The Economic Response to the Covid-19 Pandemic in the Czech Republic

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The Czech Republic (CZ) entered the pandemic in exceptionally good economic condition, with the lowest unemployment rate in all of the EU, [1] with solid economic growth (2.6 %) and increasing real wages together with low public indebtedness at a level of about 31 % of GDP. Therefore, the Czech Republic does have sufficient room for manœuvre to enact fiscal expansionary measures. On the other hand, the country had an inflation rate higher than the central bank's target and those of other EU countries and an exchange rate with the euro diverging strongly from the purchasing parity level. [2] The present Czech government coalition is comprised of the movement ANO, controlled by the billionaire Andrej Babiš, and a junior partner, the ČSSD (Czech Social Democratic Party). The minority government is supported by the KSČM (Communist Party of Bohemia and Moravia). Admittedly, the government has pursued social dialogue, although many long-term problems have not been tackled appropriately or have been completely ignored.

In terms of the EU, the majority of Czechs feel that the Union failed at the beginning of the pandemic and that it is very good that the country remains outside the euro area. Smaller opposition parties claim the weakening of the CZK (Czech crown) is a problem and would not have occurred if the CZ had been a part of the euro area; at any rate, about 75 % of the population does not want the euro. The relationship to the EU is viewed pragmatically in terms of the aid the CZ can receive and how much, on the other hand, it would have to pay for being part of the Eurozone.

The Tax burden in the Czech Republic and political implications

Since the situation is in constant flux and new proposals are constantly being made, it is still too early to undertake a thorough evaluation of the stimulus programmes. However, up to now the government has lacked a transparent overview, an evaluation of all the stimulus measures so far adopted. This makes it hard to see which groups have and have not been helped. The analysis is further complicated as the government did not limit itself to measuring the expenditure side and at the same time began implementation of various tax measures (including the abolition of the real-estate acquisition tax, which has no basis in the economic situation after the lockdown).

Although the level of public debt in the Czech Republic is very low, and its increase is for the most part not considered a major issue (unlike in other countries of the EU, for example Italy) and the demand for state bonds is quite high, the question of tax mix cannot be ignored. The Czech Republic is among the countries with a highly unbalanced tax mix. The tax burden is dominated by VAT, a regressive tax falling mostly on low-income households. However, this feature in the tax system is not accompanied by a progressive personal income tax. Property taxes are almost non-existent (and the abolition of the above-mentioned tax will only make matters worse). Revenues from personal income tax are higher than those from corporate taxes, which is a very unusual feature for a country that claims to be 'developed'. It should also be noted that personal income tax is almost entirely paid by employees, with the self-employed paying minimal taxes. Even without a fuller analysis of the Czech Republic's tax mix, we can say that it is highly unfair and puts the burden disproportionately on the shoulders of employees and low-income groups. It is important to know this, because in implementing the measures, the question of tax justice was largely ignored. The groups that did pay the largest share of taxes (for example, the employees) have been neglected in the implementation of various programmes (more precisely, it is taken for granted that 'their' interests are covered by the Kurzarbeit programmes); by contrast, the self-employed are given various benefits (for example, child care benefits, compensation bonuses). It is especially the compensation bonus (500 CZK for every day of inactivity, which can amount to 15,000 CZK a month [3]) for the self-employed that shows the Parliament's political preferences. (The minimum wage – 14,600 CZK – is lower than this bonus! [4]) Nevertheless, the political discussion has concentrated on paying the self-employed more, since 'nobody can survive on 15,000 CZK' – yet somehow employees are supposed to survive on it.

The predicament of the unemployed is even worse. Unemployment benefits are very low and the period during which they can be drawn is very short. Unemployment benefits for low-income employees are around 8,000 CZK, yet this does not seem to be an issue.

On the other hand, representatives of entrepreneurial circles are keen on changing the tax structure, probably aiming at permanent changes in the already highly unfair tax mix. New suggestions include not only changes in VAT (lowering the rate for the tourism sector by 10 %). These measures are supposed to help the suffering sector, while at the same time the rate for basic food is 15 %! [5]

One of the most dangerous proposals aimed at a permanent change of the tax structure [6] is the loss carry-back. This measure is tailored to big and powerful corporations that had large profits in previous years and now would be able (if this tax measure is adopted) to deduct the 'estimate of the loss'. The company can thus guess at the loss and apply this 'guess' to the current tax period. The measure would be especially attractive for financial groups and banks, as they could easily claim a loss and then let the state pay for it. Because the Czech Republic is deeply enmeshed in the international division of labour, there are many foreign companies involved. In fact, the Czech Republic can be described as a dependent economy, where key sectors are in foreign hands (from the banking to the automobile sector). Loss carry-back [7] would enable foreign parent corporations to artificially create losses and transfer them to the Czech Republic, where the state (that is, the tax payers) would bear the costs. There are two variations of this measure, one of them would comprise tax losses of 30 billion CZK.

What has been adopted here is a kind of 'salami approach' to the tax mix, in which the measures are considered separately, often under pressure of some lobby group (such as those of foreign banks and the tourism sector) and a comprehensive overview of the tax mix and the issues of tax justice are completely ignored. Those who pay the most to the public finance systems are neglected by the stimulus programmes, and the non-systemic approach to tax changes favours rent-seekers.

Kurzarbeit programmes and the labour market situation

One of the first steps in containing the effects of the lockdown was a Czech version of Kurzarbeit. The so-called 'Programmes Antivirus A and B' were established relatively quickly, with the B version aiming at maintaining the labour force with the help of subsidised wages. The programme has exposed the limits of the Ministry of Labour (insufficient staff, no experience with programmes of this type) and insufficient digitalisation of the state administration as such. Despite these flaws, the programme remains one of the most successful state initiatives, and companies are requesting that it be prolonged. The government is now considering prolonging it through August.

The programme has so far helped almost a half million employees at a cost of about 4 billion CZK.

The discussion about prolonging the Antivirus Type B programme (which involves difficulties faced by employers due to the lockdown) and discussions about a possible Antivirus C [8] programme have revealed strong lobbying interests, especially present in the National Economic Council. [9] The influential representatives of transnational companies and domestic firms vehemently refused the conditionality of state aid. The author of this article presented conditionality [10] as one of the key aspects legitimising the stimulus programmes. At the moment it is unclear whether conditionality will or will not be adopted in the state aid programmes.

I proposed that the rule should be: a company with headquarters in a tax haven is ineligible for any state aid programme. A recipient company of state aid programmes would be prohibited from paying out dividends in the Czech Republic or abroad, and from paying out bonuses to management. These rules have provoked much mayhem and threats made to me, which simply reveals the strong position occupied by lobbies (mostly foreign) in the National Economic Council and beyond.

These are, however, not the only obstacles encountered by programmes à la Kurzarbeit. The Antivirus C programme entailed a social-insurance exemption for all companies (which would be extremely expensive) on the basis of a 30 % fall in sales and with minimal concerns for preserving employment (instead, actually tolerating 10 % unemployment). No wonder that this suggestion drew sharp criticism from the trade unions. Luckily, this programme has – at least for now – been abandoned, because the Ministry of Commerce and Industry had no way to check claims of drops in sales.

Kurzarbeit programmes are closely connected to conditions in the labour market. Conditions will now be very different, as the Czech Republic had the lowest unemployment rate in the EU. Unfortunately, the reality has yet to sink it. The Ministry of Labour has started to adjust the data on job openings, as these still reflect the situation before the lockdown. The economy definitely does not have 300,000 job openings. Despite the threat of rising unemployment, companies (especially transnational) are pushing to import workers from Ukraine, Poland, Romania, etc.

The threat of rising unemployment (as many sectors have to go through restructuring and Kurzarbeit, even with the best of efforts, cannot preserve all jobs) combined with the very low unemployment benefits can have severe impacts on the Czech economy. The immediate impact concerns the weakening of purchasing power, as fear of job loss and an unstable economic situation can lead to a decrease in expenditure and thus weaken the whole economy. Tourism, especially, can be considered a luxury good, which can be done without in deteriorating socio-economic situations. In this event, state aid targeting the tourism sector would be in vain. Socio-economic instability could have a profound impact on social peace. In the long term, there is a risk that a deteriorating labour market (combined with the very low unemployment benefits and restrictions connected with it) could practically 'erase' the wage gains of the previous years. The Czech Republic has a different division of gross operating surplus and employee compensation than developed countries have. [11] Put simply, while in the developed countries (with which the Czech Republic is supposed to converge) the employee compensation is bigger than the gross operating surplus, behind the 'Iron Curtain' the inverse is true. A renewed and reinforced trend towards cheap labour would increase the Czech economy's role as a cheap supplier for (mostly) German transnational corporations and would hamper the development of its own domestic higher-value-added industry.

Long-Term problems revealed by the pandemic

As already indicated, the pandemic revealed long-term problems that have not been dealt with, at least not sufficiently.

One of them is the capacity of the state and the low degree of digitalisation. A typical example of insufficient capacity was the liquidity boost to companies, which was supposed to be channelled through the ČMRZB (The Czech-Moravian Guarantee and Development Bank) that does not even have enough qualified employees and, moreover, does not really fit the description of a development bank. These issues of course can be solved through a speedy digitalisation of public administration. A more serious problem is the strong involvement of foreign actors in economic activity. It is difficult to propose plans for a Czech development bank in a situation in which Czech banks (that is, banks with Czech ownership) are almost non-existent. [12]

The concept of the 'loss carry-back' tax measure reflects the vulnerabilities of the Czech economy, a dependent economy in which crucial economic decisions are made abroad. Many countries now realise the danger in complex supply chains. However, this issue is not limited itself to China and its policy. The Czech Republic has integrated itself into the international division of labour in terms of its cheap-labour position, proximity to Germany, and undervalued currency. These features are in contradiction to the policy of convergence. Although we could see positive developments in the labour market in previous years, the structural features have more or less remained the same. This is reflected firstly in the outflow of profits from the Czech Republic, [13] causing a substantial difference between GDP and GNI, and secondly in the division of value (as in employee compensation / gross operating surplus, [14] which from the point of view of political economy perfectly expresses the respective power of labour and capital).

The vulnerabilities also involve the problem of import dependency – in the case of basic agricultural products (which can be grown in the Czech Republic) and the import of cheap labour (from Ukraine). In both cases these import dependencies reveal long-term structural weaknesses. However, the pressure exerted by the entrepreneurial sphere to import cheap labour (causing downward pressure on wages) is extremely strong, even in the current situation.

The economic crisis has also accentuated the issue of strategic companies/sectors. The government is currently discussing the critical condition of Czech Airlines; [15] however, the companies that are part of the indisputably critical infrastructure are often in foreign hands, thus deepening the vulnerability of the Czech economy and contributing to the outflow of profits from the country. A typical example is the company Veolia, which owns parts of the water management infrastructure.

As already said, the pandemic also revealed the highly unfair tax mix. Although for now, the discussions centre on adequate manoeuvring space for fiscal measures, one has to be aware that the high deficit is not a one-off event. If the government wanted to abolish the deficit (let us assume it is 500 billion CZK) in the year 2021, this would necessarily mean deep cuts. Such austerity policy [16] would worsen economic matters and lead to second recession. However, because the Czech National Bank is reluctant even to use the policy of quantitative easing, [17] the debt will sooner or later become an issue. With the current tax mix, there is a considerable risk that the whole burden of the crisis will be shifted to low-income groups and employees, while other groups will acquire enough space for rent-seeking activities and tax exemptions.

However, the economic crisis also offers a unique opportunity to change the Czech Republic's economic model away from being a dependent economy based on cheap labour to become a country with domestic high-value industries. However, it is true that there are many actors who are influential enough to try to preserve the form of the Czech economy as it is, or who could attempt a 'spending spree' and buy out prospective Czech start-ups. Therefore, the issue of protection of domestic start-ups and small to middle-sized companies is important, including the issue of intellectual property rights. Any effort to modernise the Czech economy will inevitably clash with those actors who represent foreign interests and seek to keep the Czech Republic as a colony of more developed countries.

Conclusion

The Czech Republic has been struck by the COVID-19 pandemic (and the consequent economic crisis) while it enjoyed relatively positive economic conditions. With low unemployment, rising wages, and a low debt-to-GDP ratio the room for manœuvre has enabled an active state fiscal policy. On the other hand, the measures are being enacted on both the expenditure and income sides of the budget, which complicates the use of a transparent overall plan. the Czech tax mix is highly unfair, placing the biggest burden on low-income groups and on employees. This tendency could even worsen, as various lobby groups try to push through permanent tax changes in their favour. The same lobbyists, often represented by foreign transnational companies, vehemently refuse the conditionalities of state aid.

The pandemic revealed long-term problems of the Czech Republic in terms of its dependency on imports of food and cheap labour, and especially the strong involvement of foreign actors. Low unemployment benefits and the growing fear of unemployment not only threatens purchasing power, but in the long run jeopardises the wage gains that have been achieved in previous years. This would further prolong the Czech economy's function as a cheap-labour destination situated close to German industrial capacities. Without a consistent strategy of domestic industry support, the Czech Republic will remain a colony. [18]

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P.S.

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https://www.transform-network.net/publications/issue/the-economic-response-to-the-covid-19-pandemic-in-the-czech-republic/

Footnotes

[1] The Czech Statistical Office gives a 2.1 % unemployment rate for the end of 2019. The rate of employment (for citizens of ages of 20 to 64) was 80.5 %, the fourth highest in the EU. See https://www.czso.cz/documents/10180/91606731/czam042920analyza.pdf/

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[2] According to power purchasing parity the CZK to euro should by about 18-19 crowns for euro. In reality it is 27 CZK for euro. Simply put this means that part of Czech labour is exported for free

[3] According to the current exchange rate of about 550 euro.

[4] The minimum wage involves about 150,000 employees.

[5] At present, the Czech Republic has the highest inflation of all EU countries, a huge part of it involving the increase in food prices. The reason for this is that the Czech Republic is no longer self-sufficient in basic food categories (pork, vegetables, fruit), and the depreciated currency makes imports more expensive). Plans to increase self-sufficiency are currently being discussed in Parliament. One of them involves regulating the proportion of Czech products in stores. A starting proportion of 55 % has been suggested, and this is to increase gradually.

[6] The permanence of the changes reflects the successful efforts of lobby groups that pushed for them. Loss carry-back is a perfect example of rent-seeking.

[7] The author was able to cooperate in the resistance to this measure. One of the 'compromise' proposals includes a ceiling for loss, set at 30 million CZK (more than one million euro). Sadly, even social democratic and communist MPs supported this measure, with the logic that 'big companies are big employers'. The measure of course was not connected to employment, unlike Kurzarbeit.

[8] As this article is being written, the proposal is to be discussed in the government. Antivirus C is supposed to aim at socialinsurance exemption for small companies. Here the representatives of transnational companies claim that restricting this to smaller companies (with up to 50 employees) is 'discriminatory' and want the programme to be applied to all companies.

[9] The representatives are mostly from business and entrepreneurial entities. For example, a big domestic investor in tourism is proposing a programme to revive tourism. A representative of the PPF Group N.V. (a privately held international financial and investment group founded in 1991 in Czechoslovakia and residing in the Netherlands; it is owned by a Czech billionaire, Petr Kellner) is writing the proposals for start-up support. The foreign interests mostly involve Škoda Auto (with German ownership) and foreign banks (for example, Die Erste Group).

[10] Not to mention the possible breach of due diligence and proper management care.

[11] For a detailed analysis see the ČMKOS study, 'When will Czech wages be comparable to the developed EU?', https://ipodpora.odbory.info/dms/soubory/index?file=study-eng_20191114092817.pdf

[12] Currently, there are proposals for the combining of disperse funds in one institution and/or plans for the institutional strengthening of the ČMRZB.

[13] In 2019 the official outflow figure reached 299 billion CZK, which is a record. However, the real number, which includes the widespread use of transfer mispricing, can be estimated at 500 billion CZK.

[14] Compensation of employees to gross value added (for 2017) was 46.1 % in the Czech Republic; in Austria it was 53.3 %, and in Germany 56.4 %. See Eurostat.

[15] The author does not agree with the view that Czech Airlines is a strategic company. If the state is to act, then the only viable option would be to nationalise the company. However, the owners 'prefer' loans and bank guarantees.

[16] The Czech Republic unfortunately has its own negative experience with austerity policy. Under the right-wing government austerity policy led to a second recession in 2012/2013 and later, happily, to a change of government.

[17] The Czech National Bank is a highly conservative institution, and the expansionary economic policies are also not supported by the MPs. There was a huge political battle just to increase the bank's room for manœuvre in the case of securities trading. Now the bank can trade with securities with maturity longer than one year, which was not possible before.

[18] Ilona Švihlíková, *Jak jsme se stali kolonií*, Prague: Rybka Publishers, 2015.