Financial liberalization increases growth, but also leads to more crises and costly bailouts. We present a two-sector model that matches key empirical regularities, and derive an empirically testable condition for the gains from liberalization. Under financial repression, borrowing constraints in the input-sector lead to underinvestment and low aggregate growth. Liberalization allows for new financing instruments that relax the constraints, but endogenously generate crisis-risk. When regulation restricts external financing to standard debt, liberalization preserves financial discipline and increases allocative efficiency, growth and consumption possibilities. By contrast, under unfettered liberalization that also allows uncollateralized option-like liabilities, discipline breaks down, and efficiency falls.