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4 Labour Arbitrage on European Labour Markets

Free Movement and the Role of Intermediaries

Jan Cremers and Ronald Dekker

Abstract
This chapter focusses on the proliferation of human resource management practices: What makes HRM decide to adopt certain practices? The recruitment processes are analysed against the background of the EU regulatory framework with regard to the use of migrant labour. Specific for the EU context are three forms of regulation, related to the free movement of workers, the freedom to provide services, and the freedom of establishment. Furthermore, we take into account the economic context (of relative or absolute labour shortages on local/sectoral labour markets). In this contribution, we recognise that intermediaries have (partially) built their business models on labour arbitrage (a notion that will be explored in the next sections), among other things through strategically choosing the countries where they register their businesses. The main features in this process of efficiency seeking, are temporary employment agencies with an international focus, and consultancy firms that advise businesses on tax or regulatory arbitrage.

Keywords: human resource management, EU mobility regulation, intermediaries, human resource management

Introduction

Free movement of workers belongs to the core principles of the European Union, although the intra-European mobility of labour migrants has come under pressure in recent years. Cross-border mobility and recruitment of

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workers from abroad are often motivated by employers with arguments of labour shortages, but also with reasons of costs and employment protection, which tend to be lower for migrant workers. The cost differences mainly stem from differences in the regulatory regime in the fields of corporate law, labour law, and social security law. In our research, we found evidence that many firms adopt recruitment practices, and start using migrant labour, based on these reasons.

Theoretically, this chapter focusses on the proliferation of human resource management practices: What makes HRM decide to adopt certain practices? The recruitment processes are analysed against the background of the EU regulatory framework with regard to the use of migrant labour. Specific for the EU context are three forms of regulation, related to the free movement of workers, the freedom to provide services, and the freedom of establishment. Furthermore, this chapter takes into account the economic context (of relative or absolute labour shortages on local/sectoral labour markets). In this contribution, we recognise that intermediaries have (partially) built their business models on labour arbitrage (a notion that will be explored in the next sections), among other things through strategically choosing the country where they register their businesses. The main features in this process of efficiency-seeking, are temporary employment agencies with an international focus and consultancy firms that advise businesses on tax or regulatory arbitrage.

The current situation creates an ideal environment for fraudulent (or at least questionable) cross-border business activities. The overlapping or vaguely defined legal categories encourage arbitrage practices. Even if these practices are not illegal, we depart from the normative stance that these practices deprive workers from the wider principles that fit in a policy of rights-based migration and labour mobility. The practices described in this chapter deviate from this normative stance, and, by doing so, endanger the genuine free movement of workers in Europe.

This Chapter is structured as follows. We start with the mapping of the EU regulatory frame, relevant for the practice of free movement and arbitrage. The next section discusses cost-saving models and mechanisms and their impact on the Dutch labour market. The following section looks at the role of management and the influence of intermediaries on the decisions to 'arbitrage'. The final part contains our conclusions and recommendations.

The EU Regulatory Frame

The 1957 Rome Treaty establishing the European Economic Community contained several provisions connected to the notion of labour mobility: citizens should gain from free movement. The Treaty ensured free movement of workers.[1] This freedom meant, in particular, that workers who were nationals of one Member State had the right to go to another Member State to seek employment and to work there. The Treaty underpinned and guaranteed the residence, labour, and equal treatment rights of these mobile workers. The creation of the EU internal market, accompanied by the dismantling of internal frontiers, placed the mobility of workers and the freedom to provide services with mobile workers even more in the centre of the socioeconomic approach of the EU institutions.[2] This led to a regulatory frame that serves as a building block for the workers' mobility. Three policy areas can be distinguished with an impact on the promoted mobility:

a policies in the field of the freedom of establishment;
b policies related to the freedom to provide services;
c social policies, notably in the field of labour and contract law, pay and working conditions, and social security.[3]

The promotion of this mobility remains high on the agenda, even though the European Commission, in its analysis of the functioning of the internal market, has reported several times that the expectations of the mid 1980s about mobility in Europe have not been realised.

The establishment of a company or subsidiary in the EU is covered by the freedom of establishment, as enshrined in Article 49 of the Treaty on

1 Treaty Establishing the European Community, Rome, 1957, Articles 48 to 51.

2 J. Cremers (2012), 'Free movement of workers and rights that can be derived', *FMW: Online Journal on free movement of workers within the European Union*, 4 pp. 26-32.

3 The coordination of the national social security became one of the first pillars of the European Community legislation in this area (Council of the European Economic Community, Regulation [EEC] No. 3 of 25 September 1958, OJ No. 30, 16.12.1958. Brussels). The coordination rules are based on the principle that persons moving within the EU are subject to the social security scheme of only one Member State. The starting point in the field of working conditions and labour law was that mobile workers would fall under the application of the so-called *lex loci laboris* principle. This meant that the regulations of the country where the work was carried out would apply. The so-called posting of workers became an exception to this principle, motivated by the fact that workers that provided services (under the subordination of their posting company in the home country) would only temporarily stay in another Member State.

the Functioning of the European Union (TFEU).[4] In general, setting up a company in a foreign constituency is facilitated by that provision. Companies benefit from the internal market principles that guarantee both the right of establishment and the freedom to provide services, cf. Articles 54 and 62 TFEU. Corporate entities are creatures of national law and the rules for setting up companies vary significantly among Member States.[5] Some Member States apply the so-called real seat theory; i.e. the law governing a company is determined by the place where the central administration and substantial activities of that company are located. This requires companies having their operational headquarters within a given Member State to be established under the laws of that state. Other Member States follow the incorporation theory, which favours party autonomy in the choice of corporate law. Hence, under such law, companies may have their 'real seat' in a Member State different from the state of incorporation, which also implies that they may have a mere artificial entity in the incorporation country.[6] Companies can thus install a considerable part of their legal frameworks in another country without pursuing any real activities there. Based on the freedom of establishment and the free provision of services, these national entities are free to move around and get market access in other Member States. Conflicting or contradictory legal provisions in labour law and company law can be used by companies, which create artificial arrangements for the purpose of evading statutory and other obligations in the country of activity.

The freedom to provide services gained much support in the course of the development of the European Union. As the relationship was underscored between the working conditions of workers involved in temporary cross-border activities and the free provision of services, problems emerged. In successive cases, the Court of Justice of the European Union (CJEU) judged that it is not up to EU Member States to define unilaterally the notion of public policy or to impose all mandatory provisions of pay and working

4 European Union (2010). Consolidated Treaties. Treaty on European Union – Treaty on the Functioning of the European Union – Charter of Fundamental Rights of the European Union, Luxembourg.

5 National laws also determine the way business registers are organised and the legal value of entries. The EU Council of Ministers has so far refused to work towards a central business register. A less far-reaching alternative is developed in Directive 2012/17/EU, which establishes a system of interconnection of business registers. It is currently being implemented and will be operational by the end of 2017.

6 J. Cremers (2018), *Letterbox companies and regime shopping in Europe*. Policy Brief ETUI, Brussels, forthcoming.

conditions on suppliers of services established in another country.[7] According to this interpretation, EU Member States have no unilateral right to decide on the mandatory rules applicable within their territory, even if these mandatory rules would guarantee better provisions for the workers concerned. Measures that are likely to limit the freedom of establishment or the freedom to provide services are not per se incompatible with EU law, but have to be justified by overriding reasons of public interest and cannot be discriminatory against foreign EU service providers or companies. Restrictions must be appropriate to attain the objective pursued, and cannot go beyond what is necessary. The overriding reasons of public interests, considered by the court, are mostly limited to the prevention of abusive tax practices, for instance in case of 'wholly artificial arrangements intended to escape the domestic tax normally payable'.[8] On the other hand, the CJEU has ruled that host states may not refuse recognition of the legal capacity of a company incorporated under the law of another Member State, even if that company does not pursue any economic activity in the latter state.[9] This initiated a process of regulatory arbitrage in the EU.[10] In this context, we define regulatory arbitrage as a practice whereby firms explore (and benefit from) loopholes and conflicts in regulatory systems in order to bypass or avoid unfavourable regulation.

7 Judgments related to the free provision of services (Rüffert C-346/06 in 2008, Commission v. Luxembourg C-319/06 in 2008) created a situation whereby foreign service providers do not have to comply with imperative provisions of national law that have to be respected by domestic service providers. The Luxembourg case, for instance, centred around mandatory provisions applicable to all workers on the country's territory, irrespective of their nationality, including those temporarily posted. Luxembourg required a written (labour) contract for all employees, whether they were national or foreign citizens. The Court ruled that these national mandatory regulations beyond the list of minimum provisions 'may be regarded as a restriction on the free provision of services', and are not 'crucial for the protection of the political, social and economic order'. It can be argued that this contradicts the legislative intention of the PWD, which states explicitly (Article 3.10) that the Directive's application 'shall not preclude' Member States applying 'to national undertakings and to the undertakings of other States, on a basis of equality of treatment [...] terms and conditions of employment [on issues other than minimum standards] in the case of public policy provisions'. See: J. Cremers (2013), ′Free provision of services and cross-border labour recruitment′, *Policy Studies*, 34(2) pp. 201-220.

8 European Court Reports 2008, I-02875ECLI:EU:C:2008:239

9 E. Wymeersch (2003), *The transfer of the company's seat in European Company Law*, Financial Law Institute. Gent University.

10 M. Gelter (1 April 2010), 'Tilting the Balance between Capital and Labour? The Effects of Regulatory Arbitrage in European Corporate Law on Employees', *Fordham International Law Journal*, 33, Fordham Law Legal Studies Research Paper No. 1595067; ECGI – Law Working Paper No. 157/2010.

The free movement principles in the European Union affect the respect for the well-balanced regulatory framework for social policy, including social security and labour standards that exist in EU Member States. This regulatory framework was and is characterised by a mixture of labour legislation and collective bargaining, partly resulting from national litigation and case law. Soon after the introduction of the internal market, collisions emerged between the economic reasoning in the EU and the social policy covering labour standards and equal treatment of workers. The emphasis on the primacy of economic freedoms, vigorously promoted by EU institutions, negatively affected the application of national social security rules and working conditions of workers. The recruitment of a foreign workforce brought with it the risks of undermining or evading existing social standards with the aim to gain a competitive advantage, while the relocation of production and the competition waged in the sphere of taxation and social security created new tensions between regions. The freedom of establishment created an industry of incubators able to deliver ready-made companies whose sole purpose was to circumvent national regulations, labour standards, and social security obligations.[11] Efficiency-seeking, so far mainly used in the fiscal area, also became mainstream in the social field.

Cost-saving Models and Mechanisms

In an analysis of the work of the labour inspectorate related to the respect for and compliance with the applicable Dutch regulations of pay and working conditions in cross-border recruitment practices, several mechanisms that have come into vogue in recent decennia could be traced.[12] Although the sample in this study was based on files and cases in which there was already a suspicion of breaches, and the outcome is thus not representative of the overall development, the research gave important proxy evidence of the tendencies on the Dutch labour market. Moreover, the analysed files testify to more than simple loopholes and inconsistencies in legislation. The report reveals that these loopholes, combined with a lack of coherence in the overall policy, and the absence of collaboration between the different

11 For an overview of relevant sources, see: K. Kall and N. Lillie (2017), *Protection of Posted Workers in the European Union: Findings and Policy Recommendations based on existing research*. University of Jyväskylä.

12 J. Cremers (2017), *Drie jaar ervaring met intensievere cao-naleving: Een analyse van de nalevingsdossiers n.a.v. het Sociaal Akkoord 2013*. Tilburg: Tilburg Law School.

policy areas, lead to 'creative' forms of labour recruitment and hiring of workers, very often to the detriment of the recruited workers.

These methods have been the subject of several studies referred to by different names, ranging from 'regulatory competition' to 'regime-shopping', 'social engineering', or 'social dumping'.[13] One of the main characteristics is that several of the methods are not necessarily unlawful; they twist the law and are found in the margins of the applicable regulatory frame. Other methods profit from loopholes and contradictions in that frame. Some methods are lawful, although they are morally blameworthy, other methods are against the law, but because of the complexity of the legislative framework and the absence of straightforward redress mechanisms, difficult to tackle. Some methods can be traced by the enforcement and compliance authorities, but effective and dissuasive sanctions (especially in a transnational context) are nonexistent. Most of the methods are planned, well-organised, and set up with business consultants who will explain to you that everything is perfectly legal. The methods consist of well-established and well-designed business models that have been thought of with all the legal details; this leads to competition based on wage costs, and to distortion of competition with genuine companies who actually comply with the legal and conventional frame.

The compliance evaluation distinguishes cost-saving models in four areas: savings on direct wage costs, saving on indirect wage costs and employers' contributions, savings on social security contributions, and fiscal savings (income tax, turnover tax, corporate income tax). The analysis of the inspection reports describes the existence of five different, partly intertwined, circumvention mechanisms that serve in the search for cheap labour:

a fraudulent contracting/pay-rolling;
b chains of subcontracting;
c the use of foreign legal entities;
d the provisions of services with posted workers;
e regime-shopping in the field of social security and taxation.

One of the common denominators of all analysed mechanisms is the use of outsourced labour on projects and workplaces. This takes the form of a subcontracted workforce, hired and leased workers, external recruitment, agency work, and posting of workers (and self-employed persons). Pretended contracting, based on the provision of services, can blur the labour

13 M. Bernaciak (2015), *Market Expansion and Social Dumping in Europe*. Brussels: ETUI/ Routledge.

relationship of the involved workers. The externalisation often takes the form of the recruitment of a foreign workforce through establishments abroad (in many cases initiated by Dutch user firms or headquarters). The introduction of a foreign legal entity in a subcontracting chain complicates the control and enforcement. It can lead to delays and even to defeat. Investigation of facts and verification of data in a foreign constituency depends on transnational cooperation and mutual assistance.

The Impact on the Labour Market

The question is how does this development affects the labour market? In general, agreement among researchers exists that, in the years before the crisis (the period 1999-2008), no evidence can be found of large-scale substitution or direct displacement of residents after the arrival of foreign labour, staying for the long term.[14] The increased arrival of labour migrants from Central and East European countries, by contrast, had a positive effect on domestic employment.[15] Ultimately, the influx of labour migrants had a (slight) downward effect on the average wage level and caused substitution to a limited degree of the workforce already present. This effect was limited to the lowest wage levels and completely absent in the higher levels. For the lowest-wage earners, a high share of labour migrants in a sector and region entailed a negative downward pressure on their wages. But, in overall terms, the supply of foreign workers supplemented the inland supply.

However, some evidence can be found that this changed after the onset of the financial and economic crisis.[16] In the period 2009-2015, labour migration from Western European countries decreased, whilst migration from Eastern Europe did not change. In the agricultural, the manufacturing, the construction, the retail, and the transport sectors, the total employment of Dutch workers decreased with dozens of percentages, combined with an increase of foreign labour. In these sectors, the search for cheap labour was combined with an ongoing process of flexibilisation of labour relations. The jobs were most often shifted from direct labour to temporary and flexible contracts. The cost reduction was achieved through the recruitment of

14 SEO (2011), *De economische impact van arbeidsmigratie: verdringingseffecten 1999-2008*, Amsterdam.

15 D. Dustmann (2008), *The Labour Market Impact of Immigration, Centre for Research and Analysis of Migration*, University College London.

16 SEO (2014), *Grensoverschrijdend aanbod van personeel*, Amsterdam.

labour migrants who accept lower wages and high flexibility. This type of substitution mainly took place in labour-intensive jobs with standardised work, with a calculation and a competition based on price, not on quality, and in situations in which language skills are neither essential, nor important. The recruitment of labour migrants, as several sources indicate, thus further facilitates the externalisation and flexibilisation of the labour market.[17] Since fixed-term contracts have a short duration and they terminate at no cost, they provide firms with scope for wage adjustment.

How does this relate to the current situation with repeated notifications of labour shortages? Analysis of labour market shortages in the Netherlands focus mainly on *absolute* shortages (no labour supply available). The *relative* shortage in terms of the labour (or employment) volume of jobs that are difficult to fulfil given the offered conditions (pay, working conditions, OSH) cannot be found in employment statistics and prognosis. According to an EU survey (published in 2016) 40% of the interviewed employers were confronted with recruitment problems. Around half of the cases belonged in the category of real qualification shortages, and one third of the cases were related to a remuneration that was too low. Unattractive working conditions, combined with atypical working time, poor career perspectives, and a lack of training facilities, explain why it is often difficult to find the right person, especially if no permanent job is in sight. There are clear indications that this relative type of labour shortage has been encountered in recent years with the recruitment of labour migrants. Longitudinal analysis reveals that a large majority of labour migrants from CEE countries in the Netherlands keep working in temporary jobs and contracts, which are low-paid and in precarious occupations, despite several years of service.[18] Local Dutch surveys among employers engaging foreign labour, provide further evidence. In local communities with a high registration of CEE workers, this survey investigated the motives for employers to recruit foreign workers (mainly through agencies).[19] Employers praised the labour migrants for their work ethic, commitment, and flexibility. Migrants are willing to accept arduous work, irregular working times, and long working days. Labour migrants carry out seasonal work and cater to peaks in agriculture, horticulture, and manufacturing. The motives of employers are induced by a combination of

17 D. Raess and B. Burgoon (2015), Flexible Work and Immigration in Europe. *British Journal of Industrial Relations*. SEO (2014), *Grensoverschrijdend aanbod van personeel*, Amsterdam.

18 A. Strockmeijer (2017), ´´Mobiliteit binnen de perken,´ *Tijdschrift voor Arbeidsvraagstukken*, 33(2), Amsterdam: Boom.

19 J. Cremers and A. Strockmeijer (2017), *De inzet van arbeidsmigranten in Zeewolde*, Tilburg Law School.

frictions and relative shortages on the labour market: the search for cheap labour, hard work, flexibility, and an offer that Dutch workers will not accept. The involved employers are well aware of the fact that their offer is not attractive. Without labour migrants, the wheel stops turning.

Cross-border Hiring and Sourcing

A substantial part of labour migration is driven by the behaviour of employers, who actively search for workers from abroad in order to deal with labour shortages at home, but also to cut back on wages and other labour costs. 'The central feature of demand-driven systems is that "the initiative for the migration comes from the employer"'.[20] In the local surveys, mentioned beyond, both reasons for wanting to hire migrant workers are mentioned regularly. A straightforward analysis of the different factors underlying the decision to hire migrant workers include a mix of institutional factors, economic circumstances, and the match (or lack thereof) between employers' demands and employee skills and requirements.[21] In this paragraph, we include the possibility that these decisions are also influenced by a process that can neutrally be described as management learning, but could also be characterised as copycat behaviour by employers. We assume that HR practices are copied from other organisations and also actively propagated by consultants and labour market intermediaries.

Intermediaries on the labour market make active use of loopholes and gaps in the legislation that among other things:

> pave the way for companies and intermediaries who can easily and at low cost be established as a legal entity in a foreign country, can quickly disappear across the border, go bankrupt and re-set up again from the beginning. This has also led to an industry of business consultants who can explain how perfectly legitimate such practices are. It is therefore imperative to strengthen the legal framework and to eliminate the gaps and imperfections in the legislation in a coherent and integral manner. This requires a thorough analysis in line with internal market regulation,

20 C. Finotelli and H. Kolb (2017), '"The Good, the Bad and the Ugly" Reconsidered: A Comparison of German, Canadian and Spanish Labour Migration Policies', *Journal of Comparative Policy Analysis: Research and Practice,* 19(1) pp. 72-86.

21 See, for an overview: M. Ruhs and B. Anderson (eds.) (2010), *Who Needs Migrant Workers?* Oxford: Oxford University Press.

> not only in the interests of the employees concerned but also in the interests of bona fide companies and consumers.[22]

What is the rationale behind the practices that we have examined in the previous sections? Different views exist about the proliferation and adoption of management practices on the continuum between fully rational and decidedly emotional behaviour.[23] Managers can be hypothesised to make decisions on adopting new HR management practices with a combination of the views below: this is a multidimensional approach to this type of decision-making. Alternatively, managers could choose between the different views below, based on the context for the decision: this is a contingent approach to this type of decision-making. Empirical research with concern to the role that these different views play in adopting management practices indeed suggests that the choice is influenced by the context and by a combination of different views.[24]

- rational view: adopt, because these practices work or promise to do so;
- psychodynamic view: adopt, because it 'feels good' to adopt, preventing the anxiety associated with doing nothing;
- dramaturgical view (rhetoric): adopt, because somebody (gurus, consultants) tells you that it is a good idea to adopt;
- political view: adopt, because the powerful (Anglo-Saxon business community, multinational firms, business schools) tell you that it is a good practice to adopt;
- cultural view: adopt, because the practices fit the cultural characteristics of your organisation (e.g. Hofstede dimensions);
- institutional view: adopt for symbolic reasons (seeking peer and shareholder legitimacy).

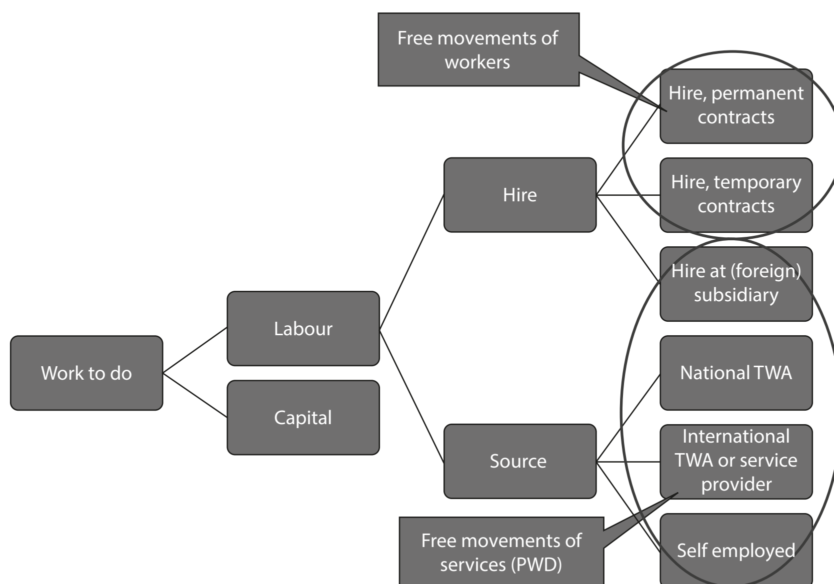
When we apply these different views on the specific topic of HRM practices and the possibilities for using migrant labour, the decision problem for organisations can be visualised by the stylized decision tree in Figure 1 below.

22 J. Cremers (2016), 'Economic freedoms and labour standards in the European Union', *Transfer: European Review of Labour and Research,* 22(2) pp. 149-162.

23 A. Sturdy (2004), ′The adoption of management ideas and practices theoretical perspectives and possibilities,′ *Management Learning*, 35(2) pp. 155-179.

24 E. Daniel, A. Myers, and K. Dixon (2012), 'Adoption rationales of new management practices', *Journal of Business Research,* 65(3) pp. 371-380.A.I. Rautiainen (2009), 'The interrelations of decision-making rationales around BSC adoptions in Finnish municipalities', *International Journal of Productivity and Performance Management,* 58(8) pp. 787-802.

Figure 1 Simple model of HR (labour demand) decision-making



The model of labour demand decision-making illustrates that there are ample opportunities for organisations to articulate part of their supply in terms of specific demand for migrant labour, either through direct hires (possibly at subsidiaries abroad) or through different forms of sourcing (e.g. through temporary work agencies, hereafter TWA). The model shows that agencies and other intermediaries have an incentive to 'influence' the decision-making of organisations in this respect, namely in order to increase their 'part of the pie' of labour demand. The different stages in the process during which HR business consultants can influence decisions are easy to identify. It identifies the many degrees of freedom that organisations have to translate 'work to do' into 'labour demand' and also the many degrees of freedom to locate that labour demand in foreign jurisdictions.

Similar to this approach, and very critical with respect to hiring migrant workers, Gordon (2017) states that:

> employers' recruitment of would-be migrants from other countries, unlike their use of undocumented workers already in the United States, creates a transnational network of labour intermediaries – the 'human supply chain' – whose operation undermines the rule of law in the workplace, benefitting U.S. companies by reducing labour costs while creating

> distributional harms for U.S. workers, and placing temporary migrant workers in situations of severe subordination. It identifies the human supply chain as a key structure of the global economy, a close analogue to the more familiar product supply chains through which U.S. companies manufacture products abroad.[25]

With this simple decision framework, it is possible to hypothesise a role for either business consultants or labour market intermediaries to give advice at different stages of the decision process. We will assume that these intermediaries act in their own interest and that organisations are likely to listen to the advice given to them for reasons of both a rational view (lower costs) and other factors, which involve managerial anxiety, political and peer pressures that are a combination of the other possible views on adopting (new) managerial practices.

The Role of Intermediaries in Practice

Both TWAs and business consultancy firms that provide HR management advice are examples of so-called Advanced Business Services (ABS) at the labour market. It is argued 'that ABS, as a complex, hold considerable power, which they exercise in a large measure by operating legal, accounting and financial vehicles designed partly to escape the control of governmental or intergovernmental organisations through the use of offshore jurisdictions'.[26] It seems fair to assume that the intermediaries and consultants focus on the cost benefits of regulatory (labour) arbitrage and are less inclined to 'sell' decent labour market arrangements. Berntsen has described these practices for TWAs:

> Firms employing foreign workers in host countries strategically situate themselves in particular regulatory regimes or industries. In the Netherlands, for example, the benefits applicable to posted workers in the construction sector are more extensive than in the metal sector, allowing for cost savings when firms post workers under the conditions for the metal industry. TWAs can choose between situating themselves in the host country and employing the foreign workers under TWA contracts, or

25 J. Gordon (2017), 'Regulating the Human Supply Chain', *Iowa Law Review*, 102(2).

26 D. Wojcik (2012), 'Where governance fails: Advanced business services and the offshore world', *Progress in Human Geography*, 37(3) pp. 330-347.

> posting the TWA workers from the home country, or even a third country in which social security contributions are lower. With the first option, employment conditions have to be regulated in line with the host-country framework; in the second and third option, there will be a combination of host- and sending-country regulations.[27]

Furthermore, it is documented in the management literature that big consultancy firms play an important role in the propagation of HRM practices. In general, it is argued that business consultants 'create and disseminate ideas' about management innovation and have 'persuasive power' in doing so.[28] More specifically, McKinsey & Co. played an important role in spreading the influential concept of the 'war for talent' in the HR field.[29] Other researchers have found 'that texts from management consultants and mainly American business school academics have diffused extensively into the important setting of English healthcare organisations.'[30] Offshoring, in particular, could also be regarded as a mere 'management fad'. Even a large consultancy firm argued that business should and would be weighing pros and cons of offshoring more carefully.[31]

The process described above started with big consultancy firms advising multinational corporations that already had offshore subsidiaries, mainly for 'tax arbitrage' purposes. The aforementioned ABS organisations have thereby 'taught' businesses to evade government regulation in general. A SOMO report concludes 'There is obviously a web of consultancy firms, sometimes related in ownership but rather a network of business management tax advisory firms that specialise in creating and managing letterboxes [...]'.[32]

27 L.E. Berntsen (2015), ´Agency of labour in a flexible pan-European labour market: A qualitative study of migrant practices and trade union strategies in the Netherlands,´ *Jyväskylä studies in education, psychology and social research*, 0075-4625 p. 526.

28 E. Abrahamson (1991), 'Managerial fads and fashions: The diffusion and rejection of innovations', *Academy of management review*, 16(3) pp. 586-612. A. Alharbi and A. Mamman (2015), 'Why Human Resource Management Innovations have many Versions not in Theory but in Practice', *International Journal of Academic Research in Business and Social Sciences*, 5(11) pp. 214-229.

29 J. O'Mahoney and A. Sturdy (2016), ´Power and the diffusion of management ideas: The case of McKinsey & Co., *Management Learning*, 47(3) pp. 247-265.

30 E. Ferlie (2016), 'The political economy of management knowledge: management texts in English healthcare organisations', *Public Administration*, 94(1) pp. 185-203.

31 Deloitte Consulting (April 2005), *Calling A Change in the Outsourcing Market: The Realities for the World's Largest Organizations*.

32 McGauran (2016), *The impact of letterbox-type practices on labour rights and public revenue*, Brussels: SOMO/ETUC. The report identifies different employment relationships used for social dumping, all of which involve artificial arrangements with no material activities in the country of registration, established with the sole purpose to recruit workers for working abroad.

The use is no longer restricted to large multinational corporations, but has evolved into a 'general purpose technology' management innovation, also available to small- and medium-sized companies (SMEs) without a preexisting international presence. SMEs in Europe are advised to relocate their administrative seat to another jurisdiction (Cyprus, Lichtenstein), for the sole reason that it will give them a competitive advantage in reducing their wage bill.

Our field work and analyses of the work of the labour inspectorate reveal that organisations have several options for hiring migrant labour. The setting up of a foreign subsidiary, or cooperating with an existing one that is nothing more than an empty shell, provides the opportunity to evade labour standards, social security, and taxation regulations. These subsidiaries are called 'mailbox' or 'letterbox' companies or, in legal terms: 'artificial arrangements'.[33] The regulatory framework related to the phenomenon of artificial arrangements is stretched over various national and EU policy areas, with noncoherent, contradictory, or even conflicting rules in company, labour, and contract law; internal market regulations; tax rulings; and social security legislation. As a result, many loopholes for labour arbitrage can be identified. Furthermore, the fragmented nature of both regulation and its enforcement makes it difficult to monitor and combat abusive practices.[34]

In the labour and social security policy areas, this notion was first signalled in the 1990s in the international transport sector. It was based on

33 Most definitions of letterbox companies refer to tax evasion by a business that establishes its domicile in a tax-friendly country with just an address, while conducting its commercial activities in other countries. The European Commission states that 'letterbox subsidiaries' are artificial arrangements established in countries solely to qualify for a softer tax regime and cut their bill. European Commission (2013), *MEMO, Questions and Answers on the Parent Subsidiary Directive*. Linkage with the free provision of services led to a definition beyond taxation. The EC refers in a Communication on smart regulation to legislative loopholes; 'letterbox companies are companies which have been set up with the purpose of benefitting from legislative loopholes while not themselves providing any service to clients'. European Commission (2013), *Smart regulation – Responding to the needs of small and medium-sized enterprises*.

34 'For trade unions and (understaffed) enforcement authorities it is difficult to trace and combat the situations; the fluidity in the cross-border context with firms often disappearing across borders or going bankrupt, complicate their efforts to enforce (and execute) local labour standards. And in the relatively few cases where trade unions and host state institutions do succeed in reaching the workers, they experience enormous practical difficulties in establishing exactly which conditions (should) apply to a specific individual employment relationship, because the rules are so complicated in cross-border situations.' M. Houwerzijl (2016), ′Letterbox strategies to suppress wages & labour standards: About the deliberate use of rules on determining applicable labour law and company law 'in search of cheap labour', in *A hunters game: how policy can change to spot and sink letterbox-type practices*. Brussels: ETUC.

dubious practices and problems caused by letterbox companies, which only had addresses in the country of establishment and all activities offshored to a different jurisdiction, often combined with 'bogus self-employment' among drivers and circumvention of statutory pay and working time standards.[35] The phenomenon became associated with a 'cheap labour business model': letterbox companies that operate in a cross-border context and pick and choose the social security and labour standards regime that is the least regulated and the most profitable. Ownership and employer liabilities are obscured or blurred by using proxy owners or strawmen. These entities take advantage of limited inspection competences and a lack of transnational enforcement mechanisms to deprive workers of their wages and contributions. In practice, the cross-border recruitment, through artificial arrangements, prevents states from reinforcing employment and labour standards.

The divergence of conflict rules, the legal complexity, and loopholes hamper effective application of the law and therefore favour unreliable actors. This situation undermines legal certainty about the law governing the operations of companies, and may work both to the detriment of bona fide cross-border establishment and provision of services, and to the detriment of effective monitoring and enforcement of the rules. In all this uncertainty and complexity, one thing is certain: the current situation creates an ideal environment for mala fide cross-border business activities.

Concluding Part and Outlook

In this chapter, we have documented recent studies that shed light on the impact of artificial recruitment arrangements on compliance with and respect for labour standards and social security obligations. Due to the primacy of freedom of establishment, and with the deregulation of company law dominating the EU internal market, there is a serious tension in the enforcement of labour standards, social security, and tax laws. The introduction of free movement in the European Union created an attractive open market for businesses, whilst the respect for the well-balanced national social regulatory framework became subordinated to the promotion of competition and mobility.

35 J. Cremers (2011), *In search of cheap labour in Europe: working and living conditions of posted workers*, Brussels: i-books/CLR-Studies.

By the late 1980s, the first indications of the practice of bypassing the applicable rules through the use of foreign labour-only subcontractors led to questions related to the role of cross-border labour recruitment. A matrix of complex, semilegal, or outright unlawful employment arrangements emerged, involving foreign corporate entities with questionable substance in the country of establishment. Through these channels, the basic principle of *lex loci laboris* eroded. The consequences in cross-border situations included regime-shopping, social dumping, and the threat of the unequal treatment of workers. For undertakings, it meant a distortion of competition and a race to the bottom, as the level playing field was vanishing. The free provision of services, combined with the deregulation of company law and the freedom of establishment, created a situation whereby service providers from abroad could circumvent mandatory rules that are imperative provisions of national law, and which have to be respected by domestic service providers. The primacy given to competition and deregulation created a climate in favour of labour arbitrage.

This puts the advocates of free movement inside the EU in a dilemma: the poor regulation of the recruitment of foreign labour creates tensions in the local market. Abuses build a breeding ground for strong anti-Europe sentiments (e.g. Brexit). Cross-border recruitment is channelled through constructs established in other constituencies. The possibility for host countries to verify the legality of the construct is very limited. Circumvention practices related to artificial legal entities, acting in the frame of the freedom of establishment, can only come to an end through policies that lie partly outside the social domain, such as national and European re-regulation of company law.

Employers have a strong and legitimate interest in the recruitment of foreign labour, as do agencies and other intermediaries. It would be logical for the management side to take a strong stand in favour of a coherent and consistent labour mobility regulation, based on decent workers' rights and equal treatment, and developed in the framework of national and EU social dialogue. Free movement of workers might only stay upright in the EU if grounded on the principle of equal treatment in the territory where the work is performed.

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