www.irmbrjournal.com June 2018
International Review of Management and Business Research Vol. 7 Issue.2

The Impact of Public Sector Expenditure on the Development of the Nigerian Capital Market

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Abstract

This study was carried out to examine the effect of public sector expenditure on the development of the Nigerian capital market, through an empirical examination of the transmission of capital, recurrent and total public sector expenditure on market capitalization and value of transactions. Secondary data were extracted, tabulated and analysed using the ordinary least square of multiple regression technique. The study found that capital expenditure, recurrent expenditure and total government expenditure had significant relationship with market capitalization, and total value of transaction. The study recommended, among others, that government should take steps to strengthen the capital market and enhance public confidence in its operation so that beneficiaries of public sector spending can channel some of this into transactions in the capital market. The study suggested that government can use public sector expenditure as a tool to improve the performance of the capital market in Nigeria, by re-engineering public perception of the investment valence of the capital market.

Keywords: *Capital Expenditure, Recurrent Expenditure, Market Capitalization, Market Development*.

Introduction

The capital market has become, increasingly, recognized as a viable and efficient tool for the growth of an economy (Soludo, 2005). The capital market is a segment of the financial market where medium to long term financial instruments are created and traded to meet the long term funding needs of economic agents (Nyong, 2005). Many economies appreciate the capital market as a major source for long term finance and, accordingly, adopt policies that will enhance its activities. The degree of effectiveness and efficiency of the market often determines the extent of its contribution to the process of economic development (Adedipe, 2004). There is no doubt that government plays a significant role in the development of the economy because, through its public sector expenditure, it exercises control over the economy and channels resources to the desired direction of economic development. Public expenditure refers to the expenses

which government incurs for the maintenance of the operations of government and the well-being of the society in general (Okoh, 2008). In Nigeria, according to Nyong (2007), public sector expenditure has increased continuously in the last three decades. Razin (2007) believes that government expenditure affects the development of the capital market through its effect on the decisions and activities of the private firms and households benefiting from it. The Nigerian capital market had been growing steadily prior to the global recession, necessitating the various sub-national governments to undertake fiscal policy interventions to stabilize and grow their sub-economies. This is hinged on the fact that fiscal policy is a vital instrument for macroeconomic management and a rewarding stabilizing instrument. All things being equal, the turnover of firms which enjoy high government patronage may experience a boost, which could translate into enhanced profitability and impressive dividends for the shareholders of the firms. Improved profitability and impressive dividends enhance the attractiveness of firms listed on the capital market and drive up demand for them on the trading floor. This drives up the stock price and market capitalization of the firm and hence, the market capitalization of the entire capital market given that the market is functional and efficient. A second channel through which public sector expenditure affects stock market development is through the transmission of the income (wages, salaries, debt payments, etc.) of government employees and contractors into savings accumulation and investments. Government employees and contractors may invest part of their derived incomes in capital market securities. This flow, however, depends on their perception of the market – its stability, returns on investment therefrom relative to alternative investments. If these recipients' perception and expectations of the capital market performance is favourable and assured, this could elicit their participation in the market, *ceteris paribus*, leading to increase in stock market transactions (Edore, 2014). For this reason, several policies have been formulated by relevant authorities towards enhancing the development of the Nigeria capital market by seeking to draw recipients of public sector expenditure into investments in the capital market. The capital market plays an important role in the economic development of many countries because the positive performance of capital market tends to affect business investment activities which, in turn, affect the wealth and consumption of households. Although in the past decades, public sector expenditure in Nigeria has risen significantly, the transmission of this to the development of the capital market has hardly been investigated. It is generally held that the performance of the capital market in a developing economy, like Nigeria, is significantly influenced by macroeconomic factors, yet the direction of this influence remains unsettled. There is a gap in empirical literature on the connection of public sector expenditure in Nigeria and the direction of capital market performance indicators. Therefore, the objective of the study is to examine the nature and direction of the relationship between public sector spending and capital market development in Nigeria. More specifically, it seeks to determine the relationship between public sector expenditure and market capitalization as well as to ascertain the relationship between total public sector expenditure and value of transactions on the Nigeria's capital market. In order to achieve these objectives, the study is divided into five sections. Section one is the introduction, section two reviews related literature while section three presents the research methodology. Section four is on presentation, analysis and discussion of findings and, finally, section five is on the summary of findings, conclusion and recommendations.

Based on the study objectives and the research questions above, the following null hypotheses were formulated for the study.

Hypothesis one:

H_o: There is no significant relationship between public sector expenditure and market capitalization in Nigeria.

Hypothesis two:

H_o: There is no significant relationship between total public sector expenditure and value of transactions in the Nigeria capital market.

This study will be relevant to several organizations, institution and governing bodies regulating the stock market activities in Nigeria. This work will also be of immense benefit to the policy makers and economic planners in terms of using the findings in formulating and implementing appropriate policy measures towards accelerating growth through the capital market. To the academia, the findings of the study will add to the available literature on the current scenario of public sector expenditure in Nigeria and its level of contribution to capital market development, as well as form the basis for further research.

Theoretical Framework and Literature Review

Theoretical Framework

This work is based on the Keynesian total expenditure model or the Keynesian theory, which is that government spending stimulates expansion in business output and provides short term stimulus to halt a recession or depression (Aigheyisi and Edore, 2014). According to the Keynesian total expenditure model, government spending stimulates expansion in business output and provides short term stimulus to help halt a recession or depression. This model is supported by the Ram's (1986) Growth Accounting Model which suggests that government expenditure generally affects economic growth and performance in a favourable manner through a positive externality effect on growth. This model is supported by the Growth Accounting Model (Ram, 1986) which suggests that government expenditure generally affects economic growth and performance in a favourable manner through a positive externality effect on growth (Oaikheman and Aigheyisi, 2014). Hence, according to this theory, government expenditure affects the development of the capital market through its effect on the decisions and activities of the private sector firms and households (Razin, 1987). Keynes rejected the classical view and offered a completely new concept of output determination. He believes that spending induces business firms to supply goods and services. From this, he argued that if total spending fell, business firms would respond by cutting back production. Less spending would thus lead to less output. Hence, this work is based on this Keynesian theory which emphasized that public sector expenditure will enhance economic growth and development since capital development is an aspect of economic development.

Literature Review

Public expenditure refers to the expenses which government incurs for the maintenance of the government and the society in general (Okoh, 2008). Throughout the 19th century, most governments followed laissez faire economic policies and their functions were only restricted to defending aggression and maintaining law and order (Wagner, 1962). The size of public expenditure was very small, but now the expenditure of governments all over has significantly increased. In the early 20th century, John Maynard Keynes advocated the role of public expenditure in determination of level of income and its distribution. Classification of public expenditure refers to the systematic arrangement of different items on which the government incurs expenditure (Nyong, 2007). Different economists have looked at public expenditure from different points of view and have classified it as follows:

a. Expenditure on political executives i.e. maintenance of ceremonial heads of state, like the President.
b. Administrative expenditure; to maintain the general administration of the country like government departments and agencies.
c. Security expenditure; to maintain the armed forces and the police.
d. Expenditure on administration of justice includes maintenance of courts, judges, public prosecutors.
e. Developmental expenditures; to promote growth and development of the economy like expenditure on infrastructure, irrigation etc.
f. Social expenditure; on public health, community, welfare, social security etc.
g. Public debt charges; include payment of interest and repayment of principle amount.

Government issues domestic instruments such as development bonds to raise funds with which to finance infrastructural development, amongst others. If the coupon rates on the bonds are attractive, this may stimulate increased transactions in the securities leading to increase in volume of stock market transactions, (Anyanwu, 1997). However, if government expenditure engenders increase in the lending interest rate of lending institutions, this may impact negatively on the development of the capital market as the stock prices of quoted firms may be adversely affected as a result of their inability to obtain business loans at the higher interest rate, and increase in their interest expenditure arising therefrom, thus leading to a decline in their profit levels, which could have adverse effect on stock prices and transactions on the capital market (Onoh, 2002).

The capital market is the market for organized issuance and trading of corporate stocks, either through official trading or over the counter, in electronic or physical form (Suthar, Patel and Parikh, 2012). This facilitates the flow of funds from economic agents with surplus funds to those in need of funds. Clearly, the greater this transmission efficiency is, the higher the rate of capital formation and consequently the higher the growth of the capital market in particular and the economy, in general (Udoka and Ibor, 2014). This is because the market exhibits daily, weekly, monthly, quarterly and annual behaviours and also responds to internal and external developments and shocks, which can be monitored and analyzed through the major market indices such as market capitalization, All-Share index, number of listed companies, etc. The capital market provides facilities for trading on the financial assets and instruments to infuse liquidity (Nzotta, 2004) and is the second segment of the financial market. Onoh (2010) views the capital market as the market for long term financial instruments and a platform for channeling funds from the surplus units of the economy to the deficit ones.

Stock market development indicators are also used as capital market development indicators in numerous empirical works (Kolapo and Adaramola, 2012). Thus, the stock market is described as a market for second-hand securities and is also referred to as the secondary segment of the capital market. It provides the facilities needed to induce liquidity in securities (bonds, equity etc.) that had been issued at the primary window of the capital market, through trade in the securities (Salami, 2004).

Effective mobilization and allocation of investment funds to enable business and the economies harness their human, material and management resources for optimal output have long been advocated in financial literature. It is generally conceded that the capital market plays a prime role as the medium through which efficiency in capital formation and allocation is mostly promoted; thus, making obvious the prominent role which the development of the capital market can play in promoting the growth of businesses and the economies of developing countries like Nigeria. Identifying the underlying factors that influence the development of the capital market has been a subject of debate among economists and financial experts; while some studies have identified macroeconomic factors influencing capital market development (Aya, 2011), others have isolated both macroeconomic factors and institutional qualities (Cherif and Gazdor, 2010). However, market development is a multidimensional concept. It is usually measured by capital market size, liquidity, volatility concentration with world capital markets, or the legal rule in the market (Garcia, 1999). Many researchers used market capitalization as a percentage of gross domestic product (GDP) to measure capital market development because it is believed to be a better proxy and less arbitrary than other individual measures of capital market development that are often used such as number of listed companies, change in the stock market index, index of capital market size and liquidity (Aya, 2011).

In Nigeria, most studies on capital market development have hardly focused on the relationship between capital market and government expenditure (Anyawu, 2005). The few that have concentrated on analyzing the macroeconomic factors that influence capital market development have limited themselves to the use of narrower measures of capital market development (Akpan, 2011). An examination of the empirical literature indicates scholar have isolated the fact that macroeconomic factors such as income level, gross domestic investment, banking and financial sector development, private capital flows, stock market

liquidity, savings rate and macroeconomic stability policies (including interest, exchange rate and inflation rates), impact on capital market development (Akpan, 2011) .

Government expenditure affects the development of the capital market through its effect on the decisions and activities of the private sector firms and households (Razin, 2007). All things being equal, the turnover of firms which enjoy high government patronage, may experience a boost, which could translate into enhanced profitability and impressive dividends for the shareholders of the firms (depending on the level of the firm's expenses and its dividend policy) which impacts the well-being of their households. Without doubt, improved profitability and impressive dividends enhance the attractiveness of firms listed on the stock exchange, and drive up demand for them on the trading floor. This drives up the stock price and the market capitalization of the firms, and hence the market capitalization of the stock exchange, as well as the value of transactions, given that the market is functional and efficient. A second channel through which government expenditure affects capital market development is its effect on the income (wages, salaries, etc.) of government employees. Government employees may invest part of their income in capital market securities, depending on their perception of the market, expectation of returns on investment and the rate of return on alternative investment. If workers' perception of the stock market is favourable, and their rational expectations of superior returns on market investments are high, this could elicit their participation in the market, *ceteris paribus*, leading to increase in capital market transactions. Nonetheless, the empirical literature on the relationship between government spending and capital market development is very lean.

Empirical Review

Aigheyisi and Edore (2014) employs the methodology of co-integration and error correction mechanism to investigate the effect of government expenditure and volume of transactions on the trading floors of the Nigeria capital market using annual time series data sourced from the Central Bank of Nigeria Statistical Bulletin. The empirical evidence indicates that short run and long run effects of government recurrent expenditure and volume of transaction on the Nigerian stock exchange are statically insignificant. Government capital expenditure is observed to have had significant negative short run and long run effects on volume of transactions in the capital market (Owolabi and Ajayi, 2013). Yartey (2004), examined the macroeconomic and institutional factors influencing capital market development in forty two (42) emerging economies including South Africa, using a panel data and adopting a generalized method of moment (GMM) and found that macroeconomic factors such as income level, gross domestic investment, financial sector development, private cash flows and stock market liquidity are important correlates of capital market development in emerging countries markets. It is noted that the empirical literature on the relationship between government spending and the capital market in Nigeria is very lean.

Bekhet and Othman (2012) employed the methodology of vector error correction modeling to examine the role of fiscal policy in the Malaysian stock market using quarterly data covering the period from 1999 – Q1 to 2011 Q4. The analysis showed amongst others, that government expenditure had no significant long-run and short-run effect it on the growth of Malaysian stock market in the same period. Similarly, Gowriah et al (2014) investigate the effect of monetary and fiscal policies on stock prices on the Mauritius Stock Exchange. The results revealed no significant short term or long term relationship between budget deficit and stock prices.

Research Methodology

Research design is a framework or plan that is used as a guide in collecting and analyzing data for a study. In this research, the type of research design employed is the ex-post facto design, because this is a systematic empirical study in which the researcher does not, in any way, control or manipulate the independent variables. That is, this research design was chosen because the event that is observed in this research work (public sector expenditure) had taken place already and nothing can be done to manipulate

the figures under the years surveyed, except to observe and evaluate them either to guide policy or explain scenarios.

Sources of data

The secondary data used in the study were sourced from Central Bank of Nigeria Statistical Bulletins and Stock Exchange Factbook, complemented with journal publications, textbooks and internet sources.

Method of data collection

The desk survey method was used to collect, collate, summarize and tabulate data from the indicated publications, without any form of manipulation by the researcher.

Model specification

To assess the impact of public sector expenditure on the development of the Nigerian capital market, we formulated the model equations as:

Model Equation 1
MKT CAP = f (CAPEXP, RECEXP, TOGEXP)
The regression model, based on the above function, is represented as follows:

$MKTCAP = b_o + b_1 CAPEXP + b_2 RECEXP + b_3 TOGEXP + u$ ---------- (1)

Where;

MKTCAP	=	Market capitalization
CAPEXP	=	Total government capital expenditure
RECEXP	=	Total government recurrent expenditure
TOGEXP	=	Total government expenditure
u	=	Stochastic error

Model Equation 2

We formulate the second model as:
TOTVOT = f (CAPEXP, RECEXP, TOGEXP)

$TOTVOT = \beta_o + \beta_1 CAPEXP + \beta_2 RECEXP + \beta_3 TOGEXP + u$ ---------- (2)
Where TOTVOT = Total value of transactions
And other variables are as previously defined.
A *priori*, $b_o, b_1, b_2, b_3, \beta_0, \beta_1, \beta_2, \beta_3 > 0$
Mathematically, these models are represented as;
$Y = b_o + b_1X_1 + b_2X_2 + b_3X_3 + U$

Techniques of data analysis

The study employed the ordinary least square of multiple regression statistical technique to empirically assess the impact of the independent variables on the dependent variable. The choice of the techniques is based on the fact that the computational procedure of regression is fairly simple as compared with other econometric techniques and the data requirements, has minimal bias and is widely used in research.

Data Presentation, Analysis and Discussion of Findings

Data presentation

The macroeconomic and financial indicators on Nigeria's public sector expenditure and the Nigerian capital market collected, presented and used for analysis in the study cover the period 1990 to 2015:

Analysis of data

The result of the regression on the relationship of public sector expenditure and the development of the Nigerian capital market is presented in Tables 1 and 2, below:

Table 1: Regression result

Dependent variable: MKTCAP

Variable	Coefficient	Std error	t-stat	Prob
C	4.942708	1.300347	3.801069*	0.0007
CAPEXP	13.430190	0.796140	16.86913*	0.0000
RECEXP	9.6399386	2.715725	3.668999*	0.0000
TOGEXP	3.974717	0.775554	5.125006*	0.0070

R^2	=	0.973047
R^2(adj)	=	0.964062
SER	=	566553.4
DW	=	1.777999
F-stat	=	108.3038

*Significant at 1% level.

Source: Authors' computation with E-views

Table 2 Regression result

Dependent variable: TOTVOT

Variable	Coefficient	Std error	t-stat	Prob
C	9.620174	2.632803	3.653966*	0.0012
CAPEXP	29.83839	12.87838	2.316936*	0.0290
RECEXP	11.15815	0.795639	14.02413*	0.0000
TOGEXP	2.852792	0.965709	2.954098*	0.0059

R^2	=	0.967805
R^2(adj)	=	0.958458
SER	=	611523.1
DW	=	2.072211
F-stat	=	103.5417

*Significant at 1% level.

Source: Authors' computation with E-views 7.0

Analysis of data (Model Equation 1)

From the results under model equation one, presented on Table 1, the coefficient of multiple determinations (R^2) is 0.967805 and an adjusted R^2 is 0.958458, indicating that over 96 percent of variations in the observed behaviour of market capitalization is jointly explained by the independent variables namely: CAPEXP, REXP, TOGEXP. This shows that the model fits the data well (has a tight fit). The model reports an effectively high F-statistic value of 108.3038 which, when compared with the table value, indicates that the high-adjusted R^2 value is better than would have occurred by chance; therefore, the model is statistically robust and good for prediction. Using this criterion, therefore capital expenditure, recurrent expenditure and total expenditure are significant at one and five percent levels. Specifically, a one percent increase in these variables; CAPEXP (13.43%), REXP (9.96%) and TOGEXP (3.97%) will prop up the market capitalization more than proportionately. The constant term indicates that, if all variables are held constant, the capital market development will be improved by 4.94. The DW statistic (1.7779) is used to test for the serial correlation in the residuals of the model. The decision rule is that if the calculated DW falls outside du and 4-du, then there is a serial correlation in the residuals. This study's calculated DW statistic of 1.777, which falls outside the region (though close to 2.0), indicates that the estimates should be interpreted with caution. The goodness of fit of the model indicated by the adjusted R-squared, shows that total variation in the observed behaviour of market capitalization (MKTCAP), used as a measure of capital market development, is jointly explained by variations in CAPEX, REXP, TOGEXP Overall, the relationship of the model variables did not occur by chance and further that the model fits the data well and the signs of the parameter estimates conform with *a priori* economic theory expectations.

Analysis of data (Model Equation 2)

In the second model, the result presented showed that the R-squared (0.967805) and adjusted R-squared (0.958458) confirmed the model estimated to have a goodness fit. In particular, the high adjusted R-squared value of about 96 percent proved that model has a very high explanatory power. The f-statistic high value of 103.541 also showed that at the standard one percent, significance level proved that the entire model was statistically significant. This implies impact on the dependent variables. The DW value of 2.072211 revealed the presence of no autocorrelation among the residual terms in the model. This means that the model is well specified and well-behaved; therefore, good for statistical prediction and policy formulation.

Test of Hypotheses

In order to test the already stated hypotheses, the following decision rule is stated.

Decision Rule

The decision rule is to reject the null hypothesis of the F-calculated is larger than F-tabulated and accept it if the F-calculated comes out lower than t-tabulated.

Hypothesis One: There is no significant relationship between public sector expenditure and market capitalization in Nigeria

Result: F-calculated = 108.3038, F-critical at (N-K)(k-1) at 22 df 0.01 = 3.07

Based on these results and decision rule, the null hypothesis is rejected and alternate hypothesis is accepted. So, it is concluded that there is a significant relationship between public sector expenditure and market capitalization.

Hypothesis Two: There is no significant relationship between public sector expenditure and value of transactions in the Nigeria capital market

Results: F-calculated = 103.5417; F-critical at (N-K)(k-1) at 22 df 0.01 = 3.07

Based on these results and decision rule, the null hypothesis is rejected and the alternative is upheld: that there is a significant relationship between public sector expenditure and total value of transaction.

Discussion of Findings

The study examined the relationship of public sector expenditure and capital market development in Nigeria. From the results of our analysis of the data used, capital expenditure has a significant impact on the growth and development of capital market using market capitalization as a proxy. This means that government can use public sector expenditure as a tool to improve the performance of the capital markets in Nigeria, by re-engineering public perception of the investment valence of the capital market. The finding conforms to the works of Razin (2007) who postulates that government expenditure affects the development of the stock market through its effect on the decisions and activities of the private sector firms and households.

In hypothesis two it was shown that there is a significant relationship between public sector expenditure and total value of transactions traded in the capital market. Expenditure plays a vital role on the growth and development of capital market transactions. It was a factor that catalyzed the activities of capital market in Nigeria. The finding conforms to the works of many scholars who posit that government expenditure positively affects value of transaction in Nigeria.

Summary of Findings, Conclusion and Recommendations

Summary of Findings

Based on the analysis of the results, the following findings were made thus;

1. There is a significant relationship between capital expenditure and market capitalization.
2. There is a significant relationship between recurrent expenditure and market capitalization.
3. There is a positive relationship between total public sector expenditure and market capitalization.
4. There is a positive, and significant, relationship between total public sector expenditure and total value of transactions.

Conclusion

The study concludes that government expenditure positively influences total capital stock available to the public, which when employed in the acquisition of stocks/capital market instruments, enhances the development of capital market.

Recommendations

Based on the study findings, it is recommended that government should take steps to strengthen the capital market and enhance public confidence in and perception of its operations so that beneficiaries of public sector spending can channel some of this into transactions in the capital market. Secondly, policies to make capital expenditure more productive should be pursued to enhance its contribution to economic growth through enhanced purchasing power of the beneficiaries of public sector expenditures, to impact the implicated stock market performance indicators favourably.

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