

Descriptive Analysis of Savings and Growth in Nigeria

Economy

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Abstract

This study aims at providing qualitative analysis of the relationship between domestic savings and economic growth in Nigeria. This study employed annual secondary data obtained from World Data Indicator (WDI), World Bank publication and Statistical Bulletin of the Central Bank of Nigeria for the period of 1970 to 2006. Descriptive Statistics were used.

This study therefore concludes that the problem with Nigeria's economy is not that of mobilizing domestic savings but that of intermediation and thus recommends that government should adopt policy enhancing intermediation between savings and investment in the economy by providing regulating and coordinating role to ensure effective intermediation between savings and growth in the economy.

Key words: Domestic Savings, Economic Growth, Investment

1. Introduction

Savings which is defined as that part of income not immediately spent or consumed but reserved for future consumption, investment or for unforeseen contingencies, is considered as an indispensable weapon for economic growth and development. Its role is reflected in capital formation through increase capital stock and the impact it makes on the capacity to generate more and higher income.

It is widely agreed on one side that countries that save more also tend to grow faster provided the financial system is deep while on the other hand, some analysts fear that a rising savings rate could hamper economic recovery if consumer expenditures form a large component of aggregate demand. Low savings rate has been cited by some study as one of the most serious constraint to sustainable economic growth, one of those studies is that of World Bank that concludes that on the average, third world countries with higher growth rates incidentally are those with higher saving rates (World Bank 1989). United Nation also maintained that increasing savings and ensuring that they are directed to productive investment are central to accelerating economic growth (UN Department of Economics and Social Affairs 2005). This makes savings as a macroeconomic variable to attain economic growth a subject of critical consideration.

This study is devoted to examining the trend of domestic savings and economic growth in Nigeria economy. The essence of analyzing the trend of savings and investment is to find out whether saving promoting policies lead to more investment activities and consequently economic growth in Nigeria. In other words, it enables us to examine the existence of savings – investment gap in the economy, and the reaction of savings and investment to various policies in the country between 1970 and 2006.

According to Lewis (1954), ‘The central problem in the theory of economic development is to understand the process by which a community which was previously saving and investing 4 or 5 percent of its national income or less converts itself into an economy where voluntary savings increases to about 12 or 15 percent of national income or more. The wholesome idea about development is rapid capital accumulation (including knowledge and skills with capital)’, He explained further that, we cannot explain any industrial revolution until we can explain why savings increase relative to national income. This necessitates examining the interaction between domestic savings and economic growth of the country.

Moreover, the relationship between savings and investment can have significant implication on the state of the economy. High savings and investment gap can have resultant effect on balance of payment equilibrium. Although attracting foreign capital remain a necessity that cannot be avoided especially for a developing economy like Nigeria. Long term and heavy dependence on foreign capital can have adverse effect on economic stability. This will leave countries vulnerable to external shocks and in terms of Foreign Direct Investment there may be a continual outflow of profits lasting much longer than outflow of debt service payment on loan of equivalent amount in term of repatriation of profits. While a loan involves an obligation for a definite number of years, FDI may be a long term commitment.

Though it is assumed that increases in the level of investment will bring about reduction in unemployment rate as well as poverty and an increase in the provision of social and infrastructural facilities in the country, but do we generate enough domestic private savings to boost investment need as well as developmental need in Nigeria? However do we really need to save more in the economy? Ordinarily other external sources are expected to fill the gap between investment and savings. This is a case when required investment is greater than the actual savings. Contrary to this, in Nigeria’s situation except in 1986, domestic savings has always been greater than investment in which case there is no gap to fill. Where now does the problem lies? Is it savings, investment or the link? Apart from 1986 when gross domestic savings (GDS) was very low, GDS as a percentage of gross domestic products (GDP) has always been higher than gross capital formation (GCF), while the growth rate of the economy has been dismally low

However, investment outcome has not been encouraging in Nigeria which is a reflection of sub optimal operating environment, resulting from inappropriate policy initiatives (Ebjemito *et al* 2004). It has been the desire of successive government in Nigeria to increase its national output and the economic wellbeing of the people through rapid industrialization. The efforts and policies embarked on seems to have been less successful, Thus Nigeria (like any other developing economy) sees attracting foreign investment as alternative to domestic source of financing. Attracting foreign investors is the primary target of most of the states in the country to achieve growth as well as providing employment opportunities to the teeming unemployed in the economy. This is a reflection of recent foreign tours to China and other developed countries by the Governors of various states and bilateral agreements at the federal level. Nigeria’s economy is now tending towards over reliance on foreign economy both in consumption and investment pattern. Little or no effort is being made at mobilizing domestic savings for domestic investment. The fact is that foreign investment is almost crowding out domestic investment.

Masson *et al* (1998) pointed out that capital accumulation, not technological progress, explains the growth rates of the East Asian “tigers” along with Korea and Hong Kong. Some studies in Nigeria argue that there is need to increase the tempo of investment that would lead to higher growth rate as is the case with Asian tiger to register increased growth and development in Nigeria (Soludo 1998; Ebajemito *et al.* 2004; World Bank 2007). Nigeria’s investment /GDP ratio which average 22.9 percent in 70’s, 16.5 percent in 80’s 19.8 percent in 90’s is averagely below the benchmark of international investment /GDP ratio of 20 percent that is believed to propel an economy to the path of growth and development (Usman 2007), though 23 percent on the average was attained in 2000-2005 but drastically reduced to 12.5 percent in 2006. For instance investment /GDP has never gone below 20 percent in some Asian countries like China, Korea, Malaysia, Singapore and Thailand with 30.5 percent 28.4 percent, 22.9 percent, 40.5 percent, and 25.8 percent respectively in the 70’s, while in the 80’s it was 36.2 percent, 30.4 percent, 27.8 percent, 42.5 percent, and 29.5 percent respectively. 39.1 percent, 35.4 percent, 36.3 percent, 35.3 percent, and 36.3 percent respectively in 90’s, while averagely it was 39.6 percent, 30 percent, 23.2 percent, 22.9 percent and 25.7 percent respectively for 2000-2005 (World Bank 2007). How do we reverse this ugly trend? This is probably the reason why opting for foreign resources is prioritized by governments in Africa countries especially Nigeria.

The expansionary measure introduced by Nigeria’s government in the early 70’s was aimed at increasing the liquidity in the economy so as to aid the growth of the economy. It was aimed that this will increase the disposable income of the people which is expected to be distributed over both savings and consumption. This is consequently expected to raise the level of investments and thus increase the growth of the economy.

In the same decade, indigenization policy was introduced, which aimed at domestic ownership of production in the economy. The effectiveness of this measure is expected to be reflected in the rate of savings, investment and economic growth of the country.

Apart from this introduction, this paper is divided into five sections. Section two discusses the trend of economic growth; section two examines the trend of domestic savings. While section three examines the trend of investment, section four analyzes the gap between savings and investment, and section five highlights the findings.

2. The Trend of Economic Growth

The growth rate of domestic product in Nigeria reached its peak in 1970 with about 25% annual growth. In the mid-1970s, income fluctuated with little overall trend, but then it plummeted in 1981 with the onset of an acute economic crisis. Despite the discovery and exploration of crude oil in 70’s, it consistently fell beyond zero percent in 1975 and 1978 with exception of 1974 when it was 11%. This continued to fall to about -13% in 1981 which marked the beginning of economic crises as a result of fall in the price of crude oil in the global market. Between 1981 and 1984, real output fell at an annual average rate of nearly 6 percent which incidentally increased to about 10% in 1985. The Structural Adjustment program adopted in 1986 brought about temporary relief, with real growth averaging over 8% per annum between 1988 and 1990. Despite the introduction of structural adjustment program in 1986 to resuscitate the economy as recommended by the World Bank, the growth of GDP in the economy could not attain two digits throughout the 80’s except in 1988. The 1990s, however, witnessed nearly complete stagnation, with average income growing at a rate almost less than half a percentage point per annum. and throughout the 90’s, it has the highest of 8% in 1990 and since then fell to zero percent in 1994 and 1 % in 1999. It increased to 5% in 2000 and 11% in 2003 and thus decreased through to 2006.

In order to fully explain the trend of economic growth between 1970 and 2006 period, it was found desirable to split the period into three sub-periods, with the line of demarcation given by the initiation of major economic reforms under the aegis of the 1986 Structural Adjustment Program (SAP). We refer to these periods as the pre-liberalization era (1970-1986) and the economic liberalization era (1987-1999) and democratic or post liberalization era (2000-2006). The central objective of Nigeria's Structural Adjustment Program was to restructure and diversify the productive base of the economy in order to reduce dependence on the oil sector and on imports. Originally planned to last for only two years (July 1986 to June 1988), the SAP period was extended several times to allow for the phased introduction of the requisite policy reforms and provide a period within which results could come to fruition. In policy analysis, therefore, the SAP epoch is now generally taken to cover the period from 1987 to 1992. Unfortunately, the SAP did not deliver all its protagonists promised

2.1 *Pre Liberalization Era: 1970-1986*

Oil already accounted for 57.5% of total exports in 1970, and by 1977, it accounted for 93.3% (Iyoha 1995). During the boom, balance of payments surpluses and buoyant government revenues led to a major expansion in government expenditures, including capital expenditures.

Investment, and particularly public investment, rose very sharply during this period: in 1976, the aggregate investment-income ratio was an impressive 31.5%, while aggregate domestic savings was around 26%. See table 1 in appendix.

Over the full period of the oil boom, the excessive and highly inefficient public investment response is consistent with successive governments having viewed the boom as effectively permanent. Bevan *et al.* (1992) observed that it was not until after the fall of oil revenues in 1980/81 that the Nigerian government recognized the transitory nature of the shock.

2.2 *Liberalization Era: 1987-1999:*

The SAP and post-SAP periods were marked by deregulation and economic liberalization. However, the success of market liberalization was constrained throughout by haphazard implementation, frequent policy reversals, weak institutions, and the regional redistribution syndrome. Thus, in spite of a determined effort to deregulate and liberalize both the real and financial sectors of the economy, the average rate of economic growth barely exceeded that of the pre-liberalization period.

The Structural Adjustment Programme introduced in 1986 constituted the institutional framework for the design and application of trade and commercial policies for a substantial part of the 1987–1999 periods.

Towards the end of the 1980s, the continuation of economic distress led to the introduction of a new set of reform-oriented measures, some of which were a direct reversal of measures introduced under the SAP. These measures include prohibition of export of certain crops and their derivatives, reversal of 1988 tariff reforms and adoption of fixed exchange rate in 1994.

Indeed, overall average economic growth differs only marginally between the pre liberalization and liberalization era, this amount to 3.7% during the period of economic controls, and 3.6% during the liberalization era, while the post liberalization has average of 6% economic growth (see table 2 and 3). The inter-temporal pattern of growth differs markedly, with the first period characterized by a massive boom and bust cycle and the second by protracted stagnation following an initial burst of growth.

2.3 Democratic or Post Liberalization Era: 2000-2006

For the first two years after the return to democratic rule in 1999, the Nigerian economy continued to report poor overall economic performance. It was widely expected that with the dawn of democratic revival in Nigeria, economic growth would resume and accelerate, leading to significant reduction in poverty. Unfortunately, this did not immediately happen and economic growth continued to be lackluster and unprepossessing. This necessitates the actualization of the U.N.'s Millennium Development Goals (MDGs). Thus, starting from 2001, government started to introduce economic reforms. In 2003, the reform programme was formalized and systematized and government began to implement a comprehensive reform program known as the National Economic Empowerment and Development Strategy (NEEDS). The comprehensive reform program was implemented in four main areas: Macroeconomic Reform; Structural Reform; Governance and Institutional Reform; and Public Sector Reform. Under the Macroeconomic Reform Program, government adopted prudent oil price-based fiscal rule; introduced Medium Term Expenditure Framework (MTEF) and Medium Term Sector Strategies (MTSS); improved implementation of monetary policy by Central Bank; undertook a bank consolidation exercise to strengthen financial sector; adopted trade liberalization policies; and undertook the privatization of some government enterprises. Under the Structural Reform Program, there has been a bank consolidation exercise to strengthen financial sector; Trade liberalization reform; and privatization of some government enterprises. Under Institutional and Governance Reforms, government introduced the *Due Process* mechanism in public procurement; adopted the *Extractive Industries Transparency Initiative (EITI)* in Nigeria; and established the Economic and Financial Crimes Commission (EFCC) and Independent Corrupt Practices Commission (ICPC) to address corruption in public offices. Under the Public Sector Reforms, there has been a restructuring of some government agencies and an increased focus on service delivery.

The improvement in macroeconomic policy making, guided by reforms of 2003 and good governance has started to yield good dividends. Real GDP growth has improved, averaging 6.0 percent per annum since 2003 which is an improvement over 3 percent attained for the period of 2000 - 2003.

Overall, in contrast to the trend of growth of GDP, the percentage of GDP saved continued to increase from 12% in 1970 to 28% in 1974 and 31% in 1977 and 1980, while the growth of GDP fell from 25% in 1970 to 11% in 1974 while it was 6% and 4% in 1977 and 1980 respectively. The proportion of GDP saved continued to fall from 31% in 1980 to 13% in 1985 and it increased to 29% in 1990 while the annual growth rate continued to rise from -13% in 1981 to 10% 1985 and fell back to 8% in 1990. It continued to fall to zero percent in 1994 and increased cyclically to 5% in 2000 while the percentage of GDP saved decreased to 21% in 1994 but to later increase to 42% in 2000.

3. The Trend of Domestic Savings

The proportion of GDP committed to savings continued to rise from 12% in 1970 to 28% in 1974. It then started to fluctuate until 1980. Hence the proportion started falling from about 31% in 1980 to about 12% in 1986, after which it started increasing continuously up to 29% in 1990. Thereafter it started falling ridiculously to about 18% in 1995. Since then it has been fluctuating at increasing rate to about 42% in 2000 and 39% in 2005 and thereabout in 2006 (See table 4).

The relative increase in this proportion in the early 70's up to 1980 can be attributed to the expansionary policy of the government through increase in wages of the workers in the early 70's. This effect lasted till late 70's specifically 1980 when Nigeria experienced another downturn in the economy. The reduction in this proportion from 1980 to 1986 was as a result of economic crisis experienced then when the prices of crude oil fell in the world market.

In 1986, Nigeria government took a bold step at combating the effect of this crisis by introducing Structural Adjustment Program (SAP). Domestic savings reacted instantly to this policy and picked up from about 12% in 1986 to about 29% in 1990, 35% in 1996 and 42% in the year 2000.

4. The Trend of Investment

The ratio of investment to G D P also seems to follow the same trend as domestic savings in the early 70's. The oil boom of the early 1970s had a pervasive effect on the growth and development of the economy. Oil suddenly became the dominant sector of the economy, accounting for more than 90 per cent of exports, and the main source of revenue. Between 1972 and 1974, federal revenue from oil increased fivefold, contributing about 80 per cent of total revenue. Nigeria's new wealth substantially affected the scope and content of investment, production, and consumption patterns, the government's approach to economic management, and the policies and programs implemented. Federal expenditures doubled between 1973 and 1974, and between 1974 and 1975, much of the increased expenditure went into investment. It increased from about 15% in 1970 to about 31% in 1976, which is the highest within the period under study.

Since 1976, apart from some years after the introduction of S A P in 1986, investment as a percentage of G D P was dismally low on annual basis. It fell from about 31% in 1976 to about 9% in 1985. It has since then increased cyclically to about 23% in 1991 and 1993 and to about 26% in 2002 but never up to pre crisis level.

This proportion reacted positively to the expansionary measure of government in the early 70's up to some years before the 1981 economic crisis. The crisis forced the proportion of G D P committed to investment to fall from about 23% in 1981 to about 9% in 1985.

It is worth noting that the indigenization policy introduced by the federal government in the late 70's has a negative effect on the proportion of Gross Domestic Product invested. This is manifested in the reduction of the proportion from about 31% in 1976 to about 21% in 1980 and about 9% in 1985 (See table 5 in appendix)

Considering the privatization and commercialization policy embarked upon by the government in the late 90's, it seems not to have any significant effect on the proportion of G D P invested. Though, relatively higher than before then, but not yet up to about 31% attained in 1976.

5. Savings – Investment Gap

Savings and investment ratio to GDP seem to move closely together and are relatively following the same trend between 1970 and 1986, which thereafter followed diverse trend though they are both cyclical (see table 6 and figure 3 in appendix). Starting point of such departure appears to coincide roughly with the implementation of Structural Adjustment Program (S A P) and gets wider the following decades.

Actually the focus of this study is not to examine the rate of investment needed to spur economic growth but the relevance of domestic source of financing the investment and its consequential effect on economic growth. Table 6 reveals that out of 37 years under study, investment is higher than savings in just 14 years and the difference in this year are so small relative to the remaining 23 years. This is more pronounced between 1981 and 1983. It is clear from Fig 3 that the gap between investment and savings is so wide at about 15% of GDP in 1990, about 21% in the year 1996, about 22% in the year 2000, and 17% in 2004 and

19% in 2005 compared with the highest of 6% ever recorded as the difference between saving and investment in favour of investment within the period.

Averagely about 3.58% of gross domestic product saved between 1970 and 2006 were not invested if we assume that the total investments were financed by domestic savings only. This figure corresponds with about 15% of the total domestic savings in the economy within the period. Without any prejudice to all other external source of finance, the domestic resources available for investment is greater than the level of investment, the total amount of domestic savings in the economy, if properly channeled is sufficient to finance the domestic investment.

To conclude this section, we shall examine the correlations between savings, investment and economic growth in Nigeria. Table 7 revealed that savings and investment are positively correlated but this correlation is very weak. Growth and investment are also weakly and negatively correlated. The correlation between savings and economic growth is positive but very weak. These correlations imply that there is a weak relationship between savings, investment and economic growth rate in the economy. This points to the fact that investment is not responding to savings in Nigeria's economy and also that investment in the economy is not transforming into growth as proposed by economic theories. In this case, we can establish that the problem with Nigeria's economy is not that of mobilizing domestic savings but that of intermediation.

The negative correlation between economic growth and investment is in support of empirical evidence by (Guseh & Oritsejafar 2007) which shows that investment has negative impact on economic growth in Nigeria, indicating that investment has not promoted economic growth.

6. Analysis

There are several important findings from the trend of savings and economic growth in Nigeria from 1970 to 2006.

- i. Economic crisis of 1981 affected both the proportion of GDP committed to savings and those invested negatively
- ii. Prior to the introduction of Structural Adjustment Program (SAP) in 1986, both savings ratio and investment ratio follow the same trend and thereafter followed diverse trend.
- iii. Structural Adjustment Program (SAP) of 1986 has significant effect on both the ratio of saving and investment in Nigeria. This effect is more pronounced in savings than investment.
- iv. The saving-investment gap in the economy gets wider after the introduction of SAP in 1986 with domestic savings far above the domestic investment.
- v. Contrary to the Asian tiger, domestic savings is relatively higher than domestic investment in Nigerian economy. This implies that the problem is not the level of savings but the transmission of that savings into investment.
- vi. Since we cannot establish strong link between domestic savings and investment, then savings in Nigeria's economy could not necessarily lead to growth. In which case, one can conclude that domestic savings may not cause any growth in the economy in the short run.
- vii. We can establish hitherto that the consumption pattern is skewed in Nigeria, that is, as consumption is an essential factor on the supply side of the economy, Nigerians consume more of luxury and imported goods at the expense of domestic products.

7. Policy Implications and Conclusion

This study has established that the problem with Nigeria's economy is not that of mobilizing domestic savings but that of intermediation and for government to achieve rapid economic growth objective, maximum efforts should be directed towards;

(a) Saving-investment gap – Government should pay particular attention to the relationship between domestic saving, and total investments in the economy. Ironically most of the resources in the economy are exported out of the country which could be interpreted as forgone domestic investment opportunities. The reversal of this trend would enhance the future growth potential of Nigeria economy, provided these resources are channeled to investment.

(b) To rectify saving-investment gap in the economy there is need to pay proper attention to both capital and money market in the economy. Also, Government should also provide incentives for investment by creating enabling environment through provision of infrastructural facilities and social amenities for both existing firm and new ones.

(C) Consumption behaviour – Government should adequately monitor consumption behaviour in the economy by applying appropriate fiscal and monetary policy. Policy aimed at encouraging consumption of locally produced goods and services will promote investment in the economy and will prevent capital flight from the country.

In conclusion, government should adopt policy enhancing intermediation between savings and investment in the economy. Such policies will stimulate domestic investment, consumption and savings simultaneously which will eventually result to higher rate of economic growth. Policy enhancing savings without proper channeling to investment conserves resources and reduces consumption as well as investment.

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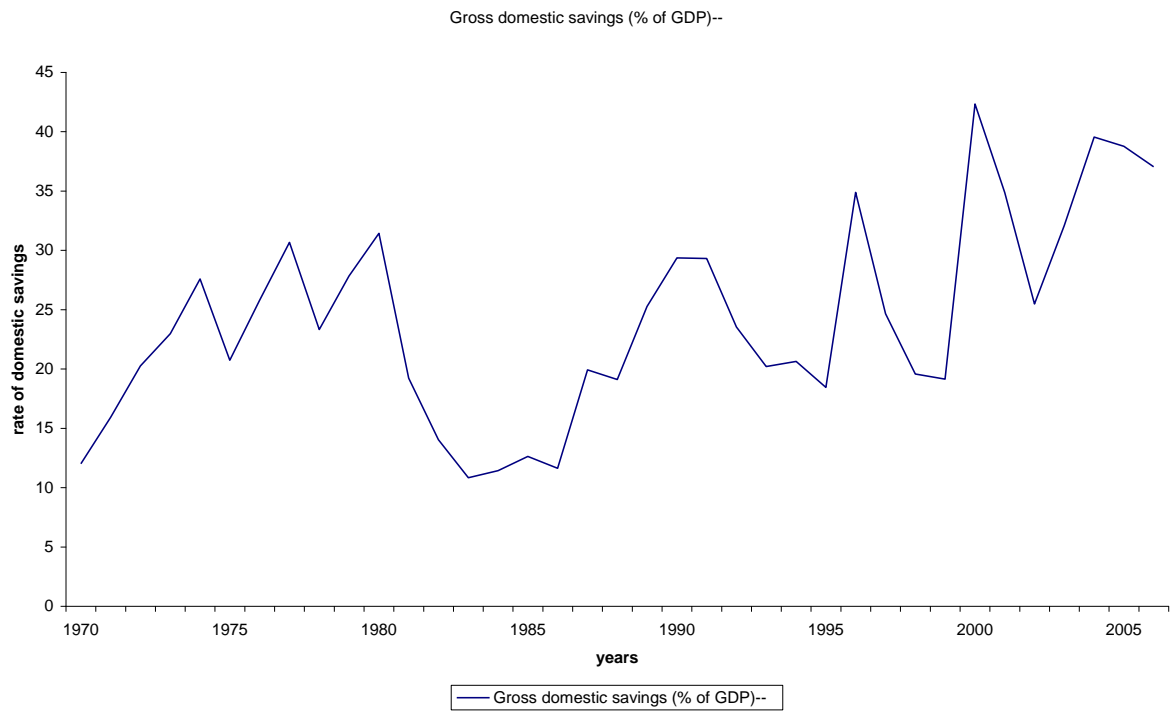


Figure 1: Gross Domestic Savings (% of GDP)



Figure 2: Gross Capital Formation (% of GDP)

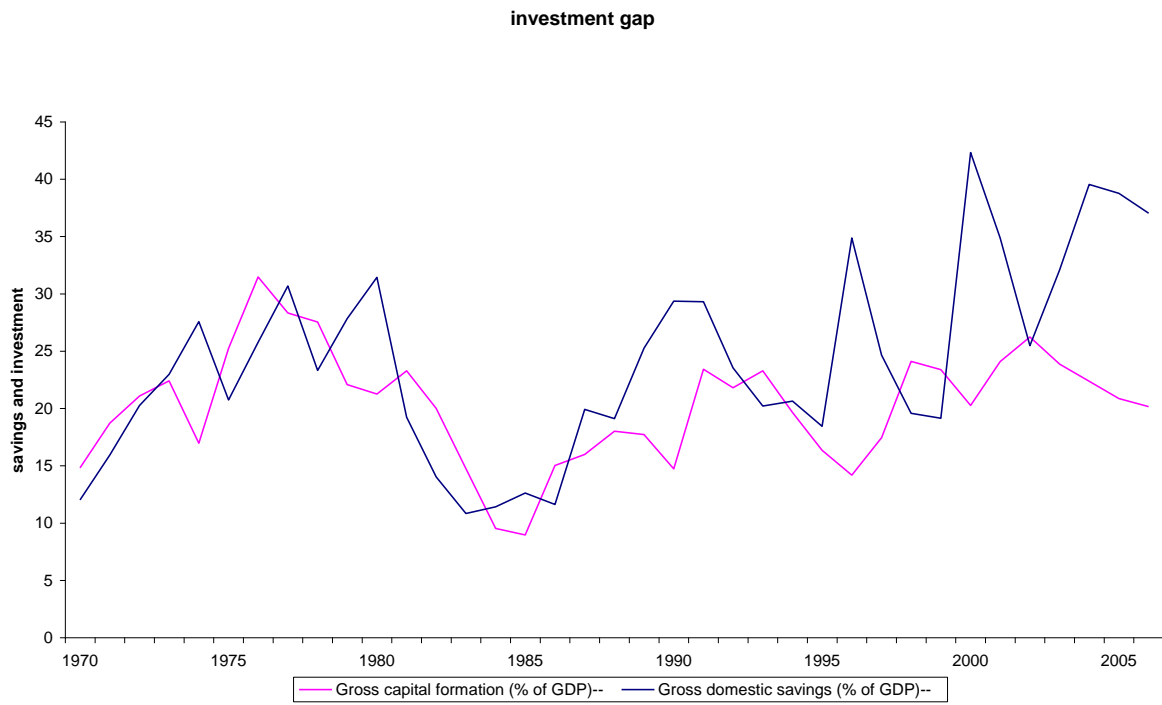


Figure 3: Investment Gap

Table 1: Pre Liberalization Era

YEAR	GDP GROWTH ANNUAL %	GDS% OF GDP
1970	25	12
1971	14	16
1972	3	20
1973	5	23
1974	11	28
1975	-5	21
1976	9	26
1977	6	31
1978	-6	23
1979	7	28
1980	4	31
1981	-13	19
1982	0	14
1983	-5	11
1984	-5	11
1985	10	13
1986	3	12
AVERAGE	3.705882353	19.94117647

Table 2: Liberalization Era

YEAR	GDP GROWTH ANNUAL %	GDS% OF GDP
1987	-1	20
1988	10	19
1989	7	25
1990	8	29
1991	5	29
1992	3	24
1993	2	20
1994	0	21
1995	3	18
1996	4	35
1997	3	25
1998	2	20
1999	1	19
AVERAGE	3.615384615	23.38461538

Table 3: Post Liberalization Era

YEAR	GDP GROWTH ANNUAL %	GDS% OF GDP
2000	5	42
2001	3	35
2002	2	26
2003	10	32
2004	11	40
2005	5	39
2006	6	34
AVERAGE	6	35.42857143

Sources: Author's Computations

Table 4: Savings (% of GDP)

Nigeria	GDP (mill)	GDS (mill)	GDS (% of GDP)
1970	78,540	12,972	12
1975	102,971	34,226	21
1980	124,803	93,710	31
1985	106,964	33,724	13
1990	138,794	38,577	29
1995	156,909	47,257	18
2000	182,466	76636	42
2005	239,723	93492	39

Sources: Author's Computations

Table 5: Investment (% of GDP)

Nigeria	GDP (mill)	investment (mill)	investment(% of GDP)
1970	78,540	17,463	15
1975	102,971	43,876	25
1980	124,803	47,313	21
1985	106,964	18,317	9
1990	138,794	22,273	15
1995	156,909	45,405	16
2000	182,466	36,493	20
2005	239,723	47,945	21

Sources: Author's Computations

TABLE 6

SAVINGS-INVESTMENT GAP

Year	GDS % of GDP	GCF %of GDP	GAPS
1970	12.01473	14.82118	-2.80645
1971	15.92613	18.72121	-2.79507
1972	20.25791	21.0853	-0.82739
1973	22.97822	22.41013	0.56809
1974	27.58111	16.97103	10.61008
1975	20.73793	25.23076	-4.49284
1976	25.76805	31.47452	-5.70647
1977	30.6759	28.32634	2.349562
1978	23.32205	27.53169	-4.20963
1979	27.8358	22.08194	5.753868
1980	31.43107	21.25204	10.17904
1981	19.22977	23.28053	-4.05076
1982	14.03518	20.00231	-5.96712
1983	10.82703	14.74293	-3.9159
1984	11.42403	9.526158	1.897874
1985	12.62746	8.968555	3.658905
1986	11.62848	15.03107	-3.40259
1987	19.9201	15.98108	3.939018
1988	19.10247	18.00706	1.095406
1989	25.26399	17.72562	7.53837
1990	29.35615	14.73471	14.62145
1991	29.30717	23.42616	5.881012
1992	23.54127	21.80342	1.737848
1993	20.20821	23.28695	-3.07874
1994	20.62868	19.63477	0.993919
1995	18.44204	16.33872	2.103313
1996	34.87439	14.17421	20.70018
1997	24.64646	17.44571	7.200752
1998	19.57021	24.11223	-4.54202
1999	19.14744	23.3824	-4.23496
2000	42.32974	20.26252	22.06722
2001	34.86691	24.09032	10.77658
2002	25.47087	26.22879	-0.75792
2003	32.08446	23.86222	8.22224
2004	39.54338	22.36304	17.18034
2005	38.7683	20.86071	17.90759
2006	33.5	12.5	21.00
	855.3731	729.1783	126.1948

Sources: Author's Computations

Table 7: **Savings-Investment-GDP Growth Correlation**

	GDP GROWTH	INVESTMENT	SAVINGS
GDP GROWTH	1.0000		
INVESTMENT	-0.1559	1.0000	
SAVINGS	0.1477	0.3812	1.0000

Sources: Author's Computations

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