, the long term impact of military governance on economic growth in Nigeria is seen to be relatively diminished.

The short run relationship of the variables was measured using the error correction mechanism employing lagged values of the variables. In this analysis it was revealed that the R-Squared was 86.280 (a strong fit), the DW-Statistic was 1.7192 (below the mid-value of 2) an indication of positive autocorrelation which implies that in the short-run, successive lag values will carry forward their error terms to the next period. This incidence of positive autocorrelation can be related to the Osaghae (1998) which demonstrated that in spite of the fact that Nigerians are quick to move from one situation to another speedily putting aside their differences for short run economic gains, they quickly return to their differences as soon as their initial economic desire is satisfied. As a result of this, we see that the political structure of the country has persistently remained skewed towards a politico-ethnic structure with political power highly centralized within the structure of the Federal Government. For the short run relationship between stock market development and economic growth, we observe that the size of the stock market is the most significant variable in relation to economic growth with a probability of 15 in 1000 followed by the efficiency of the stock market (14 in 1000) and activity of the stock market (10 in 1000). Looking at the short run impact of financial intermediaries on economic growth, the results obtained suggest that in the short run, the stock market is considered to be less significant in contribution to financial deepening, a finding which is consistent with existing literature. We observe from the long run relationship that even though the stock market increases its significance, financial intermediaries still remain comparatively significant as argued in Allen and Gale (2000) and a host of other studies on financial structure. Looking at the short run impact of financial intermediaries on economic growth, there is a clear indication that
the size, activity and efficiency of financial intermediaries is not at all significant to economic growth with probabilities of 2 in 1000, 0 in 1000 and 8 in 1000 respectively. Our results show that Ethnicity, Civil War and Military Government clearly have overwhelming short term effects on financial development considering their probabilities relative to those of the other independent variables of 756, 827 and 341 respectively with the short term effect of Civil War being the most significant short run relationship with economic growth consistent with Collier (2008). It is not surprising that the activity of financial intermediaries had no effect on economic growth considering the large significance of the socio-political disturbance variables (ethnicity, civil war and military governance) in the short run. In general, the short run relationship demonstrates that financial development does not significantly affect economic growth in Nigeria as a result of these socio-political disturbances highlighted but as the impact of the disturbances wear off in the long run as a result of the presence of more stable governments and growth oriented social, political and macroeconomic policies, we see the significance of the socio-political variables diminishing and giving way to increased significance of the financial development variables with the size of the financial intermediary leading financial development and economic growth.

A further test was conducted to observe the number of co-integrating vectors amongst the variables. The Johansen Full Information Maximum Likelihood Test revealed that at least five co-integrating vectors were in existence which enabled the rejection of the null hypothesis of no co-integrating vector using both the Eigenvalue statistics and the Trace statistics. The presence of an underlying macroeconomic structure lends credence to the validity of the finance-growth theory as evidenced in the literature review.

5.2 Relevance of Results

In sum, this analysis revealed the presence of long-run macroeconomic structures within the Nigerian financial system but suggested that GDP per Capita may currently be driven by other factors outside of the financial system
such as crude oil revenue bringing a reflection on the oil exportation capacity of the Nigerian economy and the natural resource trap highlighted in Collier (2008) and elaborated in Moyo (2009). Collier argued that resource rich underdeveloped countries tend to leave other sectors under developed while governments concentrate their effort on the prebendalistic extraction of resource spoils.

The foregoing results are particularly relevant as this study set out to investigate how the character of a state could serve as an impediment to financial structure driven economic growth. By integrating the characters of the state revealed in the detailed study of the political economy of Nigeria into a cointegration and analysis it becomes apparent that in spite of steady growth in GDP per capita figures and financial intermediary and market figures the financial sector may still be significantly under developed to the extent that capital flow through the economy may still be heavily impeded as highlighted in Nzotta and Okereke (2009) with its attendant implication on entrepreneurial development and growth of the private sector. Eliminating ethnicity, the core character of the state highlighted in Osaghae (1998) would enable more nationally focused government driven development initiatives which will draw investments from across all ethnic groups; this is demonstrated by the result of positive autocorrelation in the error correction mechanism test (short run relationship). Following Schumpeter's (1911) analysis on funding of innovative thinking, it can be argued that a faster growing banking sector and financial market driven by higher and sustainable investments such as can only be driven by a government focused on a balanced national development agenda as opposed to a regional agenda will see the financial sector acting as the lead indicator in economic growth.

6.0 CONCLUSION AND POLICY IMPLICATIONS

The Borderline between Economics and Politics has been an area many researchers in Political Economics have frequently shied away from, most preferring to concentrate on Economics while others on Politics (Collier, 2008). This research however has explored the borderline terrain drawing
inferences from both fields to analyse contemporary issues unique to both fields using the Nigerian Economic and Political platform as an empirical example. This study therefore compliments the vast body of literature in the field of financial development and economic growth by drawing inferences that may be useful for understanding the growth trajectory of developing economies and why Western oriented development policies often led by the World Bank and IMF typically fail to liberate these economies (Brown, 1995).

Being a major oil exporter, Nigeria has maintained a strong oil export capacity on the average of two million barrels per day giving the country a strong macroeconomic outlook built on decaying political structures. Collier (2008) argued that most resource rich under-developed countries tend to neglect the development of other sectors such as the financial sector as successive governments preferred to concentrate their efforts on exploitation of natural resource driven wealth. This argument supported by De Soto (2000), Moyo (2009) and further elaborated by the foregoing analysis demonstrates that the character of a state plays a key role in the development of its financial intermediaries and markets and therefore the views originated by Schumpeter (1911), developed by Goldsmith (1969) and given empirical evidence by a host of researchers such as Levine (2004) cannot hold as entirely true in Nigeria (a typical developing economy) without bringing into perspective the character of the state as an endogenous variable.
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