

◀ FIVE-PARTY GOVERNMENT TAKES OFFICE IN THE CZECH REPUBLIC

Key takeaways for investors from the appointment of the Petr Fiala Government

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Issues & Sectors	Parliamentary Elections, Government Relations
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Following the surprise victory of the three-party SPOLU alliance during October's parliamentary elections and their coalition deal with the Pirates and Mayors alliance, the Czech Republic finally has a new government, led by centre-right Prime Minister Petr Fiala and supported by five, ideologically diverse parties in the lower house. The Fiala Cabinet takes office during the onslaught of the fourth COVID-19 wave, with a clear need to focus on economic recovery and fiscal stability, alongside stated priority areas such as digitalization and EU affairs, ahead of the Czech EU Presidency in the second half of 2022.

The Fiala Government, finally appointed by President Miloš Zeman on 17th December, will face strong public pressure to deliver on its promises, which could place additional strain on a five-party coalition already straddling a range of ideological and policy positions. Major policy disagreements and coalition fractures seem almost inevitable: the key question is whether the need for political and economic stability will triumph over short-term political jostling.

In this memo, Kesarev takes a deeper look at the Fiala Government, its priorities for the next four years, as well as the prospects for political stability and implications for international investors.

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POLITICAL LANDSCAPE

More than two months after the Czech Republic held much-anticipated parliamentary elections to elect the 200 members of the Chamber of Deputies, the lower house of the country's bicameral legislature, the country finally has a new government, supported by a five-party coalition of ideologically diverse parties and led by centre-right politician Petr Fiala as Prime Minister.

The appointment of the Fiala Government on 17th December comes after the centre-right SPOLU (Together) coalition (an electoral alliance between three conservative parties: the liberal-conservative Civic Democratic Party (ODS), the Christian Democratic KDU-ČSL and the fellow liberal conservative TOP09) emerged as the surprise winner of parliamentary elections held on 8th-9th October¹. Beating pre-election forecasts, SPOLU secured 27.8% of the popular vote and narrowly defeated the populist ANO party of now former Prime Minister Andrej Babiš, which received 27.1%.

Alongside SPOLU and ANO, two other formations passed the 5% threshold to enter the lower house of the Czech parliament. Piráti+STAN, the electoral alliance of the liberal Mayors and Independents (STAN) movement and the progressive liberal Czech Pirate Party (Piráti), came in third with 15.6%, while the Freedom and Direct Democracy Party (SPD), a right-wing populist and anti-EU formation secured 9.5%. Before the elections, SPOLU and Piráti+STAN had indicated their willingness govern in a coalition should they win the parliamentary vote.

ANO's defeat was widely seen as a vote against illiberalism and in favour of improving relations with Brussels. The outgoing PM was running on a soft Eurosceptic platform and campaigning on a mostly ideological basis against liberal social ideas. However, the election campaign was also shaped by corruption scandals involving Babiš that shifted the public mood against ANO. Another significant takeaway from the elections was the poor performance of the Social Democratic Party (ČSSD) and the Communist Party of Bohemia and Moravia (KSČM), none of which were able to pass the 5% threshold needed to enter the Chamber of Deputies, leaving the Czech lower house without traditional left-wing parties for the first time in decades.

COMPOSITION OF THE CHAMBER OF DEPUTIES

Political Party/Alliance	Popular Vote – October 2021 (%)	Number of MPs	Affiliation
SPOLU (centre-right coalition of the ODS, KDU- ČSL and TOP09 parties)	27.8	71	government
ANO (populist, conservative-liberal)	27.1	72	opposition
Piráti+STAN (alliance between the Czech Pirate Party and the Mayors and Independents, progressive-liberal)	15.6	37	government
Freedom and Direct Democracy (SPD, right-wing populist, hardline Eurosceptic)	9.5	20	opposition
Total		200	

(Source: Central Election Commission of the Czech Republic)

¹ See [here](#) for our overview of the October parliamentary elections

The elections were immediately followed by political uncertainty as Czech President Miloš Zeman was hospitalized a day after the October vote. As President, Zeman holds the constitutional powers to appoint the new government before the country's parliament provides a vote of confidence. Before being hospitalized, Zeman, an ideological ally to Babiš, said he would task the head of the largest single party with forming a government, leading to speculation that he wanted to keep the former PM in power. Upon his recovery and Babiš' acceptance of his new role as an opposition leader, however, Zeman eventually confirmed that he would ask Fiala to start negotiations about a new cabinet.

By the opening of the new Czech lower house of parliament on 8th November, SPOLU and Piráti+STAN, had agreed a coalition deal, indicating their readiness to take office. On 28th November, Zeman appointed Fiala as PM and started interviewing his nominees for the different cabinet positions. Although Fiala was poised to lead the next government, Zeman voiced strong opposition to Jan Lipavský, an MP from the Czech Pirate Party and Fiala's nominee for Foreign Minister, over his ideological opposition to the progressive-liberal Pirates and Lipavský's critical views on the Visegrád Group and Israel.

Responding to this move, the PM-designate vowed to stand behind his originally proposed cabinet line-up and even considered a legal challenge against the President's decision. On 14th December, however, Fiala announced that the Czech President would swear in the new cabinet as proposed. Zeman's decision came as he decided not to delay the new government in view of the resurgent COVID-19 pandemic, the energy price crisis and the economic difficulties facing the country², however he also received guarantees from Fiala that his Government will support the country's strategic partnership with both Israel and the Visegrád Group.

THE NEW GOVERNMENT AND ITS PRIORITIES

Following his failure to block Lipavský from becoming Foreign Minister, Zeman on 17th December appointed the Fiala Government in its entirety, including all original candidates proposed by the SPOLU leader. Formally, the Czech parliament is due to confirm the new cabinet in a vote of confidence in January, but the Fiala Cabinet has already assumed office. Below we outline a number of policy implications and priorities:

The new PM assumed office with a decade-long political and brief governmental experience.

By profession, Fiala is a political scientist and university professor who held different academic positions at the Charles University in Prague and at Masaryk University in Brno. Entering politics in 2011, he briefly served as the chief advisor for science in the Government of Petr Nečas, as well as Minister for Education, Sports and Youth between 2012 and 2013 in the same cabinet. As the leader of ODS since 2014, Fiala was instrumental in forming the SPOLU alliance that put him forward for Prime Minister earlier this year. As a centre-right politician, he is a fierce opponent of illiberalism and a strong supporter of economic and social conservative values, as well as his country's Euro-Atlantic orientation.

Fiala will have four deputies and 13 additional ministers. Based on the five-party composition of the ruling coalition, the Fiala Cabinet has four deputy Prime Ministers from each of ODS's fellow coalition partners. Reflecting the balance of power between the two largest parties in the two governing blocs (ODS has 34 MPs, while STAN has 33), STAN leader Vit Rakušan will serve as First Deputy Prime Minister, as well as Interior Minister. The Deputy PM list also includes Labour and Social Affairs Minister Marian Jurečka (from KDU- ČSL), Health Minister Vlastimil Válek (from TOP09) and Pirates leader Ivan Bartoš who will serve as Deputy PM for Digitalization and Regional Development Minister. In line with the coalition deal, the Fiala Government will operate under a new ministerial structure that includes three new ministers in the Government's Office, responsible for science and innovation, legislation and European affairs. The new ministries are likely to be among the key stakeholders, as well as priority areas in terms of policy-making.

² See [here](#) for our November overview of the coalition deal between SPOLU and Piráti+STAN

- › Fiala's senior ruling ODS party will control five ministries, including the portfolios of finance, defence, justice, culture and transport.
- › The second largest single party, STAN, will be in charge of the portfolios of European affairs, industry and trade, as well as education, youth and sports.
- › Fellow SPOLU alliance member KDU-ČSL will control the environment and transport ministries in the Fiala Government.
- › The third member of SPOLU, TOP09, has secured the newly created science and innovation ministry.
- › The fifth member of the governing coalition, the Pirate Party, will control the portfolios of foreign and legislative affairs.

Digitalization will have an elevated status in the new government structure. As well as creating a separate science and innovation ministry, Deputy PM Bartoš will be responsible for digitalization as a separate policy area, while it will also be connected to regional development. Among other initiatives, the coalition deal includes the implementation of an eGovernment Cloud concept in the state and private sectors, the adoption of more flexible rules for purchasing cloud services in line with EU standards, strengthening cybersecurity capabilities and completing the implementation of the country's so-called Act on the Right to Digital Services, a gradual digitization plan aimed at improving public administration services by 2025. Efforts to enhance digitalization will also be supported by the EU's post-pandemic recovery funding package³, from which the country is entitled to €6.3 billion in grants. Under the Czech national recovery plan, 22% of the EU-funded grants will support digital transition. Among others, the plan provides for investments in digital infrastructure, the digitalization of the public administration, particularly in the areas of health, justice and construction permits, and promotes the digitalization of businesses in the cultural and creative sectors.

Fiscal concerns and the economy are among Fiala's short-term priorities. As a centre-right fiscal conservative, the new PM is widely expected to rework his country's state finances. During the two pandemic years, Czech national debt increased significantly, reaching a record €14.5 billion last year, with a considerably higher deficit expected for 2021. Under Babiš, the former parliament already approved a budget for 2022, however Fiala and his governing majority will implement revisions to improve state finances through cutting state spending and reconsidering public investment projects. Besides a public promise not to raise taxes and cut subsidies to large companies, the new PM has vowed to cut taxation in certain areas and is also likely to address the energy price crisis. Although generally supportive of joining the Euro, the need for fiscal stability means this is unlikely to be considered in the medium term.

The new government will have to confront a resurgent pandemic. The Czech Republic has seen an unprecedented spike in COVID-19 cases during the fourth wave of the pandemic, to which the outgoing government responded with wide-ranging restrictions over the past months. Although the fourth wave is now in decline, tackling the pandemic remains a priority for the new PM, as well as boosting the country's vaccination rate, which has plateaued at 61%. However, while Babiš was preparing to mandate vaccines for the elderly from next March, the new Cabinet seems unlikely to enforce compulsory vaccinations. Furthermore, the Fiala Cabinet, which held its first session on 17th December, will not call on the Czech lower house to extend the ongoing state of emergency past 25th December, but promised further changes if the situation deteriorates. The fourth wave could also further impact GDP growth, which the European Commission expects to be 3% this year and 4.4% in 2022 after a 5.6% downturn in 2020.

The Czech Republic will have a firmly pro-EU cabinet. The new governing coalition has expressed a strong interest in improving Czech-EU ties. In practice, this is evidenced by the establishment of a separate EU affairs ministry as the Fiala Government prepares for the Czech Presidency of the Council of the

³ See [here](#) for our November overview of the state of EU recovery funding in CEE markets

European Union, which will start in July next year. Besides likely priorities such as the economic recovery, green transition and digitalization, the Czech EU Presidency program is likely to have a broader geopolitical focus, including a tougher approach on Russia in relation to the war in Ukraine, and on China. Prior to his appointment as PM, Fiala promised “a revision of relations with Russia and China” and is planning to adopt national-level Magnitsky legislation (modelled after the US Global Magnitsky Act to sanction corruption and human rights abuses in authoritarian states). SPOLU came out strongly against Russian or Chinese investments in the Czech nuclear energy sector after the so-called Vrbětice revelations, in which Czech authorities accused Russian secret services of being responsible for the explosion of two Czech arms storage sites in 2014. Furthermore, Jana Černochová, the new Defence Minister, recently signalled that the Czech Republic should replace outdated Russian technologies used by the military, indicating potential tenders and contracting opportunities for (Western) security companies and defence suppliers. The Fiala Government is planning to spend 2% of the country’s GDP on defence to meet its NATO spending targets.

THE COMPOSITION OF THE NEW GOVERNMENT

Cabinet Member	Portfolio/Responsibility	Party Affiliation
Petr Fiala	Prime Minister	ODS
Vit Rakušan	Interior Affairs	Mayors
Ivan Bartoš	Digitalization and Regional Development	Pirates
Marian Jurečka	Labour and Social Affairs	KDU- ČSL
Vlastimil Válek	Health	TOPo9
Zbyněk Stanjura	Finance	ODS
Jana Černochová	Defence	ODS
Pavel Blažek	Justice	ODS
Martin Baxa	Culture	ODS
Martin Kupka	Transport	ODS
Anna Hubáčková	Environment	KDU- ČSL
Zdeněk Nekula	Agriculture	KDU- ČSL
Helena Langšádlová	Science and Innovation	TOPo9
Petr Gazdík	Education, Youth and Sports	Mayors
Jozef Síkela	Industry and Trade	Mayors
Mikuláš Bek	European Affairs	Mayors
Jan Lipavský	Foreign Affairs	Pirates
Michal Šalomoun	Legislation	Pirates

POLITICAL STABILITY IS NOT GUARANTEED

Following the parliamentary elections, Fiala said the Czech Republic faces its worst crisis in modern history. The multiple crises hitting the country, together with the ambitious promises of the five-party coalition agreement, are likely to serve as a force to hold the coalition together. At the same time, there could be destabilizing factors. The Fiala Government will be supported by the first five-party coalition in the democratic history of the Czech Republic: the coalition includes four conservative-liberal parties (ODS, KDU-ČSL, TOP 09 and STAN) and one progressive-liberal formation (the Pirates). Consequently, the stability of the coalition heavily depends not only on the coalition deal between the five parties but also on a wide range of ideologies somehow co-existing in government.

In this regard, the Czech Pirate Party seems the most likely to be involved (or even initiate) a coalition turmoil or fracture. The Pirates performed worse than expected during the October parliamentary elections (securing only four seats), for which many in the party blame STAN, the party they ran with in an electoral alliance. With the new parliament, this alliance has likely come to an end: STAN leader Vit Rakušan already signalled that his party would run on a separate ticket during the next electoral contest. Under this scenario, the coalition would face a crisis, however Fiala could continue governing as the remaining four parties hold 104 of the 200 seats in the lower house. Ideological or policy differences might not be limited to the Pirates only, however: ODS has traditionally been a soft Eurosceptic formation in comparison to the other two members of the centre-right alliance. The next year is likely to present a number of challenges that could result in heated political debates even within the Fiala-led centre-right alliance.

While the ruling coalition and its parliamentary majority will ensure a smooth legislative process, further clashes are likely between the governing bloc and President Zeman. Fiala's future policies on the EU, Russia and China are among the most likely areas where the two sides could seriously disagree, since the President remains a firm supporter of cooperation with the two Eastern states, while the Fiala Government is heavily critical towards both Moscow and Beijing over geopolitical reasons and human rights concerns. Another complicating factor in Czech politics is the President's health: Zeman, 77, has been hospitalized on multiple occasions and his recent health problems have cast a shadow over the future of the new government in the middle of a transitional period.

LOOKING AHEAD

With the Fiala Government sworn in on 17th December, the Czech Republic is now governed by its first-ever five-party coalition, spanning a wide ideological spectrum. As the country confronts multiple major crises, the new PM must focus on economic recovery, fiscal stability, boosting vaccination rates and improving Czech-EU ties. The five-party majority in the Czech parliament will enable Fiala to pursue his conservative-liberal agenda and the coalition agreement holds a number of opportunities for international investors, particularly within the digital and defence sectors.

At the same time, the stability of the coalition could very well be tested not only by ideological but also policy differences. Of the five governing parties, the Czech Pirate Party is the most likely to be part of a potential coalition turmoil, given its ideological distance from the remaining four ruling parties, however political differences could also emerge between any of the five governing formations. Furthermore, the ideological distance between the new PM and President Zeman – and the clash over ministerial nominations – are likely to be followed by other political conflicts that could hinder Fiala's agenda.

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