

THE GLOBALISATION EFFECTS ON THE TRADE FLOWS: CZECH EXPERIENCE

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Abstract

The Czech Republic is a small open economy, which is vitally dependent on its export performance. In the period after EU accession the intensity of international cooperation grew rapidly in all the Central European countries, which is mostly the result of the huge FDI inflow at the beginning of the decade. In this context one significant problem for the Czech Republic and some other countries of the region appeared: the valuation of the trade flows based on the cross-border measuring overestimates the country's trade balance in comparison with its value added created. This is the case of trade declared by non-resident units, which is more and more common within the European Union. This phenomenon is even enhanced by the strategic geographical location of the Czech Republic, which is important factor why a lot of this "quasi-transit" trade is being operated. The overvaluation of the trade balance is divided into exports (which are over-valuated) and imports (which are under-valuated). It is concentrated in several commodity groups, among them especially computers and electric equipment are significant. The revision of the foreign trade data, which aim is to follow more consistently the ownership approach, significantly changed the picture of the Czech economy, specifically the role of external demand to the economic growth.

Key words: Globalisation, Foreign trade, Balance of Payments, Quasi-transit

JEL Code: F10, F15, F23

Introduction

The surplus of the balance of trade according to the foreign trade statistics in the Czech Republic has been gradually increasing since joining the EU in 2004. This trend coincided to the effect of the rapid growth of the foreign direct investment to manufacturing sector in the preceding years. However, such a development was in contrast to the balance of payment. Moreover, there was observed a growing discrepancy between supply- and use-side of certain commodities during the compilation of the supply and use tables mainly due to exports and imports from the foreign trade statistics. Exports even exceeded production in some of these

commodities. So it seemed that exports were overestimated and imports underestimated or both exports and imports in the foreign trade statistics far exceeded the real economic inputs and outputs of the domestic economy.

The alleged positive balance was actually caused by the value added generated by non-residents and so cannot be included in the value added of the domestic economy. For this reason there was defined a new national concept of foreign trade in the Czech Republic and was developed corresponding methodology of adjustment of traditional foreign trade data. This phenomenon can be associated with two different but complementary issues. First - the increasing influence of non-residents over the flows of goods across the borders of the Czech Republic. Secondly - an increasing number of movements of goods across the national borders without changing the ownership.

This article describes the separation between foreign trade statistics and change of ownership principle within in the EU due to the VAT registered non-residents and introduces the Czech approach to follow the concept of change of ownership related to exports and imports in National Accounts and Balance of payments.

1 What is foreign trade?

Measuring trade flows is (among others) connected with empirical evaluation of economic theories focused on this issue, which have long history (beginning by Mercantilists, Adam Smith's absolute advantage theory, David Ricardo's comparative advantage theory, etc.). Although the search for greater comparability of trade statistics has been going on for a very long time, it was not until the nineteen-twenties that significant developments towards the solution of the problem took place. Modern history of trade statistics started in 1928, when the League of Nations organized the International Conference Relating to Economic Statistics which devoted a significant part of its proceedings to these statistics (see UN, 1998).

1.1 Definition of foreign trade

International Merchandise Trade Statistics (IMTS) defines "trade" in the name of this statistical domain as a reflection of the dominant role of buying and selling in the generation of the cross-border flows of goods (see UN, 1998). The national foreign merchandise trade data collections, in general, rely on administrative sources of data, and are set up to record transactions associated with the physical movement of goods across borders. The data collection systems lack the necessary mechanisms to determine when, where and with whom

change of ownership occurs. Nevertheless, since most traded commodities are crossing the border as part of a normal buying and selling operation between an importer and an exporter, the change of ownership is largely approximated by the cross-border movement of goods. Therefore, data compiled following the IMTS 2010 recommendations have in general to be adjusted prior to use in statistics based on balance of payments methodology (for further details see IMF, 1993). The difference between the trade measured by cross-border activities and change of ownership is rising due to globalisation (see OECD, 2008) and specific role plays also the legislation within EU, which is further elaborated below.

1.2 Non-resident trading: specific of the European Union

The EU has two separate statistical systems for the physical movement of traded goods (see UNECE, 2013):

1. Extrastat is a statistical data collection that is based on the custom declarations of goods entering and leaving the EU
2. Intrastat is a statistical data collection on trade flows between countries within the EU.

Intrastat is closely related to the system of value added tax (VAT) in the EU. All VAT registered entities in a country A (above the threshold) are obliged to report their transactions across the borders of the country A to Intrastat in the country A. However, VAT registered entities are not only residents of the country A.

According to the VAT legislation harmonized across the EU, non-resident traders are obliged to register for VAT in any country where they realized any taxable transactions. These taxable transactions include supply of goods (e.g. sales of goods on internal national market or dispatch of goods to other member states and also any transfer of own goods for business purposes across the borders to the country) or the intra-EU acquisition of goods (also any transfer of goods for business purposes across the borders from the country). In all these cases non-resident traders have to register for VAT and consequently they become respondents to Intrastat in the country where they are not seated and do not have even any physical representation (in tax terminology: ‘VAT-only’).

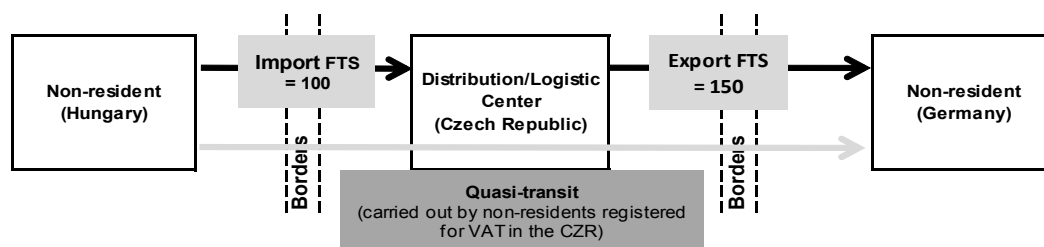
The reasons behind the business transactions carried out by non-residents are closely linked with the existence of the global supply chains, where goods are traded within related companies (see Dunning, 1993 or Hummels, 1998). For goods which enter EU from third countries, there generally is a requirement for a local VAT number to clear the goods through customs. In these cases fiscal representatives are used for the administrative operations like

custom clearance, VAT settlement and Intrastat filing. As explained in (UNECE, 2013), there are number of other reasons why a non-resident company would transit through one EU member state to sell his products in another. One of these advantages can be favourable VAT legislation, which enables to deduct the VAT duty on arrival side automatically when the goods is allocated for further dispatch to other EU country. In this case, cash flow of the trader is not affected.

Another advantage is that, once the goods have been cleared in one member state, the goods are free for transport elsewhere in the EU without any further customs clearance. In practice it means that the trades can store the goods anywhere within the EU and makes the logistics easier. The Czech Republic serves as typical location for storing and other logistic operations for the Germany and other big EU markets. Besides the strategic location the Czech Republic is one of the countries with favourable tax environment for traders mentioned above. This effect was strongly supported by the existence of the global production chains, which significantly increased their extent in the last decade, especially in selected industrial branches such as computer technology and electronic equipment (see Arndt, Kierzkowski, 2001 or Yi, 2003).

As for the Czech Republic, there can be identified two prevailing issues concerning non-resident activities that are essential for the FTS. Firstly, there are significant flows of goods imported to the Czech Republic by non-residents that are re-exported without any change of ownership to resident (see Figure 1). The core of these transactions is the same as in case of quasi-transit even though they are related mostly to the trade within the EU. As they are not carried out by residents they must not be included in the exports and imports according to the change of ownership principle.

Fig. 1: Illustration of the impact of ‘internal’ quasi-transit carried out by non-residents on the trade balance

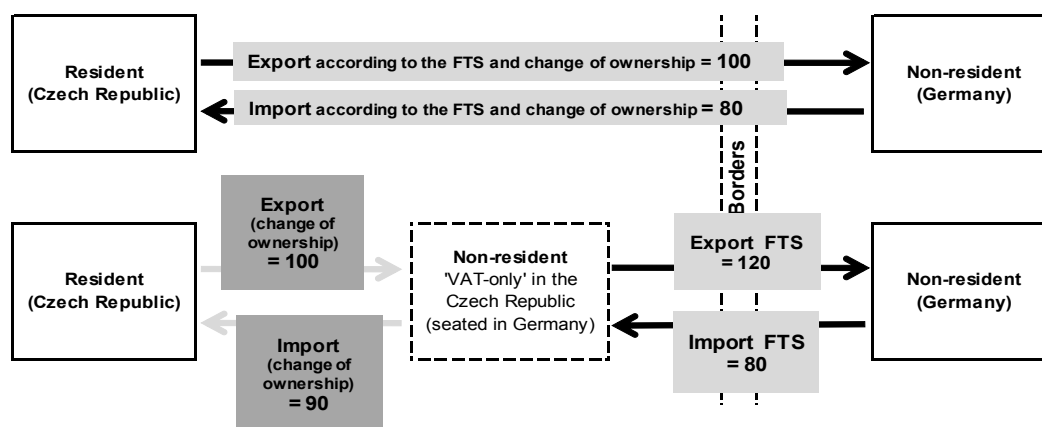


Source: Rojíček, M., Košťáková, T., & Sixta, J. (2012)

Secondly, there are significant flows of goods across the borders reported by non-residents that are related to their activities on the internal national market: their imports are sold to residents and their exports come from domestic production. In any case, the value of imports and exports via non-residents reported to the FTS can differ greatly from the value of transactions between them and residents (see Figure 2).

In both cases, the balance of exports and imports declared by the FTS is influenced and thus must be adjusted for the value added generated by non-residents if it is to be corresponding to the change of ownership principle.

Fig. 2: Illustration of the impact of trading carried out by non-residents on the trade balance



Source: Rojíček, M., Košťáková, T., & Sixta, J. (2012)

2 Impact of globalisation on statistics

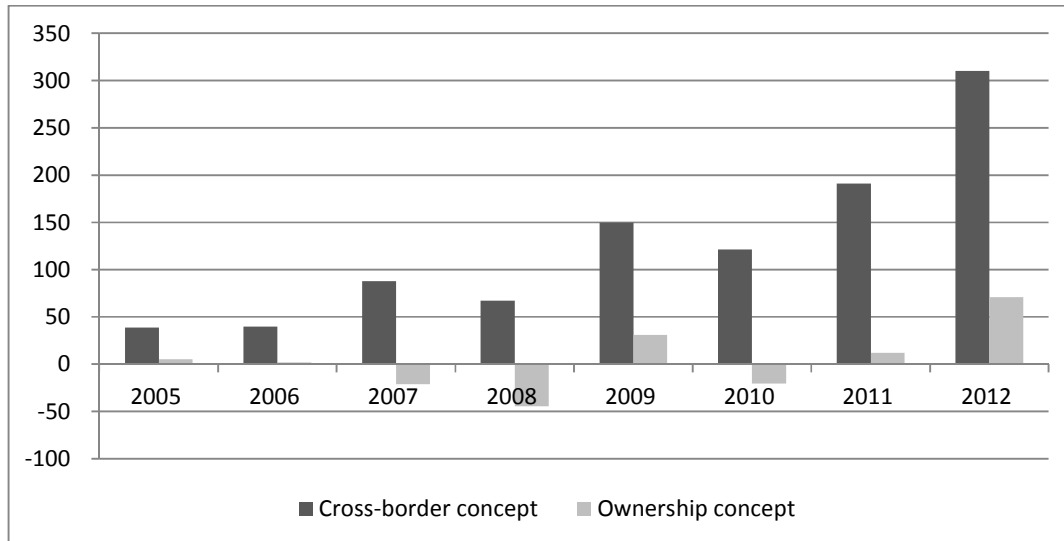
Generally, there is serious effect of the trading via non-residents on the consistency between supply and use side in the economy. For some commodity groups exports exceed the production or the imports exceed domestic uses. In this case commodity balancing process within supply and use tables is very difficult as the data sources are considerably inconsistent (see Eurostat, 2002).

Another problem arises regarding consistency of the current and financial account balance. The balance of payments is based on the monitoring of transactions between resident and non-resident entities, both in real terms (current account) and financial transactions (financial account). As for the trade carried out by residents the balance of real transactions (foreign trade) will be reflected in financial transactions, namely the balance of receivables

and liabilities to non-residents. If the balance of foreign trade is carried out by non-resident units, residents' financial claims on non-residents do not arise and there is a disproportion between the current and financial account balance.

Consider the following very common situation where a Czech company (resident) sells to its parent company goods at a fixed price. The parent company (registered for VAT only in the CR) then exports goods and reports to statisticians an entirely different value (usually higher) at which goods are sold on Western markets. At the first look it seems that Czech economy gains high export prices, but subsidiary (resident) has significantly lower yields. At macro level there is a disproportion between the current and financial account balance, the (value of) movement of goods is higher than money transfers.

Fig. 3: Difference of trade balance between cross-border and ownership concept (2005 – 2012, bln. CZK)



Source: Czech Statistical Office, www.czso.cz

From 2011 the Czech Statistical Office publishes on monthly basis besides the “traditional” foreign trade data (cross-border statistics) also data adjusted for the value added created by non-residents (so called “national concept” – data calculated by ownership principle). Time series from 2005 was recalculated and the difference has been rising in time (see Figure 3). In 2005 the cross-border trade balance showed surplus 39 bln. CZK and after adjusting by the non-residents value added the real surplus of the Czech economy was only 5 bln. CZK, so the difference was 34 bln. CZK. In the following years the difference increased every year and in 2012 the difference reached 240 bln. CZK (i.e. more than 6 % of GDP). The

figures calculated by national concept are included in the national accounts and balance of payments statistics, so the picture of the macroeconomic balance of the Czech economy is not distorted.

Conclusion

The Czech Republic is a small open economy, which is vitally dependent on its export performance. In the period after EU accession the intensity of international cooperation grew rapidly in all the Central European countries, which is mostly the result of the huge FDI inflow at the beginning of the decade. In this context one significant problem for the Czech Republic and some other countries of the region appeared: the valuation of the trade flows based on the cross-border measuring overestimates the country's trade balance in comparison with its value added created. This is the case of trade declared by non-resident units, which is more and more common within the European Union. This phenomenon is even enhanced by the strategic geographical location of the Czech Republic, which is important factor why a lot of this "quasi-transit" trade is being operated. The overvaluation of the trade balance is concentrated in several commodity groups, among them especially computers and electric equipment are significant. The revision of the foreign trade data, whose aim was to follow more consistently the ownership approach, significantly changed the picture of the Czech economy, specifically the role of external demand to the economic growth.

The national concept of foreign trade based on the change of ownership principle is consistent with the methodology of Balance of Payments and National accounting. While in the global context most attention is devoted to the problem of recording "processing" operations, for countries within the EU the problem of quasi-transit trade and the role of non-resident units seems to be very topical. At present this issue is being seriously discussed at the expert level.

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