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Minorities and trade: what do we know, and how can policymakers take it into account?

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11/2016

Minorities and Trade

What Do We Know, and How Can Policymakers Take It into Account?

Benjamin Mueller
Alexandros Ragoussis

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Abstract

This literature review discusses links between the presence of minorities and economic outcomes at the individual, economy and cross-country levels. Drawing on a large number of related studies, we highlight consistent facts and arguments that can guide integration policies and unleash the potential of ethnic diversity for growth and trade. We conclude with what can be done to harness ethnic diversity in order to strengthen economic ties, both within and across countries.

Keywords: diversity; minorities; employment; trade; immigration; growth; ethnic networks; network effects

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Benjamin Mueller and Alexandros Ragoussis

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1 Introduction

Immigration has risen fast on the agendas of politicians, journalists and academics alike over the last few years. In 2015 alone, migration was a top priority area of work for the Turkish Presidency of the G20, the Russian Presidency of the BRICS¹ and the exclusive focus of successive summits of the European Union. The unprecedented level of displaced populations fleeing conflict zones – in excess of 50 million people by now, the highest total since the Second World War – has not only stirred emotions and sparked intense deliberations about political responses; it has also re-opened the discussion about the day after: in particular, the effects of ethnic diversity in the hosts' countries, both in the short and long run.

Clusters of populations with different origins, cultures, languages or religions, and their interaction with dominant majorities, have been a source of debate and tension throughout human history. The current migration of refugees bolsters existing sets of minorities in various countries who tend to have settled for a range of reasons at different points in time, or it creates pockets of new minorities. There may be several dimensions of diversification of minority migrants compared to the rest of the population, but ethnicity stands out as being central among them, capturing the essence of their identity contrast.

The following literature review contributes to the ongoing policy response to resurgent global migratory flows by focussing on what are arguably some of the most evident effects of ethnic diversity, namely those on economic ties between communities within and across borders. Literature was selected that is most germane to the question of how minorities influence economic patterns at the micro and macro levels. Most of the research under review was published in high-impact journals within the last two decades, while some enduring concepts concerning migration and economic trends that have stood the test of time are also integrated into the analysis. Our objective is to summarise, highlight and structure evidence around the question of how increased ethnic diversity affects trade patterns. Implications for an even more relevant and timely question flow naturally from this: What can policymakers do to harness ethnic diversity in order to strengthen ties within and across countries and economies? The main novelty of our approach lies in synthesising and categorising a range of effects that have been identified at different levels – both within and across borders – as well as in highlighting relevant linkages with ongoing policy debates.

In what follows, a number of key facts are distilled and discussed. Ethnic minority groups exhibit distinct trading behaviour. Their patterns reflect “self-help network effects” manifested through higher rates of self-employment, higher levels of interaction within one's community and the presence of enclave dynamics, such as spatial concentration and persisting gaps in educational and income terms. These patterns can be exogenously induced (e.g. by barriers to formal employment and various types of discrimination), endogenously induced (through strong family ties or cultural preferences against assimilation) or a mix of both. As such, their intensity varies widely among groups and host countries. From a broader perspective, aggregate economic outcomes are affected by the presence of minorities largely *indirectly*. Ethnic fragmentation is associated with disparities in governance, political and social instability, as well as income inequalities

1 Brazil, Russia, India, China, South Africa; see Ufa Declaration of BRICS leaders.

that do not foster growth. Yet, cross-border effects are, unsurprisingly, more clear-cut: the presence of ethnic minorities boosts international trade due to immigrants' superior knowledge of foreign countries' markets, languages and business practices. Transaction costs for international trade are lower and contractual enforcement is better supported in their presence.

How can policy take these facts into account, especially given the current political turmoil surrounding the movement of minorities? Several recommendations stand out. First, we argue that governments should unleash the economic potential of ethnic diversity early enough by tackling exogenous drivers of enclave dynamics among ethnic groups and new settlers. Second, the systematic monitoring and projection of economic effects stand to make a great difference in the success of policies in the area of migration. Third, both monitoring and policy design are more successful when governments coordinate with each other in the formulation of migration policies. The ongoing European experience of managing displaced populations demonstrates how far we are from that objective. Last but not least, the potential for cross-border trade associated with ethnic diversity is probably a key neglected factor that could make the greatest difference, both for the well-being of the immigrants themselves and for the host countries in the longer run. We argue that governments need to invest in linkages of ethnic populations with their home countries as a strategic priority, given the global paucity of opportunities for economic expansion in the decades ahead of us.

The review is structured as follows. Section 2 discusses distinct trade patterns of ethnic minorities at the micro level along with their endogenous and exogenous drivers. The next section takes the discussion to the macroeconomic level by looking first into aggregate economic outcomes in the presence of ethnic diversity, and then into effects on cross-border exchanges. Section 4 concludes with policy implications.

2 Distinct features of trade-related behaviour among minorities

High rates of self-employment and strong interactions within one's community are commonly observed among immigrants in a variety of contexts. The following section begins by reviewing related evidence at the micro level: What behavioural traits have been observed among minority groups, and what are the likely factors that drive them? Discrimination against minorities in formal employment offers some explanation for the persisting gaps between minorities and the broader population, while various degrees of intergenerational assimilation among different minorities drive such patterns over time – a point which is of particular relevance to policy.

2.1 Self-employment

Ethnic minority and immigrant groups are commonly over-represented in the self-employment sector in developed countries (Clark & Drinkwater, 2006), which tends to set a ceiling on their income and social-mobility prospects. This is owing to the fact that ethnic immigrants tend to live in geographically concentrated areas in their destination countries, usually in relatively deprived neighbourhoods. Ethnic immigrants often face

barriers to entry to consolidated sectors of economic activity and employment (Hills et al., 2010). These hurdles take the form of language difficulties, lack of formal schooling / training, geography / segregation, and overt or covert discrimination (Nunn et al., 2010). Self-employment may thus be a response to blocked upward mobility or the manifestation of group-specific cultural resources (Metcalf, Modood, & Virdee, 1996). Ethnic minority migrants respond to earnings differentials between paid and self-employment, so discrimination in the labour market can bring about higher rates of self-employment among discriminated-against groups; other aspects of ethnic minority culture, such as religious or family ties, may facilitate migrants' entrepreneurial ambitions (Clark & Drinkwater, 2006). Additionally, minority-run businesses are often reliant on informal sources of finance, as racial disparities exist in access to start-up capital (Metcalf et al., 1996; Parker, 2004).

These generalisations hide wide variations in self-employment rates by racial origin, gender, and over space and time. The behavioural traits of different ethnic minorities are influenced by a multitude of factors. For example, living arrangements of ethnic minority families in the United States are influenced by cultural heritage, such as the structure of the family in their country of origin (Giuliano, 2007; Alesina & Giuliano, 2009). The work and fertility choices of second-generation American immigrant females is influenced by female labour-force participation and fertility rates of their parents' country of origin (Fernández, Fogli, & Olivetti, 2004; Fernández & Fogli, 2009). Future self-employment rates of some minority groups fall as the proportion of first-generation immigrants in the population declines: second-generation immigrants find self-employment less attractive than entering the paid labour market (Clark & Drinkwater, 2006). In the United Kingdom, this phenomenon is particularly pronounced among Indian and Chinese immigrants, whereas Pakistanis and Bangladeshis – groups who underwent similar demographic changes over time – broadly maintained their self-employment levels over multiple generations. It is possible that these particular minorities engage in a deliberate form of economic and cultural self-segregation, a so-called ethnic enclave economy (Nguyet Erni & Yuk-Ming Leung, 2014). In the United Kingdom, Pakistanis and Bangladeshis are most likely to concentrate in a particular geographic area (though it is not entirely clear whether by choice, owing to one-time contingencies, or due to governmental policy and/or social attitudes). These two groups also face the highest levels of wage and employment discrimination in the UK labour market, which may explain their differential self-employment trends relative to Chinese and Indians (Platt, 2007; Palmer & Kenway, 2007). In the United Kingdom, the ethnic wage deficit is highest for Bangladeshis, and Pakistani and Bangladeshi women experience the widest salary gap relative to the UK wage levels of whites (Garner & Bhattacharyya, 2011).

It bears noting that ethnic minority entrepreneurs earn substantially less than white entrepreneurs (Clark, Drinkwater, & Leslie, 1998; Fairlie & Robb, 2008). Additionally, ethnic minority entrepreneurs tend to be concentrated in industrial sectors with high business failure rates, such as retail, catering and transport (Parker, 2004). Employment of illegal immigrants by struggling ethnic minority businesses is common (Jones, Ram, & Edwards, 2006). At the same time, self-employment has multiple beneficial effects, such as enhancing job satisfaction levels, feelings of self-worth and family / cultural ties (Metcalf et al., 1996). Current United Kingdom policy aims to raise the self-employment rates of under-represented ethnic minority groups through an Ethnic Minority Employment Stakeholder Group (see Bell & Casebourne, 2008).

The evidence is fairly clear that first-generation ethnic immigrants in developed countries are more likely to be self-employed than the majority population, as a result of their minority status and its associated barriers to formal employment. Self-employment can indeed be an appealing professional route where migrants face fewer discriminatory barriers. Although minority immigrants who run their own businesses must work hard for it to thrive, they can provide comfortable lives for their families if they succeed. First-generation immigrants are “willing to put family before self, and work over leisure”; however, “few entrepreneurs feel that the business provides what they would wish for a son in his first job” (Metcalf et al., 1996).

There is a paradox therein, insofar as first-generation ethnic minorities benefit from policies that make it easier to open their own businesses; hence self-employment can be economically empowering for minorities and generate opportunities for financial security and personal advancement. At the same time, minority entrepreneurs often wish for their children to enter more formal career paths, indicating that minorities engaged in self-entrepreneurship choose this out of convenience / availability rather than objective desire alone. Persistently high rates of self-employment can reflect an enclave dynamic in a particular ethnic minority (Portes & Manning, 2005). Enclave dynamics can be lucrative and generate significant economic payoffs for founders of such groups (such as the first wave of Castro refugees and exiles from Cuba), but not for subsequent waves (Portes & Shafer, 2006). Such a lack of assimilation in cultural and educational terms can produce lasting employment and income gaps in minority groups relative to the broader population. So although self-employment can be empowering for minorities, it can also end up as a trap that produces segregation.

2.2 Trading within one’s community

Countries such as the United States, the United Kingdom and Canada, on which most of the research on employment patterns of immigrants is focussed, are populous, prosperous and English-speaking, and thus highly desirable destinations for immigrants. However, ethnic and religious minorities are present in many countries that may not be major immigrant destinations, such as developing, non-English-speaking countries. Research on ethnic and religious minorities in such countries reveals that economic activity is correlated with ethnic community membership and shared cultural backgrounds (Duanmu & Guney, 2013). Ethnic identity may be a driver of trade preferences among minorities, thus fostering economic links among minorities, both within and across a destination country’s borders.

This behaviour is not surprising. People tend to associate themselves with others who are similar in some salient respect, such as ethnic identification, religion or race. Despite the rapid development of modern market-based and liberal societies, in-group network effects persist (Guiso, Sapienza, & Zingales, 2009). Ethnic network effects endure due to their problem-solving functionality, for example the promotion of information flows among “clan” members, or honour-based contract-enforcement features (Bowles & Gintis, 2004). Cultural group affinity supports economic cooperation by means of sentiments that reinforce group membership, such as maintaining ethnic purity and personal loyalty among group members (Loury, 2000).

The intensity of that distinct behaviour is often attributed to levels of generalised trust in a society – in other words, the fact that people appear to trust each other less in culturally diverse settings (Alesina & La Ferrara, 2005; Soroka, Johnson, & Banting, 2006; Ermisch & Gambetta, 2010). This is not a clear-cut finding, and other research disputes the point (Bahry, Kosolapov, Kozyreva, & Wilson, 2005). For instance, ethnic diversity levels in 20 European nations were found to have no negative association with generalised trust across society (Hooghe, Reeskens, Stolle, & Trappers, 2009). Which side of the trust / diversity debate holds is an important factor in the economic behaviour of ethnic minorities: if it is true that a culturally heterogeneous society experiences lower levels of trust, ethnic networks will tend to foster community-based trade patterns, both within the destination country as well as between the destination and origin countries. Trust effects can also be “imported” by migrants. For instance, immigrants to the United States from countries with less well-developed investor and legal protections are more reluctant to buy shares in the United States: this implies that minorities from particular regions extrapolate certain economic traits in their countries of origin to the destination country (Osili & Paulson, 2008).

A compelling point in the debate on levels of trust in multicultural societies is that links between diversity and trust are not stationary and deterministic, but a dynamic function of a society’s ability to exploit the economic potential of cultural heterogeneity. Diversity can foster increased contact between different ethnicities and thereby reduce prejudice and hostility, insofar as these are a function of ignorance (Allport, 1954). Direct contact between different cultures can bring about more benign cross-cultural relationships, and thus promote increased social and economic exchanges (Sigelman & Welch, 1993). An ethnically diverse environment is theoretically more capable of providing opportunities for inter-ethnic contact and exposing consumers to products from different cultures and traditions, which can reduce information asymmetries between different ethnicities (Mooy & Robben, 1998). Peaceful, stable and open pluralistic societies can generate higher levels of trust between different ethnicities: this helps to reduce minorities’ reliance on their own ethnic networks for economic advancement (Radnitz, Wheatley, & Zurcher, 2009).

2.3 Evolving enclave dynamics

Ethnic minorities can be differentiated into transient migrants (who retain the long-term objective of returning to their homelands, and thus embark on their journeys as sojourners with no plans to settle permanently) versus ethnic minorities who aspire to settle permanently in a foreign land. Transient migration is a necessary but insufficient condition for becoming what is one of the earliest concepts in post-war research on the economic implications of cross-border migration: so-called middle-man minorities who occupy trades connecting producers and consumers. A middle-man minority’s chief traits are: thrift (willingness to endure short-term deprivation in order to hasten the long-term objective of returning to the homeland), long work hours and a high savings rate. Middle-man minorities focus on making money rather than spending it and exhibit a strong future time-orientation with a view to capital accumulation (Bonacich, 1973). This creates a notable preference for occupations that are mobile, cashflow-rich and easily liquidated: “capital employed by a trader or money lender turns over much faster than that used in industrial establishments” (Hoselitz, 1963). Favoured middle-man minority professions include independent artisanship, farming in crops with rapid turnover, skilled trades

(barbers, shoemakers, goldsmiths, jewellers, restaurant owners, tailors, laundry) and credit-provision. The common occupational characteristic of middle-man minorities is the need for their professions to provide constant levels of liquidity that remain relatively immune to economic up- or downturns.

Ethnic enclaves may develop among middle-man settlers out of convenience (e.g. shared language), but the longer that middle-man minorities remain in their host country, the more their ethnic community ties tend to weaken. Nonetheless, sojourner minorities exhibit different characteristics from minorities who move to their host country with the deliberate intention of settling in for the long run – the latter creating a rationale to orient oneself outwards and mix with other communities. By contrast, middle-man minorities “have no desire for full participation in the community life of his adopted land” (Siu, 1952). Other characteristics of middle-man minorities include: resistance to out-marriage, residential self-segregation, the establishment of language and cultural schools for their children, maintenance of unique cultural traits (including, often, a distinctive religion) and a tendency to avoid involvement in local politics (except in affairs that directly affect their group). Middle-man minorities typically form highly organised communities as a result of their resistance to assimilation.

The literature on middle-man minorities (also known as “trading diasporas”) is well-established and has stood the test of time (Brubaker, 2005; Cohen, 2008). It accounts for differences in the economic experiences of transient minorities, who believe they are moving temporarily, as opposed to immigrants proper, who move to a country with the specific intent of settling. This is of particular relevance as European policymakers face hard choices in terms of integrating refugees into the labour market with a view to long-term assimilation, or as a temporary solution until a semblance of stability and prospects for growth return to their home countries. In terms of how to promote assimilation and break down barriers between minorities and host societies, it is helpful for policymakers to bear in mind that enclave dynamics are in part need-driven (i.e. brought about by the absence of economic opportunities for minorities outside of their cultural group), and in part brought about deliberately by the constellation of certain cultures within certain settings (Nguyet Erni & Yuk-Ming Leung, 2014). The many effects discussed above vary among ethnic groups (by origin countries / cultures) and the minority’s host country; they can be exogenously induced (by barriers to formal employment, wage discrimination, difficulties accessing capital and education, ghettoisation / involuntary demographic concentration in public housing, and a dearth of opportunities to assimilate) or endogenously induced (through strong family ties, cultural preferences against assimilation, ethnically diverse host countries with lower levels of generalised trust, or the case of “middle-man minorities” who deliberately choose self-isolation for economic and/or cultural reasons).

3 How does trade-related behaviour of minorities impact aggregate outcomes?

Aggregate economic outcomes are shaped by the micro-level dynamics discussed above, as well as by the strength of their exogenous and endogenous driving factors. In what follows, we turn the focus to the macro level, in particular the effects of a minority's presence on a nation's economic growth and social cohesion, as well as on international trade beyond its borders.

3.1 Domestic channels

The presence of ethnic minorities in a country is likely to affect its economic growth rate. Ethnic diversity exerts an indirect influence over economic performance through its effects on the content and design of public policy, levels of political fragility and other macroeconomic factors. In developing countries, differences in levels of ethnic diversity are associated with disparities in governance, the stability of social peace and growth indicators. The pattern is no different in developed countries: cultural and ethnic homogeneity tends to be associated with growth premia (Patsiurko, Campbell, & Hall, 2013). Developing societies that are more ethnically heterogeneous are associated with lower educational attainment rates, lower levels of political stability, underdeveloped financial systems, distorted foreign exchange markets, high government deficits and insufficient levels of public infrastructure. Ethnic diversity and the presence of minorities partly account for Africa's growth tragedy (Easterly & Levine, 1997). Inversely, social cohesion creates conditions for cooperation and coordination; it is worth noting that some have found negative correlations between ethnic diversity and cohesion (Campbell & Hall, 2009). However, that leaves the issue unclear as to whether such adverse links between diversity and cohesion are causal, or whether targeted governmental policies can provide remedies.

Democracy plays a positive role in ameliorating the negative growth effects in ethnically diverse countries (Bluedorn, 2001). Polarised societies suffer from rent-seeking by various competing groups and struggle to reach consensus policy decisions on public goods (Alesina & Tabellini, 1989; Alesina & Drazen, 1991; Shleifer & Vishny, 1993; Alesina & Spolaore, 1997). That helps explain why ethnically diverse developing societies find it difficult to achieve sound public policymaking: "ethnic diversity may increase [political and social] polarization"; this impedes "agreement about the provision of public goods" and creates "positive incentives for growth-reducing policies, such as financial repression and overvalued exchange rates that create rents for the groups in power at the expense of society at large" (Easterly & Levine, 1997). Furthermore, ethnic diversity is linked to high black market premia and a sluggish pace of financial development, as well as insufficient provision of public infrastructure and low levels of education.

The evidence that has appeared to date on direct links between ethnic diversity and growth is more ambiguous; some ethnic diversity measures are strongly correlated with control factors in regression analyses, reducing their significance when entered jointly in cross-country growth regressions (Easterly & Levine, 1997). However, the indirect link between ethnic heterogeneity and public policymaking is robust: the high presence of ethnic minorities in African economies plays an important part in explaining the continent's poor

relative economic growth; Easterly and Levine (1997) conclude it accounts for up to one-third of the growth differential between Africa and East Asia. But while it is clear that ethnic divisions undermine good governance in a state (Min, Cederman, & Wimmer, 2010), it is erroneous to conclude from this that ethnic diversity and ethnic divisions go hand in hand. Indeed, an important gap in the literature concerns the role of institutions and political processes in forming growth-promoting cohesion in culturally diverse societies, which is an important point made by Patsiurko et al. (2013) in their discussion on negative growth effects of ethnic diversity in developed countries. For example, Collier (2000, 2001) makes a compelling case that heterogeneity is likelier to produce fragmented societies in undemocratic states, which are less able to deal positively with ethnic diversity than democratic states. Advanced, stable democracies are more than capable of producing policy responses to prevent or reduce the harmful social effects of migration.

The causal link between cultural heterogeneity and growth is provided by polarisation. Ethnic and religious polarisation can have large and persistent negative effects on economic development due to their impact on policymaking. Polarisation is associated with lower investment levels, increased government consumption and heightened risks of civil conflict (Montalvo & Reynal-Querol, 2005). Evidence shows, for example, that ethnolinguistic diversity is strongly correlated with corruption, which in turn lowers rates of private investment; moreover, ethnolinguistic fractionalisation is a proxy for ethnic conflict, which can produce political instability and, in extreme cases, outright civil conflict (Mauro, 1995).

As regards religious minorities, the evidence paints a different picture. The general result is that religious diversity, measured as a fractionalisation index, has no effect on economic growth or quality of government (Barro 1997a, 1997b; Tavares & Wacziarg, 2001; Collier & Hoeffler, 2004; Alesina, Devleeschauwer, Easterly, Kurlat, & Wacziarg, 2003). The determining factor is whether the presence of religious minorities is accompanied by ethnic fractionalisation, since the evidence is unequivocal that social polarisation has a negative effect on growth.

Overall, the effects of the presence of ethnic and religious minorities in a society depends on the degree of economic freedom it awards its minority groups. Fractionalisation, be it ethnic or religious, increases poverty levels and the unequal distribution of income. Countries blighted by such conditions often also exhibit features of “diseconomies”: chief among these are excessive savings rates (which lower private investment rates), natural resource abundance accompanied by corruption and/or rent-seeking, and competitive sectarian social dynamics that harm public welfare (Kim, 2014). For example, in Vietnam, 55 per cent of ethnic minority groups work in agriculture, as opposed to 30 per cent of ethnic majority groups. Two-thirds of the earnings differentials between ethnic groups in Vietnam can be attributed to differences in endowments, the rest due to differences in the returns to endowments. Ethnic minority children in Vietnam are more likely to drop out of school in order to seek work than ethnic majority children (Dang, 2008).

3.2 Cross-border trade

The presence of ethnic minorities in foreign countries influences their host country's trade patterns. In general, the link between migration and trade is positive, suggesting a complementary relationship (Akkoyunlu & Siliverstovs, 2009; Ghatak, Silaghi, & Daly, 2009; Girma & Yu, 2002; Wagner, Head, & Ries, 2002). Studies on immigrant networks show that whereas the type and scope of entrepreneurial activities differ among immigrant groups and destination countries, ethnic immigrants can find or create trading niches to fill with their labour (Light, 1985; Light & Bonacich, 1988). For instance, Min (1990) surveyed Korean immigrants in Los Angeles and found that the most frequent occupation of Korean immigrant entrepreneurs is import-export trading activities with Korea, mainly in fashion goods. Min writes:

Korean exports to the U.S. have substantially increased since the early 1970s, when a massive influx of Koreans to the U.S. started. By virtue of the advantages associated with their language and ethnic background, Korean immigrants have been able to establish import businesses dealing in Korean-imported merchandise.

A look at other minorities confirms the effect. In a nod to the case of ethnic Chinese networks, for instance, trade premia between pairs of countries hosting populous communities are called the "Chinatown effect" (Rauch & Trindade, 2002). Other studies point to higher trade flows between the United States and United Kingdom and the origin countries of different ethnic minorities (Bardhan & Guhathakurta, 2004). This effect can be nuanced. Bilateral ethnic trade links appear to be stronger when the origin country suffers from higher levels of corruption (which creates higher barriers to bilateral trade for non-members of the ethnic group in question, and correspondingly creates entrepreneurial openings for minorities who move from such countries but retain links there). Ethnic community trade connections are less important if the minority's origin country is English- or Spanish-speaking, presumably because strong trade links with such origin countries already exist, regardless of the presence of ethnic minorities in the destination country (Dunlevy, 2006).

Two distinct driving channels

Immigrants affect trade through two channels: they bring with them a preference for home-country products, and they benefit from foreign (origin) market information as well as social networks in their former home countries. The former suggests that immigrants' consumption of their preferred home-country products increases the host country's imports of these goods, whereas the latter implies higher export and import flows between host and destination countries due to a decrease in the transaction costs that are associated with obtaining foreign market information and establishing trade relationships. The two impact channels through which ethnic minorities influence cross-border trade, then, are:

- **Information channel:** knowledge spillovers and reduced informational costs stimulate exports from migrant host countries to migrant origin countries (Gould, 1994). Transnational ethnic networks mitigate informal barriers to bilateral trade by facilitating informational exchanges between members of the same ethnic community concerning levels of demand for particular products / services, business and legal

customs in host / origin nations, and by instilling mutual confidence in direct person-to-person trade (Bandyopadhyay, Coughlin, & Wall, 2008).

- **Preference channel:** consumption preferences of migrants change the composition of import flows into host country (McLeod, 1990).

The empirical evidence confirms the existence of a robust effect through both channels. In an early contribution, Gould (1994) found that a 10 per cent increase in immigrants to the United States increases US exports to the country of origin by 4.7 per cent and US imports from the country of origin by 8.3 per cent. This suggests that the preference channel – immigrant preferences for home-country products – plays an outsized role relative to the information channel. Small groups of immigrants in a host country can exhaust most of the export effects from the host country to the origin country; at low levels of immigration, the elasticity of trade to migration is high, diminishing as immigration levels increase (Egger, Ehrlich, & Nelson, 2012). By contrast, a relatively large community of migrants is required before effects on trade flows from the origin country to the host country are exhausted in the preference channel (Gould, 1994).

Not all goods are equally affected by the trade impact of ethnic networks. Bettin and Lo Turco (2012) find that the presence of ethnic migrant minorities stimulates the import of primary and final goods from the origin country to the host country (i.e. the preference channel), and the export of differentiated, low-elasticity substitution goods from the host country to the origin country (i.e. the information channel). In addition, they find that the presence of migrants from developing countries in advanced economies enhances exports of labour-intensive goods to their origin countries, suggesting a third channel through which minorities influence cross-border trade: a technology channel. Bettin and Lo Turco (2012) propose that migrant employees in Western manufacturing firms can lower the information costs for firm owners by establishing contacts in migrants' origin countries, facilitating the cross-border exchange of goods between the developed and the developing world. This creates export opportunities for firms in advanced economies and can provide previously inaccessible products to consumers in emerging markets. Rauch and Trindade (2002) show that ethnic Chinese networks contribute to increased bilateral trade flows – an effect most pronounced for differentiated products (as opposed to homogeneous ones). Differentiated low elasticity of substitution sectors are most affected by trade barriers (Chaney, 2008); as a result, these sectors benefit most from the reduction in search costs associated with matching potential trading partners, thanks to the presence of immigrants. In this technology channel, then, bilateral trade in differentiated goods between developed and emerging economies is positively influenced by the stock of migrants from developing countries, and the magnitude of this effect is bigger for exports than for imports (Bettin & Lo Turco, 2012).

Box 1: International trade and migration in economic theory

Formal economic theory has approached ethnic diversity from the perspective of human capital movement, its drivers and the effects on a range of outcomes, including international trade. Textbook models of trade such as Heckscher-Ohlin provide a simple conceptual framework for the relationship between commodity and factor movements: trade is the product of differentials in relative returns to production factors, both of which interrelate closely with factor movements (e.g. of human capital) across borders (see Ohlin, 1991). International trade and migration are treated as substitutes in that setting; and since barriers to the free movement of people are generally more pronounced than those for commodities, that is indeed the view that dominates to date. Theoretically, however, the relationship could go both ways, depending on the relative scarcity of labour in the source and destination countries. A movement of labour away from a labour-scarce into a labour-abundant country is only expected to contribute to more trade. But even if labour is balanced across countries, Markusen (1983) showed in his so-called Specific Factors model (a close theoretical variant to the Heckscher-Ohlin model) that trade and factor movements can complement each other on the basis of human capital externalities or industry-specific economies of scale. In this view, diversity boosts trade levels through the commercial benefits brought by ethnic networks: such networks generate positive externalities.

Shifting angles is also informative. Ethnic diversity stands to boost trade, and trade stands to improve the lives of minorities substantially. Textbook models of trade such as Heckscher-Ohlin and Specific Factors yield standard predictions about this (see Box 1): wages of skilled groups and occupations in trade-intensive sectors stand to gain a great deal from openness. Heterogeneous patterns at the level of firms point to conclusions in the same direction. Exporting firms not only rely on the skills of ethnically diverse populations (Parrotta, Pozzoli, & Sala, 2014); they also offer higher wages and better employment (see Bernard & Jensen, 1999), ultimately helping to improve standards of living for immigrants engaging in such industries.

These effects are also discernible at the aggregate level. In a rare study discussing income redistribution among ethnicities, Saaria, Dietzenbacher, and Losd (2015) identify export growth as the prime driving factor behind rising incomes of ethnic minorities in Malaysia. In an ethnically diverse society experiencing large disparities in opportunities for social mobility, such as Malaysia, it is hardly surprising that minorities turn to markets abroad for commercial opportunities. Global ethnic networks help widen access to world markets. Given the fact that segregation does exist to a varying extent in most countries hosting minorities, the opportunity presented by international trade in empowering minority populations is likely important universally, despite its relatively neglected status as an instrument for minority advancement to date.

Network effects are not automatic

There must be a certain number of immigrants in order for cross-country networks and other trade effects to materialise (Rauch, 1999, 2001). Coughlin and Wall (2011) suggest that ethnic networks increase levels of trade (i.e. the intensive margin) but are not a necessary criterion for the existence of trade (i.e. extensive margin). Information is just one of a range of barriers to entry into overseas markets, and the presence of ethnic minorities alone does not lead to market entry, though it can deepen existing links. Saxenian (1999) shows that a transnational community of Indian engineers has facilitated outsourcing of software development from Silicon Valley to regions such as Bangalore and Hyderabad. The role of network effects in the trade patterns of ethnic and religious

minorities is linked to the phenomenon of trade diasporas and their role in overcoming barriers to trade. Determining the relative importance of contract enforcement versus informational barriers is especially important, since they point to quite different areas of concern for policymakers.

Trade effects pertaining to contract enforcement and cross-border levels of trust may be less reliant on ethnic networks than on institutional developments such as international commercial arbitration and improving communication technology. That said, the increased share of differentiated products in international trade, increased levels of migration and increasing levels of foreign investment all point towards the growing importance of cross-border network effects. The impact of the internet and e-commerce on such effects is not fully understood yet; to the extent that the internet disseminates information but impedes understanding, ethnic network effects may become more valuable in terms of facilitating trade in the future, with the possible downside risk of greater interethnic strife due to increasing societal polarisation aided by the internet.

The key to emphasising the positive trade effects of ethnic networks is ensuring that a) network members are reliant, trustworthy and law-abiding, b) networks link the “right” countries with trade-complementary economic endowments, making them trade-enhancing rather than trade-diverting, c) networks are open rather than closed to new members. Domestic network effects may be efficiency-enhancing while impeding international trade by creating informal barriers, such as facilitating collusion to restrict the market access of foreign firms – as has been documented in large co-ethnic networks of business groups such as the Japanese *keiretsu* or the Korean *chaebol*; see Lawrence (1993) and Saxonhouse (1993).

4 Policy implications and concluding remarks

There are two key policy concerns emanating from the above literature overview. The first relates to ameliorating the potential negative consequences of ethnic diversity on matters relating to the economic fecundity of societies. The objective is many-sided: minorities need to be woven into the fabric of society in order to minimise enclave dynamics, prevent persistent gaps in income levels from taking hold and mitigate the risk of social conflict. The second policy concern is more forward-looking; it relates to harnessing the potential of ethnic diversity to support growth and trade. Policymakers recognise the importance of integrating diverse ethnicities to fully reap the benefits of diversity (Dustmann, 1996), although approaches to that end vary substantially around the globe.

Both of these concerns are extremely relevant and timely in light of the ongoing wave of refugees fleeing conflict zones around the world. The short-run integration of newly settled populations in different parts of Europe, as well as their medium to long-run economic success, is likely going to become a crucial issue for the political future of the European Union.²

2 On the social integration of ethnic minorities into the EU labour market, see the EU Commission report by Süßmuth et al. (2007).

Several recommendations stand out in the discussion of these concerns. First, we argue that governments can unleash the economic potential of diversity early enough by tackling exogenous drivers of enclave dynamics among ethnic groups and new settlers. Low generalised levels of trust, the lack of opportunities in the labour and housing markets, and various types of discrimination exacerbate minorities' biases towards trade within their own clan, ethnicity, religion or family. Obstacles to social trust between minorities and majorities posed by cultural impediments are harder to tackle but arguably critical, given the inverse correlation between societal polarisation and economic growth. The rest of these frictions to successful integration are critically influenced by government action. The treatment of minorities and ethnic groups varies substantially across countries (see Organisation for Economic Co-operation and Development, 2013; Froy & Pyne, 2011), and the scope for governmental intervention in these areas is significant in an equally large number of countries. Whether it be through anti-discriminatory legislation, affirmative action or interventions to provide equal opportunities, governments need to set targets and eliminate those conditions that sustain segregation. The right mix and intensity of instruments is a matter of context and deliberation, although the action itself is not.

Second, we argue that governments need to invest in linkages of ethnic populations with their home countries as a matter of strategic priority. The cross-border trade potential that comes with diversity is probably the neglected factor that stands to make the greatest difference, both for the host countries and for the well-being of the immigrants themselves in the longer run. Broadly speaking, ethnic diversity is best handled by inclusive knowledge-economies, which are built on the recognition that knowledge and ideas are key drivers of prosperity and growth. Arguably, a free / trade-based economy that is accompanied by reduced levels of conflict (internal and cross-border) and lower poverty levels deals well with diversity of any sort (Kim, 2014). Elevating the economic capacity of people to trade may, in the long run, make it possible to convert ethnic heterogeneity from an impediment to economic growth into an advantage (Snodgrass, 1995). Particularly relevant to that end are instruments of export capacity-building targeting small and medium-sized enterprises and services industries; building relevant skills; and credit availability for small businesses.

Third, a systematic projection of the economic effects of the movement of people and diversity stands to make a great difference in the success of government policies in this area. The information needs in that respect are fundamental and go far deeper than systematic analytical work. In fact, there are persistent gaps in data on ethnicity and minority status but also discriminatory practices across countries – high-income countries included (see Simon, Piche, & Gagnon, 2015, for a recent account). Moreover, despite the wide recognition of the value of evidence-based policymaking, efforts to enhance the evidentiary basis in the area of minority integration is often met with resistance. Sentiments of deepening divisions around ethnicity can be found in every effort to map intra-national clusters, which – again – is not particular to developing countries.³ Although an effort is being made to overcome these fears and collect information systematically, the analytical work that would help guide policies remains scarce and sporadic.

3 See, e.g., debates in France on “Engagement républicain contre les discriminations”, published in *Libération*, 23 February 2007, and “Statistiques contre discriminations”, published in *Le Monde*, 13 March 2007.

Fourth, both monitoring and policy design are more successful when governments coordinate with each other to achieve common overarching objectives. Distinct patterns of economic behaviour among ethnic groups that inhibit growth are rooted in failures that are often country-specific, where international advice and scrutiny can help. Better management of the movement of people itself is also crucially dependent on international coordination. The recent European experience of receiving and accommodating displaced populations has demonstrated how challenging the objective of international coordination in these matters is.

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