


## Chapter 10

# Investigating the Effect of Diplomatic Representation on Trade: A Case Study of Croatia

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### ABSTRACT

*Economic diplomacy is an unavoidable tool for improving economic standards, and it needs to be an important instrument for policy makers in stimulating international trade and supporting domestic firms. This chapter analyses the impact of economic diplomacy on bilateral trade flows in Croatia in the period from 1992 to 2017. The authors use an applied gravity model of trade by employing fixed effects model (FE), random effects model (RE), and pseudo Poisson maximum likelihood (PPML) estimator. PPML estimator takes into count zero trade flows because estimating zero trade flows with OLS estimator could lead to several biases. The problem of dependence between diplomacy representatives was solved by constructing individual regressions using FE model and PPML estimator. The hypothesis of the chapter, which was tested, states that diplomatic representation has had positive and significant effects on bilateral trade flows (imports and exports) of Croatia. The results of the analysis have shown that the diplomatic representation via embassies and consulates is a relevant trade and trade-enhancing factor.*

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## INTRODUCTION

How important economic diplomacy representatives are for promoting trade? What is the impact of embassies and consulates on trade flows? This chapter tries to answer the aforementioned questions. Economic diplomacy can be defined as the use of government relations and government influence to stimulate international trade, Bergeijk and Moons (2011:3). Economic diplomacy is hereby directed to open markets, use bilateral relations to help domestic companies, stimulate cross border activities and boosting exports. Diplomatic relationship between can take form of state visits, Nitsch (2007), trade missions, embassies and consulates which are significant determinant of bilateral trade flows and foreign direct investment (FDI) (Rose, 2008, Head and Ries, 2010, Yakop and Bergeijk, 2011). The investigations on this important topic have been scarce so far, Mlinarić, Perić and Matejaš (2019). There are many intercorrelated activities which have impact on country development, Jošić and Mlinarić (2018) but micro and macro influence of economic diplomacy cannot neglected anyone in the world, Mlinarić, Perić and Matejaš (2019). Croatia is aware of economic diplomacy importance but still needs medium and long term strategy. Missing strategy needs to be accomplished in short run horizon and it is condition sine qua non for Croatian economic development. There is no doubt that economic diplomacy represent the utilization of all economic instruments in furtherance of the state interest when dealing with other states, multinational companies, international institutions like NGOs and other, Mlinarić (2018). The aim of this chapter is to investigate the impact of economic diplomacy on bilateral trade flows in Croatia. More specifically, we wanted to see how would the establishment of an additional embassy or consulate affect bilateral trade flows between Croatia and diplomatic trade partner countries. The analysis is conducted by employing gravity model of trade using OLS, fixed effects (FE), random effects (RE) and PPML specification, which is highly recommended in the case of zero trade flows. The contribution of the chapter can be seen in constructing the complete time series of data observed in the period from the year 1992 to 2017 which was somewhat hard to obtain. This is improvement in regards to the most of other comparable studies on effects of economic diplomacy on trade where data were organised and structured in a 5-year intervals (for example Correlates of the war database, Bayer 2006) or only for one or few chosen years. Economic diplomacy is represented by foreign missions (embassies and consulates) for Croatia. The hypothesis is a positive interdependence between economic diplomacy and bilateral trade flows, which is in line with previous studies in this field. There are also cultural issues of diplomacy due to the Croatian tradition. This is because Croatia import-export evaluation is very close to political strategies, often criticized with the absence of clearly stated export policies and national economic weaknesses. Cultural effects will not be a part of this research.

Chapter is structured in six chapters. After the introduction, second chapter elaborates on and presents an overview of studies related to the impact of economic diplomacy representatives on trade. In the third chapter the facts about the historical background and establishment of bilateral diplomatic relations is explained. Also, the number of foreign missions and staff in Croatia and Croatia' diplomatic missions abroad is displayed and explained. In the fourth chapter data and methodology are presented while the most important results of the analysis are shown in the fifth chapter. Final chapter explains limitations of the analysis, proposes policy recommendations and gives suggestions for future research.

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