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### **Migrant networks: empirical implications for the Italian bilateral trade**

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# **Migrant networks: empirical implications for the Italian bilateral trade.**

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*Abstract:* A significant number of empirical studies, focusing on different countries, have found a positive link between migration and trade. This paper studies the relationship between emigration, immigration and trade using Italian data. The sample regards 51 foreign trading partners and spans from 1990 to 2005. The results suggest that: networks of Italian emigrants in foreign countries boost bilateral trade. The effects of immigrants are weak, on exports, or negative, on imports. Results do not change when the cultural and institutional dissimilarities between countries are considered.

*Keywords:* International migration, Italian bilateral trade

*JEL:* F10, F22, F23

## 1. Introduction

A country of huge emigration flows in the past, Italy now is a land of immigration. From 1861 to 1976, approximately one Italian out of four emigrated and the majority settled permanently abroad, principally in other European countries and the Americas (Del Boca and Venturini, 2003; Hatton and Williamson, 1998, Livi Bacci et al. 1996, Maddison 2001). Many of the emigrant communities have maintained strong relations with the home country. These cultural, familiar and socio-economic links have also been reinforced by institutional norms, as the Italian law of citizenship, which establishes that the emigrants' offspring are themselves Italian, and by various bilateral treaties between the home country and the principal destination countries, which specified various aspects of the emigrants' status in the receiving country (Gabaccia, 2000).

By the mid seventies Italy had become one of the richest countries in the world and the direction and entity of its migration's flows changed significantly. The emigration numbers fell abruptly while those of immigration started to rise rapidly. The fewer and more modern emigrants began to include the Eastern areas of the world among their preferred destinations, while the growing flows of immigration originated mainly from the developing countries: North Africa, Asia and more recently Latina America and East Europe. The share of immigrants was about 1,3% of the Italian population in 1990, it was 5% in 2005 and, in the Italian national institute of statistics (ISTAT) projections, it will reach a 10% by 2010.

In this paper we investigate whether these immigration and emigration flows have an influence on the Italian bilateral trade. The reason is that several studies empirically support the hypothesis that the transnational social and business networks of immigrants have a positive impact on the bilateral trade relations between their countries of origin and of destination (e.g. Gould, 1994; Head and Ries, 1998; Girma and Yu, 2002; Wagner, Head and Ries, 2002; Saavedra and Herander, 2005; Dunlevy, 2006).

These studies have considered only the effect of a country's immigrants on its bilateral trade flows (an exception is Rauch and Trindade, 2002), because of a generalized scarcity of data on countries' emigrants. However, as we discuss in the next section, a natural interpretation of networks theory is that both, immigrants and emigrants, may affect trade.

Data are available on both the Italian emigration and immigration phenomena, and this makes the wider perspective of this paper feasible. In particular, records of the presence of Italian emigrants worldwide are kept in the Registry of Italians Residing Abroad (AIRE), held by the Italian Ministry of the Interior. This paper uses these data, together with those on immigration and on the flows of Italian bilateral trade with 51 foreign trading partners. The data span from 1990 to 2005.

In particular, we test whether the impact of emigrants and immigrants networks is statistically significant both for Italian export and import, taking into account the potential endogeneity concerns. Moreover, we ask whether this effect works through the information about economic opportunities abroad or the preferences for home-country products.

We also test a corollary of the general prediction, which is that the information provided by migrant networks is most valuable when referring to more dissimilar economies (Girma and Yu, 2002; Dunlevy, 2006). The underlying presumption is that dissimilarity between countries raises the informal barriers between them, and hence enhances the value of the information provided by the migrants' networks. To this aim, we split the sample into two subsets. One, which is called "Old Markets", is composed by the group of countries that have older commercial, political and colonial relations with Italy and, also, share many institutional, religious and cultural similarities with it (e.g. many European and American partners). The other subset, of the "New Markets", has opposing characteristics. It mainly includes the Asian countries and East European economies. Following the

hypothesis on dissimilarity, the migrants' networks related to the New Markets should be the ones with a higher impact on the Italian bilateral trade<sup>1</sup>.

Our dataset shows that emigrants reside mostly in countries of the Old Markets, while immigrants originate principally from the New Markets. Moreover, Asia and East Europe represent the areas of the world where the Italian trade flows are growing more rapidly. Following the hypothesis on dissimilarity, this evidence suggests that the immigrants' links with the New markets should have a positive and strong impact on bilateral trade.

Our findings are as follows. At the aggregate level, only the networks of *emigrants* have a positive and statistically significant impact on Italian trade. Moreover, this effect works through the information effect and not through the preference channel: emigrants affect trade because of their knowledge on foreign market opportunities, not because of their preference for home-market products. The partition of countries into the New and Old markets does not modify these results and only corroborates the prevalence of the emigrants' networks effects. Hence, the hypothesis on dissimilarity does not find econometric support for the case of Italy and, what is more, that the emigrants' transnational links still matter, even for groups countries where they should count less (the Old Markets), while those of immigrants are too weak to affect the Italian bilateral trade, even for the areas of the world they represent more (New Markets).

The paper is organized as follows. Section 2 discusses the theoretical framework. Section 3 introduces the econometric specifications and the expected signs of the determinants of Italian trade. Section 4 presents the results. Section 5 concludes.

## **2. Emigrant and immigrant networks: theoretical framework and some stylized facts**

The central hypothesis of the theory of social and business networks is that the transnational links shaped by migrants foster bilateral trade by lowering informal impediments to it. In what

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<sup>1</sup> The complete list of countries defining the Old and New Markets unit is in the Appendix.

follows we will call it the general *networks effect*. Its relevance has been tested for a number of countries. Gould (1994) has found trade creating effects of immigrants for the United States, Head and Ries (1998) for Canada, Girma and Yu (2002) for the United Kingdom, Rauch and Trindade (2002) for the Chinese communities worldwide and, finally, Wagner, Head and Ries (2002), Herander and Saavedra (2005) and Dunlevy (2006) have confirmed the positive impact of immigrants at the sub-national level in the international trade of the Canadian provinces and American states.

Most studies distinguish between two main channels through which the networks effect is supposed to work. The first is the *information effect*. It consists of a reduction of the information costs and uncertainty that characterize economic interactions in international markets. Migrants are able to provide information about business opportunities, the bureaucratic and commercial environments of potential trading partners and their reputations. The second is the *preference effect* taking place through the diffusion of preferences: immigrants in a country increase imports from their country of origin due to their taste for products from home.

The predictions of network theory have been tested for a variety of countries, but, with the exception of Rauch and Trindade (2002), they have been focused on just one side of the phenomenon: immigration. This can be due to a generalized scarcity of databases on countries' emigration flows and on the final destinations of expatriates, but a natural interpretation of the theory is that both kinds of communities, immigrants as well as emigrants, may influence the bilateral trade flows. There are available data for both the Italian emigration and immigration in Italy and this makes the wider perspective of this paper feasible.

When both sets of networks are taken into consideration, as they are in this paper, it can though that those of emigrants and those immigrants may have influences of different intensity on a country's bilateral trade. These differences can stem from various factors. For example, emigrants and immigrants' ties can be connected to different sets of countries, and the characteristics of these countries may affect the importance of networks' ties. In Rauch and Casella (2003), the value of

transnational links depend on the relative resource endowments of countries, in Girma and Yu (2002) and Dunlevy (2006) it relates to differences in culture and institutions. The underlying hypothesis is that the informal barriers separating more dissimilar countries are higher, and, consequently, more valuable is also the information conveyed by the migrants' networks. Another possibility is that the bulk of emigration and immigration have occurred in different historical periods, and time may affect the strength of migrants' ties with the country of origin. Gould (1994) hypothesis that time has a negative effect on ethnic links, Rauch (2003) sees time as one of the factors that may cause a decay on diasporas' transnational ties. Other elements of differentiation may be related to the characteristics of the goods traded, or to those of the individuals composing each group of networks.<sup>2</sup>

The raw data on Italian emigration and on immigration in Italy shows that there is not much overlap between the world distribution of the two phenomena, and this geographic separation makes the analysis in terms of the characteristics of countries sensible.<sup>3</sup> To control how each group affects trade in relation to the economies they are tied to, we will focus on differences between countries in terms of culture and institutions. For example, Girma and Yu (2002) and Dunlevy (2006) have found that the subsets of immigrants related to more dissimilar countries have a higher impact on exports in UK and USA.

In our paper, when splitting the data on emigrants and on immigrants in relation to the similarity of countries, we can expect two kinds of results. First we should find a positive and higher impact of both subsets of emigrants and immigrants related to the more dissimilar countries. Second, the

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<sup>2</sup> If emigrants or immigrants affect differently the trade of differentiated and homogenous goods then, following Rauch and Trindade (2002) and Rauch and Casella (2003) they should have a different impact on trade. Also individuals' characteristics, as skills or level of education, can affect trade differently. On both these possible effects, see footnote 22.

<sup>3</sup> The greater part of emigration and of immigration have occurred in different historical periods of time, and this reinforces the substantial independence between them.

impact of the group with a geographic distribution more biased towards the more dissimilar countries should be stronger.<sup>4</sup>

To test these points, we separate the set of countries into two groups. We call Old Markets the countries that trade since older times with Italy or have been Italian colonies, and share with the country more institutional and cultural similarities. To this group belong the European Union members and some Scandinavian economies, the North and South American countries and finally Lybia that has been Italian colony in the past. The New Markets have the opposite attributes and, mostly, are composed by Asian and East European countries. The inclusion of the ex-Communist economies in the New Markets follows from the reasonable assumption that generic ignorance on the economic potential of countries that have only recently opened to trade may add to the informal barriers to trade generated by cultural and institutional dissimilarities.

A variety of indicators measure the degree of institutional and cultural similarity of the two groups with Italy. In particular, the indexes contained in Kaufmann et al (1999) are used as a proxy for the “quality of institutions”. The first six rows of Table 1 regard these indexes. Higher values of the coefficients are associated with more effective institutions<sup>5</sup>. The first and the second columns of the Table confirm that the Old markets have a higher degree of similarity with Italy than the New Markets. The second set of indicators is the average percentage of Christians in the total population of each country and Italian schools.<sup>6</sup> They are a proxy for the diffusion of Italian language and culture in foreign countries (the three rows from below in Table 1). In this case also, the numbers of the first two columns are more similar to each other than those of the third: Italy and the Old Markets are closer in terms of culture than they are to the New Markets.

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<sup>4</sup> The geographic distribution of each group is, of course, not static. The empirical analysis of the subsequent sections will take into account the time variation of trade and migration in relation to the two sets of countries.

<sup>5</sup> Index values are the positive functions of civil liberties, political rights, independence of the media, political stability, quality of bureaucracy, the supply of public services, effectiveness and predictability of judiciary institutions and enforceability of contracts, and the negative functions of regulatory burdens on foreign trade and business development and corruption.

<sup>6</sup> “Christianity” includes a variety of religions, which are listed in the Table footnote. Italian schools, expressed in absolute numbers and as a percentage of the total population of each country, are those officially recognized by the Italian state.



Rows 1 and 2 of Table 2 show that Italy trades more with the area of the Old Markets, its most similar and oldest trade partners. However, trade is gradually shifting toward the Old Markets: the flows with the latter are growing more rapidly than those with the New Markets, (rows 3 and 4). This is not surprising, considering that the same phenomenon is taking place in the majority of the developed countries.

More interestingly, row 5 of the Table shows that the Italian emigration is highly concentrated into the group of similar countries, the Old Markets, mostly located in the Western areas of the world. The average presence of Italians in the Old Markets is *eighty* times higher than in the New Markets. The former have been the traditional destinations of historical Italian emigration, but the very recent emigration is gradually shifting toward the emerging areas of the world.<sup>7</sup>

Immigration, on the other hand, originates mostly from the New Markets. This is shown in row 6 of Table 2. The average number of immigrants originating from countries of the New Markets is four times higher than that originating from the Old Markets. More significantly, row 8 of the Table shows that the immigration from the New Markets is increasing very rapidly. Since 1990, it has increased by ten-fold, while that from the Old Markets has increased by less than twice. In sum, the Table shows that trade is concentrated into the Old Markets but is shifting toward the New Markets and, also, that emigration and immigration are independent phenomena, with different geographical distributions and evolutions in history.

### **3. Empirical model**

In this section, we estimate a gravity model of trade augmented by both the emigration and immigration variables to assess the links between migration and bilateral trade flows between Italy and 51 foreign countries in the period 1990-2005.

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<sup>7</sup> The AIRE dataset spans from 1990 to 2005, but a substantial part of the entries correspond to emigrants of the second or even third generation, and these are concentrated into the Old Markets. These registrations are a consequence of the Italian law of citizenship. Also, entries in the Old Markets are concentrated in the very initial years of the registry's existence (since 1990) and then grow very slowly, while the opposite happens with the entries of the New Markets.

The specification used by the empirical literature on trade and migrations (e.g. Bergstrand 1985, 1989 on the gravity model; Gould, 1994, Head and Ries 1998, Rauch and Trindade 2002, Girma and Yu 2002, Dunlevy 2006 on migration and trade) is:  $Y_{it} = (X_{it}, IMMI_{it})$ , where the  $Y_{it}$  is the home exports of goods (or imports from) to foreign country  $i$  at time  $t$ ,  $X_{it}$  is a vector of explanatory variables influencing the bilateral trade between home country and foreign country  $i$ , (e.g., tariff rates and transportation costs, differences in factor endowments, populations, languages, institutions) and  $IMMI_{it}$ , represents the immigrants from foreign country  $i$  to the home country.

In particular, we use distance to captures the time and costs of trading, the GDP terms to describe differences in demand and supply, the GDP deflators to reflect substitution effects, populations to describe differences in market sizes, the stock of Italian emigrants in country  $i$  and the stock of immigrants from country  $i$  to Italy.

The model to be estimated is

$$Y_{it} = a + \alpha_1 GDP_{it} + \alpha_2 DEFL_{it} + \alpha_3 POP_{it} + \alpha_4 GDP_{ITt} + \alpha_5 DEFL_{ITt} + \alpha_6 POP_{ITt} + \alpha_7 DIST_{it} + \alpha_8 EM_{ITt} + \alpha_9 IMMI_{it} + \alpha_{10} D_{EU} + \alpha_{11} D_{NM} + u_{it}$$

Where  $i = 1, \dots, 51$  (countries) and  $t = 1990, 1995, 2000, 2005$ . Variables, except dummy variables, are in natural logs. Specifically,  $Y_{it}$ : volume of Italian exports or imports,  $GDP_{it}$ ,  $GDP_{ITt}$ : foreign country and Italian GDP,  $DEFL_{it}$ ,  $DEFL_{ITt}$ : foreign country and Italian deflators,  $POP_{it}$ ,  $POP_{ITt}$ : foreign country and Italian populations,  $DIST_{it}$ : the distance from the capital city in country  $i$  and Rome (km),  $EM_{ITt}$ : number of emigrants from Italy to country  $i$ ,  $IM_{it}$ : number of immigrants in Italy from country  $i$ ,  $D_{EU}$ : European Union dummy. It is equal to 1 when a country is in the European Union in the 1990s.  $D_{NM}$ : New Markets dummy. It is equal to 1 when a country in the sample is considered a “new market” in world trade (for example Asia, East Europe).  $D_{OM}$ : Old Markets dummy. It is equal to 1 when a country in the sample does not belong to the group of “new

markets” but represents an old market (for example Latin America, EU - except Ireland-, USA, Japan, Australia).<sup>8</sup>

Italy has always traded with all the countries analyzed during the sample period. Hence unlike Head and Ries (1998) and Eaton and Tamura (1999), we do not use Tobit estimation but pooled OLS. Further details on databases and sources are given in the Appendix.

The expected signs of the gravity model are as follows<sup>9</sup>. Distance has a negative effect on trade (both exports and imports), because the overall transaction costs of bilateral trade (given by formal and informal barriers to trade, and transportation costs) generally increase with distance. The importing country’s GDP should have a positive effect on bilateral trade (foreign GDP for the export equation and Italian GDP for the import equation). The signs of the coefficient of the population variables are a priori ambiguous. They depend on which effect, market size or specialization, prevails when the size of population varies. The signs of the coefficients of the deflators are also influenced by different factors. However, under the normal hypothesis of the elasticity of the trading countries’ aggregate demand and supply, the deflator of the foreign country can be expected to have a positive effect on the export equation and a negative effect on the import equation of the home country, while the coefficients of the home country deflators are expected to have the opposite signs.

As said in the previous paragraph, the theory of transnational networks predicts a positive effect of migrants on bilateral trade. This is the *networks’ effect*. It works through two main channels. One concerns information, migrants may be in a better position than other people to conduct trade with their country of origin or of destination because of the information they possess, they have deeper knowledge of business opportunities, the bureaucratic and commercial environments of potential trading partners and their reputations. This leads to the *information effect*. The other channel

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<sup>8</sup> For a detailed account of *EU*, New and Old markets see the list of countries in the Appendix.

<sup>9</sup> For a more complete discussion on the expected signs, see Gould (1994).

determines a *preference effect*: migrants increase trade from their countries of origin because of their taste for goods from their home countries.

If there is a positive relationship between migration and bilateral trade flows, indicating a *network effect*, the coefficients of emigration and immigration variables,  $\alpha_8$  and  $\alpha_9$ , should have positive signs. The *information effect* should have a positive influence on both imports and exports, while the *preferences* of immigrants for home goods should positively affect imports and the preferences of emigrants should positively affect exports. Hence, the coefficient of the immigrant variable is expected to be higher in the import equation, and the coefficient of the emigrant variable is expected to be higher in the export equation<sup>10</sup>.

The impact of networks on bilateral trade can marginally decrease with the size of migrant stocks and with the passage of time. A generally accepted explanation is that the interactions between the members of networks become more difficult and information circulates less easily as their numbers increase (Gould, 1994). Also, ties with the country of origin can become weaker, and the information about business opportunities conveyed by migrants can be less valuable, as the time of migration extends farther into the past. As in Rauch and Trindade (2002), we control for the size effect by adding the squared variable to the regression. If the impact of networks is positive but marginally decreasing in size, the expected signs of coefficients are, in turn, positive for the stock variable and negative for the squared variable.

The model includes observations on the Italian *GDP* and on the Italian deflator and population, which do not vary across trading partners but only over time<sup>11</sup>, and hence, we do not jointly utilize time dummies capturing unobservable time heterogeneity.

Unlike Gould (1994) and Head and Ries (2002), we do not include the lagged dependent variable among the regressors. Given the time dimension of our data, a five-year lag in exports and imports would not be meaningful in accounting for possible decision, production and delivery lags.

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<sup>10</sup> The results of previous work are not conclusive in this respect, on this point see Wagner, Head and Ries (2002).

<sup>11</sup> We have also estimated the models reported in this paper for the export and import equations by using country specific dummies and/or time dummies. However, these dummies have always low explanatory power.

The prevalent cross-sectional nature of our data prevents a direct test of the hypothesis that the causality runs from migrants to trade. However, we exclude the potential endogeneity of the networks with respect to trade by evaluating a model where emigrants and immigrants are replaced by lagged pre-determined regressors.<sup>12</sup>

With the purpose of avoiding a potential multicollinearity with the distance variable, which changes across trading partners but not over time, we do not use country-specific dummies. A related reason is that these dummies would cancel from our data all of the between-country heterogeneity in trade and migrations: the object of this study. Moreover they are scarcely significant. Instead, we include the specific fixed-effect dummies,  $D_{EU}$  and  $D_{NM}$ , which are meant to capture the different propensities of the Italian economy to trade with these geographic areas. The dummy  $D_{EU}$  (European Union) is used to control for the common market effect, while the dummy  $D_{NM}$  (New Markets) groups the 27 new trading partners discussed above.

After testing the main prediction of the theory about the trade effect of networks we are interested in testing the corollary that the information conveyed by migrants is most valuable when referring to the most dissimilar economies (Girma and Yu 2002 and Dunlevy 2006). To this purpose, it is useful to use the geographic differentiation of the set of countries between Old and New Markets that has been developed in the previous paragraph.

To check for the potentially dissimilar effects of emigrants and immigrants in the two world areas, the stocks of emigrants and immigrants are disaggregated by multiplying them by the two dummies  $D_{NM}$  and  $D_{OM}$ . This allows the elasticity of the coefficients of the two variables to vary across the two groups of countries. For this purpose, the specification of the model is modified as follows:

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<sup>12</sup> Empirical studies of networks generally assume that the direction of causality runs from immigration to trade. More generally, by focusing on immigration from developing economies, the literature partially excludes a problem of endogeneity: developed countries have binding quotas that make migration much more of an exogenously determined variable than trade flows. Besides, studies on migration suggest that individual migration decisions are primarily determined by wage differentials and the size of the existing migrant community, rather than the size of bilateral trade flows. On the other hand, these specifications apply less to migrants from a developed country. Hence, in principle, their decisions to migrate might be influenced by trade. Finally, *IV estimation* by using lagged migrant flow as an instrument reinforce this hypothesis.

$$Y_{it} = a + \alpha_1 GDP_{it} + \alpha_2 DEFL_{it} + \alpha_3 POP_{it} + \alpha_4 GDP_{ITt} + \alpha_5 DEFL_{ITt} + \alpha_6 POP_{ITt} + \alpha_7 DIST_{it} + \alpha_8 EMI_{it} * D_{NM} + \alpha_9 EMI_{it} * D_{OM} + \alpha_{10} IMMI_{it} * D_{NM} + \alpha_{11} IMMI_{it} * D_{OM} + \alpha_{12} D_{EU} + \alpha_{11} D_{NM} + u_{it}$$

The parameters  $\alpha_8$ , and  $\alpha_9$  represent different elasticities on bilateral trade of Italian emigrants in the New and Old Markets, while  $\alpha_{10}$ , and  $\alpha_{11}$  represent different elasticities of immigrants in the New and the Old Markets.

As we have seen in Table 2, the average presence of emigrants in the New Markets is eighty times lower than in the Old Markets, while immigrants originate principally in the New Markets. Moreover, the Old Market economies share in common many institutional and cultural characteristics with Italy, while the New Markets are dissimilar in many respects. Taking into consideration these factors, the expected signs both for export and import are as follows.

If the trade effect of migrants mainly depends on the transmission of information and this, in turn, is related to the size of the networks, then the coefficient of the variable emigrants Old Markets should be positive and higher than the coefficient of the same variable for the New Markets:  $\alpha_9 > \alpha_8$ . For the same reason, the coefficient of the immigrants New Markets should be positive and higher than the coefficient of immigrants Old Markets:  $\alpha_{10} > \alpha_{11}$ .

On the other hand, if the value of the information transmitted is more related to its content than to the size of the networks, then the expected direction of the inequality between the coefficients on emigrants will change. The relation should be  $\alpha_9 < \alpha_8$ : the coefficient of the variable emigrants New Markets should be higher (or more significant) than the coefficient of the variable emigrants Old Markets.

#### 4. Key findings

Tables 3 and 4 show the estimation results for the exports and imports equations respectively. Different specifications are reported to test for different hypothesis. In all cases, the explanatory power of the regressions is very high: in the export equations, the adjusted  $R^2$  ranges from 0.84 to 0.86, while in the import equation it varies from 0.72 to 0.74.

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The control variables of the gravity model have the expected signs in all the specifications. In particular, the distance variable always has a significant negative effect both on exports and imports. In the export equations (Table 3) higher foreign income and higher foreign prices boost exports (respectively, with a demand and a substitution effect), while the coefficient of the foreign population variable is negative<sup>13</sup>. This demonstrates that, controlling for the market size proxied by population, Italy trades more with richer countries.

The variables of Italian *GDP*, deflator and population also have the expected signs, but only the *GDP* is statistically significant. The positive coefficient of this variable confirms that, given the elasticity of world demand for Italian products, an increase in home production determines higher exports. In the import equations (Table 4), both the *GDP* and the populations of foreign countries have a positive impact on imports (this implies that, for given income levels, Italy imports more from big countries), while, as expected, the price deflators have a negative effect on imports from those countries. The coefficients of the Italian population and price deflator variables are positive and statistically significant, demonstrating that income and internal prices have both a positive effect on the country's demand for foreign goods.

As suggested by the positive and significant coefficients of the dummy  $D_{EU}$  in both the import and export equations, Italy trades more with countries of the European Union. Interestingly, the dummy  $D_{NM}$ , New Markets, is always positive and significant in the export equations (see Model III in Table 1 and 2). This confirms that, as seen in Table 2, in the sample period considered (1990-

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<sup>13</sup> As stressed by Gould (1994) population is not signed a priori "because market size can have a negative effect on trade if economies of scale are present or a positive effect if a larger population allows for more specialization".

2005), the Italian propensity to export to the New Markets increases, while the exports to the Old Markets (except the *EU* economies) show some decline. Note that the inclusion of these two dummies improves the regression's explanatory power (see Model I, II versus Model III in Table 3 and 4).

As expected, the emigration variable has a positive and highly significant impact (1% significant level) in both equations, of exports and of imports. This gives support to our hypothesis that the social and business links of Italians living abroad affect Italy's bilateral trade flows with their countries of residence.

Contrary to the theory's prediction and to the results of empirical studies on other countries, the variable regarding immigration is significant at a 5-10% significance level in the imports' equations, but with a negative sign (see Model I, II, III in Table 3 and 4), it is non-significant in the exports' equation.<sup>14</sup> This sign could suggest a substitution effect of immigration on bilateral imports, perhaps due to import-substituting activities performed by the immigrants, but the highly aggregated level of the data and the bilateral character of the trade relationship makes this result difficult to interpret. Obviously, the either negative or non-significant coefficients in the two equations exclude a networks' effect of immigrants on trade.

As said in the previous paragraphs, the *network effect* of migrants can be disaggregated into a preference and an information effect. If the *preference effect* of emigrants for home goods influences Italian exports, the coefficient of the variable emigrants should be higher in the export than in the import equation. Our findings, in Tables 3 and 4, are not consistent with this expectation: the difference between the two coefficients is not significant. However, this result should not be surprising. In previous works, from Gould (1994) to more recent studies, the preference effect has been conceived as an "ethnic" component of the foreign demand of a country's products. While it can have some weight on a developing country's exports, it should not

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<sup>14</sup>A similar outcome is in Girma and Yu (2002) for the U.K, but it concerns only the subset of immigrants originating in the most similar countries (in their case, those belonging to the Commonwealth), while the coefficient of immigrants from non-Commonwealth countries is significant and positive.



be expected to be significant for the exports of a developed economy, which, in a very significant proportion, are composed by goods produced for international rather than ethnic tastes.

Considering Model III in Table 3 and 4, the final results are that a 10% increase in the stock of emigrants increases Italian exports by 1.3% and imports by 1.2% (positive trade effects), while a 10% increase in the stock of immigrants *reduces* the Italian imports by 1% (trade-substitution effect)<sup>15</sup>.

We control for the direction of causality from migrations to trade assumed in this paper. To this aim we substitute the contemporary stocks of migrants by lagged emigrants and immigrants. In this way, these lagged variables are predetermined with respect to trade (see Model V in Table 1 and 2). Despite this experiment being is more relevant for emigrants, the estimation reveals that the trade impacts of both immigrants and emigrants do not change with the predetermined variables, hence migrations precede trade and not vice versa.<sup>16</sup>

Now, we test the hypothesis that the positive impact of emigrants on bilateral trade can marginally decrease with the size of the stock of emigrant networks and with time (see Model VI in Table 3 and 4).<sup>17</sup> The coefficient of the stock of emigrants remains positive and significant in both the export and the import equations, while, as expected, the coefficient of the squared variable is negative, but it is not significant (also see the test in the table Notes) . This suggests that the networks of Italian emigrants have an impact on trade that it does not tend to decrease significantly with size and time.<sup>18</sup> Model IV illustrates the results of the disaggregation of the variables emigrants and immigrants for the two world areas, the New and the Old Markets (Tables 3 and 4) and for the

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<sup>15</sup> We also perform a sensitivity analysis to check for the robustness of the estimated elasticities of emigrants and immigrants to the inclusion of other potential determinants of trade: foreign direct investment (inward and outward), the number of Italian schools and of Italian entrepreneurs in the foreign countries. The dimension and significance level of the elasticities of the migrant network is similar to the previous estimates. These results are available on request.

<sup>16</sup> Gould (1994) and Dunley and Hutchinson (1999) perform Granger causality tests finding that immigration precedes trade for most of the US's trading partners. We cannot perform this analyses because of the short span of our time series data.

<sup>17</sup> We perform the test only on emigrants because this is the only variable with a positive and significant coefficient

<sup>18</sup> This result differs from Rauch and Trindade (2002), where the coefficient of the squared variable of ethnic Chinese immigrants is negative and significant.

two equations, exports and imports. This is useful to control whether the migrant links with the New Markets have a higher impact on bilateral trade because of the extra information they convey.

Regarding immigrants, the disaggregation confirms the results obtained above: both groups have a negative impact on trade, which is significant only in the import s equation. Therefore, contrary to the expectations based on the hypothesis of Girma and Yu (2002), even the immigration originating in the more dissimilar economies, the New Markets, has a negative impact on import flows: the potential links that these immigrants establish is not strong enough to compensate for the negative or not significant effect that they seem to have on trade. More generally, it is not possible to reject the hypothesis that the effects on trade of these two different immigrants' stocks do not differ (see the linear restrictions reported in the *Notes* of Table 4).

Again relatively to emigrants, the disaggregation shows that the two coefficients are not significantly different (see the linear restrictions in the table Notes), but the meaning of this result is different from above. While it confirmed the absence of an immigrants' effect, with respect to emigrants it bears the opposite implication. The result shows that the emigrants' impact on bilateral trade is positive and robust to the division of the sample into the two subsets, one of similar and one of dissimilar countries, one with a large stock of emigrants, the other with a very reduced stock. The outcome is in contrast with Girma and Yu (2002) and Dunlevy (2002): the more marked dissimilarity of one subset of countries does not add value to the information conveyed by the networks related to those countries.<sup>19</sup>

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<sup>19</sup> A frequently tested implication of network theory concerns the types of goods traded in the international markets (e.g. Gould 1994, Head and Ries 1998, Rauch and Trindade 2002). It is hypothesized that the value of the information provided is higher for differentiated than for homogeneous goods (Rauch 2001). To control for these aspects, we have separated the Italian bilateral trade flows into two main groups, one including differentiated manufactures and the other non-differentiated manufactures and other goods. The proportion of differentiated goods over the whole of bilateral trade with the Old markets is 62%, while this share is 52% for the New markets (ISTAT, COMTRADE). The lack of statistical differentiation between the coefficients of the variable emigrants in the Old and New Markets suggests that this differentiation is not relevant for our analysis. Another implication of network theory is that transnational links are more easily established by skilled migrants. The proportion of the stock of emigrants of people holding a tertiary degree and of entrepreneurs are both clearly higher in the New Markets than in the Old. In particular, the percentage of emigrants with tertiary education in the New markets is 7.3% versus 2.4% in the Old Markets, while the share of entrepreneurs is 20% in the New versus 5.7% in the Old Markets (AIRE). Again, the two coefficients are not statistically different and the hypothesis is not supported by Italian data.

## 5. Conclusions

To our knowledge, this paper is the first empirical study of the relationship between emigration, immigration and Italian trade. We have focused on Italy, because of it is a country characterized by important outflows and inflows of population and by a marked geographic and historical separation between these two movements.

The main prediction of network theory is that migrations can have a positive effect on bilateral trade flows. Our findings are that *emigrants* have a significant and robust effect on bilateral trade. In particular, emigrants affect trade because of their knowledge on foreign market opportunities, not because of their preference for home-market products. We also find that the networks of *immigrants* in Italy, if they exist, are too weak to significantly affect the exports to their countries of origin and to compensate for the negative relation between immigration and imports that emerges from the estimates.

The separation of the world into two main areas, one of similar and known countries, the other of dissimilar and less explored ones, does not modify significantly these results. The networks of emigrants influence trade flows with the known and similar countries, where ties should count less, and also with newer and dissimilar trade partners, where links should be more important, but the presence of emigrants is scant. These are, instead, the countries from which most of the immigration in Italy originates from, but, even in relation to these areas, the impact of immigration on trade remains weak or negative.

These results show that the Italian emigrants communities maintain robust ties with their country of origin that do not seem to decay with time or be weakened by countries' similarities. They suggest that entrepreneurs and economic agents in Italy prefer to interact with their nationals abroad rather than with immigrants, even when the information potentially supplied by the latter could be economically more valuable. This may be related to the Italian economic structure, characterized by a small average size of firms and low-skill intensive sectors of specialization. A further

investigation on these topics may help to shed light on the role of emigrants in facilitating trade and on the apparently absent effects of immigrants.

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<b>Table 1 Institutions and culture: Old and New Markets</b>			
<i>Variables</i>	<i>Italy</i>	<i>Old Markets*</i>	<i>New Markets**</i>
<i>Institutions</i>			
Voice and accountability (a)	1.05	0.40	0.04
Political instability and violence (b)	0.26	0.23	-0.08*
Government effectiveness (c)	0.84	0.60	0.12
Regulatory burden (d)	0.89	0.46	0.12
Rule of law (e)	0.78	0.53	0.05
Corruption (f)	0.68	0.60	0.02
<i>Culture</i>			
Christians on population	0.95	0.81	0.31
Number of Italian schools		323	47
Share of schools on population (millions)		0.35	0.08
<p><i>Notes:</i> *. ** A detailed list of the countries belonging to each group is in the Appendix.  a, b, c, d, e, f are the (cross sectional and time series) averages of six standardized indicators provided by Kaufmann et al. (1999). Each original indicators is expressed in terms of deviations from its own mean: greater values are associated to greater effectiveness of institutions. The values in this table (averages) also have the same meaning. The negative value (*) is associated to greater political instability. "Christians" includes Roman Catholics, Greek Catholics, Protestants, Anglicans, Lutherans, Orthodox and other Christians. Italian Schools includes Dante Alighieri and other Italian Schools. Further details on these variables in the Appendix.</p>			

<b>Table 2 Trade and migration: Old and New Markets</b>		
<i>Variables</i>	<i>24 Old Markets*</i>	<i>27 New Markets**</i>
<i>Trade</i>		
Exports (\$ mill.)	13.909	3.665
Imports (\$ mill.)	13.337	4.253
Exports growth#	0,8	2,7
Imports growth #	0,6	3,1
<i>Migration</i>		
Emigrants (stocks)	33.895	419
Immigrants (stocks)	3.478	13.350
Emigrant growth#	350	1128
Immigrant growth#	80	981
<p><i>Notes:</i> *. ** A detailed list of the countries belonging to each group is in the Appendix  # percentage increase between 2005 and 1990</p>		

**Table 3** *Export equation*

Explanatory Variables	<i>Model I</i>	<i>Model II</i>	<i>Model III</i> ♦	<i>Model IV</i>	<i>Model V</i>	<i>Model VI</i>
Intercept	-107.836 (-1.32)	-126.407 (-1.55)	-51.42 (-0.62); [-0.59]	-30.77 (-0.36)	242.141 (1.49)	-44.425 (-0.52)
Foreign -country GDP	0.691*** (16.19)	0.656*** (14.79)	0.661***,+++ (15.15), [14.17]	0.665*** (15.51)	0.643*** (14.29)	0.66*** (2.37)
Foreign -country deflator	0.302* (1.72)	0.338* (1.95)	0.336**, ++ (1.99) [2.40]	0.351** (2.05)	0.317* (1.95)	0.328* (1.92)
Foreign–country population	-0.078 (-1.60)	-0.058 (-1.20)	-0.079*, + (-1.67), [-1.70]	-0.094** (-2.08)	-0.033 (-0.66)	-0.080* (-1.67)
Italian GDP	0.046* (1.71)	0.060** (2.24)	0.061**, + (2.35), [1.94]	0.063** (2.39)	0.062** (2.27)	0.062** (2.37)
Italian deflator	-0.302 (-0.38)	-0.104 (-0.41)	-0.112 (-0.45), [-0.44]	-0.090 (-0.36)	0.277 (0.93)	-0.106 (-0.43)
Italian population	5.936 (1.28)	6.94 (1.51)	2.72 (0.59), [0.56]	1.565 (0.33)	-13.78 (-1.04)	2.328 (0.49)
Distance	-0.640*** (-13.10)	-0.601*** (-11.99)	-0.579***,+++ (-11.60), [-11.09]	-0.565*** (-11.36)	-0.627*** (-11.74)	-0.581*** (-11.56)
Emigrants	0.079*** (3.99)	0.071*** (3.58)	0.129***,+++ (5.03), [4.69]			0.156** (2.065)
Immigrants	0.012 (0.36)	0.016 (0.49)	-0.002 (-0.88), [-0.82]			-0.003 (-0.083)
Lagged Emigrants					0.124*** (4.64)	
Lagged Immigrants					-0.014 (-0.39)	
Squared Emigrants						-0.0017 (-0.38)
Emigrants Old Markets				0.134*** (4.54)		
Emigrants New Markets				0.123*** (4.09)		
Immigrants Old Markets				0.004 (0.12)		
Immigrants New Markets				0.024 (0.75)		
Dummy EU (1990)		0.260** (2.46)	0.356***,+++ (3.34), [2.79]	0.36*** (3.19)	0.261** (2.32)	0.354*** (3.28)
Dummy New Markets			0.412***,+++ (3.44), [3.18]	0.37*** (2.74)	0.430*** (3.36)	0.419*** (3.44)
Adjusted $R^2$	0.846	0.850	0.8585	0.8580	0.865	0.857
Observations	204	204	204	204	153	204

**Notes:** ♦ optimal model;  
\*\*\* 1%, \*\* 5%, \* 10% significant level based on ( t-values);  
+++ 1%, ++ 5%, + 10% significant level based on [ t values] – heteroskedasticity robust standard errors  
Testing restriction in model IV,  $H_0$  : Emigrants Old Markets = Emigrants New Markets,  $F(1,190)=0.12$ , p-value=0.72;  
Testing restriction in model VI  $H_0$  : Squared Emigrants=0,  $F(1,191)=0.12$ , p-value=0.72.

<b>Table 4 Import equation</b>						
Explanatory Variables	<i>Model I</i>	<i>Model II</i>	<i>Model III</i> ♦	<i>Model IV</i>	<i>Model V</i>	<i>Model VI</i>
Intercept	-302.972** (-2.67)	-323.77*** (-2.87)	-275.59***,++ (-2.36); [-2.20]	-243.03** (-2.04)	-146.91 (-0.63)	-266.26** (-2.22)
Foreign-country GDP	0.601*** (10.24)	0.562*** (9.17)	0.567***,+++ (9.27); [10.48]	0.576*** (9.51)	0.572*** (8.82)	0.570*** (9.21)
Foreign-country deflator	-0.760*** (-3.15)	-0.719*** (-2.99)	-0.72,***,++ (-3.01); [-2.85]	-0.674*** (-2.77)	-0.753*** (-3.23)	-0.731*** (-3.02)
Foreign-country population	0.087 (1.30)	0.108 (1.61)	0.094 (1.40); [1.58]	0.072** (1.12)	0.148* (2.01)	0.094 (1.40)
Italian GDP	-0.009 (-0.25)	0.007 (0.19)	0.008 (0.21); [0.30]	0.008 (0.23)	-0.0006 (-0.15)	0.008 (0.23)
Italian deflator	0.601* (1.70)	0.595* (1.69)	0.590*,+ (1.69); [1.67]	0.565 (1.62)	0.918** (2.15)	0.598* (1.71)
Italian population	17.04*** (2.67)	18.18*** (2.86)	15.47***, ++ (2.35); [2.19]	13.64* (1.82)	6.865 (0.52)	14.94** (2.21)
Distance	-0.742*** (-11.03)	-0.69*** (-9.89)	-0.683***, +++ (-9.66); [-9.86]	-0.673** (-10.02)	-0.77*** (-10.03)	-0.686** (-9.63)
Emigrants	0.091*** (3.31)	0.082*** (2.96)	0.119***, +++ (3.27); [2.74]			0.155 (1.45)
Immigrants	-0.092** (-2.01)	-0.088* (-1.92)	-0.100**, ++ (-2.17); [-2.18]			-0.100** (-2.16)
Squared Emigrants						-0.002 (-0.35)
Lagged Emigrants					0.097*** (2.52)	
Lagged Immigrants					-0.133** (-2.53)	
Emigrants Old Markets				0.123** (2.25)		
Emigrants New Markets				0.115** (2.17)		
Immigrants Old Markets				-0.089** (-1.99)		
Immigrants New Markets				-0.057^ (-1.50)		
Dummy EU (1990)		0.29** (1.99)	0.355**,+++ (2.34); [2.74]	0.330* (1.83)	0.255 (1.57)	0.349** (2.28)
Dummy New Markets			0.269 (1.56); [1.08]	0.14 (0.45)	0.247 (1.34)	0.270 (1.57)
Adjusted $R^2$	0.728	0.732	0.735	0.735	0.746	0.733
Observations	204	204	204	204	153	204

**Notes:** ♦ optimal model; \*\*\* 1%, \*\* 5%, \* 10% significant level based on ( t-values);  
+++ 1%, ++ 5%, + 10% significant level based on [ t values] – heteroskedasticity robust standard errors  
Testing restriction in Model IV  $H_0$  : Emigrants Old Markets = Emigrants New Markets,  $F(1,190)=0.032$ , p-value=0.85;  
 $H_0$  : Immigrants Old Markets = Immigrants New Markets,  $F(1,190)=0.68$ , p-value=0.40.  
Testing restriction in model VI  $H_0$  : Squared Emigrants=0,  $F(1,191)=0.14$ , p-value=0.70.



## Data Appendix

<i>Data</i>	<i>Source</i>
<i>Gross Domestic Product: current prices, US billion dollars</i>	World economic outlook 2006, International Monetary Found. ( <a href="http://www.imf.org/external/pubs/ft/weo/2006/01/data/dbcdatm.cfm">http://www.imf.org/external/pubs/ft/weo/2006/01/data/dbcdatm.cfm</a> )
<i>Gross Domestic Product Deflator: index</i>	World economic outlook 2006, International Monetary Found.
<i>Population</i>	Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, 2005. <i>World Population Prospects: The 2004 Revision</i> . Dataset on CD-ROM. New York: United Nations. Available online at <a href="http://www.un.org/esa/population/publications/WPP2004/wpp2004.htm">http://www.un.org/esa/population/publications/WPP2004/wpp2004.htm</a>
<i>Distance</i>	The great circle distance in km between capital cities, which is available on <a href="http://www.wcrl.ars.usda.gov/cec/java/lat-long.htm">http://www.wcrl.ars.usda.gov/cec/java/lat-long.htm</a> .
<i>Italian emigrants: stocks</i>	AIRE (Anagrafe Italiani Residenti all'Estero); people registered at AIRE database from 1990 to 2005
<i>Immigrants: stocks</i>	ISTAT, migration trends and foreign population, istat annuals on line; "foreign presence in Italia: social – demographical characteristics; residence permits on 1 <sup>st</sup> January of the year
<i>Exports: current prices, U.S million dollars</i>	ISTAT, Coeweb – statistics on the international trade..
<i>Imports: current prices, U.S million dollars</i>	ISTAT, Coeweb – statistics on the international trade. Values in current million dollars.
<i>Foreign direct investment inward and outward: current prices, U.S million dollars</i>	OECD International Direct Investment Statistics International direct investment by country <i>Vol 2005 release 01</i>
<i>Italian Schools: total number of Dante Alighieri and other Italian Schools.</i>	<ul style="list-style-type: none"> <li>- Dante Alighieri schools - <a href="http://www.scuoladantealighieri.org/">http://www.scuoladantealighieri.org/</a></li> <li>- Italian schools – the list is published by the Italian Foreign Ministry on its site <a href="http://www.esteri.it">www.esteri.it</a></li> </ul>
<i>Christians: % of Christians (Roman Catholics, Greek Catholics, Protestants, Anglicans, Lutherans, Orthodox and other Christians) on population</i>	The World Factbook, Central Intelligence Agency

**Table 5** Sample of countries and regional dummies

<b>Countries</b>		
Albania #	Malaysia #	Hungary #
Algeria #	Morocco #	Ireland, *
Argentina	Mexico	Venezuela
Australia	Norway	
Austria	Netherlands*	
Brazil	Philippines #	
Bulgaria #	Poland #	
Canada	Portugal *	
Chile	UK *	
China #	Czech Rep. #	
South Korea #	South Africa	
Croatia #	Romania #	
Denmark *	Russia #	
Egypt #	Singapore #	
France *	Slovakia #	
Germany *	Slovenia #	
Japan #	Spain *	
Greece *	USA	
India #	Sweden *	
Indonesia #	Switzerland	
Iran #	Thailand #	
Israel #	Tunisia #	
Libya	Turkey #	
Luxembourg *	Ukraine #	

Notes: \* denotes EU member countries in the 1990; # denotes countries considered in the New Market Dummy variable

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