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How Businesses in the Czech Republic are Benefiting from its Integration into the European Union

Kevin Starke

ABSTRACT

This paper will explore how businesses in the Czech Republic have benefited from its accession into the European Union (EU). Both the process of accession and the necessary changes that the Czech Republic had to make will be outlined. The costs and benefits associated with EU membership will be described. Recommendations will be made for changes to the government and their policies regarding human resource development, tertiary education and innovation so that the country can overcome current challenges. The current opinions of Czech citizens will be stated and analyzed showing both their support for the EU membership and their fears of losing autonomy. Costs and benefits will be broken down into two groups, those arising from the EU market and those related to central decision-making and governance. Both groupings will be evaluated to show that most costs occur in the short run, and that the long-run benefits are much greater.

INTRODUCTION

In the past 20 years there have been endless changes occurring in the Czech Republic; it was not until 1989 that they were free from the Soviet Empire. Since then it has been a time of great improvement, with a movement to a free market economy, democracy and an increase in international trade. Currently, and for the past decade, the majority of the significant changes in this area can be attributed to the accession of the Czech Republic into the EU.

Recently, there has been much debate over whether the Czech Republic is truly benefiting from being a member of the EU, and the number of people skeptical of its membership has been increasing. Many businesses and politicians fear that the loss of autonomy and policy change that accompany membership will have more drawbacks than the benefits that the EU has to offer. As with all issues, there are pros and cons to joining the EU, but it is clear that for the Czech Republic the benefits outweigh the costs and this report will explain why. Although this report could not address all of the issues involved in accession into the EU, it will focus on those issues that most impact the Czech Republic's business community.

HISTORY OF THE EUROPEAN UNION'S FIFTH ENLARGEMENT

The fifth enlargement of the EU began after the fall of the Soviet Block in 1989 when it was made clear that many of these Central and Eastern European (CEE) countries would be the next to be nominated for accession into the EU. It took four years for this nomination to come to fruition, and in 1993 the Copenhagen European Council officially issued the invitation. To become members of the EU, these countries would have to meet stringent criteria in areas including monetary policy, government and market economies. The Czech Republic's accession into the EU officially began when the European Agreement went into force in February 1995, by ratifying the agreement, the Czech Republic officially showed its interest in EU membership, and agreed to the processes necessary to become a member (Czech National Bank, 2008).

The Copenhagen Criteria was the foundation for the accession of the Czech Republic into the EU. The main requirements of the criteria were the capacity to handle market forces and competitive pressure, as well as the existence of a market economy that functioned properly. The fulfillment of these requirements was assessed through annual reports using various specific criteria, which were the necessary benchmarks that each country had to reach.

The main conditions analyzed were:

Demand-supply equilibrium achieved through free competition of market forces

- Full liberalization of prices and trade flows
- The existence of a developed financial sector without any obstacles to market entry and market exit
- Enforceability of law, including ownership rights
- Macroeconomic stability, including price stability, sustainable public finances and sustainable international financial accounts
- A broad consensus on the principles of economic policy
- A sufficiently developed financial sector capable of channeling savings into productive investment (Czech National Bank, 2008)

At a EU summit in Copenhagen during December 2002 the accession of the 10 candidate states was approved for the year 2004 (Czech National Bank, 2008), and the Czech Republic held their referenda to decide whether to enter the EU from June 13-14, 2003. Though before the referenda was held it appeared that it would not pass, once the records were tallied it was found that the approval rate of those who voted was 76 per cent (Doyle & Fidrmuch, 2006). With this response, the Czech Republic had only to wait for the official welcome from the EU, which would occur in less than a year. Finally, after referendums were held and passed in all of the candidate states, the fifth enlargement of the EU occurred on May 1, 2004 with the membership of the Czech Republic, Slovakia, Estonia, Hungary, Poland, Lithuania, Slovenia, Latvia, Malta and Cyprus (Czech National Bank, 2008). This event put a long series of events into motion that are continuing to occur today, which have greatly affected people within the new accession areas and throughout the EU. It was also this event that evoked the current debates over whether or not the Czech Republic will benefit from the accession.

CZECH REPUBLIC IN THE EUROPEAN UNION

Ever since the Czech Republic entered the EU four years ago they have been working strenuously to gain as many benefits as they can from their membership. While the government has been working to administer the required common policies, the businesses have been taking advantage of the new opportunities available to them. Improvements have not occurred overnight, and there are many changes that need to take place in order for the Czech Republic to receive all of the benefits available.

Although the process of integrating into the EU is known to be a time-consuming one, there are many Czech Republic citizens that are beginning to debate whether becoming a member was the best decision. The current President, Vaclav Klaus, is not helping to decrease the euro-skepticism within his nation as he recently stated that regarding the accession into the EU, "there has been no measurable impact on the economic growth of... the Czech Republic" (The Associated Press, 2007). This viewpoint is not what all people believe, as many view their entrance into the EU as a great step forward. A strong example of this opinion is Petr Zahradnik of the Central European Banking Group, who is quoted saying, "The main advantage in my opinion consists in the ability of not only big companies but also SMEs and individuals or family firms to compete with their European Union competitors" (Bakshian, 2004).

The full integration of the Czech Republic will continue slowly over many years, as the country begins to get comfortable with the market, the policies and the EU central governance. During this time the above division will continue to exist, but with a few changes the country will hopefully begin to become more pro-EU. The current situation in the Czech Republic is not optimal for integration into the EU and there are several current challenges that the country must overcome in order to gain all of the possible benefits of integration.

CURRENT CHALLENGES FACING THE CZECH REPUBLIC

After four years of EU membership, the Czech Republic has begun to take advantage of the wealth of opportunities open to them, but in order to make the best of these opportunities, there are certain changes that need to be made. It can be seen in news articles and journals that the government of the Czech Republic is not overly supportive of the EU accession. As I established earlier, the current President, Vaclav Klaus, has voiced his opposition to the EU and is vehemently against further integration. An example of the President's distaste for the EU is his opinion of the Registration, Evaluation, Authorisation and Restriction of Chemical Substances (REACH) directive that binds member countries to investigate the effects of chemicals on the health of the environment and humans. This directive will require the investment of billions in the chemical industry and may possibly threaten Czech chemical companies. President Klaus was quoted saying that, "This is the most horrible thing that has ever arisen in the EU" (*International Herald Tribune*, 2007). It appears that the president is unable to focus on the long-term benefits of the directive, such as increased health and safety, a healthier environment and more knowledgeable chemical regulations, and can only see the short-term costs.

By completing personal interviews, I found that certain students and managers within the Czech Republic feel that the structure of the current government is not conducive to effectively governing the country (A. Bonnyman, personal communication, December 5, 2008), and others believe that a more pro-EU government would increase the benefits that the Czech Republic receives (P. Zvarova, personal communication, December 6, 2008). These opinions show that people believe the Czech Republic's situation can be improved by their membership in the EU and feel that having a government that supports the directives would increase the benefits. For these reasons, further change to the Czech government is a necessity if the continued integration of the Czech Republic is to be as advantageous as possible.

Another current challenge to be faced is that the Czech Republic, like all new entrants to the EU, has much less research and development (R&D) in production than do the 15 nations that were EU members prior to the 10 candidate countries being accessed in 2004 (EU15). This is something that Czech businesses need to improve if they are to compete with foreign business. Businesses will no longer be able to rely on technological advances coming from international companies, because the rate of innovation will need to be much higher in order to stave off their foreign rivals. Technological advances will have to occur locally within R&D facilities, but in order for this to happen, the Czech Republic will have to be more open to innovations. In order to create an environment that is open to innovations, the politicians, business sectors and the public must all view these innovations as important. Currently, these aforementioned groups perceive innovation to be relatively unimportant, which is one reason why the R&D in production is so low. That few businesses are willing to take risks, and that long-term, detailed strategic plans are rare, not only in business but also in government, are indicators of the value that these three groups place on innovation (Kaderabkova, 2005). In order to overcome these faults, a large change will need to occur, whereby businesses begin to believe that R&D is integral to their success and realize that innovations are a great means to increase, or create new profits.

Lastly, insufficient government policies supporting human resource development is another challenge that the Czech Republic currently faces. This insufficiency is another component of the lack of innovation in Czech business and is made worse by the low levels of tertiary education in the country. These two deficiencies create an environment where life-long learning is uncommon, and the lack of education can also lead to employees that add very little input into their jobs. The education system is currently not highly capable of training the flexible and creative workers that would allow businesses to function more efficiently and would be able to improve the level of R&D. Increasing the supply of tertiary education and policies supporting human resource development need to be urgent priorities for the Czech Republic, because their importance will only grow as the Czech Republic continues to integrate into the EU (Kaderabkova, 2005).

COSTS AND BENEFITS OF EU MEMBERSHIP

Integration into the EU takes years to occur fully, during which there are many costs and benefits that affect the integrating country. As the Czech Republic has only been a member of the EU for four years, there are still many years of change to come, but this does not mean that costs and benefits have not been occurring already. On the contrary, most costs of joining the EU occur promptly after a country shows its interest in accession and many benefits begin shortly thereafter.

Currently the Czech Republic is in a period where costs have been accrued and benefits from membership have begun to occur. Though there are many costs that are created due to integration into the EU, the benefits more than outweigh them. In this section these costs and benefits will be addressed in two different groups: those that arise due to the participation in the EU market, and those related to the central decision-making and governance in Brussels.

Participation in the EU market

Upon entering the EU, the Czech Republic gained full access to the markets of all of the member states. This access can be greatly beneficial to companies as it enhances the market opportunities within the Czech Republic. Companies now face reduced or eliminated trade, tariff and non-tariff barriers due to the EU's free movement of goods and services. These reduced barriers not only allow the movement of factors of production, but also permit people from throughout the EU to move freely in search of jobs and opportunities. This free movement could come at a cost, as many people fear that highly skilled labour will move to the older EU countries for higher wages and benefits (Andronikidis & Bitzenis, 2006). This fear has been substantiated by studies; for example one that stated five to 30 per cent of Czech doctors might leave the country after the accession. However, it can also be stated that many more customers will enter the Czech Republic for services as they are of a higher quality than those within other new EU member states. For the above example, it is believed that there will be an increase in elective procedures such as plastic surgery and dentistry for which the patients pay out-of-pocket (Spritzer, 2004). This example shows that costs to the Czech Republic associated with the loss of skilled labour can be significantly lessened by the increased demand for these skilled jobs from other new EU members.

Other inherent costs created by access to the EU market include the costs of preparing the Czech Republic for its entry into the market itself. These costs could be exacerbated, the weaker the economy and environment within a country, the higher the transition costs can be. One such cost is that of modernizing the entire Czech industry, without which the Czech Republic would be at a great disadvantage compared to the more developed and advanced EU15. This disadvantage relates to a fear that many businesses within the Czech Republic have regarding the threat of other nations to their domestic producers' market positions (Andronikidis & Bitzenis, 2006). The pressure to modernize its industry in fear of losing domestic production could actually be quite beneficial for the Czech Republic in the long run. Michael Porter (2007) supports this argument when he claims that, "When supporting industries are competitive, firms enjoy more cost effective and innovative inputs." Due to the pressure being exerted from foreign companies on the Czech market, firms are forced to be more competitive and innovative. This change, partnered with the modernization within the country should create a business environment in which companies and their suppliers are more efficient and produce a higher quality product. These firms will then be more capable to compete, which will not only benefit them, but also their local consumers, who will have access to locally produced, higher quality goods.

The connection formed between the Czech Republic and the other nations within the EU has produced many beneficial opportunities for Czech businesses. There is now easier technology transfer from other nations to the Czech Republic, as barriers have been decreased, which will create more interaction between Czech companies and those in different areas of the EU. Czech entrepreneurs will also have access to many new markets from which they can gain new ideas for products. Another benefit from this connection is increased Foreign Direct Investment (FDI) and trade flows, which will come from both EU and non-EU nations (Andronikidis & Bitzenis, 2006).

A business student that I interviewed explained this boost in FDI by expressing that he felt that the accession into the EU has created a great increase in goodwill, as it shows that the Czech Republic is now part of “an exclusive group of highly developed countries” (L. Drencak, personal communication, December 7, 2008). Non-EU countries are more willing to invest in FDI in the Czech Republic now that they are a part of the EU because it shows an improvement in their business environment and investment climate (Andronikidis & Bitzenis, 2006).

The free movement of people throughout the EU has led to an increase in the number of foreign nationals in the Czech Republic, which an Audit Commercial Manager that I interviewed believes has benefited the Czech Republic by creating more diversity, which presents the ability for a nation to benefit from the exchange of ideas that diversity brings with it (A. Bonnyman, personal communication, December 5, 2008). Reduced barriers also lead to reduced costs of business, as products can be transported within the area without fees, reducing the costs of logistics. Other reductions to business costs will come from the use of cheaper inputs available in newly accessed markets, and the reduced costs of entry into new markets (Andronikidis & Bitzenis, 2006). Due to all of these factors, “Czech businesses will step by step use the benefits of the internal market and they will be more active in setting up subsidiaries and offices in the EU” (Tax, 2004).

The preferential tariffs that the EU has with other countries also offer many opportunities for Czech businesses. Their exporters will not only have free access to countries such as Hungary and Poland, but they will also be able to benefit from trade agreements with the Mediterranean countries, Mexico and Chile. Exporters will also advance from the new export channels opened to them by EU membership along with the fact that their products will now say “Made in EU.” This new branding will prove to people that the products produced in and exported from the Czech Republic are of a high quality, which could increase people’s willingness to buy them. Access to new trade markets is a good development for Czech business, because recently trade within the EU constituted 85 per cent of their total trade, and the new preferential agreements will give Czech companies the opportunity to expand their operations into markets that they previously had no access to, which could bring immense growth to their national exports (Tax, 2004).

Central Decision-Making and Governance in the EU

By joining the EU, the Czech Republic has agreed to follow the various treaties and policies that are created by the European Commission in Brussels. In order to initially follow these common policies, the Czech Republic faced high costs of improving their national legislation, as well as the costs of adopting the EU standards for enterprise (see the Copenhagen Criteria mentioned above), and the policies themselves. Central governance, like that which occurs within the EU, can often create disparities between the different areas being governed and thus creates central bureaucracy. This is when all parties argue and lobby against policies and issues that are not the most beneficial for them, and decision-making becomes difficult and time consuming. Businesses within the Czech Republic are worried that due to common policies and central bureaucracy, the Czech Republic will compromise its culture and lose certain economic advantages (Andronikidis & Bitzenis, 2006).

Another concern for Czech businesses is that since the EU takes five per cent of the annual common budget for its own administration, some individuals believe that it is very unlikely for the Czech Republic to receive more than it gives in the long run. These people further believe that since the Czech Republic will undertake legislation created by the EU, “National elections will become a mock, since no matter who wins the elections in the Czech Republic, the European representation will remain average” (Mach, 2003). These are not the views of all citizens within the Czech Republic, but the fear of losing autonomy is one of the largest concerns I found when completing my interviews (P. Zvarova, personal communication, December 6, 2008). However, arguments against these views hinge on the fact that the EU does not have the legislative force to ensure that all nations enforce these legislations, only that they adopt them into their own policies (Quigley, 2008). Thus the Czech Republic will be able to keep some autonomy, and the decisions made by their government will continue to be of vast importance.

Though the EU policies can create some loss of autonomy for the Czech Republic, they also create various benefits. An example of a major benefit that arose due to the adoption of EU policies is the strengthening of the Czech Republic's international accounting standards (Andronikidis & Bitzenis, 2006). Because of these heightened standards, the accession into the EU has made it more likely that foreign investors will invest in Czech companies. Investors will now have more faith in the accounting figures and practices of Czech businesses and they will know that the accounting systems used are of the same quality as the EU15.

Additionally, along with the strengthening of accounting standards, accession into the EU will also improve the regulations for start-ups, increase the transparency of business operations, and increase the environmental regulations that Czech businesses must follow (Andronikidis & Bitzenis, 2006). Though many Czech citizens and businesses see the increased environmental regulation as a large cost, I agree with Michael Porter (1991) in his opinion that, "Strict environmental regulations do not inevitably hinder competitive advantage against foreign rivals; indeed, they often enhance it. Tough standards trigger innovation and upgrading." Though it is true that there will be high upfront costs to businesses arising from the increase in regulation, Porter states that:

Properly constructed regulatory standards, which aim at outcomes and not methods, will encourage companies to re-engineer their technology. The result in many cases is a process that not only pollutes less but lowers costs or improves quality. Processes will be modified to decrease use of scarce or toxic resources and recycle wasted by-products" (Ibid).

Considering these long-term benefits, Czech companies will be better off with the new environmental standards, and the innovations created will help them compete against foreign firms at a higher level.

Corporate Social Responsibility (CSR) is another area in which Czech businesses can benefit from higher EU requirements and beliefs. As I have learned in my courses at the University of Economics in Prague, CSR is not a major concern within the Czech Republic. There are disparities in wages and positions between females and males, and many students believe that businesses practicing CSR are doing it only as a marketing ploy (Quigley, 2008). An easy way for the Czech Republic to benefit from CSR is to have firms establish equal pay for equal work, no matter what sex the worker is. Not only would this simple change directly benefit those who are receiving higher wages, but it would also create a much better work environment, based on respect and equal rights, for their employees (Spidla, 2007).

Lastly, an immense benefit to the Czech Republic is the large sum of money currently being given to them from the common EU budget. New EU countries are usually net recipients of the EU budget for several years after their accession, because the more developed countries contribute funds so that the new members can bridge the gap in development and technology. In the 2007 budget, the Czech Republic received 17 billion Czech Korunas more than they paid into the EU, the largest amount that the country has received since their accession in 2004. They received such large sums particularly due to the EU's cohesion and structural funds (Radio Praha, 2008). Additional money also went to fund three projects that are being "financed by the European Social Fund: the Competitive Education Program, the Prague Adaptability Program and the Human Resources and Employment Program" (Velek, 2007). As the titles of the programs and funding bodies show, not only is the EU trying to improve the infrastructure of the Czech Republic, but also improve the quality of life and cohesion within the country.

Short-Term Costs Lead to Long-Term Benefits

Many of the costs associated with the Czech Republic's accession into the EU are upfront, such as improvement of legislation, markets and industry. Though there are certain costs that will persist into the future, such as decreased autonomy, loss of skilled workers and reductions in funding by the EU, it is clear that the Czech Republic is receiving a net benefit from joining the EU. In the long run, the country will be able to benefit from the EU's modernized industries, more experienced exporters and innovative industries that arose due to more stringent environmental regulations.

CONCLUSION

Since the fifth enlargement of the EU in 2004, there has been continual change occurring throughout the Czech Republic. In order for Czech businesses to gain as much out of the EU membership as possible, other specific changes must occur in the country. The Czech government needs to be changed in order to govern more effectively and increase support for EU policies. There must be increased policies and funding regarding human resource development and tertiary education, which the EU has already begun to fund through the European Social Fund. Innovation must also increase throughout the Czech Republic, as their proportion of R&D is much lower than the more developed EU15. Higher environmental regulations and increased competition will help to heighten the level of innovation in the country and make firms more able to protect their domestic markets.

The new markets and trade agreements that accompanied the accession have increased competition for firms, but also created many new avenues of growth. The increased competition will not only boost innovation, but also the quality of local goods, which creates a great benefit to the Czech Republic in the long run. Lastly, the potential costs of having to follow policies created in Brussels are not as high as the benefits that these policies and the EU budget create. In conclusion, it is for all of the above reasons that the Czech Republic made the correct decision by joining the EU, and will continue to benefit from it long into the future.

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