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Steven Globerman

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Views expressed in this manuscript are those of the author(s) alone. For more information contact the Co-Directors of the Centre, Dr. Don DeVoretz, Department of Economics, SFU (e-mail: devoretz@sfu.ca) or Dr. David Ley, Department of Geography, UBC (e-mail: davidley@unixg.ubc.ca).

Globalization and Immigration

Steven Globerman

Director, Center for International Business
Western Washington University
Bellingham, Washington 98225
Steven_Globerman@wwu.edu

Introduction

The academic literature has explored at length and in detail the relationship between international trade and foreign direct investment. The early theoretical literature viewed international trade and foreign direct investment as substitutes. Specifically, serving foreign markets through exports was seen as an alternative to serving foreign markets through establishing a wholly owned or partly owned affiliate in that market. The latter mode of serving the foreign market would presumably be chosen if costs related to transportation or tariff barriers made it uneconomical to service the market from the home country.

Modern theories of foreign direct investment acknowledge that the firm-specific assets of international companies are often best exploited by establishing majority-or even wholly owned-affiliates in foreign markets. Primarily driving this relationship is the existence of market imperfections that are most effectively addressed by “internalizing” transactions within an integrated company such as the modern multinational company (MNC). In particular, market imperfections arise in transferring intangible assets on an arms-length basis. Since the firm-specific assets of MNCs usually rest upon unique intangible assets such as technological know-how or brand reputation, the MNC becomes a preferred mode for many types of international business.

At the same time, modern theories of international trade have come to emphasize increasing returns to scale and imperfect competition as important determinants of trade flows. To make a complicated story simple, if not simplistic, the primary consequences of increasing returns and product differentiation are international trade flows characterized by a high degree of horizontal and vertical production specialization accompanied by intra-industry trade. As an illustration, the Ford Motor Company builds components and parts for its models in different locations and ships those components and parts to assembly facilities in other locations. The assembly facilities, in turn, are specialized for specific car models. The assembled cars are then shipped back to those countries in which components and parts, as well as other assembled cars were produced.

The net result is that modern theories of international business view international trade and international production as complements with both phenomena promoted by trade liberalization agreements and related developments such as lower communication and transportation costs. Most gratifyingly, the empirical evidence tends to offer fairly strong empirical support for the presumption that international trade and foreign direct investment are complements rather than substitutes. As a consequence, policymakers have come to be less concerned about trade liberalization leading to “giant sucking sounds” created by FDI fleeing certain locations in favour of other locations. Trade liberalization leads to increased specialization in both production and investment, but both trade and investment are promoted on a national basis by regional and multilateral agreements encouraging closer economic integration.

By contrast to the literature on FDI, relatively little attention has been paid in the literature to the relationship between trade and investment flows, on the one hand, and international migration flows, on the other hand. To some extent, this relative neglect reflects the practical reality of legal restrictions on migration flows that have been much stronger, in the post-WWII period, than legal restrictions on capital flows.

To the extent that economists worried about possible linkages between international trade and international migration in the past, application of the Heckscher-Ohlin and Factor-Price Equalization Theorems led to the strong inference that international trade and international migration were substitutes. Specifically, to the extent that migration is primarily driven by economic incentives, differences in real wages – or in returns to human capital more broadly – will generate incentives to migrate. But since international trade operates to equalize returns to factors of production on a global basis, increased international trade should lead to reduced international migration, all else being constant.

On the other hand, to the extent that migration is primarily driven by non- economic considerations, such as a desire to reunite with family members or to escape political persecution, there is no reason to expect a systematic relationship between trade and migration. In particular, the international equilibration of factor returns might have little or no impact on incentives to migrate, although, at the margin, economic considerations might predispose an essentially non-economic immigrant to choose one country rather than another.

Transaction Costs and the Trade-Migration Linkage

Neoclassical trade theory offers no grounds for expecting trade and migration to be complementary activities. However, the introduction of market imperfections can rationalize a complementary relationship between trade and migration in the same way as it rationalizes complementarity between trade and FDI flows. In the former case, specific human capital embodied in immigrants may be best exploited by those immigrants engaging directly in trade-promotion activities rather than “renting” their services to other parties engaged in international trade.[1] As an illustration of this notion, imagine that the relevant proprietary knowledge is a personal trust relationship with exporters in the home country. Immigrants enjoying this trust relationship could conceivably "sell" introductions to the exporters, as well as offer recommendations about the trustworthiness of third parties. However, specific mechanisms ensuring the reliability of behaviour, such as family censure, may simply not be transferable to transactions involving third-parties. Moreover, it is likely to prove difficult to price the value of such trust capital, thereby making it hard to accomplish an arms-length transfer of such capital.

Other, related forms of specific human capital, can be valuable assets of immigrants. They include, as examples, knowledge about the potential exporting and importing opportunities in the home country, knowledge about the uncodified and idiosyncratic political and social obligations required to do business in the home country, and language skills. Again, to the extent that it is more profitable to exploit such capital directly in trade-related activities than by selling such capital in open market transactions, increased trade may require a concomitant increase in immigration.

In effect, immigration might reduce transactions costs in international trade, just as FDI does. A significant reduction in transactions costs might well offset the influence of factor price equalization such that increased migration leads to more rather than less international trade. To be sure, if a reduction in transactions costs is to be substantial, certain *a priori* conditions will presumably exist. One is that significant differences in political and cultural conditions exist between the countries in question such that immigrants can yield valuable services as political and cultural "intermediaries."

A second is that the immigrants should be able to function as trade entrepreneurs. For example, immigrants with little or no commercial background are unlikely to serve as effective vehicles for integrating commercial markets in different countries. Hence, non- economic immigrants are much less likely to promote international trade than entrepreneurial immigrants.

A third is that there are strong potential trade complementarities to begin with. In particular, the relevant trade complementarities should arguably promote inter-industry trade. This is because large political and cultural differences between countries are likely to be mirrored by substantial differences in industrial development, geography and other attributes that condition comparative advantage. Put somewhat differently, intra-industry trade is less likely to

[1] A full exposition of this argument is provided in Steven Globerman, "Immigration and Trade" in Don J. DeVoretz, ed., *Diminishing Returns: The Economics of Canada's Recent Immigration Policy*. Toronto: C.D. Howe Institute, 1995, pp. 243-67.

characterize trade between two countries with substantially different industrial structures than between countries with similar industrial structures.

The Case of Canada and China

In fact, the trade and immigration conditions surrounding the relationship between Canada and China are arguably fairly conducive to complementarity between trade and migration, if such complementarity is to be observed anywhere. For example, the industrial structures of the two countries are substantially different reflecting noteworthy differences in factor endowments and relative factor prices. Thus, the opportunities for realizing large (conventional) gains from inter-industry trade exist, although the small size of the Canadian economy limits the magnitude of the gains compared to, say, trade between China and the United States. To the extent that immigration promotes trade, the seemingly large potential for gains from trade should contribute to a strong complementarity between trade and migration.

The marked differences in the political and cultural conditions when comparing Canada and China also contribute to a potentially stronger complementarity between immigration and trade than might be anticipated in the case of trade among developed Western Economies. That is, business-oriented immigrants presumably have a larger potential role to play in reducing the types of transactions costs discussed earlier in the case of Canada-China trade. Moreover, the largest share of immigrants who have entered Canada under the Investor and Entrepreneur class categories come from Hong Kong and Singapore.

The relatively large Chinese communities of Canada’s major cities further contribute to the maintenance of good air transportation linkages between Canada and Hong Kong, as well as a burgeoning Canadian media that focuses on aspects of China including economic and business conditions. While improved transportation and additional communication sources may work to diminish the importance of personal contacts and other forms of knowledge that are uniquely possessed by recent Chinese immigrants, they might also increase the demand for information about China by stimulating interest in business opportunities in China on the part of Canadian residents. In short, the growth of “non-immigrant” sources of knowledge might actually have an overall stimulatory effect on the demand for specialized knowledge about business conditions and opportunities in China.

The Evidence

Available evidence documenting the linkage between immigration from China to Canada and bilateral trade between China and Canada is limited and inconclusive. Perhaps the strongest and best evidence is a recent study by Keith Head and John Ries of the University of British Columbia who specific and estimate a “gravity model” of Canadian trade flows to determine: 1) if Canada enjoys disproportionately large trade flows with China given “conventional” determinants of trade flows; 2) if any anomalous trade patterns can be linked to migration patterns. They conclude that exports to Canada from China (including Hong Kong) are larger than would be predicted from standard gravity models, and that immigration from China to Canada is a significant variable helping to explain the anomaly.

Globerman offers less rigorous and more equivocal evidence on the trade-migration linkage. He documents the disproportionate growth of imports from Southeast Asia, especially from Hong Kong, into Canada from 1970 to 1992. He also reports the disproportionate share of immigration to Canada from Southeast Asia over the same period. This relationship, by itself, supports Head and Ries’ findings described above. However, he also shows that exports from Southeast Asia to the United States also increased rapidly over the same period, even though immigration from Southeast Asia to the United States was quite modest over that period compared to immigration from Latin America and other parts of Asia. Globerman also finds that trade between Canada and developing countries such as India and Pakistan, in relative terms, grew hardly at all over the 1970s and 1980s, notwithstanding disproportionate inflows of immigrants to Canada from those countries.

It might be that the trade – immigration linkage between Canada and China is more readily identifiable than the linkage between Canada and other countries because of the unique concentration of Hong Kong immigrants in the Investor and Entrepreneurial categories. Certainly, as noted above, the mix of immigrant skills will influence the strength of the linkage as much, if not more, than the size of the overall immigration flows.

Concluding Comments

To the extent that a significant trade-immigration linkage does exist between Canada and China, the resulting policy implications are not obvious. In principle, there is no reason to favour promoting trade with any individual country, as opposed to promoting trade on a multilateral basis. In addition, the public policy motives for encouraging immigration extend well beyond trade promotion, especially since other, more robust, tools exist to promote increased imports, e.g. remove tariff and non-tariff barriers to imports from Southeast Asia. Nevertheless, the potential for trade and immigration to be complements highlights the relevance of provisions in trade agreements pertaining to immigration, such as in the NAFTA Agreement. Specifically, closer economic integration, presumably the objective of bilateral, regional and multi-regional agreements, is enhanced by a more liberal environment for the international migration of managers and entrepreneurs. Furthermore, migration is not a zero-sum game. Closer economic integration presumably benefits both the country “sending” immigrants, as well as those receiving the immigrants. However, and as with other, more direct trade promoting activities, a competition among countries to attract business and entrepreneurial immigrants, will ensure that the associated benefits to the receiving country are dissipated. That is, while immigrants may benefit, the broader society of the receiving country may not.

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