

Two notable features of globalisation are the growth of immigration and the growth of international trade in services. Exploring links between these phenomena, **Gianmarco Ottaviano, Giovanni Peri** and **Greg Wright** find that immigrants play a key role in promoting UK exports of business and legal services – not just to their home countries but across the world.



Immigration: the link to international trade in services

The volume of international trade in services has grown rapidly in recent decades, outpacing growth in goods trade. Between 1980 and 2011, global goods trade increased on average by 7.3% annually, while global services trade rose by 8.2% per year. Over the same period, many developed countries also experienced rapid growth in immigration.

Much research has analysed the link between immigrants and trade in goods, yet the link between immigrants and trade in services is almost unexplored. But this link may be particularly important due to the customer-specific information that is often required for the provision of services. Trade in business and legal services, for example, depends on good working relationships between clients and suppliers.

We explore the link between immigration and services trade by focusing on potential channels through which UK immigrants promote trade in services

between their host country and its trading partners (or alternatively replace trade by producing locally what would otherwise be imported from their home countries). We draw on two data sources: the International Trade in Services survey and the quarterly Labour Force Survey. These allow us to distinguish 42 service types, which we use to explore the relationship between firm-level exports and imports of these services and the changing pool of immigrant workers in the local labour markets from which firms draw their workforce.

Figure 1, which breaks down UK trade in services by service type, shows the dominant role of business services and royalties and licensing agreements in both imports and exports. These two types of services require a significant amount of country-specific and institution-specific knowledge.

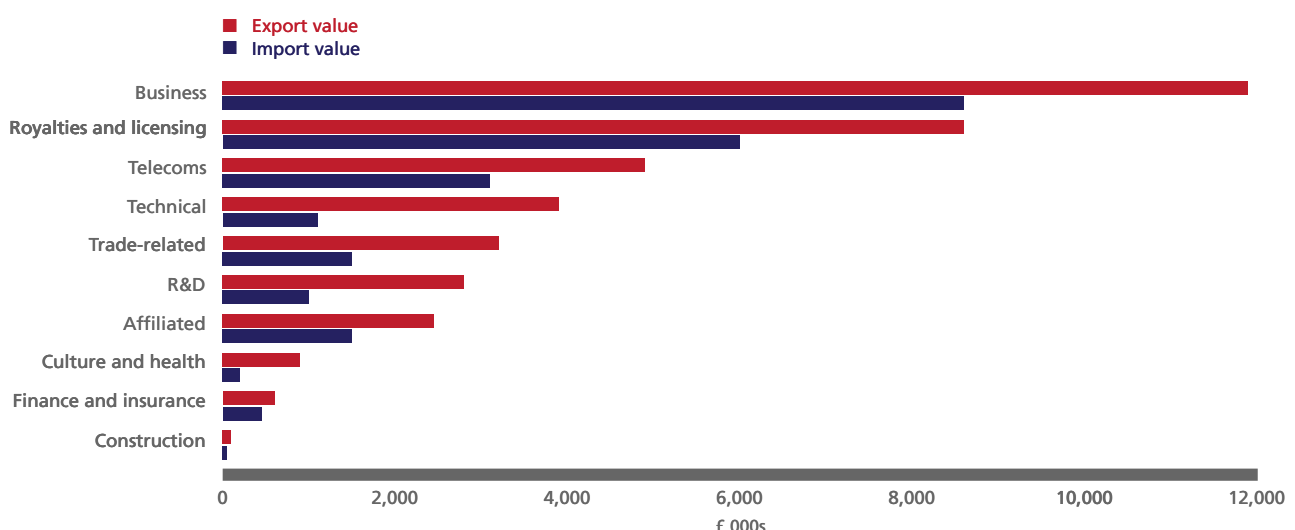
Our findings indicate that immigrants promote exports of services to consumers

Immigrants are key to overcoming cultural and institutional barriers to trade

(‘final services’), both in aggregate and in particular to their countries of origin. We also find that they reduce imports of some types of business to business services (‘intermediate services’). These effects are particularly strong when the trading partners are culturally and institutionally dissimilar.

So exactly how do immigrants have these effects on trade in services? One way may be by reducing the costs of exporting (importing) services to (from) their home country by helping domestic firms to overcome cultural and

Figure 1:
UK services exports and imports by service type, 1999-2005 (thousands of pounds sterling)



institutional barriers with the foreign market. Relative to trade in goods, this cost reduction may be particularly important, since providing a service abroad often requires an understanding of cultural specificities that goes well beyond what is required when selling a physical good abroad.

For example, selling business services overseas will require a nuanced understanding of the business culture in the foreign market, while selling legal services abroad will clearly require a detailed knowledge of the legal system. Such considerations of culture and language are of relatively minor importance in export transactions involving physical products – UK whiskies, say, or Chinese TV sets.

Reductions in imports of some intermediate services may come about where immigrants substitute for work that is otherwise performed by workers in their home country and then imported. In other words, firms may be able to hire a local immigrant instead of ‘offshoring’ the work to the immigrant’s home country.

Finally, in addition to the potential reduction in bilateral trade costs, immigrants may foster services trade to all destinations by increasing the overall productivity of the firm, thereby boosting the profits associated with overseas sales.

Potential sources of these productivity gains include a ‘diversity effect’ – in which immigrants foster creativity and help to generate new ideas – and a ‘specialisation effect’ – in which immigrants possess a comparative advantage in performing certain production tasks, allowing greater division of labour within the firm. When these gains are large enough and firms face fixed barriers to exporting, these productivity gains may help firms to access foreign markets that they might not otherwise reach.

Our empirical analysis seeks to measure the causal relationship from immigration to trade in services. One source of potential bias in our estimates is that a booming local labour market increases trade activity and, at the same time, attracts immigrant workers, which would introduce a spurious correlation between the two phenomena.

We avoid this by focusing on the parts of immigrant flows that are explained by historical patterns of immigration. To the extent that immigrants settle in some

areas to be near their compatriots, the historical settlements of each immigrant group will be not only a good predictor of the current settlement patterns of that group but also unrelated to current economic conditions in that area. We make use of these ‘network-driven’ inflows of immigrants to track their causal impact on the services trade of firms in the local labour market.

So what do we find? First, a one percentage point increase in immigrants from a particular country into a local labour market leads firms in that area to export 6-10% more services to that country (a bilateral effect). This effect is driven primarily by export growth among firms already serving the market rather than by new firms entering the market.

Furthermore, the effect is strongest for services that are intensive in the use of language and legal expertise but is insignificant for technical services. This is consistent with the view that immigrants constitute an effective channel of trade creation for services in which cultural content plays an important role. In further support of this view, we find that the effects are two to three times larger when exporting to non-Anglo-Saxon countries than to Anglo-Saxon countries.

Second, we find a role for the aggregate share of immigrants in a local area on UK services exports, above and beyond any effect due to the bilateral cost reduction. This effect is approximately four times smaller than the bilateral impact, and it suggests the existence of productivity gains associated with immigrant labour.

The effect not only induces firms to export more to their existing partners, but also promotes entry of new firms into previously untapped markets. Specifically, we find that a one percentage point increase in the aggregate share of immigrants in the total population of a local area leads to a 0.10% increase in the probability that a firm exports some services. These effects are also strongest in the case of language- and legal-intensive service types, suggesting that immigrants are key to overcoming cultural barriers to trade.

Finally, immigrants may reduce imports of intermediate services. We find strong evidence for this effect, and once again it is almost exclusively due to trade in language- and legal-intensive services –

Immigrants may reduce offshoring of services with important cultural content

that is, services with high cultural and institutional content. Overall, we find that bilateral offshoring (imports of intermediate services) with an immigrant’s country of origin falls by 1% per year in response to a three percentage point increase in immigration from that country.

Conclusion

Immigration and international trade in services are among the fastest growing aspects of globalisation. We find that there are economically important links between these phenomena, which imply that immigration policies may affect the export and offshoring activities of services firms.

Since trade in services requires the overcoming of cultural and institutional barriers to a much greater extent than trade in goods, the role of immigrants in facilitating services trade may be critical and quantitatively more relevant than in facilitating goods trade. At the same time, we find that for services with important cultural content, immigrants may reduce the offshoring of those services, an important nuance in the link between immigration and trade.

This article summarises ‘Immigration, Trade and Productivity in Services: Evidence from UK Firms’ by Gianmarco Ottaviano, Giovanni Peri and Greg Wright, CEP Discussion Paper No. 1353 (<http://cep.lse.ac.uk/pubs/download/dp1353.pdf>).

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