



# From human capital externality to entrepreneurial aspiration: Revisiting the migration-trade linkage



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## ARTICLE INFO

### Article history:

Received 18 January 2016

Received in revised form 2 November 2016

Accepted 3 November 2016

Available online 13 January 2017

### Keywords:

Immigrant networks

Entrepreneurship

Trade

Gravity model

China

## ABSTRACT

The economics literature tends to view the positive impact of migration on trade as a product of human capital externalities. Drawing on the sociological perspectives of immigrant adaptation, we instead focus on entrepreneurial aspirations that drive immigrants into trade-creation activities. Considering levels of migrant educational attainment while applying entrepreneurship theory to China as the source of both migrants and traded goods, we propose and find support for our key hypothesis that the pro-trade effect of migrant networks is greater among low-skilled than high-skilled immigrants, thus adding precision to existing knowledge of how immigrants positively influence trade.

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## 1. Introduction

Since Gould's (1994) seminal work, the contribution of immigrants to international trade has been widely recognized. The literature, predominantly concentrated in the field of economics, identified two channels through which migrant networks impact trade. First, there is an information effect in that migrant networks help reduce transaction costs in trade by mitigating information asymmetries and inadequate contract reinforcement. Second, there is a demand effect as immigrants help stimulate trade by demanding goods from their country of origin. Using the same network logic, each of these arguments suggests a positive pro-trade effect of migration. However there has been no attempt to integrate the two, leaving these arguments to simply co-exist in the literature without informing each other. In examining the migration-trade nexus, scholars might choose one of the two arguments to build a theoretical base; when both arguments are included, inconsistent or even contradictory results often emerge (Greenaway, Mahabir, & Milner, 2007; Wagner, Head, & Ries, 2002).

A more problematic limitation in the existing literature is associated with two assumptions underpinning the information effect, which lack scrutiny to date. First, proponents of this effect essentially assume that immigrants promote trade by offering information to other economic agents who are directly engaged in trade activities, described by Gould (1994: 302) as immigrant networks leading to "a beneficial human capital-type externality." In other words, immigrants facilitate trade only indirectly. Second, scholars assuming this human capital externality perspective maintain that higher levels of education affords migrants with better information gathering abilities which in turn helps facilitate trade (Felbermayr & Toubal, 2012). It follows that the pro-trade effect should be greater from high-skilled than from low-skilled migrants, with skills being measured by pro-migration educational attainment.

Affirming the pro-trade effect of migrant networks while exploring the effect from an entrepreneurial perspective, a theory to reconcile the two mechanisms and draw on immigrants' economic and psychological aspirations is proposed. This perspective treats immigrants as individuals who are directly engaged in trade, rather than mere facilitators of trade activities by other economic agents. Stemming from insights in the literature on international entrepreneurship (e.g. Chandra & Coviello, 2010; Coviello & Munro, 1995) and grounded in the social science tradition of ethnic studies (e.g., Light & Bonacich, 1988; Portes,

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1981), we see the entrepreneurial pursuits of immigrants at the intersection of economic and psychological adaptation, implying the possibility that immigrant entrepreneurs who endeavour to bring in goods from their countries of origin could be the ones who help to create demand for such goods.

The compatibility of the economic (Portes, 1981) and psychological aspirations (Berry, 1997) is enabled by exploring educational attainment, a key quality for this immigrant population, weighing heavily on the broadly received migrant network effect. Departing from the prevailing human capital externality-centered theory, our entrepreneurship theory suggests that low-skilled migrants, in comparison to their high-skilled counterparts, have stronger aspirations – first, to get involved in exporting activities because of their stronger incentive (rather than “capability”) and second, to demand goods from their origin country because of their lower level of acculturation. The two processes of immigrant adaptation, apparently interrelated but rarely examined simultaneously in the literature, should generate varied levels of aspirations for consuming home-country goods and for engaging in activities of importing such goods, respectively, which in turn could inspire entrepreneurship among the immigrants.

We test our theory in the context of China as it is one of the largest sources of emigrants and exports worldwide, and yet China has surprisingly received scant attention in regards to the migration-trade nexus despite the country’s large scale and diverse profiles of outbound people and product flows. In previous investigations, China has often been left out of data pools for unspecified peculiarities (e.g., White, 2007). Thus, in addition to advancing the existing theory of the migration network effect, China-focused studies will contribute to policymaking in destination countries that have traded with China extensively and have received large numbers of Chinese immigrants in recent decades. To set a stage for testing our key hypothesis concerning migrant educational attainment, we start with a baseline hypothesis pertaining to the widely assumed migrant network effect and then a second hypothesis concerning the heterogeneity of traded goods. Findings from testing the second hypothesis will contribute to our understanding of how Chinese immigrants influence China’s exports, which have become increasingly sophisticated over the years (Schott, 2008). Our main focus is the third hypothesis that examines the effect of skill-level of immigrants in terms of educational attainment. Our main contribution is the idea that immigrants engage in trade due to their motivation above and beyond existing emphasis on knowledge. Although the impact of ethnic networks on international trade was identified many decades ago, we provide up to date evidence that immigrant-owned businesses belong to the contemporary phenomenon of international entrepreneurship (Sui, Morgan, & Baum, 2015), that immigrant entrepreneurship is a unique case of “consumers as international entrepreneurs” (Chandra & Coviello, 2010), and that entrepreneurial aspiration may highlight the unique “cognitive aspects of the venture creation process” involving immigrants (Hitt, Li, & Xu, 2016, p. 68).

In the following sections of the current paper, we first conduct a critical review of existing literature. We then present a theory combining the processes underpinning the migration-trade nexus, followed by offering three testable hypotheses in the context of China. The subsequent section describes our methodology, which involves applying a gravity model to migration and trade data from China as the source country, complemented by illustrations from our field work with immigrant entrepreneurs. Finally, we present our results and contributions to the important areas of immigrants, trade, and entrepreneurial activity (Ahlstrom & Ding, 2014; Gould, 1994; Sui et al., 2015).

## 2. Literature review

The link between trade and migrant networks is formally conceptualized by Gould (1994) and later confirmed by a number of academic contributions concerning host countries such as the U. K. (Girma & Yu, 2000), Canada (Head & Ries, 1998), U.S. (Mundra, 2005), and France (Combes, Lafourcade, & Mayer, 2005). According to these studies, the effect of migration networks emerges mainly through two channels. First, migrant networks help overcome information barriers as well as contract enforcement challenges, thus reducing transaction costs for trade (Dunlevy, 2004). The channel operates through knowledge-related mechanisms, such as migrants’ familiarity with markets and institutions, possession of personal ties, and mastery of languages and cultural nuances in their country of origin (Gould, 1994), all important resources and capabilities for conducting international business effectively (Sui et al., 2015; Tarique & Schuler, 2010). This information is especially valuable when there are vast differences between trading partners in terms of institutions, languages and cultures (Dunlevy, 2004), and when the business and political environment is less transparent in the country of origin (Rauch, 1999).

Second, migrant networks help create demand for goods from origin countries, thus stimulating trade and promoting imports from the origin to destination country (Girma & Yu, 2000). It is often assumed that migrants are likely to retain preference over certain goods that originate from their home countries. In El Salvador’s case, for example, trade due to the demand effect accounts for as much as 10% of a country’s total trade (Orozco, 2008). Importantly, entrepreneurially minded consumers could exploit the opportunities from such demand to create market internationally (Chandra & Coviello, 2010). We will argue that it is exactly the case with Chinese immigrants.

While the migrant-trade nexus has become a widely accepted theorem, the mechanisms through which migrant networks facilitate trade is far from being fully established. Empirical findings have been inconsistent, especially when both information and demand effects are considered (Wagner et al., 2002). Seeking for more precise conceptualizations, some scholars have examined the nature of traded goods as the dependent variable in the migration-trade link. Evidence has started to emerge suggesting that the pro-trade effect of migrant networks should be greater for goods that are more sophisticated and thus require more developed insight. Rauch (1999) differentiates traded goods into three categories – organized exchange, reference priced, and differentiated, and has found that the effects of geographic proximity, common language, and colonial ties are most common for differentiated goods. Apparently, migrants convey trade-relevant information on differentiated goods that may not be captured by the price system (Greenaway et al., 2007; Rauch & Trindale, 2002).

The area where much is unknown relates to the composition of the migrants as the independent variable in the migration-trade equation. Given their focus on the information effect, a few scholars have included migrants’ skill levels, measured by educational attainment in their gravity models (e.g., Felbermayr & Toubal, 2012). A common assumption is that skilled (i.e., more educated) migrants have a greater ability than the low-skilled migrants to convey relevant information, thereby contributing more to trade between origin and destination countries. In his original conception of “immigration links”, Gould’s (1994) attention is directed at “the foreign market knowledge that immigrants naturally embody” and the possible “knowledge spillovers that can reduce information costs to economic agents who do not migrate” (314). Implicitly, immigrants would facilitate trade by providing the needed information to those agents such that the more immigrants know, the more often trade will occur. Equating

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