Abstract:

In this paper we explore empirically a long-standing question in the literature on finance for growth, namely whether the financial structure –in terms of the size of the banking system relative to the capital markets– matters for economic growth. We build upon the existing literature by constructing a new measure of the “balancedness” of the financial structure which is broader, as it includes the domestic bond market as well as external sources of financing. It is also bounded and more linear than existing ones. We find that a more balanced financial structure –in terms of the size of banks relative to the capital markets– is associated with higher economic growth. Such finding points to banks and capital markets being more of a complement than a substitute. This is in line with Greenspan’s idea of one market serving as “spare wheel” of the other.

JEL: O16, G15, G21