



Transborder Provision of Services and Social Dumping :
Rights-based Mutual Trust in the Establishment of the Internal
Market

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**Transborder Provision of Services and Social Dumping :
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ABSTRACT

This article reexamines the debate between harmonization of social laws and regulatory competition in the EU. The recent case-law of the European Court of Justice allows companies to provide services across the EU from the member State of their choice, with only limited possibilities for the host State to impose compliance with certain standards that go beyond the minimum provisions listed in the 1996 Posted Workers Directive. This, combined with the enlargement of the EU, has given rise to renewed fears about 'social dumping' in the EU, and it has shed doubt about the optimistic view that the EU member States would progressively converge towards higher social standards. This article discusses the plausibility of the 'race to the bottom' scenario in this context. It seeks to move beyond the usual dichotomy opposing de-regulation at domestic level to re-regulation at EU level. Instead, it shows that mechanisms allowing for an improved monitoring of the EU member States' behavior and for learning across jurisdictions could constitute a more promising avenue, provided certain institutional conditions are created.

KEYWORDS

Regulatory Competition. - Social dumping. - Mutual trust. - Posted Workers.

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I. Introduction

European economic integration was perhaps the clearest expression of what J. G. Ruggie retrospectively referred to as the ‘embedded liberalism’ characteristic of the post-World War II international economic order.¹ In this order, the reduction or elimination of trade barriers between modern Welfare States should serve to enhance the redistributive capabilities of each State vis-à-vis its own citizens, thus leading the regulatory State at domestic level to complement trade liberalization at international level : the gains from trade should benefit the Welfare State, just like the Welfare State should protect the losers from international trade, thus ensuring that international trade remains a politically desirable option.

This however presupposed that the Welfare State should not be obliged to renounce its regulatory functions under the pressure of trade liberalization. And it also assumed that in their domestic policies, States are not primarily motivated by the need to improve their international competitiveness – that they are not mutating from Welfare States to ‘national competitive States’, to use the concept of J. Hirsch.² However, since the early stages of European integration, fears have been expressed that the lowering of barriers to trade and the free movement of capital within the EU, in addition to creating efficiency gains, also may create incentives for the EU Member States to adopt legislation or policies that are considered desirable in order to benefit the most from the opportunities created by market integration or in order, at least, not to be put at a disadvantage as a result of such integration. This, it has been argued, may operate at the detriment of workers, particularly the least qualified, since these are much less mobile than capital. Indeed, calls for more social Europe have been primarily motivated by this risk of ‘social dumping’, in the presence of the strong diversity of social protection legislations across the Member States and in the absence of a binding ‘floor of rights’.³

This debate has been revived in recent years, particularly as the result of the enlargement of 2004. It has been lively particularly in the area of trade in services. Central to the debate has been the question whether the EU Member States can trust each other’s legislation insofar as it relates to the protection of workers, or whether limits should be imposed to the principle of mutual recognition of domestic legislation in order to avoid the scenario of a ‘race to the bottom’ from materializing in the area of social standards. In revisiting the debate, this chapter argues in favour of a much more contextualized approach, taking into account the modalities of preference-formation at domestic level. Since the question of ‘trust’ between member States depends, ultimately, on how trade unions and employers’ organisations influence national policy-making, and whether or not preference-setting at that level is hostage to the requirements of competitiveness in the internal market, it is only by focusing the attention on those decision-making processes that the question of trust may be addressed. In the context of transborder provision of services, trust may travel in both directions : it may be seen as referring not only to the trust in the regulation of the service provider by its home State, but also to the trust in the fact that regulation in the receiving State is animated by the purpose of improving the

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¹ John G. Ruggie, ‘International Regimes, Transactions, and Change : Embedded Liberalism and the Postwar Economic Order’, 36(2) *Int. Org.* 379 (1982).

² Joachim Hirsch, *Der nationale Wettbewerbsstaat: Staat, Demokratie und Politik im globalen Kapitalismus (The Competitive National State: State, Democracy and Politics in Global Capitalism)*, Edition ID-Archiv, Berlin and Amsterdam, 1995.

³ See Martin Rhodes, ‘The Future of the ‘Social Dimension’ : Labour Market Regulation in Post-1992 Europe’, *Journal of Common Market Studies*, vol. 30 (March 1992), pp. 23-52.

situation of workers – including posted workers –, rather than by protectionist motives. Which of these two competing understandings of trust should prevail in any particular case should depend, ultimately, on process-based considerations, related to the quality of democratic decision-making in the respective jurisdictions concerned.

This chapter recalls the stages of the debate on the protection of social rights in the transborder provision of services (II). It then examines whether the fears of ‘regulatory competition’ in this area are justified (III), and what the notion of trust may contribute to the discussion (IV). It concludes by a call for moving beyond the de-regulation / re-regulation debate by refocusing our attention to the empowerment of actors at the national level. Our alternative is not between the ‘race to the bottom’ and a chimerical European Welfare State: it is between taking the institutions as they are or transforming them to ensure that they contribute to social progress (V).

II. The provision of services and labour rights: stages of progress towards regulatory competition

1. Stage One : Before the Posted Workers Directive

Much of this story is well known, and it can be summarized briefly. In the *Rush Portuguesa* Case which it decided in 1990, the European Court of Justice took the view that the provisions of the EEC Treaty relating to free provision of services precluded France from prohibiting a person providing services established in another Member State from moving freely on its territory with all his staff, or from making the movement of staff in question subject to restrictions such as a condition as to engagement *in situ* or an obligation to obtain a work permit. ‘To impose such conditions on the person providing services established in another Member State’, the Court noted, ‘discriminates against that person in relation to his competitors established in the host country who are able to use their own staff without restrictions, and moreover affects his ability to provide the service’.⁴ This meant that the local workforce could not be protected from foreign competition through the imposition of restrictive immigration rules. However, the Court added, ‘in response to the concern expressed in this connection by the French Government’, that ‘Community law does not preclude Member States from extending their legislation, or collective labour agreements entered into by both sides of industry, to any person who is employed, even temporarily, within their territory, no matter in which country the employer is established; nor does Community law prohibit Member States from enforcing those rules by appropriate means’.⁵

The judgment was the source of considerable legal uncertainty at the time it was delivered, for it did not make clear which of the laws of the host Member State the service provider established in another Member State should comply with, or which instead, affecting the ability of the service provider to provide the service, should be considered as an obstacle to the freedom to provide services, and thus potentially in violation of European Community law. Under one interpretation, all rules imposing burdens on service providers established in other Member States when they already comply with comparable rules in their country of origin should be considered as *de facto* discriminatory (since they impose a double burden on foreign service providers) and therefore as prohibited under Community law. For example, where service providers already pay social security contributions for the same periods of employment and for the same workers in their home State, they should not have to pay social security contributions in the host State in which they post workers to perform a service, even where this would compensate for the fact that they do not comply with the legislation on minimum wage in the host State.⁶

⁴ Case C-113/89, *Rush Portuguesa Lda v Office national d’immigration*, [1990] ECR I-1417, para. 12.

⁵ *Id.*, para. 18.

⁶ See for instance Joined Cases 62 and 63/81, *Seco SA and Another v EVI* [1982] ECR 223 ; Case C-272/94, *Criminal proceedings against Guiot*, [1996] ECR I-1905 ; Case C-164/99, *Portugaia Construções* [2002] ECR I-787, paragraph 16. These judgments prescribe the recognition of by the receiving State of the sending State’s legislation, but only when the latter may be considered to provide an equivalent protection to the worker.

Under another interpretation, certain rules applicable to employment relations in the host State are 'mandatory' in nature, and due to their particular importance, they should be complied with even by the service providers established in another Member State. This latter interpretation would be consistent with the 1980 Rome Convention on the Law Applicable to Contractual Obligations⁷ which, although it provides that a contract of employment in principle will be governed by the law of the country where the worker habitually carries out the work (i.e., the home State) (Art. 6(2)), nevertheless provides that 'mandatory rules' should be complied with in the host State (Art. 7). But the Rome Convention did not specify which rules could thus be considered mandatory, and neither *Rush Portuguesa*, nor the other judgments adopted by the European Court of Justice in this area, seemed to provide for such specification.

2. Stage Two : The 1996 Posted Workers Directive

Following the *Rush Portuguesa* decision, negotiations began on what would become the Posted Workers Directive, finally adopted in 1996.⁸ The Posted Workers Directive imposes an obligation on the host Member State to ensure at a minimum that service providers established in another Member State comply with the rules pertaining to (a) maximum work periods and minimum rest periods; (b) minimum paid annual holidays; (c) the minimum rates of pay, including overtime rates, but excluding supplementary occupational retirement pension schemes; (d) the conditions of hiring-out of workers, in particular the supply of workers by temporary employment undertakings; (e) health, safety and hygiene at work; (f) protective measures with regard to the terms and conditions of employment of pregnant women or women who have recently given birth, of children and of young people; and (g) equality of treatment between men and women and other provisions on non-discrimination (Art. 3(1)). In principle, in order to be imposed on the service provider established abroad, the rules relating to these areas should be stipulated by law, regulation or administrative provision. But the Directive provides that, as regards the construction sector, they may also be contained in collective agreements or arbitration awards which have been 'declared universally applicable'.⁹

The difficulties of interpretation of the Posted Workers Directive stem from the fact that it seeks to pursue, simultaneously, three quite different objectives. On its surface, it aims at facilitating the transnational provision of services, by clarifying the labour legislation applicable to the employment relationship between the service provider and the workers she posts temporarily in another Member State for the duration of the service provided. It is in order to provide this clarity that the Directive specifies under which conditions the regulations applicable to employment relationships in the host Member State may be imposed on the service provider established in another State, defining strictly, for instance, which collective agreements may have to be complied with by that service provider.

But a second and no less important objective of the Directive was to protect workers' rights. The workers concerned fall in two categories. The local workforce, established in the host Member State, should be protected from the risks of 'unfair competition', by competitors operating under a regulatory framework less protective of workers' rights and therefore less costly to comply with.¹⁰ And the posted workers themselves should be protected against the risks which would be entailed by an employment relationship being entirely regulated by the country of establishment, a regime which could be easily abused by unscrupulous employers tempted to resort to 'social dumping'. This explains why the Directive imposes an obligation on States to guarantee a core set of rules to posted

⁷ Convention on the Law Applicable to Contractual Obligations, OJ L 266 of 9.10.1980, p. 1.

⁸ Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, OJ L 18, 21.1.1997, p. 1.

⁹ On this condition, see below, text corresponding to n. 21.

¹⁰ As explained by the European Court of Justice in *Laval* (Case C-341/05, *Laval un Partneri Ltd.*, [2007] ECR I-11767 – for a discussion of this case, see below) : Article 3(1) of the Posted Workers Directive 'prevents a situation arising in which, by applying to their workers the terms and conditions of employment in force in the Member State of origin as regards those matters, undertakings established in other Member States would compete unfairly against undertakings of the host Member State in the framework of the transnational provision of services, if the level of social protection in the host Member State is higher' (para. 75).

workers : Article 3(1) of the Directive provides that the host Member State ‘shall ensure’ that these rules are effectively applied.

Finally – and this is a third objective, distinct from the two others –, the Directive sought to protect the Member States themselves, in their regulatory capacity, allowing them to go beyond the minimum protection they should ensure. The Directive states in its Preamble that ‘the mandatory rules for minimum protection in force in the host country must not prevent the application of terms and conditions of employment which are more favourable to workers’ (Recital 17), an authorisation reiterated in Article 2(7). Since it would not be acceptable for a legislative instrument to derogate from the obligations of the EU Member States under the EC Treaty, this provision should not be seen as exempting the Member States from having to comply with the requirements free provision of services (now under Article 56 TFEU (ex-Art. 49 EC)). But it does imply that, provided it is not discriminatory and does not impose a disproportionate restriction to the provision of services (as would be the case if the posted workers were already protected under legislation ‘equivalent in substance’ in the Member State of establishment), the host State may impose compliance with its domestic legislation to the relationship between the posted workers and their employer.

In sum, it would seem consistent with these three objectives to interpret the Posted Workers Directive as clarifying the law applicable to posted workers in a transnational provision of services (a) by imposing on the host Member State to extend to posted workers a core set of rules applicable to the workers employed locally ; and (b) by allowing the host Member State to extend its protection beyond that minimum, unless this represents a discriminatory or disproportionate interference with the freedom to provide services, as recognized now under Article 56 TFEU. In line with the case-law of the European Court of Justice based on that provision of the Treaty, the host Member State would be considered to impose a disproportionate restriction to the freedom to provide services if the protection it intends to grant to workers already is already ensured by an equivalent legislation in the Member State of establishment.

3. Stage Three : The debate on the Directive on services in the internal market

The 2004 proposal for a Directive on services in the internal market

It is precisely this balance which the initial proposal of the European Commission for a Directive on services in the internal market, in the form in which it was proposed in January 2004 as part of a package of measures to encourage growth and improve competitiveness in the EU,¹¹ created a risk of disrupting. The ‘country of origin principle’ was at the core of the directive. This principle, which specific, sectoral directives had already relied upon,¹² would have ensured that a service provider wanting to supply services to clients in another Member State would in general be subject only to the rules and regulations of the Member State where it is established. The country of origin principle was defined in the proposal of the Commission as implying that ‘Member States shall ensure that providers are subject only to the national provisions of their Member State of origin which fall within the coordinated field [i.e., which concern any requirement applicable to access to service activities or to the exercise thereof]’ (Art. 16(1), al. 1). This principle was to cover all national provisions relating to access to and the exercise of a service activity, ‘in particular those requirements governing the behaviour of the provider, the quality or content of the service, advertising, contracts and the

¹¹ COM(2004)2 final, 13.1.2004.

¹² See, e.g., Article 2(1) of Council Directive 89/552/EEC of 3 October 1989 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities, OJ L 298, 17.10.1989, p. 23 (as amended by Directive 97/36/EC of the European Parliament and of the Council (OJ L 202, 30.1.1997, p. 60)) ; or Article 3(1) of Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the internal market (‘Directive on electronic commerce’), OJ L 178, 17.7.2000, p. 1. The lead author of the proposal of the Commission on the directive on electronic commerce, Emmanuel Crabit, was also closely involved within DG internal market in preparing the proposal for a directive on services in the internal market (see Emmanuel Crabit, ‘La directive sur le commerce électronique’, *Revue du marché unique et de l’Union européenne*, 2000, pp. 749-834).

provider's liability' (Art. 16(1), al. 2). As stated in the extended impact assessment accompanying the proposal :

The barriers affecting the freedom to provide services require mainly that Member States refrain from applying their own rules and regulations to incoming services from other Member States and from supervising and controlling them. Instead they should rely on control by the authorities in the country of origin of the service provider. This would remove the legal uncertainty and costs resulting from the application of a multitude of different rules and control measures to which cross-border service providers are currently subject.¹³

The impact assessment stated, rather candidly, that 'this means that Member States must have trust and confidence in each other's legal systems and control measures'.

Although the generalization of the country of origin principle went beyond the existing case-law of the European Court of Justice,¹⁴ it was presented as fully preserving the Community *acquis* in the area of the posting of workers. Indeed, Article 17 of the proposed Directive stated that the country of origin principle did not apply to matters covered by Directive 96/71/EC. And, while Article 24 of the proposal for a directive on internal services in the internal market contained 'specific provisions on the posting of workers', it did seem to preserve the full integrity of the system established by the Posted Workers Directive : it merely stated that the Member State of posting should in principle 'carry out in its territory the checks, inspections and investigations necessary to ensure compliance with the employment and working conditions applicable under Directive 96/71/EC', the imposition of certain types of obligations being excluded ; and that the Member State of origin of the service provider should ensure that both its authorities and those of the Member State of posting receive the information necessary to ensure full compliance with the legal requirements imposed on the service provider.

There was a clear risk however that the principle of the country of origin would in fact entirely reverse the system of the Posted Workers Directive. In this Directive, the list of rules contained in Article 3(1) of the Directives constitutes a *minimum* protection the host State is obliged to provide. Once the Posted Workers Directive becomes a derogation to the principle of the country of origin, these rules come to define instead the *maximum* degree of protection a State may offer : while the matters 'covered' by the Posted Workers Directive, as listed in Article 3(1) of this instrument, were 'excluded' from the application of the principle of the country of origin principle (Art. 17 (5)), all the other aspects of the employment contract were to be regulated by the law of the State of establishment rather than by the law of the host State. Although the proposal of the Commission did provide for the possibility of certain case-by-case derogations to the principle of country of origin (Art. 19), none of them was really relevant to the protection of posted workers, and the derogations seem to be premised, rather, on the need to ensure an adequate protection of the recipient of services, rather than of those working for the service providers themselves. For some observers, this opened the way to social dumping, if we understand by this expression the choice of employers to work under a set of rules aimed at the protection of workers which allows them to be more cost-effective than potential competitors operating on the same market.¹⁵ The timing was particularly ill-chosen. The proposal was presented only weeks before the enlargement to ten new Member States. There were strong fears that the protection of workers was significantly weaker in those countries, giving the employers in those

¹³ Extended impact assessment of proposal for a Directive on services in the internal market, SEC(2004) 21, 13.1.2004, pp. 23-24.

¹⁴ In a case concerning the legal basis of Directive 94/19 on deposit-guarantee schemes, the Court in fact explicitly denied that there existed a general principle of supervision by a home State : see Case C-233/94, *Germany v. European Parliament and Council of the EU*, [1997] ECR I-2405, para. 64. The imposition of an across-the-board country-of-origin principle therefore constitutes an innovation.

¹⁵ See, for a critique under this angle of the proposed directive, Olivier De Schutter & Stéphanie Francq, 'La proposition de directive sur les services dans le marché intérieur : reconnaissance mutuelle, harmonisation et conflits de lois dans l'Europe élargie', *Cahiers de droit européen*, 2005, pp. 603-660. See also R. Blanpain (dir.), *Freedom of services in the European Union – Labour and social security law : the Bolkestein initiative*, The Hague, Kluwer Law International, 2006, 386 pages. For a longer discussion of social dumping and the ambiguity of its definition, see below, text corresponding to n. 41.

countries an unfair advantage in the internal market if they were authorized to provide services following the regulations imposed on them in the State of establishment only, with the exception of a minimum set of rules imposed by the State of posting in the areas listed in Article 3(1) of the Posting Workers Directive.¹⁶

Both the European Economic and Social Committee¹⁷ and the European Parliament reacted with hostility to the proposal. In a resolution of 16 February 2006,¹⁸ the Parliament proposed to replace the principle of the country of origin by a reaffirmation of the freedom to provide services, implying that no restriction to that freedom shall be allowed which does not comply with the principles of non-discrimination, necessity, and proportionality (Art. 17(1)). It also proposed to explicitly state the primacy of Directive 96/71/EC over the Directive on services in the internal market (Art 3(1)), and the insertion of a provision recognizing that the provisions of this latter directive on the freedom to provide services 'do not prevent the Member State to which the provider moves from imposing requirements with regard to the provision of a service activity, where they are justified for reasons of public policy, public security, environmental protection and public health. Nor do they prevent Member States from applying, in conformity with Community law, their rules on employment conditions, including those laid down in collective agreements' (Art. 17(3)). In sum, rather than the revolution proposed by the European Commission through the country of origin principle, the Parliament proposed to reaffirm the case-law of the European Court of Justice, and to facilitate the exercise of the freedom to provide services by a series of measures which the initial proposal of the Commission already contained (such as the establishment of single points of contact or administrative cooperation between the authorities of the State of establishment and those of the State where the service is provided).

The 2006 Directive on services in the internal market

The new proposal that the European Commission put forward in April 2006 took into account these concerns. Directive 2006/123/EC of 12 December 2006 on services in the internal market,¹⁹ adopted on the basis of this proposal, explicitly states that it does not affect the Posted Workers Directive, and that therefore it 'should not prevent Member States from applying terms and conditions of employment on matters other than those listed in Article 3(1) of Directive 96/71/EC on grounds of public policy' (Recital 86). Indeed, the Directive should not affect labour law applied in accordance with national and Community law (Article 1(6)), and as proposed by the Parliament, the primacy of Directive 96/71/EC is explicitly affirmed (Article 3(1)(a)). Although it contains a number of rules on administrative simplification, which aim to facilitate the exercise of freedom to provide services, the country of origin principle has disappeared : instead, as proposed by the Parliament, the principle of free provision of services is reaffirmed, which implies that any restrictions are allowable only insofar as they comply with the principles of non-discrimination, necessity and proportionality (Art. 17).

4. Stage Four : the judicial imposition of regulatory competition

The recent case-law of the European Court of Justice threatens to re-establish exactly the regime that the European legislator, after a fierce battle in 2004-2005, had decided not to set up. In *Laval*,²⁰ the Court was asked by the Swedish Labor Court to deliver a preliminary ruling in a case opposing a Latvian contractor, Laval un Partneri Ltd., to a Swedish trade union. A subsidiary company to Laval intended to use Latvian posted workers on a construction site in the town of Vaxholm, for the renovation and extension of school premises. It intended to pay these workers less than the minimum

¹⁶ See in particular, expressing this concern, Daniel C. Vaughan-Whitehead, *EU Enlargement versus Social Europe ? The Uncertain Future of the European Social Model*, Edward Elgar, Cheltenham, 2003.

¹⁷ See European Economic and Social Committee (EESC), opinion on 9 February 2005 (OJ C 221 of 8.9.2005, p. 113).

¹⁸ Doc. EP 369.610, P6_TA(2006)0061, 16 February 2006.

¹⁹ OJ L 376 of 27.12.2006, p. 36.

²⁰ Case C-341/05, *Laval un Partneri Ltd.*, [2007] ECR I-11767. For useful commentaries, see Aravind R. Ganesh, 'Appointing Foxes to Guard Henhouses : The European Posted Workers' Directive', 15 *Columbia J. of Eur. L.* 123 (2008) ; S. Deakin, 'Regulatory competition after *Laval*', *Cambridge Yearbook of European Legal Studies*, 10 (2009): 581-609.

amount stipulated in a collective agreement concluded between, on the one hand, the Swedish building and public works trade union, in its capacity as the central organisation representing building workers, and the central organisation for employers in the construction sector (Sveriges Byggindustrier). This collective agreement imposed a number of pecuniary obligations on the employers, including on the hourly wage and other matters referred to in Article 3(1), first subparagraph, (a) to (g) of Directive 96/71 (such as working time and annual leave), which went beyond those set out in the applicable Swedish legislation ; some of them related to matters not referred to in that article. Agreeing to the terms of this collective agreement would have extended the same obligations to Laval. However, Laval had signed, on 14 September and 20 October 2004, in Latvia, collective agreements with the Latvian building sector's trade union, of which 65% of its workers were members. None of the members of the Swedish trade unions parties to the collective agreement concluded with the Sveriges Byggindustrier were employed by Laval. Laval therefore considered that it should not conclude another, separate collective agreement for work to be performed in Sweden. A social conflict followed the refusal of Laval to agree to the terms of the collective agreement proposed by the Swedish unions. It led ultimately to other trade unions boycotting all Laval's sites in Sweden. In February 2005, the town of Vaxholm requested that the contract between it and Baltic be terminated. A month later, Laval was declared bankrupt.

The main question submitted to the Court concerned both the interpretation of the Posted Workers Directive and of Article 49 EC. The Posted Workers Directive, it will be recalled, provided that in the construction sector, the rules imposed on the service provider established abroad may be stipulated in collective agreements or arbitration awards which have been 'declared universally applicable'. Member States which have no system for declaring collective agreements or arbitration awards to be of universal application in the building sector may base themselves on collective agreements 'which are generally applicable to all similar undertakings in the geographical area and in the profession or industry concerned, and/or collective agreements which have been concluded by the most representative employers' and labour organizations at national level and which are applied throughout national territory', provided that their application to the service providers established abroad does not result in any discrimination between them and national undertakings in the same sector (Art. 3(8)). In the decentralized Swedish system however, management and labour set the wage rates through collective negotiations, 'on a case-by-case basis, at the place of work, having regard to the qualifications and tasks of the employees concerned'²¹: the Court took the view that rates of pay set through such a decentralized procedure cannot be imposed on service providers established in other Member States, who cannot be obliged to negotiate with the local unions to that effect.

The Court acknowledged that the protection of the Posted Workers Directive was not to prevent application of terms and conditions of employment more favourable to workers. This however, the Court said, 'cannot be interpreted as allowing the host Member State to make the provision of services in its territory conditional on the observance of terms and conditions of employment which go beyond the mandatory rules for minimum protection. As regards the matters referred to in Article 3(1), first subparagraph, (a) to (g), Directive 96/71 expressly lays down the degree of protection for workers of undertakings established in other Member States who are posted to the territory of the host Member State which the latter State is entitled to require those undertakings to observe. Moreover, such an interpretation would amount to depriving the directive of its effectiveness'.²² The Court concluded that posted workers may not be protected through the legislation of the State of posting beyond the level of protection which must be guaranteed to these workers under Article 3(1), first subparagraph, (a) to (g) of Directive 96/71.²³

Turning then to the requirements of Article 49 EC (now Article 56 TFEU) and to the question of whether the collective action resorted to by the Swedish unions was in violation of this provision, the Court takes the view that 'the right of trade unions of a Member State to take collective action by

²¹ *Laval*, para. 69.

²² *Laval*, para. 80.

²³ *Laval*, para. 81.

which undertakings established in other Member States may be forced to sign the collective agreement for the building sector – certain terms of which depart from the legislative provisions and establish more favourable terms and conditions of employment as regards the matters referred to in Article 3(1), first subparagraph, (a) to (g) of Directive 96/71 and others relate to matters not referred to in that provision – is liable to make it less attractive, or more difficult, for such undertakings to carry out construction work in Sweden, and therefore constitutes a restriction on the freedom to provide services within the meaning of Article 49 EC'.²⁴ While acknowledging that the right to take collective action is a fundamental right recognized under Community law (paras. 90-91), and thus may constitute an overriding reason of public interest justifying, in principle, a restriction of one of the fundamental freedoms guaranteed by the Treaty,²⁵ the Court notes that this right may be subject to certain restrictions, and must be exercised in accordance with national and Community law. The Court defines its role as having to balance the right to collective action against the freedom to provide services :

Since the Community has [...] not only an economic but also a social purpose, the rights under the provisions of the EC Treaty on the free movement of goods, persons, services and capital must be balanced against the objectives pursued by social policy, which include, as is clear from the first paragraph of Article 136 EC, inter alia, improved living and working conditions, so as to make possible their harmonisation while improvement is being maintained, proper social protection and dialogue between management and labour.²⁶

However, the Court considers that the obstacle to the freedom to provide services created by the collective action launched by the Swedish unions cannot be justified with regard to the objective of improving social protection, since, 'with regard to workers posted in the framework of a transnational provision of services, their employer is required, as a result of the coordination achieved by Directive 96/71, to observe a nucleus of mandatory rules for minimum protection in the host Member State' (para. 108). In other terms, collective action cannot seek to impose obligations on employers beyond the obligations the host State must impose in accordance with Article 3(1) of the Posted Workers Directive. The Court concludes that the blockade imposed by the Swedish unions on the construction side of the company's subsidiary violates Community law and should not be allowed : Article 49 EC and the Posted Workers Directive preclude a trade union from resorting to collective action in order to force a provider of services established in another Member State to enter into negotiations with it on the rates of pay for posted workers and to sign a collective agreement the terms of which lay down, as regards some of the matters referred to in Article 3(1), first subparagraph, (a) to (g) of the Posted Workers Directive, more favourable conditions than those resulting from the relevant legislative provisions in the State concerned, while other terms relate to matters not referred to in Article 3 of the directive.

A second question submitted to the European Court of Justice in *Laval* concerned the Swedish Law on workers' participation in decisions ('the MBL'). The Swedish courts interpreted s 42 of the MBL as prohibiting taking collective action with the aim of obtaining the repeal of or amendment to a collective agreement between other parties. In 1989, it was held by the labour courts in a dispute concerning working conditions for the crew of a container ship named *Britannia*, flying a foreign flag, that that prohibition extended to collective action undertaken in Sweden in order to obtain the repeal or amendment of a collective agreement concluded between foreign parties, in a workplace abroad, if such collective action is prohibited by the foreign law applicable to the signatories to that collective agreement. In reaction, and with a clear intention to combat what they saw as a risk of social dumping which workers would be prohibited from countering through collective action, the Swedish legislature adopted in 1991 the 'Lex Britannia'. This legislation restricted the scope of the principle expounded in

²⁴ *Laval*, para. 99.

²⁵ *Laval*, para. 103. See, e.g., Joined Cases C-369/96 and C-376/96, *Arblade and Others* [1999] ECR I-8453, paragraph 36; Case C-165/98 *Mazzoleni and ISA* [2001] ECR I-2189, paragraph 27; Joined Cases C-49/98, C-50/98, C-52/98 to C-54/98 and C-68/98 to C-71/98, *Finalarte and Others* [2001] ECR I-7831 ; Case C-36/02, *Omega* [2004] ECR I-9609, paragraph 35.

²⁶ *Laval*, para. 105.

the *Britannia* judgment, by providing that the prohibition to resort to collective action to undo an existing collective agreement shall apply only if an organisation commences collective action by reason of employment relationships falling directly within the scope of the Swedish Law. In practice, the 'Lex Britannia' thus authorized collective action against foreign service providers only temporarily active in Sweden, even in circumstances where such service providers had concluded a collective agreement in their home State.

When asked whether the 'Lex Britannia' violated EU law, the European Court of Justice held that 'national rules, such as [the 'Lex Britannia'], which fail to take into account, irrespective of their content, collective agreements to which undertakings that post workers to Sweden are already bound in the Member State in which they are established, give rise to discrimination against such undertakings, in so far as under those national rules they are treated in the same way as national undertakings which have not concluded a collective agreement'.²⁷ Such discrimination, the Court reasoned, could not be justified under the EC Treaty. The Court noted that the 'Lex Britannia' 'is intended, first, to allow trade unions to take action to ensure that all employers active on the Swedish labour market pay wages and apply other terms and conditions of employment in line with those usual in Sweden, and secondly, to create a climate of fair competition, on an equal basis, between Swedish employers and entrepreneurs from other Member States'.²⁸ But this intention – to combat 'social dumping' – does not appear to the Court to correspond to the grounds of public policy, public security or public health which may justify derogations from the freedom to provide services. The 'Lex Britannia' thus violates Community law.

Laval, which was decided on 18 December 2007, does not stand alone. It may be replaced in a broader context in which the European Court of Justice increasingly appears to favor an interpretation of the requirements of Community law that seeks to encourage competition between the national regulatory systems, and that treats with suspicion any attempt by the Member States to limit the impacts of such competition on the protection of workers.²⁹ In *Viking*,³⁰ decided only a few days before *Laval*, the International Transport Workers' Federation (ITF) and its local affiliate, the Finnish Seaman's Union (FSU), resorted to collective action in order to prevent Viking, a Finnish ferry boat operator, from re-flagging a Finnish vessel as an Estonian vessel to escape the application of Finnish employment laws and the applicable collective agreement. The Court considered that such collective action, in the form of a strike and a boycott, should be treated as a restriction to the freedom of establishment recognized under Article 43 EC (now Art. 49 TFEU), since it has 'the effect of making less attractive, or even pointless, [...] Viking's exercise of its right to freedom of establishment, inasmuch as such action prevents both Viking and its subsidiary, Viking Eesti, from enjoying the same treatment in the host Member State as other economic operators established in that State'.³¹

The Court acknowledged that the right to take collective action for the protection of workers is a legitimate interest which, in principle, justifies a restriction of one of the fundamental freedoms guaranteed by the Treaty, and that the protection of workers is one of the overriding reasons of public interest recognised in its case-law.³² However, even if they pursue a legitimate aim compatible with the EC Treaty and are justified by overriding reasons of public interest, restrictions to freedom of

²⁷ *Laval*, para. 116.

²⁸ *Laval*, para. 118.

²⁹ See Ian H. Eliasoph, 'A 'Switch in Time' for the European Community ? Lochner Discourse and the Recalibration of Economic and Social Rights in Europe', 14 *Columbia J. of Eur. L.* 467 (2008).

³⁰ Case C-438/05, *International Transport Workers' Federation and Finnish Seamen's Union v. Viking Line ABP and OÜ Viking Line Eesti*, [2007] ECR I-10779.

³¹ *Viking*, para. 72.

³² Referring to the social provisions of the EC Treaty, the Court also noted that 'the Community has thus not only an economic but also a social purpose', which implied that 'the rights under the provisions of the Treaty on the free movement of goods, persons, services and capital must be balanced against the objectives pursued by social policy, which include, as is clear from the first paragraph of Article 136 EC, inter alia, improved living and working conditions, so as to make possible their harmonisation while improvement is being maintained, proper social protection and dialogue between management and labour' (para. 79).

establishment are only acceptable insofar as they are suitable for securing the attainment of the objective pursued and do not go beyond what is necessary in order to attain it. While the Court recognized the legitimacy for unions to seek to safeguard the rights of *current* employees of the vessel, it expressed the view that any collective action going beyond that objective would be disproportionate : resorting to strikes or boycotts to avoid reflagging would be unacceptable, in the eyes of the Court, if it were established that the jobs or conditions of employment at issue were not jeopardised or under serious threat. Such would be the case, in particular, if the company concerned has agreed to a binding undertaking that the reflagging would not result in terminating the employment of any person employed by them at the time it is made, even if such undertaking does not include the renewal of short term employment contracts or prevent the redeployment of any employee on equivalent terms and conditions.³³ In other terms, collective action by unions may seek to protect the acquired rights of existing employees : it would be abusive if it were to serve, instead, to discourage the exercise of freedom of establishment by companies seeking to relocate themselves to benefit from a more favourable regulatory environment.³⁴

III. Regulatory competition and fundamental social rights

1. *Evaluating the impact of Laval (I) : the static perspective*

Any evaluation of the *Laval* case-law should include both static and dynamic considerations. The most obvious questions it raises concerns the question of how conflicts between social rights and economic freedoms are resolved, which constitutes the static perspective. In line with the existing case-law, the *Laval* judgment treats fundamental rights as primary law, and as having a hierarchical rank equivalent to, rather than superior to, the fundamental economic freedoms of the EC Treaty. The implication is that, when the exercise of a fundamental economic freedom appears in conflict with a fundamental right, the two rights must be balanced against one another.³⁵ The fundamental rights recognized as part of EU law include a number of social rights listed in the EU Charter of Fundamental Rights.³⁶ Therefore, the Member States may justify restrictions to fundamental economic freedoms by invoking the need to protect certain social rights recognized as fundamental, for instance the exercise of the right to resort to collective action. But they may do so only to the extent that such restrictions are not discriminatory vis-à-vis foreign service providers ; and that such restrictions are both necessary for the protection of the social right concerned and proportionate to that objective.

A fundamental critique that has been levied against this approach is that it violates the decoupling between the economic and the social spheres in the European project. The project of European integration led to attribute to the European Union the task of establishing an internal market,

³³ See para. 82 of the judgment and the 10th question referred to the European Court of Justice by the the Court of Appeal (England and Wales) (Civil Division).

³⁴ The distinction between these two purposes of resorting to collective action was put forward by AG Poiares Maduro in the opinion he delivered in the *Viking* case : ‘collective action to persuade an undertaking to maintain its current jobs and working conditions must not be confused with collective action to prevent an undertaking from providing its services once it has relocated abroad. The first type of collective action represents a legitimate way for workers to preserve their rights and corresponds to what would usually happen if relocation were to take place within a Member State. Yet, that cannot be said of collective action that merely seeks to prevent an undertaking that has moved elsewhere from lawfully providing its services in the Member State in which it was previously established’ (para. 67). This latter form of collective action, in the view of the Advocate-General, ‘entirely negates the rationale of the common market’ (para. 68).

³⁵ See the opinion of AG Mengozzi, para. 84. Among typical examples are Case C-67/96, *Albany International BV* [1999] ECR I-5751, paragraphs 59-62 ; Case C-112/00, *Schmidberger* [2003] ECR I-5659, paragraph 71.

³⁶ Initially proclaimed as political declaration in 2000 (OJ C 364, 18.12.2000, p. 1), the Charter is not recognized as legally binding : see Article 6(2) of the Treaty on European Union as amended by the Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007 (OJ C 306, of 17 December 2007, p. 1) (referring to the EU Charter of Fundamental Rights in the revised form it has been proclaimed on 12 December 2007 (OJ C 303 of 14.12.2007, p. 1)). However, fundamental social rights not listed in the Charter of Fundamental Rights could nevertheless be recognized as part of the general principles of EU law as derived from international instruments for the protection of human rights binding upon the EU Member States, and from the common constitutional traditions of the Member States. For a discussion of the relationship between fundamental rights as part of the general principles of EU law and international human rights law, see Israel de Jesus Butler and Olivier De Schutter, ‘Binding the EU to International Human Rights Law’, *Yearbook of European Law*, vol. 27 (2008), pp. 277-320.

characterized by the protection of economic freedoms and the prohibition of distortions of competition (areas which were removed from politics to be made supranational), while the protection of social rights (the Welfare State) remained in the hands of the Member States (and thus subject to political contests within at the national level): subordinating the latter to the economic freedoms of the Treaty would be in violation of this fundamental division of labour between the two levels. The main exponents of this critique summarize thus : ‘Europe was conceived according to principles of a dual polity. Its ‘economic constitution’ was non-political in the sense that it was not subject to political interventions. This was its constitutional-supranational *raison d’être*. Social policy was treated as a categorically distinct subject. It belonged to the domain of political legislation, and, as such, had to remain national’.³⁷ Under this original scheme, ‘trust’ between the Member States takes on a very different meaning, almost at the opposite end to the interpretation given to the notion when it is used in the expression ‘mutual trust’ : it is seen as referring to the notion that each State should trust that the social policies implemented in other member States, since they are the outcome of democratic processes, seek to ensure a fair distribution of the gains from economic growth, and should not, presumptively at least, be treated as protectionist or as directed against the other member States.

Even if we accept that the provision of social rights at domestic level may be tested against the requirements of the economic freedoms constitutive of the internal market, another problem resides in the methodology of balancing social rights against these freedoms. Although the right to resort to collective action is not typical in this regard, social rights usually require from States that they take measures which ensure their progressive realization, to the maximum of the resources available to the State. Because both the level of achievement of these rights and the rhythm at which they should be realized remain rather underspecified under the relevant international human rights instruments, States are recognized a broad margin of appreciation at the level of implementation : the basic requirement is that they make progress towards the full realization of the rights concerned, and that they monitor progress. In this respect, what States need in order to discharge their obligations towards economic and social rights is not simply that no conflicting obligation is imposed on them, through other instruments : it is that they preserve the policy space they require to implement policies in areas such as health, education, or social security, without being forced to limit themselves to what is ‘strictly necessary’ to comply with such obligations.

2. Evaluating the impact of Laval (II) : the dynamic perspective

Adopting a static perspective is not enough. We must also ask which incentives are created, both for States and for economic operators, by the legal rule announced by the Court. It is here, in a dynamic perspective, that the notions of ‘social dumping’ or ‘regulatory competition’ intervene. The notion of ‘social dumping’ may of course be given various definitions, ranging from situations in which an employer deliberately violates existing legislation in order to achieve a competitive advantage to situations where practices as regards working conditions and wages comply with the applicable labour legislation and simply reflect different levels of productivity between workers, without entailing any distortion of competition.³⁸ The notion is used here to refer to the (perfectly legal) practice of companies to locate their activities in the State, and thus under the regulatory regime, that will make compliance with social regulations least costly, in order to be the most competitive in the internal market. ‘Regulatory competition’ in turn refers to the choice of States to regulate wages and other working conditions in order to ensure that the companies established under their jurisdiction will not be placed at a competitive disadvantage as a result of higher labour costs being imposed on them than would be justified by the productivity of their workers, in comparison to companies established in other member States who compete on the same markets.

It deserves notice that there are few restrictions to the potential ‘abuse of the right to establishment’ in EU law, when a company decides to reincorporate in a Member State other than its State of origin in

³⁷ Christian Joerges and Florian Rödl, ‘Informal Politics, Formalised Law and the ‘Social Deficit’ of European Integration: Reflections after the Judgments of the ECJ in Viking and Laval’, *European Law Journal*, vol. 15, n° 1 (2009), p 1-19, at p. 5.

³⁸ For a discussion of these various definitions, see Daniel C. Vaughan-Whitehead, *EU Enlargement versus Social Europe ? The Uncertain Future of the European Social Model*, Edward Elgar, Cheltenham, UK, 2003, pp. 325-327.

order to benefit from a more favourable regulatory environment. In *Centros*, the Court expressed the view that ‘the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment’ as recognized in the treaties.³⁹ Although the Court added that this should not be seen as an obstacle to the adoption by States of measures aimed at preventing fraud, for instance where it is established that the formation of the company intends to evade obligations towards private or public creditors,⁴⁰ the case was widely seen as promoting regulatory competition in corporate law in the EU.⁴¹ *Centros* was reaffirmed in a case in which a company incorporated in the Netherlands was denied by the German courts the capacity to be a party to legal proceedings in Germany without reincorporating in Germany, a restriction to freedom of establishment which the Court considered a violation of the rules of the EC Treaty on freedom of establishment.⁴² Finally, in *Inspire Art*, decided in 2003, the Court considered that it was not abuse of the right of establishment to seek to circumvent the more demanding conditions imposed under Dutch company law by incorporating in the United Kingdom, even if almost all the activities of the company do in fact take place in the Netherlands : ‘the fact that a company does not conduct any business in the Member State in which it has its registered office and pursues its activities only or principally in the Member State where its branch is established is not sufficient to prove the existence of abuse or fraudulent conduct which would entitle the latter Member State to deny that company the benefit of the provisions of Community law relating to the right of establishment’.⁴³

When it was presented with the proposal of a Directive on services in the internal market, the European Parliament insisted on a definition of establishment requiring ‘the actual pursuit of an economic activity at the place of establishment of the service provider’, excluding therefore ‘letter box’ companies, established in one Member State with the sole purpose of working under its regulatory framework. The Court itself subsequently agreed that restrictions on the freedom of establishment could be justified in exceptional circumstances ‘on the ground of prevention of abusive practices’, for instance in order to ‘prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory’.⁴⁴

However, the main safeguard against the risk of companies relocating in order to escape certain onerous regulatory requirements and hire workers under the terms of a domestic legislation less protective of the rights of workers stems from the fact that, for a number of EU Member States, the State of incorporation is not the decisive factor for purposes of determining the State of establishment. These States rely instead on the ‘real seat’ doctrine, which presupposes that the company is considered to be established where it concentrates its activities or has its main place of business, thus creating a link between the ‘nationality’ of the company – the law under which it operates – and its ‘residence’ –

³⁹ Case C-212/97, *Centros Ltd*, [1999] ECR I-1459 (para. 27).

⁴⁰ See para. 38 of the *Centros Ltd* judgment.

⁴¹ See W.F. Ebke, ‘Centros- Some realities and some Mysteries’, *American Journal of Comparative Law*, vol. 48 (2000), pp. 623-660 ; A. Looijestijn-Clearie, ‘Centros-Ltd – A complete U-turn in the Right of Establishment for Companies’, *International and Comparative Law Quarterly*, vol. 49 (2000), pp. 621-642 ; W. R. Roth, ‘From Centros to Uberseering: Free Movement of Companies, Private International Law and Community Law’, *International and Comparative Law Quarterly*, vol. 52 (2003), pp. 177-208 ; M. Siems, ‘Convergence, Competition, Centros and Conflicts of Law: European Company Law in the 21st Century’, *European Law Review*, vol. 27 (2002), pp. 47-59; S. Deakin, ‘Two types of regulatory competition: competitive federalism versus reflexive harmonisation. A law and economics perspective on Centros’, *Cambridge Yearbook of European Legal Studies*, vol. 1 (1999), pp. 231-260.

⁴² See Case C-208/00, *Überseering BV v. Nordic Construction Company Baumanagement GmbH* ECR [2002] ECR I-9919.

⁴³ Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*, [2003] ECR I-10155, para. 139. See E. Wymeersch, ‘The Transfer of the Company’s seat in European Company Law’, *Common Market Law Rev.*, vol. 40 (2003), pp. 661-695 ; C. Kersting and C.P. Schindler, ‘The ECJ’s Inspire Art Decision of 30 September 2003 and its Effects on Practice’, *German Law Journal*, vol. 4 (2003), p. 1277.

⁴⁴ Case C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995 (para. 55).

its principal place of business –.⁴⁵ A company will therefore not be authorized to rely on its freedom of establishment in order to develop activities in one Member State while remaining governed by the law of the Member State of origin (where it was initially incorporated), solely in order to benefit for the more favorable regulatory provisions of the latter. This is illustrated, for instance, by the *Cartesio* judgment of 16 December 2008.⁴⁶ The Hungarian law applicable did not allow a company incorporated in Hungary to transfer its seat abroad while continuing to be subject to Hungarian law as its personal law. This in practice obliged the company wishing to convert itself into a company governed by the law of another Member State, first to cease to exist as a Hungarian company. The Court refused to treat this as a disproportionate restriction to the freedom of establishment of companies: instead, it took the view that it is up to the national law of the Member State of incorporation to decide whether a company may transfer its registered office or its actual centre of administration to another Member State without losing its legal personality.

Thus, the freedom of establishment of companies is not unlimited. Certain restrictions are imposed on companies seeking to incorporate themselves under the laws of the Member State that impose the lightest burdens. These restrictions in turn diminish the pressure on States to relax their regulatory standards, since they are allowed to react to the clearest instances of abuse, such as the setting up of ‘letterbox’ or ‘front’ subsidiaries.⁴⁷ Nevertheless, within these broad limitations summarized above, companies may choose where to establish themselves and, thus, under which rules to provide services across the EU. What are the consequences? Some have noted the disciplining virtue that could result from ‘regulatory competition’, in the meaning which has been referred to above: States will act more rationally, it has been suggested, if some degree of horizontal economic competition is organized, obliging them to offer the best ‘fit’ of regulation combined with well-educated workforce and other advantages to the companies locating their activities under their jurisdiction.⁴⁸ However, there are also instances in which ‘regulatory competition’ may lead to sub-optimal outcomes: in what may be understood as one form of the prisoner’s dilemma, States will legislate, not in accordance with the ‘real’ preferences of the domestic constituency (i.e., what that constituency would have chosen in the absence of competition from other jurisdictions), but taking into account the need to attract companies (or to stem their relocation abroad) as a source, primarily, of employment creation. The notions of ‘social dumping’ and of ‘regulatory competition’ both suggest the risk of a ‘race to the bottom’ in the presence of a variety of regulatory regimes coexisting in an area in which the factors of production are mobile and in which mutual recognition of these regulatory regimes is established.⁴⁹ A decisive question for the future direction of social rights in the EU is whether such a ‘race to the bottom’ is likely, and whether *Laval* encourages such an evolution.

But does it? In substance, the European Court of Justice considers that the *minimum* (or ‘mandatory’) rules which the host Member State must impose compliance with on its territory in fact should be treated as the *maximum* level of protection that State may grant to workers posted on its territory: any further restriction to the freedom to provide services is likely to impose a disproportionate burden on the service provider, and collective action seeking to coerce that service provider into agreeing to more favourable terms of employment are considered to constitute an abuse of the right to resort to collective action. This turns the Posted Workers Directive on its head. It also amounts to choosing,

⁴⁵ This constitutes a notable difference with the U.S., where incorporation is decisive. See David Charny, ‘Competition Among Jurisdictions in Formulating Corporate Rules: An American Perspective on the ‘Race to the Bottom’ in the European Communities’, *Harvard International Law Journal*, vol. 32 (1991), p. 423.

⁴⁶ Case C-210/06, *Cartesio Oktató és Szolgáltató bt*.

⁴⁷ Case C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited above, para. 68.

⁴⁸ See, e.g., Joel P. Trachtman, ‘International Regulatory Competition, Externalization, and Jurisdiction’, *Harvard International Law Journal*, vol. 34, n° 1 (1993), p. 48, at pp. 51-53. For a comparison between the U.S. and the EU debates on regulatory competition, see also Catherine Barnard, ‘Social dumping and the race to the bottom: some lessons for the European Union from Delaware?’, *Eur. L. Rev.*, vol. 25 (2000), pp. 57-78.

⁴⁹ Cary has been credited for introducing the notion of the ‘race to the bottom’: see William L. Cary, ‘Federalism and Corporate Law: Reflections upon Delaware’, *Yale L.J.*, vol. 83 (1974), p. 663, at p. 666. However, the idea is already expressed with great clarity by Justice Brandeis, in *Liggett Co. V. Lee*, 288 U.S. 517, 559 (1933) (Brandeis, J., diss.), where he makes reference to the ‘race of laxity’ between States as businesses would move to the States with the least demanding regulatory requirements.

among the different objectives pursued by the Posted Workers Directive, the freedom to provide services above the other two objectives – the protection of the rights of workers and the preservation of the policy space of the host State. And it is premised on the idea that the application of any legislation at the place of posting which differs from the legislation imposed on the service provider in the State of establishment is *per se* a restriction on the freedom to provide services, *whether or not the legislation of the State of establishment provides an equivalent level of protection to workers*.

Thus, *Laval* reflects an understanding of mutual trust in the transnational provision of services in the EU which may be called ‘blind’ : it is not conditional on the State of establishment of the service provider guaranteeing workers with a level of protection of their rights equivalent to that ensured in the host Member State. In contrast, although it too suggests that the country of origin principle has its basis in the freedom to provide services,⁵⁰ the opinion of AG Mengozzi in the *Laval* case describes the first question submitted to the Court as being ‘whether, in circumstances where a Member State has no system for declaring collective agreements to be of universal application, Directive 96/71 and Article 49 EC must be interpreted as preventing trade unions of a Member State from taking, in accordance with the domestic law of that State, collective action designed to compel a service provider of another Member State to subscribe, by means of a tie-in agreement, to a collective agreement for the benefit of workers posted temporarily by that provider to the territory of the first Member State, *including cases (sic) where that provider is already bound by a collective agreement entered into in the Member State where it is established*’ (para. 162). In his reading of Article 49 EC, ‘host Member States, and in particular their courts, [should] assess the equivalence or essential similarity of the protection already available to posted workers under legislation and/or collective agreements in the Member State where the service provider is established, in particular as regards the pay such workers receive’ (para. 264), and only if there exists such an equivalent protection of workers should restrictions to the freedom to provide services resulting, *inter alia*, from collective action by unions, be considered disproportionate. It is significant that these qualifications are absent from the reformulation by the Court of the question of interpretation it is submitted.⁵¹ The remainder of the judgment confirms that in the view of the Court, it does not matter whether or not the foreign service provider is bound, in the Member State of establishment, by rules ensuring a protection of workers equivalent to that they would be guaranteed by the extension to such workers of collective agreements concluded in the State of posting by the local unions for the benefit of the local workforce. It is in that sense that *Laval* may be said to organize regulatory competition between the EU Member States.

Similar considerations apply if we examine the second part of the judgment, which concerns the allegedly discriminatory character of the ‘Lex Britannia’ adopted in 1991 by the Swedish legislature in order to combat ‘social dumping’. The Court takes the view that it is discriminatory not to apply a rule prohibiting collective action aimed at setting aside collective agreements already concluded between labor and management to collective action against service providers established in another Member State. Again in contrast to the position of the Advocate General Mengozzi,⁵² the judgment of the Court thus seems to rely on the assumption that collective agreements concluded abroad must be trusted in principle to offer a sufficiently high level of protection of workers. Whether such trust should be blind or should instead be seen as a rebuttable presumption that the protection of workers is sufficiently

⁵⁰ See opinion of AG Mengozzi, para. 132 : ‘...the application of the ‘core’ terms and conditions of employment that must be guaranteed by the host Member State to workers temporarily posted to its territory, under Article 3 of Directive 96/71, constitutes a derogation from the principle of application of the legislation of the Member State of origin to the situation of the service provider of that Member State that posts those workers to the territory of the first Member State’.

⁵¹ *Laval*, paras. 51-53.

⁵² The view of AG Mengozzi was that, taking into account ‘the extent of the coverage of collective agreements in the Swedish building sector and the possibility, deriving from the regime established by the MBL, of compelling domestic employers not affiliated to an employers’ organisation to conclude an agreement of that kind by means of the right granted to trade unions to take collective action, the Swedish system appears, by subjecting a foreign service provider to the latter regime, to ensure the equal treatment provided for by Article 3 of Directive 96/71 as between that provider and the domestic undertakings carrying on business in the Swedish building sector which are in a similar situation’ (para. 193 of the opinion). That opinion accepts the premise of the Lex Britannia, that employers operating in Sweden and having concluded collective agreements under a foreign legislation may be treated as having concluded no collective agreement at all. Implicit is that such foreign collective agreements may not be trusted, and are no substitute for the conclusion, in Sweden, of collective agreements with the Swedish unions.

robust is not clear. The Court does note at one point that the *Lex Britannia* ‘fails to take into account, *irrespective of their content*, collective agreements to which undertakings that post workers to Sweden are already bound in the Member State in which they are established’.⁵³ This suggests that collective agreements which are insufficiently protective of workers may not shield the foreign service providers having concluded them from having to face collective action by Swedish unions. But the remainder of the judgment of the Court does not refer back to this proviso, and suggests instead that the EU Member States should trust collective agreements concluded in another Member State as ensuring a level of protection equivalent to collective agreements concluded under their own jurisdiction.

IV. Mutual Trust in Social Europe

In defence of the *Laval* and *Viking* cases, it may be said perhaps that they rely, albeit implicitly, on the notion of mutual trust: each member State should agree to treat the protection of workers that any other member State achieves at domestic level as equivalent in principle to its own, and this should suffice to justify a presumption that the service provider established in another member State, and operating under the laws of that State, should be allowed to provide services throughout the Union, without being imposed to comply with the regulations of the host State, with the exception of the set of mandatory rules defined in the Posted Workers Directive. Such a presentation would be misleading, however. As noted above, the notion of mutual trust, with all the positive connotations it conveys, could be used in almost the exactly opposite way, to refer instead to the need to trust the receiving member State that seeks to impose its rules on the service provider posting workers on its territory, without presuming that any rule going beyond the bare minimum is discriminatory in intent, or imposes burdens in fact that should be treated, presumptively, as violating to European compact. But the presentation of *Laval* and *Viking* as based on a notion of mutual trust also fails for two other reasons that go beyond the semantics.

First, this presentation tends to underestimate the imbalance that results from a situation in which companies are free to move, within certain limits, from one jurisdiction to another, without the free movement of workers constituting a credible counterweight to this mobility of capital.⁵⁴ As Lord Weddenburn already stated forcefully in 1973, ‘the true correlative to an international agreement securing the right to capital the right to move and, therefore, organize across the boundaries of national states would be an agreement securing to collective organizations of workpeople the right to take common action in negotiating, bargaining with and, if need be, striking against the multinational enterprises. [...] It is not true free movement of labour but free international trade union action which is the true counterpart to free movement of capital’.⁵⁵ It is particularly disquieting therefore that, in *Viking*, the transnational organisation of labour is seen as potentially ‘abusive’,⁵⁶ since it could discourage companies from exercising their freedom of establishment. Indeed, the absence of robust social competences at European level is an argument in favor, not against, the exercise of transnational collective action, since no regulation can be expected to intervene at European level to counter the impact of companies relocating in order to benefit from the most favorable regulatory environment.

Second, the judgments in *Laval* and *Viking* appear very deferential to the result of domestic processes through which norms ensuring the protection of workers are set. However, there can be a wide gap between the regulatory framework applicable in any Member State and its effective implementation. For instance, in a review conducted by Vaughan-Whitehead on the impact of enlargement of social Europe, it has been noted that in a number of Central and Eastern European countries, complaints mechanisms were hardly ever made use of by the concerned workers, because of a fear of reprisals in

⁵³ *Laval*, para. 116 (emphasis added).

⁵⁴ See for instance, of the very limited flows of cross-border migration within the EU, Loukas Tsoukalis, *The New European Economy Revisited*, Oxford Univ. Press, 3rd ed. 1997, pp. 117-121.

⁵⁵ K. Wedderburn, ‘Industrial Relations’, in H.R. Hahlo, J. Graham Smith, & R.W. Wright (eds.), *Nationalism and the Multinational Enterprise: Legal, Economic and Managerial Aspects*, A.W. Sijthoff, Leiden et Oceana Publications, Dobbs Ferry, New York, 1973, p. 249.

⁵⁶ See in particular, the opinion of AG Poiares Maduro, paras. 70-71.

fast-changing and fragile economic contexts.⁵⁷ The same study documents practices, such as certain employers systematically outsourcing the hiring of workers to employment agencies in order to avoid the payment of certain contributions and having a direct legal relationship with workers, or the practice of under-declaring wages, that may undermine certain social protection schemes. Such problems – sometimes resulting in the outright violation of the social legislation applicable – seem to a certain extent unavoidable so long as the standards of living remain relatively low : as Vaughan-Whitehead noted, referring to the situation prevailing at the time of enlargement of the EU in 2004, ‘living standards [in the new Member States of Central and Eastern Europe] have so far not developed enough to induce employees to choose their working patterns on the basis of other criteria – for instance, the need to take care of children or the wish to have more leisure time, and so on – than the basic necessity to escape from poverty’.⁵⁸ The implication however is that trust between jurisdictions in principle should be based not only on substantive considerations – i.e., what regulatory framework is in place in the State of establishment, and which protection it grants to workers –, but also on process-based considerations, such as the effectiveness of social dialogue at domestic level and the existence of monitoring mechanisms, whether at domestic or at international level, ensuring that the interests of workers are adequately taken into account.

Yet, pointing at the weaknesses of the *Viking-Laval* line of cases does not necessarily imply that the converse attitude – blindly trusting the domestic political processes in the receiving State – would necessarily be correct. The question of which level of mutual trust is desirable or acceptable between the EU Member States cannot be separated from certain hypotheses about the formation of preferences at domestic level. But how such preferences are formed cannot be merely assumed : it must be tested empirically, and if necessary, it must be transformed.

The process of national policy-making is in fact far more complex than is generally assumed in the usual ‘regulatory competition’ scenarios. The idea of ‘regulatory competition’ is premised on the view that States will seek to create a regulatory environment as favorable as possible to the undertakings established under their jurisdiction, in order to attract them, as a source of capital mobilization and employment creation, transfers of technologies, and fiscal revenues, for the State concerned. But this is in fact a highly reductionist view. It impoverishes our understanding of States’ behaviour just like the idea of the *homo economicus*, in classical economics, impoverishes our understanding of the behaviour of the individual. It underestimates the complexity of decision-making processes at domestic level – and in particular the weight of workers’ unions in our advanced Welfare States –.⁵⁹ It is precisely the reality of the contest of the definition of the ‘public interest’ in each State that is ignored when the national preferences of each State are pre-defined, or depoliticized, based on a view of governments as systematically seeking to attract foreign capital by creating a regulatory environment favorable to the undertakings established on their territory.⁶⁰ Instead, while it is acknowledged that ‘social policy regulations that have (or are perceived as having) the effect of reducing profits and hence capital incomes are [...] vulnerable to increased capital mobility’, the ‘race to the bottom’ in this area ‘will at least be impeded by the political commitment of national

⁵⁷ Daniel Vaughan-Whitehead, ‘The World of Work in the New EU Member States : Diversity and Convergence’, in Daniel Vaughan-Whitehead (ed), *Working and Employment Conditions in New EU Member States. Convergence or Diversity ?*, International Labour Office, Geneva, 2005, pp. 1-43, at p. 16.

⁵⁸ *Id.*, p. 16.

⁵⁹ This is not to say that States cannot be treated as ‘rational actors’, for instance to describe their position in international negotiations. For instance, the ‘liberal intergovernmentalist’ model of international negotiations adopted by Andrew Moravcsik takes as its departure point ‘the assumption that states act rationally or instrumentally in pursuit of relatively stable and well-ordered interests at any given point in time’ (Andrew Moravcsik, *The Choice for Europe. Social Purpose and State Power from Messina to Maastricht*, Routledge, London and New York, 1998, p. 18), but Moravcsik rightly distinguishes the formation of national preferences as a separate and contested moment, noting that his ‘rationalist framework of international cooperation’ does not assume that states are ‘unitary in their internal politics’. Quite to the contrary in fact : ‘National preferences – the underlying ‘states of the world’ that states seek to realize through world politics – are shaped through contention among domestic political groups. The unitary-actor assumption maintains only that once particular objectives arise out of this domestic competition, states strategize as unitary actors vis-à-vis other states in an effort to realize them’ (*id.*, p. 22).

⁶⁰ See, in contrast to the classical ‘regulatory competition’ approach that obliterates this dimension, Daniel C. Esty and Damien Geradin, ‘Regulatory Co-opetition’, *Journal of International Economic Law*, 2000, pp. 235-255, at p. 238.

governments to social policy purposes and by the resistance of unions and other groups that would suffer from deregulation and setbacks'.⁶¹ The literature adopting a 'varieties of capitalism' approach also warns that the respective national response strategies within the EU may vary critically depending on the organisational power of trade unions and employers' organisations in each State, with widely diverging outcomes across States.⁶²

The reductionist view of the formation of the political preferences of each State not only seems to assume, without justification, that the interests of the business community will be systematically prioritized above those of workers or of the public as a whole. It also underestimates the potential role of what Scharpf refers to as 'political imitation' – i.e., of the process through which each State seeks inspiration from the others, in making decisions of its own.⁶³ Communication between jurisdictions matters, not only because it may lead to a 'race to the bottom' in certain areas, as States observe each other and do not wish to have their competitiveness undercut by the regulatory choices made in other States, but also because 'best practices' can be shared, and relied upon by various groups within the State, to force a 'race to the top'.

Indeed, at the core of the idea of democratic experimentalism, as pioneered in particular in the work of Ch. Sabel and J. Zeitlin,⁶⁴ is the intuition that governance in multi-level (or federal) entities should be conceived in order to encourage local experiments (the search, in each sub-unit, of innovative solutions to the problems to which all units are confronted), combined with a pooling of the results following such experiments (on the basis of the evaluation made of those experiments). In this view, the combination of decentralized experimentation with the pooling of information and evaluations performed jointly should allow all sub-units of the system to benefit from the progress in understanding made in local settings. Such collective learning may potentially result in the empowerment of groups at the domestic level, whose inability to propose credible alternatives may otherwise lead to their marginalization from the political process. It is precisely the potential of such collective learning that is underestimated in the scenarios of 'regulatory competition' that assume that States act with the main or even the sole purpose of enabling undertakings established on their territory to increase their competitiveness : such scenarios simply ignore the reality of democratic self-determination.

It is clear, of course, that 'democratic experimentalism', and the collective learning that it seeks to encourage, only have chances of succeeding if certain institutional conditions are fulfilled, both at EU and at national level. Prominent among them are : (1) at national level, a strong involvement of national actors, including parliaments and civil society organizations, and the establishment of an institution specifically tasked with identifying good practices from foreign experiences and with examining whether they should inspire developments in the domestic setting ; (2) at EU level, the development of a set of outcome indicators which may allow for different national experiences to be compared against one another, and the creation of a forum in which those experiences can be examined in the light of the specific national context in which they have emerged. Institutions matter,

⁶¹ F. Scharpf, 'Introduction : the problem solving capacity of multi-level governance', *Journal of European Public Policy*, vol. 4 (1997), p. 520, at p. 524.

⁶² Georg Menz, *Varieties Of Capitalism And Europeanization: National Response Strategies To The Single European Market*, Oxford Univ. Press, 2008 ; and see for an earlier contribution George Menz, 'Re-regulating the Single Market: national varieties of capitalism and their responses to Europeanization', *Journal of European Public Policy*, vol. 10(4) (2003), pp. 532-555.

⁶³ F. Scharpf mentions 'political imitation' as a possible factor weighing against the pressure exercised on national regulators by 'regulatory competition', in areas such as process regulations or taxation of mobile factors or households where such competition may exist (F. Scharpf, *Governing in Europe. Effective and Democratic?*, Oxford, Oxford University Press, 1999, pp. 90-91). He then states, however, that such 'political imitation' will not be considered further in his examination of the regulatory competition debate.

⁶⁴ See in particular Charles F. Sabel and Jonathan Zeitlin, 'Learning from Difference: The New Architecture of Experimentalist Governance in the European Union', *European Law Journal*, vol. 14 (2008), p. 271, and Charles F. Sabel and Jonathan Zeitlin (eds), *Experimentalist Governance in the European Union: Towards a New Architecture*, Oxford Univ. Press, 2010. See also Oliver Gerstenberg and Charles F. Sabel, 'Directly-Deliberative Polyarchy: An Institutional Ideal for Europe?', in Christian Joerges and Renaud Dehousse (eds), *Good Governance in Europe's Integrated Market*, Oxford Univ. Press, 2002, pp. 289-342.

in that sense. But the important message here, in the context of the discussion of mutual trust in the provision of services across borders, is that neither full harmonization nor full decentralization, combined or not with mutual recognition, are desirable (or objectionable) in the abstract: the allocation of competences across different levels of governance and the rules regarding mutual recognition in the regime of trade in services can only be evaluated in combination with specific modes of political organisation, at each level, and of the capacity of the different actors involved to bring about certain results.

V. Conclusion

This paper has examined the debate on the impact of the transborder provision of services on the protection of the fundamental rights of workers. In this context, the question of the role of trust in mutual recognition of services regulation in the EU is essentially whether a presumption may be established in favor of recognizing the regulation of the State of establishment of the service provider as equivalent, in the degree of protection it provides to the worker, to that of the State of posting. We now see why this question is one that cannot be appropriately addressed without asking a series of other, interrelated questions. One is whether the State of establishment of the service provider, beyond having in place a regulatory framework that complies with the requirements of the fundamental social rights of workers, also has a well-functioning institutional framework – including labour inspectorates, social dialogue at company and sector levels, and courts – ensuring that these rights are effectively protected.⁶⁵ Another is whether the decision-making process within the State is sufficiently inclusive and organized in order to ensure that the policy choices of the State – its ‘public interest’ – will not be captured by particular factions, but will instead be the outcome of deliberative procedures, informed by the choices made in other States.⁶⁶ Even when both these conditions are fulfilled, however, the risk of ‘regulatory competition’ remains present, albeit in a limited sense: the risk is that, as the result of the non-cooperative behavior of one or more EU Member States, all States shall be hesitant to raise the levels of protection of workers’ rights, in order not to impose excessive regulatory costs on companies established under their jurisdiction. In 1996, the Posted Workers Directive sought to respond to this risk, by requiring from the State of posting that it ensure compliance, at the very least, with a core set of rules ensuring a minimum protection of workers.⁶⁷ The recent case-law of the European Court of Justice redefines this minimum as a maximum: it now appears that States shall not be allowed to move beyond the imposition of this core set of rules, as any attempts to do so would be treated, presumptively, as a disproportionate restriction to the freedom to provide services across borders.⁶⁸

In recent years, the debate on ‘regulatory competition’ has moved beyond the simplistic view that States were always motivated primarily, in their regulatory choices, by considerations linked to the need to attract foreign capital, even at the price of the protection of the rights of workers. A more complex picture has emerged both within the economics of federalism and public choice theory⁶⁹ and outside that research program, for instance in the writings of proponents of democratic experimentalism.⁷⁰ These authors have reminded us that decision-making in democratic polities is the result both of the competition of various groups seeking to influence outcomes and of deliberative processes: the alternative to harmonization and the imposition of top-down regulations that could freeze the search for alternatives, then, may be to empower those among these groups that have a progressive agenda, and to strengthen such processes. They also put forward that decentralized decision-making (and the resulting ‘competition’ between sub-units of a multi-layered system of governance) can in fact have benevolent effects: by encouraging local experimentation and collective learning, it can broaden our political imagination and increase the voice of groups that would otherwise be marginalized, because they would have no alternative to oppose to the discourse

⁶⁵ See above, text corresponding to nn. 57-58.

⁶⁶ See above, text corresponding to nn. 59-62.

⁶⁷ See above, text corresponding to nn. 8-9.

⁶⁸ See above, text corresponding to nn. 24-26.

⁶⁹ See the authors cited in n. 60.

⁷⁰ See the authors cited in n. 64.

prioritizing competitiveness that would have been tested elsewhere. Whether these benefits can outweigh the risks of regulatory competition, in an area such as the transnational provision of services, cannot be decided in the abstract : it will depend, primarily, on whether unions and civil society actors at domestic level manage to mobilize effectively, and can push for the adoption of the best practices identified in other jurisdictions, or whether instead they will be overpowered by the pressure exercised by the business community, in favor of the kind of ‘laxity’ that Justice Brandeis feared.⁷¹ Let us not forget : it was on the ‘strength of the trade union movement in European countries’ and on the ‘sympathy of European governments for social aspirations’ that the experts who worked with Bertil Ohlin to prepare the 1955 report on the ‘Social Aspects of European Economic Co-Operation’ were basing their optimism⁷² – and their ghosts are still haunting the European house.

⁷¹ See above, n. 52.

⁷² Ohlin, Bertil, et al. (1956), *Social Aspects of European Economic Co-Operation*, Report by a Group of Experts, International Labour Office, Geneva (reproduced in *International Labour Review*, vol. 74, pp. 99 and ff.).