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ARTÍCULOS

Government financial regulation and growth

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Abstract

The effects of financial system on economic growth rate are identified. To do this in an endogenous stochastic growth model with two types of financial systems, efficient and inefficient ones, the effects on growth are studied. This investigation shows that financial inefficiency has a negative impact on growth. A financial regulation through a capital yield tax corrects negative impacts on growth; furthermore, the necessary conditions for growing under this scenario are characterized. An empirical study is carried out in order to verify the relationship between economic growth and financial regulations.
Keywords: Financial market; regulation; efficiency of capital market; economic growth; macroeconomic equilibrium.
JEL **Classification**: E44; G10; G14; G18; O40.

Resumen

Mediante un modelo de crecimiento endógeno estocástico se analiza el impacto del sistema financiero, bajo escenarios de eficiencia e ineficiencia del mismo, sobre la tasa de crecimiento. Se muestra que las ineficiencias del sistema financiero tienen un impacto negativo sobre el crecimiento económico, lo cual es corregido mediante la regulación financiera a través de un impuesto al rendimiento del capital. Asimismo, un análisis empírico corrobora los resultados teóricos correspondientes.
Palabras clave: mercado financiero; regulación; eficiencia del mercado financiero; crecimiento económico; equilibrio macroeconómico.
Clasificación JEL: E44; G10; G14; G18; O40.

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Introduction

It is known that there is a link between financial system and real economy as Bagehot (1873), Gurley and Shaw (1955) and McKinnon (1973) showed. Furthermore, there are studies that revealed positive impacts on real economy due to a solid financial system, that is without inefficiencies such as credit constrains. Banerjee and Newman (1993), Galor and Zeira (1993), Aghion and Bolton (1997) and Piketty (1997) exposed that a financial sector can promote both physical and human capital accumulation under credit constraints conditions and nevertheless stimulates growth. On the other hand, Benabou (1993, 1996a, 1996b), Durlauf (1996a, 1996b), Fernández and Rogerson (1994, 1996), Kremer and Maskin (1994), Rivas-Aceves and Martínez Pérez (2011) and Rivas-Aceves (2012) uncovered that credit constraints and any other financial inefficiencies actually inhibits capital accumulation.

Herein it will be seen that relationship between financial system and real economy is favorable, positive or direct, if credit constraints and inefficiencies of financial sector are not present. This is consistent with the results found by the second approach described above. Consequently, the linkage is negative when financial system is not efficiently while reallocating resources in its possession, as a result a negative impact on economic growth takes place.

There have been several studies that show main conditions needed to minimize or even disappear negative impacts on real economy caused by an inefficient financial system. Some of them introduce government into economic system to regulate capital markets, see Barth, Caprio and Levine (2001a, 2001b, 2004, 2006), Levine (2011), La Porta, López-de-Silanes and Shleifer (2005), and Rivas-Aceves (2012).

The present analysis extends in two different ways the one carried out by Rivas-Aceves (2012) as follow: First, the theoretical model has been extended by using an stochastic growth model with a geometric Brownian motion plus Poisson jumps, this allows to analyze whether radical changes in marginal product of capital as well in capital yield affects macroeconomic equilibrium and therefore economic growth. Second, the research purports to further investigate the ultimate relationship between economic growth and financial systems regulations by a cross-section analysis based on data belonging to 40 developed and emerging countries and referring to the period ranging from 2000 to 2013. Regarding empirical evidence, De Serres *et al.* (2006) studied the effect of finan-