Measuring the Impact of Financial Intermediation: Linking Contract Theory to Econometric Policy Evaluation *

Robert M. Townsend
Department of Economics
MIT

Sergio S. Urzua
Department of Economics
Northwestern University

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Abstract

We study the impact that financial intermediation can have on productivity through the alleviation of credit constraints in occupation choice and/or an improved allocation of risk, using both static and dynamic structural models as well as reduced form OLS and IV regressions. Our goal in this paper is to bring these two strands of the literature together. Even though, under certain assumptions, IV regressions can recover accurately the true model-generated local average treatment effect, these are quantitatively different, in order of magnitude and even sign, from other policy impact parameters (e.g., ATE and TT). We also show that laying out clearly alternative models can guide the search for instruments. On the other hand adding more margins of decision, i.e., occupation choice and intermediation jointly, or adding more periods with promised utilities as key state variables, as in optimal multi-period contracts, can cause the misinterpretation of IV as the causal effect of interest.

Keywords: Contract Theory, Financial Intermediation and Econometric Policy Evaluation.