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THE IMPACT OF BREXIT ON THE CZECH ECONOMY

Summary: This paper is about the impact of Brexit on the Czech economy. Part 1 deals with an analysis of selected problems connected with Brexit impact on the Czech economy and the analysis is supplemented by the SWOT analysis (part 2). Changes in the degree of globalization of V4 countries since 1991 are discussed as an opportunity for mutual economic relations intensification (part 3). Conclusion: it is expected that the impact of Brexit on the Czech economy will not be very important.

Keywords: British investments in CR, the Czech balance of payments, V4 countries mutual economic relations.

JEL Classification: F5, F53.

Introduction

This paper deals with possible impacts of Brexit on the Czech economy. Up to now, the Czech evaluation of Brexit impact on the Czech economy has been optimistic. However, before the UK files an official request for its leaving of the EU, some of the conclusions resulting from our analyses may have a preliminary character [*Tenth of Surveyed Firms Anxious over Brexit*, 2016].

Under condition of a high degree uncertainty, it is recommendable (in my opinion) to take into consideration the research results of the probable future trends of economic, political and social globalization (with an accent on economic globalization) to be able to analyze Brexit potential effects on the Czech economy.

The Czech economy is a middle-European export-oriented economy with a relatively strong industrial base; this is a fact explaining certain hesitations as for potential impact of the so-called Brexit. Under conditions of the anti-Russian economic sanctions, Czech exporters suffered not unimportant real losses, i.a., a loss of a potential growth of exports to their well-known territory.

In this situation, the Czech exporters practically have only one possibility to compensate for their export losses: to try to export their goods and services to Asian and Latin American selected countries, but this is a long-term adaptation process. However, there is a possibility to intensify mutual economic relations in the framework of V4 Agreement as well.

Both possibilities depend on the final conditions of Brexit arrangements with EU. This is the reason, why the probable globalization trends should be taken into consideration. In academic literature, four possible globalization models were analyzed. However, the first model which expects that the process of economic globalization will continue is by majority of Czech economists expected to be most probable.

In this case, the Czech Republic would have to re-define its economic strategy and to formulate its new economic policy. In this paper, I am trying to examine the Czech potential position (by SWOT analysis) and a possibility of intensifying mutual economic relations of V4 countries, if the present globalization trend would continue.

1. The Czech opinion on Brexit

Let us cite some selected statistical data on the Anglo-Czech economic relations. The British investments in the Czech Republic rank seventh among foreign investments. Their volume is estimated at more than 40 billion CZK. In the long run, the Czech Republic has been providing foreign companies relatively significant investment incentives. In general, we can say that British investments remain relatively stable: After the end of temporary advantages, British companies did not leave the Czech Republic. The share of British owners in the registered capital of domestic companies amounts to 40.6 billion Czech korunas. Nowadays, 4,540 Czech companies have an owner from the UK [Bisnode, 2006]. According to estimates by the Roklen bank, in April 2016 British investors managed assets of almost 12 billion euros in the Czech Republic (i.e. ca. 330 billion CZK) [Roklen Bank, 2016].

Many famous British companies such as Marks and Spencer, Panasonic, etc., are present in the Czech Republic. Big international companies consider their presence in the Czech Republic strategically important; however, these companies are likely to already have their ‘B plans’. A leaving of these ‘big’ ones would mean a loss of job opportunities for Czech employees and loss of tax income for the Czech Republic. In the event that companies with British owners were not taken over by other foreign investors, no radical change in outflow of dividends abroad would occur.

As far as companies with a share of British investors lower than 50% are concerned, a deeper analysis would have to be made to be able to make more reliable conclusions as to the impact of Brexit. Provided the business environment in the Czech Republic does not worsen significantly in the medium term, the British investors – owners of shares or property interest as part of their portfolios would not probably opt for a ‘sale’ on which they would lose their money.

Now, there are two possible Brexit scenarios for British investors: a scenario of maintaining the possibility to operate in the EU common market of goods (the issue of conditions is not dealt with here) or a scenario of a ‘complete divorce’, i.e. with a customs border for British products sold to the EU countries. It is evident that the first scenario would have to be favorable both for the UK and the EU the Czech republic included; another question is which of them would gain more. Until the United Kingdom files an official request for leaving the EU, all reasoning is basically a mere speculation.

An essential question for the Czech Republic also consists in a potential influence of Brexit on the Czech foreign trade balance. The United Kingdom is the fourth major export destination for Czech exporters. Up to now the development of this balance has been favorable – since 2001 the volume of mutual trade (except for 2009) has been growing with a positive balance for the Czech Republic. From January to April 2016 the value of goods imported from the UK to our country amounted to 27.5 billion CZK. The Czech export in the opposite direction reached 60.8 billion [Novinky.cz, 2016]. Impacts on the mutual trade with the Czech Republic would not have to be substantial (at least in the medium term).

Nevertheless, a detailed view of the structure of the Czech foreign trade with the United Kingdom implies that Brexit might result in many Czech exporters losing their most important market and being forced to adapt structurally. Analyses of these potential effects appeared in the Czech Republic already in April 2016. According to the data published by the Roklen Bank, some changes might have a considerable impact.

In the mutual trade exchange with the United Kingdom, Czech entrepreneurs generated the highest trade balance surplus in the area of products of engineering and electrical engineering industry and transport equipment manufacturing.

The share of the Czech Republic's foreign trade of goods with the United Kingdom is the largest of the Central European countries (except for Slovakia), which also illustrates importance of the British market for the Czech economy.

When evaluating a potential impact of Brexit on the Czech Republic the impact on the Czech state budget have also be taken into consideration. This is a question of a change in the position of the Czech Republic from a net recipient of the European money to a payer.

Michal Řičař (Bisnode analyst), comments on the current situation in the cited document: "The exit of Britain must influence every member state at least by the change that will be made in the EU budget which is the basis defining who is the net recipient and who is the net payer in relation to the EU treasury – right now the Czech Republic is a net recipient. However, this is a long-term outlook, since in practice impacts of the exit will show in the EU economy not earlier than with a new budget, i.e. in 2022 and later" [Řičař, 2016].

Now, the allocation of the EU funds to the Czech Republic in the whole programming period is EUR 24.2 billion (ca. 654 billion CZK). At shrinkage by the UK's money, this amount might decrease by approximately 6% and in 2017-2020 Czech Republic might lose 38 billion CZK, which less than 9.5 billion CZK per year. Therefore, the direct impact of Brexit on drawing the EU funds might be negligible under the first scenario. Under the second scenario, however, the income shrinkage may reflect in the overall reduction of the mutual trade exchange between both countries, which would affect the growth rate.

The issue of adopting the single EU currency is of considerable significance for further development of the Czech economy. In early July 2016, a wide-ranging interview with the Czech Prime Minister Bohuslav Sobotka was published. Prime Minister said that Czech Republic will not be prepared to accept euro earlier than after 5-10 years; however, in the long run the Czech government takes adoption of the single currency into account [Právo, 2016, p. 7].

Since July 2016, the Czech Government attitude towards euro adoption has been changing; however, up to now, no decision was taken. After the British government declaration about Brexit in February 2017 [*The United Kingdom's Exit from and New Partnership with the European Union*, 2017], the British parliamentary discussions on topical questions were started. The Government has provided for four debates in the House of Commons in Government time on the impact of EU exit on a variety of sectors, such as: workers' right s, transport policy, science and research, and security, law enforcement and criminal justice. As it is not yet clear, what sort of measures concerning Schengen will be taken, the Czech government is eventually prepared to act independently to protect the rights of Czech citizens living and working in Great Britain [Day, Foster, 2017].

2. The current situation of the Czech economy

In this short paragraph, the author tries to briefly summarize his view of strengths and weaknesses of the Czech economy, existing open opportunities of its development and existing serious threats endangering its development in a period of next 5-7 years at least. The SWOT method has been used to make the analysis. Although this method is applied at the company level most frequently, it is convenient for the purposes of this paper because of its briefness and clear arrangement, complementing the previous text in which some of the potential impacts of Brexit on the Czech economy have been characterized.

Table 1. Czech economy from the perspective of the SWOT analysis

Strengths: 1. Relatively rapid growth of the economy (higher than the EU average) 2. Strong national currency 3. Adequately educated, skilled workforce 4. Relatively low unemployment	**Weaknesses:** 1. Non-existence of a functioning capital market corresponding to the level of development of the national economy 2. A lack of workforce in some occupations 3. Low workforce mobility in the national economy 4. Low efficiency of investments funded from the state budget
Opportunities: 1. Growth of export of competitive products and services to non-EU countries 2. Significant development of agriculture and water management 3. Increase in investments in science and research, healthcare and education 4. Reduction of inbuilt corruption by system measures (corruption must not pay off)	**Threats:** 1. Potential influx of unadaptable economic migrants and their support to the detriment of the country's own population 2. Non-existence of progressive wealth tax 3. Excessive outflow of profit to foreign countries 4. Negative aspects of the excessive network of store chains 5. Process of impoverishment of poor population resulting in a growing social disparity

Analogical applications of the SWOT method to the other countries may facilitate focus of additional analyses on key issues of economic relations within the V4 and may be a guideline for deeper analyses at the level of sectors and braches of business.

3. The possibility of intensifying mutual economic relations of V4 countries

Evaluation of the development of the globalization process must encounter considerable difficulties that result already from the fact that it can be examined and explained from many different points of view and by many different methods. For the purpose of this paper, the author used the globalization index KOF [KOF Swiss Economic Institute, 2016] which is a comprehensive index, trying to assess the development of the overall degree of globalization at three levels: economic, social and political. Although the structure of this index was criticized in literature, when the objections published concerned, among other things, distribution of weights of the index constituents, statistical sources used and their credibility, changes in the index structure in relation to its update, etc., a certain information value of this index cannot be denied.

In this paper we focus on use of merely one of its components, i.e. economic globalization index, to characterize the degree of economic globalization of the V4 countries. This approach has been applied for several reasons. Firstly, with regard to the question on how the degree of economic globalization of the V4 countries has been developing during the existence of the V4 Agreement (which has been primarily a political agreement from the very beginning); with regard to significance for the analysis only selected years are mentioned here.

In terms of the present validity of statistical data, the year 2013 can be considered the most relevant, since at the time of preparation of this paper large data on the following three-year period until 2016 have not been published yet. This is important for evaluation of real opportunities for development of economic relations among V4 countries after Brexit. In our paper we thus limit ourselves to the Czech opinion only. V4 countries are listed in Table 2 by their abbreviations in alphabetical order.

The following table shows a degree of economic globalisation of V4 countries by means of the KOF index in which a higher number represents a higher degree of globalization globally, i.e. not the placings of the country.

Table 2. Degree of economic globalization of V4 countries

Country	1993	1998	2004	2008	2009	2013
CZE	55.80	70,14	85.44	84.63	85.16	82.89
HUN	56.54	77.12	90.07	88.12	89.90	86.85
POL	46.12	51.98	73.59	71.33	73.02	75.72
SVK	53.99	64.29	86.59	84.85	84.89	83.63

Source: KOF Swiss Economic Institute [2015].

From signature of the V4 agreement till 2004 (the Czech Republic joining the EU), the degree of economic globalization of the member countries grew most, in absolute terms, in Hungary, followed by Slovakia taking the second place. Czech Republic fell slightly behind Slovakia. Poland also made a significant progress as to the degree of globalisation.

In 2013, the highest value of the index was maintained by Hungary (despite its previous decline caused by the global crisis). Slovakia remained second (also with a slight decrease), while Czech Republic closely after Slovakia was placed third (also at a decrease when compared with 2009). Poland remains fourth with its degree of the economic globalization growing significantly.

The very placings of countries give only an overall picture of how far each country is integrated in the global economy; however, it does not say anything about either its economic power, or the level of economic development. One can get the idea of economic significance of particular countries and opportunities for further development of their mutual economic relations only after a comparative analysis of significant indicators that are collected by the World Bank together with other international organizations. Relevant for the EU (including V4 countries) are the relevant data of the ECB, Eurostat and other institutions, including national ones. After comparing ca. 25 major indicators briefly, we can state that although economic differences between V4 countries are not negligible, in the future development they can be optimized to a condition acceptable for the interests of all participants of the V4 group. However, justification of this statement goes beyond the extent of this paper.

Higher values in the economic globalization index are closely related with ‘openness’ of a given economy. Small, open economies are by definition more engaged in international trade than rather big economies.

The economic globalization index (KOF) consists of two indices, when the first of them illustrates real economic flows. “The second index refers to restrictions on trade and capital using hidden import barriers, mean tariff rates, taxes on international trade (as a share of current revenue) and an index of capital controls. Given a certain level of trade, a country with higher revenues from tariffs is less globalized” [KOF Swiss Economic Institute, 2015].

Should the overall index of economic globalization express a real degree of economic globalization, it would have to take duty-free trade of V4 countries within the EU into account. If export to countries outside the EU significantly increases within the export of any V4 country, it will reduce its degree of globalization.

In 2015 and until mid-2016, Hungary placed 9th and 7th, Czech Republic 12th and 15th, Slovakia 16th and 12th and Poland 41st and 36th in the worldwide chart of the economic globalization index (based on the KOF).

In the 2015 worldwide overall globalization index, Hungary took the 9th place (85.78), Slovakia 16th place (83.62), Czech Republic (83.60) and Poland 23rd place (79.90). The figures above show that in terms of the overall globalization V4 countries are among 25 most globalized countries in the world and that the difference among the values of V4 countries, shown in the index, is relatively very small. These facts support the idea that opportunities for further development of mutual relations among V4 countries are open.

Conclusions

1. The Czech evaluation of Brexit impacts on the Czech economy, as presented above, can be perhaps characterized as over-optimistic, but I believe it is realistic; during the last 8 month, this approach has not changed. One of the factors that may contribute to materialization of this optimistic scenario is also deepening of mutual economic relations among V4 countries.
2. I believe that on condition that the present form of the market economy (including the assumption of sustainable growth) continues to exist, the overall trend of globalization is likely to remain preserved; it is also probable that mutual proportions of the above mentioned three constituents of the KOF index could be changed as a result of the real economy development.
   I consider to be possible, for example, that development of any of the constituents can stagnate (an example is the stagnation of economic globalisation in 2015 which still continues). However, it seems to me that more natural would be to expect that (after experience with previous regional integration attempts) the idea of the 'total globalization' (under the rule of some 'World Government') will remain a sci-fi still for a longer time. Negative impacts of a too rapid and chaotic economic globalization necessarily require application of effective instruments of international regulation which will respect interests of all UN members.
3. From the perspective of long-term development trends, Brexit could remain an episode rather than a start of globalization regress. In a period of next 5-7 years, however, it may cause very serious transfers in the economic, social and political area, not only in Europe. The British Empire, presently surviving as a free British Commonwealth of Nations, will likely make efforts to re-

tain its relatively significant position in the world. For the Czech economy the V4 countries can definitely contribute to it, which can help them – when taking steps jointly – create wider maneuvering economic space, by deepening their mutual economic relations, to resist harmful and unreasonable migration policy which endangers interests of the EU population and Europe as a whole.
5. The longer the EU negotiations about Brexit conditions with Great Britain will be lasting, the less costly and painful the adaptation process of the Czech economy may be expected.

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WPŁYW BREXITU NA GOSPODARKĘ CZECH

Streszczenie: Celem artykułu jest przedstawienie wstępnej oceny wpływu Brexitu na gospodarkę czeską w kontekście globalizacji gospodarczej. Część 1 odnosi się do analizy wpływu wybranych problemów związanych z BREXIT-em na gospodarkę Czech, w tym z wykorzystaniem analizy SWOT (część 2). Zmiany w stopniu globalizacji krajów V4 począwszy od 1991 r. są prezentowane jako sposobności dla intensyfikacji wzajemnych relacji ekonomicznych (część 3). Wnioski: oczekuje się, że wpływ BREXIT-u na gospodarkę Czech nie będzie zbyt istotny.

Słowa kluczowe: brytyjskie inwestycje w Czechach, saldo bilansu płatniczego Czech, wzajemne relacje ekonomiczne krajów V4.