Financial Effects on Structural Similarity: A Panel Data Analysis

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Using panel data for 136 OECD country pairs for the period 1983–2003, this paper investigates the effects of financial integration on structural similarity. Theoretically, financial integration motivates countries to specialize based on their comparative advantages and lowers the structural similarity between a pair of countries. This suggests that financial integration can deteriorate one of the optimality conditions for a monetary union, namely, business cycle synchronization given the positive correlation between structural similarity and synchronization. The existence of this channel becomes problematic when the monetary union follows financial integration. This research aims to assess whether the negative relationship between financial integration and structural similarity are empirically supported. The empirical analyses affirm the relationship. The impacts of the channel is estimated to be extremely large and cannot be neglected. The effects of many other variables considered as important determinants of structural similarity, including bilateral trade and the difference in the GDP per capita are weakly estimated.

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