**Financial Unsustainability of the Czech Welfare State**

The Czech society has been exposed to increasing uncertainties and shocks emerging from both geopolitical and economic realities. International rating agencies as well as domestic institutions and expert bodies warn against the socio-economic trajectory of the Czech Republic which is characteristic of the unsustainability of the state finances, structural deficit, fiscal expansionism and negative demographic dynamics. Recent analyses have shown that the country has experienced slow post-pandemic recovery, high inflation and a record speed of debt expansion in comparison with other EU member states. This briefing draws upon the reports presented by Moody’s, the Supreme Audit Office of the Czech Republic and the Czech Fiscal Council to address the relevant problems in question.

**Introduction**

There is an increasing number of analyses and subjects that warn against the problems that the Czech Republic will face in the near future. One of them is an August report elaborated by a leading credit rating agency Moody’s. On one hand, it reaffirmed the Aa3 rating which is positive in terms of the credibility of the Czech Republic as far as solvency and risk profile are concerned; on the other hand, however, it deteriorated the prospects of the Czech economy from stable to negative due to the imminent risks emerging from the disruptions of gas supplies from Russia which have been of utmost importance for the country. In the case that the Czech Republic would not be able to substitute Russian gas in a sufficient amount and at reasonable prices, the national economy would fall into deep recession inevitably.

**Rating to worsen due to energy crisis**

The government has discussed alternative supplies with Norway or Qatar. At the beginning of September when gas supplies via Nord Stream 1 were suspended, the Czech Republic reoriented to the gas supplies from Norway and LNG from different countries through hubs in the Netherlands and Belgium. Under these circumstances, up to 65 per cent of the gas consumed in Prague was of Norwegian origin. The situation, however, will probably change considerably in winter when the demand in Europe is usually fourfold-fivefold higher compared to the summer months. LNG will, therefore, be more expensive and less available which will be combined with the objective lack of sufficient transport capacities.[[1]](https://china-cee.eu/2022/09/27/czech-republic-social-briefing-financial-unsustainability-of-the-czech-welfare-state/%22%20%5Cl%20%22_ftn1) Petr Fiala´s cabinet has already taken some steps to mitigate the risks and negative impacts of the energy crisis in this regard. In September, Prime Minister attended the inauguration of an LNG terminal in Eemshaven, the Netherlands, which will be used by three companies from three countries – Shell (the Netherlands), Engie (France) and ČEZ (the Czech Republic). The LNG supplies from this terminal will be transported through the German territory. The Eemshaven terminal is to cover roughly one-third of gas consumption in the Czech Republic during the next five years.[[2]](https://china-cee.eu/2022/09/27/czech-republic-social-briefing-financial-unsustainability-of-the-czech-welfare-state/%22%20%5Cl%20%22_ftn2) It is the first terminal in which the Czech side has leased a share. At least the first supplies come from the US Cheniere Energy, Inc. which was the first US company to export LNG abroad in 2016. Interestingly, the same company concluded a 25-year contract with Taiwan two years later.

The US business will thus capitalise on the next round of crisis in relations between the West and Russia, on the economic war against Russia, as well as on military conflict in the Ukraine. The Czech cabinet is doing its best to interpret these steps as the necessary measures to eliminate the dependence on „Russian autocracy“ but such argumentation is misleading for it deepens both Czech and European dependence on the US, not to mention the economic and social aspects of the breaking away from the Eurasian major power.[[3]](https://china-cee.eu/2022/09/27/czech-republic-social-briefing-financial-unsustainability-of-the-czech-welfare-state/%22%20%5Cl%20%22_ftn3) The domestic opposition is calling upon the cabinet to maintain supplies from Russia as Budapest did to minimise the massive social effects on households and companies. Severely negative impacts are reflected by the abovementioned Moody’s report, whereby the agency worsened the GDP growth forecast to 2.3 per cent in 2022 and 1.0 per cent in the following year while before the outburst of the Ukrainian crisis the outlook anticipated the growth of 3.5 per cent in 2022 and 3.2 per cent in 2023. The present and expected development, moreover, puts in danger the credit strength and rating of the country, even though the renewed agencies have not deteriorated the rating yet.[[4]](https://china-cee.eu/2022/09/27/czech-republic-social-briefing-financial-unsustainability-of-the-czech-welfare-state/%22%20%5Cl%20%22_ftn4)

**An alarming tendency**

The fundamental risk is posed particularly by the expanding state debt that calls into question the very financial sustainability of the state activities as confirmed by recent analyses put forward by the Supreme Audit Office of the Czech Republic (SAO) and the Czech Fiscal Council (CFC). Supervising the draft of the state closing account for 2021, the SAO drew a conclusion that the state budget deficit reached a record level and the country has the fastest pace of year-on-year debt expansion among the EU member states as well as one of the lowest rates of economic growth. Even though the overall level of indebtedness in relation to GDP remains relatively low, it is the trend which is alarming. The level of public debt in relation to GDP was 41.9 per cent in 2021 whereas the EU average amounted to 88.1 per cent last year, however, the year-on-year debt growth equalled 4.2 per cent in the Czech Republic in contrast to -1.9 per cent in the EU. The fiscal expansionism is amplified by the increasing (quasi-)mandatory expenditures. That is why President of the SAO Miloslav Kala emphasises the need for substantial reform of the structure of mandatory expenditures including higher efficiency and reduction of the state apparatus, reform of the social and public health systems and, last but not least, reduction of agendas and services provided by the state.[[5]](https://china-cee.eu/2022/09/27/czech-republic-social-briefing-financial-unsustainability-of-the-czech-welfare-state/%22%20%5Cl%20%22_ftn5) Nearly 94 per cent of state revenues was absorbed by the (quasi-)mandatory expenditures in 2021, accounting for 73 per cent of all expenditures. It follows then that the Czech state could not spend money on investment or compensations related to the coronavirus pandemic without further indebtedness.

It is not without interest that despite massive compensations and subsidies during the pandemic period in 2020 and 2021, only 8 per cent of expenditures were those connected with the pandemic. Last year, the Czech Republic experienced a GDP growth of 3.3 per cent while the EU average amounted to 5.4 per cent. Such figures might be affected by the German economy´s performance whose growth was even lower, and also by a negative balance of external trade. Its final deficit reached 1.5 billion CZK (61.2 million EUR). As a whole, the economic performance in 2021 was typical of slow post-pandemic recovery, high inflation, rocketing state indebtedness, and the lowest unemployment rate in the EU.[[6]](https://china-cee.eu/2022/09/27/czech-republic-social-briefing-financial-unsustainability-of-the-czech-welfare-state/%22%20%5Cl%20%22_ftn6) These parameters remain to be relevant this year, being, at the same time, multiplied by shocks emerging from the Ukrainian crisis.

**Structural deficit and demographic development**

The September Czech Fiscal Council´s report on the long-term sustainability of public finances reaffirmed negative trends whose common denominator is serious impacts on the state budget creating a systemic imbalance between revenues and expenditures. The engines of this imbalance are ongoing fiscal expansionism and negative demographic development. The CFC warns that if a radical revision of tax and expenditure policies is not carried out, during the 2030s financing of the state debt will be hardly possible. One of the key concepts used by the CFC is that of a „structural deficit“ which reflects the situation of the Czech public and state finances from a medium-term perspective. The structural deficit means that the state budget generates losses regardless of the business cycle. At present, it amounts to about 220 billion CZK (9 billion EUR). The crucial point is that the gap cannot be overcome through economic growth only but systemic, comprehensive reforms are needed as well. The conclusions of the CFC, therefore, coincide with those drawn by the SAO. Moreover, the government´s plans expect a structural deficit of 2.9 per cent in relation to GDP for the following years which indicates that no reforms are scheduled.

Fiscal expansionism is typical for both the former and the incumbent cabinets. The balance has been deteriorating significantly since 2020. The reasons, nevertheless, are not only the anti-crisis measures during the pandemic period but also such decisions as the cancellation of the super-gross wage in 2020 leading to slumps in tax revenues. The Czech legislation defines the so-called debt brake which is a 55-per cent threshold of the level of debt in relation to GDP, entailing obligatory restrictions on state expenditures including the balanced budgets of all government institutions. According to recent calculations, the threshold will be reached in 2028.[[7]](https://china-cee.eu/2022/09/27/czech-republic-social-briefing-financial-unsustainability-of-the-czech-welfare-state/%22%20%5Cl%20%22_ftn7) The financial unsustainability of the state budget will also be worsened by further expenditures in response to the energy crisis which is accompanied by the failure of energy markets and steep rise in prices of energy that exposes many people to the inability of payments.

**Conclusion**

Even though the economic and social impacts of the present multiple crises are yet to occur, the contours of future problems are increasingly obvious. Rising indebtedness, growing risks of insolvency, bankruptcies of businesses and the subsequent rise of unemployment. While the letter does not pose a big problem given the high levels of employment, the others should be prevented as much as possible. From recent surveys follow that up to 30 per cent of SMEs can go bankrupt during the winter months.[[8]](https://china-cee.eu/2022/09/27/czech-republic-social-briefing-financial-unsustainability-of-the-czech-welfare-state/%22%20%5Cl%20%22_ftn8) It is related to the energy prices and the problem of fixation. According to the data of the Confederation of Industry of the Czech Republic, only 20 per cent of companies have agreed on the price of electricity with the energy producers.[[9]](https://china-cee.eu/2022/09/27/czech-republic-social-briefing-financial-unsustainability-of-the-czech-welfare-state/%22%20%5Cl%20%22_ftn9) From all these parameters emerges that both the Czech economy and society will be exposed to enormous pressures next year which can result in recession and social unrest.

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