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Making sense of Bolkestein-bashing: Trade liberalization under segmented labor markets ☆

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Abstract

An increase in the range of tradable goods is analyzed in a two-country Dornbusch–Fischer–Samuelson style model, where labor cannot relocate to another sector upon a non-expected increase in the range of goods that can be traded.

The effect of liberalization on the terms of trade tend to favor the poorer country (the "East"), if (as assumed) the most sophisticated goods are tradable before reform. Second, under ex-post liberalization, there exists a class of workers in the West who are harmed because they face competition from Eastern workers and cannot relocate to other activities. But if the East's economy is relatively small, their wage losses are not very large. Things are different, however, if there exist asymmetries in labor market institutions, such that upon reform, labor can relocate in the East but not in the West. Some workers in the West can then experience very large wage losses. Thus, rigid labor markets in the West magnify opposition to reform there.

Keywords: Trade liberalization; European integration; Bolkestein directive; Labor mobility; Labor market institutions; Comparative advantage; Terms of trade

JEL classification: F16; F11; F13

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1. Introduction

Trade liberalization is often met with sharp opposition. Recent examples include concern about a sharp increase in textile imports from China into the European Union (following the phasing out of the multi-fiber agreement (MFA)), as well as complaints in France and other EU countries against the so-called “Bolkestein” directive, which allows service providers from a given EU member to temporarily work in another member country, under the regulatory regime prevailing in the source country. Thus, a Polish plumber or hairdresser could freely offer his services in France, while not being bound by French labor law and other local regulations, provided his stay is short enough. One way to view such a reform is that it simply widens the range of goods that are tradable: haircuts and plumbing services can now be purchased “in Poland”, with the twist that the worker performing the service has to be moved to France, and then back to Poland, which is a particular form of transportation cost.

While part of the complaints have to do with the fact that French labor laws impose a tax on labor which is higher than in Poland, the bottomline is that Polish wages are a third of French wages (they would thus remain much lower even with similar labor market regulations), so that French plumbers and hairdressers simply feel they are going to disappear. Similar concerns are voiced about textile jobs disappearing because of Chinese imports, or offshoring to India of services such as call centers or consumer banking.

Economists usually interpret resistance to such reforms through the lens of the Stolper–Samuelson theorem. It says that the return to the relatively scarce factor is bound to fall when an economy opens to trade, so that if compensatory transfers are not feasible, some social groups would oppose liberalization.

The problem with this view is that one then has to conceive of French hair-dressers as part of a larger group, the “unskilled”, who, if scarce relative to the East, suffer of any trade intensive in unskilled labor. Thus, there is no reason why French hairdressers should complain more about Polish hairdressers than about, say, Polish textiles, or indeed about competitions from the millions of unskilled unemployed in the French labor market. Furthermore, if there are only a few skill categories, then trade in just that number of goods is enough to bring about factor price equalization. Further increases in the range of tradable goods should not have any additional harmful effects on the scarce factor, while it can bring beneficial effects if there are increasing returns to scale.[1]

One way to solve this paradox is to think about resistance to reform in terms of a segmented labor market where moving between occupations is costly. If labor markets were perfect, any adverse effect of liberalization in haircuts would be diluted in the form of a lower unskilled wage in the economy, and would not be particularly concentrated on hairdressers. However, if labor markets are segmented, in that moving to an occupation is difficult (at least in the short run), then each occupation becomes a different kind of labor input, and it is conceivable that liberalizing trade in haircuts would have large adverse effects on French hairdressers, who are prevented from relocating to other occupations. These, in turn, are sheltered from the downward pressure on unskilled wages exerted by the reform. Thus, labor rigidities concentrate losses upon the occupations that are liberalized.

One may add that regulatory entry barriers play an important role in generating labor market segmentation. These barriers are well documented. For the French case, for example, a number of them are reported by Cahuc and Kramarz (2004). For example, a lot of professions (hairdressers,

[1] Such effects, well understood since Helpman and Krugman (1985), are left out of our analysis here.