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# Services Provision and Temporary Mobility: Freedom and Regulation in the EU

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# Services Provision and Temporary Mobility: Freedoms and Regulation in the EU

Giuseppe Bertola and Lorenza Mola\*

## Abstract

International posting of workers and mobility of self-employed service suppliers lie between outright migration and trade in goods: their regulation, for both distributional and market-correcting purposes, is not as difficult to harmonize as that of labour markets, but personal mobility is more visible and socially intrusive than product market interactions. This paper analyzes economic and legal tensions between national regulatory frameworks and international competition in these areas, in both the intra-EU and global contexts, highlighting how interactions between the external and internal roles of the European Commission may foster efficient integration of markets and policies in this and other fields.

**Keywords:** Economic integration, Trade in services, GATS, European Union, Labour regulation, Services regulation, Harmonization, Posted workers

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# Services Provision and Temporary Mobility: Freedoms and Regulation in the EU

## 1. Introduction

Services trade liberalization is slow and difficult in both the European and global trade liberalization processes. The relevant policy tensions are tightly related to each other: since the European Union (EU) is based on a structure of more or less complete internal freedoms and external policy frameworks, trade patterns are shaped by the evolving interplay of rules at the national, EU, and global levels.<sup>1</sup>

The Bolkenstein directive proposal aimed at completion of a European Single Market to include services, but was opposed in first reading by the European Parliament in early 2006.<sup>2</sup> Opposition to it came mostly from left-wing portions of the political spectrum, and from relatively rich countries. The original directive proposal relied radically on country-of-origin principle for the free movement of services. Only removal of that principle allowed a new draft of the Directive, featuring a very long list of exceptions to the basic freedom to provide services throughout the EU, to be finally approved by the Parliament and adopted jointly with the Council in late 2006.<sup>3</sup>

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<sup>1</sup> An earlier discussion of relevant insights can be found in Lavenex's (2000) analysis of links between international WTO negotiations and European integration in the area of trade in services. We focus on the EU: Fink and Jansen (2009), and Hoekman et al. (2007) offer a related analysis focused on the multilateral/regional integration contexts.

<sup>2</sup> European Commission, Proposal for a Directive of the European Parliament and of the Council on services in the internal market, 13 January, 2004, COM (2004) 2. See Vogt (2005) for a summary of the proposal's provisions and a characterization of the European Parliament's debate.

<sup>3</sup> Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, *OJ L* 376, 27 December, 2006, p. 36–68.

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Imperfect integration in the services area implies that external policies have to be chosen and implemented mainly by individual EU member countries, rather than by the Union as a whole. Services trade liberalization is also highly controversial in the global context.<sup>4</sup> At the same time as the Bolkenstein Directive encountered formidable obstacles in the EU co-decision process, the Doha Round of trade negotiations was stuck on issues involving not only agricultural market liberalization, but also services market access. At the Hong Kong Ministerial Conference of the WTO (Doha Work Programme, Ministerial declaration, adopted on 18 December 2005, WT/MIN (05)/DEC), developing countries expressed fears of foreign dominance should their (public) services be opened to competition, while their citizens' rights to enter developed countries for the purpose of providing services remained subject to restrictive temporary-work-permit and visa policies.<sup>5</sup>

Controversy about trade liberalization is not unusual, of course. Economic integration fosters efficiency of competitive market interactions, but markets are not always perfectly competitive. At the same time as trade becomes increasingly free across countries, within each country economic activity remains subject to tax and regulation policies meant to offset market imperfections and to influence the distribution of economic welfare. The eight rounds of multilateral trade-in-goods liberalization in the GATT/WTO era and the long path of European economic integration both needed to surmount opposition, reconciling vast differences of opinion and conflicts of interest. In areas where regulation is pervasive, policy harmonization is necessary to achieve economic integration. Full liberalization of trade in goods entailed not only removal of all tariffs and quotas, but also harmonization (or mutual recognition) of technical requirements. While services trade barriers are all the more striking as most goods trade is now free, liberalization of trade in services may be perceived to be tantamount to deregulation, and is not an

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<sup>4</sup> See Hufbauer and Stephenson (2007), and Jara and del Carmen Domínguez(2006) for a review of the relevant negotiations.

<sup>5</sup> The Indian Union Minister of Commerce and Industry, questioning US policymakers' attitudes towards use of H1B visa by Indian IT companies, pointed out that "while India continues to liberalise its services economy, it expects at least equal movement from important trading partners like the US in areas of our interest like Mode-4" (Shri Kamal Nath, <http://pib.nic.in/release/release.asp?relid=27999>).

appealing policy proposition in countries that – for a variety of reasons – do extensively regulate their services industries.<sup>6</sup>

This paper reviews legislative developments and policy issues in this area, highlighting, on the one hand, legal interactions between lack of intra-EU integration and regulation of external access to EU markets by third-countries providers and, on the other, the peculiarities of forms of economic integration involving personal mobility. Services trade is in this respect similar to immigration into labour markets, and it proves helpful to also analyze similar issues arising in the context of temporary mobility on posting basis. This is regulated at the EU level through the Posted Workers Directive,<sup>7</sup> according to which host Member States must ensure that the undertakings guarantee workers posted to their territory the terms and conditions of employment laid down by their law and/or by collective agreements universally applicable to their relevant labour market.

We discuss below how that legislation was rooted in tensions arising in the early 1990s, upon completion of the Single Market. It is interesting to note here that similar tensions are present in the current crisis context. In February 2009, deteriorating labor market conditions prompted British workers to resent the presence of Italian posted workers at a refinery site, causing a flurry of media and policy attention to the economic and legal issues we study in this paper (*Financial Times*, 2009), and inducing the European Commission to include a review of worker-posting issues among its *Driving the European recovery* guidelines.<sup>8</sup> As we discuss below, entitling

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<sup>6</sup> See Monti (2003) for a discussion of the issues involved.

<sup>7</sup> Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, *OJ L 18*, 21.1.1997, p. 1–6.

<sup>8</sup> The European Commission, in its Communication for the spring European Council -Driving European recovery - Volume 1 , COM(2009) 114 final, Brussels, 4 March 2009, sets among its goals:

Ensuring the free movement of workers within the Single Market which will be the source of new opportunities. It can help address the persistence of mismatches between skills and labour market needs, even during the downturn. In this context, the Posted Workers Directive serves to facilitate free movement of workers in the context of crossborder provision of services, whilst effectively safeguarding against social dumping. The Commission will work with the Member States and Social Partners on a shared interpretation of the Directive to ensure that its practical application - in particular administrative cooperation between Member States - works as intended.).

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posted workers to local rights hampers integration and reduces international competition. But the protection afforded by labour market regulation is valuable in times of crisis, and is weaker in Britain than in countries where binding collective agreement coverage allows the Posted Workers Directive to reduce the intensity of international wage competition.

## 2. Market Integration and Policy Harmonisation

When markets do not deliver politically acceptable outcomes, economic integration is restrained by concerns about the feasibility of redistribution policies and regulatory policies. Tensions arise from the fact that economic integration has implications for income distribution: removal of barriers to trade and factor mobility allows poor countries' citizens to compete with the relatively poor citizens of rich countries, and rich countries' relatively rich citizens to earn higher returns from investment of their wealth in poor countries. The resulting higher inequality in rich countries increases the costs of redistribution policies, and more generally of government interventions addressing financial markets' inability to provide suitable protection against the risk of poverty and of income fluctuations.

By making it easier for private market interactions to work around legal constraints, integration may more generally make it difficult for governments to enforce regulation in fields where *laissez faire* competition does not suffice to achieve efficiency. For example, asymmetric information problems that prevent markets from providing high-quality services. Just like social policies, regulation meant to address such problems is endangered by a 'race to the bottom' if integration of markets is not accompanied by integration of regulatory frameworks. Allowing markets to be larger and more powerful improves welfare when markets work well, but can certainly lower welfare when market outcomes are not optimal.

The tension between economic and policy integration has different intensity in different contexts. For example, concerns about redistribution policies are not as

strong when economic integration occurs across countries with similar levels of development and factor endowments – such as the original Community members – as they are when trade is liberalized between countries at widely different levels of development. But policy concerns also depend on the structure of markets. As removal of international barriers strengthens competitive forces, its impact on market efficiency and income distribution depends on whether market imperfections are due to barriers to entry or to scarce and asymmetric information. Market integration may be opposed by producers who enjoy monopoly rents but, to the extent that regulation is made more difficult by international trade opportunities, also by consumers concerned with product quality. This perspective may imply that some markets are easier to integrate than others.

## 2.1. EU Freedoms and Legal Integration

Lack of effective policy integration has predictable consequences for the extent of feasible economic integration, and for the allocation of external policy-making powers at the supranational, Community level, across the EU's four internal freedoms of mobility: for goods, capital, services (and freedom of establishment), persons.<sup>9</sup>

Concerns about market imperfections are certainly relevant to trade in such goods as medical drugs. In the EU, to achieve a very high degree of goods market integration it was essential to achieve integration of markets' legal frameworks, including those relevant to third-country trade. It used to be the case that cars required yellow headlights to be registered in France and headlight sweepers to be registered in Sweden. To some extent, such rules were meant to segment markets, acting as implicit barriers to trade, and could in theory be simply repealed simultaneously in all countries. Many aspects of technical specifications are meant to enforce safety standards in matters too difficult for individual customers to judge, however, and

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<sup>9</sup> See more specifically Oliver (1999) and Snell (2002) for a technical discussion of EU legal integration modes in the fields of goods and services.

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needed to be harmonized. Removal of internal barriers to trade in goods also required a common EU position in external negotiations concerning tariffs and third-country products' access to the single internal market.

Capital mobility is also essentially free, with some tensions regarding lack of harmonized capital income taxation. By contrast, labour and services markets have proved to be most difficult to integrate and liberalize in the EU. Within-EU personal mobility is much lower than in the US for institutional reasons (Finkin and Jacoby, 2004). While labour mobility is formally unrestrained, subsidiary non-harmonized policies still limit access to social infrastructure (Leibfried, 2005). This also makes it difficult to devise and implement the EU external common immigration policy envisioned since the Amsterdam Treaty. And cross-border market access in services industries remains rather heavily restrained even after the recent Services Directive (and this implies peculiarly complex external arrangements, discussed in the Section 4 below).

The differently incomplete integration across the four areas reflects the different extent to which the legal integration of regulatory policies would be necessary in theory, and is in practice made difficult by heterogeneous *status quo* policy configurations and lack of a suitable negotiation framework. The 'negative' integration process of market deregulation, meant to implement the freedoms enshrined in the European Community Treaty (ECT) and to foster competition, clashes with real or perceived needs to restrain market forces through 'positive' integration. Positive integration can take the form of supranational regulation but also of harmonization, on the basis of general requirements legislated at the supranational level, of national regulation. This has not been easy in the areas where it has taken place. As regards trade in goods, the Single Market Program did painstakingly harmonize the legislation – such as the safety- and pollution-relevant features of cars – that would have functioned as implicit barriers to trade if left untouched, and would have left markets unable to function if simply dismantled. The complex task of ensuring that legal frameworks are consistent with economic

integration, however, is most often assigned to “relative” (or contingent) rules,<sup>10</sup> such as the mutual recognition principle and the country-of-origin principle (see Graham, 2006). These, and the symmetric *ius loci* principle of ‘national treatment,’ are all meant to allow regulation to differ across countries while respectively ensuring non-discriminatory or different treatment of the covered subject, such as goods or service providers in the State of destination. The differences between them are subtle. For example, mutual recognition of qualifications binds the host country to allow market access to foreign entities only upon a specific list of certificates previously agreed as equivalent. The broader country-of-origin principle instead, if applied to service providers' own qualities, deprives the host State of the power to set the applying (equivalent) conditions, and leaves it to each home State to determine which qualifications and licenses of its nationals allow performance of services by them in both States. Thus, the country-of-origin principle requires a higher degree of mutual confidence than mutual recognition of detailed regulations that are explicitly deemed to be equivalent. Mutual recognition of technical standards, stemming from the ‘origin’ or ‘Cassis de Dijon’ principle, played an important residual role in areas of goods trade where supranational regulation would have been excessively complex, or redundant.

### 3. Personal Mobility: Posted Workers and Service Providers

Positive integration has proved difficult or impossible in very important areas. Posting of workers and trade in services through personal mobility are an interesting middle ground between (so far) relatively uncontroversial goods trade liberalization and hugely controversial immigration.

The different pace of market integration across areas of international activity arguably reflects not only the political and cultural impact of personal mobility, but

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<sup>10</sup> Ortino (2004), pp.16-30, provides a critical overview of approaches to trade liberalization.

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also the greater need for regulation of more problematic and important markets. Worker posting and service provision through personal mobility may well trigger some of the same social tensions as immigration, as shown by the British refinery case mentioned in our Introduction.<sup>11</sup> And market interactions may be hampered by a variety of imperfections (Rubalcaba, 2007), such as asymmetric information problems, that may be more relevant when personal rather than technical characteristics have to be assessed. The heterogeneity of regulatory frameworks in these areas (reviewed by Conway and Nicoletti, 2006) is perhaps not as strong as that of Welfare State configurations (see e.g. Esping-Andersen, 1990), but is certainly higher than that applicable to goods markets (even delicate ones, such as that for pharmaceutical products), and is empirically relevant to the intensity of international trade in services (Kox and Lejour, 2005).

We proceed to illustrate these general insights with a discussion of economic and legal aspects of two particularly controversial integration modes, both involving personal mobility, where conflicts between national policies and international market integration are particularly apparent and not fully resolved: the situation that led to the Posted Workers directive, and the Bolkenstein effort to achieve a single market in services.

### 3.1. Labour Markets and Economic Integration: Posted Workers

The origins and current configuration of worker posting rules in the EU (Deinert; 2000; and Houwerzijl, 2006) offer clear insights into the Community's approach towards the interaction between free movement of services mandated by the EC Treaty and national systems of social policy. In the early 1990s, implementation of Single Market public procurement rules implied that much East-German construction activity was performed by British, Portuguese, and Italian firms posting

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<sup>11</sup> Bhatnagar (2004) notes that socio-political barriers may be in the way of liberalization of worker movement, and argues that the temporary nature of service provision mobility is unlikely to have lasting social and cultural spillovers. As pointed out by Epstein, Hillman, and Weiss (1999), however, temporary work visits can easily turn into illegal permanent immigration.

workers to German construction sites, at the same time as many German construction workers were able to draw unemployment benefits of Bismarckian generosity. Clearly, integration grants both rich and poor countries new trade and specialization opportunities: East German reconstruction would of course have been much more expensive if only German labour could have been employed. Equally clearly, the German system of employment-based social insurance was ill equipped to cope with the new types of labour market risk generated by economic integration. Intuitively, generous income guarantees for domestic workers clash with competition by low-wage foreigners (see Appendix for an outline of the relevant economic arguments). As discussed in Bean et al. (1998), the German government's reaction was twofold. On the one hand, it reduced German construction workers' entitlement to unemployment benefits. On the other hand, and simultaneously, it imposed a minimum wage for construction work done on German soil (regardless of the worker's and employment contract's nationality). From the economic point of view, a minimum wage for posted workers reduces incentives to exploit gains from trade in labour services, just like a minimum price for imports is equivalent to a trade quota. Accordingly, it has negative implications for aggregate welfare across the integrated economic area, and may in fact not suffice to reduce unemployment or to increase welfare in countries where the minimum wage is binding (Meier, 2004).

From the legal point of view, the German legislation triggered a lengthy and heated controversy over the two contrasting principles of free service mobility - through posted workers, in this case -, and of employees' rights - the terms of employment law applicable to the posting situation (see Davies, 1997; and Giesen, 2003). Implementation of these two principles in the relevant context is discussed in Bertola and Mola (2008), who also highlight how ECJ case law and controversial negotiations of EC legislation have so far proved unable to resolve all tensions between principles that remain incompatible as long as labour law remains assigned to the national level of the EU legal system.

Continued controversy about posting of workers is a clear indication of tensions between national welfare systems and economic integration. Since building has to be

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performed on-site, the implications of foreign competition are more visible than in the case of, for example, relocation of automotive plants. Immigration is even more visible and excites even clearer resentment when immigrants are felt to draw on the destination country's welfare system. As the German posted workers case clearly illustrates, however, foreigners need not draw benefits themselves to trigger important consequences. When foreign competitors cause the low wages of native low-skill workers to fall below welfare benefit floors, substitution of the indigenous poor by foreigners is effectively subsidized by the taxpayers of more generous constituencies. When this is not acceptable by the destination country, attempts to restrict mobility and economic integration are the logical consequence – as in Germany in the 1990s. As mentioned in the Introduction, similar issues now arise in times of crisis even in less regulated labour markets such as Britain's.

### **3.2. Regulation and Cross-Border Provision of Services in the EU**

Conflicts between national policies and international competition also arise in the broader context of trade in services. All member countries of the EU regulate their services industries, in different ways and with different degrees of stringency, and in all countries the presence of foreign services suppliers is limited. As discussed below, regulation reduces the quantity of services offered, while perhaps increasing their quality and certainly increasing providers' income. To the extent that these effects motivate regulation, they also motivate restrictions to cross-border supply.

These theoretical relationships suggest that foreign suppliers should be fewer (as a proportion of total employment) in countries that regulate services more stringently. Some relevant information is available on temporary work permits. The data, like the permits themselves, is scarce, but available information does indicate that temporary worker mobility is related to internal regulation and to services trade integration between the sending and receiving countries.

**Figure 1** displays indicators of professional services regulation and of the presence of foreign professional. The number of permits issued in each country generally reflects both demand- and supply-side factors. In countries where the number of permits is small, attractive work opportunities for foreigners may be few, or tightly rationed. From either perspective, it is interesting and unsurprising to see a broadly negative relationship between the intensity of observed professional work inflows and the tightness of professional services regulation (with higher numbers indicating stronger restrictions to competition). In countries that more strongly restrain competition in the professional services industry, such as Italy and Germany, few foreigners are able to offer their services; looser regulation, as in Sweden or in the UK, is accompanied by larger foreign inflows. As shown in **Figure 2**, work permits (and product market regulation) are positively related to the more general Eurostat measure of services trade integration, covering also cases where services provision does not entail personal mobility. This evidence, albeit limited and noisy, does indicate that countries where markets are more heavily regulated tend to be less open to access by foreigners.

Why is internal regulation stringent and international integration limited in some countries? In the case of services, foreign competition need not tend to decrease the income of relatively poor residents of rich countries (faced, like German construction workers, by plentiful competitors from poorer countries), and policies that limit competition are not necessarily motivated by redistribution towards relatively poor domestic residents. Resistance to deregulation and integration may be motivated by protection of rich producers' income and/or of the quality of available services, either or both of which may be the victims of foreign access to domestic markets. Just as liberalization of trade in goods allows high-income individuals in rich countries to purchase goods manufactured by less developed countries' cheap labour, foreign access to low-skill (e.g. household care) service markets may improve the terms of trade for the relatively rich citizens of rich countries. In the case of high-skill professional services, however, opposition to international trade goes hand-in-hand

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with opposition to liberalization of internal markets, and reflects concerns about efficiency as well as distribution motives.<sup>12</sup>

Regulation of services may address market failures in delicate matters of health, education, and other personal services. When quality is important but difficult to assess, competition may indeed associate high quality with high prices and incomes, and producers may attract customers with signals of their self-confidence, such as luxurious premises. Combined with enforcement of minimum quality standards, high prices possibly ensure supply of high quality. Combined with barriers to entry and ceilings on the number of suppliers, however, minimum prices simply enforce monopoly power, and support the market incomes of producers.

Whether motivated by quality concerns or income distribution issues, resistance to trade in high-skill services in developed countries could be overcome by international (or supranational, within the EU) agreement on harmonized regulation. In comparison to the case of goods markets, regulation is at the same more difficult and more necessary in the case of skilled services provision.

It is more difficult, because the very pronounced heterogeneity of country-specific regulatory frameworks makes it impossible to adopt country-of-origin principles (as the first version of the Bolkenstein directive attempted to do), and a positive harmonization approach would have to deal with the fact that plumbers' skills and medical doctors' qualifications are not as easily defined as a car's safety and pollution characteristics. But harmonization is more necessary, and lack of harmonization a steeper obstacle to effective integration, because service providers' skills may be even more difficult for customers or market agencies to assess than cars' characteristics, and poor judgment can have even more severe consequences. Moreover, just like opposition to trade in manufactures, opposition to services trade liberalization has distributional and social motivations: regulation also serves purposes of income support for service providers and is more stringent in rich than in poor countries, as the latter have more pressing priorities than services quality.

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<sup>12</sup> See Paterson, Fink, Ogus et al. (2003) for a review of professional services regulation and of its economic impact in EU member countries.

These tensions were all very apparent in the controversies surrounding efforts to liberalize trade in services within the EU. In principle, restrictions to the freedom to provide services within the Community are prohibited, by requiring destination countries to treat like their nationals all service providers who are nationals of another Member State (Arts.49-50 ECT). In practice, the limited extent of liberalization reflects the way in which such prohibition has so far been implemented by Community' jurisprudence and legislation, interacting with each other and with goods trade liberalization (see Bertola and Mola, 2008, for a more detailed and technical account).

The ECJ does admit national restrictive measures which obey to overriding public interest, such as the need to ensure observance of professional rules of conduct connected, in particular, with the administration of justice and with respect for professional ethics. However, such restrictions must be objectively justified (necessary) and proportionate to achieve the imperative requirement of public interest. In these respects, the case law on freedom to provide services is rather similar to the Cassis de Dijon decision in goods trade liberalization. Implementation of restrictive measures on foreign service providers lawfully providing similar services in the Member State of establishment is generally prohibited, unless necessary and proportionate to pursue an overriding public interest.

The new Services Directive does not add much to this case law (Barnard, 2008; and De Witte, 2007).<sup>13</sup> It was the result of a compromise between the Commission's proposal and the Council, on the one side, and the Parliament, on the other side. Its coverage is limited because it does not apply to whole categories of legislation (regulation of services of general interest, of monopolies providing services, measures to protect or promote cultural, linguistic and media pluralism, criminal law, labour law and social security legislation, in Art.1) and to whole sectors of the economy (financial services, electronic communication services, transport, services of work temporary agencies, healthcare services, audiovisual services, gambling

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<sup>13</sup> The Services Directive and its original proposal are also extensively and critically analyzed by Hatzopoulos (2007) and Davies (2007).

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activities, services connected with the exercise of official authority, social services related to social housing, childcare and support of families and persons, private security services, notaries and bailiffs, and the field of taxation, Art.2). Moreover, it is provided that other Community law, including the Directives on posted workers and on professional qualifications,<sup>14</sup> should prevail.

Within its scope, the Directive relies on harmonization of procedures and regulations through a principle/derogation technique and flanking measures. The principle is not the country of origin, but an absolute presumption of market access and equal treatment, accompanied however by many qualified and specified exceptions (i.e. the possibility for Member States to make access to, or exercise of, a service activity conditional on compliance with requirements).

## 4. EU and Global Services Trade Liberalization

The tensions discussed in the previous sections are even more apparent when it comes to provision of services by third-country nationals, where such sensitive issues are involved as Community market protection and immigration. If the internal market were truly complete, it would be impossible to deny third-country nationals who have been allowed into the EU the freedom to move to supply a service in another Member State. Perfect market integration would also imply common rules as regards access to the EU, both by third-country nationals who wish to establish themselves or reside in a Member State and provide a service, and by those service providers coming to the EU just to provide a service occasionally and temporarily. But because market integration in services is still imperfect, and regulation of a common migration policy is still in the making, the EU remains, to very a large extent, nationally fragmented towards third-country nationals who provide services.

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<sup>14</sup> Directive 2005/36/EC of the European Parliament and of the Council of 7 September 2005 on the recognition of professional qualifications, *OJ L 255*, 30.9.2005, p. 22-142.

National rules still apply to third-country nationals who are not long-term residents and, once allowed into the EU, wish to enter another Member State in order to provide services (see Bertola and Mola, 2008). Here, we focus on conditions for access to the services market(s) of the EU, in particular as regards legal competences at the Member State and supranational policy-making levels.

Neither for migration nor for temporary movement of services there is a harmonized, common legislative framework. At the Member States level, rules are very different also as regards temporary *versus* permanent migration. Access to labour markets differs from access for purposes of service provision.

Also interestingly, however, efforts towards common rules are increasingly important and effective. When third-country service suppliers wish to migrate into a Member State for the purposes of an economic activity ('economic migration'), the Commission has sought to take legislative action under the recently established EC migration policy (since the Treaty of Amsterdam, entered into force in May 1999), based on Art.63, par.3 ECT, which provides that the Council adopts measures concerning conditions of entry and residence, and standards on procedures for the issue by Member States of long-term visas and residence permits (Hedemann-Robinson, 2001). And while there is no multilateral venue for migration negotiations (Hatton, 2007), services provisions by means of personal temporary and transnational mobility is the subject of General Agreement on Trade in Services (GATS), where the EU is a member alongside its Member States.<sup>15</sup>

#### **4.1. Harmonization Pressure from GATS Negotiations**

When foreign suppliers provide their service on a temporary basis they are partially covered by EC external trade competences in the field of trade in services (see Cremona, 2001; and Cremona, 2002, for more detailed legal analysis); because of EC

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<sup>15</sup> See Chadhuri et al. (2004), and Grynberg and Qalo (2007) for a discussion of the relevance of WTO for international movement of people to provide services.

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and its Member States' membership to the WTO, they are internationally bound to their commitments made under the GATS.

Since the establishment of the WTO in 1994, international multilateral commitments have become possible not only in the GATT (General Agreement on Trade and Tariffs) framework but also in that of disciplines applying to trade in services (the GATS) and the Trade-Related Aspects of Intellectual Property Rights (TRIPs). The GATS defines international trade in services by means of the modalities or 'modes' these services are supplied.<sup>16</sup> For our analysis, the most interesting one is 'Mode 4,' whereby the service supplier temporarily moves in its physical person capacity to the host country (Breining-Kaufmann, Chadha, and Winters, 2003).<sup>17</sup>

Mode 4 is akin to the traditional concept of service provision in EU law. According to the definitions set out by the GATS, this modality of trading services internationally arises where firms from outside the EU provide services to a service recipient in a Member State by temporarily moving into that State through the posting of their workers, or where third-country nationals move temporarily to the EU to provide a service in a Member State. An interesting indication of what may worry the Members can be found in the Annex to the GATS on Movement of Natural Persons Supplying Services under the Agreement, which explicitly states that the scope of Mode 4 does not extend to measures affecting persons seeking access to the employment market, nor to measures governing citizenship, residence or permanent employment.<sup>18</sup> Moreover, the right of Members to apply 'measures to regulate the entry of natural persons into, or their temporary stay in its territory, including those measures necessary to protect the integrity of, and to ensure the orderly movement of natural

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<sup>16</sup> Commercial linkages may exist among all four modes of supply. For example, a foreign company established in country A (Mode 3) may employ nationals from country B (Mode 4) to export services cross-border into countries B, C etc. Similarly, business visits into A (Mode 4) may prove necessary to complement cross-border supplies into that country (Mode 1) or to upgrade the capacity of a locally established office (Mode 3).

See Jansen and Piermartini (2005) and Jansen and Piermartini (2009) for a review of linkages among trade sectors and flows.

<sup>17</sup> See also Wamsley-Winters (2005) for an economic assessment, and Magdeleine-Maurer (2008) for estimates of the phenomenon.

<sup>18</sup> See also Bast (2008) for legal insights of GATS Annex on Movement of Natural Persons Supplying Services.

persons across its borders', is unaffected. Therefore, Mode 4 is different from economic migration as regards the applicability of laws and requirements of Members. However, the Annex also requires that 'such measures are not applied in such a manner as to nullify or impair the benefits accruing to any Member under the terms of a specific commitment.'

Right of free access to national markets by service providers established in another Member State, in combination with some harmonization, would have had far-reaching implications not only for the EU internal market but also for the interestingly intricate interaction between the EC and its members vis-à-vis the GATS (Bertola and Mola, 2008). Trade policy and global institutional developments place increasing pressure on the EU and its member countries to adopt common rules. Recent multilateral negotiations have increasingly focused on services trade liberalization (Winters et al., 2003). Overall, issues covered by GATS Mode 4 are still within the 'shared competence' between the EU Member States and the Institutions, and unanimity in the Council of the EU is often required to adopt a common position on Mode 4 at the WTO. As a result, EU institutions' decision powers are intricately relevant. This makes GATS an interesting test case for resolution of tensions between international economic integration and national regulatory and social policies.

As said, since external powers are limited by the lack of harmonisation at the EU level vis-à-vis third-country nationals and service providers, there is still room for national limitations and variations to specific commitments within the GATS. These, however, make it difficult for the EU to provide legal certainty in multilateral negotiations. The Commission acting externally as the Community negotiator, as well internally as the promoter of integration,<sup>19</sup> seeks to present a single offer to the other WTO Members, typically under the form 'all Member States (except) ...', but has to represent all the differing positions of the Member States in GATS Mode 4

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<sup>19</sup> For an insightful analysis and argument on how the institutionalized setting of the WTO has an important influence on EC internal and external competences and distribution of powers among the Commission and the Member States, with regards to another WTO agreement such as the TRIPs, see Billiet (2006). Similarly, but in an area of external economic policy which has been left outside the WTO, see developments recently reported by the *Financial Times* (2008) on the interaction between third countries and EU/Member States actors as regards foreign investment negotiations.

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whenever a qualified majority or – when required – unanimity is not achieved. The resulting schedule is a very complex document.<sup>20</sup> Actually, while the EU does speak with one voice (the Commission's) in the GATS, in the absence of a single market in services specific commitments vis-à-vis third countries have different contents whenever common/uniform positions are modified at individual Member States level.

Pressure from WTO trade partners for a single EU offer generates a *de facto* tension with internal matters, as a common position requires (and more heavily regulated Member States often resist) some harmonization and some removal of internal (intra-EU) barriers. At a different level, negotiations and lobbying at the Commission also involve Europe-wide (rather than country-specific) services providers, whose interests mainly lie with protection against, and access to, non-EU competitors and markets.

## 5. Conclusions

The facts and mechanisms we have analyzed highlight policy tensions and possible resolutions within the EU and the WTO. Conceptual and practical interactions between the two levels illustrate the general principle that an internal market necessarily implies a common external position, and the practical insight that 'positive' integration of regulatory framework can be achieved if a constructive negotiation framework is able to pursue the collective gains from a broader and appropriately regulated market.

Much progress has been made as regards posted workers and service providers, but market integration in these areas is not yet complete. For citizens of an EU Member State, who enjoy free entrance to and rights to stay in every EU Member State, market access is similarly unrestrained insofar as their activities fall within the scope

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<sup>20</sup> See Langhammer (2005) for a discussion and a quantitative analysis of cross-country heterogeneity in the GATS limitations of commitment.

of freedom to provide services. But regulations applying to service providers are not yet harmonized or mutually acknowledged across countries and sectors, and the uneven and complex market access rules for third-country nationals and service suppliers also contributes the segmentation of services markets.

While the Single Market Program readily implies a common EU position as regards trade in goods, lack of harmonized immigration and citizenship rules obviously prevents EC-level negotiations with third countries as regards migration flows. Moreover, it is difficult to envision a common legal immigration policy in the absence of a single labour market. And since internal harmonization proves to be very difficult in services markets, external relationships are unsurprisingly difficult too. Only a properly harmonized supranational regulatory framework in the services area would establish a supranational exclusive competence in external negotiations, and enable EU member countries, already represented by one voice in the GATS, to undertake the same commitments as it happens in the GATT.

The field of trade in services and temporary supplier mobility, as an intermediate case between trade in goods and outright migration, features incomplete internal harmonization and multi-layered external negotiations, whose interaction and evolution offer insights of more general interest. Our analysis of various aspects and modes of service provision suggests that the extent to which general principles are applicable to specific situations depends in interesting ways on the structure of market interactions, on the legal instruments used to regulate them, and on the modes adopted to achieve market and policy integration.

As is the case along other dimensions of the EC's legal evolution, the ECJ's case law inspired by application of fundamental 'freedom' principles plays a crucial role in fostering internal market and policy integration in the case of intra-EU personal mobility.<sup>21</sup> In the case of trade in services, not only third-country providers but also domestic providers of services to third countries favour an external common position

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<sup>21</sup> See Moore (1998) and Moore (2002) for a discussion of the interplay between the freedom of movement and subsidiarity principles in ECJ case law concerning immigration and social security.

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on international trade in services. And, inasmuch as EU countries need to participate (individually as well as through Commission representation) in external negotiations, the GATS process of global trade liberalization contributes in applying pressure towards harmonization of country-specific regulation within the EU and removal of internal trade barriers.

To the extent that this process may also work for other modalities of trade in services, it may make it possible for EU member countries to extend an effective Single Market to increasingly important aspects of economic interaction, characterized by intense entry and exit of firms and by fragmentation of production processes across international boundaries, to which traditional harmonization processes are not easily applicable.

However, at present the EU proves to be unable to reach legislative conclusions on a Blue Card for third-country service suppliers. Posting of workers is reportedly also under review, even if so far only by a high level group of the Commission. The recent Commission Proposal for a Council Directive on a single application procedure for a single permit for third-country nationals to reside and work in the territory of a Member State and on a common set of rights for third-country nationals legally residing in a Member State (COM (2007) 638) takes steps in exactly these directions. While explicitly not aiming to “harmonize admission conditions for labour immigrants, which will remain in the hands of the Member States”, it is firmly and sensibly motivated by the need to simplify the currently fragmented regulatory framework discussed in this paper. If adopted, it may trigger further steps in the legislative and jurisprudential harmonization of the regulation needed for markets to function well, and integration to be viable.

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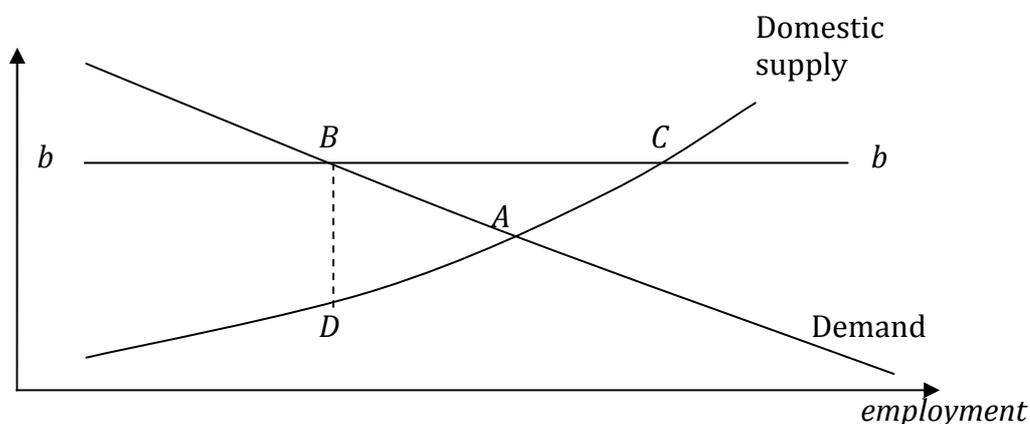
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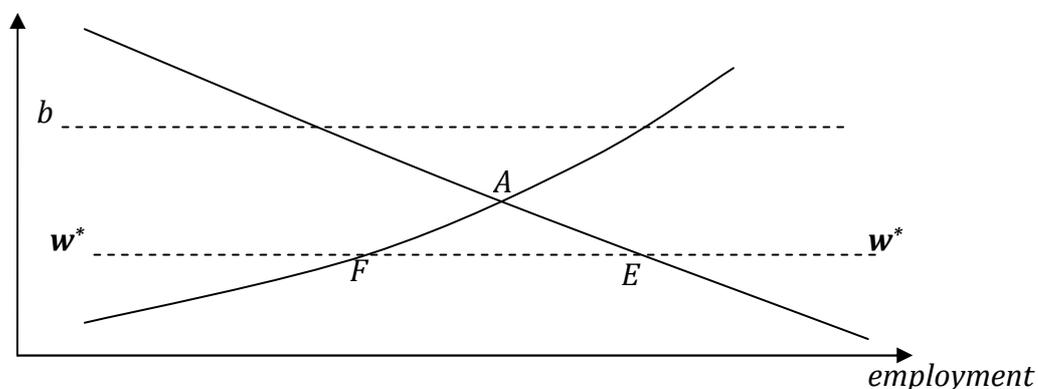
## Appendix

### Foreign competition and labour income support policies



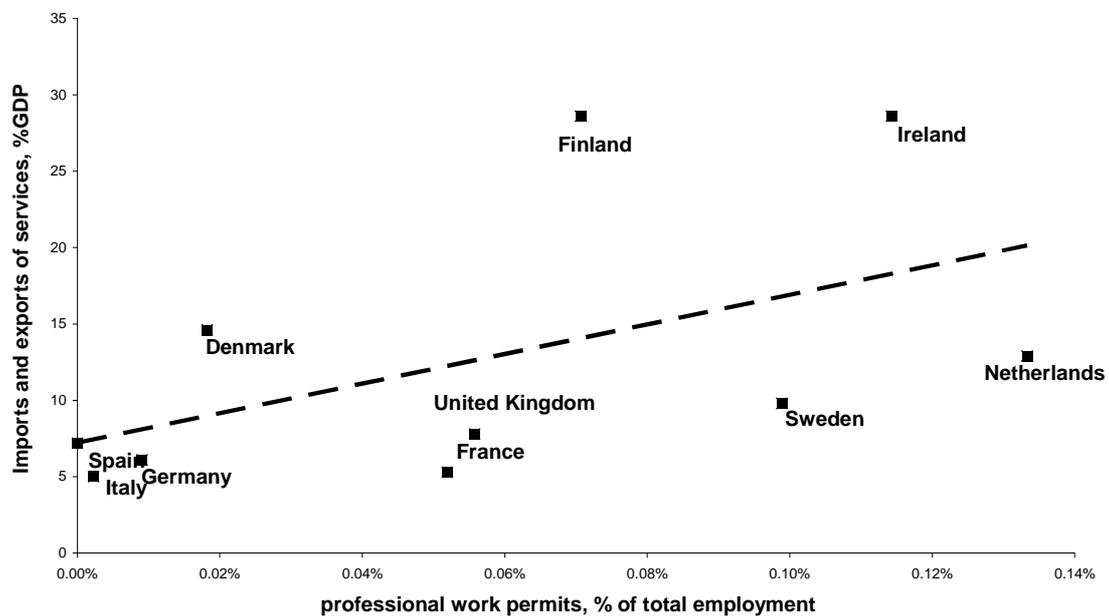
The figure above depicts demand and supply in a country's market for low skill labour. If the wage implied by the *laissez faire* configuration (point A) is deemed too low, taxes, subsidies, and regulation policies can raise it to the level of line  $bb$ . Employment decreases to point B, as the higher price of production reduces the derived demand for labour. The horizontal distance between points B and C measures labour that would be willing to work at the going wage  $b$  but remains idle. Imperfections in other markets (such as those for financial, insurance, and education services) and politico-economic considerations can rationalize this apparently inefficient outcome.

Suppose now similarly skilled workers from other countries can access this labour market, and that the wage they are willing to work for - represented by the horizontal line  $w^*w^*$  in the figure below - is lower than the *laissez faire* point A in the figure (and, a fortiori, than the welfare floor level of points B and C):



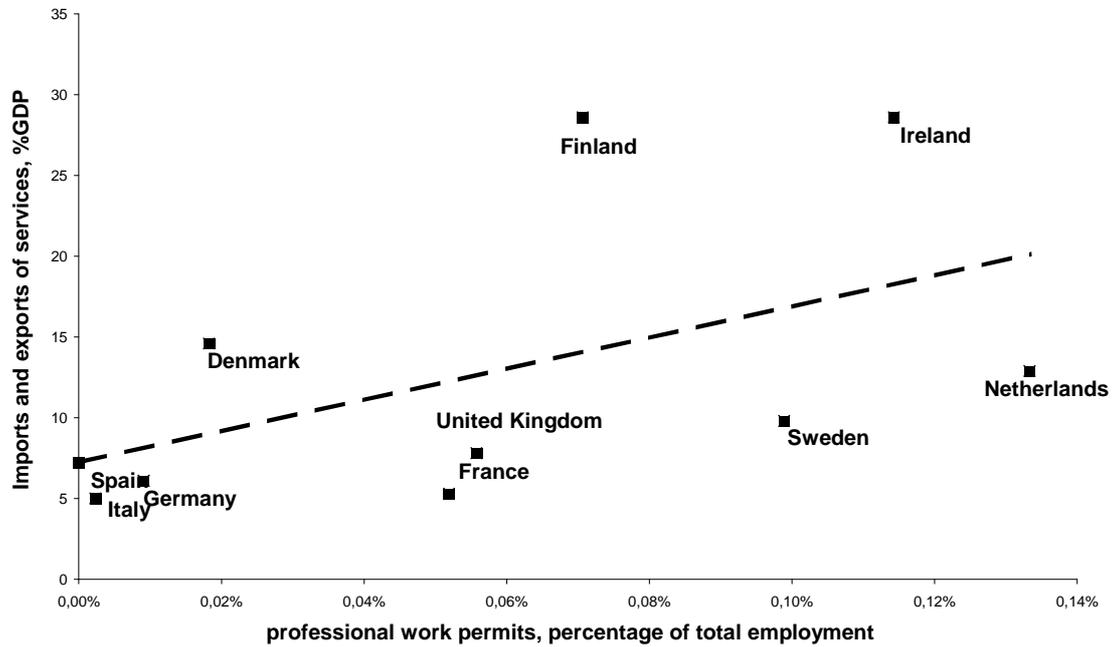
In *laissez faire* labour market equilibrium would be at point *E*: national workers would be employed up to *F*, with *FE* foreigners. The market would benefit from the lower price and higher quantity corresponding to the movement down the derived demand for labour; the equilibrium wage of low-skill domestic workers would be lowered by integration, to  $w^*w^*$  from point *F*. If policies support a wage floor at the level of line *bb* for domestic workers, production increases by more (from point *B* to point *E*), but the cost of income support policies also increases. Were all national workers entitled to benefits that are higher than the wage at which foreigners are willing to work, then all would be replaced by foreigners. This limit case and the perfect elasticity at  $w^*w^*$  of foreign labour supply, are of course an exaggerated depiction of more general and nuanced phenomena, but are not very distant from what was observed in Germany when the Single Market public procurement rules made it possible for firms employing British, Italian, and Portuguese labour to undercut German firms whose labour costs were propped up by generous unemployment insurance provisions, originally meant to support construction workers' income in the face of cyclical and seasonal fluctuations rather than of international market competition.

**Figure 1**  
**Professional services regulation and professional work inflows**



Horizontal axis: Annual inflow of professional work permit holders as a fraction of total country employment; definitions vary across countries; source: European Commission Communication SEC(2005)1680 'Policy Plan on Legal Migration', Table 4. Vertical axis: overall regulatory index for professional services, larger numbers indicate more stringer regulation; source: Conway and Nicoletti (2006).

**Figure 2**  
**Services trade integration and professional work inflows**



Horizontal axis: Annual inflow of professional work permit holders as a fraction of total country employment; definitions vary across countries; source: European Commission Communication SEC(2005)1680 'Policy Plan on Legal Migration', Table 4. Vertical axis: Imports plus exports of services as percent of GDP, 2003; source: Eurostat.

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