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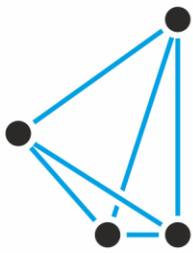
2018/January

Think Visegrad in Brussels

Labour market reform and Visegrad countries: Deep rooted concerns and how to address them

Alena Kudzko





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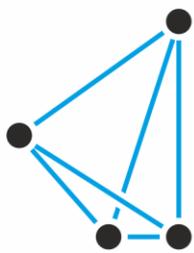
Issues of labour mobility and labour markets have been among the most contentious discussions on the crowded EU agenda of the past couple years. Proposals calling for reform of the regulations on posted workers and for the enhancement of social rights, advocated primarily by Western countries - including most notably France - and the EU Commission, have been accompanied by both domestic and EU-wide squabbling. Visegrad countries (the Czech Republic, Hungary, Poland, and Slovakia) have often found themselves on the defensive, seeking at once to both fend off accusations of “social dumping” and foil the undesired reforms. They fear that some of the proposals on labour reform fail to coincide with their economic interests and the principle of the free market, or perceive them as an encroachment of the EU Commission on national competencies.¹

The fact that these reforms have featured prominently on national and European political agendas does however not make their debate the one with the greatest potential economic impact. The envisioned reform of the Eurozone, fiscal rules, investment packages, the Brexit deal, and discussion on the next Multiannual Financial Framework (MFF) are all likely to have more significant consequences for the economic performance of the entire EU and of individual countries than the labour market reforms.

Nonetheless, although the reform of the rules on posting and transport and the proposal enhancing the social dimension of the EU are, *in their current formulation*, neither fundamental nor detrimental to the economic performance of the EU or individual countries, they are reflective of broader trends and of the future that many fear is to follow. As part of a broader economic reform package, they run parallel to deeper **uncertainties about the future of Central European economies and their position in the EU**. Furthermore, the political symbolism of the debate on posted workers and social rights has been perceived – often diametrically – differently in various parts of Europe, keeping these issues in the media and political spotlight.

This paper aims to explain economic concerns behind the Visegrad countries’ positioning on the ongoing labour market reforms in the EU, and recommends steps to be taken at the EU and national level to avert the type of future that they fear – the shattering of the current economic model without a viable substitute and a slipping away of CEE countries to the political and economic periphery of Europe.

¹ The author is grateful to Think Visegrad Brussels office and fellowship scheme for the opportunity to conduct research in Brussels that informed this paper.



Posted workers, transport sector, and social rights: brief overview of the reform agenda

Posted and transport worker

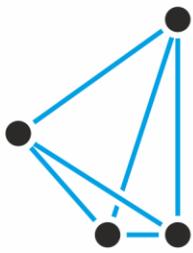
After 18 months of talks, EU member states finally reached an agreement in late October on “posted workers”, an accord aimed at changing the 1996 directive that allowed EU countries to “post” a worker for a certain period of time to another state without necessarily abiding by all local laws, including the obligation to provide locally set bonuses, holidays, and over-time compensation. The issue was one of the priorities of French President Emmanuel Macron for his “protection agenda” in the EU reform as the current European system of posting is seen in France as undermining the principles of “fair, regulated and governed” competition. Under the agreement reached in October, the posting time was shortened from the current 30 months to 12 months extendable by a further six. As a compromise, the rule will come into force after a four-year transition period following the final agreement (the European Parliament is currently in negotiations with the Council on the final version of the text). Unlike the French proposal, transport workers are to be excluded from the deal until an agreement on the mobility sector is reached.

The agreement was adopted by a qualified majority, with Hungary, Lithuania, Latvia and Poland voting against the proposal. The UK, Ireland, and Croatia abstained over concerns regarding the transport sector. Although originally opposing the proposed revisions, a number of Central and Eastern European members ultimately voted in favour: Bulgaria, the Czech Republic, Romania, and Slovakia.

Social Rights

In an attempt to address public discontent following years of austerity, the EU Commission has focused on elevating the social agenda in its governance plans. The European Pillar of Social Rights has been portrayed as a vehicle for both boosting growth and regaining the support of the public. The Commission is hence determined to “put social priorities where they belong: at the top of Europe’s agenda” and achieve a “Social triple-A” for the continent². The European Pillar of Social Rights was proclaimed and signed by the Council of the EU, the European Parliament and the Commission during the Gothenburg Social Summit for fair jobs and growth in November 2017. The Pillar sets out 20 principles and rights, divided into three

² Jean-Claude Juncker, http://europa.eu/rapid/press-release_IP-17-114_en.htm. See also, for example, Jean-Claude Juncker, Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz (2015), The Five Presidents’ Report: Completing Europe’s Economic and Monetary Union, 22 June 2015 https://ec.europa.eu/commission/publications/five-presidents-report-completing-europes-economic-and-monetary-union_en.



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categories: equal opportunities and access to the labour market, dynamic labour markets and fair working conditions, and public support /social protection and inclusion.³ It is primarily envisioned as a platform for the Eurozone area but is applicable to all Member States willing to participate.

The popular momentum that has allowed the Commission to advance its social agenda has also mobilized many national governments. In some countries, the free movement of people is increasingly seen as an unwelcome component of European policies that undercuts the prosperity of local populations. The feeling of dissatisfaction with the uneven distribution of economic benefits is exacerbated by the fear of losing one's job to a foreigner, often to cheaper labour from CEE. This particularly concerns manufacturing or lower-level service jobs. Many Western countries, with the buy-in from a number of Central European states (including Slovakia and the Czech Republic), are now more politically motivated to equalize the playing field for their domestic populations by lobbying for the upward harmonization of social standards across the EU.

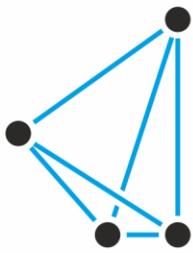
Reactions from V4 and what's behind it

The coordination of the social and labour agenda has been challenging for the V4, as it has been for the entire EU with the purported East-West divide, due to conflicting political preferences and unequal positions of dependency on the Eurozone reform agenda in the first place. There has, nevertheless, been a shared Visegrad perspective involving at a minimum **caution and concern** with respect to the overall direction of the reforms. The curtailing of the freedom of movement of labour and services and harmonization of the social agenda at the EU level are particularly viewed as posing significant risks. At least to a certain degree, V4 countries have expressed a common concern that higher social standards and the upward reform of labour regulations to match those in Western countries will precipitate **the loss of their competitive advantage and an unsustainable burden on national budgets**.

The discontent has been much more pronounced from Poland and Hungary than from Slovakia and the Czech Republic. Poland has led the opposition to the reform of the posted workers directive, denouncing it as veiled protectionism that limits free and fair competition. During the vote on the Pillar of Social Rights in the European Parliament in January 2017, the overwhelming majority of V4 MEPs voted against the proposal. The arguments raised were two-fold: that the reform is not in the interest of CEE countries and will lead to more inequality, and that it violates the principle of subsidiarity.

A member of the Eurozone, Slovakia unavoidably holds a position different from its V4 neighbours. With the government's public commitment to remaining in the

³ https://ec.europa.eu/commission/priorities/deeper-and-fairer-economic-and-monetary-union/european-pillar-social-rights/european-pillar-social-rights-20-principles_en



“core of the EU”, the country is more receptive to reforms and closer integration. Despite initial opposition towards the reforms, Slovakia, together with the Czech Republic, ultimately voted in favour of the compromise on posted workers, ostensibly after the “charm offensive” by the French President and potentially with the expectation of concessions in other, more salient issue areas. Slovakia is similarly more amicable towards proposals on the social agenda.

Reactions explained

The fact that Visegrad countries were recently at loggerheads with the EU and the West more broadly over migration, and that clashes exist between the EU and Hungarian and Polish governments about the rule of law and freedoms in the two countries, are two focus points that can lead to interpretations that the spat over posted workers or social policy is mostly simply yet another demonstration of the region’s refusenik attitude. The political dimension aside, V4 countries do maintain **legitimate worries about the impact of accelerated upward convergence, concerns that are conditioned by the structure of the region’s economies**. A couple factors that work in tandem can be pinpointed, including the **shared characteristics of economies** and labour markets in the region and related considerations about the **future direction and speed(s) of EU integration**.

Shared characteristics of V4 economic models and labour markets

- ***Cheap labour is still a primary source of competitiveness***

Cheap labour has so far been the cornerstone of competitiveness in the region. Even though wages in V4 are growing at a pace that exceeds the EU average, they are still considerably lower than those in older or Western member states. (Fig. 1; Fig.2)⁴

⁴ For the purposes of data comparison, the “Central and Eastern European” (CEE) countries on the graphs are identified as Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.

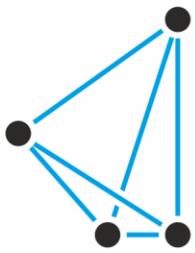


Figure 1. Growth rate, average hourly labour cost

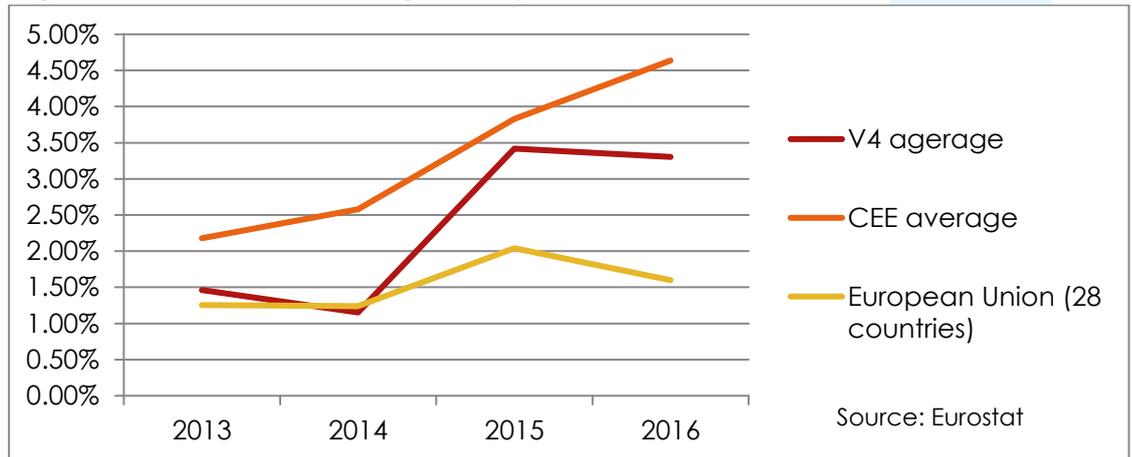
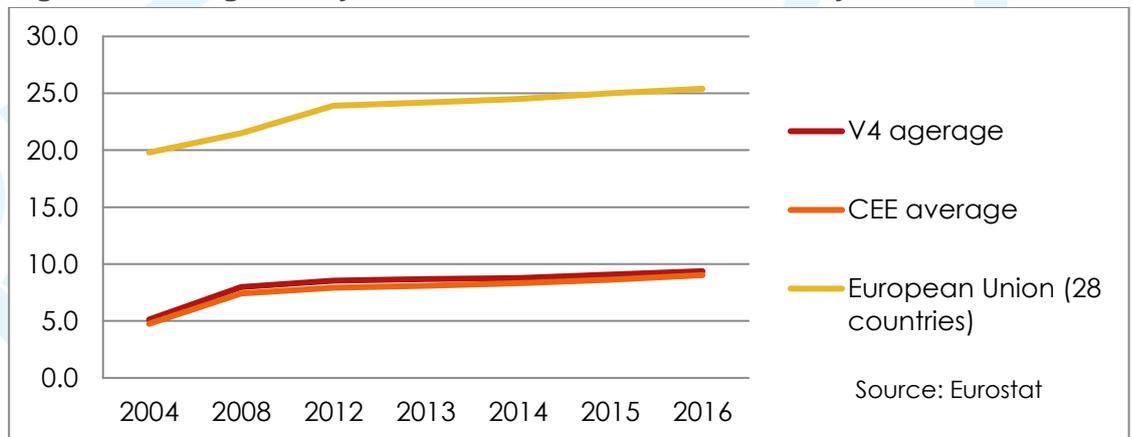


Figure 2. Average hourly labour cost for the whole economy, in EUR



- **Gap in productivity**

The gap in productivity between V4 and Western countries is still large. The countries are still on the lower rungs of the technology ladder and find it difficult to move up the production chain. (Fig.3)

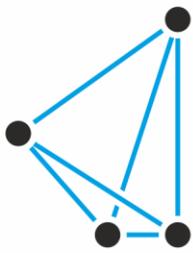
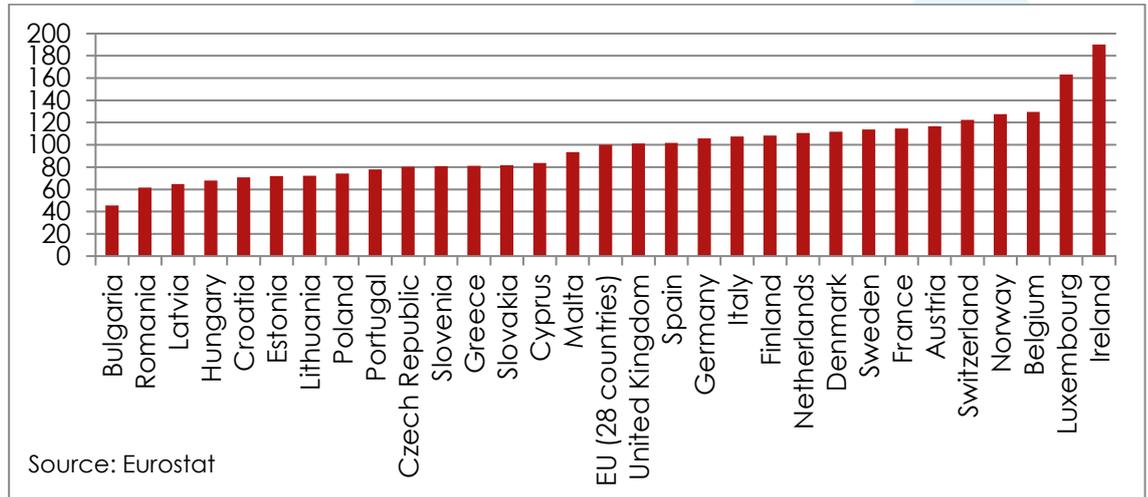


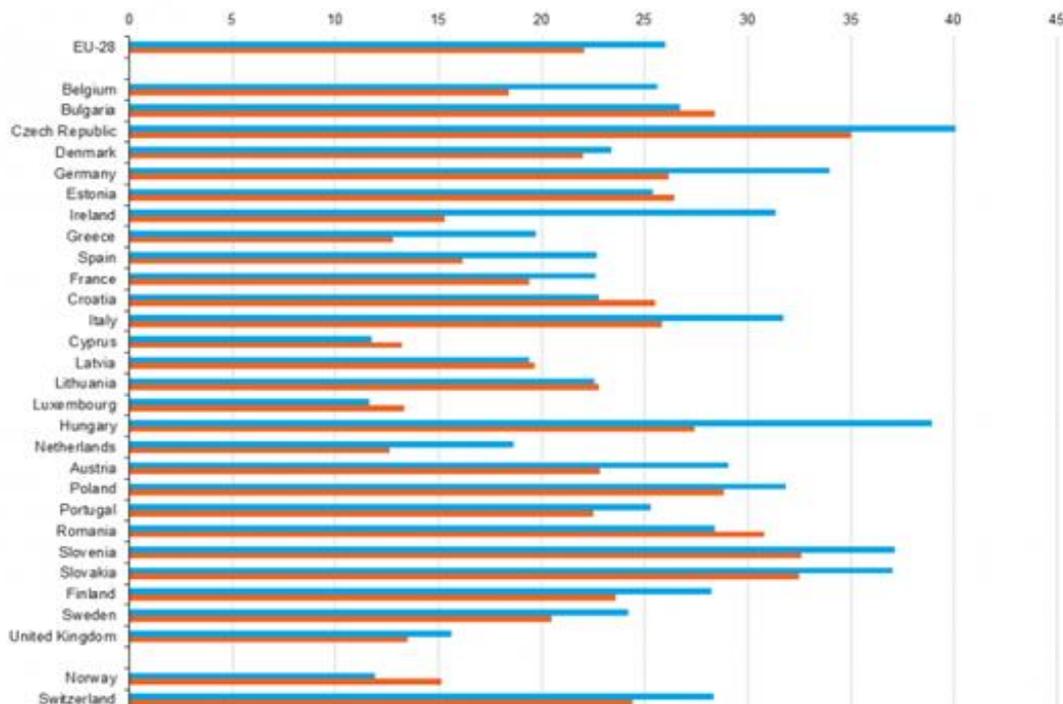
Figure 3. Nominal labour productivity per person employed (EU-28 = 100), 2016



- Concentration of labour force and value added in one sector**

The role of industry and manufacturing is strong compared to Western countries where services account for a larger share of jobs and value added. Within industry and manufacturing, the automotive industry has become especially well-entrenched, drawing attention to the need to diversify economies by creating suitable conditions for other sectors. (Fig. 4, Fig.5) **Figure 4. Relative importance of manufacturing, 2014**

Figure 4. Relative importance of manufacturing, 2014



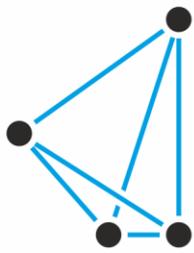


Figure 5. Value added, 2014 (in billion EUR)

	Mining & quarrying	Manufacturing	Electricity, gas, steam & air con. supply	Water supply, waste & remediation	Construction	Distributive trades	Transport & storage	Accommodation & food services	Information & communication	Real estate activities	Professional, scientific & technical	Administrative & support services	Repair, computer, personal & household goods
EU-28	65.0	1710.0	218.9	102.0	510.7	1242.6	515.3	230.5	552.1	272.2	667.6	486.0	10.9
Belgium	0.3	49.9	5.9	2.7	16.5	41.4	15.4	5.1	13.7	5.7	22.1	16.0	0.2
Bulgaria	0.6	5.3	1.3	0.3	1.4	4.4	1.8	0.6	1.8	0.5	1.2	0.7	0.0
Czech Republic	1.1	33.6	5.0	1.3	5.5	12.9	5.6	1.5	5.5	3.0	5.6	3.0	0.2
Denmark	4.3	29.8	2.9	1.9	9.6	24.5	13.1	3.0	10.0	9.6	12.2	6.4	0.2
Germany	5.2	519.8	40.5	23.0	90.5	269.1	98.6	36.1	113.0	80.9	148.4	105.1	1.4
Estonia	0.2	2.7	0.6	0.1	0.9	2.0	1.2	0.3	0.7	0.6	0.6	0.6	0.0
Ireland	0.5	36.9	3.5	0.4	4.8	18.0	6.9	3.9	22.5	1.4	8.6	9.8	0.2
Greece	0.3	10.0	2.4	0.6	3.7	14.8	5.0	3.8	3.1	0.5	4.0	2.2	0.1
Spain	1.4	97.6	19.6	9.0	31.7	92.5	41.5	24.5	30.7	12.7	38.2	29.6	1.1
France	1.8	201.0	30.3	10.7	88.7	168.4	76.6	36.3	77.7	35.4	87.5	71.8	2.4
Croatia	1.1	4.6	1.2	0.6	1.6	3.9	2.0	1.4	1.5	0.4	1.4	0.6	0.1
Italy	3.7	204.1	25.8	12.4	46.6	118.7	54.8	27.5	45.6	17.0	52.3	33.9	0.9
Cyprus	.	0.8	.	0.1	0.5	1.6	0.7	1.0	0.8	0.1	0.9	0.2	0.0
Latvia	0.1	2.0	0.6	0.2	0.9	2.3	1.6	0.2	0.7	0.7	0.6	0.4	0.0
Lithuania	0.1	3.3	0.8	0.3	1.3	3.7	2.0	0.2	0.8	0.6	0.9	0.6	0.0
Luxembourg	0.0	2.5	0.4	0.1	2.3	5.4	1.5	0.7	2.9	0.9	3.1	1.8	0.0
Hungary	0.2	19.9	1.9	0.7	2.8	8.3	4.6	0.9	4.0	1.8	3.6	2.5	0.1
Malta	.	.	.	.	0.3	0.8	0.4	0.3	0.5	0.2	0.5	0.4	0.0
Netherlands	9.3	58.7	6.4	3.6	24.5	72.3	27.9	9.2	25.9	14.5	37.2	25.2	0.3
Austria	1.2	49.3	5.2	2.0	15.7	32.6	13.2	8.2	9.3	8.6	13.7	10.5	0.1
Poland	7.3	57.7	12.1	3.8	14.1	35.5	13.4	2.4	11.9	5.0	11.0	6.7	0.3
Portugal	0.4	17.4	4.5	1.4	5.2	14.6	6.1	3.4	4.9	1.1	4.9	5.0	0.1
Romania	3.4	15.9	3.9	1.0	4.7	10.4	4.4	0.9	4.3	1.5	3.0	2.3	0.1
Slovenia	0.1	6.9	0.8	0.3	1.3	3.3	1.7	0.6	1.1	0.3	1.5	0.6	0.0
Slovakia	0.3	11.5	1.9	0.4	1.5	5.6	2.6	0.4	2.3	0.8	2.3	1.2	0.0
Finland	0.2	24.6	3.5	0.8	9.3	14.7	7.8	2.1	8.2	4.0	6.6	5.1	0.1
Sweden	1.8	51.8	8.4	1.8	20.3	39.7	14.4	6.0	18.9	18.1	20.6	12.0	0.3
United Kingdom	20.0	189.6	29.0	22.2	104.6	221.1	90.5	50.1	129.8	45.5	174.8	131.9	2.6
Norway	65.1	24.6	5.5	0.8	17.7	24.4	18.6	3.7	12.2	10.0	14.2	9.0	0.1
Switzerland	0.7	89.3	6.8	1.9	25.5	79.4	22.5	10.0	21.0	5.8	36.2	14.6	0.2
FYR of Macedonia	.	0.9	.	0.1	0.3	0.8	0.3	0.1	.	0.1	0.2	0.1	0.0
Turkey	4.3	63.6	5.7	2.9	.	.	.	.	.	.	.	.	.
Bosnia and Herzegovina	0.3	1.7	0.5	0.2	0.5	1.8	0.5	.	0.6	0.1	.	0.1	0.0

Source: Eurostat

- **Automated jobs – risk of redundancy**

The importance of industry and manufacturing and the solidification of the “assembly line” economy model creates the risk that many jobs will be replaced by robotization.

- **Foreign-owned capital**

Attracting Foreign Direct Investments after the transition from the communist economy helped re-industrialize local economies and aided them in joining the modern production chain. The fact that capital is foreign owned, however, engenders negative repercussions on both incomes and the potential of technological advancement in the region. This also spearheads local dissent towards the practice of foreign companies in using CEE countries as low-cost production bases while repatriating profits abroad. (Fig.6)

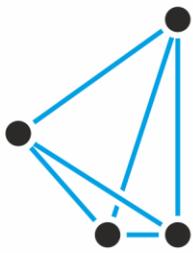
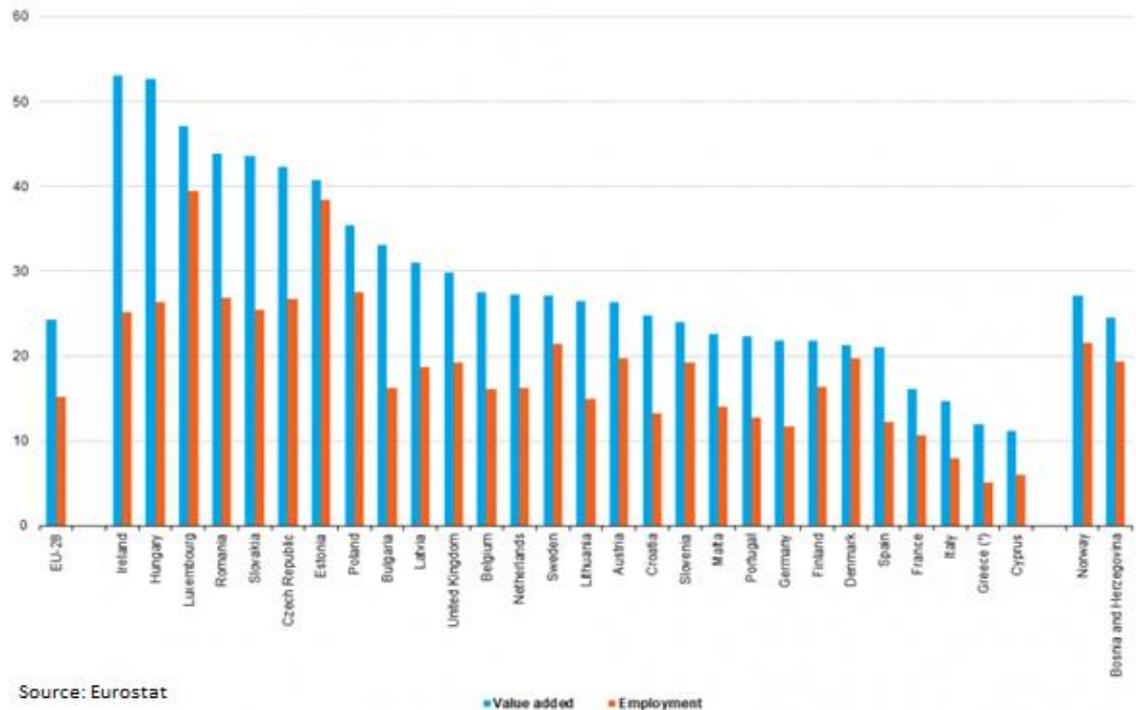


Figure 6. Share of value added and employment accounted for by foreign-controlled enterprises, non-financial business economy, 2014 (%)



Source: Eurostat

Value added Employment

- ***Wages grow also because of shortage of labour***

The current and forecasted growth of wages is also shaped by the fact that there is a shortage of labour in the region, including qualified labour. The shortage of labour is partially driven by the brain drain that was sped up by the freedom of movement provisions in the EU and the promise of better job opportunities in the West. The demographic situation in the region (low birth rates and an aging population) is also contributing to a decrease in the supply of labour. Finally, although the ability to attract more and more producers to the region is often helpful to economies, the saturation of the market also creates competition for labour. The gaps have been so far filled with cheap short term contractors from other countries, often from outside the EU, including most prominently Serbia and Ukraine.

- ***Labour is the main source of income***

As capital is often foreign owned and the social welfare system generally less generous, labour remains the main source of income. Given that the rate of return on capital is higher than the economic growth of wages and that wages are still significantly lower in Central Europe, the expected convergence in the level of life between Western and Central Europe has been truncated. This, in turn, has exacerbated social tensions. (Fig.7)

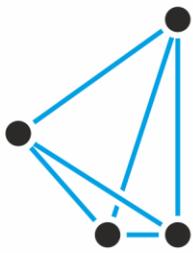
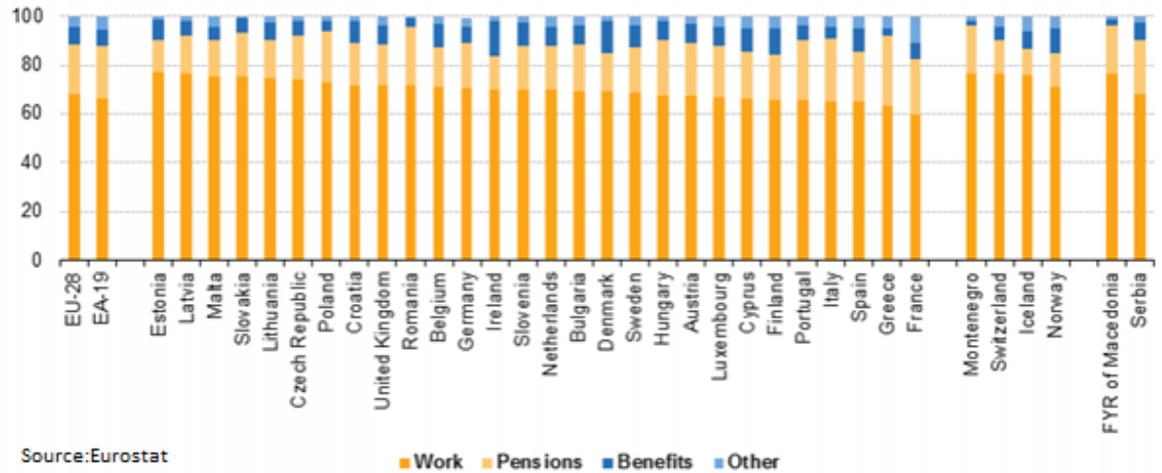


Figure 7. Shares of income components, 2014 (% share of the total household gross income)



Source: Eurostat

Work Pensions Benefits Other

- **Low investment into R&D**

The low investment into R&D is also exacerbated by the fact that the ownership of “local” industries is located abroad. This means that considerable shares of profits are repatriated abroad instead of being reinvested domestically, including into R&D, in the country. (Fig.8, Fig.9)

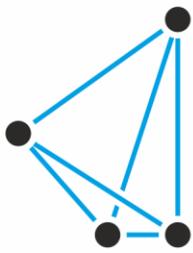
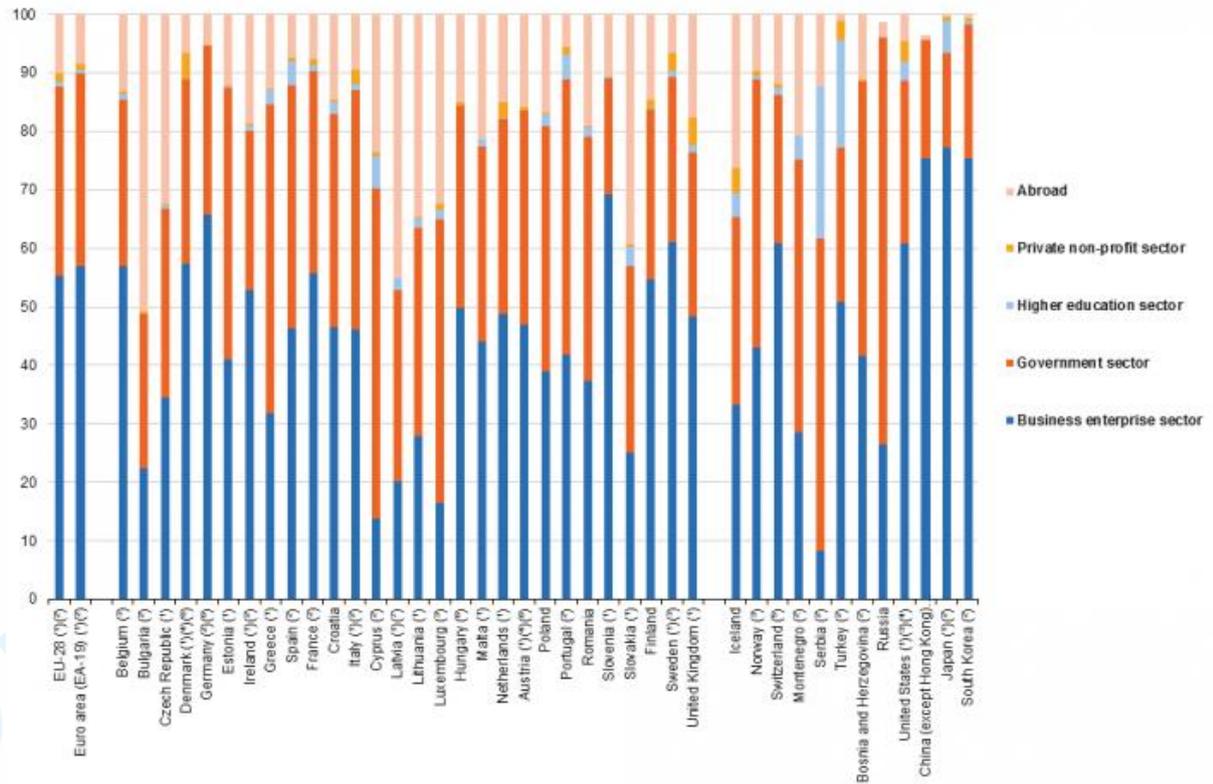


Figure 8. Gross domestic expenditure on R & D by source of funds, 2015 (% of total gross expenditure on R & D)



Note. When definitions differ, see http://ec.europa.eu/eurostat/cache/metadata/en/rd_esms.htm.

(*) Estimates or provisional.

(*) 2014 instead of 2015.

(*) 2013 instead of 2015.

(*) Definition differs.

(*) 2012 instead of 2015.

(*) Higher education sector: not available.

(*) Private non-profit sector: not available.

Source: Eurostat (online data code: rd_e_fundgerd)

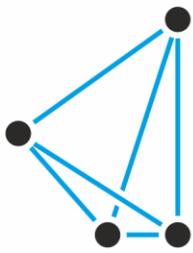
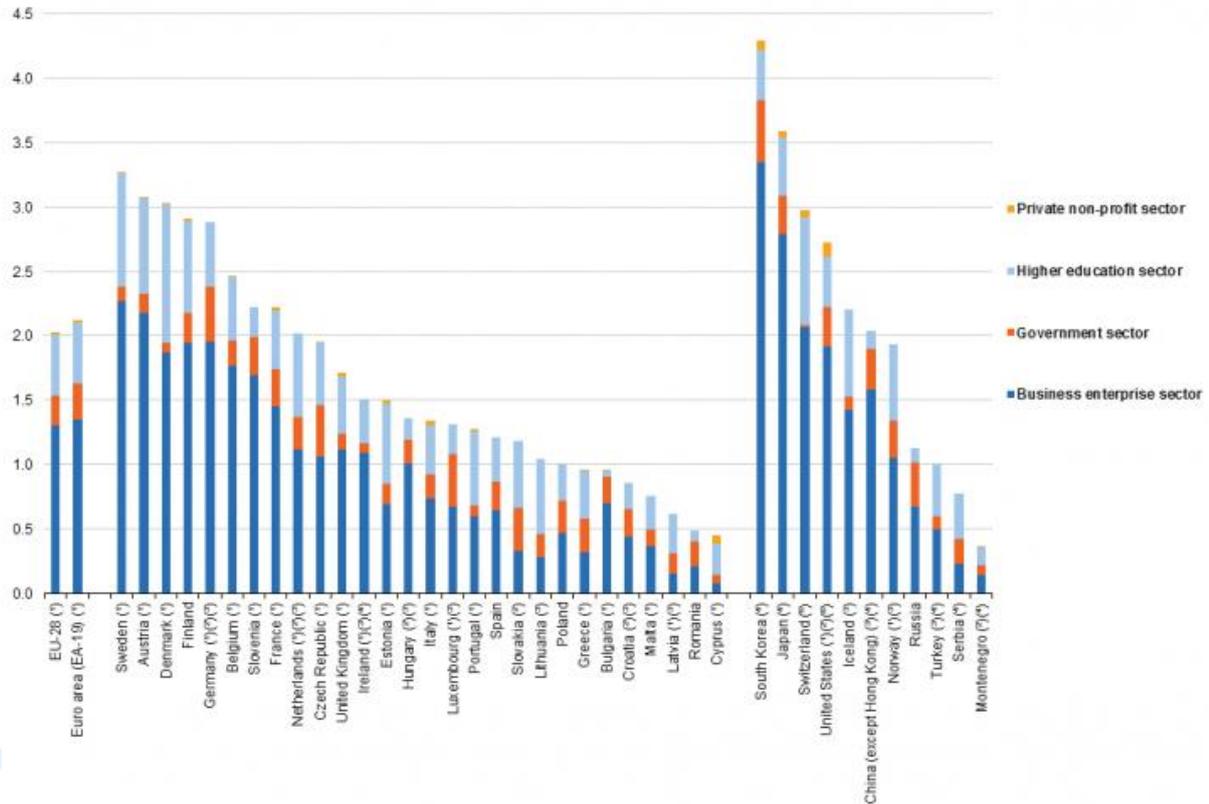


Figure 9. Gross domestic expenditure on R & D by sector, 2015 (% of GDP)



Note: When definitions differ, see http://ec.europa.eu/eurostat/cache/metadata/en/ird_esms.htm.

(*) Estimates or provisional.

(*) Definition differs.

(*) Private non-profit sector: not available.

(*) 2014.

(*) 2012.

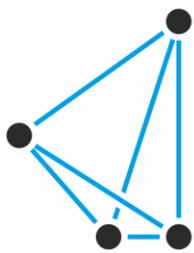
(*) 2013.

Source: Eurostat (online data code: rd_e_gerdtot)

Overall, the **reliance on cheap labour and the successful use of this advantage in one dominant sector** (manufacturing - specifically assembly stages of the manufacturing process) have prompted the Visegrad call to forestall changes to the current labour market regulations that make this advantage possible.

On the other hand, **the same factors have impelled Visegrad countries to seek reform**. The various aforementioned determinants have contributed to models that have ensured economic growth that has been faster than in Western states, but they also render the model unsustainable in the long-term. The fact that wages are forecasted to continue to grow, that shortage of labour is forecasted to persist, and that automation may arise in the future present tangible risks to jobs in the manufacturing sector. The V4 is consequently under pressure to contemplate an alternative growth model regardless of the domestic political agenda of the French President.

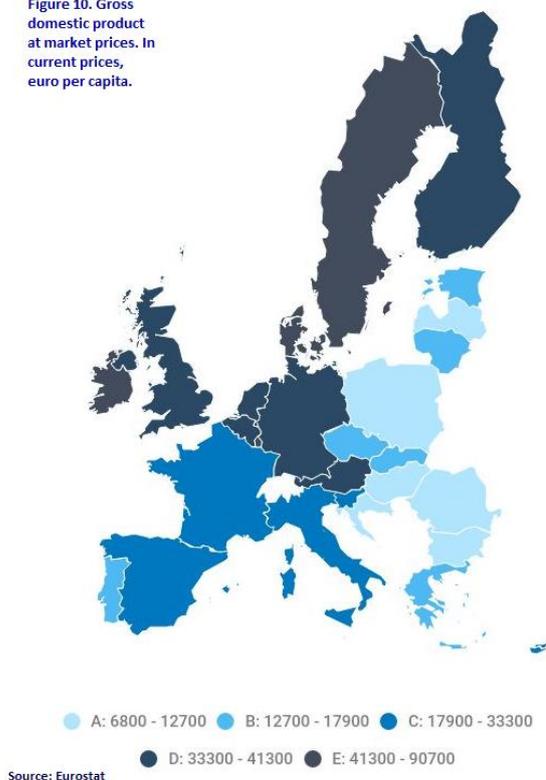
The rigidity and deep embeddedness of the current model also imposes **constraints on the speed of reforms**. European economic realities are currently far



from the desired convergence levels (Fig. 10). Assuming the achievement of convergence prematurely and introducing the same (higher Western) standards all across Europe might mean a demise of the current growth model without a solid alternative replacement.

Multispeed Europe and free marketers

Figure 10. Gross domestic product at market prices. In current prices, euro per capita.



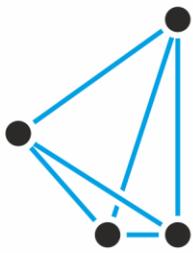
Not all of the proposed reforms target all EU member states, at least in the short run. The European Pillar of Social Rights, but also other integration proposals, have been primarily designed for members of the Eurozone. However, this does not alleviate the concerns of Eurozone members (out of V4, only Slovakia) nor of those currently outside it.

To advance the **Eurozone**, Slovakia might be cajoled into adopting social legislation that does not match its public financing capacity. With few reform specifications already agreed upon, it is hardly possible to safely predict that the costs of excessive social legislation would be smaller than the potential benefits arising from membership in the single currency and the stable environment entailed. The discussion on the introduction of a compensation

mechanism and funds to serve as anti-cyclical stabilizers is promising but not advanced enough yet to estimate a definitive impact on the national economy and budget.

The **non-Eurozone countries**, on the other hand, are concerned that the accelerated Eurozone integration will leave them further behind and outside of additional convergence schemes.

An additional factor worrying the V4 is the loss of an ally in Britain following the referendum over Brexit. The **Brexit** decision has shifted the balance of opinion in the EU towards the adoption of EU-level social policies. Traditionally, CEE had a strong ally in Britain as regards to scepticism towards social legislation (work environment, non-discrimination, social dialogue, working time, etc.) at the EU level and support for arrangements that render the movement of people in the Single Market relatively smooth and free of bureaucratic hassle. With Britain out of the picture and CEE countries holding diverging political and economic priorities, it is now easier to achieve



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compromise strongly tilted towards the **gradually converging Franco-German social and labour philosophy**.

Furthermore, the current reforms on upward harmonization of social policies and wages are interpreted as a sign that Member States - led by France - are opposing a genuine single market in Europe and using regulations as a form of protectionism with a particular focus on benefiting their own national economies. The protectionist agenda might be a temporary response to the pressure to counterweigh populist movements. If the incumbent governments implement reforms that generate support from domestic populations, the market might start opening up again. But those betting on this to happen might be in for a long and tense wait.

What to do

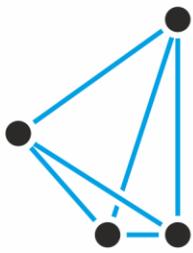
Given the widely-held perception, following a series of crises, on the need for reforms, it seems clear that they are bound to happen. But Visegrad countries possess opportunities **both to influence the direction of the reforms and to prepare themselves for the future that the reforms aim to usher in**. Efforts need to be marshalled in several directions – at the EU level and domestically.

1. Help design and implement fair cohesion and compensation schemes

As established above, the V4 have legitimate grounds to be worried: a combination of labour market reforms and attempts to rapidly introduce higher social and welfare standards across Europe, including in CEE, might lead to the loss of the competitive advantage of Central European countries, increased unemployment, and the inability of countries to stabilize the labour market and national economies overall. To communicate this situation to Brussels and EU partners effectively, Visegrad countries could intensify constructive diplomatic effort at the EU level.

While the convergence of the standard of living is certainly a worthy aspiration, CEE will need and have all the grounds necessary to **request continuous support** from the EU, including with regard to measures that aim to address social issues.

The negotiations of the post-2020 MFF are the right time to secure fair access to EU funds for affected regions and population groups. The engagement of the EU in this area ranges from Structural and Investment Funds and the European Fund for Strategic Investment to funds specifically targeting unemployment, education, training and other social issues – the European Globalization Adjustment Fund, the Youth Employment Initiative, Erasmus+ and Erasmus Pro, the Employment and Social Innovation Programme and the Fund for European Aid to the Most Deprived. The amount of money available at the EU level is insufficient to address all the problems facing the region. It is in the interest of the regions falling behind and the EU as a whole to make more funds available for social cohesion and convergence measures.



Think
Visegrad
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POLICY BRIEF

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Think Visegrad in Brussels

The adjustment mechanisms do not have to be applicable to the whole Union. If the “coalition of the willing” goes ahead with a more rigorous agenda – and Eurozone countries seem to be heading this way – special frameworks can be introduced for the members of the circle. **The lack of fiscal and monetary flexibility can be compensated, for example, with unemployment recovery funds** during times of recession. But it is crucial to **maintain an open door for the non-Eurozone** countries.

2. Compromise strategically and fairly

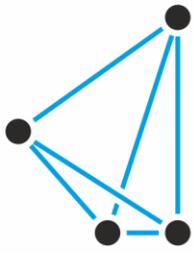
As in any collective action situation, the cherry-picking of measures that each country likes is not going to get anyone anywhere. Compromises and trade-offs are unavoidable. **Central Europe will have to accept some of the measures that are not directly to its liking.** Among the policies that Central European countries should choose to compromise on are the shared asylum system and broader participation in the resettlement and relocation of refugees. While the issue has been contentious in many CEEs, the number of asylum seekers CEEs were requested to take is in no way detrimental either to the economic situation in the respective countries or the “traditional way of life”.

Contributions through multiple channels and other demonstrations of solidarity (the recent announcement that V4 countries will contribute €35M to the EU-financed work in Libya to help manage migration is a good example) would further help the cause in rightfully demanding equal **solidarity in other areas (e.g. attaining a larger share of cohesion and structural funds).**

The recent spike in attention to posted workers and truckers and the adamant push by Emmanuel Macron to reform the posted workers scheme is just one illustration of how painful the process of convergence between East and West is and how far away Europe remains from the ideal single labour market. The agreed reform of the posted workers directive will affect some CEE countries more than others: Poland sends a somewhat notable percentage of people while for Slovakia and the Czech Republic the numbers are negligible. Overall, the reform will not strike an unrecoverable blow to CEE economies as the share of posted workers among the labour force is small. Even for Poland, which sends 22% of the total EU-wide number of posted workers, their share of Polish domestic employment is just 2.5%. Concessions in this sector can be converted into concessions in other sectors.

3. Do the homework

Finally, as mentioned above, EU level solutions are irrelevant without proper domestic action. It is important to keep many of the competencies and associated responsibilities for social progress in the hands of national and local governments for more efficient decision-making and for a better and more flexible implementation of the



measures. There is significant space for improving good governance, ensuring efficient and transparent administration, and reforming educational and training systems.

Most importantly, the V4 cannot afford to lose any time in **fostering other sources of competitiveness in addition to their currently cheap labour force**. The postponement of reforms will afford some extra necessary time but will not help avoid the unavoidable. The recipe is not new but is yet to be achieved. The **transition to a knowledge and innovation-based** economy requires a better focus on several targets:

- Higher investment in R&D
- Making education systems competitive and relevant for market needs
- Availability and deeper penetration of lifelong education schemes
- Creation of a stable macroeconomic environment with strong, efficient, and corruption- and favouritism-free public institutions

The V4's demonstrated effort in supporting the digital economy and start-up ecosystems is laudable. Much is yet to be done though for this sector to replace manufacturing both in terms of value added and employment.

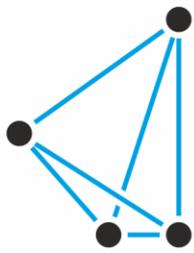
Avoiding political fallout

A faster pace of the reform of labour markets towards harmonizing wages and social contributions across Europe might paradoxically serve as a brutal wake-up call and push the V4 to introduce shock therapy into its effort to develop an alternative growth model that is not focused solely on cheap labour.

But even with Britain gone, the reform is likely to be incremental – though potentially proceeding at a faster pace that it would have if Britain had stayed in the EU. What is still at stake is the potential political fallout. Eurosceptic actors are eager to use the labour market reform endeavour to inflame the perceived neglect of the East by the dominant Western countries of the EU. The convergence pace is much slower than Central Europeans were promised – or assumed – when they joined the EU. Too much shock therapy and the framing – by anti-EU forces - of the labour reform as the culprit of any problems that might arise in the region might consequentially trigger the alienation of local populations towards the EU.

Furthermore, a certain consternation is noticeable also among those in support of further integration and reform. The tweaks in the posted workers directive are not expected to deliver any significant economic results. The frustration by many is also due to the fact that political capital has been wasted on finding a compromise on a minor issue rather than addressing more significant concerns, including the productivity and competitiveness of European markets.

Addressing genuine concerns of Central European countries and helping the region transit to a new growth model in an orderly fashion is important for the EU if it wants to remain credible towards all of its citizens and to keep populists and



demagogues at bay. On the other hand, an orderly reform process beneficial for both the region and the entire continent is only achievable with a constructive approach from Central Europe and a robust domestic reform effort.

Recommendations

The entire Union should:

- (Re)intensify efforts to facilitate convergence
 - Design convergence funds with proper financial support that reflect the idiosyncrasies of Central European economic models and expedite transition to a knowledge-based economy
 - Rely on incremental reforms that heed national socio-economic models and the current discrepancies between them
- Keep the door open for non-Eurozone members
- Work on improving efficiencies of the current legislation
- Compromise fairly

Visegrad countries specifically should:

- Enhance diplomatic efforts to communicate genuine economic concerns
- Seek new alliances after Brexit, with Scandinavian countries being potential allies regarding the EU-wide social agenda
- Domestically, elaborate on a reform agenda following a proper impact assessment and accelerate transition to a knowledge based economy as a new economic growth model: invest in R&D and human capital, enhance transparency of public administration, reform the education and training system.