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Think Visegrad
V4 Think-Tank Platform

Brexit Scenarios and the

Economic Implications for the Visegrad Four

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Abstract

This paper examines the potential impact of Brexit – the United Kingdom's withdrawal from the European Union – on the Visegrad Group. Part One outlines the current state of withdrawal negotiations, the position of the UK, EU and the Visegrad countries, and potential future scenarios. It shows that a range of possible outcomes remain possible, from the UK's continued membership of the European Economic Area to a no-deal Brexit, where UK-EU trade reverts to WTO terms. Part Two discusses the potential impact of these scenarios for the Visegrad countries in terms of exports and trade, the EU budget, and migration. If the Withdrawal Agreement is ratified, the economic losses of Brexit are likely to be modest, while the impact of changes to UK migration policy and contributions to the EU budget for the Visegrad Four will also be limited. However, a no-deal Brexit could cause significant short-term economic disruption.

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Think Visegrad – V4 Think Tank Platform is a network for structured dialog on issues of strategic regional importance. The network analyses key issues for the Visegrad Group, and provides recommendations to the governments of V4 countries, the annual presidencies of the group, and the International Visegrad Fund.

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Introduction

This paper examines the potential economic impact of Brexit, the United Kingdom's withdrawal from the European Union, on the Visegrad Four (the Czech Republic, Hungary, Poland and Slovakia). It considers the potential Brexit outcomes and examines the principle channels through which the UK's withdrawal may impact on the economies of the Visegrad countries compared with a no-referendum counterfactual. Section One sets out the current state of negotiations[2] and shows why a range of possible scenarios for the UK's future political and economic relationship with the EU are possible. It also argues that the UK will remain in a transition phase beyond the 21-month timeframe currently envisioned by the UK government and the EU. Section two examines the impact on the Visegrad countries with reference to these scenarios in terms of four channels: trade and exports; migration and remittances; the EU budget; and foreign direct investment.

Section One: Brexit negotiations and future scenarios

The state of negotiations

On June 23rd 2016, the United Kingdom voted narrowly in favour of leaving the European Union. The official process for the UK's departure began on March 29th 2017, when the government invoked Article 50 of the Lisbon Treaty. Unless Article 50 is extended or revoked, the UK will formally cease to be a member on March 29th 2019. If a Withdrawal Agreement has been signed and ratified by the UK and the EU before the conclusion of the Article 50 process, the UK will then enter a transition period, which is currently set to run to the end of 2020, but could be extended by up to two years. During this period, the UK will effectively be a non-voting member of the EU. It will remain in the Single Market and Customs Union and EU law will continue to apply.

During the transition period, the UK and EU intend to conclude a comprehensive agreement on the future relationship. The parameters for the future relationship have been set out in a Political Declaration accompanying the Withdrawal Agreement, however these are broad in nature and carry

[2] As of 18th January 2019.

no legal force.[3] If the Withdrawal Agreement is not ratified by the end of March 2019 and the Article 50 process is not extended or revoked, the UK will exit the EU without any transition arrangements and revert to trading with the EU on WTO terms.

Under the Withdrawal Agreement, if no new free-trade agreement has been reached at the end of the transition period, a "backstop" arrangement will apply to prevent the establishment of a hard border between Northern Ireland and the Republic of Ireland. The backstop comprises two parts. If stage one of the backstop were triggered, there would be a single customs area and guaranteed partial regulatory harmonisation between the whole of the UK and the EU, while Northern Ireland would remain part of the Single Market. In stage two, should the mainland UK opt for a trading regime that diverged from EU standards in certain areas, Northern Ireland would remain in the Single Market. This would prevent the imposition of tariffs on trade but would not ensure frictionless trade between the mainland UK and the EU, as the former would not be part of the EU common regulatory regime with the EU on goods. Both Northern Ireland and the UK mainland would, however, be bound to some EU restrictions on competition, taxation, environment and labour policy to ensure a "level playing field" for business.[4]

The UK negotiating position

In a speech in January 2017, Prime Minister Theresa May set out her negotiating objectives for the UK's future relationship with the EU. May ruled out membership of the European Economic Area and stated that the UK would leave the Single Market. Free movement of labour from the EU would no longer be permitted, the jurisdiction of the European Court of Justice would end, and the UK would end substantial contributions to the EU budget. The UK would also seek a deal with the EU that would allow it to conclude free trade agreements with other countries.[5]

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[3] "Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom," available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/759021/25_November_Political_Declaration_setting_out_the_framework_for_the_future_relationship_between_the_European_Union_and_the_United_Kingdom__.pdf.

[4] Springford, J. "Brexit deal done – now for the hard part," Centre for European Reform, 15 November 2018, available at: https://www.cer.eu/insights/brexit-deal-done-now-hard-part.

[5] "The government's negotiating objectives for exiting the EU: PM speech," 17 January 2017, available at: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech

Based on the EU's existing relationships with third countries, this position suggested that the UK would seek an extensive free-trade agreement with the EU similar to that recently concluded with Canada and South Korea.[6] This would meet the red lines set by the Prime Minister and allow the UK to conclude FTAs with third countries, but would create substantial non-tariff barriers to trade. In its White Paper published in July 2018, the government instead put forward a proposal for a bespoke relationship that would effectively keep the UK in the single market for goods (but not services). The UK government has proposed a "dual-tariff regime" that would in theory allow the UK to remain in the EU customs union for goods while also pursuing an independent trade policy.[7]

The negotiating position of the EU and Visegrad Four

Since the UK referendum, the EU has insisted on a two-stage negotiation process ("a phased approach"), in which the terms of the UK's withdrawal from the EU would first be settled, before a new political, trade and security agreement could be reached. The EU's three negotiating priorities in the first phase were to secure the rights of citizens; ensure that the UK met its existing budgetary commitments; and avoid a hard border on the island of Ireland through "flexible and imaginative solutions."[8]

Regarding the second phase, the EU has indicated that it is open to a range of different models for the future relationship, but that it must be based on a "balance of rights and ensure a level playing field." The European Council guidelines reflect concerns articulated clearly by the French and German governments on the need to maintain EU and the integrity of the single market. Leaving the EU, and in particular the Single Market, must inevitably lead to greater frictions in trade. The European Council's guidelines underline the importance of maintaining the integrity and proper functioning of

[6] Presentation of Michel Barnier, European Commission Chief Negotiator, to the Heads of State and Government, 15 December 2017, available at: https://ec.europa.eu/commission/sites/beta-political/files/slide_presented_by_barnier_at_euco_15-12-2017.pdf.

[7] The Future Relationship between the United Kingdom and the European Union, UK Government White Paper, July 2018. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725288/The_future_relationship_between_the_United_Kingdom_and_the_European_Union.pdf.

[8] "Guidelines following the United Kingdom's notification under Article 50," European Council, 29 April 2017. Available at: https://www.consilium.europa.eu/media/21763/29-euco-art50-guidelinesen.pdf.

the Single Market and the indivisibility of the four freedoms. They warn that there can be no "cherry picking" through participation in the Single Market on a sector-by-sector basis.[9]

In the first phase of negotiations, the Visegrad Four had a strong interest in ensuring that the rights of its citizens in the UK would be protected and that existing UK commitments to the EU budget are honoured, as all four states are net recipients of EU funds. At an EU summit in Bratislava in September 2016, shortly after the UK's EU referendum, the Visegrad Group issued a joint statement warning that they would veto any agreement that did not protect their citizens' rights in the UK.[10]

As discussed below, a no-deal Brexit would harm these two vital interests and negatively impact the economies of the Visegrad countries. The Visegrad Group has less interest in taking a tough line on the Irish border – and the insistence on a backstop arrangement – which are the areas of most concern for the UK parliament and could lead to the rejection of the Withdrawal Agreement by the UK. There have been indications that officials in some Visegrad countries are unhappy with the tough approach the EU has taken on this issue. In September, Konrad Szymański, the Polish Europe Minister, reportedly stated that the European Council's negotiating guidelines may have to be re-written to reach agreement. At a separate meeting in Salzburg, Viktor Orban, the Hungarian president, stated that he did not wish to "punish" the UK for its wish to leave the bloc.[11] However, these interventions have had no practical impact on EU policy. In October 2018, for example, the Hungarian Foreign Minister criticised the performance of the European Commission, but also added that it was essential for the EU to remain united during the negotiations.[12] Overall, since the start of formal negotiations, the EU27 have shown a high degree of unity and the Visegrad Four have backed the position agreed by the European Council in April 2017.

If a Withdrawal Agreement is ratified, there is greater potential for diverging interests to come to the fore during the second phase of negotiations regarding the future relationship, as all EU states have a veto over the final deal. The Visegrad Group may place less emphasis than France and Germany on

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[9] European Council Guidelines, 23 March 2018, available at: https://www.consilium.europa.eu/media/33458/23-euco-art50-guidelines.pdf.

[10] "Visegrad Group of EU states 'could veto Brexit deal,' BBC News, 17 September 2016. Available at: https://www.bbc.com/news/world-europe-37396805.

[11] Barigazzi, J., "Poland breaks ranks from EU Brexit unity," *Politico*, 21 September 2018. Available at: https://www.politico.eu/article/poland-breaks-ranks-from-eu-brexit-unity/.

[12] Statement of Péter Szijjάartó, Minister of Foreign Affairs and Trade, 15 October 2018. Available at: http://www.kormany.hu/en/ministry-of-foreign-affairs-and-trade/news/central-europe-s-expectation-with-respect-to-the-european-commission-is-that-the-brexit-negotiations-end-in-an-agreement

protecting the integrity of the Single Market. While protecting the rights of citizens currently resident in the UK is of paramount importance, they have little interest in facilitating further emigration. This raises the possibility that the Visegrad Four could be more receptive than more federalist EU members to the UK's efforts to secure a high level of access for goods without accepting all the responsibilities of Single Market membership, particularly if the UK were to offer to raise its offer on future EU budget contributions.[13]

However, the likelihood that the Visegrad states will challenge the dominant Franco-German line on future relations with the UK should not be overstated. Maintaining the Single Market is also of high importance for all the Visegrad countries. The share of UK inputs in the economies of the Visegrad group is very small compared to the other 26 EU countries, and to Germany in particular. There is therefore limited value in expending political capital in pushing for a different strategy. Moreover, the Visegrad states are generally less exposed to the UK economy than many of the advocates of a hard line on Single Market integrity, so they cannot argue that they will suffer disproportionate losses.

Causes of uncertainty

The UK's political establishment and the broader public remain fundamentally divided on what form Brexit should take, or indeed whether the UK should withdraw from the EU at all. On 15th January the House of Commons rejected the Withdrawal Agreement by a record margin of 230 Members of Parliament (MPs), with 118 deputies from the ruling Conservative Party voting against.

The vote against the bill united MPs who seek a much closer relationship with the EU post-Brexit (or seek another referendum) and MPs who seek a harder Brexit. Many MPs in the governing Conservative Party object to the backstop arrangements, which if activated would bind the UK in a customs union with the EU and prevent it pursuing a fully independent trade policy. The Labour Party's position to date has been to vote down the Withdrawal Agreement in the hope of forcing a General Election. It has also called for amendments to the Political Declaration to seek a closer future relationship with the European Union, including membership of the Customs Union and possibly also the Single Market.

[13] Springford, J., Lowe, S., and Oppenheim, B., "Will the unity of the EU27 crack?" Centre for European Reform, March 2018. Available at: https://www.cer.eu/sites/default/files/pbrief_eu27_crack_15.3.18.pdf

It is unclear what amendments the government can make to secure a majority for the Withdrawal Agreement. The government could re-write the Political Declaration to signal its intention to seek a softer Brexit in the hope of winning the support of the Labour Party. Any majority for the Withdrawal Agreement would rely heavily on votes from the opposition Labour Party and could lead to a split in one or both major parties. A majority of MPs are opposed to the UK leaving the EU without a deal, however this is the legal default in the absence of the ratification of the Withdrawal Agreement or the revocation of Article 50.

Even if the Withdrawal Agreement is passed, the EU is unlikely to accept the UK's current official proposals for the future trading relationship put forward by Theresa May in January 2017, as they would undermine the cohesion of the Single Market. The UK's proposals for a Facilitated Customs Agreement would effectively give it access to the Single Market for goods while diverging in the regulation of services and limiting migration and budgetary contributions. EU Commission officials and several EU government leaders have indicated that this is unacceptable as it would undermine the integrity of the Single Market by allowing freedom of movement for goods while limiting freedom of movement for labour and services. UK proposals for a dual customs regime could also enable the UK to gain a competitive advantage. The EU has long been reluctant to split the four freedoms and this determination has only hardened in recent years as a result of internal conflicts over fiscal policy and the legal order.[14]

The Conservative Party is reliant on a coalition with the Democratic Unionist Party (Conservative Party) to pass legislation. Together, the Conservative Party and DUP have a working majority of only 13, giving rival factions favouring either harder or softer negotiating terms significant power. Following a failed no-confidence vote, May has pledged to step down as Prime Minister before 2022. This could take place while negotiations on the future relationship are ongoing and could also trigger a General Election and change of government. Her successor could favour a harder Brexit with little or no customs and regulatory alignment. Michael Gove, the Environment Minister and a prominent proponent of Brexit, has argued that the government's negotiating stance on the future arrangement can be amended once the UK's departure from the EU has been formalised.

[14] Lowe, S, "Inching our way towards Jersey," Centre for European Reform, 11 July 2018. Available at: https://www.cer.eu/insights/inching-our-way-towards-jersey.

Implications and scenarios

Given the UK's sharp domestic political divisions, and that its current proposals are unacceptable to the EU, negotiations over the future relationship are likely to last beyond the initial two-year transition period foreseen in the Withdrawal Agreement. The OECD notes that the time taken to negotiate recent free-trade agreements has been at least three years. UK-EU negotiations will be facilitated by the fact that UK law and regulations are currently in full alignment with EU norms. However, the Switzerland-EU model, which is the closest approximation to the hybrid trading relationship proposed by the UK took ten years to conclude, and is not an arrangement that the EU wishes to reproduce.

At the time of writing, five main scenarios are possible: 1) "no deal Brexit," in which the UK reverts to trading with the EU on WTO terms; 2) a Canada-style free-trade agreement for Great Britain, with Northern Ireland remaining in the Single Market; 3) a "Customs Union plus" arrangement based on the "backstop" in the Withdrawal Agreement; 4) an enhanced Customs Union arrangement with close regulatory alignment in goods; 5) a Norway-style arrangement under which the UK remains in the Single Market and European Economic Area. Given the current lack of majority for any Brexit deal in the UK House of Commons, it is also possible that the Article 50 process could be extended and a second referendum held. This could include an option to remain in the EU. In December the European Court of Justice ruled that the UK can stop Brexit by unilaterally revoking Article 50.

If the Withdrawal Agreement is ratified, the UK's existing proposals for the future trading relationship and the backstop arrangements in the Withdrawal Agreement indicate that the UK government will prioritise continued close regulatory alignment in goods– "customs union plus" or the "Jersey model"[15]– in its negotiations with the EU, while formally remaining outside the Single Market. However, the Withdrawal Agreement does not preclude the UK government shifting its stance and electing to remain within the European Economic Area (like Norway) and the Customs Union at the end of the transition period. However, this would require the UK to abandon its current red lines on immigration, budget contributions and the jurisdiction of the ECJ.

The Withdrawal Agreement also does not rule out a Canada-style free-trade agreement between the mainland UK and the EU. However, the backstop arrangement in the Withdrawal Agreement makes this politically difficult for the UK government as it would have to impose a hard border between Great

[15] "Inching our way towards Jersey."

Britain and Northern Ireland, breaking up the UK's single market. This would be strongly opposed by the DUP, on which the government is currently dependent for its majority.

In his legal advice to the UK government, Geoffrey Cox, the UK Attorney General, stated that if the backstop were triggered, there is no lawful way for the British government to pull out of the backstop arrangements unilaterally. He also noted that if a trade deal could not be reached, the EU and UK could jointly accept that in view of the fact that negotiations had broken down, the Great Britain parts of the customs union would "fall away," leaving only Northern Ireland in the Customs Union.[16] This would in effect result in the mainland UK moving to trading with the EU under WTO terms, on similar lines to a "no deal" scenario (but with Northern Ireland remaining subject to the backstop arrangements). However, this could only lawfully be achieved with the consent of both parties.

Prime Minister May has sought further assurances from the EU that it has no desire to see the backstop come into force, and to agree that if a new agreement has been reached but the backstop risks coming into force because ratification is not complete, the EU and the UK would seek to apply the agreement on a provisional basis pending ratification.[17] In their response, Donald Tusk, President of the European Council, and Jean-Claude Juncker, President of the European Commission, made clear that there could be no amendments to the Withdrawal Agreement, including a unilateral exit mechanism from the backstop or a time limit. However, they also noted that the EU was committed to ensuring the temporary nature of backstop, and that this pledge by the European Commission has a legal standing in the Union. The letter also noted that "should national ratifications be pending…the commission is ready to propose provisional application of relevant parts of the future relationship."[18]

The UK government has stated that it will allow MPs to vote before the backstop is initiated, although a vote against the triggering of the backstop would contradict commitments made in the Withdrawal Agreement. The EU will not agree to a legally binding deadline for the Customs Union as this would negate its purpose as a guarantee against a hard border in Northern Ireland. Among others, Peter

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[16] "Geoffrey Cox's Brexit legal advice: attorney general's letter in full," *The Times*, 5 December 2018. Available at: https://www.thetimes.co.uk/article/geoffrey-cox-s-brexit-legal-advice-the-attorney-general-s-letter-in-full-288sd9tlh.

[17] "Letter from the Prime Minister to President Juncker and President Tusk," 14 January 2019, available at: https://www.scribd.com/document/397428698/Letter-From-the-Prime-Minister-to-President-Juncker-and-President-Tusk#fullscreen&from_embed.

[18] "Joint letter of President Tusk and President Juncker to Theresa May, Prime Minister of the United Kingdom," 14th January 2019. Available at: https://www.consilium.europa.eu/en/press/press-releases/2019/01/14/joint-letter-of-president-tusk-and-president-juncker-to-theresa-may-prime-minister-of-the-united-kingdom.

Pellegrini, the Prime Minister of Slovakia, has publicly emphasized that the Withdrawal Agreement cannot be revised. The UK previously tried to negotiate a unilateral termination mechanism from the backstop on the grounds that there was no prospect of an agreement, but this was rejected by the EU.

Table 1: Summary of Brexit Scenarios

	Context	Acceptable to current UK government?	Acceptable to EU	Trade tariffs	Non-tariff barriers	EU budget payments	Free move-ment
Extended transition	Withdrawal Agreement ratified. UK requests transition extension.	Probably	Yes	No	No	Yes	Yes
WTO	Withdrawal Agreement not ratified. UK leaves EU without deal	No	No	Yes	Yes	No	No
Basic Customs Union	No trade agreement reached at end of transition.	No	Yes	No	Yes	No	No
Enhanced Customs Union	EU accepts adapted version of current UK proposals.	Yes	Unclear	No	Partial	No	No
FTA	UK government changes policy and imposes hard border with Northern Ireland	No	Yes (with NI backstop)	No	Yes	No	No
Norway/EEA	UK government abandons red lines on immigration and budget contributions.	No	Yes	No	No	Partial	Yes

Source: Author's elaboration.

Section Two: Implications for the Visegrad Four

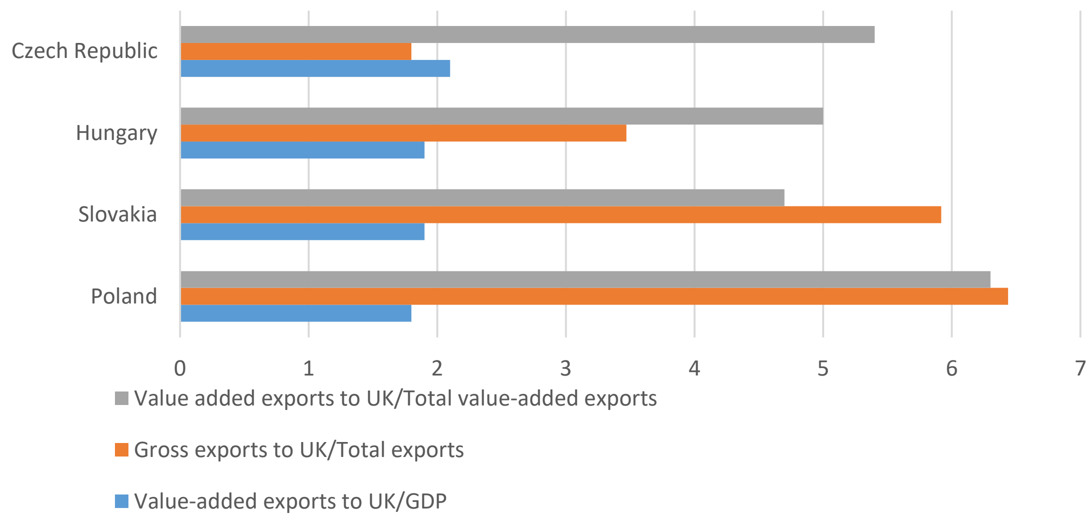
External trade

The Visegrad Four have a relatively high level of goods trade with the UK. The UK accounts for 6.4% of total Polish goods exports, 6% for Slovakia, 5% for the Czech Republic and 3.5% for Hungary. This was equivalent to 2.6%, 3.5%, 4% and 5% respectively of GDP in 2015. This compares with an EU27 average of 2.5% of GDP.

The Visegrad economies are highly integrated into manufacturing supply chains with Germany and their economies are therefore potentially exposed to further indirect effects from a decline in UK demand for German exports. The combined direct and indirect impact of Brexit can be assessed using the recently updated and revised World Input-Output Database (WIOD). Drawing on the WIOD, the Vienna Institute for International Economic Studies (WIIW) has calculated the value of exports from Central Europe either directly made to the UK or indirectly via third countries and finally absorbed by the UK. The WIOD provides figures for value-added exports, rather than gross exports, showing the amount of income that is generated in the Visegrad Countries through indirect and direct exports to the UK. The results are shown below. The UK accounts for between 4.7% (Slovakia) and 6.3% (Poland) of total value-added exports, however this is only equivalent to around 2% of GDP for each of the Visegrad states.[19] WIIW calculates that a fall in final demand in the UK of 1% would result in a decline in GDP in the Visegrad states of 0.06%. This captures both the direct effect of lower demand for Visegrad exports, and the indirect effects on the Visegrad states of reduced exports from other EU states, in particular Germany and France. However, this calculation does not take into account the impact of tariffs or non-tariff barriers.

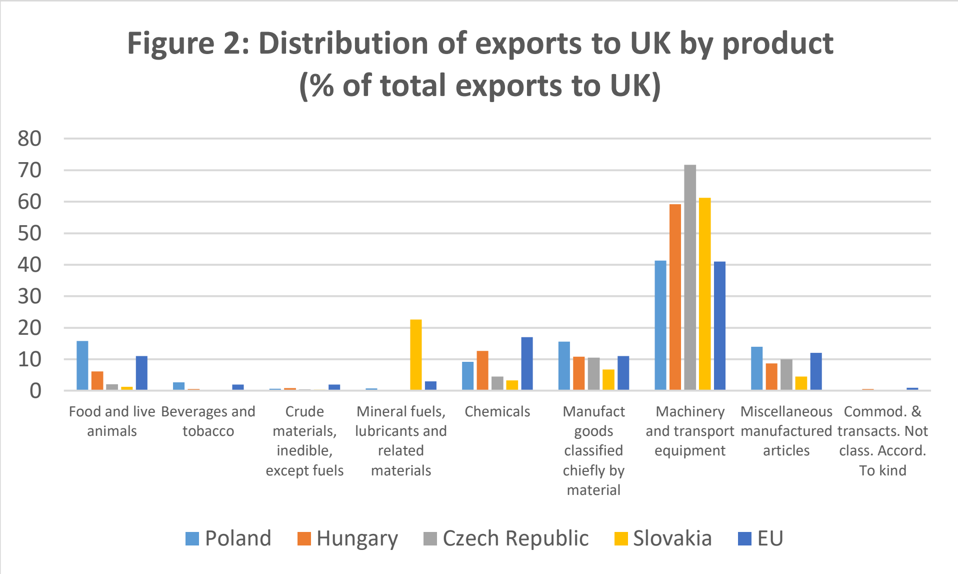
[19] "Labour shortages driving down economic growth?" The Vienna Institute for International Economic Studies, 10 November 2016. Available at: https://wiiw.ac.at/labour-shortages-driving-economic-growth--dlp-3996.pdf

Figure 1: Direct and indirect exports to UK (% share)



Sources: Eurostat; Vienna Institute for International Economic Studies.

The structure of exports to the UK is in line with the countries' broader export profile, with a high share of machinery and transport goods. The category accounts for between 40% and 60% of total exports from the Visegrad countries to the UK. Manufactured goods also account for a significant share of exports from Poland, Hungary and the Czech Republic, but a smaller share of exports from Slovakia. The structure of the Visegrad Group's exports to the UK are close to those of the UK as a whole, although machinery accounts for a larger share for Hungary, the Czech Republic and Slovakia, while Poland accounts for a larger share of food exports than the EU average.

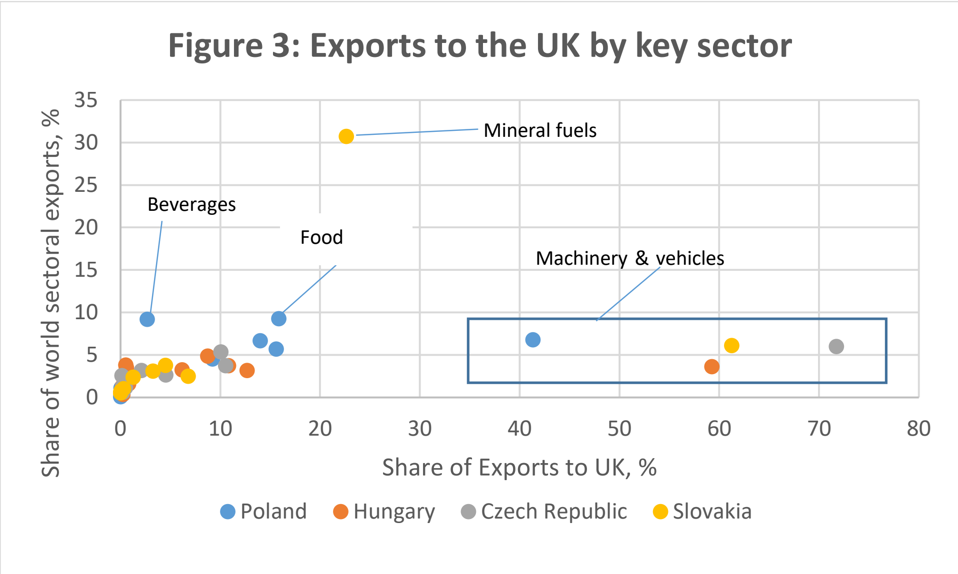


Source: UN Comtrade.

Figure 3 plots sectoral exports to the UK as a share of total exports to the UK and the country's total world exports of this product type. This gives an indication of the most exposed sectors from a change in trading arrangements. For the Czech Republic, Hungary and Slovakia (with the exception of mineral fuels), the UK accounts for no more than 6% of world exports of any goods sector. The UK accounts for around a third of total world exports of mineral fuels from Slovakia, however this product group is a small share of overall Slovak exports.

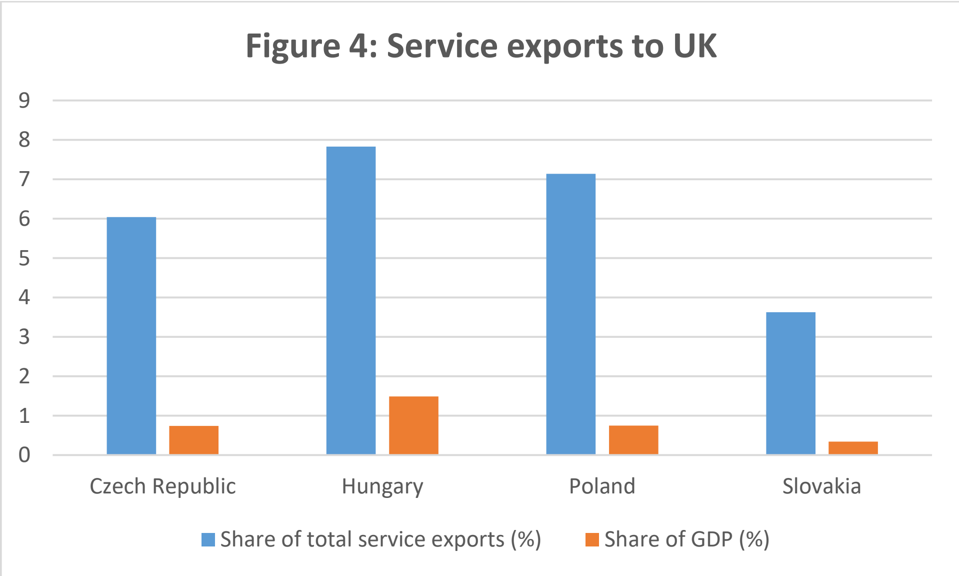
Poland's export profile to the UK is more diversified than the rest of the Visegrad Group. Food and live animals account for around 16% of Poland's total exports to the UK, and this makes up almost a tenth of total world sales (this may in part reflect the large Polish expatriate community). Likewise, beverage sales to the UK, while a small share of total exports to the UK, make up almost 10% of total world beverage exports. The UK is the second largest market for Polish agricultural exports overall. The exposure of Poland's agricultural sector is significant given the high levels of tariffs that are applied on many food products when trading on WTO terms, which can reach up to 50% in the case of meat products, 30% for dairy, and 20% for processed fruit and vegetables.

Given that exports for all the Visegrad countries are strongly oriented toward machinery and transport, there is potentially scope for coordination between the Visegrad Group in negotiations with the over the future trading relationship. The UK's negotiating priorities for the future trading arrangement would appear to favour the Visegrad Four. As noted above, the UK is proposing to effectively remain within a customs union and maintain a high degree of regulatory alignment in goods, while diverging in services. UK officials have also identified the automotive industry as one of the most vulnerable to trade tariffs and customs delays and is likely to prioritise an agreement with the EU that will maintain as frictionless trade as possible for this sector to minimise disruption. Such proposals would in principle favour the Visegrad Four, given the importance of automotive exports and the relatively small share of services in total exports. However, the EU Commission and major EU states are highly sceptical of the UK's proposals as they would appear to allow the UK to remain close to the single market in goods without accepting freedom of labour or regulatory alignment in services.



Source: UN Comtrade.

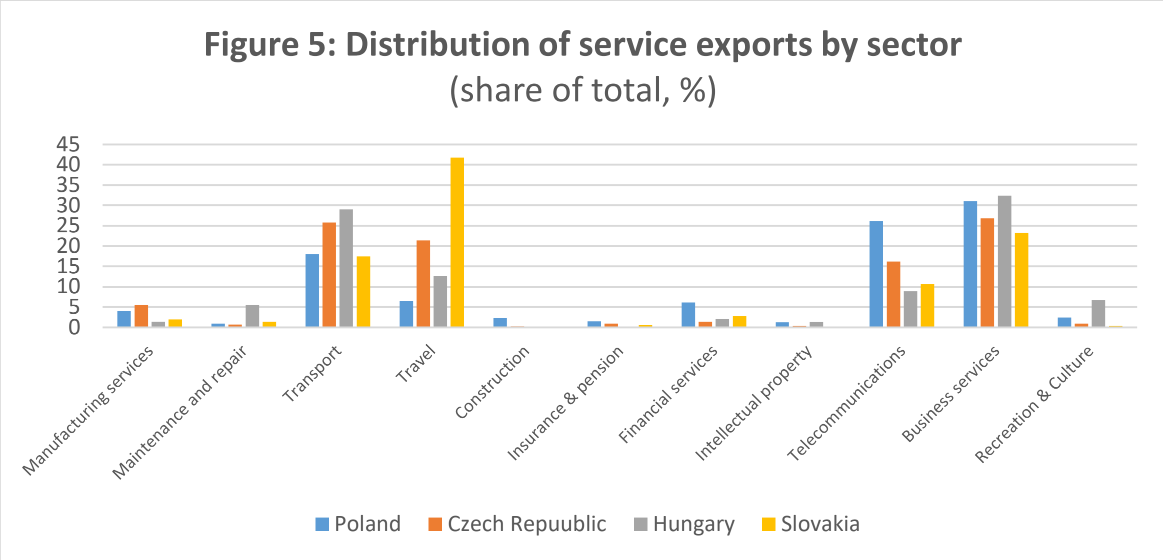
The UK accounts for a slightly larger share of service exports from the Visegrad Four, ranging from 3.6% for Slovakia to 7.8% for Hungary. However, services account for a much smaller share of the economy in all Visegrad states. Service exports to the UK are equivalent to 0.3% of GDP for Slovakia, 0.75% for Poland and the Czech Republic, and 1.5% for Hungary.



Source: Eurostat.

Business services, including outsourcing, and transportation make up a large share of service exports to the UK for all four Visegrad countries. Travel, which includes revenue from tourism, is also significant for Slovakia and the Czech Republic, while telecommunications and IT account for over 20% of service exports from Poland. Financial services, manufacturing services, maintenance and repairs, construction, cultural services and insurance accounted for small shares of the total in all four countries. Of the main service exports to the UK, the transport, business service and IT sectors are likely to be the most exposed. Eurostat data shows that a large share of the service trade in these sectors depends on cross-border supply (mode 3 in the WTO's terminology), which is more likely to be disrupted by regulatory divergence between the EU and UK. By contrast, travel services are typically not provided across borders as they usually involve the consumer travelling to receive it (mode 2). Regulation of the telecommuncations sector, by contrast, has remained at a national level even within the EU, and so is less at risk of disruption.[20]

[20] Lowe, S, "Brexit and services: How deep can the UK-EU relationship go?", Centre for European Reform, December 2018. Available at: https://www.cer.eu/sites/default/files/brexit_trade_sl_pbrief_6.12.18.pdf



Source: Eurostat.

The impact of Brexit on Visegrad exports

Under all scenarios, the UK's withdrawal from the EU will reduce demand for exports from the Visegrad countries relative to the status quo, both by lowering the UK's growth rate and by imposing tariff and/or new non-tariff barriers.

Although the UK has not yet left the EU, the referendum result has already had a short-term impact on the UK's economy as a result of increased policy uncertainty, which depressed investment and consumption, and currency depreciation, which pushed up inflation and holds back household spending. Since the start of 2017, the UK has grown on average by 0.3% a quarter, compared with 0.6% on average for other advanced economies. Research by the Centre for European Reform (CER) comparing the UK's actual output against a counterfactual "synthetic" UK that mimics the economic performance of the UK had it elected to remain in the EU suggest that as of June 2018 output was 2.5% lower than it would otherwise have been.[21]

If the Withdrawal Agreement is ratified, the UK economy is likely to experience a short-term rebound as firms implement investment plans that had been delayed because of the perceived risk of no deal.

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[21] Springford, J, "The cost of Brexit to June 2018," Centre for European Reform, 30 September 2018. Available at: https://cer.eu/insights/cost-brexit-june-2018.

Nevertheless, performance of the UK economy since the referendum suggests that even an extended transition scenario may have negative impact on the performance of the UK economy. Business uncertainty may remain elevated during a transition as the ultimate destination of trade negotiations remains in doubt. While the UK's terms of trade with the EU will be unchanged, lower UK growth during this period will have a mild negative impact on EU exports, including from the Visegrad Four.

Almost all economic studies have also concluded that Brexit will reduce the UK's long-term trend growth rate and household income compared with the UK's ongoing membership of the EU. These studies assume that withdrawal from the EU will result in increased frictions to trade with the EU (through tariffs and/or non-tariff barriers) lowering potential future welfare gains from trade.[22] In addition to these static effects, reduced trade may further reduce the UK's trend growth through lower productivity as exporting firms tend to be more competitive.[23] Brexit may lead to the loss of foreign direct investment dependent on the UK's access to the single market, increasing the cost of capital and reducing R&D intensity. Productivity could be further reduced if Brexit limits migration flows, which could reduce firms' managerial quality.

In November 2018, the UK government published its forecast for economic growth under five scenarios compared with a baseline of continued EU membership. The government's median forecasts are that the UK GDP would be reduced by 7.6% under WTO/No Deal; by 4.9% under a free-trade agreement, by 1.4% under a Norway/EEA scenario, by 0.7% under the Chequers proposals and 2.2% in an enhanced customs union.[24] Other econometric estimates produced by the National Institute for Economic and Social Research, the IMF and the World Bank give similar estimates, although not all scenarios are covered in all cases.

In addition to lower UK growth and consumption, Brexit will also result in increased non-tariff barriers (NTB – administrative, technical, customs and regulatory obstacles to trade) for both goods and services exports from the Visegrad countries. Under all scenarios, EU exports will be subject to

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[22] The exception to this is research by Patrick Minford (https://www.e-elgar.com/shop/should-britain-leave-the-eu), who argues that unilateral removal of all tariffs post-Brexit would raise UK incomes by 4% by 2030. For a critique, see https://www.lse.ac.uk/europeanInstitute/LSE-Commission/Hearing-11---The-impact-of-Brexit-on-jobs-and-economic-growth-sumary.pdf.

[23] Egert, B. and P. Gal (2016), "The quantification of structural reforms: A new Framework", OECD Economics Department Working Papers.

[24] "EU Exit: Long-term economic analysis," UK Government, November 2018. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/760484/28_November_EU_Exit_-_Long-term_economic_analysis__1_.pdf

increased customs administration and delays. Under a WTO or FTA scenario, mutual recognition of regulations could end leading to increased barriers to market entry for EU exports. NTB would be lower under a EEA/Norway or Enhanced Customs Union scenario, as the UK would continue to apply all or some of the rules of the single market, implying mutual regulatory recognition. The UK government estimates that NTB are equivalent to a 10% tariff for goods in a No Deal/WTO scenario, falling to 4% in an Enhanced Customs Union. Research by the OECD suggest that EU barriers to services trade with countries outside the Single Market are four times as higher than with those within it.[25]

However, the implied cost of NTB may be significantly higher for exports from the Visegrad countries given the large share of transport and machinery in total exports. The reliance of the automotive industry on just-in-time production techniques and extended supply chains, in which products may cross the UK border on multiple occasions before final assembly, means that the impact of non-tariff barriers on the machinery and transport sector may be significantly above the economy-wide average. Furthermore, trade elasticities for vehicles tend to be high, with demand responding strongly and rapidly to changes in price and household income. Likewise, NTB for agricultural goods, for which there are a greater number of regulatory checks, are likely to be above the average for the goods sector. This is particularly significant for Poland, given the significant share of food and beverages in exports to the UK.

In the event of No Deal and a WTO scenario, Visegrad exports to the UK will also be subject to tariffs, which would be likely to mirror the EU-applied Most Favoured Nation tariff schedule. These differ significantly between products, with an average of 3% for manufactured goods, 4.5% for car components and 10% for completed vehicles. Based on the Visegrad states' export structure at a two-digit HS code level, the average ad valorum tariff for the Visegrad countries appears to be relatively modest, estimated at 5% for Poland, 3.4% for Hungary, 3.9% for the Czech Republic and 1.8% for Slovakia.

As a result of much higher non-tariff barriers and lower UK domestic demand, exports from the Visegrad group to the UK are likely to decline significantly in the long term in the event that the UK leaves the single market. The UK government estimates that under a No Deal/WTO scenario, UK imports from the EU would decline by 39% in the long-term, under an FTA by 12%, in an WTO/Norway

[25] Giles, C., "A goods-only Brexit deal puts UK service sector jobs at risk," *Financial Times*, 5 July 2018. Available at: https://www.ft.com/content/f3f5506c-7f6d-11e8-8e67-1e1a0846c475.

scenario by 8% and in an enhanced customs union by 14%.[26] These estimates are broadly in line with other studies. Dhingra et al find that under a "soft Brexit" (EEA/Norway) option, EU exports to the UK would fall by 22%, and if the UK leaves the Single Market, they would be 38% lower in the long run.[27] Lawless et al. found that under a WTO scenario UK imports from the EU would fall by 30%. The NIESR found a larger impact, with EU-UK goods and services trade falling by 59% under a WTO scenario and by 45% under a FTA scenario.[28]

Cross-country studies have found that the overall impact on the Visegrad Four from reduced exports would be limited but not insignificant. A study by the Netherlands Planning Bureau found that under a static WTO scenario (which does not account for the negative impact on UK productivity of reduced trade), GDP in the Visegrad Four by 2030 would be 0.6% lower compared with the baseline in Poland, Slovakia and the Czech Republic, and 0.8% lower in Hungary. Under a static FTA scenario, the losses are lower, ranging from 0.7% for Hungary to 0.4% for Poland. When dynamic gains from trade are considered, the GDP losses from Brexit are roughly twice as large.[29] The IFO Centre for Economic Studies concluded that the impact on the Visegrad Four would be more modest, ranging from 0.25% for Poland to 0.35% for Slovakia under a pessimistic (WTO or FTA) scenario.[30] These potential losses should be set in the context of robust long-term growth outlook for the Visegrad Four. Between 2020 and 2030, the OECD forecasts that the economies of the Visegrad countries will grow between 22% (in the case of Poland) and 32% (Slovakia).[31] A reduction of 0.5-1% point in total GDP compared to a no-Brexit scenario is therefore relatively minor.

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[26] Ibid.
[27] Dhingra S. et al, "The cost and benefits of leaving the EU: trade effects," *Economic Policy*, Volumer 32, Issue 92, October 2017. Available at: https://academic.oup.com/economicpolicy/article/32/92/651/4459728
[28] Ebell, M, "Will new trade deals soften the blow of hard Brexit?" National Institute of Economic and Social Research, 27 January 2017. Available at: https://www.niesr.ac.uk/blog/will-new-trade-deals-soften-blow-hard-brexit.
[29] "Trade effects of Brexit for the Netherlands", Netherlands Bureau for Economic Policy Analysis, June 2016, available at: https://www.cpb.nl/sites/default/files/omnidownload/CPB-Backgroud-Document-June-2016-Trade-effects-of-brexit-for-the-netherlands.pdf
[30] "Ökonimische effekte eines Brexit auf die deutsche und europäische Wirtschaft,"IFO Institut, June 2017. Available at: http://www.cesifo-group.de/DocDL/ifo_Forschungsberichte_85_2017_Felbermayr_etal_Brexit.pdf
[31] OECD real GDP long-term forecast, available at: https://data.oecd.org/gdp/real-gdp-long-term-forecast.htm#indicator-chart.

Foreign Direct Investment

The UK's withdrawal from the EU could potentially lead to a redirection of foreign direct investment away from the UK to other member states. The UK is the largest recipient of FDI in the EU, and behind only the US and China globally. The UK has structural advantages to attract FDI, such as flexible labour and product markets. However, membership of the Single Market is an important factor in determining FDI, as it has made the UK an attractive export platform for multinationals to sell into the EU market. Were the UK to leave the Single Market under a WTO, FTA, or Customs Union scenario, increased non-tariff barriers would likely lead to a decline in FDI. Dhingra et al find a statistically significant positive effect from EU membership and extrapolate that a departure from the EU would lead to a fall in future FDI inflows of 22%.[32] This is in line with a projection by PWC that UK FDI flows would fall by a quarter in 2020.[33] The government's official modelling has put the loss in FDI flows at 10% over 15 years under an EEA scenario, and 18-26% under a WTO/FTA scenario.[34] It is likely that a significant share of these lost FDI flows would be redirected to other parts of the EU Single Market. In the long-term, this could imply a rise in the EU27's stock of investment of $320-$400bn, or 3-4%.[35]

As export-oriented economies with large manufacturing sectors, the Visegrad countries could be well placed to receive a share of the FDI diverted from the UK.[36] The UK government has identified the pharmaceutical, automotive and chemical industries as the sectors for which EU access is most important, and therefore most vulnerable to a redirection of FDI to other members of the Single Market.[37] The revealed comparative advantage of the Visegrad Four in the pharmaceutical and chemical industries is below the EU average, suggesting they may struggle to attract a large share of redirected FDI in these sectors (although economic structure is not static – in the mid-1990s, none of the Visegrad Four had a comparative advantage in automotive sector). If the UK were to leave the Single Market, UK financial institutions will lose their EU passporting rights. The EU is likely to place

[32] "The cost and benefits of leaving the EU: trade effects."
[33] "Leaving the EU: implications for the UK economy," Discussion Paper, PWC, 2016.
[34] "The long-term economic impact of EU membership and the alternatives," UK Government, April 2016. Available at:https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/517415/treasury_analysis_economic_impact_of_eu_membership_web.pdf.
[35] Calculations based on OECD investment stock data - https://data.oecd.org/fdi/fdi-stocks.htm.
[36] A study by the Hungarian Central Bank that Hungary may benefit from FDI financing car industry investments flowing to the continent, https://www.mnb.hu/letoltes/mnb-op-125-final.pdf.
[37] "EU exit analysis cross Whitehall briefing," UK Government, January 2018. Available at: https://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Cross-Whitehall-briefing/EU-Exit-Analysis-Cross-Whitehall-Briefing.pdf

significant barriers to the UK financial services market as the dominance of the City of London in euro-denominated financial trading has long been seen as a structural problem. However, the Visegrad Four are likely to struggle to compete with Paris and Frankfurt in attracting financial services relocating from the City of London. The Czech government made a bid to host the European Banking Authority but lost out to Paris.

By the contrast, the Visegrad Group has a higher revealed comparative advantage in the automotive sector than the UK and the EU average and may benefit from a redirection of investment in this area.[38] Investment decisions in the automotive sector are often made on the basis of internal competitions between company plants and there have already been cases of production being relocated from the UK to Visegrad Four.[39] Several reports have emphasized the particular importance of EU Single Market access for the UK automotive sector. For example, KPMG argues that most of the recent investment by car manufacturers in the UK is in new vehicles that will predominantly be sold in the EU market. Head and Mayer estimate that UK car production would fall by 12% or almost 180,000 cars if the UK were to leave the Single Market. This is largely because major manufacturers would move production away from the UK.[40] PWC finds that by 2023, two-thirds of UK car assembly could be simply relocated to the EU as the same vehicle is already produced in both the EU and the UK (16.5% of the total) or the same platform is used (50.6% of production). For example, the MLB 2 platform of the VW Group is used in both the UK and in Bratislava, Slovakia.[41] There have already been cases of car manufacturers shifting production to Visegrad countries, such as the decision by Jaguar Land Rover to relocate work from the UK to Slovakia.[42]

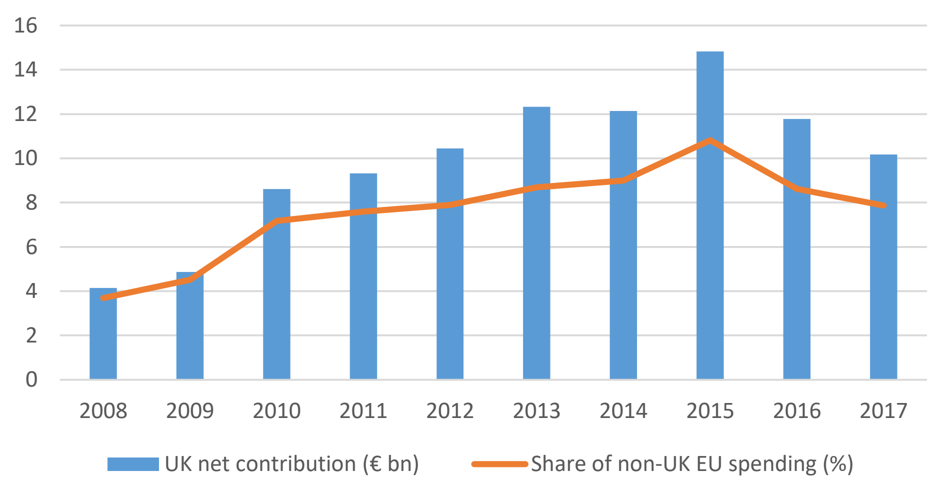
[38] Data from IFO Center for Economic Studies, available at: https://www.cesifo-group.de/ifoHome/facts/DICE/Business/Structural-Policy/Industrial-Policy/revealed-comparative-advantage.html/
[39] For example, PSA Peugeot-Citroën's decision in 2006 to close its plant in Coventry, transferring production to Slovakia.
[40] Head K., and Mayer T., "Brands in motion: How frictions shape multinational production," December 2015. Available at: http://www.cepii.fr/PDF_PUB/wp/2015/wp2015-26.pdf.
[41] "Industry dynamics in the global and European arena." PWC.
[42] Campbell, P., "Jaguar Land Rover to shed jobs, move work to Slovakia," *Financial Times*, 11th June 2018. Available at: https://www.ft.com/content/f2c6e930-6d7f-11e8-852d-d8b934ff5ffa.

The EU Budget

The UK makes up a significant share of the EU budget, accounting for 12-14% of gross revenues. In 2017, UK contributions (net of the rebate) stood at €13.8 billion, making it the fourth largest contributor to the budget with Italy, behind France and Germany. Net of public receipts from the EU, the UK was the second biggest contributor to the budget in 2017, behind only Germany.

Netting out the UK rebate and public receipts of EU funds, the UK has on average accounted for around 7.5% of non-UK EU spending in 2008-17. The UK's withdrawal from the EU is therefore lead to a significant shortfall in funds for the EU budget. This could have a significant impact on the level of investment in the Visegrad countries. Since accession to the EU in 2004, the four states have been among the largest recipients of cohesion funds to support investment and reduce wealth disparities between EU regions. In 2013-17, net contributions from the EU budget to the Visegrad states averaged 2.3% of GDP in Poland, 3.9% in Hungary, 2% in the Czech Republic, and 2% in Slovakia.[43] In particular, EU cohesion funds account for a large share of public investment in the Visegrad states: in 2017 it was equivalent to 61% of the total in Poland, 55% in Hungary and Slovakia, and 43% in the Czech Republic. The average for the EU13 new member states is 41% of total public investment in fixed capital.[44]

Figure 6: Net UK budget contributions



Sources: UK House of Commons, European Commission.

[43] Author's calculations based on http://ec.europa.eu/budget/figures/interactive/index_en.cfm
[44] https://cohesiondata.ec.europa.eu/Other/-of-cohesion-policy-funding-in-public-investment-p/7bw6-2dw3

UK contributions after Brexit

Under the financial settlement in the Withdrawal Agreement, the UK will continue to contribute to the EU budget during the transition phase in 2019-20 as if it were still a Member State. After this date, it will also continue to contribute its share of outstanding and contingent commitments (*reste à liquider*) incurred before the end of 2020.[45] The UK's net contribution under the Withdrawal agreement (leaving aside possible future payments for market access) is estimated at €2.4 billion with the rebate in 2021-27,[46] or around 25% of the current level. Post-2027, net payments are estimated at around €6 billion in total, primarily comprising pension contributions.[47] If the Withdrawal Agreement is ratified, therefore, all programmes operating under the EU's 2014-20 budget will be fully funded, including European Regional Development programmes that run until 2023. There would therefore be no immediate reduction or delay in EU transfers to the Visegrad Group, and no immediate impact on growth through this channel. The end of the initial transition period set out in the Withdrawal Agreement coincides with the conclusion of the current seven-year budget cycle (the Multiannual Financial Framework, MFF, running from 2014-20). If, as is likely, the transition period were extended, this could result in higher net revenues to the EU than budgeted in the early part of the next MFF, which runs from 2021-27.

In a No Deal scenario, in which the UK leaves the EU without a Withdrawal Agreement, the UK would make no contribution to the next EU MFF. There is also a risk that UK contributions for the current MFF would be terminated early or withheld, which could lead to a shortfall on the current EU budget in 2019-20. Based on projections from the UK Office for Budget Responsibility forecasts, the shortfall for the years 2019 and 2020 would total £24bn (€26.6bn).[48] Advocates of a no-deal Brexit have been critical of the UK-EU financial settlement and argued that by withdrawing without a transition agreement in 2019 the UK could withhold a total of £39 billion in payments to the EU.[49]

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[45] "The EU-UK Withdrawal Agreement," European Parliamentary Research Service, July 2018. Available at: http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/625110/EPRS_IDA(2018)625110_EN.pdf

[46] "Modelling the European Union's next Multiannual Financial Framework after Brexit," Bruegel Policy Brief, January 2018. Available at: http://bruegel.org/wp-content/uploads/2018/03/Annex-PB-2018_01.pdf.

[47] Ibid.

[48] "Economic and fiscal outlook", Office for Budget Responsibility, October 2018. Available at: https://cdn.obr.uk/EFO_October-2018.pdf.

[49] https://www.economistsforfreetrade.com/wp-content/uploads/2018/10/A-BUDGET-FOR-BREXIT-ECONOMIC-REPORT-20-Oct-18.pdf

It is unclear whether the EU27 would respond to an immediate shortfall in the current budget for 2019-20 by reducing spending in proportion to the net contribution or request additional contributions from members. The relevant regulation in the current MFF states only that the MFF should be adjusted "accordingly" in case of Treaty change. The Jacques Delors Institute notes that when Croatia joined the EU in 2013, the Council and European Parliament adopted a compromise position, in which funds were re-allocated on the one hand, but payment ceilings for member states were also increased.[50] A no-deal Brexit could therefore lead to an increase in EU budget contributions in 2019-20 and a reduction in some budget allocations, including on cohesion spending, which would particularly impact the Visegrad countries.

UK payments to the EU budget was an emotive issue during the referendum campaign. The UK government is seeking to sharply reduce contributions to the EU budget and to end the UK's participation in the Common Agricultural Policy and regional development initiatives. However, the UK wishes to continue to participate in EU-wide research and education initiatives such as Horizon 2020. Under a FTA or Enhanced Custom Union scenario, the UK's contributions to the EU budget could fall to an equivalent level to that of Switzerland, whose contributions to the EU budget have averaged around 0.02% of Gross National Income, compared with 0.33% for the UK as an EU member. This would imply payments over the next MFF would be around 6% of the no referendum counterfactual.

If the UK were to seek to remain in the Single Market under an EEA/Norway scenario, the EU would demand higher UK contributions to the EU budget. Norway, which is in the single market but does not participate in the common agricultural policy will make an estimated €447m a year in 2014-21 in payments for participation in EU programmes, and contribute a further €391m a year over this period to cohesion policy. Norway's payments to the EU (including contributions to EU cohesion policy) have historically been equivalent to 0.16% of Norway's GNI, or around half the relative level of the UK's payments.[51] It therefore remains possible that the UK may continue to make substantial payments to the EU even after leaving the EU. Indeed, if, as is likely, the transition period is extended beyond 2020, the UK will continue to contribute to the EU budget as if it were a full member for some or even all the next budget round.

[50] "Brexit and the EU budget: Threat or opportunity?" Jacques Delors Institute, January 2017. Available at: http://institutdelors.eu/wp-content/uploads/2018/01/brexiteubudget-haasrubio-jdi-jan17.pdf
[51] "EU Exit: Long-term economic analysis,"

Negotiations on the next MFF are being conducted on the assumption that there will be no UK contributions beyond existing commitments under the Withdrawal Agreement. The Bruegel Institute calculates that if the 2014-20 budget had been drawn up using EU27 contributions and receipts (excluding the UK from both sides), this would have resulted in a shortfall of €73 billion, or 7.5% of EU27 payment ceilings over this period.[52] This can be considered an upper bound for the budget shortfall for the next MFF.

In their position papers for the budget round, the Visegrad Group, along with the Baltic states and Romania, have suggested covering this shortfall by increasing overall contributions to the EU budget from member states to around 1% of EU GNI to 1.2%.[53] Emanuel Macron, the French President, has also called for increased member contributions to offset the impact of the UK's departure and an increase in the size of the budget as a share of EU GNI.[54] However, this is likely to be resisted by several net contributors, in particular the so-called "frugal four," comprising Austria, Denmark, Sweden and the Netherlands.

The EU Commission's proposals for the next MFF foresee a rise in spending of 4.4% in real terms (from €1,087 billion to €1,135 billion in commitments in 2018 prices.) This would bring the budget to 1.11% of GNI, compared with the current level of 1.03%.[55] However, these funds must also cover increased spending on new priorities, including border management and defence. While Commission President Jean-Claude Juncker has called for an increase in the EU budget, he has also recommended reductions in spending on cohesion policy and agricultural support to fund new priorities.[56] Overall, the EU Commission's proposed budget amendments point to a reduction in allocations for cohesion spending of around 7% in real terms in 2021-27, and 15% for the common agricultural policy.

EU research suggest that cohesion spending has contributed significantly to economic growth in the Visegrad Four. Bradley et al. find that the cumulative multipliers from investment of cohesion funds are well above 1 for all the Visegrad states (2.4 for Hungary and Poland, 2.6 for Slovakia and 4.4 for the

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[52] "Modelling the European Union's next Multiannual Financial Framework after Brexit,"
[53] Szczepanik, M.,"Central Europe in the Negotiations of the EU Multiannual Financial Framework," PISM Bulletin, 19 September 2018. Available at http://www.pism.pl/publications/bulletin/no-128-1199.
[54] "Macron, in European Parliament, urges EU to seize chance to reform," Politico, 4 April 2018, available at https://www.politico.eu/article/macron-in-european-parliament-urges-eu-to-seize-chance-to-reform/
[55] Ferrer, J. N., and Gros, D., "The Multiannual Financial Framework, where continuity is the radical response," Centre for European Policy Studies, 4 May 2018. Available at: https://www.ceps.eu/system/files/JNFandDG_MFF_0.pdf
[56] Begg, I., "What to know about the EU's new budget," Chatham House, 3 May 2018. Available at: https://www.chathamhouse.org/expert/comment/what-know-about-eu-s-new-budget

Czech Republic, behind only Ireland and Romania).[57] Econometric modelling by the EU Commission indicates that by 2023 cohesion spending will have raised GDP compared with the baseline by 3.5% in Slovakia, 4% in the Czech Republic, 4.3% in Poland and 5% in Hungary.[58] Overall, EU Cohesion Policy in the period 1991-2008 is estimated to have added 1.4% to the median annual growth, and to have reduced regional disparities by 8 basis points in terms of the Gini index.[59] However, the EU also notes that assessing the socio-economic impact of cohesion and rural development policies is challenging and subject to considerable uncertainties.[60] High investment from the EU may crowd out other sources of public or commercial funding. Research by the Vienna Institute for International Economic Studies shows that cohesion funds have heterogenous impacts on company performance – while investment in Research and Development tends to raise firms' productivity, funding designed as overall "business support" correlates with negative productivity growth rates.[61]

In any case, if the EU Commission's recommendations are adopted, the impact of Brexit on EU transfers to the Visegrad countries is likely to be limited. Cohesion funds from the EU accounted for around 1.5% of GDP in the Visegrad Four in 2017. Everything else being equal, the proposed real-terms cut in cohesion funds imply a small reduction in investment of 0.1% of GDP. Reduced cohesion funds for the Visegrad group may also be partly offset by the expansion of the European Fund for Strategic Investment, which is an increasingly attractive alternative to the grants-based system around which cohesion policy is structured.[62]

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[57] Bradley, J., Untiedt, G., Mitze, T., "Analysis of the impact of cohesion policy," European Commission, May 2007,available at: http://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/hermin07.pdf.

[58] "Ex post evaluation of cohesion programmes 2007-13," European Commission, September 2016. Available at: http://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/expost2013/wp1_pl_report_en.pdf

[59] Fiaschi, D., Lavezzi, A. M., Parenti, A., "Does EU Cohesion Policy Work? Theory and Evidence," Associazione Italiana di Scienza Regionali, September 2017. Available at: https://www.aisre.it/images/aisre/59bd4aa18275f0.33463013/FiaschiLavezziParenti_Final_Revision.pdf

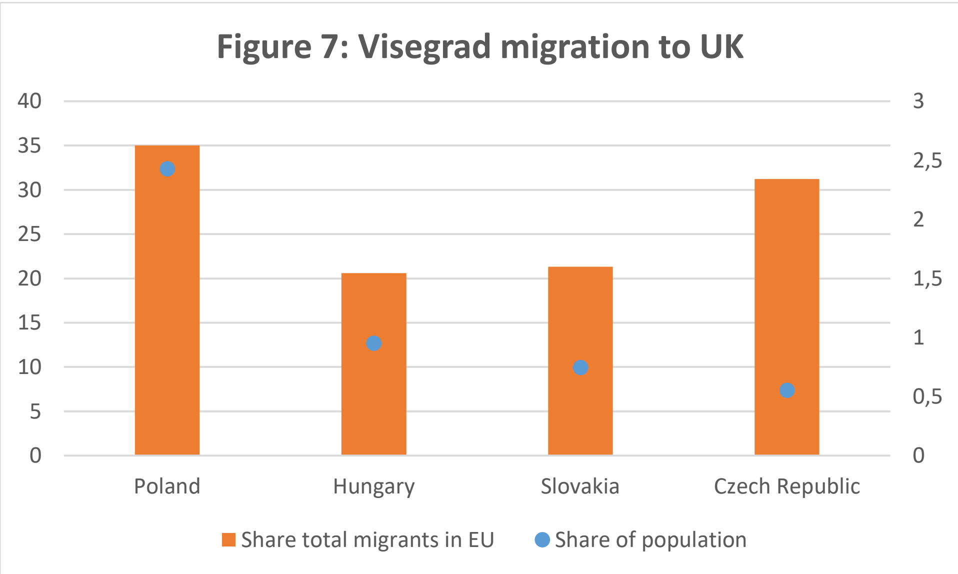
[60] "The impact of cohesion policy 2007-13: model simulations with Quest III," European Commission, April 2016. Available at: http://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/expost2013/wp14a_final_report_en.pdf

[61] "Cohesion policy meets heterogenous firms," Vienna Institute for International Economics, March 2018. Available at: https://wiiw.ac.at/cohesion-policy-meets-heterogeneous-firms-dlp-4451.pdf

[62] "Five key considerations for the future of cohesion policy," Vienna Institute for International Economics, November 2017. Available at: https://wiiw.ac.at/five-key-considerations-for-the-future-of-eu-cohesion-policy-n-264.html

Migration after Brexit

Migration to the UK from the Visegrad states has been substantial, supported by the UK's flexible labour market, low unemployment rate and the decision of the UK not to impose transitional arrangements to restrict migration following EU enlargement in 2004. Assessing the scale of migration to the UK is complicated by the fact that the UK government does not collect comprehensive data on passengers leaving the country. The latest UK data suggest there are around 920,000 Poles resident in the UK, 93,000 Hungarians, 79,000 Slovaks and 54,000 Czechs. The UK accounts for around 35% of total migration from Poland to other EU states, 31% for the Czech Republic, and 21% for the Czech Republic and Slovakia.[63]



Source: UK Office of National Statistics; Eurostat.

Policy scenarios

The Withdrawal Agreement between the UK and the EU secures the rights of EU citizens currently residing in the UK. Freedom of movement will continue to apply during the transition period. At the

[63] Data from the UK Office of National Statistics and Eurostat available at: https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/datasets/populationoftheunitedkingdombycountryofbirthandnationality, and http://appsso.eurostat.ec.europa.eu/nui/show.do.

end of the transition period, all EU citizens lawfully residing in the UK will be able to remain indefinitely.[64]

In the event of a No-Deal Brexit, the legal status of Visegrad citizens currently living in the UK would be less secure, but in practice it is unlikely that there would be any immediate negative impact. The UK government prioritised early agreement on the mutual protection of citizens' rights at an early stage of negotiations. UK Prime Minister Theresa May has publicly emphasized that in the event of no deal the rights of EU citizens would still be protected.[65] The key parts of EU law on freedom of movement have been incorporated into UK law, along with amendments to immigration rules to give effect to the planned future status of EU citizens in the UK under the Withdrawal Agreement. Nevertheless, the UK has explicitly threatened retaliatory action in the event that EU countries subject UK nationals to the same requirements as third countries and deny UK travellers visa-free access.[66] In the event of a serious breakdown in relations between the UK and EU it is possible that the issue of citizens' rights could again become an object of negotiation, which would be of major concern to the Visegrad countries.

If the Withdrawal Agreement is signed, UK immigration policy is likely to become significantly more restrictive at the end of the transition period. Public concern over high immigration and the inability of the government to limit migrant flows from the EU are widely regarded as a key determinant of the UK's vote to leave the EU in 2016. In her Lancaster House speech in January 2017, Prime Minister Theresa May made clear that she regarded an end to the freedom of movement as a prerequisite for the delivery of the Brexit vote.[67] Speaking in March 2018, the Prime Minister reiterated that the "Norway Option" (continued membership of the EU single market) was not acceptable as it would require the UK to maintain freedom of movement.[68]

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[64] Withdrawal Agreement. Citizens who have lawfully resided for five years in the UK at the end of the transition period may apply for the right to reside permanently. Those not yet eligible for this status may remain in the UK until they reach the five-year threshold, at which point they will have the right to reside permanently.

[65] "Transcript of Theresa May's post-Salzburg speech," *Financial Times*, 21 September 2018. Available at: https://www.ft.com/content/bb313136-bda9-11e8-8274-55b72926558f.

[66] "Cost of No Deal revisisted," The UK in a Changing Europe, September 2018. Available at: http://ukandeu.ac.uk/wp-content/uploads/2018/09/Cost-of-No-Deal-Revisted.pdf.

[67] "The government's negotiating objectives for exiting the EU: PM speech," UK Government, 17 January 2017, available at: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech

[68] "In full: Theresa May's speech on future UK-EU relations," BBC, 2 March 2018. Available at: https://www.bbc.com/news/uk-politics-43256183

The government has yet to publish its post-Brexit immigration policy but has indicated that it intends to limit “low-skilled” immigration from the EU by setting a high earnings threshold for EU workers to qualify for a work visa. The government has suggested an earnings threshold of £30,000 a year[69] (equivalent to the national median annual salary),[70] but this has not yet been finalised and is opposed by some members of the UK Cabinet.[71] Modelling by the UK government suggests that this threshold would decrease overall EU migration to the UK by 90,000 a year, or around 80% of the annual total over the past 10 years. A lower threshold of £20,500 would decrease immigration by 40,000 or 36% of the annual total. However, potential migrants from the Visegrad countries would likely be disproportionately affected. UK data suggests median earnings of migrants from EU8 countries are just over 60% of the level of migrants from the EU14.[72] A survey by the National Bank of Poland found that median annual earnings of Polish migrants were £17,100 in 2016, suggesting a much larger share of workers would be excluded even with the lower threshold.[73]

Despite the government’s stated objective of ending freedom of movement, the UK may ultimately continue to provide a preferential migration regime for EU citizens to secure access to the common market. The EU is unlikely to agree to a future trading arrangement that would allow the UK a high level of access to the single market for goods without such an arrangement. Switzerland, which is not part of the European Economic Area, nevertheless has a mutual agreement on freedom of movement with the EU.

Moreover, the UK’s policy track record suggests that it may continue to allow higher volumes of migration from the EU than foreseen in the government’s modelling. In 2010, the Conservative government was elected with a manifesto pledge to reduce net immigration to under 100,000 per year. While EU membership precluded restrictions on EU migrants, the government did not exercise

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[69] “EU migrants will have to earn £30,000 before coming to Britain under crackdown,” *The Telegraph*, 15 December 2018. https://www.telegraph.co.uk/politics/2018/12/14/eu-migrants-will-have-earn-30000-coming-britain-crackdown/?fbclid=IwAR00f5swf9hqL86xJKFWtSgzLvpWHdmZZyB_ZkAb6NZWsrXSmoCjJaxz4tw

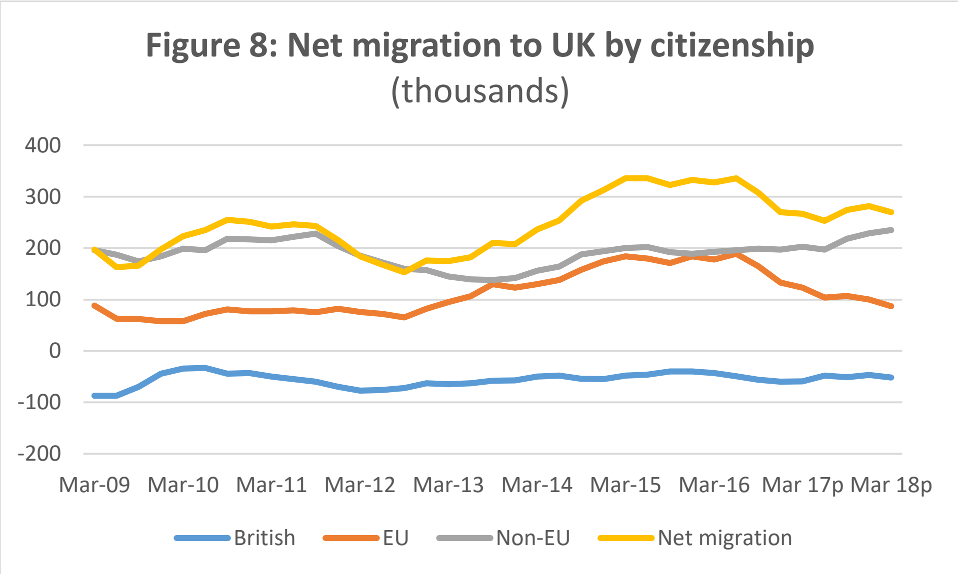
[70] Median full-time weekly earnings were £569 per week in 2018. https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2018.

[71] “May’s cabinet split over £30,000 immigrant salary threshold,” *The Guardian*, 19 December 2018. Available at: https://www.theguardian.com/uk-news/2018/dec/19/may-cabinet-split-over-30000-immigrant-salary-threshold

[72] UK Office for National Statistics. Available at: https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/articles/migrationandthelabourmarketuk/2016#what-were-the-employment-characteristics-of-foreign-nationals-in-the-uk

[73] “Polacy pracujący za granicą w 2016 r.,” Naradowy Bank Polski, 2018. Available at: https://docplayer.pl/105361309-Polacy-pracujacy-za-granica-w-2016-r.html

the powers it had to reduce migration from outside the EU, principally because of the negative impact this would have on the economy. As the chart below shows, non-EU migration remained significantly above the government's official target in every year after 2010. Official government studies that recommended a reduction in unskilled migration found that migration has had no or limited impact on employment or unemployment outcomes of the UK-born workforce and is not a major determinate of their wages. At the same time, it has a positive impact on productivity and a positive net impact on government finances.[74]



Source: UK Office of National Statistics.

Potential impact

Brexit will reduce earnings growth in the UK relative to the no-referendum counterfactual, which impact on remittances and other transfers to the Visegrad countries. Eurostat provides estimates of remittance flows from the UK to the Visegrad countries. These comprise personal transfers (made by migrants registered in the UK to households in the Visegrad countries) and compensation of non-resident (seasonal) workers. The latter will tend to overstate the additional income received by

[74] Research by the UK Migration Advisory Council showed that a 1 percentage point rise in immigration resulted in a 2-3 percentage point rise in productivity (http://ukandeu.ac.uk/immigration-has-made-the-uk-more-productive-and-prosperous-and-will-again-in-the-future/)

households, since a share of earnings by non-residents is spent on living costs in the host country. On the other hand, there is a systemic problem of under-coverage in personal remittance data, as payments in cash and through informal transmission channels is not captured.[75]

On average in 2010-16, remittances from the UK have accounted for just over a quarter of total remittances to the Czech Republic from EU countries, 34% in Hungary and just under 40% in Poland (transfer data from Slovakia is not available). In 2016, the most recent year available, personal transfers from the UK to Poland reached €1bn, to Hungary, €155m, and to the Czech Republic €140m. Eurostat data suggests that on average in 2010-16, remittances from the UK were equivalent to 0.22% of GDP in Poland, 0.13% in Hungary and 0.8% in the Czech Republic. The contribution of remittances flows to household income is therefore statistically significant but modest. A fall in remittance flows from the UK, either because of a further devaluation of sterling, lower income growth, or a rise in unemployment among migrant workers, would have only a limited impact on the countries' balance of payments.

Brexit is likely to reduce the size of the overall EU labour market and lead to a decrease in aggregate labour market flexibility across the bloc. Following its withdrawal from the EU, the UK could impose high earning requirements for EU labour that would significantly reduce further migration from the Visegrad Countries. The UK economy has historically proven to be an attractive destination for migrants from the Visegrad countries as its economy is characterised by a high level of labour flexibility compared to other high-income EU.[76]

Outward migration from the Visegrad Group to the UK has had a significant impact on the economies of the sending states. The émigré community in the UK is equivalent to 1% of the economically active population of the Czech Republic, 2.9% of Slovakia, 2% of Hungary and 5.4% in Poland. Research suggests that emigration from central Europe has had a negative impact on the sending states' labour markets, creating labour shortages and exacerbating negative demographic trends by drawing away young and relatively well-educated workers.[77] Migrants from the Visegrad states to the UK tend to be young and more educated than the national average. For example, a survey of Polish migrants in the

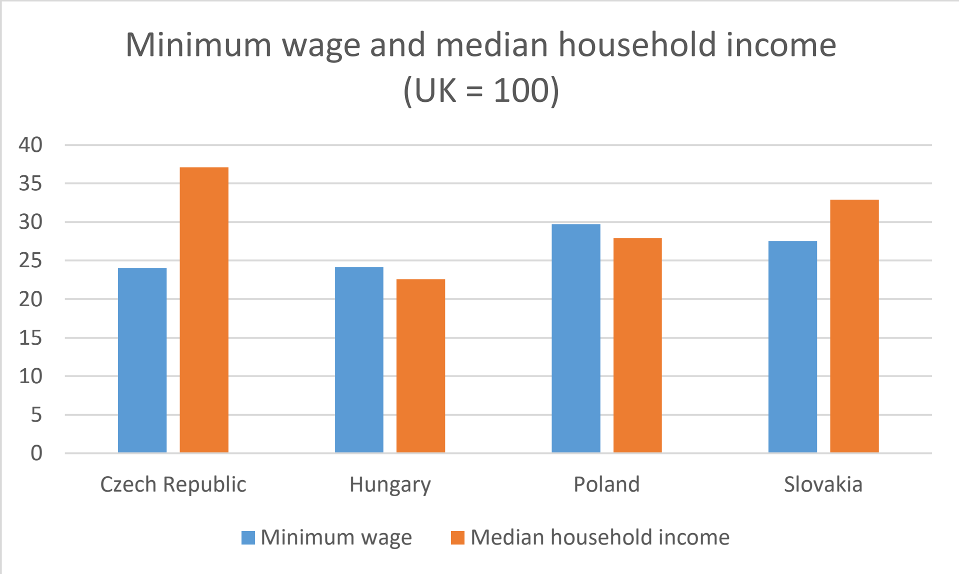
[75] "Personal remittance statistics," Eurostat, November 2018. Available at: https://ec.europa.eu/eurostat/statistics-explained/pdfscache/39326.pdf
[76] "OECD employment outlook 2013," OECD. Available at: https://www.oecd.org/els/emp/Employment-Outlook-2013-chap2.pdf
[77] "People on the move: migration and mobility in the European Union," January 2018. Available at: http://bruegel.org/2018/01/people-on-the-move-migration-and-mobility-in-the-european-union/

UK by the Polish Central Bank found that 80% of recent migrants were under 35, and 33% had higher education.[78] Labour markets in the Visegrad countries have grown increasingly tight. The vacancy rate in the Czech Republic in the second quarter of 2018 stood at 5.1%, the highest in the EU. In Hungary it had risen to 2.8%, the same level as Germany and double the rate recorded in mid-2014. It has also doubled in Poland and Slovakia, although it remains significantly below the EU average of 2.2% in both countries. The Visegrad countries have had some success in limiting labour shortages by increasing inward migration, in particular from Ukraine. However, research by the Vienna Institute for International Economics suggests that migration from Ukraine cannot provide a long-term solution to the Visegrad countries' labour shortages. Most migration is short-term in nature, with migrants visiting for a few months to earn additional money.[79] In 2016, Andrzej Duda, the Polish President, told a meeting of the Visegrad Four that that countries needed to do more to stop young people from emigrating.[80]

Given these factors, it should not be assumed that the Visegrad group will prioritise migration arrangements in future trade negotiations between the EU and the UK. Indeed, the Visegrad Four could be more amenable than some other countries to a trading deal that provided the UK with enhanced access to the EU market for goods while restricting freedom of movement.

Nevertheless, the UK's withdrawal from the EU is likely to have only a limited impact on total levels of emigration from the Visegrad Four. Over the past decade, the Visegrad countries has achieved significant convergence with the EU income levels in purchasing power parity terms. However, in nominal price terms, median household incomes and minimum wages remain between a quarter and a third of the level of Western European states. Even if Central Europe's convergence trends with the EU average are sustained, emigration to Western Europe is likely to remain an attractive option for young workers in the short-to-medium term.

[78] "Polacy pracujący za granicą w 2016 r.,"
[79] "Guest workers won't solve CEE labour woes," BNEIntellinews, March 2018. Available at: http://www.intellinews.com/comment-guest-workers-won-t-solve-cee-labour-shortage-woes-139130/
[80] "Poland: We must do more to stop young from emigrating," *Associated Press*, 16 October 2016. https://www.usnews.com/news/world/articles/2016-10-14/central-european-leaders-debate-regions-role-in-europe



Sources: Eurostat: UK Office of National Statistics.

It is also unlikely that Brexit will lead to a significant number of migrants returning to their home countries in the event of a sharp economic downturn in the UK. Research on migration patterns in the EU during the global financial crisis found that there was no evidence of "mass return," although the probability of return is higher among workers with secondary or higher education. Individuals from the EU8 with work experience abroad are also more likely to move abroad again, suggesting that in the event of an economic downturn many migrants from Visegrad countries would move to a third EU state, rather than return to their home country.[81]

[81] "Returning home at times of troubles? Return migration of EU Enlargement migrants during the crisis," Institut for the Study of Labor, December 2012. Available at: https://pdfs.semanticscholar.org/374f/86f3e8e6aee36a84c318c991c1cea66497ab.pdf

Conclusion

Brexit is a major policy concern for all the Visegrad countries. The UK is the EU's second largest economy, the largest recipient of FDI in the bloc, the fourth biggest net contributor to the EU budget, and over the past fifteen years has been an important destination for intra-EU labour migration. The Visegrad countries, for their part, have export-oriented economies and since their accession to the EU in 2004 they have been net recipients of budgetary funds, while experiencing significant out-migration, including to the UK.

After Brexit, freedom of movement for EU citizens to the UK is likely to end, limiting migration of workers from the Visegrad group to the UK. Brexit will eventually reduce or eliminate UK contributions to the EU budget, which will lead to a fall in the net inflow of cohesion funds. The UK's trading regime with the EU will change, and the UK may leave the EU single market and customs union, creating substantial non-tariff barriers to trade.

If the Withdrawal Agreement is ratified, the overall impact on the Visegrad Four will be limited. However, even under a pessimistic "hard" Brexit scenario, long-term growth for the Visegrad countries is projected to be around 0.5% lower compared with the baseline, a modest loss in the context of the Visegrad Four's expected cumulative growth over this period. If Brexit results in tariff and non-tariff barriers to trade, this could lead in the longer-run to the diversion of investment flows to other EU countries in the medium to long-term, including the Visegrad countries. The Withdrawal Agreement will secure the rights of the Visegrad Four's citizens currently resident in the UK. The Group is unlikely to be concerned by a more restrictive UK immigration policy in the future, as migration is already seen as an economic risk in the context of the declining labour force. The impact of the loss of UK budget contributions should also not be overstated. An increase in budgetary contribution of 0.1% of GDP a year from all the member states would be sufficient to meet the UK's current contributions.[82]

A no-deal scenario represents a more serious threat to the interests of the Visegrad Four's interests, as the rights of their citizens would be less legally secure and their exporters would face immediate disruption to trade. Government officials in the Visegrad states have emphasized the risks to business

[82] "Will the unity of the EU27 crack?"

posed by a no-deal Brexit.[83] A sudden shift to WTO trading terms would likely result in a significant and immediate disruption to goods exports from all the Visegrad countries, as the dominant machinery and transport sectors are typically integrated into complex supply chains that depend on low border frictions and just-in-time deliveries. Automotive sales are also highly responsive to changes in consumer sentiment and income, and so the economic shock of a no-deal Brexit would likely lead to a rapid contraction in UK demand for cars and transport goods. Polish food and agricultural producers would suffer disproportionately from a shift to WTO trading terms under a no-deal scenario, as tariffs on agricultural products are particularly high and regulatory checks onerous.

There is a broad commonality of interests and risks with regard to Brexit for the Visegrad Four. A large number of citizens from the Visegrad Four are resident in the UK. Protecting their citizens in the UK is an issue of paramount concern – as shown by the joint statement from the Visegrad Four at the Bratislava summit in September 2016, before the start of formal negotiations. There is also a significant asymmetry between the Visegrad Four and the UK on migration issues, as relatively few UK citizens are resident in these countries. In the event of no deal, the European Commission has advised EU member states to take a generous approach to the rights of UK citizens, to encourage reciprocal approach by the UK. Given the mismatch between the numbers of migrants in the V4 and the UK, the Visegrad countries are likely to implement this recommendation. The Czech government has drafted legislation in the event of a no deal Brexit. It would grant a transition period for UK citizens in the Czech Republic where they would be treated like EU citizens. The Polish government has also prepared a bill allowing UK citizens resident in Poland to remain in the country for a minimum of three years after Brexit.[84]

The Visegrad Group's goods export exposure is close to or below the EU average, and the long-term losses are forecast to be small relative to the countries' total GDP growth. The export profile of the four Visegrad countries is broadly similar, with a large emphasis on machinery and transport. All four countries run a trade surplus with the UK. They therefore have a shared interest in a future trading deal with the UK that maintains low barriers to trade in manufactured goods. Poland stands out from

[83] See for example the presentation for businesses by the Polish Ministry of Enterprise and Technology of November 22nd, available at: https://www.mpit.gov.pl/media/66010/brexit.pdf.
[84] Krupa, J., "Polski rząd przygotował projekt ustawy ws. praw Brytyczyków w Polsce," forsal.pl, 12 January 2019. Available at: https://forsal.pl/artykuly/1391847,polski-rzad-przygotowal-projekt-ustawy-ws-praw-brytyjczykow-w-polsce.html.

the other Visegrad countries as its exports to the UK are more diversified, with a large share of agricultural and food exports. Poland will therefore have a broader range of negotiating concerns regarding the future relationship, as negotiations on agricultural products are often among the most challenging part of free trade deals, and many free-trade agreements do not remove agricultural tariffs.

The value of services exports to the UK was significantly lower than for goods for all the Visegrad countries. However, there is greater variation – service exports in 2016 were worth almost 50% of goods exports in Hungary, but under 10% in Slovakia. The Visegrad countries are unusual within the EU in running a services surplus with the UK (overall the value of UK services exports to the EU was 60% higher than services imports in 2016). The Visegrad Four may have an interest in facilitating greater alignment in services between the UK and EU in a future trade agreement than some other countries. With the exception of Slovakia (which uses the euro) the Visegrad countries may be more flexible on allowing continued access to the EU market for UK financial services in exchange for concessions in other areas. Indeed, the concentration of European financial services in the euro zone states could have negative consequences for the Visegrad Group, as it increases the risk of a two-tier Europe between euro and non-euro members.

The European Commission has adopted a series of regulations on issues such as aviation and haulage to limit disruption in the event the UK leaves the EU without a deal. Aside from citizens' rights, the Visegrad Group have to date announced few additional measures to supplement these "mini-arrangements." The short-term impact of no deal for Visegrad exporters is difficult to quantify and will depend to a large extent on decisions taken by the UK itself, such as whether it initially holds back on regulatory and custom checks to minimize disruption. The UK's preparations for a no-deal scenario have been limited and much of the infrastructure required to manage new customs and regulatory procedures is not in place. This could potentially lead to major disruption for EU exporters, but there is little that the Visegrad Group can do in advance to mitigate the impact on business.