

Ten Years After: Post-crisis Financial Integration in East Asia

Douglas Arner

Financial integration is less pronounced in East Asia than among states in Europe and North America, or compared to economic integration within the region. Cross-border trade flows, direct investment and investment in capital goods have long been greater and faster growing than other investment flows, while regional institutional and legal structures are scarce and frequently insubstantive. This dichotomy persists despite suggestions since the early 1990s that Asian financial integration would accelerate, most especially following the East Asian financial crisis of 1997-98, including the growth of regional representative organizations and in national enthusiasm for the World Trade Organization. In particular, it defies post-crisis expectations that greater financial integration might prevent or lessen the impact of future financial shocks. This article suggests explanations in legal, governance and institutional frameworks for the paradox of modest financial integration accompanying robust economic growth and trade integration. First, cultural norms militate against regional innovation in financial markets and systems. Second, other economic institutions have tended to resist market-orientated regional reform. Above all, states failed to collaborate effectively in solutions to regional contagion during and following the 1997-98 financial crisis. Without improving financial integration, Asia will maintain a reliance on risk averse portfolio selection and excessive international reserve accumulation, all to the detriment of its financial markets.