Presentation

The title of this issue of *Ekonomiaz* is «Banking & Regional Growth». It sets out to analyse the influence of the banking system and of monetary policy on regional economic growth, with «regional» understood as referring both to distinct economic areas within a national economy and to sovereign states within supranational economic units.

It is well known that the exceptionally favourable financial conditions (low interest rates & high rates of growth in the volume of bank lending) that prevailed from the late 1990s until well into the second half of the first decade of the 21st century not only contributed to a great extent to the extraordinary growth of the Spanish economy over that period but also, to some degree, were responsible for distorting its prevailing growth model and for the increase in its vulnerability and financial instability that culminated in the profound crisis that we have been suffering since 2008. This alone more than justifies the decision by the Editorial Board of *Ekonomiaz* to produce this monographic issue of the journal devoted to studying the influence of monetary and financial factors on regional growth, and the implications that the new banking landscape that is emerging in Spain in the wake of the crisis holds for that growth.

However, this is admittedly an extremely ambitious, complex task, because it does not entail just looking separately at two elements (the banking system and growth) that are intrinsically highly complex and can be tackled from very different perspectives. The challenge faced is greater still, first of all because analysing the influence of «financial matters» on growth involves a need to specify the links (and feedbacks) that may exist between the two, and secondly because it entails identifying all the elements of the financial structure that contribute most to the attainment of balances, sustainable growth from a regional viewpoint, and this is far from easy in view of the great expansion and increase in sophistication in finance in the past few decades, and the reflections on its economic functions sparked by the current crisis.

It would be tempting to approach this difficult task via conventional models of economic growth, limiting the analysis of the contribution of the financial system to identifying market failures and asymmetries of information that prevent it from properly performing its intermediary role, thus resulting in inefficiency in the allocation of financial resources in spatial terms. But, as argued below, such an approach would

mean taking the principle of monetary neutrality as an article of faith (which is precisely what orthodox theory does). This would not only simplify the analysis to be conducted but would also introduce self-censorship, because the principles of monetary and bank neutrality prevent the inclusion in the analysis of functions other than the brokering and facilitating of transactions (which would thus be left as the only basic acknowledged functions of the financial system in this analytical context and of monetary policy in regard to growth). This would preclude the analysis of matters of considerable current interest and relevance such as the interventions of monetary authorities to stimulate growth, guarantee financial stability and encourage the provision of loans by lenders to help increase the stock of productive capital; or the encouraging of effective demand in a context of deep recession such as that which the Spanish economy has been suffering for some years now.

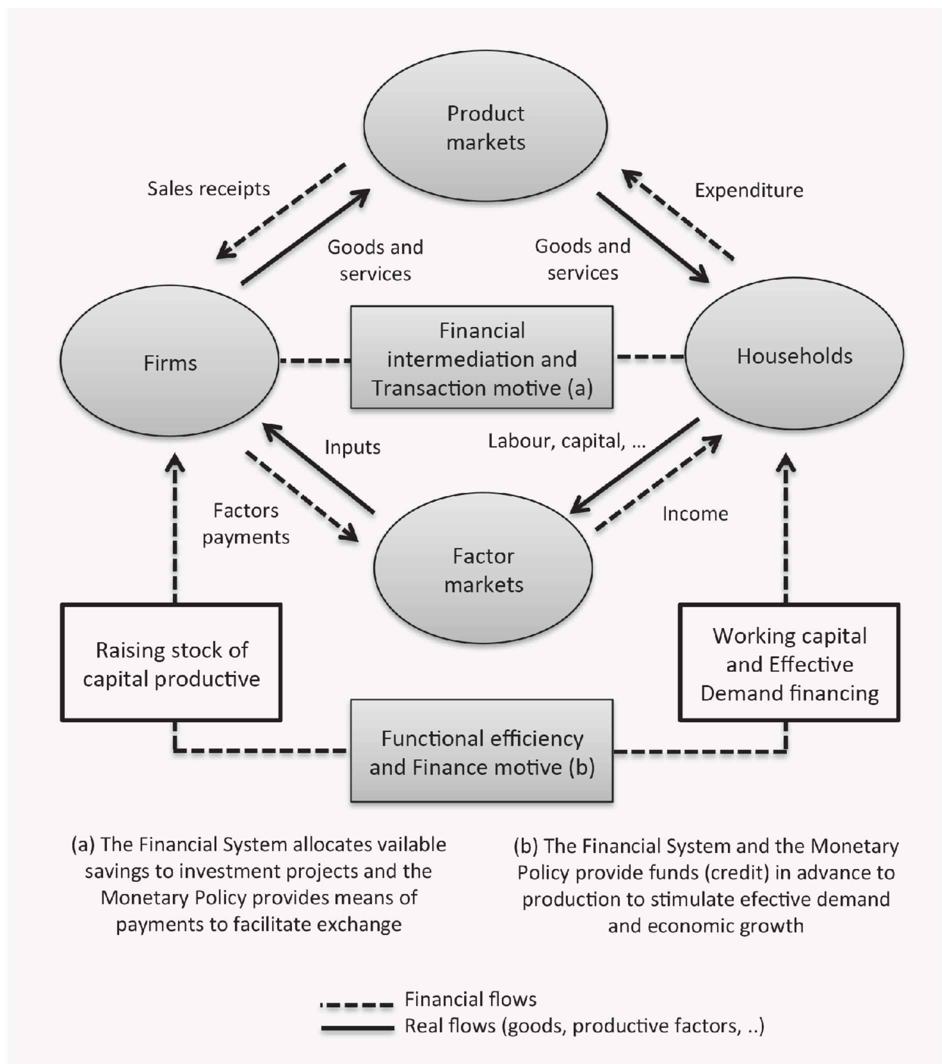
Analysing and considering all the issues that we seek to tackle here is clearly incompatible with the principle (or article of faith) of monetary neutrality upheld by the conventional approach, in which it has always been difficult and awkward to integrate monetary and financial variables satisfactorily into the modelling of the operation of the economic system, to the extent that analysis is often conducted in real terms and it is assumed that the conclusions reached are equally valid in a world with money and financial markets.

The argument of monetary neutrality has also been used by specialists in regional economics to rule money and financial flows out of their analyses of the determinant factors in regional growth, as they see no reason to question the validity of the principle at regional level. But two other arguments have also been used to justify not considering financial and monetary factors in regional growth: first, it is argued that monetary and financial stimuli are useless in this context because of the openness and perfect mobility of financial capital at inter-regional level, which make it impossible to maintain monetary conditions different from those of the «rest of the world». Secondly, it is argued that monetary considerations are irrelevant at regional level because regional economies (in a broad sense that includes national economies which form part of a monetary union) do not have at their disposal the conventional monetary instruments that are available to national economies with full economic and political sovereignty, e.g. exchange rates and banking/financial regulation policies.

The conclusion drawn from these reasons is that since there is no regional monetary identity, financial matters do not constitute a feasible lever for attempting to influence regional economic dynamics. But the fact that the lever cannot be moved – for whatever reason – does not mean that its present fixed position is not conditioning the economic results observed, or that if the movement of the lever could be recovered it could not be used to solve the problems of growth and backwardness that affect some regions. There are many other reasons that could be put forward to explain why financial issues are ruled out of the argument concerning regional economic growth, but it is strikingly inappropriate to defend

the assumption of monetary neutrality at regional level, because the existence of major inequalities between regions in terms of the availability and degree of use of production factors, of potential output, of specialisation, etc. could result in monetary or financial stimuli producing different effects on different regions, and lasting effects on output levels in some regions.

Figure 1. **INTERMEDIATION AND FINANCING FUNCTIONS IN THE FINANCIAL SYSTEM**



In spite of the points made in the foregoing paragraph, orthodox monetary theory has always maintained that growth in real income, be it at national or regional level, depends in the long term only on real factors which have nothing to

do with monetary issues, because money (and financial issues) is considered as a veil that only influences the determination of price levels (inflation). By extension, this model further holds that the banking system also plays a neutral role in regional development, because banks merely redistribute the national money supply at regional level.

Only in the short term, under certain assumptions camouflaged under the name of «market failures» (incomplete information and price rigidity) is the possibility envisaged that monetary policy and the banking system may influence the real world, and then always negatively, by causing fluctuations in output levels over the long term (when there is price rigidity in markets) or when market failures in the form of information asymmetries or high transaction costs break up regional lending markets and prevent credit from being allocated efficiently. However it is important to stress that in the absence of such market failures the theory always postulates the existence of interfaces which assure financial flows between regions and thus enable a competitive equilibrium to be attained that ensures the efficient distribution of financial resources at regional level, in which resources are able to move from regions where the available financial resources (savings) exceed their potential uses (investment) to regions where there is excess demand.

From this perspective it is usually concluded that if there were no barriers preventing resources from being mobilised and if banks acted efficiently as brokers then regions would never face financial problems in the form of credit rationing. This approach assumes that financial flows between regions are directed by «market forces» (interest rates & the profitability of investment) towards the places where they are most in demand, so the banking system is positively stimulating the economic growth of society; it further assumes that this process will, in one way or another, have positive fallout for the least favoured regions.

Although some authors recognise that this result could help to perpetuate differences between regions, insofar as those that export savings would experience a reduction in the volume of funds for lending to finance their own investment projects, and financial dependence on the most highly developed regions would thus increase, it is argued that the banking system cannot be said to be behaving in a discriminatory fashion because it acts only in accordance with the signals received from the market, which in turn reflect differences between regions in terms of their potential and actual possibilities for growth.

However the conventional argument as outlined in the previous paragraph, which allocates a neutral role to money and the banking system in regional economic growth, or even a negative role if certain conditions arise that are described as «market failures», has been refuted by other theoretical approaches which specifically reject the principle of monetary neutrality and acknowledge other ways in which the financial sector can influence growth. A case in point is the post-

Keynesian theory concerning regional credit markets, which not only expressly rejects the assumption of monetary neutrality but also looks at two new elements in a more in-depth examination of the factors that determine the volume of regional credit: a) the level of development attained by the banking system; and b) changes in the liquidity preferences of all the agents involved in the process of creating loans at regional level, i.e. savers, lenders (banks) and borrowers (investors).

By incorporating the level of development of the banking system into their analyses, post-Keynesian authors reject the idea that banks play an exclusively passive intermediary role between savers and investors because – at least in the most highly developed economies in economic & financial terms – the banking system has plenty of means at its disposal for increasing the credit supply over and above the limits of its own deposits. From this it becomes immediately apparent that the role played by the financial system in a developed economy is not constrained merely to acting as an intermediary between savers and investors, as is widely held, but also extends to what can be thought of as financing work, insofar as the banking system now not only redistributes resources that it has captured in the form of deposits but also has many other ways of extending its credit offering in some regions without reducing it in others. It is precisely by using this function that the financial system is able to exert a positive influence on the level of economic activity in a region. From this perspective, the question that must be tackled empirically is not how big a share regions have in the overall volume of credit (credit distribution) but *why* lenders (banks) are unwilling to lend and borrowers (investors) are unwilling to borrow more in certain regions, and *how* economic policy can be used to facilitate the creation of credit in certain regions. This requires an analysis that is contextual rather than purely theoretical.

Another significant hypothesis that can be drawn from the post-Keynesian analysis is that, given that the creation of credit in more developed economies depends on the behaviour of the lenders (banks) and borrowers (investors), and especially on the changes in their respective liquidity preferences, less developed economies may be expected to face more unstable credit availability patterns, since they undergo bigger changes in liquidity preferences in the course of the economic cycle and may well have less developed banking systems. The hypothesis that emerges from this framework of analysis is therefore that less developed regions must deal with a pattern of availability of credit that is highly sensitive to the economic cycle, and not only with a decreasing share in total bank lending at national level, as upheld by the conventional theory.

From what has been said in this foreword so far it may be concluded that in spite of the progress made in the last few decades in research into the influence of monetary and financial factors on regional economic development, many unknowns still remain. Moreover, the current crisis has opened up fronts that some theorists (wrongly) thought were closed. But rather than interpreting this as a

negative point that calls consolidated hypotheses and financial theories into question, the scientific community should take the opportunity to engage in a self-critical reflection on the functions of finances. Otherwise, many of us fear that the crisis, which is still very much alive in countries such as Spain, will not even serve to teach us to try and do things better next time, because unfortunately financial instability is an intrinsic element in the development of the market economy, as rightly pointed out by economists of such intellectual stature as John Maynard Keynes and Hyman Minsky, whose work orthodox thinkers and those responsible for economic policy have become aware of too late (especially in the case of Minsky), and have all too often misinterpreted.

For some years now, leading analysts and opinion makers have been calling for firm, decisive action on the part of the economic authorities to restructure the financial sector, which is considered currently to be not only oversized but also dysfunctional, in view of the increasing de-linking observed between finance and growth. Many years ago James Tobin, an author who is surely free from any suspicion of heterodoxy, expressed his scepticism at the idea that the workings of the free market could ensure efficiency in the financial system. In the 1980s Tobin openly expressed his opinion contrary to the trend towards liberalisation and deregulation that prevailed at that time, because he considered that they did not offer any guarantees of also achieving the «functional efficiency» of the system. Today it seems that these opinions have resurfaced, and some people go further and argue that the «dark side of finance» must be reined in, when a few years ago they were declaiming that it was impossible to hold back the tide, particularly in the world of finance. What a paradox!

We therefore fear that as soon as a light appears at the end of the tunnel and it can be certified accountably that the crisis is over, the pendulum of the debate on financial issues will swing from its current position to the opposite extreme. We can hope to be wrong in this, but history tells us that some errors tend to repeat themselves. That is why we believe that it is so important to leave a written record now of the reflections made by numerous researchers in the financial sector at this time, concerning the implications for regional growth and development of the new financial and banking landscape that is emerging in Spain in the wake of the crisis. We further believe that it is important for these reflections to be based on a wide range of theoretical viewpoints, methodological positions and historical and spatial contexts, because that very disparity of viewpoints will provide interested readers with a more plural, more enriching view of the issues dealt with. It is with this in mind that we set out to design the content of this issue. Whether or not we have succeeded, only our readers can tell.

The nine articles contained in this issue are grouped into three blocks. Block One opens with an article by **Carlos Rodríguez** that provides a synthesis of the literature on the regional repercussions of the workings of the banking system,

including the most recent publications concerning the study of the link between finance and growth. The ultimate aim of this analysis is to highlight the core, non-neutral role played by banks in regional economic growth, not just because of the supposed existence of information asymmetries and market failures that break up regional credit markets but also because of the spatial/regional differences that exist in the lending strategies of banks, including the offering and availability of regional loans.

Next, Professor **Antonio Torrero** analyses an issue which has, unfortunately, been of great current interest in Spain in recent years: the possibility and effects of internal devaluation. His analysis, based on his exhaustive knowledge of the works and thinking of John Maynard Keynes and inspired by the experience of the return to the gold standard in the United Kingdom in 1925, is of great interest not just because it clearly illustrates the real repercussions at sectoral and micro-economic level of monetary decisions, but also because it clearly exposes the ingenuity and short-sightedness with which the repercussions of financial phenomena are all too often analysed.

The third article in Block One is by professors **Santiago Carbó** and **Julia García.** It describes the changes that have taken place in the structure of the Spanish banking market during the financial crisis, and the peculiarities of that market. At the same time it assesses what effect those changes may have had on the financing channels of the Spanish economy. In particular, the article examines whether the creation of internal liquidity circuits by Spanish banks has managed to counteract the reduction in the offering of bank lending at a time characterised by increases in defaults and a shrinkage in the availability of credit.

Block One closes with an article by **Victoria Chick**, **Sheila Dow** and **Carlos Rodríguez** that analyses what characteristics and features should predominate in a banking system that seeks to contribute to economic growth. The arguments and positions used in the analysis are based not only on theory but also on evidence and past experience arising from the extraordinary transformation undergone by the Spanish banking system in the past few decades.

Block Two comprises four more articles in very different forms that seek to set their analyses in a regional context. It begins with an article by **Angel Bergés**, **Emilio Ontiveros** and **Francisco José Valero** that analyses the effects of the banking crisis and the sovereign debt crisis on the Spanish economy, plus their respective feedbacks and negative implications for the proper performance of the function allocated to the financial and banking system in Spain, i.e. to finance productive economic activity. The conclusion reached is that there is a need for a European banking union and a single supervisory body to eliminate the problems of transmitting the ECB's monetary policy so that funding reaches businesses, and that the ECB needs to begin directly buying government debt.

Next comes an article by **Carlos Rodríguez**, **Fernanda Faría** and **David Padrón** that examines the potential asymmetric effects of the single monetary policy on the countries that make up the eurozone. This is done by synthesising empirical evidence on regional asymmetries in single monetary policy, built up over the course of the almost fifteen-year history of the eurozone. The purpose of this analysis is two-fold: a) to encourage reflection on the empirical results achieved to date; and b) to propose changes in the ECB's current operational framework for monetary policy with a view to attenuating those effects.

Block Two ends with two articles that analyse relational banking and the factors that determine access to external funding for SMEs in Spain. **Gary A. Dimsky** examines the important role that relational banking can play in Spain in providing finance for the production sector, and the difficulties that the major changes taking place in the Spanish financial sector may entail for this segment of the economy, which may end up causing a reduction in the availability of credit in less developed regions.

The article by **Yaiza Armas**, **Esperanza Gil**, **Estefanía Hernández** and **Sandra Morini** analyses the determinant factors for access to external funding, with special reference to the crisis and its effects on the financing of SMEs in Spain between 2009 and 2011. Their findings indicate that the sector, size and age of firms are all influential in the process obtaining financing, in its use and efficiency and in firms' expectations of securing it.

The third and final block comprises a single article by **Alberto Alberdi** that examines the banking system in the Basque Country. The author analyses the role of the banking system in funding the impressive process of growth undergone by the Basque economy from 1980 onwards, and particularly in the last economic cycle leading up to the Great Recession. He shows that in spite of the relative soundness of its external position, the Basque economy has also taken an active part in the wave of «financialisation» that led to the current crisis, especially through the mortgage boom and financial investments intended to set up corporate groups. The article concludes that in the wake of the crisis and the collapse in lending, signs of the credit crunch and the capital crunch can also be seen in the Basque Country, and that this may make it more difficult to achieve economic recover, in the face of new regulatory requirements.

The «Other Contributions» section features two articles. The first, by **Juan Antonio Calvo**, **Ana Cristina Mingorance** and **Carolina Bermejillo**, describes the model of growth in the Basque Country and compares it with those of other regions ("autonomous communities") in Spain. The main conclusion reached is that the pattern of growth has traditionally been based on increasing the hourly productivity of the labour force: the increases in the periods from 1970 to 1992 and again from 2006 to 2011 outstripped the rise in GDP, though for different reasons. In the first

period the essential cause was the accumulation of capital, while in the second it was technological progress. In the intermediate period from 1993 to 2005 variables linked to the labour market, the rate of participation (above all), the rate of employment and the average number of hours worked were the determining factors for the growth of the Basque economy.

Finally, an article by **Nagore Aranguren**, **Juan Luis Ochoa** and **Elena Ochoa** examines the public disclosure of corporate and environment-related information by large companies (with over 250 employees) in Gipuzkoa in 2008. The disclosure of this information was made compulsory when the new 2007 General Accounting Plan came into force. The article analyses the contents of annual reports for 2007 and 2008 and calculates two disclosure indices. The results for the 49 firms analysed show a high degree of compliance with the regulation, but reveal that the quality of the information disclosed was low.