IL **DIPARTIMENTO DI ECONOMIA** E IL **CENTRO SRAFFA**
ORGANIZZANO IL SEMINARIO***:***

THE ROLE OF GROSS CAPITAL FLOWS IN THE GREAT FINANCIAL CRISIS. THE CASE OF SPAIN

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Abstract

There is a widespread consensus that the crisis in the Euro Zone is the consequence of too much cross-border borrowing and lending since the launch of the euro, driven by current account imbalances, funded with net capital flows. Against this backdrop, some researchers have shifted their research interest to gross capital flows, arguing that the Great Financial Crisis is another episode of financial instability that cannot be correctly understood in the light of net flows that cancel one another out.

In this paper, we focus on the Spanish economy since the onset of the euro and consider the responsibility of banks and their indebtedness to the rest of the world in the increasing external exposure to a sudden stop and a capital reversal. The justification of our choice is that Spain experienced rocketing private indebtedness between 1999 and 2007, much of it due to a real estate bubble, funded with domestic bank debt that was refinanced abroad. Additionally, Spain showed very large trade deficits, especially over 2004-2008. Nevertheless, the corresponding net capital inflows that funded those imbalances were dwarfed by much larger gross capital inflows and outflows.

Although we agree that the main cause of the crisis in Spain (and in the EZ) is too much debt, we hold that the main source of external indebtedness for the Spanish economy has not been the accumulated current account deficits, although they are fairly relevant, but rather banks' indebtedness to the rest of the world, driven by bank credit to households and non-financial corporations. A logical conclusion from this account, if we are correct, is that the measures adopted to rebalance the Spanish external sector required by creditor countries, whilst over-focused on CA imbalances, are detrimental to economic growth. Moreover, without the supervision and regulation of the banking sector, surveillance of CA balances will not prevent another crisis like the current one from happening again. Contractionary measures with a view to rebalance the external trade sector, justified on the basis of moral hazard or on the politically unattainability of other Keynesian policies should be rejected.

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