

Cross-border provision of labour services and local labour markets: A spatial CGE analysis

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Extended abstract

The free movement of workers and citizens is one of the four fundamental freedoms championed by the European Union within its borders, together with the free movement of goods, capital and services. Nevertheless, it is well known that labour mobility within the EU remains relatively limited when compared to internal country mobility or to the US. To a lesser extent, the same holds true for trade in goods and services and cross-border investments, where national frontiers still play a role in shaping overall patterns.

In an attempt to foster labour and service mobility to reap the benefits associated with a larger internal market, EU Member States agreed in 1996 to introduce regulation that allows for cross-border provision of labour services. There are essentially three variants of cross-border provision: the direct provision of services between two companies under a service contract; exchange of labour services in the context of an establishment or company belonging to the same group; and hiring a worker via a temporary work agency established in another Member State. Through this system, individuals from one member state can work in another member state for a limited period of time, while continuing to pay social contributions (during 24 months) and labour taxes (during 183 days) in their country of origin. The regulation stipulates minimum level of conditions under which employment takes place, pertaining to minimum rates of pay, rest periods, and maximum worktime and overtime periods; as well as provisions of non-discrimination, conditions regarding health and safety etc.

As such, the system aims to strike a balance between fostering mobility and preserving worker rights in the destination countries. Nevertheless, different actors have voiced concerns regarding the system, and more so over recent years, as the number of foreign temporarily contracted workers has steadily increased and now represents a non-negligible share of employment in specific sectors and member states.

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In this paper, we use a spatial CGE model¹ covering all EU NUTS2 regions and 5 NACE2 sectors to perform a simulation outlining the likely socio-economic outcome from changes to the regulation of cross-border provision of labour services. Following its national account treatment, the cross-border provision of labour through the system of temporary contracts is modelled as trade in services. This means that internationally mobile workers are assumed to export a service from their country of origin to their country of actual working residence, although in reality, however, physical labour is almost exclusively supplied in the latter. We account for cross-border provision of low- and high-skilled labour services, the latter providing labour services to the business services sector and the former providing labour services to the manufacturing and construction sector. This stylised representation of the phenomenon allows us not only to keep the model tractable, but also to keep track of direct and indirect effects of policy changes on labour types and sectors not involved in the cross-border exchange of labour services in the model. Technically, we capture the international mobility of labour through the system of temporary contracts in the model by introducing two additional sectors in the sending region. One of the two additional sectors uses low-skilled labour as its only input, and produces a tradeable output which is used as an intermediate input in the manufacturing and construction sector in the receiving countries (regions). This tradeable intermediate input embeds the labour services of the temporary employed foreign workers. It enters the production function of the construction sector as a CES-subnest, where it acts as a substitute for local low-skilled labour. We take 12 as the elasticity of substitution between the local low-skilled workers and the imported labour services, midway in the range of values found in the empirical literature² The second of the two additional sectors uses high-skilled labour as its only input, and produces a tradeable output which is used as an intermediate input in the business service sector in the receiving countries (regions). The elasticity of substitution between the local high-skilled workers and the imported labour services is also set to 12. Modelling the international mobility of labour through the system of temporary contracts as trade in services has the additional advantage of being consistent with the treatment in the national accounts: the value added (wages) created (earned) by these workers is counted in the sending country GDP. The ‘trade’ in services is assumed to be costless to account for the fact that temporary employed foreign workers are physically located in the destination of their exports. This feature creates an important difference in the model between exports of services produced in EU regions by local workers and exports of labour services by workers temporarily employed abroad. For example, a German business service provider selling its services to a Czech firm would incur a trade cost, whereas a German worker temporarily employed in the Czech Republic providing a similar business service would not, which can be interpreted as a gain in efficiency for the system due to the reduction of physical and cultural distance between the provider and the customer of

¹We take outset in Mercenier et al. (2016) and extend the model to allow for cross-border provision of labour services

²We take 12 as a compromise between the value of 20 found by D’Amuri et al. (2010) for Germany, and 7.8 as found by Manacorda et al. (2012) for the UK. Whereas some studies have found differences in substitutability between natives and immigrants depending on the level of education Ottaviano and Peri (2012), the previously mentioned studies have not, and we ignore this differentiation for this analysis.

the service.³

Taking outset in the data and work of Pacolet and De Wispelaere (2014) we impute the net flows of temporarily employed workers.⁴

We consider two scenarios, outlining socio-economic territorial impact in the short and long run: first, we estimate the impact of the existing system by comparing it to the hypothetical situation where it would be abolished. Second, we consider a reform scenario capturing the idea of further homogenisation in the working conditions between local and temporary employed foreign workers, modelled as a reduction in the wage gap between the receiving country's workers and temporarily employed foreign workers.

A clear indication that emerges from our analysis is that a full abolition of the system would have negative economic consequences for the Union as a whole and for both new and old Member States. More nuanced results emerge from the analysis of a policy aimed at closing the gap in labour remuneration between local and temporarily employed foreign workers. There we can see a potentially positive effect for the overall EU, even though admittedly very small in size. However, the spatial distribution of winners and losers from such a policy would not be as clear-cut as sometimes assumed in policy debates and it would also vary from the short to the long run. Old member states (EU15) would indeed gain employment and GDP for a few years at the expense of new ones (EU13), but as the local labour market adapt to the new conditions and the interaction between changes in external competitiveness and product market integration kicks in, there is a reversal in outcomes and new members states end up with higher levels of income, employment and salaries than in the baseline thanks to gains in competitiveness.

It should be noted, however, that the economic impacts of the second simulated scenario, which aims to limit the wage gap, are so small that it can be considered negligible, as the local impacts of restrictions in factor mobility are offset by trade of the goods produced by the same factors located in different areas.

References

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³Notice, however, that the analogy is not perfect because the business service provided by the worker temporarily employed abroad is modelled as a substitute for a factor input, labour, whereas the standard business service purchase is modelled as intermediate consumption, so the two services are not directly comparable and have are characterised by different substitution parameters.

⁴Pacolet and De Wispelaere collected data on the number of 'portable documents A1' (PDA1) which have been issued by the countries of origin. These documents are used to prove that a person pays social contributions in another country, and exempts her temporarily to pay social contributions in the member state of destination. There exists proof that some people delay or forget requesting this document before starting to work abroad. On the other hand, people may apply for multiple PDA1 in one year. The number of PDA1 therefore should be seen as an approximation to actual number of active workers employed abroad under the system of temporarily employment contracts.

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