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The implications of credit activity on economic growth in Romania

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Abstract

The economic crisis has questioned the efficiency of the existing economic model and created many doubts regarding the role that banks play in supporting the economic growth. Currently, the lack of confidence in the banking sector, due to the macroeconomic imbalances manifested, led to a contraction in credit activity which slowed down the economic recovery. The paper aims to analyze the relationship between credits and economic growth in Romania at a regional level. The analysis takes into account data for the period of 2005-2014. The results of this study indicate that credits have a significant influence on the evolution of gross domestic product in Romania.
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1. Introduction

The stability of the financial sector plays an important role in economic development of any country. The literature provides evidences that there is a correlation between economic growth and credit market. An increase in the allocation of capital accelerates growth leading to long-run economic growth. Therefore, it can be said that the financial sector and economic development are strongly related.

After the economic crisis the banking sector was submitted to a reforming process, aiming to make the sector safer and to help it regain its main function that of financing the real economy.

In the past years the Romanian economy has become highly dependent on the financing coming from the banking sector. The increasingly integrated financial markets have facilitated the foreign capital inflows and the expansion of the Romanian banking system but it also facilitated the transfer of the crisis effects within the Romanian banking sector. Nowadays, the main focus of the authorities it is to restart the lending activity of the banks which, is believed, that it will support economic growth.

The paper analyzes the relationship between credits and economic growth in Romania at a regional level. The aim of this paper is to see if the credits granted by the banks affect in any way the Romanian economic development.

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The article revises, at first, the theoretical and empirical literature emphasizing few of the main statements about the relationship between credits and economic growth. Further, the article presents an econometric analysis that shows the credit impact on economic growth in Romania, using panel data.

2. Literature review

The correlation between financial sector and economic growth has been a theme in numerous studies, both theoretical and empirical. There are papers showing the pro and con arguments about the impact of financial system on a country's economic growth. Conclusions that can be drawn are that financial development leads to economic growth, forecasting the future rates of economic growth or technological change. Moreover, the quality of financial system is influenced by economic activity.

Some economists, such as Walter Bagehot (1873) and John Hicks (1969) argue that the financial system played an important role in the ease of capital mobility in England. In 1912, Joseph Schumpeter argued that identifying and funding the entrepreneurs with the best chances of implementation of innovative products would encourage banks to technologically innovate. At the other pole, Joan Robinson claims that the financial system automatically responds to requests from various financial arrangements created by economic development. In addition, Robert Lucas (1988) and Nicholas Stern (1989) do not support that the financial system-economic growth relationship is significant.

Levine (1997) sustains that, among the functions that financial systems have, it can be listed: mobilize savings, allocate resources, ease the exchange of goods and services, monitor managers and facilitate risk management. There are two ways in which financial systems affect economic growth: technological innovation and capital accumulation. In the class of growth models (Romer-1986, Lucas-1988, Rebelo-1991), which it is based on capital accumulation, the steady-state growth is affected by the rate of capital formation and the role of financial system is to modify the savings rate or to reallocate savings to some technologies that produce capital. Another class of growth models (Romer-1990, Grossman and Helpman-1991, Aghion and Howitt-1992) concentrates on technological innovation. The steady-state growth is influenced by the financial system through the rate of technological innovation. It is difficult to conclude that the financial system responds automatically to economic activity.

Recent models of growth indicate that there are many ways besides technological growth (Pagano, 1993), although it can sustain itself without technological progress (Lucas, 1988). Pagano (1993) presents three channels by which economic growth might be affected by financial sector, these are: increasing productivity of investments, reducing transaction costs and promoting or declining savings.

The main role that meets the financial system in a modern economy is resource allocation, allowing risk sharing between firms and households by pointing the savings from the latter to the corporate sector. The two functions that financial systems may have are allocation of savings to investment and risk-sharing between economic operators.

Allen and Oura (2004) argue that the financial system plays an important role in understanding variations in growth. Risk taking by entrepreneurs to obtain high yields can lead to growth and crisis. For sustainable growth should be avoided bubbles, contagion and financial fragility. They claim that the growth is discontinuous; booms are followed by periods of crisis. The financial system can contribute to improving crisis through internal regulations on the control activities of financial institutions and restrictions on international capital flows.

King and Levine (1993) analyze the way economic growth is affected by financial systems. In the proposed model, financial systems affect entrepreneurial activities leading to improved productivity in four ways. The first way is where potential entrepreneurs are assessed by the financial systems and the best projects are selected. The second way shows how resources are mobilized to finance projects. Third, allowed investors to diversify risks associated with innovative activities. Fourth, potential compensation for engaging in innovation are revealed by financial systems. The main idea of the study is that better financial systems boost productivity. Also, government policies on financial systems have an impact on long-term growth.

Leitão (2012) analyzes the relation between economic growth and bank credit. Introducing variables as domestic credit, savings, bilateral trade and inflation, it is shown that endogenous models have a greater potential to explain

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