THE CAPITAL MARKET DEVELOPMENT AND ECONOMIC GROWTH: THE NIGERIA EXPERIENCE

Ben-Caleb, E.
Department of Accounting
School of Business, CDS
Covenant University, Ota, Ogun State
bencaleb1@yahoo.com 08036997782

Abstract

The activeness of the capital market is a major factor in determining the level of growth in any economy, in view of the long term investible funds it provides. Unfortunately, in Nigeria like many emerging economies, the money market dominate the financial sector forcing businesses to rely on short term funds for their investment with the attendance riskiness. This paper empirically examines the relationship between the capital market and economic growth in Nigeria. A correlational research design was employed making use of twenty one years data (1986-2006). It was then analysed using Ordinary Least Square regression. From the result it was found that a strong and positive relationship exists between the capital markets development and Nigeria economic growth. The paper recommended among others that market friendly macro economic policies as well as effective and enforceable regulatory framework should be put in place. These will not only ensure orderly and equitable dealings in securities but will also discourage insider abuses thus, activating the capital market for sustainable economic growth and development in Nigeria.

Key words: Capital Market, Development, Economic Growth, Nigeria.

1.0 Introduction

Macro economic theorists have long identified investment as one of the major determinant of aggregate demand or national output. But profitable investment requires long term commitment of capital most times longer than the period most savers will allow. According to Olugunde et al (2006) "the investment that promotes economic growth and development requires long term funding, far longer that the duration for which most savers are willing to commit their funds". This underscores the cruciality of the financial market in general and the capital market in particular in driving the rate of growth of an economy through the mobilisation and allocation of capital resources for investment.

The financial market in it simplest form connotes a platform through which economic agents meet to trade funds through intermediaries (Santomero and Babbel 2001: 4). The market is broadly divided into money market and capital market. Whereas the former is for the trading of short term funds, the later is for the trading of medium to long term funds. More so, while it is true that the two markets perform important roles in an economy, it is the capital market that provides investment funds. It is the capital accumulation role of the capital markets that power capital formation which drives economic growth. More so, the capital markets are considered better avenues of mobilising domestic and international capital and hence meet the fixed capital needs of the private sector, which is invariably the engine of economic growth and development. Decrease in capital investment in an economy leads to lowered production and productivity and hence retarded growth (Olugunde et al, 2006)

In Nigeria, like many emerging economies the commercial banks or money market institutions dominate the financial market. And banks have not been reliable source of long term finance, due principally to increasing risk and tenure crises associated with bank lending (Iyoha and Itsede 2003:9). This could explain in part the unimpressive

performance of our economy. Besides, Mohtadi & Agarwal (2003) observed very little and in some cases the non existence of empirical evidence on the seminal role of the stock markets development as a driver of long–run economic growth especially in the developing countries. This could explain to great extend the unfriendly government policies and poor regulations of the Nigeria stock exchange, which has giving way to insider abuses, margin trading, and price manipulations as well as over reliance of Nigerian businesses on the money market for investible funds with its attendance riskiness.

It is on this basis that this paper undertakes to empirically determine the relationship and impact of the capital market and Nigeria economy. The objectives set to be achieved in this paper are first to establish the relationship between the capital market and economic growth and secondly to determine the impact of the capital market to Nigeria economy for twenty one years (1986-2006). The study is anchored on two principal hypotheses, herein stated in the null form;

I. There is a negative relationship between the capital market and economic growth

II. From 1981 to 2006 the capital market has not had any significant impact on Nigeria economic growth.

1.1 Literature Review

1.1.1 The Nigeria Financial Market

Financial market is an important part of any modern economy. It connotes the combination and interplay of individuals, institutions and instruments to mobilized and channelled funds efficiently from savers to users (Al-Faki, 2006). It consist of two segments namely; the money market and the capital market. Whereas the money market provides finance on short-term basis to individuals, businesses, enterprises, governments and their agencies, the capital market, on the other hand, provides finance to corporate bodies, governments and their agencies on medium to long-term basis. In Nigerian the former is said to dominate the financial sector (Eriki 2007).

The Capital Market

The capital market is the arm of the financial market devoted for the trading of financial instruments that have original maturities of more than one year (Peter and Milton, 2006). It embraces all the arrangements that facilitate the buying and selling of securities. According to

Al-Faki (2006) the capital market is "a network of specialised financial institutions, series of mechanisms, processes and infrastructure that, in various ways, facilitate the bringing together of suppliers and users of medium to long-term capital for investment in socio-economic developmental projects. It major segments are: – The Primary Market and the Secondary market.

The ***Primary market*** is "the conduit for the sales of new securities". (Pandey 2005:421). It is a market for new capital issues by firms and other institutions, including governments. The mode of offer for securities traded in this market includes offer for subscription, right issues, offer for sales, private placement etc. The fund raised in the primary market goes to the company or institution concern through its agents, (issuing houses). The ***secondary market*** on the other hand, is the market for the exchange of securities. It is the market for the trading in existing securities. This consists of the exchange over the counter market, where securities are bought and sold after their issuance in the primary market (Murinde, 2006). In the secondary market, securities are exchange for cash between and amongst investors with stock brokers or dealers acting as intermediaries. The secondary market can be organised or unorganised. An organised market is a stock market (e.g. the Nigeria Stock Exchange) with physical location, trading in designated (quoted) securities. An unorganised market has no physical trading location but transactions are conducted mainly through telephone calls and the computer. It is otherwise called an Over-the Counter Market (OTC). The OTC trades in unquoted securities (Al-Faki, 2006).

The Nigeria Stock Exchange Market

The Nigeria Stock Exchange is the hub of the capital market. NSE provides a mechanism for mobilizing private and public savings,

and makes such available for productive purposes. It also provides a means for trading existing securities, as well as encouraging large-scale enterprises to gain access to public listing. It first came into existence in 1960 with the establishment of the Lagos stock Exchange (LSE), but became operational in 1961. In 1977, following the recommendation of the government Financial System Review Committee of 1976 the LSE was renamed and reconstituted into the Nigeria Stock Exchange (Nigeria Business Information Data, 2004). The Nigeria Stock Exchange is the only exchange in Nigeria with about ten trading floors as at June 2007, located in Lagos, Kano, Kaduna, Ibadan, Port Harcourt, Onitsha, Yola, Abuja, Benin and Uyo (Eriki 2007). The NSE operates the main exchange for relatively large enterprises and the second tier security market (SSM) where listing requirement are less stringent for small and medium scale enterprises.

1.1.2 Economic Growth and Development in Nigeria

Economic growth is one of the macro economic goals of every society. The developed wish to have a sustained level of growth and development, while the developing wish to attain the developed status. Whereas economic growth is a quantitative measure that connotes the increasing ability of a nation to produce more goods and services, or simply, an expansion of a nation's productive capacity over the long term (usually measured by the GDP), Economic development on the other hand is a qualitative measure and has been defined as "the unending improvement in the capacity of individuals and society to control and manipulate the forces of nature in order to live a better and more rewarding life" (Ekwuruke, 2006). More so, while it is possible to have growth without development, it is impossible to experience development without growth. Ultimately, however, the aim of growth and/or development process is to enhance the wellbeing of the citizenry

In Nigeria, the growth and development planning and programming date back to the 1960s when she gains her independence. A number of such plans and policies can be harvested, and they include; the *First National Development Plan (*1962-1968), Second national development (1970-1974); The Third National Development plan (1975-1980) and the Forth national development plan (1981-1985). Others

are; the Structural Adjustment Programme (SAP) (1986); the Fifth development programme (1988-1992) which was interjected by a three year "rolling plan" (1990-92); the perspective Plan and Vision 2010. Also the democratic dispensation saw the introduction of the Nigeria Economic Policy (1999-2003); followed by National Economic Empowerment and Development Strategy (NEEDS) and SEEDS; Seven Point Agenda which is on going (2007-2011) (Iyoha & Itsede, 2003: 366; Iyoha and Oriakhi, 2002:37; Photius; 2004).

All these plans and policies were to bring about the needed growth and development of the Nigeria economy. Has that been achieved? If not, why not? Iyoha & Itsede (2003: 366) while reviewing some of these policies, lamented that at the end of about ten rolling plans, Nigerians are no better off than they were during the years of fixed medium-term planning.

Speaking more figuratively, Economic growth in Nigeria was dismal throughout the 1980s and much of the 1990s. For instance, Iyoha and Oriakhi (2002:37) reported a negative average annual growth rate of per capita income of -4.6% between 1978 and 1987, indicating a catastrophic fall in living standard during the period. The question is why should Nigeria not develop despite the huge amount of money realised from oil? The answer to the above question is that the windfall was misapplied due largely to poor leadership and governance and poor and ineffective macro economic policies.

Further more; the poor economic performance in Nigeria has been attributed to the **collapse of investment.** For instance, It was reported that investment income ratio fell from 31.5% in 1979 to as low as 9% in 1985 with marginal increases during the SAP period, investment -GDP ratio is yet to exceed 17%. Explaining further the reasons for Nigeria slow growth rate, Iyoha and Oriakhi (2002:54) stated that good policies matter and can bring about development. They attributed the crippling development of Nigeria economy to poor policies, policies inconsistencies, policies reversals and a lack of policy coherent. Taiwo (2001:30-32) added among other reasons a falling investment-GDP ratio (which fell to 6% between 1995-1999 period) leading to continued de-industrialisation.

1.1.3 Capital Market and Economic Growth

Goldsmith (1969) cited in Levine (1997) is said to be the first to document the relationship between financial market and economic growth and development. Since then a lot of important progress had been made through rigorous theoretical work geared toward carefully illuminating the nexus between the capital market and economic growth and development.

For instance, Fama (1991) opined that stock markets are not only a single leading indicator of business cycle but it is also a predicator of economic activities. His position was supported by Edo (1995) who asserted that securities investment provides a veritable medium through which savings are transformed into investment that engenders economic growth and development. This is in view of the platform provided by the capital market for mobilising savings at lower cost which facilitate investments into the most productive technologies which translates into higher national productivity, hence economic growth (Greenwood and Smith, 1996).

Also, Bencivenga, et.al (1996) and Levine (1991) argued that stock market liquidity (the ability and ease of equity trading) plays a significant role in economic growth. They noted that profitable investment requires long term commitment of capital, and that savers may not be willing to relinquish their saving for a long time, so the capital market provides this link and ease the tension through liquidity function. Further more, Randal, et.al. (1999), studied whether financial development causes economic growth or whether it is a consequence of increased economic economic growth or whether it is a consequence of increased economic activity, using Granger-causality tests. They came out with the findings that, an active equity market is an important engine of economic growth in developing countries. This implies that the link between financial market and economic development is stronger in low income countries. This conclusion is in support of Levine (1997), who stated that liquidity-the ability to buy and sell equities is the strongest connection to long term growth. She concluded, 'countries with more liquid stocks tend to grow faster'.

In the same vein, Mohtadi and Agarwal (2003) did an empirical evaluation of the relationship between stock market development and long-run growth, using a time series cross country analysis. They came out with the findings that; stock market development contributes to economic growth both directly and indirectly. Direct contribution, according to them implies the impact of market liquidity (turn over ratio) on economic growth, while the indirect contribution is the impact of Market size (market Capitalisation ratio) on investment, which in turn affect economic growth. They finding was not far from the opinion of Eriki (2007), in his lecture 'functions of the capital market', who submitted that apart from acting as barometer of economic performance, and as a gauge of investor's confidence, the capital market provide the capital funds and investible funds needed for the development of the real sector. And that since growth is majorly determine by the real sector, a nation is only as developed as its capital market.

Other authors with similar view includes Tokumbo (2004), Murinde (2006), Peter and Milton (2006) etc.

From the forgoing, it seems to be unequivocal that the capital market is essential to the health of any economy.

2.0 Materials and Methods

This study is a correlational research which attempt to generate the degree of association between the capital market and Nigeria economic growth. We employed the Ordinary Least Square (OLS) Regression to determine the impact of the stock market development on Nigeria economic growth in 21 years (1986-2006). Our data were obtained from three sources the National Bureau of Statistics, sources-Security and Exchange Commission and the

In order to simplify our work and guide our analyses two simple definitional model were build. Models are build to simplify the complexities of real life (Ologunde, et al 2006). This is also in tandem with the recommendation of Koutsoyiannis (1977:12) as cited in Ologunde, et al (2006) that the first and most important step in attempting the study of any relationship between variables is to express the relationship in mathematical form.

Specifically, we post the following equations;

GDP= f (MACAP, NFDI)———————— (1)

GDP= f (VAST, NFDI) ———————— (2)

Where GDP is the Gross Domestic Product representing economic growth (the dependent Variable), MACAP is the Stock market capitalisation representing the size of our capital market (independent variable) and VAST is the value of Share Traded representing the liquidity of the market (the independent variable). NFDI is the Net Foreign Direct Investment introduced in the two models as the control variable.

The models were transformed into a linear form as follows;

GDP= a + b1 (MACAP) + b2 (NFDI) +———————— (3)

GDP= a + b1 (VAT) n+ b2 (NFDI) + å ———————— (4)

An error component (å) was included to capture other explanatory variables not included in these models

Our expectation was that if the capital market has impacted significantly on Nigeria economy for the period under consideration, then b1 and b2 should be significantly positive.

3.0 Result and Discussion

3.1 Data Presentation and Analyses

The data use in this study representing the dependent and independent variables as well the control variable are as presented in appendix I to this paper. The descriptive statistic (table 4.1) reveal that GDP rose from a minimum of about N69 billion in 1986 to a maximum of about N18.6 trillion in 2006 with a mean of about N4.1 billion and a standard deviation of about N5.2 billion. The independent variables and the control variable show similar trend of continuous increases. For instance, the stock market capitalisation rose from N3.7b in 1986 to N4.2trillion in 2006 with a mean of N634b for the 21 years considered. Also, Net Foreign Direct Investment rose from a low of N735m in 1986 to a high of N574 billion in 2006.

Table 4.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
GDP	21	69146.99	18564594.73	4.0867E6	5.18582E6
MACAP	21	3687.80	4228572.10	634779.2714	1.06768E6
VAST	21	22.00	468588.40	60217.1429	1.19197E5
NFDI	20	735.80	573835.10	108403.0650	1.40935E5

3.2 Pearson Moment Correlation Analyses

Correlation was employed to measure the degree of association between the dependent variable-GDP and the independent variables MACAP and VAST. Table 4.2 shows the result of the correlation analyses. The correlation coefficients between GDP and MACAP, VAST and NFDI are respectively 0.975, 0.956 and 0.947. These coefficients are highly significant even at 99% confident level given their common P-values of 0.000. The result shows that the two independent variables as well as the control variable have direct association with GDP, implying that any increases in MACAP, VAST or NFDI will induce a movement of GDP in the same direction

Table 4.2: Pearson Correlations

		GDP	MACAP	VAST	NFDI
GDP	r	1	.975**	.956**	.971**
	Sig. (2-tailed)		.000	.000	.000
MACAP	r	.975**	1	.994**	.967**
	Sig. (2-tailed)	.000		.000	.000
VAST	r	.956**	.994**	1	.947**
	Sig. (2-tailed)	.000	.000		.000
NFDI	r	.971**	.967**	.947**	1
	Sig. (2-tailed)	.000	.000	.000	

**. Correlation is significant at the 0.01 level (2-tailed).

3.3 Regression Analyses

We employed the ordinary least square regression to determine the extent to which the dependent variable has been influenced by the explanatory variables within the period under consideration.

Two simple models guide our analyses.

In model one, we regressed GDP on MACAP and NFDI. The result as summarised in table 4.3

The result reveals the coefficient of MACAP as 2.732 which is highly significant at á = 1% levels. This gives an impression that any unit increase or decrease in MACAP will have a more than double impact on GDP. The control variable in this model-NFDI also has a significant positive coefficient of 15.656 with a p-value of 0.000, which is highly significant at 1% level, indicating that a 10% increase in foreign direct investment could induced about a 150% increase in GDP "all things been equal". The result also shows an adjusted coefficient of determination (adj. R^2) of 0.960 indicating that about 96% of the variation in the GDP is caused by MACAP and NFDI. The F ratio of 227.375 vhich is significant at I% level of significance confirms that the model free from serious specification bias.

4.3: Regression Result Four Model One

	Constant	MACAP	NFDI	R2 Value	Adjusted. R2	F-Value	Sig of F value
	602.002	2.732	15.656	0.964	0.960	227.375	0.000
		3.147	2.346				
		0.006	0.031				

in… app… GDI… of ab… standa… the co… instance… N4.2trill… Also, Net… to a high o…

we replaced our independent variable in model …ST while we retain the NFDI as our control …ressed GDP on VAST and NFDI. The result …he coefficients of VAST and NFDI 16.722 …nificant at 5% and 1% levels respectively, …d 0.001. This result leaves us with the …e independent variables will induced

a more than proportionate change in the GDP. Further, the adjusted R^2 reveal that about 95% of the changes in GDP can be explained by the independent variables. Again, the specification of this model is considered fair as signalled by the F value which is significant at á = 1%.

Table 4.4: Regression Result Four Model Two

	Constant	VAST	NFDI	R^2 values	Adjusted R^2	F-Value	Sig of F value
Coefficient	487654.750	16.722	22.296	0.959	0.954	197.439	0.000
t-statistics	1.287	2.547	3.935				
p-values	.215	.021	.001				

3.4 Hypotheses Testing

This paper was anchored on two propositions which we subject to test in this section.

Hypothesis One: we proposed here that there is a negative relationship between the capital market and economic growth. From the result of the correlation analyses in table 4.2, we saw that all the capital market variables namely; stock market capitalisation (MACAP) and the Value of Share traded (VAST) have correlation coefficients of 0.975 and 0.956 respectively. This coefficient are strong and positive given their common P-values zero. This result threw out our null hypotheses in favour of our alternative. Hence, we conclude that the capital market have a positive relationship with economic growth.

Hypothesis Two: our proposition in hypothesis two was that, for the 21 years period (1986-2006) the impact of the capital market on Nigeria economic growth had not been significant. The result of our regression analyses when we regressed GDP on MACAP indicate coefficient of 2.732 with a p-value of 0.006 which is highly significant at 99% confident level. Besides, the t statistic of 3.147 posted by this model is higher than the critical value of 2.8450 (1%). This result favours the alternative hypothesis at the expense of the null hypothesis. The regression result of model two where we regressed GDP on VAST another capital market development indicator, further confirms this position in terms of coefficient and its significant (see table 4.4). We therefore

conclude that for the past 21 years the capital market has had significant impact on the Nigeria economic growth.

4.0 Conclusion and Recommendation

The main trust of this paper was to investigate into the degree of association as well as the extent of impact between capital market development and Nigeria economic growth. From the result obtained from the data analyses the following findings can be summarised;

i. The relationship between capitals market development and Economic growth is strong and positive.

ii. That the size of the capital market (market capitalisation) is a good determinant of the size of the economy (GDP).

iii. That an active capital market (value of share traded) can leads invariably to an active economy.

It is therefore clear that the capital market is essential for the growth of any nation. It is the channel through which private and public savings are mobilised, and make available for productive purposes, thus enhancing national productivity which translates in economic growth. More so, the liquidity of the stock market (the ease of buying and selling securities) has been adjudged the strongest connection to long term growth. It is therefore not surprising that in Nigeria for instance, the sector first hit by the global melt-down was the stock market, leading to the shrinkage of other sectors in response to it. This makes proactive macro economic measure in favour of the market imperative.

4.2 Recommendation

Based on the revelations from this study, the following recommendation are made with a view that their eventual implementation will in no small measure boost the growth and development of the capital market and consequently, greater benefits to the Nigerian economy. The recommendations are:

1) Proper, adequate and enforceable regulatory framework should be but in place, to ensure orderly and equitable dealings in securities, the protection and security of investors as well as the

discouragement of insider abuses and pull-operations. The extent to which these laws are enforced will have a direct bearing on the development of the stock market.

2) Fiscal incentives, such as differential taxation in favour of listed companies can be used to remedy the problem of low market float. Market float connotes the number and variety of securities available for trading on the stock market, (Eriki 2007). Such an incentive will help increase the number of listed companies on the exchange and improve liquidity of the market.

3) Liquidity of the capital market can be enhanced through aggressive public enlightenment campaign. Such campaigns should be targeted at educating the public on the wealth creating potentials of the capital market as well as against the buy-and-hold attitude of the Nigerian investors, which has the capacities to suffocate the stock market.

4) The regulatory agency may soft pedal on conditions for listing on the first tier securities market, which appear to be too stringent. At least companies that qualify or meet the second tier listing requirements should be admitted into the first tier. As second tier securities does not motivate many investors.

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Appendix 1: Data used for the analyses

YEAR	GDP @ Current Basic Prices	MACAP (₦ Million)	VAST (₦ Million)	Net FDI (Nm)
1986	69146.99	3687.80	22.00	735.8
1987	105222.85	4031.60	27.20	2452.8
1988	139085.29	5089.00	22.40	1718.2
1989	216797.53	8034.70	22.90	13877.4
1990	267549.98	12134.80	87.80	4686
1991	312139.73	18447.50	90.00	6916.1
1992	532613.83	26245.80	237.10	14463.1
1993	683869.78	41830.90	286.60	29660.3
1994	899863.23	61023.90	401.30	22229.2
1995	1933211.55	175064.70	1788.10	75940.6
1996	2702719.12	279783.20	6922.60	111297.8
1997	2801972.57	276304.60	10923.20	110456.2
1998	2708430.87	256774.70	13555.30	80751.1
1999	3194014.96	294465.30	14026.60	92725.3
2000	4582127.30	466058.70	28154.60	115952.2
2001	4725086.00	648449.50	57612.60	132481
2002	6912381.24	748734.60	59311.30	225972
2003	8487031.58	1325672.90	113886.60	
2004	11411066.90	1926465.10	233885.60	249157.7
2005	14572239.11	2523493.30	254707.80	302753.4
2006	18564594.73	4228572.10	468588.40	573835.1

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