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The geography of asset holdings : Evidence from Sweden

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Abstract

This paper analyzes the determinants of cross-border asset holdings on cross-country data and a Swedish data set. We focus our analysis on the effect of the euro not only for the determinants of bond holdings, but also of equity and banking assets. With the help of a simple theoretical model, we attempt to disentangle the different effects that the euro may have had on asset holdings for both euro zone countries and countries outside of the euro zone such as Sweden. We find evidence that the euro has implied 1) a unilateral financial liberalization which makes it cheaper for all countries to buy euro zone assets. For bonds and equity holdings, this would translate into a 14% and 17% decrease in transaction costs. Using Swedish data, we find that the effect is larger for flows than for stocks. 2) a preferential financial liberalization which on top of the previous effect has decreased transaction costs inside the euro zone by 17% and 10% for bonds and equity respectively. 3) a diversion effect due to the fact that lower transaction costs inside the euro zone have led euro countries to purchase less Swedish equity. Our empirical analysis also suggests that the elasticity of substitution between bonds inside the euro zone is higher than between bonds denominated in different currencies. We illustrate this effect for transaction costs generated by the difference in the legal system.

Keywords: International Asset Trade, Gravity Equation, Euro.

JEL Classification: F30, F36, F41, G11.

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1 Introduction

Financial integration has been one of the major trends characterizing the world economy in the recent past and partially explains the increase in cross-border asset holdings. All industrialized countries have been affected by this process. The creation of the euro can at least partially be interpreted as affecting this process of financial integration but in an asymmetric way for countries inside and outside the euro zone. From that point of view, an interesting question is to what extent the euro can be considered as unilateral or preferential financial liberalization. The question is important especially for countries outside the euro zone but which trade a lot with the euro. Sweden has also some specific characteristics that makes it an interesting country to analyze in terms of the determinants of its financial flows. It is a very open country for both trade and financial flows, it is a member of the largest and most integrated regional trade agreement, the European Union, but at the same time an outsider of the euro zone. If one believes that financial integration and financial flows generate gains in terms of risk diversification and allocation efficiency, it is important to estimate both the opportunity cost of being outside the euro zone and the cost or gain of the creation the euro for outsiders such as Sweden. This is one objective of this paper although we do not attempt to answer the question by providing a welfare number but more modestly by providing estimates on financial flows.

Our paper is very much related to the analysis of Lane (2006) on the impact of EMU on bond portfolios. It also builds on recent papers that have analyzed the financial gravity equation such as Portes and Rey (2005), Portes, Oh and Rey (2001) and Aviat and Coeurdacier (2005).

Our additional contribution is both theoretical and empirical. Based on the model of Martin and Rey (2004 and 2006), we derive a testable financial gravity equation that informs us on the different potential effects of the euro on cross border asset holding. Empirically, we analyze, not only the determinants of bond holdings, but also of equity and banking assets. Also, we attempt to disentangle the different effects that the euro may have had on asset holdings for both euro zone countries and countries outside of the euro zone which may be of particular interest for Sweden. In theory, the euro may have had several effects on the cost of transacting assets: on transactions inside the euro zone, on purchases of euro assets by countries outside the euro zone and on purchases of non euro assets by euro countries. As in trade theory, these changes in transaction costs may also have resulted in diversion. In addition, and as noted by Lane (2006), the euro may have increased the elasticity of substitution between assets of the euro zone. This actually has a negative effect on the holdings of euro assets by countries in the euro zone. The reason is that the increased elasticity magnifies the impact of any remaining transaction cost (due to different legal systems in the euro zone for example) on cross-border holdings of euro assets in the euro zone. Hence, at least theoretically, it is not obvious that the euro increases the cross-border demand for assets inside the euro zone. We attempt to analyze these different effects from a theoretical point of view

and quantify those with the help of cross-country data on asset holdings and Swedish data on foreign asset purchases. We find evidence that the euro has affected both transaction costs and the elasticity of substitution but the effect is different for different classes of assets and also different whether countries are in or out of the euro zone. In particular, we find that transaction costs have decreased inside the euro zone.

Our estimates (which depend on the elasticity of substitution between assets) suggest that the transaction cost to buy assets from the euro zone has decreased by around 17% for equity and 14% for bonds. This has benefited both those countries that are in and outside of the euro zone. On top of this effect, those countries inside the euro zone benefited from a 17% and 10% decrease of transaction costs for bonds and equities respectively. Hence, for a country inside the euro zone the transaction cost for the cross border purchase of a euro bond or equity has decreased by 31% and 24% respectively. Hence, the euro can be interpreted as both preferential and unilateral financial liberalization. This resembles some recent results (see Baldwin (2006) and Flam and Nordstrom (2003)) in the literature on the euro effect on trade in goods. However, contrary to this literature we find no effect that the euro has decreased the transaction cost for euro countries of purchasing assets outside the euro zone. In fact, for equities we find evidence that some diversion has taken place in the sense that euro countries buy less equities from outside the euro zone. The comparison of asset trade between euro zone countries and the nordic countries in (Finland) and out (Sweden, Norway, Denmark) of the euro zone suggests that for equity holdings some trade diversion due to the introduction of the euro exists. This diversion effect does not come from an absolute increase in transaction costs for buying assets from the rest of the world but from a relative cost effect. For most of these findings, Sweden is not different from other countries. The only important difference concerns the intensity of bonds exchanges between Sweden and the euro area. Sweden appears to be very well integrated to the euro bond market. On Swedish data, we also confirm that the euro worked like unilateral liberalization: the portfolio bias towards the euro zone is found quantitatively large for equity and bond holdings. Interestingly, we also find that this bias (and presumably the transaction cost decrease that causes it) is larger for flows than for stocks.

Finally, our empirical analysis suggests that the elasticity of substitution between bonds inside the euro zone is higher than between bonds denominated in different currencies. Our estimate is that it is almost three times higher. This actually depresses cross border asset holdings in the euro zone as it magnifies the negative impact of remaining transaction costs in the euro. We illustrate this effect for transaction costs generated by the difference in the legal system.

The first section introduces a simple theoretical framework in order to generate testable financial gravity equations. We then present empirical evidence on determinants of cross border financial asset holdings and in particular the effect of the euro on both insiders and outsiders. We do this by using both

a cross country data set and a data set on Swedish holdings of foreign assets and Swedish capital outflows.

2 Theoretical framework

We use a simplified version of Martin and Rey (2004 and 2006) to derive a gravity equation for international trade in assets with financial transaction costs¹. There are N countries populated with L_i ($i \in N$) risk averse agents who live for two periods. Agents are endowed with projects and assets correspond to claims on those risky projects. The number of traded assets (n_j for country j) is therefore taken to be exogenous here (in Martin and Rey 2006, it is endogenous). The number of shares per asset is normalized to one. The cost of an asset issued by an agent in country j and bought by an agent in country i is $p_j \tau_{ij}$ where p_j is the price of the asset and $(\tau_{ij} - 1)$ is the bilateral financial transaction cost between the two countries. As in the trade literature, the simplifying assumption is that this cost takes a iceberg form meaning here that the transaction fee is paid in units of the asset itself.

In the second period, there are Z exogenous and equally likely states of nature (the number of states of nature is assumed to be larger than the number of traded assets), and the realization is revealed at the beginning of that period after all decisions have been taken. As in Acemoglu and Zilibotti (1997) and Martin and Rey (2004), the technology implies that each project gives dividends in only one state of nature. In all other states of nature, the dividends are zero. All risky claims to operating profits are traded on the stock market at the end of period one, so that each claim corresponds to an Arrow-Debreu asset. No duplication occurs in equilibrium so that each investment/asset in the world is unique². This modelling introduces a simple incentive for agents to diversify their portfolios.

A representative agent in country i maximizes utility subject to the first period budget constraint (in second period consumption is the dividend of shares purchased in first period):

$$\begin{aligned}
 \underset{C_{1i}, C_{2i}, s_{ij}}{\text{Max}} E(U_i) &= \ln C_{1i} + \beta \ln \left[\sum_{z=1}^Z \frac{1}{Z} C_{2i}(z)^{1-1/\varepsilon} \right]^{\frac{1}{1-1/\varepsilon}} \\
 &= \ln C_{1i} + \beta \ln \frac{1}{N^{1-1/\varepsilon}} + \beta \ln \left[\sum_{h=1}^N \sum_{l_h=1}^{n_h} (d_{lh} s_{il_h})^{1-1/\varepsilon} \right]^{\frac{1}{1-1/\varepsilon}} \\
 \text{s.t.} \quad &: y_i = C_{1i} + \sum_{h=1}^N \sum_{l_h=1}^{n_h} \tau_{ih} p_h s_{il_h},
 \end{aligned} \tag{1}$$

which is of the non-expected form introduced by Epstein and Zin (1989) and Weil (1990). This allows the intertemporal elasticity of substitution (which we assume to be 1 for simplicity) to be different from the coefficient of relative risk aversion ($1/\varepsilon$). C_{1i} and C_{2i} are consumption in first and second period

¹See also Aviat and Coeurdacier (2006) for a derivation of financial gravity equation in related framework.

²In Martin and Rey (2006) where the number of assets is endogenous, this is shown to be an equilibrium as agents have no incentive to replicate an existing asset.

respectively. y_i is per capita income and s_{il_j} is the demand by an agent of country i for the asset of agent l_j of country j . Remember that assets are all different in the sense that they give dividends in different states of nature (this is the reason why agents want to diversify their portfolio and buy all existing assets) but they are symmetric in the sense that they all give in only one state of nature. This symmetry implies that the “typical” demand by an agent of country i for an asset of country j can be denoted as: $s_{il_j} = s_{ij}$.

Note that for the second period, this utility function is similar to the one introduced by Dixit and Stiglitz (1977) to represent preferences for differentiated products and ε can be interpreted as the elasticity of substitution between assets. In what follows, we impose $\varepsilon > 1$ to have financial home bias and realistic asset demands.

If we call $r_j = d_j/p_j Z$, the expected return of asset j , the value of the aggregate demand by country i agents for assets issued in country j is (exclusive of transaction costs):

$$Asset_{ij} = L_i p_j n_j s_{ij} = \frac{\beta L_i y_i n_j}{(1 + \beta)} \left(\frac{r_j Q_i}{\tau_{ij}} \right)^{\varepsilon - 1}, \quad Q_i = \left[\sum_{h=1}^N n_h \left(\frac{r_h}{\tau_{ih}} \right)^{\varepsilon - 1} \right]^{\frac{1}{1 - \varepsilon}}. \quad (2)$$

Note that as in the trade literature a “price index” Q_i specific to each country appears in the demand for assets. We can think of it in our context as a financial price index for all assets that compete with the imported asset. It measures financial remoteness (see Anderson and van Wincoop (2003) and Head and Mayer (2004) for the trade version). A country with a low Q_i (for example because its own financial markets are very diversified and it issues many assets) is a country to which (for a given relative return and bilateral transaction cost) it is difficult to sell financial assets. Note that an empirical difficulty (again common to the trade in goods literature) is that this price index is supposed to contain all potential asset suppliers in the world.

What are the effects of the euro in this theoretical context? The euro can most obviously be interpreted as a decrease in transaction costs τ_{ij} between two countries i and j inside the euro zone. This should increase the cross-border demand of euro assets by euro countries. Note that this decreases the “financial” price index Q_i of the euro countries and therefore exerts a negative impact on the demand by euro countries for assets outside the euro zone.

However, we may also think that the euro makes it easier for non euro countries to buy euro assets, which we would interpret as a decrease in τ_{hj} where country j is in the euro but not h . This increases the demand for euro assets. Symmetrically, the euro could make it easier for euro countries to buy non-euro assets (a decrease in τ_{jh} where country j is in the euro but not h).

Finally, it is intuitive to believe that the euro has also increased the elasticity of substitution between assets of the euro zone. The reason is that with a single monetary policy the correlation between asset returns (dividends and even more so interest rates) should increase. This effect is not straightforward to capture in our simple model because the elasticity of substitution between assets is the same for all assets

and is the inverse of the coefficient of relative risk aversion which is the same for all agents. However, it should still be true that for two countries i and j , the demand by country j for assets of country i depends on the interaction between bilateral transaction costs τ_{ij} and the specific elasticity of substitution between these two countries ε_{ij} in the following way: $(\tau_{ij})^{1-\varepsilon_{ij}}$. This has important implications. Suppose we divide bilateral transaction costs into those related to the euro and all others related to cross-border asset transactions that are not affected by the euro (for example the difference in legal systems among euro zone countries). For a country pair inside the euro zone, transaction costs are lower so this should exert a positive impact on their bilateral cross border asset holdings. However, the negative impact of difference in legal systems τ_{ij} will be magnified by the introduction of the euro if we believe that ε_{ij} is larger for euro zone countries.

We are now ready to produce the financial version of the gravity equation for the holdings of assets of country j by country i (ignoring constants and assuming for the moment that the elasticity of substitution is the same for all countries) which will be the base of our empirical specification:

$$\log(\text{Asset}_{ij}) = \log L_i y_i + \log n_j - (\varepsilon - 1) \log \tau_{ij} + (\varepsilon - 1) \log r_j + (\varepsilon - 1) \log Q_i. \quad (3)$$

The first term is a size factor and corresponds to GDP of country i . The second one is the number of assets in country j . This latter variable may be related to economic size (GDP and market capitalization) but also to the financial sophistication of the country that may be linked to its status as a recognized financial center. In Martin and Rey (2006) where the number of assets issued by a country is endogenous it is shown to increase with the income of the country and with financial openness of the country when the country is relatively rich. The third term indicates that transaction costs between the two countries have a negative impact on asset holdings. The effect depends on the elasticity of substitution which may be different for different assets: typically higher for bonds than for equities. The fourth term implies that countries with high expected returns should get more demand for their assets. The last term is the financial price index which is specific to each country. Note that only one variable is country pair specific: the bilateral transaction costs and we will focus our attention on the determinants of those costs in the empirical section. All other terms are country specific. Note also that, in a given class of assets (bonds or equities), the reaction of the demand to a change in transaction costs depends on ε , the elasticity of substitution between assets. It therefore assumes that this elasticity is not affected by the change in the transaction cost itself. In the case of the euro, we will need to relax this assumption as the euro is both a decrease in transaction costs and potentially a factor that increases the substitutability of assets of the euro zone.

3 Empirical evidence

3.1 Empirical Strategy

Following our theoretical model, we propose two identification strategies to test equation (??).

- **Specification (a)**

First, we estimate the following equation using only country i fixed-effects (α_i). We use the GDP of country j (GDP_j) for the market size (n_j) of the “destination” country (the country that sells the asset and imports capital). We also proxy the financial sophistication of market (j) by the ratio of stock market capitalisation over GDP ($\frac{MktCap}{GDP}$) $_j$. We do not have to proxy the market size ($L_i y_i$) for the “source” country (the country that buys the assets and exports capital) since it is included in the fixed-effect (α_i). Expected returns in country j are approximated by the log of the average gross equity return in US\$ over the period 1990-2001 ($\log r_j$).

$$\log(Asset_{ij}) = \alpha_i + \beta \log(GDP_j) + \gamma \left(\frac{MktCap}{GDP} \right)_j + (\varepsilon - 1) \log Z_{ij} + (\varepsilon - 1) \log r_j, \quad (4)$$

where Z_{ij} are the transaction costs on international financial markets. We assume the specific functional form:

$$Z_{ij} = d_{ij}^{\delta_1} \exp(\delta_2 euro_{ij} + \delta_3 commonlang_{ij} + \delta_4 legal_{ij} \dots), \quad (5)$$

where d_{ij} is the bilateral distance, $euro_{ij}$, $commonlang_{ij}$, $legal_{ij}$ are dummies that indicate that both countries belong to the euro zone, share a common language and a common legal system. We describe these in more detail in the next section.

To analyze the impact of the euro on the elasticity of substitution between assets inside the euro zone, we will add an interaction term between the euro dummy and the identity of the legal system.

The use of fixed-effects in the source country dimension (i) allow us to control for for the financial price index Q_i . Indeed, as shown by Anderson and Van Wincoop (2004) (see also Baldwin and Taglioni (2006)), this strategy control for the “multilateral resistance term” (Q_i). Since transaction costs affect the financial price index, the omission of source country fixed-effects might bias the the estimated coefficient on our transaction cost variables. This specification has the main advantage to keep variability in two dimensions (country j and bilateral dimension). Strictly speaking, this equation is the exact counterpart of equation (??). This is our preferred specification since we control for the financial remoteness of country (i) and we keep a reasonable number of parameters to estimate. However, without fixed-effect in the country (j) dimension, we might not control perfectly for some unobservable country-specific factors that can affect international asset holdings. In order to deal with this issue, we will add a large set of

control and dummy variables in the country (j) dimension (financial sophistication, corruption index, presence of tax havens and financial centers in the sample and some regional dummies).

In the second specification, we control for fixed-effects in both dimensions.

- **Specification (b)**

We add fixed-effects in the destination country (j) dimension:

$$\log(\text{Asset}_{ij}) = \alpha_i + \alpha_j + (\varepsilon - 1) \log Z_{ij}. \quad (6)$$

In this case, only the impact of the dyadic variables Z_{ij} can be estimated.

3.2 Data description

3.3 Cross country data

Our data set concerns the year 2001³ and our sample contains 27 “source” countries (j) and 61 “destination” countries (j)⁴.

To estimate “gravity equation” of bilateral international asset holdings, we use two different data sources for asset holdings: first, we use the Coordinated Portfolio Investment Survey (CPIS) in 2001⁵ provided by the IMF which geographically breaks down securities holdings (bonds⁶ and equities). The associated dependant variables are (Equity_{ij}) which is the log- of aggregate equity holdings in country (j) of investors in country (i) (in USD) and (Bond_{ij}) which is the log- of aggregate bond holdings in country (j) of investors in country (i) (in US dollars). Second, we use data on bilateral banking financial assets in 2001 provided by the Bank of International Settlements (BIS): the BIS issues quarterly the international claims of its reporting banks on individual countries, geographically broken down by nationality of reporting banks⁷. Unfortunately, this dataset includes only 19 “source” countries (j) among the 27 countries used from the CPIS data. The dependant variable (BankAsset_{ij}) is the log of banking claims in country (j) held by banks of country (i) (expressed in US dollars). This data partially overlaps data on negotiable securities since around one third of banking assets are bonds and equities but include a large part of bank lending (around two thirds⁸) which are excluded from the CPIS dataset.

We use the log- of “destination” countries GDP (GDP_j) to control for market size⁹. The GDP is

³Although using panel data would be more appropriate but we are restricted by our data set on international financial claims.

⁴We restricted our sample according to missing values on bilateral asset holdings and data availability for control variables. See appendix for a country list.

⁵Coordinated Portfolio Investment Survey Data, <http://www.imf.org/external/np/sta/pi/datarsl.htm>

⁶Bond holdings include Long-Term Debt Securities and Short-Term Debt Securities

⁷See <http://www.bis.org/statistics/histstats10.htm>. To get more robust results, we averaged quarterly data for portfolio stocks in 2001.

⁸see appendix for a more precise description of the BIS dataset

⁹Some might argue that market capitalization could be a better proxy for the Gravity Model of Equity Holdings but no one of our results were affected by this choice. Moreover we control for the ratio of stock market capitalisation over GDP. We first added GDP/Capita in the regressions to better control for the development of financial markets but the results were mixed because of interaction with the corruption variable.

expressed in current US dollars. We also control for the financial sophistication of the destination country using the stock market capitalisation over GDP¹⁰.

We use stock market data (monthly stock prices in US \$ from 1990 to 2001 of the main stock market index of the country¹¹) to compute the log of the average gross stock returns of country j (Ret_j) over the period. We will not use these series of returns to explain bilateral bond holdings since bond holdings are mainly public bonds but unfortunately we do not have data on bond prices for a large sample of countries¹².

Our focus is on the determinants of the bilateral transaction costs. Since variables related to the flows of information between markets, bilateral trade intensity and the quality of institutions have been shown to perform well in gravity equation for asset trade, we include the following determinants of the geographical allocation of asset holdings (see Portes and Rey (2005), Aviat and Coeurdacier (2005), Lane and Milesi-Ferretti (2004)):

We use the log of distance between the two main cities of country pairs ($Distance_{ij}$) since it might proxy for some transaction costs between markets (Portes and Rey (2005)).

We use a “Common Language” dummy ($CommonLang_{ij}$) if country i and country j share the same language¹³.

We use a dummy for the proximity of legal systems from La Porta *et al.* [1997,1998]. We distinguish between “common law” systems (or “English law”), “French law”, “German law” and “Swedish law”. The dummy variable $Legal_{ij}$ equals one when source and destination countries have the same legal system. Indeed, legal system similarities might also reduce information asymmetries and contracting costs.

We also control for bilateral goods trade between countries. The variable ($Trade_{ij}$) is the log of bilateral imports from country (j) to country (i) that is not due to market sizes. In other word, this is the residual of the regression of bilateral imports on GDP_i and GDP_j ¹⁴. The data on international trade flows come from the dataset CHELEM (CEPII, Paris).

We use an index of corruption for the “destination” country ($Corruption_j$) since it is likely that hidden bribes reduce transactions in international markets. This index is developed by *Transparency International*¹⁵ and gives some insights on the degree of corruption as seen by business people, academics and risk analysts.

¹⁰We use past data (from 2000) to reduce endogeneity issues

¹¹Most data on stock returns are from Martin and Rey [2002] and Global Financial Data.

¹²However this is less an issue than for equity returns since there is much less variability in bond returns across countries. One could also argue that equity returns might not be the relevant variable for banking assets given that a large share of cross-border banking assets is made of bank loans but we cannot provide better data on banking portfolios returns.

¹³We also constructed a “Colonial Link” dummy which was equal to one if country (j) was a former colony of country (i) (or vice-versa) but this variable was almost never significant so we drop it from our regressions.

¹⁴We normalize trade by market sizes in order to have a correct estimate of the impact of countries GDPs on bilateral asset holdings. We also used exports from (i) to (j) or the average of imports and exports but none of the results were affected.

¹⁵<http://www.transparency.org>, “Corruption Perception Index”

To control for the impact of the Euro on bilateral asset holdings, we construct the following dummies: $Euro_{ij}$ is equal to one when both countries belong to the Euro zone and zero otherwise, and $Euro_j$ is equal to one when the destination country (j) belongs to the Euro zone but not the source country (i)¹⁶. We will also make some robustness checks by controlling for the impact of the European Union: $Eurcom_{ij}$ is equal to one when both countries belong to the European Union.

We add a variable $TaxHaven_j$ to control for destination countries with very favorable fiscal treatment and $FinCenter_j$ to control for the presence of financial centers in our data. The variable ($TaxHaven_j$) equals one if the destination country is considered as a tax haven and zero otherwise¹⁷. Similarly, the variable $FinCenter_j$ equals one if the country is considered as a financial center. Financial centers are Luxembourg, Hong-Kong, United Kingdom and Singapore.

Finally, to control for unobservable regional variables that might affect bilateral asset holdings, we add some regional dummies in the “destination country” dimension. We have five such dummies: Europe, North America, Central and South America, Africa, Asia and Oceania¹⁸.

3.4 Results

The results of the two specifications are shown in table 1 and 2. The impact of the usual gravity variables is consistent with those of Portes and Rey (2005), Aviat and Coeurdacier (2005), Lane and Milesi-Ferretti (2004). The estimated coefficients on $Distance_{ij}$, $Trade_{ij}$, $CommonLang_{ij}$ and $Legal_{ij}$ all show up with the expected sign and for most regressions are significant.

A novel feature of these regressions is that we make comparisons across types of assets. The variables related to information or legal asymmetries ($CommonLang_{ij}$ and $Legal_{ij}$) matter more for equity holdings and banking assets. This is somehow consistent with the idea that equities and banking assets are more information intensive assets than bonds. This is especially so because most bonds are public bonds and not corporate bonds. In both specifications, bilateral equity holdings and banking asset holdings are more affected by the trade intensity between countries than bond holdings. This is consistent with two competitive explanations that have been brought by the theoretical literature: it is likely that trade proxies for some information flows between countries and this is not surprising that it mainly affects the allocation of information intensive assets. A second explanation suggested by Coeurdacier (2005), is that buying assets of firms that compete with local firms (firms that export towards market (i)) are a good hedge against fluctuations in the performance of local firms in the presence of portfolio home bias.

¹⁶Note that due to the presence of fixed-effects in the dimension (i), we cannot use a variable that is equal to one when the country (i) is in the euro but not the country (j).

¹⁷Countries are considered as tax haven according to the classification of GAFI (Groupe d’Action Financière). We consider five Tax Havens in our sample, namely Netherlands, Switzerland, Luxembourg, Panama, Ireland

¹⁸see country list in appendix

	Equityij (1)	Bondij (2)	BankAssetij (3)
GDPj	1.134*** (.080)	.875*** (.083)	.821*** (.063)
Mktcap-gdpj	.878*** (.233)	.043 (.326)	.374** (.183)
Retj	2.750 (2.142)		-.540 (1.487)
Tradeij	.491*** (.086)	.185** (.090)	.376*** (.073)
Distanceij	-.243** (.101)	-.592*** (.130)	-.354*** (.117)
Legalij	.222** (.122)	.167 (.134)	.475*** (.112)
CommonLang	.437*** (.156)	.271 (.225)	.368** (.174)
Corruptionj	-.155*** (.053)	-.184** (.075)	-.040 (.063)
TaxHavenj	1.192*** (.422)	.195 (.331)	.608** (.333)
FinCenterj	-.025 (.293)	.747 (.524)	1.294*** (.293)
Euroij	.957*** (.303)	1.849*** (.338)	.861*** (.299)
Euroj	.509** (.269)	.759** (.307)	.761*** (.286)
e(N)	1034	1031	897
e(r2)	.766	.678	.703
e(F)	120.437	65.308	96.096

Table 1: Gravity Models on world asset holdings with source country fixed-effects. Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. Regional dummies of destination are included but not reported.

	Equityij (1)	Bondij (2)	BankAssetij (3)
Tradeij	.393*** (.067)	.123 (.079)	.344*** (.070)
Distanceij	-.420*** (.095)	-.747*** (.116)	-.490*** (.123)
Legalij	.189* (.104)	.183 (.122)	.447*** (.111)
CommonLang	.497*** (.129)	.378** (.190)	.424*** (.162)
Euroij	.372** (.183)	.917*** (.196)	.044 (.156)
e(N)	1034	1031	897
e(r2)	.787	.716	.717
e(F)	744.994	312.073	227.545

Table 2: Gravity Models on world asset holdings with source and destination country fixed-effects. Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country.

The effect of distance on bond holdings is almost twice the effect it has for equity and bank assets. According to the first specification, when distance between two markets doubles, bilateral bond holdings are reduced by 60%, while banking assets by 35% and bilateral equity holdings, the least affected, by 25%. This might be surprising since according to Portes and Rey (2005) and Portes, Oh and Rey (2001), distance proxy some informational costs and then should affect to a lower extent trade in public bonds, which is the largest part of international bond holdings. However, distance may also proxy for transaction costs (costs of phone calls, of trading assets outside the local financial markets, different opening hours of markets...). In this case it would square well with the theoretical framework developed in the first section. Indeed, if bonds of different countries are better substitutes than are equities of different countries (because of risk idiosyncratic to the firm), then we would indeed expect that the coefficient on transactions costs is higher (in absolute value) for bonds than for equity. In the theoretical framework, this would translate into a higher elasticity of demand (ε). This interpretation is strengthened by the fact that other variables that proxy for financial transaction costs (financial center, corruption and the euro effect) have (in absolute term) a larger effect on asset holdings in the case of bonds than in the case of equity.

The Euro Effect

In the first specification we only include country dummies in the source country dimension which allows us to analyze the impact of the euro on financial trade not only in the euro zone (through the variable Euro_{ij}) but also between the rest of the world and the euro zone (Euro_j).

Table 1 and 2 provide two important regularities in the data related to the impact of the Euro on international asset portfolios.

First, the euro works like a unilateral financial liberalization: the positive and significant coefficient on the Euro_j dummy in Table 1 means that countries outside of the euro-zone hold more assets supplied in the euro zone than predicted by the usual variables. This is true for both bonds and bank assets and to a lesser extent for equity. The portfolio bias towards the euro-zone is large: for equities, investors hold around 60% more euro assets than predicted by the usual gravity variables and this number goes up to around 100% for bonds and banking assets. These are very large numbers and one may think that, as for the early Rose effects of the single currency on trade, they are too large to be true. However, first remember that this number is not driven by the fact that euro countries are more financially developed, have better institutions, are closer to the other main financial markets (or more integrated in product markets). We control for these observable characteristics of euro countries as much as possible. One could also argue that this result is not due to the euro but to some empirical regularity among European countries: Europe is for some unobservable reasons more attractive for investors than other regions in the world. However, we control for regional dummies of destination and in particular a dummy for “broad”

Europe. This variable equals one for a significant number of Central and Eastern European countries but creating two different dummies, one for Western Europe and the other for Central and Eastern Europe did not change any of the result. Both dummies were very similar in absolute terms and non-significant¹⁹.

Second, the euro works like a preferential financial agreement. The average country exhibits a euro bias but this bias is significantly larger when the two countries are in the euro zone. Quantitatively this effect is also very large but varies across specifications and across assets. We choose to select the one in Table 2. It should be the best specification to measure the impact of bilateral variables since we control for dummies in both the source and destination dimensions. In this case, the euro increases by 150% bilateral bond holdings between two euro countries while equity holdings rise by around 45%. The impact on bank assets is not significant. Again, these results hold once we control for a relatively large set of variables that might be correlated with being part of the euro (trade linkages, geography...). Although the value of the estimates of the euro effect looks different in the two specifications (Table 1 and 2), the two specifications provide very similar quantitative results: the reason is that the estimates of table 1 also include the impact of the euro as an unilateral financial liberalization (which also affects euro countries!). Hence, the measure of the euro bias within the euro zone (on top of the unilateral financial liberalization) is the difference between the estimates of $Euro_{ij}$ and $Euro_j$. This yields very comparable estimates to table 2.

The results confirm those of Lane (2005) on the positive role of the euro on bond holdings between countries of the euro zone. Quantitatively, our estimated effect on bond holdings is however smaller (150% versus around 230%). We also find that the euro effect does not hold only for bonds but also for equity although with a smaller coefficient. This is not surprising since currency risk is a much larger part of the asset risk for bonds than for equities. Moreover, if we interpret the euro effect as a decrease in the transaction costs (due to currency risk) then, given that bonds are closer substitutes than equities, we should expect the impact of the elimination of currency risk to be larger on bonds than on equities. As we argued in the theoretical model we interpret this as a higher elasticity of demand (ε) for bonds than for equities and therefore a larger response of bond holdings to transaction costs.

Interestingly, these two regularities resemble the results obtained in the recent literature (see Baldwin (2006), Flam and Nordstrom (2003)) on the impact of the euro on trade in goods: the euro acted as a decrease in transaction costs between euro countries but also between euro countries and the rest of the world. The former effect is especially true for bonds and to a lesser extent for equity while the latter is true whatever the type of asset.

¹⁹We also estimated the model dropping randomly three European countries from the sample of source country since one might argue that European countries are over-represented in the sample and our estimates might suffer from some selection bias. The estimates were identical. Actually, even when we drop all euro countries as source countries, the same bias towards the euro zone exists.

We then perform robustness checks on the euro effect. Controlling for a European Union dummy (which equals one when both countries belong the European Union and zero otherwise) does not affect our results and the estimated euro effect is actually even larger for equities and not significantly different for bonds (see appendix, tables 13 and 14). However given the collinearity between these two variables, one should interpret these results with caution. We also test whether the euro effect is due to the existence of deeper agreements on the taxation of cross-border capital incomes between euro countries. We use data from Aviat and Coeurdacier (2005) about the international taxation of capital available for a restricted number of countries²⁰. Indeed, although most of the countries we study have a residence-based tax system, they charge withholding taxes when foreigners repatriate dividends, capital gains or interests. To limit double-taxation, several bilateral tax treaties regulate those withholding taxes (which makes them on average lower between euro countries). We use two different variables that describe bilateral withholding taxes on dividends (and capital gains) and on interests (from loans, deposits or debt securities), resp. DividendTax_{ij} and InterestTax_{ij} , in percents. The former should discourage bilateral equity holdings while the latter should discourage bilateral bond holdings and banking assets²¹. Although significant (at the 10% level), these variables do not change any of the results concerning the euro effects we found (see table 16 in appendix) . Moreover, strictly speaking, these coefficients provides estimates of the elasticity of demand (ε). We find this elasticity to be equal to 4 (for equities²² and banking assets) and 6.5 for bonds. As expected, estimates of this elasticity is higher for bonds than for other assets. These numbers are in the range of other estimates in the literature (see Schleifer (1986), Loderer *et al.* (1991), Wurgler and Zhuravskaya (2002) and Martin and Rey (2006) for a short survey of those elasticities).

– Quantifying the Euro Effect: the equivalent variation in transaction costs

We can now provide quantitative estimates of the fall in transaction costs due to the Euro. Remember that transaction costs are lower for all countries (the unilateral liberalization effect) and also for countries within the euro (the preferential liberalization effect). We will call the former variation (decrease) in transaction costs ($\frac{\Delta\tau_j}{\tau_j}$) and the latter ($\frac{\Delta\tau_{ij}}{\tau_{ij}}$). The estimated fall depends on our assumed elasticity of demand (ε) which may be different for bonds, equities and banking assets.

According to our estimates using international taxation data (table 16 in appendix), we use the following values: $\varepsilon^{\text{equity}} = \varepsilon^{\text{bankasset}} = 4$ and $\varepsilon^{\text{bond}} = 6.5$. The values are broadly in line with the existing empirical literature.

This implies that for equities we obtain:

$$\frac{\Delta\tau_j}{\tau_j} = \frac{0.509}{\varepsilon^{\text{equity}} - 1} = 17\% \text{ and } \frac{\Delta\tau_{ij}}{\tau_{ij}} = \frac{0.372}{\varepsilon^{\text{equity}} - 1} = 10\%$$

²⁰Data from bilateral tax treaties; <http://www.ibfd.org>

²¹Those taxes are far from being negligible, ranging from 0% for some agreements to 40%.

²²Although non significant, the coefficient on equity returns provides also an estimate of ε close to 4 (see table 1)

While for bonds, we get: $\frac{\Delta\tau_j}{\tau_j} = 14\%$ and $\frac{\Delta\tau_{ij}}{\tau_{ij}} = 17\%$. For banking assets²³, $\frac{\Delta\tau_j}{\tau_j} = 25\%$ and $\frac{\Delta\tau_{ij}}{\tau_{ij}} = 1.5\%$. Note that despite apparently larger estimates of the Euro effect for bonds than for equities, the associated fall in transaction costs is of the same order of magnitude since bonds are closer substitutes than equities.

– Quantifying the impact of the Euro on the elasticity of substitution between assets

Up to now, we have assumed that the elasticity of substitution between the assets is not affected by the euro. However, as noted by Lane (2006), the euro can be interpreted as both a decrease in transaction costs and potentially a factor that increases the substitutability of assets of the euro zone. Can we disentangle these two effects? One way is to introduce interaction terms between the euro and other transaction costs than the euro itself²⁴. If the euro has increased the substitutability of assets we should then find that the effect of any transaction costs is larger inside the euro-zone. We perform this exercise for the dividend tax (for equity), the interest tax (for bonds and banking assets) and for the common legal system. Only the interaction term for the legal system turns out to be significant and of the expected positive sign. This holds for bonds and banking assets but not for equity (see table 3). The reason why the most natural transaction costs to analyze this question (dividend and interest taxes) do not yield any result is that they exhibit extremely little variation inside the euro zone. This is not the case for the legal system for which cross-country variation exists inside the euro zone. Our interpretation is that remaining financial frictions (such as legal differences) are amplified within the euro zone because euro assets are closer substitutes. This evidence suggests that the euro has indeed increased the elasticity of substitution between assets²⁵.

	Equity _{ij}	Bond _{ij}	BankAsset _{ij}
	(1)	(2)	(3)
Euro _{ij}	.367** (.184)	.892*** (.197)	.017 (.161)
Legal _{ij} -x-Euro _{ij}	.244 (.212)	.422*** (.161)	.782*** (.157)
Legal _{ij} -x-NonEuro _{ij}	.181 (.111)	.146 (.133)	.397*** (.120)
e(N)	1034	1031	897
e(r2)	.787	.716	.718
e(F)	725.473	301.683	208.128

Table 3: Gravity Models on world asset holdings with source and destination countries fixed-effects. Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. Control variables are included but not reported.

²³For banking assets $\frac{\Delta\tau_{ij}}{\tau_{ij}}$ is not significantly different from 0

²⁴An alternative root would be to introduce interaction terms with the returns of the assets. However, two issues make this difficult. First, these returns are endogenous and second there is very little variation inside the euro zone.

²⁵Again, it is possible that assets within the Euro zone were already closer substitutes before the introduction of the Euro due to the convergence of monetary policies for instance. Strictly speaking, with our cross-sectional data, we evaluate the difference between elasticities of substitution inside the euro zone versus outside the euro zone but not their variation over time.

The estimates of table 3 provide a way to compare elasticities of substitution between two euro bonds ($\varepsilon_{euro}^{bonds}$) with respect to the average elasticity (ε^{bonds}) between two bonds which are not both issued in the euro zone (respectively for banking assets). We get the following estimates:

$$\frac{\varepsilon_{euro}^{bond} - 1}{\varepsilon^{bond} - 1} = \frac{0.422}{0.146} = 2.9 \text{ and } \frac{\varepsilon_{euro}^{bankasset} - 1}{\varepsilon^{bankasset} - 1} = \frac{0.782}{0.392} = 2$$

This suggests that the elasticity of substitution between two euro bonds (banking assets) is three (twice) times larger than for other bonds (banking assets). Such a difference implies that the fall of transaction costs within the Euro zone ($\frac{\Delta\tau_{ij}}{\tau_{ij}}$) is actually biased downwards for bonds (and to a lesser extent for banking assets). On the one hand, the introduction of the euro has decreased transaction costs between euro countries (direct effect) but on the other hand, it has amplified the effect of any remaining friction through a higher elasticity of substitution (indirect effect). Note that the direct effect enhances asset trade between euro countries while the indirect effect plays in the opposite direction. Since we found a positive euro effect, clearly the direct channel dominates the indirect one. Our empirical strategy does not allow us to disentangle properly these two effects (in particular because we do not observe all frictions between markets) and our measure of the variation of transaction costs inside the Euro zone is somehow the sum of these two effects. However, at least for the legal costs, we can measure the amplitude of this indirect effect. Given our assumed (ε^{bond}), we estimate that differences in the legal system act like a 2.5% transaction cost. Due to an higher elasticity of substitution between euro bonds, the effect of these legal transaction costs is multiplied by 3 inside the euro zone. Hence, the rise in the elasticity of substitution has been “equivalent” to a 5% increase in legal costs. This means that, the fall of transaction costs within the euro bonds market ($\frac{\Delta\tau_{ij}}{\tau_{ij}}$) necessary to match the data must have been 5% larger (going up to 22%). Of course, these are very broad estimates but one should keep in mind that this indirect channel might be larger, depending on the magnitude of the remaining financial transaction costs inside the Euro area.

Asset Trade Diversion and the Euro? The Example of Scandinavian Countries

The previous section provided new results on the euro effect for countries buying assets (destination country effect) but not for countries selling assets (source country effect). A natural question is whether the introduction of the euro has been detrimental for countries close to the euro zone but not part of it. Note that according to the theoretical model, we should expect such a diversion effect since EMU has decreased the “financial” price index of euro countries, which reduces their demand for assets outside the euro zone.

In other words, do euro countries invest less in countries which have similar characteristics than the euro countries (geographically close to the euro zone, with similar transaction costs, similar level of developments, similar diversification opportunities...) but which decided to stay outside of the euro zone?

The group of Scandinavian countries (namely Denmark, Sweden and Norway) is an interesting group to test such an hypothesis. This is especially true because Finland joined the euro while the other nordic countries did not. Of course, one could argue that these countries did not join the euro because they were less integrated *ex-ante* to the euro countries. We should, in this case, perform double-differences using data before and after the introduction of the euro to test such an hypothesis. However, given that we do not have time-series data, we will restrict our analysis to simple-difference estimates despite this empirical caveat. This can be done by adding in the regression an interaction term $\text{Euro}_i\text{-Scand}_j$ which equals one when the source country belongs to the euro and the destination is either Denmark, Sweden or Norway. We also add a dummy Scand_j to control for some specific characteristics of the Scandinavian countries for the specification without destination country fixed-effects²⁶. Finally, we also add a variable Scand_{ij} , which equals one when both countries are Scandinavian countries and zero otherwise to test some specific linkages among Scandinavian countries. For this variable, Finland is considered as a Scandinavian countries since we do not want our results regarding the euro to be driven by the presence of Finland among the euro countries.

The results are shown table 4 and 5. First, the variable Scand_j is large, positive and significant (the same order of magnitude than Euro_j), so on average, countries exhibit a bias towards Scandinavian countries for all classes of assets. We do not investigate this question but the existence of publicly traded large multinationals is a likely reason. However, for equity investment, everything else equal, euro countries invest less in Scandinavia than the average country. This effect is significantly different from zero and large: according to table 4 (which should give the most precise estimate), euro countries invest in equities around 65% less towards these countries than predicted by the country specific factors and the usual gravity variables. This “asset trade diversion” seems to hold only for equity investment, the estimated coefficients for bonds and banking assets being very close to zero and non significant. This may be because a significant portion of bonds are issued in euro.

Finally, as a robustness check, we test whether this lower level of bilateral equity investment from euro countries towards Scandinavian countries is also observed in Finland. We add an interaction term $\text{Euro}_i\text{-Fin}_j$ in the previous regression. Indeed, it is possible that the euro bias inside the euro zone does not apply to Finland, which would suggest that Nordic countries are for some unobservable reasons unattractive for euro investors. As shown in table 6, this is not the case, the euro bias for equities is actually larger for Finland than for the other euro countries (although not significantly different). This suggests that for equity holdings some trade diversion due to the introduction of the euro exists. But this does not apply to the other types of assets. We could even speculate that equity investment from

²⁶In particular, these countries have been historically more integrated to the rest of the world, so we can expect this coefficient to be positive.

	Equityij (1)	Bondij (2)	BankAssetij (3)
Euroj	.802*** (.264)	1.187*** (.435)	1.205*** (.338)
Euroij	1.222*** (.299)	2.296*** (.424)	1.335*** (.337)
Euroi-Scandj	-.375** (.162)	.130 (.264)	-.064 (.136)
Scandj	.906** (.387)	1.135** (.552)	1.156*** (.432)
Scandij	.339 (.359)	.666** (.308)	1.822*** (.296)
e(N)	1034	1031	897
e(r2)	.769	.686	.723
e(F)	128.78	62.076	111.105

Table 4: Gravity Models on world asset holdings: the case of Scandinavian countries.

Estimation with source country fixed effects. Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. The control variables of table 1 and regional dummies of destination are included but not reported.

	Equityij (1)	Bondij (2)	BankAssetij (3)
Euroij	.297* (.167)	.966*** (.212)	.070 (.155)
Euroi-Scandj	-.521*** (.163)	.056 (.249)	-.080 (.134)
Scandij	-.159 (.363)	.733** (.293)	1.892*** (.295)
e(N)	1034	1031	897
e(r2)	.788	.717	.725
e(F)	863.301	344.616	329.235

Table 5: Gravity Models on world asset holdings: the case of Scandinavian countries.

Estimation with source and destination country fixed effects. Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. The control variables of table 2 are included but not reported.

the euro zone in Scandinavia has been diverted towards Finland, a country with similar characteristics but inside the euro zone. Of course, this result must be taken with caution and this hypothesis should be tested with time-series data.

These results suggest that the European monetary union has made Scandinavian countries which do not belong to the euro zone less attractive for equity holders of euro countries. However, we cannot really say whether this comes from the elimination of the currency risk or from the creation of an unified stock market where the largest firms of the euro zone are quoted.

	Equityij	Bondij	BankAssetij
	(1)	(2)	(3)
Euroij	.236 (.202)	.972*** (.224)	.058 (.165)
Euroi-Scandj	-.518*** (.163)	.056 (.249)	-.077 (.135)
Euroi-Finj	.611*** (.142)	-.065 (.162)	.124 (.138)
Scandij	-.100 (.348)	.725** (.288)	1.910*** (.299)
e(N)	1034	1031	897
e(r2)	.788	.717	.725
e(F)	909.446	355.928	282.779

Table 6: Gravity Models on world asset holdings: the case of Scandinavian countries.

Estimation with source and destination country fixed effects. Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. The control variables of table 2 and regional dummies of destination are included but not reported.

International portfolios: is Sweden different?

We then ask whether Sweden is different from other countries with respect to the determinants of its financial trade and different from the other scandinavian countries (Denmark and Norway). To answer this question we add a Swedish dummy for the specification without destination fixed-effects, as well as Sweden dummies interacted with the euro dummies. We also keep our Scandinavian country dummy. The results are shown in tables 7 and 8.

In the specification with source country fixed effects (Table 7), the results suggest that the rest of the world holds relatively more Swedish assets. The order of magnitude of the estimate is comparable with the one we found for all Scandinavian countries. It also suggests that, euro countries hold relatively less Swedish equities than predicted by our control variables: there has been some trade diversion for equity investment, confirming the previous results. Table 7 confirms this pattern. Looking at the effect of the scandinavian dummy, we see that nordic countries seem to be very well integrated in asset markets. This intra-Scandinavia bias is particularly large for bonds and banking assets²⁷. With respect to equities and banking assets, Swedish investors do not seem to exhibit a specific euro bias (on the top of what is observed for the average country). The surprising result is for bilateral bond holdings: the euro seems to have increased financial openness in both directions in the case of bonds: the interaction term on the euro is positive and significant for Sweden both as a destination and source country. This is confirmed when both source and destination country fixed effects are added as in Table 8. In this case, for bond holdings, the interaction terms are positive, significant and large: the Swedish portfolio bias towards euro bonds is even larger than the bias of a typical euro country²⁸! Reciprocally, euro countries exhibit a bias

²⁷This very large scandinavian bias for banking assets might be partly due to the presence of interbank loans in our data

²⁸In the next section, we partly explain this larger bias by the relative stability of the krona with respect to the euro

	Equityij (1)	Bondij (2)	BankAssetij (3)
GDPj	1.129*** (.080)	.859*** (.085)	.811*** (.062)
Mktcap-gdpj	.849*** (.227)	-.030 (.316)	.368** (.159)
Retj	2.494 (2.168)		-.890 (1.485)
Tradeij	.470*** (.086)	.144 (.088)	.340*** (.069)
Distanceij	-.251** (.102)	-.590*** (.126)	-.333*** (.112)
Legaliij	.194 (.127)	.120 (.141)	.348*** (.104)
CommonLang	.446*** (.159)	.288 (.219)	.312* (.168)
Corruptionj	-.136** (.056)	-.156* (.084)	-.002 (.068)
TaxHavenj	1.288*** (.416)	.345 (.309)	.758** (.303)
FinCenterj	.102 (.280)	.940* (.506)	1.477*** (.282)
Euroj	.608** (.264)	.708** (.318)	.915*** (.289)
Euroij	1.069*** (.305)	2.027*** (.341)	1.059*** (.297)
Swej	.887*** (.284)	.723* (.417)	.552* (.315)
Swei-Euroj	-.010 (.246)	1.635*** (.490)	.128 (.305)
Swej-Euroi	-.389*** (.105)	.644*** (.138)	-.004 (.108)
Scandij	.600** (.298)	1.050** (.443)	2.324*** (.435)
e(N)	1034	1031	897
e(r2)	.768	.687	.716
e(F)	110.97	60.749	84.616

Table 7: Gravity Models on world asset holdings including Swedish specific effects.

Estimation with source country fixed effects. Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. Regional dummies of destination are included but not reported.

towards Swedish bonds although this bias is smaller than the intra-euro bias. Quantitatively, the average investor of the euro zone holds 60% more Swedish bonds than bonds of the average country. This number is about half of the euro bias between euro countries. The bottom-line is that Sweden is not different from other Scandinavian countries for equity portfolios (as well as banking portfolios) but seems to be very well integrated to the euro bonds market. A reasonable explanation for this result is that Sweden issues a significant share of bonds denominated in euro (in 2001, around 15% of Swedish public debt was denominated in euro).

	Equityij (1)	Bondij (2)	BankAssetij (3)
Tradeij	.394*** (.068)	.094 (.075)	.331*** (.068)
Distanceij	-.428*** (.096)	-.733*** (.111)	-.454*** (.118)
Legalij	.192* (.110)	.143 (.126)	.336*** (.099)
CommonLang	.497*** (.130)	.374** (.188)	.331** (.168)
Euroij	.338* (.196)	1.169*** (.195)	.082 (.162)
Swei-Euroj	-.058 (.302)	2.043*** (.442)	.049 (.336)
Swej-Euroi	-.527*** (.126)	.502*** (.140)	-.078 (.101)
Scandij	-.094 (.352)	.785*** (.298)	1.902*** (.275)
e(N)	1034	1031	897
e(r2)	.788	.722	.725
e(F)	776.081	217.998	229.159

Table 8: Gravity Models on world asset holdings including Swedish specific effects. Estimation with source and destination country fixed effects
Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country.

To test the robustness of some of these results, we now turn to Swedish data on bilateral asset holdings and bilateral capital flows. These data are available for a larger number of countries and for more than one cross sectional year. However, we loose some information since we have data on outward investment from Sweden but not on inward investment (moreover we have only one source country, namely Sweden).

3.5 Swedish data

In this section we analyze the determinants of Swedish foreign stocks and Swedish capital outflows.

3.5.1 Swedish asset holdings

- **Data description**

The Riksbank provides data on Swedish asset holdings for a very large sample of countries (68 destination countries²⁹). This data partially overlap our data on international asset holdings but includes are larger number of countries and is available for four consecutive years (2001-2004). Like the CPIS dataset, we have a disaggregation by types of securities (bonds or equities). Finally, for comparison purposes, we also include banking asset holdings from the BIS for the same sample of countries and the same years. For stock returns, we use the annual return (in Swedish krona) over the year considered. Since data on

²⁹The original was even larger but due to data availability for some of the control variables, we restrict our sample to 68 countries.

stock returns are not available for the whole set of countries, we also present the regression without stock returns.

We keep the same control variables as in the previous section but we had to drop the market capitalisation over GDP variable since this variable is not available for this larger set of countries over the period 2001-2004. We also had to choose between the common language variable, the legal variable and the Scandinavian dummy given the large overlap between these variables³⁰. We decided to keep the legal one.

We also add an additional control variable that might affect bilateral asset holdings: (ExchRateVolatility) is the log- of bilateral nominal exchange rate volatility calculated using monthly data over the period 1996-2001. Indeed, exchange rate risk might discourage some foreign investments.

• Results

The results are shown in table 9. Looking only at Swedish foreign asset holdings confirm most of the results presented in the previous section. The impact of bilateral trade gives qualitatively very similar estimates than found using data on world asset holdings. The negative effect of distance, which may proxy for a variety of transaction costs between Sweden and the countries to which it buys assets, appears much weaker for equities and banking assets. It may suggest that Sweden is financially very integrated to the rest of the world. It is however strongly negative in the case of bonds. This may again reflect that those assets are more substitutable and therefore more sensitive to transaction costs. These variables are estimated with the expected sign when significant and quantitatively the estimates are not significantly different from the ones found in the previous section. We also confirm that the euro worked like an unilateral liberalization for Swedish investors: the portfolio bias towards the euro zone is found quantitatively large for equity and bond holdings. In particular, the bias of Swedish investors towards euro bonds is the largest one and has the same order of magnitude than the euro bias of a euro country. As argued in the previous section, the Swedish and the Euro bonds markets seem to be particularly well integrated. However, note that with this data, we find a smaller Euro bias for Sweden than with the data on world asset holdings used in the previous section. This is partly because in this regression, we control for bilateral exchange rate volatility and the Krona-Euro exchange rate is relatively stable compared to other currencies³¹.

However, there are some new interesting features: the impact of corruption as barrier to international trade in assets is found to be larger for Sweden (for equity and bonds). Sweden being itself one of the less corrupted country in our sample, this is suggestive that asset trade between countries tends to cluster

³⁰Indeed, countries with a legal system considered as similar to the Swedish one are Norway, Denmark, Finland and Iceland, while countries considered as having the same language as Sweden are Denmark and Norway.

³¹Without controlling for bilateral exchange rate volatility, the euro dummy coefficient jumps to 1.6, closer to the estimates of table 8 using world data where we found a coefficient of 2.

between countries with similar institutions (see Vlachos (2004)). More interestingly, our new variable (ExchRateVolatility) shows up significantly *only* for bond holdings. This makes sense since exchange rate risk is a much larger part of the risk in foreign bond returns than in equity returns. Quantitatively, this effect is non negligible: raising the bilateral nominal exchange rate volatility by 10% lowers bilateral bond holdings by 8%. Moreover, as we just said, only a small part of the euro effect seems to due to the stability of euro-krona exchange rate.

	equityij	equityij	bondij	bankassetij
	(1)	(2)	(3)	(4)
GDPij	1.275*** (.106)	1.076*** (.121)	.920*** (.102)	.766*** (.108)
Retj	1.248 (1.375)			
distij	.362 (.313)	-.091 (.330)	-.893** (.424)	.026 (.273)
Tradeij	.862*** (.295)	.494** (.272)	.082 (.359)	1.085*** (.246)
ExchRateVolatility	.143 (.411)	.057 (.591)	-.864** (.479)	-.403 (.336)
Corruption	-.201** (.084)	-.310*** (.106)	-.566*** (.172)	-.107 (.103)
Euro	.833** (.439)	.905* (.532)	1.257** (.575)	-.032 (.508)
Legal	1.273 (.790)	1.095 (.689)	.301 (1.027)	.713 (.825)
FinCenter	1.401** (.652)	1.590** (.635)	.342 (.808)	.450 (.877)
TaxHaven	1.143** (.536)	.946** (.451)	-1.346** (.566)	.244 (.587)
e(N)	150	265	176	255
e(r2)	.884	.732	.832	.727
e(F)	31.313	39.5	74.303	45.431

Table 9: Gravity Models on Swedish foreign asset holdings.

Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors and time fixed-effects. Observations are clustered within destination country.

3.5.2 Swedish capital outflows

- Data description

The data on Swedish outflows come from the Balance of Payments statistics which provides data on aggregate asset purchases in international financial markets broken down by countries of destination and by types of assets over the period 1998-2005 (on a quarterly basis). Note that this data are on capital flows (and not stocks) and the comparison with results on stocks is *per-se* interesting. Unfortunately, we cannot analyze the determinants of Swedish capital inflows and we must focus our attention on asset

purchases by Swedish investors since we do not have the nationality of Swedish assets buyers. Due to missing data in the beginning of the period for some countries, we had to restrict the sample to 56 destination countries which are the largest markets. These 56 countries account for about 99% of total Swedish asset purchases. This dataset gives the nationality of the counter-party which might be different from the nationality of the asset involved in the transaction, however we will make the assumption that assets bought by Swedish investors to an investor in a country have been issued in the same country. This is less an issue for bank loans but might introduce some measurement errors in the series of equities and bonds purchases. We will partly control for this with our “FinCenter_{*j*}” dummies.

The dependant variables “purchaseequity_{*ij*}”, “purchasebond_{*ij*}” and “loan_{*ij*}” are respectively the aggregate purchases of equities and bonds in country (*j*) and the aggregate loans towards country (*j*) over the quarter.

We use the same control variables as in the previous section but some are now time-varying: GDP_{*ij*} which is the log of the product of Swedish and country (*j*)’ GDP, Trade_{*ij*}³² and Ret_{*j*}. Ret_{*j*} is the averaged equity return over the last four quarters in Swedish krona³³.

Like for asset holdings, we also add a measure of bilateral exchange rate risk: (ExchRateVolatility) is the bilateral nominal exchange rate volatility. At a given time (*t*), (ExchRateVolatility) is the log- of the volatility of bilateral nominal exchange rates calculated with monthly data over a five-year window before time (*t*). We also control for foreign direct investment flows (FDI_{*ij*}) to see whether asset purchases and FDI are complementary or substitutes. Similarly to the trade variable, FDI_{*ij*} is the log- of bilateral foreign direct investment outflows that are not due to market sizes³⁴.

• Results

The results are shown in table 10. Looking at capital outflows does not modify qualitatively our results. The gravity variables (Trade_{*ij*} or Dist_{*ij*}) shows up with the expected sign (when significant). Compared to the previous section, only bilateral loans gives very different quantitative estimates. Indeed, they are much more related to the geographical distance (and not so much affected by trade linkages) compared to the bilateral banking assets. They are also the only bilateral flows to be weakly (positively) affected by foreign direct investment.

With respect to the Euro, not surprisingly, we also find that Sweden trade in assets much more with Euro countries³⁵ but more interestingly, if we compare table 9 and 10, this euro bias tends to be larger for flows than for stocks (at least for equities and loans). This suggests that on the top of a

³²As in the previous section, Trade_{*ij*} is the part of bilateral trade orthogonal to market sizes. Data on bilateral Swedish trade were provided by Statistics Sweden and include a larger sample of countries than the CHELEM dataset.

³³We used annual returns rather than quarterly returns to reduce the importance of extreme events like currency or stock market crashes. Moreover, given data availability on stock markets returns, we also run regressions without this variable to reduce data attrition.

³⁴The residual of the regression of bilateral FDI flows on countries GDPs.

³⁵Again see table 15 in appendix, for robustness checks with respect to the European Union.

	purchaseequityij (1)	purchaseequityij (2)	purchasebondij (3)	loanij (4)
GDPij	1.162*** (.139)	1.180*** (.102)	.975*** (.107)	1.343*** (.136)
Retj	1.085** (.493)			
distij	-.471 (.422)	-.646* (.330)	.039 (.400)	-1.580*** (.390)
Tradeij	.635*** (.235)	.488** (.217)	.498* (.284)	-.054 (.233)
FDIij	-.100 (.117)	-.101 (.108)	-.033 (.097)	.272* (.144)
ExchRateVolatility	.199 (.530)	.360 (.438)	-2.676*** (.521)	-.217 (.564)
Corruption	-.341*** (.129)	-.352*** (.117)	-.101 (.135)	-.097 (.150)
Euro	1.146** (.528)	1.312*** (.410)	1.002*** (.376)	3.451*** (.528)
Legal	2.429*** (.876)	2.462*** (.582)	2.538*** (.699)	2.162** (1.102)
FinCenter	2.358*** (.544)	2.236*** (.493)	1.253*** (.485)	2.490*** (.937)
TaxHaven	1.163*** (.402)	1.377*** (.400)	-1.143*** (.323)	.793 (.821)
e(N)	766	1105	686	1442
e(r2)	.776	.753	.738	.7
e(F)	65.808	62.18	258.859	61.488

Table 10: Gravity Models on outflows from Sweden.

Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. Time fixed-effects are included but not reported.

reduction of transaction costs (in a “broad” sense) for holding euro assets, the introduction of the euro has also increased their liquidity, increasing the turnover on euro assets. We also confirm the impact of bilateral exchange rate volatility on bilateral bonds flows (but not equity and loans). Surprisingly, the legal variable is now very large and significant, which was not the case for bilateral asset holdings. We also interpret this result as an indicator of high liquidity (and high turnover) of nordic assets for Swedish investors, probably due to the existence of a unified nordic stock exchange for securities trading. However, it is important to keep in mind that this higher level of asset trade between nordic countries does not significantly translate into higher portfolio positions (on the top of what is explained by distance and trade linkages...) ³⁶.

Finally, we also find that bilateral exchange rate volatility reduces only trading in bonds market but with an higher elasticity for bonds flows than for bonds holdings.

The Euro Bias: estimation in the time-dimension

³⁶In other words, these results mean that Swedish investors purchase and sell much more Danish assets than German assets (more turnover on Nordic assets) but hold in their portfolio more of the German ones everything else equal.

One could argue that Sweden larger trade in assets with Euro countries reflects some unobservable variables which make these countries especially attractive for Swedish investors and which have nothing to do with the introduction of the euro. Given the time dimension of this database on capital outflows, we can partly deal with this issue. Indeed, our data start in 1998, before the introduction of the Euro and Greece joined after the other countries (in 2001).

As a consequence, we can estimate the euro effect across time as well as across countries, comparing Sweden's asset trade with a euro country with respect to a non-euro country before and after the introduction of the euro. This can be done by looking at the estimate of our euro dummy once we control for destination countries fixed-effect³⁷. In other words, with this strategy, we control for unobservable specific factors of euro countries and estimate the change of asset purchases towards these countries before and after the introduction of the euro. This is however a very restrictive test since we have little variability in the time dimension. The results are shown in table 11. This confirms that the euro had a very strong effect on bonds trading as well as bilateral loans (with comparable estimates), while the effect on equity purchases is no more significant. We see these results as a confirmation of one of the main message of the paper. The euro acted as a decrease of transaction costs for non-euro countries (like Sweden). This effect seems to be more robust for bonds purchases and loans than for equities.

	purchaseequityij (1)	purchaseequityij (2)	purchasebondij (3)	loanij (4)
Euro	-.121 (.610)	.112 (.563)	1.035*** (.324)	3.097*** (.413)
e(N)	766	1105	686	1442
e(r2)	.095	.061	.155	.077
e(F)	10.3	4.674	15.869	15.626

Table 11: Gravity Models on outflows from Sweden.

Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. Destination country fixed-effects and control variables of table 9 are included but not reported.

4 Conclusion

Can we draw some welfare implications of our empirical results for a country like Sweden? They suggest that the euro has had three main effects: 1) a unilateral financial liberalization which makes it cheaper to buy euro zone assets; 2) a diversion effect due to the fact that lower transaction costs inside the euro zone

³⁷The country fixed-effects are assumed to be constant over the period considered. In a non-reported regression, we also interacted the euro dummy with a time-trend; it did not affect our estimates.

lead the countries of the zone to purchase less Swedish assets; 3) an increase in cross-border asset holding inside the euro zone which is the counterpart of the diversion effect and corresponds to a preferential financial liberalization. The first effect should be beneficial to Sweden as it implies that it pays less to diversify risk when purchasing euro assets. This could be readily demonstrated in the model of our theoretical section. The second and third effects are the two faces of the same mechanism. The second is clearly detrimental to Sweden. If assets are imperfect substitutes (which our analysis confirms), the lower demand for Swedish equity (the only asset for which some diversion is suggested by our empirical analysis) implies a lower price of Swedish assets relative to euro assets. This implies an increase in the cost of capital for Swedish firms. At first sight, the increase in cross-border financial trade inside the euro-zone does not affect a country like Sweden (except through the diversion effect already discussed). However, in a model like Martin and Rey (2000) where the number of assets is endogenous, the increase in cross-border demand and price leads to entry of new assets and an increase in the possibilities of risk diversification. Another way to say this is that, above the transaction cost effect, Sweden should benefit from larger, more diversified financial markets in the euro zone. However, the price of those assets should also increase due to the increased demand coupled to imperfect substitution and transaction costs. Overall, Sweden benefits from more and cheaper (in terms of transaction costs) opportunities to diversify financial risk but with a deterioration of its financial terms of trade. The preferential financial liberalization that only benefits euro countries is an opportunity cost for Sweden.

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5 Appendix

5.1 Data Description

- **International Data on Bilateral Securities Holdings:**

Aggregate bilateral bonds and equities holdings in US dollars, in 2001, from the Coordinated Portfolio Investment Survey. <http://www.imf.org/external/np/sta/pi/datarsl.htm>

- **Bilateral Financial Banking Assets:** in US dollars, average over quarterly data in 2001, from the Bank of International Settlements.

A disaggregation by sector shows that banking assets are for half interbank assets, the rest is financing of the corporate sector (35%) and of the public sector (15%). A disaggregation by types of assets show that a big part is loan and deposit (around two thirds) but a non-negligible part consist in negotiable securities (bonds and equities³⁸).

See table 12 for a more precise description.

- **Bilateral Exports and Imports:** in 2001, in US Dollars from the CHELEM dataset (Centres d'Etudes Propectives et d'Informations Internationales, CEPPII, Paris).

- **Gdp:** from the International Financial Statistics.(GDP in US dollars in 2001, exchange rates used are also from the IFS).

- **Bilateral Distance:** in km, from S–J Wei's website and from various sources ("How far is it ?", <http://www.indo.com/distance>)

- **Corruption:** "Corruption Perception Index" from *Transparency International*³⁹ ranking from 0 to 10 (actually we use the opposite of the standard index to have the maximum value for the most corrupted country)

- **Common Language and Colonial Link:** various sources (for colonial link, mainly summaries of country history in Encyclopedias.)

- **Legal Variable:** mainly La Porta *et al.* [1998], various sources for missing countries ⁴⁰.

- **Stock Market Returns:** monthly data from 1990 to 2000 in UDS Dollars from Martin and Rey [2002] (World Bank and Bloomberg) and *Global Financial Data*.

- **Market Capitalisation over GDP:** Market capitalisation over GDP in 2000 are from the Financial Structure database of the Worldbank.

³⁸For some countries, namely France and UK, we know that around half of total securities are equities.

³⁹<http://www.transparency.org>

⁴⁰<http://www.llrx.com>

- **Fiscal Variables:** IBFD online products (<http://www.ibfd.org>); Latin American Taxation Database, European Taxation Database, Asia–Pacific Taxation Database, Tax Treaties Database.
- **Swedish data on bilateral asset holdings and capital outflows:** Sveriges Riksbank (Balance of Payments Statistics)
- **Swedish data on bilateral trade:** Statistics Sweden.

5.2 Country list for data on world asset holdings

- **Source Countries (i):** Australia, Austria, Belgium, Canada, Chile, Denmark, Finland, France, Germany, Hong-Kong, Ireland, Italy, Japan, Luxembourg, Malaysia, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Singapore, Switzerland, United Kingdom, United States, South Africa;
- **Destination Countries (j):**
 - **Europe:** Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Israel, Lithuania, Poland, Russia, Slovakia, Slovenia, Turkey;
 - **Asia:** China, Hong Kong, India, Indonesia, Japan, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand;
 - **Oceania:** Australia, New Zealand;
 - **North America:** Canada, United States;
 - **Central America and South America:** Argentina, Brazil, Chile, Colombia, Peru, Uruguay, Venezuela, Costa Rica, Mexico, Panama;
 - **Africa:** Algeria, Côte d’Ivoire, Egypt, Morocco, Nigeria, South Africa, Tunisia;

International Banking Assets Breakdown by Types of Assets and Sectors (in Billions USD, 2001)

		Total Assets	Loans and Deposits	Bonds and Equities	Loans and Deposits (%)
Developed	Europe ^a	3487.3	2363.0	1124.2	67
	North–America	2387.5	1684.9	702.5	70
	Asia–Oceania	632.0	519.0	113.0	82
Emerging	Africa	42.6	37.3	5.4	87
	Asia ^b	255.4	213.6	41.7	83
	Eastern Europe	142.2	114.2	28.1	80
	South America ^c	259.0	193.3	65.7	74
Financial Centers ^d		1086.2	965.8	120.5	89
Total		8292.3	6091.1	2201.2	73
Disaggregation by sector (%)			Banking Sector	Public Sector	Corporate Sector
			48	16	35

^aExcluding Luxembourg, Switzerland and United Kingdom.

^bExcluding Hong–Kong and Singapore.

^cExcluding Panama.

^dHong–Kong, Luxembourg, Panama, Singapore, Switzerland and United Kingdom.

5.3 Robustness Checks with “European Union” Dummies

	Equity _{ij}	Bond _{ij}	BankAsset _{ij}
	(1)	(2)	(3)
Euroj	.586* (.367)	.656* (.373)	.705** (.322)
Euroij	1.292*** (.438)	1.486*** (.421)	.819** (.366)
Eurcomij	-.335* (.209)	.631** (.264)	.168 (.177)
SWE-DNK-UKj	.431 (.330)	.683* (.391)	.579* (.353)
e(N)	1034	1031	897
e(r2)	.766	.681	.701
e(F)	113.194	96.702	62.658

Table 12: Gravity Models on world asset holdings with source country fixed-effects
Robustness Check with a EU dummy (Eurcom_{ij}) and a dummy for countries inside the EU but outside the euro. Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. Regional dummies of destination and control variables are included but not reported.

	Equity _{ij}	Bond _{ij}	BankAsset _{ij}
	(1)	(2)	(3)
Tradeij	.396*** (.067)	.123 (.079)	.346*** (.071)
Distanceij	-.496*** (.094)	-.722*** (.119)	-.497*** (.127)
Legalij	.185* (.103)	.184 (.123)	.445*** (.112)
CommonLang	.435*** (.129)	.397** (.188)	.416** (.164)
Euroij	.748*** (.199)	.800*** (.222)	.103 (.174)
Eurcomij	-.668*** (.206)	.219 (.232)	-.109 (.160)
e(N)	1034	1031	897
e(r2)	.789	.716	.717
e(F)	663.111	292.182	220.488

Table 13: Gravity Models on world asset holdings with source and destination country fixed-effects
Robustness Check with an EU dummy (Eurcom_{ij}). Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Robust standard errors. Observations are clustered within destination country.

	purchaseequityij (1)	purchaseequityij (2)	purchasebondij (3)	loanij (4)
GDPij	1.160*** (.138)	1.180*** (.101)	.978*** (.109)	1.331*** (.147)
Retj	1.089** (.496)			
distij	-.482 (.408)	-.654** (.328)	.034 (.400)	-1.493*** (.380)
Tradeij	.636*** (.237)	.493** (.219)	.491* (.288)	-.125 (.221)
FDIij	-.099 (.118)	-.099 (.110)	-.033 (.097)	.255* (.130)
ExchRateVolatility	.192 (.527)	.342 (.439)	-2.661*** (.519)	-.007 (.552)
Corruption	-.341*** (.130)	-.352*** (.117)	-.102 (.135)	-.074 (.146)
Euro	1.201* (.627)	1.461*** (.414)	.964*** (.352)	2.222*** (.529)
Eurcom	-.095 (.470)	-.214 (.357)	.068 (.216)	2.020*** (.571)
Legal	2.416*** (.869)	2.470*** (.581)	2.542*** (.701)	2.212** (1.043)
FinCenter	2.386*** (.559)	2.308*** (.492)	1.228** (.478)	2.137*** (.564)
TaxHaven	1.125** (.446)	1.308*** (.418)	-1.116*** (.325)	1.158** (.538)
e(N)	766	1105	686	1442
e(r2)	.776	.754	.738	.716
e(F)	71.379	56.146	134.794	58.837

Table 14: Gravity Models on outflows from Sweden: Robustness Check with EU dummy (Eurcom). Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country.

5.4 Robustness Checks with data on international taxation

	Equity _{ij}	Bond _{ij}	BankAsset _{ij}
	(1)	(2)	(3)
DividendTax _{ij}	-2.959* (1.757)		
InterestTax _{ij}		-5.352* (2.981)	-3.365 (2.306)
Euro _{ij}	.925*** (.291)	1.919*** (.354)	.771** (.318)
Euro _j	.661** (.283)	1.087*** (.365)	.692** (.305)
e(N)	793	835	863
e(r ²)	.805	.707	.703
e(F)	70.571	59.585	92.004

Table 15: Gravity Models on world asset holdings with source country fixed-effects. Standard errors in parentheses. Statistical significance at the 10% (resp. 5% and 1%) level are denoted by * (resp. ** and ***). Estimation with robust standard errors. Observations are clustered within destination country. Regional dummies of destination are included but not reported.

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