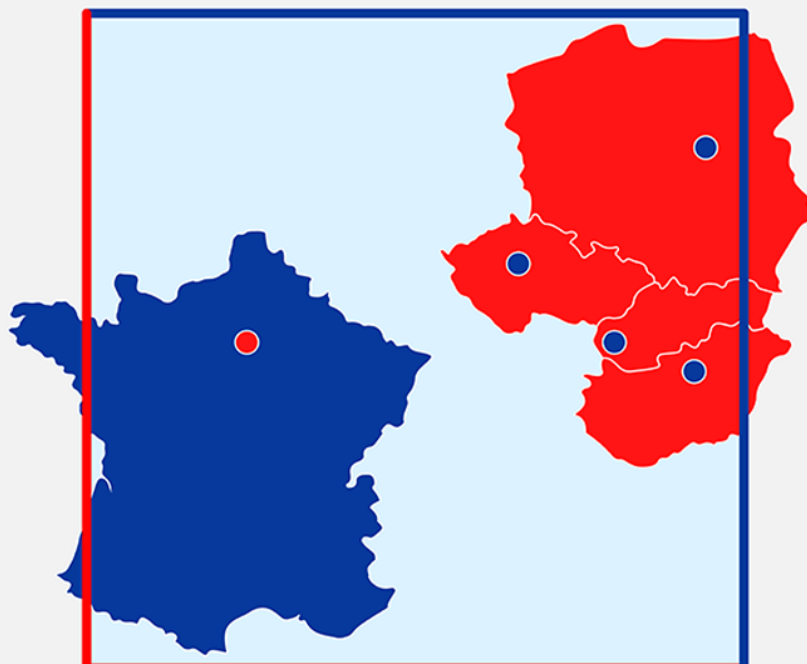


# POLICY PAPER

## What a true Social Europe means for the V4

Matej Navratil

- The aim of this paper is to present the position of the Visegrad countries (Czechia, Hungary, Poland and Slovakia) towards the proposals enhancing the social dimension of the EU. The example of the Posted Workers Directive demonstrates not only the reasons of the V4's fear of being ostracized by considerably larger Western economies in questions of upward social convergence, but also shows the background squabble during the processes which aimed to enhance the functioning of the four freedoms within the EU single market.





## Introduction

The issues of social convergence are one of the most disputed policies of the past years among the EU bloc. When asked, in the 2013 Eurobarometer, what would strengthen the feeling of being European citizen, 41% of respondents called for a "European social welfare system harmonized between the Member States".<sup>2</sup> Questions concerning social matters and upwards social convergence have been also one of the main campaign bullet points during Juncker's run for the Presidency of the European Commission in 2014. One issue in particular was for Juncker of considerable importance – the revision of the Posting of Workers Directive. This was explicitly mentioned in his political guidelines outlining his vision for European Commission.<sup>3</sup>

Although the Posted Workers Directive and the reform itself have only marginal influence on further social convergence, debates surrounding it are symptomatic and reflective of dynamics between the political position of Central European countries and the place their economies occupy within the EU on the one hand and Western European countries on the other. The issue of why Western countries, notably France, vehemently advocated for the revision of the Posted Workers Directive and the indifferent position of the V4 deserves closer scrutiny. One can draw three important inferences from the debates that are relevant for the future dynamics within the V4 bloc and between the V4 and France.

First, when it comes to following national interest, the coherence of the V4 seems to be easily shaken and compromises are difficult to achieve. Second, a series of European Court of Justice decisions have implicitly privileged the importance of economic rights above the social rights of workers and implicitly and unintentionally underlined the socio-economic East/West divide. Third, leveling the playing field and rebalancing the freedom in the

realm of services and labour, as was foreseen by the French President Macron, should be followed by an attempt of the V4 to argue for rebalancing the other two 'freedoms' of the single market – goods and capital.

The paper starts with an explanation of the evolution of the V4 economic models and their common traits. It follows with an ontogenesis of the reform processes of the Posted Worker Directive. Finally, the paper discusses the potential of the V4 to propose further economic convergence and gives recommendations for leveling the playing field in other two areas of the single market – goods and capital.

## Shared features of the V4 economic models

V4 countries share certain specific features characteristic of post-communist economic transformations. Calls for upwards social convergence have caused a certain distress in the V4 capitals, because it would considerably undermine the basis on which V4 economic models are built and also their potential for competitiveness in global markets. In order to approximate the V4's perspective in questions of upwards social convergence, it is first important to present the main building blocks on which V4 economic models are built. Thus, we will present the basic features of the V4's economies and the reasons why the region experienced unprecedented socio-economic growth in the last 15 years.

Foreign Direct Investments (FDI) have become a key driver for transition economies. CEE regional development was mainly based upon a uniquely high inflow of FDI, which in turn restructured the economic model after the fall of the state socialism.<sup>4</sup> Attracting FDI helped the region to reindustrialize the local economies and facilitated their

<sup>1</sup> This work was also supported by the Slovak Research and Development Agency under the contract No. APVV-15-0732.

<sup>2</sup> [http://ec.europa.eu/commfrontoffice/publicopinion/topics/fs5\\_citizen\\_40\\_en.pdf](http://ec.europa.eu/commfrontoffice/publicopinion/topics/fs5_citizen_40_en.pdf)

<sup>3</sup> <https://www.eesc.europa.eu/resources/docs/jean-claude-juncker---political-guidelines.pdf>

<sup>4</sup> Bohle, D., and B. Greskovits. Capitalist Diversity on Europe's Periphery. Ithaca, NY: Cornell University Press, 2012.



connection with modern production chains.<sup>5</sup> During the initial competition, the investors were able to secure benefits from the governments in form of generous tax breaks, financial support for building new factories, or promises to invest into infrastructural development. The above mentioned financial support was possible due to the V4's EU membership perspective and the availability of EU structural funds.

As a result of these transformations, the region turned into a major automotive cluster. This was possible due to cheap labour costs, which is still the main source of competitiveness for the region. As it is seen from the graphs below (Figure 1 and Figure 2), 'equal pay for equal work' would seriously undermine the competitive advantage of V4 as the hourly labour cost in the region is considerably lower than France. In France, the average hourly labour (including pay and non-wage labour costs such as social security contributions) equals 36 euros, which is above the EU average (26,8 euros). To put this into perspective, the highest average hourly labour cost from the V4 countries (Czechia), equals 11,3 euros.

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<sup>5</sup> Kudzko, A. (2018) Labour Market Reform and Visegrad Countries: Deep Rooted Concerns and How To adress them. Policy Brief 2018/January Think Visegrad Plafrom



Figure 1 Hourly labour costs in € for the whole economy (excluding agriculture and public administration), in enterprises with 10 or more employees. Source Eurostat 2018

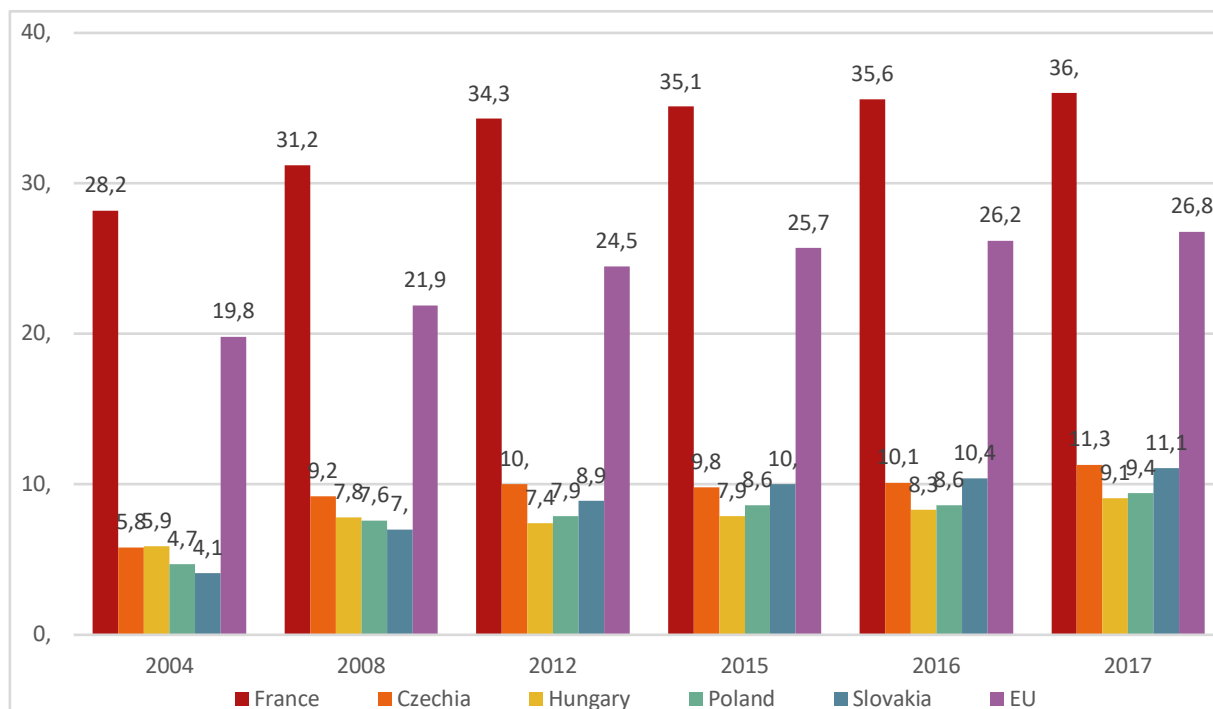
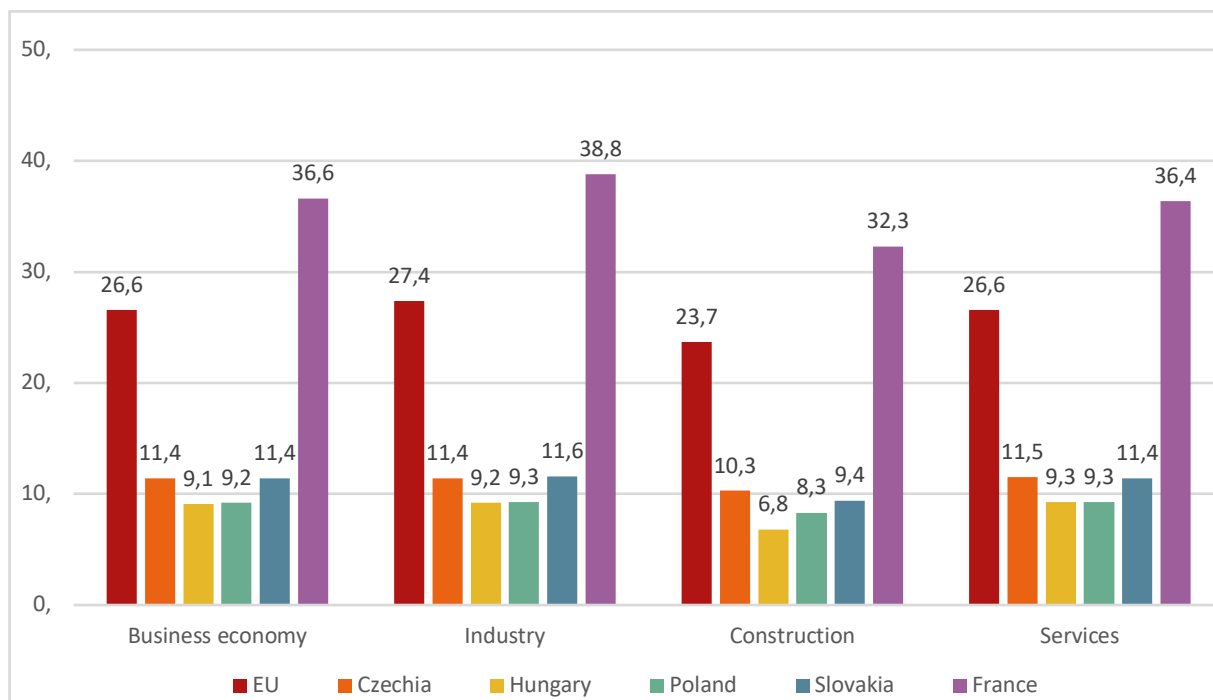


Figure 2 Hourly labour cost in €, in enterprises with 10 or more employees, breakdown by economic activity, 2017. Source: Eurostat

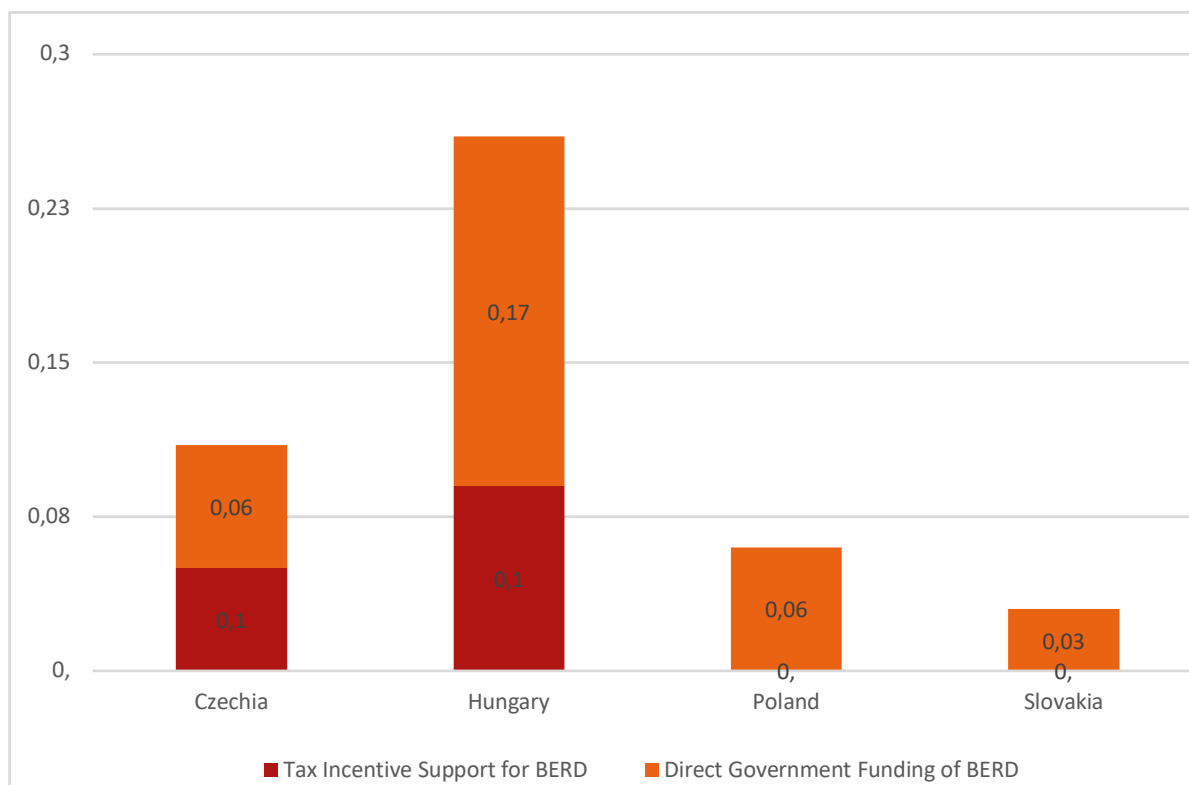




The manufacturing and industry sector still account for a large share of jobs. The automotive industry has become an important element of job creation because it facilitated the creation of supplier networks and stimulated the overall economy. However, domestic firms were unable to integrate into highest value-added segments of the value chain.<sup>6</sup> Closer scrutiny shows that the share of R&D in value added and employment remains relatively low. V4 governments (maybe except Hungary) seem to be rather reluctant to boost incentives to support increased private expenditures on R&D (BERD) (See Figure 3). However,

when looking at the expenditure on R&D as a share of GDP, only Czechia meets the standard set out by the European Commission, while the rest of the countries are below the EU 28 average (Figure 4). Considering the economic model on which the V4 economies are built, low support for R&D might endanger the embedding of companies into global markets. Should the cost of labour increase to a level not sustainable for companies to keep the factories running, the risk of relocation increases. This was the case of various automotive factory closures in the West couple of years back.<sup>7</sup>

Figure 3 Direct Government Funding and Tax Support for business R&D, 2016 as a Percentage of GDP. Source: OECD <http://www.oecd.org/sti/rd-tax-stats.htm>



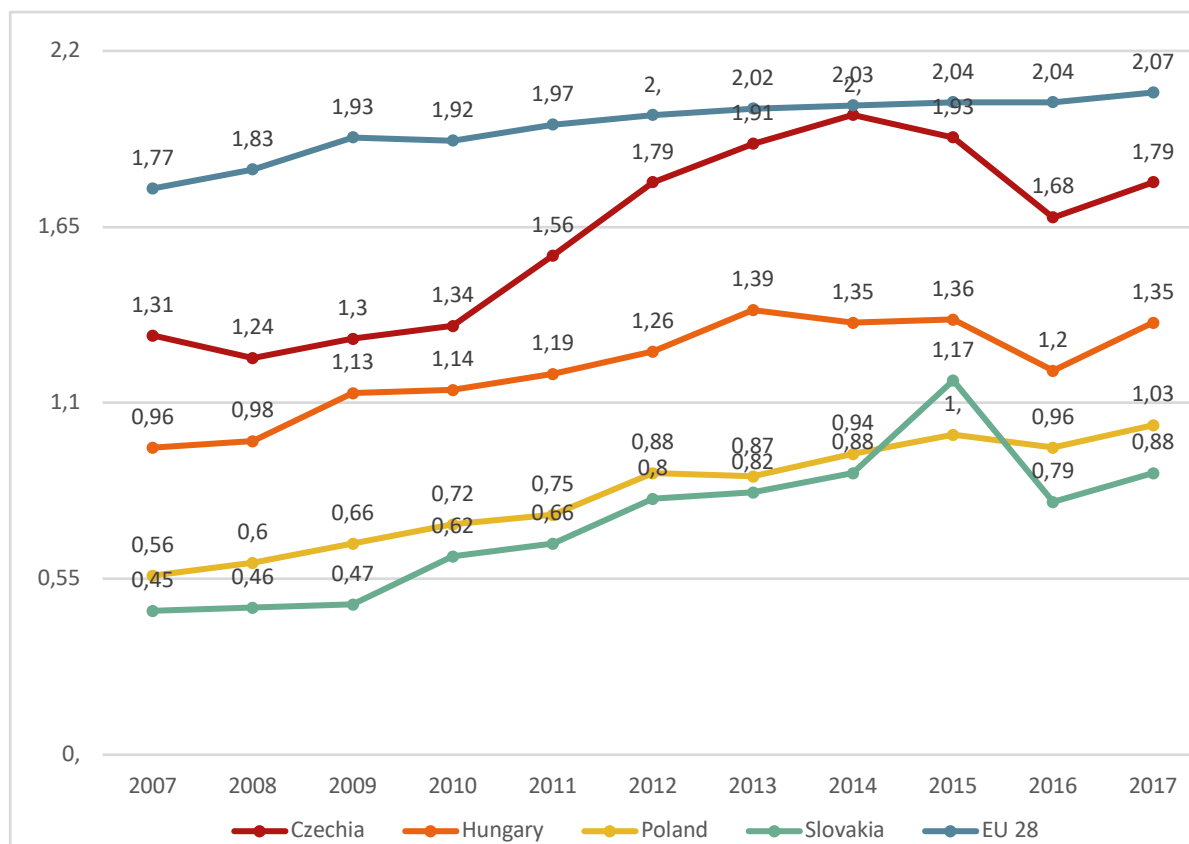
<sup>6</sup> Kureková, L.M. (2018) The automotive industry in Central Europe: A success? IZA World of Labor 2018: 448.

<sup>7</sup> Jakubiak, M., P. Kolesár, I. Izvorski, and L. Kureková. The Automotive Industry in the Slovak Republic: Recent Developments

and Impact on Growth. Commission on Growth and Development Working Paper No. 29, 2008.



Figure 4 Gross Domestic Expenditure on R&D (GERD) as % of GDP



Another problem with foreign investors opening factories in the region is that they usually seek regions with developed infrastructure so they can transport products easily around Europe. This means setting up greenfield factories in already relatively wealthy regions, usually in the proximity of capitals, neglecting other parts of the countries. A recent study (Marta, 2017) focusing on the V4's regional development suggests that international social convergence is occurring at the expense of regional divergence. In turn, disparities between the regions are increasing, which is the most visible in Poland.<sup>8</sup> The latest European Semester country report on Czechia<sup>9</sup>, Hungary<sup>10</sup>, Poland<sup>11</sup> and Slovakia<sup>12</sup>, published by the European Commission

also points out the issue of growing regional disparities. The distribution of opportunities remains concentrated into certain regions. Regional disparities also cause poor educational outcomes and inequality based on socioeconomic background, which in turn hampers the vertical social mobility of population.

Smaller cities and regions further from the countries' capital are more vulnerable to demographic changes. The ageing and shrinking of working-age population cause serious challenges to long-term economic sustainability. Moreover, a high level of foreign-based capital means that the V4 countries continues to be dependent on decisions made by international corporations abroad and more vulnerable to external shocks.

<sup>8</sup> Marta, K. (2017) Is The Regional Divergence A Price For The International Convergence? The Case Of The Visegrad Group. Journal of Competitiveness. Vol. 9, Issue 4, pp. 50 - 65, December 2017. ISSN 1804-171X (Print), ISSN 1804-1728 (On-line), DOI: 10.7441/joc.2017.04.04

<sup>9</sup> [https://ec.europa.eu/info/sites/info/files/file\\_import/2019-european-semester-country-report-czech-republic\\_en.pdf](https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-czech-republic_en.pdf)

<sup>10</sup> [https://ec.europa.eu/info/sites/info/files/file\\_import/2019-european-semester-country-report-hungary\\_en.pdf](https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-hungary_en.pdf)

<sup>11</sup> [https://ec.europa.eu/info/sites/info/files/file\\_import/2019-european-semester-country-report-poland\\_en.pdf](https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-poland_en.pdf)

<sup>12</sup> [https://ec.europa.eu/info/sites/info/files/file\\_import/2019-european-semester-country-report-slovakia\\_en.pdf](https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-slovakia_en.pdf)



## Evolution of Posting of Workers Directives

When it comes to the question of how to streamline or converge social policies among the EU members, the European Commission faces a dilemma: while it is empowered to promote the four freedoms behind the single market – inter alia the building blocks of EU's success - it has to restrain from interfering into member countries' social policies. The contentious posted workers directive shows the separation of the two spheres and is increasingly challenging.

Although posting involves only a small share of EU's total workforce (0.7%), it is particularly relevant in the construction or manufacturing sector, where it concerns 42% and 21.8% employees respectively.<sup>13</sup>

The posting of workers represents a crucial element for the well-functioning of the internal market. It enshrines the commitment to remove any obstacle to the free cross-border movement of services among the EU Member States and within the internal market. Debates about cross-border provisions came to the forefront with the accession of Portugal and Spain in 1986 and it is only after a decade, with the accession of Austria, Finland and Sweden in 1996, that the European Community adopted the first legislative proposal. This was also caused by changes happening east of the European Community's border – the fall of the Berlin Wall and transition of former Soviet satellites economies to capitalism and opening of new markets.

### The 1996 Posted Worker Directive

The original 1996 Directive serves as a general regulatory framework for the promotion and facilitation of cross-border provisions and services, while ensuring the social protection of posted workers and creating a level playing field between local and foreign companies. Within the directive, the posted worker is defined as 'a person who,

for a limited period of time, carries out his or her work in the territory of an EU Member State other than the state in which he or she normally works' (Council Directive 96/71/EC). The main question the 1996 accord sought to address was which employment conditions should apply for temporarily posted workers from one Member state to another. Before that, Member States could basically extend their national labor law to posted workers, if they decided to do so. The 1996 Directive established a set of 'hard core' minimum terms of employment or a nucleus of mandatory rules for minimum protection in the host country, such as for instance maximum work periods or minimum rates of pay, which were supposed to be in accordance with the host state. The social security system of the sending state was responsible for insuring posted workers in cases where the posting lasted for less than two years. With regards to taxation, the right to levy income tax remained with the sending country for the first 183 days, with this right moving to the receiving state after that.

As mentioned briefly above, the transition of former Soviet satellites to capitalism has increased competition in each country using posted workers from New Member states where the wages and labour costs are significantly lower. The issue of posted work became symptomatic of the East/West split within the EU in social matters.<sup>14</sup> In the wake of the 2004 enlargement, workers from Central and Eastern European Countries (CEEC) faced a period of 'transition' during which they were prohibited to settle in Western countries. This, coupled with restrained East–West solidarity via structural funds, where financial support was limited compared to previous enlargements, caused a considerable increase in using posted workers, as seen in Figure 5 and Figure 6.

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<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016SC0052&from=LT>

<sup>14</sup> Picart S. and Pochet, P. 2018. The posting workers saga: A potted version of the challenges engulfing Social Europe. ETUI Policy Brief, No6.2108.



Figure 5 Posted workers, breakdown by receiving country, absolute numbers and % of total employment, years 2010 and 2014. Source: EMPL elaboration on Pacolet and De Wispelaere (2015). Note: data on received posted workers are only available with respect to postings to single Member States (art. 12 of Reg. 883/2004).

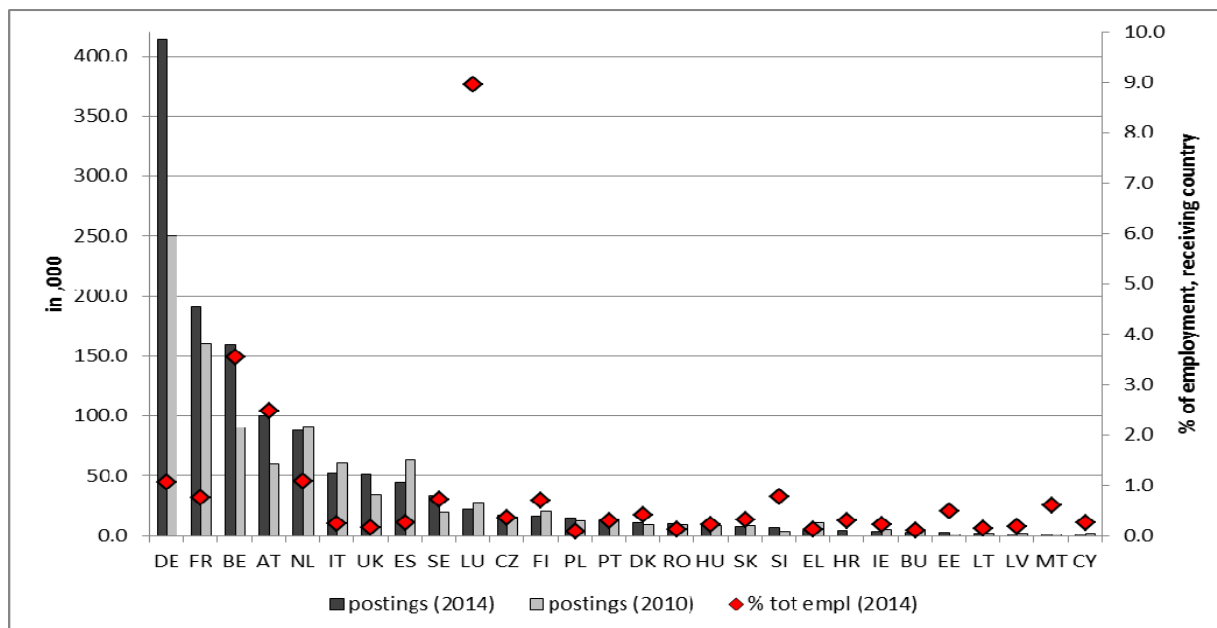
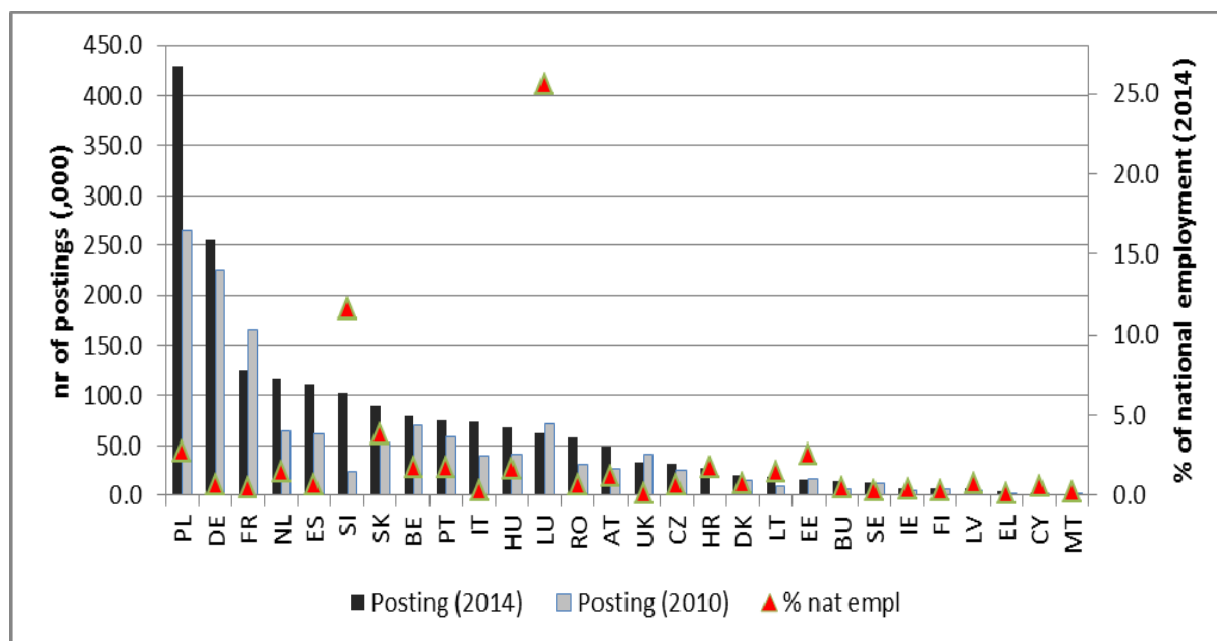


Figure 6 Posted workers, breakdown by sending country, absolute number and % on total employment, years 2010 and 2014. Source: EMPL elaboration on Pacolet and De Wispelaere (2015). Note: data on sent posted workers include both postings to single Member States and postings to multiple Member States (art. 12, 13 of Reg. 883/2004).





## Limits of the 1996 Directive

There are three main reasons why the revision of the 1996 Directive was proposed. Firstly, increasing wage gaps and divergence in labour costs have been a cause of concern mainly in Western European Countries. By providing cheaper labour force via the legally permissible posting of workers, the CEEC were accused of 'social dumping'. On the other hand, the argument of the CEEC was that this facilitates competitiveness and represents one of the building blocks of internal market freedoms. Nevertheless, companies and businesses used posted workers as a cost-effective way to enter into competition with their counterparts in the West. As a consequence, the number of posted workers between 2010 and 2016 skyrocketed by 69%.

Secondly, the original 1996 Posted Worker Directive has created in several ways a favorable environment for malpractice. Companies and businesses rotated posted workers so that they would not exceed the period of their legal stay. Another consequence of circumventing the legal provisions of Posted Worker Directive was the unparalleled creation of "letter-box companies". Certain companies transferred their workforces to intermediate companies situated in other EU member countries; number of companies opened offices in another EU country and offered to hire workforce there. In this way, the employee is subjected to employment contract of the country where the workforce is actually hired. It usually concerns countries with cheap workforce, low taxes and relatively weak trade and labour unions. Such malpractice and legal opportunism constitute instances of social dumping which legally allow companies to lower social security payments and "optimize" their expenditure on taxes. Actually, this legal loophole, together with the freedom of establishment (discussed below), allows for the opening a company in another

country, in which it has no activities and no staff, effectively creating an office which is nothing else than a letter box company.<sup>15</sup>

Finally, the reason to revise the 1996 Directive was the unclear interpretation of the established standards, insufficient oversight of and weak cooperation between the EU institutions and EU member states. The reason can be found in the series of ECJ decisions which established the hierarchy between economic freedom and fundamental social rights of employees. The legal analysis of ECJ decisions, called the Laval Quartet<sup>16</sup>, interprets the Posted Workers Directive as 'an almost exhaustive coordination of the national measures for protecting workers in posting situations'.<sup>17</sup> Through these decisions, the ECJ basically interprets the grounds which create unfair competition; where the hard nucleus of the host State is applied, it cannot be regarded as a practice of social dumping per se.

Given the shortcomings outlined, the European Commission suggested a reform, which would update the 1996 Posted Workers Directive so that it could reflect new political circumstances, while strengthening its enforcement among the Member States. The goal of the 2014 Enforcement Directive was to guarantee the compliance and a stronger enforcement of the 'hard nucleus'.<sup>18</sup> It was also aimed at strengthening the practical application of the original 1996 Posted Workers Directive, by addressing issues related to: fraud, circumvention of rules, inspections and monitoring, joint liability in subcontracting chains, and the exchange of information between the Member States.<sup>19</sup>

As the Enforcement Directive fell short, the European Commission came up, in 2016, with a revision of the rules on posting workers, which aimed to 'facilitate the provision of services across borders within a climate of fair

<sup>15</sup> Cremers, J. (2014) Letter-box companies and abuse of the posting rules: how the primacy of economic freedoms and weak enforcement give rise to social dumping. ETUI Policy Brief No.5/2014

<sup>16</sup> The Viking case, the Laval case, the Rüffert case, the Commission vs. Luxembourg (C-319/06)

<sup>17</sup> The Impact Of The ECJ Judgments On Viking, Laval, Rüffert And Luxembourg On The Practice Of Collective Bargaining

And The Effectiveness Of Social Action  
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<sup>18</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0067&from=fr>

<sup>19</sup> <https://ec.europa.eu/social/main.jsp?catId=471#navItem-5>



competition and respect for the rights of posted workers'.<sup>20</sup> The revision required to provide the same remuneration to local workers and to posted workers. In practice this would mean remuneration would not only include minimum rates of pay (...), but also bonuses or allowances where applicable'.<sup>21</sup> The political buzzword for this was 'equal pay for equal work', a phrase reiterated mainly by French President Macron.

The proposal quickly hit the wall in May, when 10 Member states' national parliaments from the region of Central and Eastern Europe triggered a 'yellow card' procedure against it. The argumentation of the concerned Member States, including all V4 countries except Slovakia, was grounded in the principle of subsidiarity. The focus of criticism was that in case the proposed Directive were enforced, it would impinge on national jurisdiction and the legitimate right of Member State to set wage levels.

After a period of 18 months of talks, Member States finally decided on the main contours of the revised Posted Workers Directive. Under the revised agreement, the posting of worker was shortened to 12 months (extendable by a further 6) and the transport workers are, as for now, to be excluded until the agreement in the sector of mobility will be reached. The agreement was adopted under the qualified majority, where from the V4, Hungary and Poland were against the proposal. Czechia and Slovakia, countries that initially expressed their opposition, eventually voted in favor of the proposal, ostensibly awaiting concessions in questions which would earn them popular public support in their domestic constituencies.

## Leveling the playing field(s)

Macron's call for upwards social convergence and reform of the labour market, with the aim to harmonize the wages and social contributions served as a wakeup call for the V4 countries to start implementing reforms into their economic models which are still built on cheap labour force

and continue to focus on manufacturing and industry. The squabble around the Posted Workers Directive also revealed the relative incoherence of the bloc on questions of national interest. For instance, Slovakia, as the only member of the Eurozone, held an unavoidably different position than the rest of the V4. Eyeballing membership in the 'EU core', which would be ostensibly built around the Eurozone members, makes it natural for Slovakia to be more receptive to French or German proposals. Moreover, having been led in the past 2 elections by a socialist government, Slovakia is also more amicable to proposals concerning social well-being and reforms of the welfare state.

The reform of the Posted Workers Directive could be also interpreted as an attempt to rebalance social rights across the continent. More specifically, Macron and the European Commission touched upon and expressed their dissatisfaction with how two basic freedoms (service and labour) of the single market are being executed. Hence, this is a chance for the V4 to make a case and argue for rebalancing of the other two freedoms, namely goods and capital. We witnessed some activity in the case of the former, when the Czech and Slovak government went on the offensive on the matter of dual food quality, a cause vehemently backed by other Central and Eastern European member states. Also, Commission President Juncker, in his state of the Union expressed his disapproval of big companies and supermarkets selling subpar versions of brand name foods to costumers in Central and Eastern European states who, through these practices, create second class citizens.

New member states viewed dual food quality as a failure of the single market and as a discrimination. The issue was a matter of criticism by the European Parliament already in 2013 when it called Commission to carry out meaningful investigation to evaluate whether the existing legislation should be amended. Only now, with the pressure of the V4, and especially Czechia and Slovakia, has the European Commission released a new common

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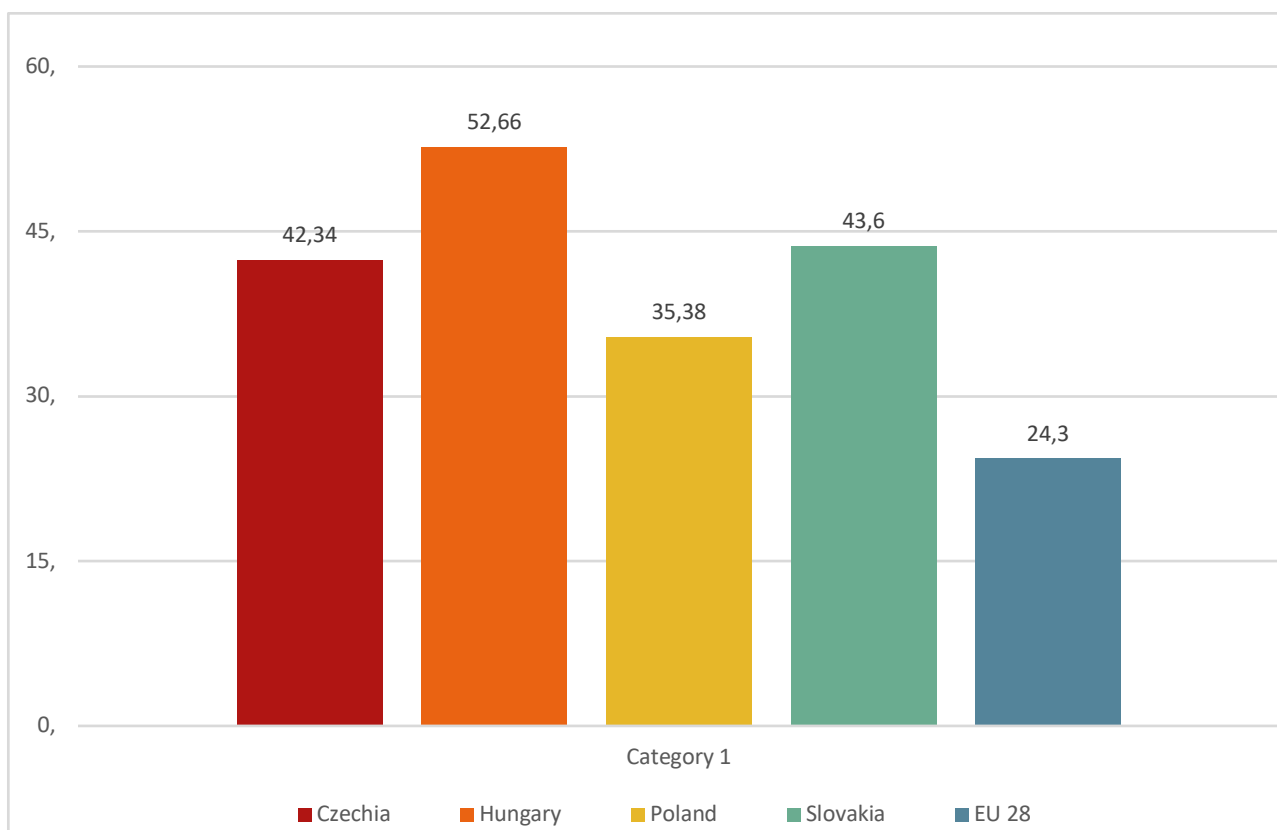
<https://www.eurofound.europa.eu/fr/publications/article/2016/eu-level-posted-workers-proposal-gets-yellow-card-from-member-states>



methodology for comparing food quality. This methodology complements the Commission's New Deal for Consumers initiative in an attempt to "clarify and strengthen consumer rights, including prohibiting dual quality practices which are misleading consumers; empower qualified entities to launch representative actions on behalf of consumers; introduce stronger sanctioning powers for Member States' consumer authorities".<sup>22</sup> Moreover, dual food quality will be under this proposal amended to the Unfair Commercial Practices Directive.

Given the success in the fight for establishing equal food quality, the V4 might lock-in in an attempt to create viable pressure on the European Commission in order to secure the rebalancing of the remaining internal market freedom – the capital. As mentioned above, the attraction of FDI helped emerging economies to enter the modern production chain. Even now, a quarter of century after the transition, foreign owned enterprises are the backbone of the V4 economies.

*Figure 7 Value Added in Foreign Controlled Enterprises. Percentage of total. Source Eurostat.*



<sup>22</sup> [https://ec.europa.eu/commission/news/dual-quality-food-2018-jun-14\\_en](https://ec.europa.eu/commission/news/dual-quality-food-2018-jun-14_en)



The dominant position of foreign controlled enterprises coupled with low labour cost creates among local populations the feeling of exploitation, mainly because the profit is often unevenly repatriated. For instance, Slovakia already experienced imbalances with regard to the freedom of capital, as only 2.2 percent of profits made by foreign companies remain in Slovakia.<sup>23</sup>

Thus, given the low investments into the R&D in the region, the V4 could possibly propose legislation which would bind foreign based companies to decrease their capital drain. Instead of repatriating, profit could be invested into boosting new R&D projects and the education of labour force in order to prepare countries of the region for the fourth industrial revolution. These forms of investments would tackle also the increasing threat of automation that the region is facing. A recent report on the potential long-term impact of automation puts Slovakia, Czechia and Poland among countries likely to be threatened by this trend.<sup>24</sup> The disruptive effects of automation on labour markets will occur in relatively high number of EU member states besides the V4. Hence, here lies the opportunity for the V4 to form a strong coalition, which would along the attempt to rebalance freedom of services and labour, propose to also rebalance the freedom of capital and goods.

## Conclusions and recommendations

Despite being perceived as a relatively homogenous entity, there are actually deep seated differences among the V4 countries, when it comes down to their situation in the EU. While, for instance, Slovakia is well embedded in what the incumbent government labels as the "EU core" and seeks closer ties with Paris and Berlin, Poland and Hungary rather seem to moan every time criticism about the state of the rule of law in case of former, or freedom of press in case of latter, is coming their way from Paris or Brussels. Political interests put aside, the V4 could eventually build a solid bloc on questions that would

be of strategic and economic interest of other EU member states. As argued above, post-communist countries share certain specific features that have influenced their socio-economic development. Cheap labour costs, high reliance on foreign investors and focus on manufacturing and industry sector were the main reasons behind economic progress, but this economic model is becoming obsolete in the wake of fourth industrial revolution. Low investments into R&D capabilities create a bottleneck for the further modernization of local economies.

The V4 countries could take the recent squabble around the Posted Workers Directive as a framework while arguing for rebalancing the rights included in the single market. With renewed debates about the benefits and importance of the single market after Brexit, the V4 could use the popular momentum to put forward a certain mount of key positions. The four freedoms are certainly one of the greatest achievements of the integrated Union, and it is inadmissible to focus on reforming only certain aspects of it. Hence, the V4 could build a like-minded coalition of countries that, besides voicing their concerns about dual-quality food, would begin to argue for stopping the capital drain taking place in the region. Only this can truly level the playing field, which Macron has been calling for insistently.



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<sup>23</sup> Interview

<sup>24</sup> <https://www.pwc.fr/fr/assets/files/pdf/2018/02/impact-of-automation-on-jobs-international-analysis-final%20report-feb-2018.pdf>



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