INGENIERIA INDUSTRIAL
UNIVERSIDAD DE CHILE

Abstract

This paper presents a simple model that shows the effects of financial liberalization on the credit market of a small, relatively capital poor economy. The empirical evidence regarding the effects of liberalization on access to credit is mixed. Some studies show that financial liberalization leads to an increase in credit to businesses (Micco, Panizza and Yañez, 2004), while others show that some businesses loose access to credit (Gormley 2008).

In our model entrepreneurs are heterogeneous in their wealth and are subject to moral hazard, which leads to some potential entrepreneurs being credit constrained. We show that the effects of financial liberalization depend on the competitive structure of domestic banks prior to liberalization. In the case of ex ante banking competition, liberalization lowers domestic interest rates and credit penetration increases. In the case of a monopolist bank ex ante, the effects of liberalization can be reversed, increasing the number of entrepreneurs that do not receive credit. We also show that the benefits of liberalization under competition are larger in economies with better loan recovery rates, but that this might not be the case when ex ante the market is not competitive.