

THE NEW EUROPEAN

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- Is the EU a free trade continent?
- The strategic relevance of trade in the TTIP era
- Commissioner Vestager on the importance of enforcing competition

FREE TRADE AND THE EU'S ROLE IN AN INTERCONNECTED WORLD



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How migration fosters trade

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Migrants have been proven to be a big force in creating trade connections between countries. But in a time of constant evolution, more research has to be done to fully understand the phenomenon.

THE RAPID GROWTH in the migrant population in many developed countries in recent decades has given origin to much debate on the socio-economic impacts of migration, also promoting a significant increase in research activity on this issue. A great amount of research in particular has focused on the analysis of the **links between international migration and international trade**. International migration and international trade are indeed two key dimensions of globalisation, even if they have not developed at the same pace: while most governments have shown to be willing to promote international trade, they have not been so liberal in their migration policies. It has been suggested, however, that a causal positive link might exist between them, ranging from migration to trade.

There are two primary theoretical (and intuitive) reasons for believing that migrants play an important role in expanding foreign trade: one is related to information costs and the other is related to preferences.

The first reason applies both to exports and to imports and relies on the idea that information costs play a major role in the fixed costs that firms have to pay to enter foreign markets. Transaction costs in terms of costs of information may indeed inhibit international trade. In such a framework, migrants may act as trade intermediaries and reduce those

costs. This occurs when migrants exploit the links to their home countries. These links include knowledge of home-country markets (e.g. local customs, laws, business practices, preferences), language and business contacts. In line with this argument, the role of business contacts and social network is crucial both to promote contractual arrangements characterized by trust and to overcome informational asymmetries. The evidence of numerous case studies indeed shows that cross-border business and social networks promote international trade (both imports and exports) by reducing the issues related to contract enforcement and by providing information about trading opportunities.

The second reason migrants may promote trade applies only to imports and relies on the idea that migrant consumers may have a preference for certain goods that are produced in their country of origin (e.g. they may prefer ethnic foods produced in their country of origin). Since goods produced in their country of origin are more costly in the host country, immigrants have an incentive to buy these goods from the home-country, thus promoting imports. This effect is likely to be small for goods that are homogeneous with respect to the goods produced in the home country. This effect is likely to become smaller over time, since it may occur that at a certain point the number of migrants is high enough for domestic firms to start producing those products.



A spice store in Germany, an example of how migrants can reduce the cost to accessing foreign markets

Taken together, the information channel and the preference channel may be called *direct migrant links*, since they are related to migrants which directly affect trade flows either to or from their country of origin. Beside them, there are also the so-called *indirect migrant links*, which are related instead to third-party migrants, the ethnicity of which pertains neither to the importing nor the exporting nation. In other words, while direct links relate an individual of a given ethnicity and living in a particular country to another individual of the same ethnicity living in the origin country, indirect links relate an individual of a given ethnicity and living in a particular country to another individual of the same ethnicity who resides in another country, where this country is different from their common origin country. The reason why also indirect links among immigrants may promote trade is that ethnic minorities living outside their home countries create formal or informal networks to which both the host country and home country have access, thus creating the potential to provide market information and to

support contractual enforcement. Indirect links are therefore mostly related to the information channel while they should not reflect the preference channel, since they do not depend on the relationships with the country of origin.

Through their direct or indirect links, migrants convey knowledge spillovers that can reduce information costs to economic agents who do not migrate. These spillovers generate additional production and trade opportunities for them, together with utility-increasing consumption opportunities for the non-migrants of both countries. In addition, migrants can also increase the productivity of the exporting firm through the so-called *diversity effect*, in which migrants foster creativity and help generate new ideas within the firm, and through the so-called *specialisation effect*, in which migrants possess a comparative advantage in performing certain production tasks, thus allowing for greater division of labour within the firm.



The Venetian Republic owed much of its power and wealth to its ability to develop and capitalise on a wide network of merchants located in foreign markets. Painting by Canaletto, *The return of the Bucintaur to the Molo on Ascension Day, 1730*.

The international trade literature has generally found a strong association between migration and trade. Cross-sectional studies in particular reveal that in general there is a positive effect of migration on trade, even if the elasticity estimates differ greatly, depending on several factors. First of all, the elasticities between immigration and trade are estimated for different countries using different estimation methods and specifications. Second, the choice of the reference period matters. In particular, the positive effect of migrants on trade is particularly strong when the first migrants from a particular origin country arrive in the host country, while this impact becomes smaller in the long run, once a large migrant community has been established there. This is especially true for bilateral import flows. Third, also institutions are relevant for the results, and in particular the type of migration and trade policies of host countries, which are expected to influence the size and characteristics of

« By reducing the costs of exporting services to their country of origin, migrants have hence a specific export promotion effect »

the immigrants, thus affecting the strength of the information and preference channels. The ability of migrants to relay information on foreign markets may indeed depend on the type of migrants (independent, entrepreneurs, family immigrants, refugees), their educational level (skilled or unskilled), the length of their stay in the host country, and the size and variety of the migrant community. Finally, the type of traded goods matters, especially for

the preference channel. The pro-trade effect of migrants is in particular likely to be lower for homogeneous goods, for which the immigrant preference effect is expected to be lower. Since in general the developed countries of the North export differentiated products to the South, the pro-trade effects of immigrants should hence be especially relevant for the trade flows between the North and the South. In addition, trade with less-developed countries requires more familiarity with the reliability of other parties, thus making the information channel more relevant in case of trade between the North and the South than in case of trade among developed countries.

Although the great majority of cross-sectional studies provide evidence of a strong and robust positive correlation between trade and migration (even showing a great deal of differences in the results), doubts persist on the role of unobserved factors which may be driving this relationship. The estimated connection between migration and trade is indeed severely reduced in panel-data analyses, which allow to account for unobserved heterogeneity in the data. Panel-data analyses in particular allow to consider both unobserved country-specific factors and unobserved bilateral ties between countries. Since cross-sectional studies cannot account for such factors because the trading partners are observed only once in a certain time period, their results should be interpreted with caution. In particular, they are likely to overestimate the impact of migrants on trade.

More in general, it is worth pointing out that the analysis of the links between migration and trade has so far almost neglected the role of additional crucial aspects. Among them, the diffusion of international trade in services and the growing development of new telecommunication technologies.

International trade in services is a key aspect of globalisation. The volume of international trade in services has indeed grown rapidly in the recent decades and has outpaced growth in goods trade. Although relatively unexplored so far, the links between migration and trade in services are instead particularly important. Migrants may indeed reduce the costs of exporting or importing services

to and from their home country by helping domestic firms dealing with cultural and institutional barriers in the foreign markets. The reason is that providing a service abroad requires the knowledge and understanding of cultural specificities that are more complex than those required when selling a good. This is true for example for services such as business and legal services, due to customer-specific information required for their provision. With their better knowledge of culture and institutions of their country of origin, migrants may help domestic firms to target the different services toward their home country customers, thus allowing them to successfully penetrate in the foreign market. By reducing the costs of exporting services to their country of origin, migrants have hence a specific export promotion effect. At the same time, migrants can also induce an import reduction effect for some intermediate services, as long as they substitute for work that is otherwise performed by workers in their home country.

The diffusion of new telecommunications technologies is certainly another key aspect of globalisation which can have important implications for the role of migrants in international trade. In particular, the use of e-mails and internet search engines is likely to reduce the demand for migrant networks. In general, however, the new telecommunications technologies are likely to be a complement to rather than a substitute for face-to-face contact: information is indeed still an *experience good* and personal contact still helps to build the trust needed to develop deals.

While the role of the diffusion of both international trade in services and new telecommunications technologies have not been sufficiently investigated so far in the studies of the impact of migration on trade, also the impact of diasporas on trade in origin countries has not been given adequate attention. The focus of the research activity has been actually on the impact of migration on trade with respect to the host country, rather than the source country. For this reason, considering the impact of international migration on trade for both sending and receiving countries with respect to the full range of international economic linkages among them is a key issue for further research on this topic.