CONSIDERATIONS ON THE ROLE OF FINANCIAL MARKETS IN ECONOMIC GROWTH

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Abstract: Generally accepted in economic literature, the financial market has a positive impact on growth in a modern economy. Nevertheless, due to the global crises starting in 2008, a number of authors are questioning today about this assertion. Among them, there are authors which are attributing as initial impulse to the crisis an exaggerated expansion of financial market (and non-covered on the real side of economy). In this study, based on economic literature and empirical evidences, we are presentig few considerations regarding the development of financial market during last decades and its role on economic growth.

Keywords: economic growth, financial market, endogenous growth

JEL Clasification: A11; D53; E44; G15.

1. Introduction

In a modern economy, the financial system provides two important functions: the allocation of savings to achieve different investment opportunities and the distribution and allocation of risks between the various operators. In economic literature there is a preponderance of work supporting a positive relationship between financial development and economic growth.

Otherwise, an efficient financial system can play a vital role in the economy, and long-term financial markets contribute to economic growth. Financial markets that works satisfactorily, having appropriate financial intermediaries, can stimulate growth by improving the allocation procedures economies, increasing volume disponiblile funds. Financialisation emerging and developing premises can create a process of development, facilitating solid growth.

This study aims at reviewing the main trends of opinion on the financial market relationship - economic growth, emphasizing the important role they play in economic growth. After an overview of the various theories and analysis on the relationship financial markets - growth, some examples of analyzes conducted on countries that allow highlighting the relationship.

Financial services are an important and growing sector in almost all economies, developed and developing. Acesora rapid growth is particularly strong in economies about rapid modernization. The financial system is more important than the direct let us believe that it occupies in the economy, the backbone of the modern economy.

2. Ideas in the literature on the relationship of financial markets – growth

In the economic literature there are different opinions regarding the relationship between financial markets and economic growth.

1) The first considers the current financial system impacts positively on growth. First authors who revealed such a relationship was Bagehot (1873), Schumpeter (1911), Gurley et Shaw (1955), but the first that gave to these ideas an empirical basis were Davis (1965), Cameron (1967) and Sylla (1969). Walter Bagehot in 1973 and John Hicks in 1969 support a positive relationship between financial markets and economic growth, citing the crucial role played by capital mobilized financial system during industralizării England. Joseph Schumpeter (1911) adds another argument, that the fact that banks in their activity periods working properly, fosters technological progress, supporting and encouraging entrepreneurs with high innovative potential. The state should have a role of regulator of bank funds, especially in economies at the early stages of development. The same author adds in 1934 that the services provided by financial intermediaries are essential to cause, facilitate and accompany the technological and economic development. More recently, Miller (1988) argues that the idea that financial markets contribute to economic growth is so obvious it does not even deserve to be discussed.

2) The second current view holds that financial markets are not essential for growth. Authors who are part of this category are opposed to the idea that financial markets have developed an active role in economic growth. The main advocate of this thesis is Joan Robinson, a Marxist economist at the University of Cambridge, colleague and friend of the great John Maynard Keynes. According to Robinson (1952): When industry leads, finance follows, in other words the role of growth lies mainly in industry, finance neservind than good foncţionare of it, you can not assign a role. Thus, economic growth is draining the financial system. Economic growth creates demands for particular type responsible financial system developing. Devoltatea financial markets can therefore be interpreted as a result of demand in the manufacturing sector. Thus, causality is reversed growth requires new ways of funding, resulting in the development of financial markets.

3) A third group of economists believes that there is an important relationship between the financial system and economic growth. Nobel laureate Robert Lucas (1988) argues that the role of financial factors in economic growth is exaggerated. Also, Mayer (1988) believes that developed financial markets do not play a major role in financing of firms. In the same vein, Stiglitz (1993) argues that market liquidity has no impact on the behavior of enterprise managers and therefore not exercise some control corporate. Economists development shown generally skeptical about the role of financial system in economic growth.

Financial markets affect saving and investment decisions and have an important role in economic growth, having five main functions: production of information to allocate capital among various investment opportunities; monitoring of investments; diversification and risk management; mobilizing savings and facilitating the exchange of goods and services. Financial intermediaries participanting on this market may be represented by: banks, investment funds, insurance companies, organized markets (exchanges), home economics, pension funds, managers etc.. These intermediaries help reduce acquisition costs and information necessary for the evaluation of investment projects, thus improving capital allocation.

For Greenwood and Smith (1997), capital markets reduce the cost of mobilizing savings and thereby may facilitate investment in more efficient technologies more productive. Risk sharing, global capital markets through investment allows ranament higher. This improves the allocation of resources and, consequently, economic growth (Devereux and Smith, 1994).

Levine (1991), Bencivenga, Smith and Sarr (1966) noted the important link that exists between stock market liquidity and growth. A high liquidity of the market facilitates investment in long-term projects with high profitability, stimulating growth. Businesses are tempted to replace savings as precious metals, land and sustainable consumption goods and cash for financial instruments such as stocks, bonds, investment funds and other securities.

Pagano (1993) and Levine (1997) argue that financial dezvoltrea affect growth by improving productivity and capital efficiency. Saint-Paul (1992) argues that financial intermediation enables technological risk diversification, investment and promoting specialization thus facilitating cereşterii productivity will lead in turn to growth.

3. Approaches based on empirical analyses and endogenous model

A number of empirical papers have attempted to determine a relationship between financial markets and economic growth. The first works that dealt about finance - growth privilege banking sector as the traditional channel of financial intermediation. There were used two indicators of financial development: monetary aggregate M3 to GDP; domestic credit volume granted by savings banks and other financial institutions to GDP.

King and Levine (1993) establish a link between development banking Positive economic growth, their study based on a sample of 24 countries. All these authors conducted a study on a sample of 77 countries between 1960 and 1989, finding that there is a significant relationship between the size of the banking sector and economic growth. Demetriades and Hussein (1997) notes, however, that these results can not be applied to all countries, especially developing ones.

With the development of capital markets, all several authors ask the question of a possible link between financial markets and economic growth. Thus, Levine and Zervos (1996, 1998) study the specific role of financial markets and conclude that there is a positive correlation between the various indicators of financial markets and the development of economic activity.

Deirguc-Kunt and Levine Deirguç (1996) remarked that countries with developed financial markets and banking systems have developed, and vice versa, implying that one can not distinguish between bank-based financial system and one based on the financial markets. Atje and Jovanovic (1993) analyzed a sample of 47 countries in the 1980s and conclude that the index of development of financial markets and positively influences the strong economic growth, much more than the bank development.

Levine (1997) reveals a new element, that the financial markets liquidity boosts economic growth through reducing investment risk. For this, the financial development is a good indicator Prevision growth rates, capital accumulation and technological progress.

Rajan and Zingales (1998) and Würgler (2000) study on the relationship finance - industries, distinguishing industries that are particularly intensive external funding those that are less. They conclude that the sectors consuming external financing develop faster in countries with developed financial systems. McKinnon (1973) and Shaw (1973) support the financial liberalization thesis. According to them, government intervention in the banking discourages saving and investment funds, financial development and thus preventing economic development. Therefore, they propose eliminating all financial restrictions. Financial liberalization is seen as a solution ecomonice development, allowing not only increased interest rates which in turn incites increasing saving among households, and improve resource allocation in the economy, which is favorable to economic growth. In the 80's, many financial liberalization programs implemented in developing countries, inspired by the two authors, lead to the rapid development of their financial systems, especially capital markets.

Until recently, the role of the financial system was not taken into account in economic growth models. Only in the '90s through endogenous growth models, economists are beginning to investigate the direct relationship between financial development and economic growth. The opinions above do not account for the role of structural change in the financial system on economic growth. Financial innovations have increased capacity to attract savings circulation of capital in the world, to stimulate entrepreneurship, dissemination risk, facilitating the exchange of goods and services and financial contracts.

However there are some negative effects of financial development, effects that have been highlighted by the financial crises over the last decades and their impact on the real economy and thus on economic growth.

The importance of financial factors in economic growth will be considered in the creation of new endogenous growth models which include the financial sector. In these models, the whole financial system (banks, financial intermediaries, equity markets, bonds, derivative products, etc.) allows the collection and use of savings.

The traditional model of economic growth consider a production function depended not only the capital stock. Thereafter, by modifying this function resulted that growth rate depends on the saving rate and the marginal productivity of capital. The assumption of decreasing marginal productivity of capital is central to ensure convergence to a stationary state. The new endogenous growth model considers that it is possible to increase productivity regardless of exogenous growth. Financial development can have a dual effect on growth: first by increasing the efficiency of capital accumulation, and thus increasing its productivity; secondly by increasing the savings rate and hence the rate of investment.

Classical market equilibrium condition requires equality between gross saving and gross investment. This condition introduced in the model and generates the hypothesis that the activity of intermediation costs and that part of the circuit savings intermediated disappears. With financial development, capital markets appear alongside other financial intermediaries, previously regarded as the only component of the financial system. Have taken into account the fact that some of the savings will be used by financial intermediaries to buy financial products and only the other side will be invested.

Differences between the financial systems are not confined to their degree of sophistication. Thus, one of the largest difereţe between different countries and, in particular, developed countries is determined by the relative importance of markets and financial intermediaries. On one side are countries whose financial system is based on banks (Germany, Japan, France), on the other hand stands countries financial system focused on financial markets (U.S., UK, Canada).

The financial sector has seen a sharp increase. According to Philippon (2007), the financial sector in 1947 represented 2.32% of GDP in the U.S. and 2.76% of the wages. The percentage in 2005 was 7.09% and 7.65%. Also, between 1996 and 2007, the profits of financial companies belonging market index S & P 500 rose significantly from $ 65 billion to $ 232 billion, reprezntând an increase from 19.5% to 27% of companies that are part of share this index. In the same period, the total market capitalization of financial firms as part of this index went from 6% to almost 18%.

The financial sector has developed very rapidly in the years after the 1990 till the crisis began in 2007. Several studies indicate that the labor force employed in this sector saw growth of 25% to 50% in many industrialized countries since 1970, representing 3-5% of the total workforce in 1997. Value added in financial services sector is considered as grown in the past 25 years, accounting for between 7-13% of GDP in Hong Kong, Singapore, Switzerland and the United States. World exports of financial services accounted for 200 billion dollars in 2005, an increase of 14% Annual average between 2000 and 2005.

Recent years have been fruitful, with many studies on the relationship between financial markets and economic growth, some of them focusing on the specific case of a single country, others are more general.

Garretsen, Lensink and Sterken (2004) show a positive relationship between economic growth and financial development. Thus, an improvement in economic growth by 1% leads to an increase of 0.4% indicator capitalization / GDP. Another group of economists (Beckaert, Harvey and Lundblad, 2005) follows the impact of financial liberalization on economic growth and concluded that liberalization actions contribute, on average, a 1% increase in the annual rate of growth.

Nieuwerburg, Buelens and Cuyvers (2006) conducted a study on the Belgian economy. They analyzed the long-term relationship between stock market development (measured by market capitalization and number of listed companies) and economic growth (measured as log differences in GDP per capita). Their study explores the role of the market share in the growth of Belgium from 1832 to the present, concluding that influenced the development of the market share growth in this country, the greatest influence was recorded in the period 1873-1935.

The case of Greek economy was studied by Hondroziannis, Lolos and Papapetrou (2005), taking into account the period 1986-1999. Their analysis concludes that there is a bidirectional relationship between economic growth and development of capital markets. Liu and Hsu (2006) focused their analysis on the cases of Taiwan, Korea and Japan, and they reached the conclusion that the development of the market shares (measured by market capitalization as a percentage of GDP and the rate of rotation as a percentage of GDP and dividend yields) of had a positive effect on economic growth in these countries. Also, the case of Egypt, Bolbol, Fatheldin and Omran (2005) showed that the development of capital markets has had a positive effect on factor productivity and growth.

Caporale and Spagnolo (2011) published a study for the three countries of Central and Eastern Europe: Czech Republic, Hungary and Poland. The choice of these countries was related to the fact that they enjoyed the largest market capitalization in the region. According to this study, there is a one-dimensional relationship of the development of capital markets towards growth. This bond becomes stronger after joining the European Union, suggesting that the financial markets of these countries have benefited from the freedom of movement of capital.

Regarding Romania, Obreja Başoveanu, Dragota, Buckle and Semenescu (2008) showed in turn that economy has benefited from the development of financial markets, however, this relationship could not be evidenced only since 2000, the previous situation this year being eloquent.

Capital market from Romania has developed quite slowly, since 1995. Moreover, after 1989, Romania had a few years with negative growth rates. Only since 2000, Romania has benefited from positive growth rates, accompanied by accelerating the development of financial markets. In terms of market capitalization of the Bucharest Stock Exchange recorded values increasing from 2002 to 2007.

Thus, an analysis of causality financial markets - growth in Romania, the studies were conclusive only for the period after 2000. Should not forget the fact that Romania, as well as Western countries with more developed economies suffered in last years of the global financial crisis, growth was also penalized. Financial market could not thus attain a high level of development that could lead to the achievement of its main functions in an economy, the efficient allocation of savings, there is still a major gap between Romania and the Central - Europe.

4. Conclusion

The financial industry is indispensable activity and growth as has been demonstrated by many reputable economists, however, the financial crisis of 2007-2009 highlighted the fact that it may have at the same time, a negative influence. Disruptions in the financial markets could endanger the real economy and decisively affect growth.

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