THE IMPACT OF FINANCIAL LIBERALIZATION ON BANK PRODUCTIVITY: BANK TOTAL FACTOR PRODUCTIVITY (TFP) GROWTH VERSUS SYSTEMIC CRISES

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Abstract: The paper aims to empirically assess the effect of international financial liberalization on the total factor productivity (TFP) of banks, explicitly accounting for its impact on the onset of systemic banking crises. The analysis is conducted using bank-level data (1,530 banks) from 88 countries for the period 1999-2011, and following the two-step selection equation approach previously used by Ranciere et al. (QJE, 2006) to study the effect on country-level GDP growth. Bank TFP is estimated non-parametrically with the Malmquist method, and international financial liberalization is proxied, as in most international macro studies, with both a *de jure*, AREAER-based, indicator of capital account liberalization and a *de facto* measure based on foreign asset and liability positions. Systemic banking crises are also measured in a standard way, using Laeven and Valencia (2012) classification. The results suggest that both *de jure* and *de facto* liberalization raise banks' TFP, even after accounting for the negative effect of banking crises triggered by financial integration. Specifically, we find that the positive direct effect of liberalization on bank TFP growth outweighs the indirect negative effect operating through a higher propensity to a systemic banking crisis.