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What is the net effect of financial liberalization on bank productivity? A decomposition analysis of bank total factor productivity growth

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Highlights

- We investigate the net effect of financial liberalization on bank TFP growth
- Estimation is based on data for 1,530 banks in 88 countries over 1999-2011
- Positive effect on bank TFP growth outweighs the negative effect of banking crises
- A battery of robustness tests corroborate the validity of the results

ABSTRACT

We employ a unique framework to quantify the net effect of financial liberalization on banks' total factor productivity (TFP) growth through a decomposition analysis of two effects: a positive direct effect of financial liberalization on bank TFP growth; and a negative indirect effect operating through a higher propensity to systemic banking crisis. The empirical decomposition is based on a sample of 1,530 banks operating in 88 countries over 1999-2011. We find that the net effect of financial liberalization on bank TFP growth is positive: the direct positive effect outweighs the negative one. An important policy implication flows from these findings.

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