INTRODUCTION

Following a series of scandals in the Czech Republic including corruption and the abuse of power, the centre-right government of Petr Nečas (Civic Democratic Party, ODS) was brought down in June 2013. The Czech parliament dissolved soon after, triggering an early election that took place on 25 - 26 October 2013.

The election was expected to end the lengthy political crisis and uncertainty and replace the caretaker cabinet of technocrats led without democratic legitimacy. However the presence of seven parties in the new parliament, of which two are complete political newcomers, could lead to new deadlocks.

This snapshot summarises the outcome of the election and sheds some light on the formation of the new government and the potential impact it could have on the business environment and the Czech Republic’s position in the EU.

A Pyrrhic victory

The election has shaken the position of the established left and right-wing parties, as two populist parties made their way into the parliament – the ANO party and the Dawn of Direct Democracy. Their rise in popularity prevented the Social Democratic Party from securing a clear victory.

After seven years in opposition, the Social Democratic Party should have been the big winner of the early election. However, landing only 20.45% of the votes, the party failed to meet its expectations. Their original plan to form a minority government with informal support from the Communists therefore failed. This is despite the Communist party obtaining the best result in its history (14.91%, up 4% from 2010).

Moreover, given his weak victory, the Socialist leader Bohuslav Sobotka is facing increasing internal opposition as the majority of the party’s representatives have called for him to step down. Therefore, the real winner of the election appears to be the recently formed ANO party.

The dealmaker

Obtaining 18.65% of votes, the Action for Alienated Citizens (ANO: Czech for ‘yes’), led by Slovak-born billionaire and media mogul Andrej Babiš, who allegedly cooperated with communist secret police in the 1980s, came in second place. Thanks to its political flexibility and pledge to eliminate corruption, the party attracted over 920,000 voters. With the campaign slogan, “Yes, We’ll Be Better Off”, Babiš claimed that his billions have made him immune to bribery and corruption, giving him the capability to deal with one of the country’s most urgent problems. The party will be a significant force in the formation of a new coalition government.

Following the election results, Babiš indicated that the party would not join a coalition. However, considering that its share of the vote was far higher than expected, ANO is likely to either enter a coalition government or support a minority coalition. The most likely scenario for the new coalition is cooperation between the Social Democrats, ANO and the Christian Democrats, which have returned to the Parliament after three years of absence (6.78%). The three parties would control 111 of the 200 parliamentary seats. Alternatively, Mr. Babiš could agree to support a minority coalition government.

Several analysts have warned that the participation of ANO in a coalition government could quickly lead to another crisis. ANO was only formed two years ago, but it has already shifted from a protest-inspired left to a centre-right party. Without a precise ideology, the party promises only one thing – to run the Czech Republic as a business entity.

The weakened right

As predicted, the centre-right parties of the former coalition government (ODS and the TOP09 party) were penalised for their scandals and unpopular austerity measures when in power. The Civic Democratic Party suffered most from the scandals surrounding the resignation of former Prime Minister Nečas and obtained only 7.72%, the poorest result in the party’s history (in 2006, ODS obtained 35% of votes).

The weakened ODS has left a political vacuum on the right which allowed the formation of new political groups. The result is likely to trigger a series of internal realignments in the ODS, including leadership change.

A setback for President Miloš Zeman?

Despite a massive electoral campaign, targeted mostly against the parties of the former centre-right coalition, the SPOZ party, affiliated with President Zeman, obtained only 1.5%, way below the 5% threshold.
necessary for representation in Parliament. However, given the fragmentation of the new Parliament - with 7 different parties - President Zeman (former Social Democrat) remains a strong player in Czech politics.

**The phenomenon of anti-establishment parties**

The Dawn of Direct Democracy (Úsvit), led by Czech-Japanese businessman Tomio Okamura, will enter parliament with 6.88% of the votes. Okamura, currently a Czech senator, has called for ‘people power’ and referenda as a way to empower voters. The ANO party and Úsvit, together with 36 independent MPs in the Parliament, prove that the Czech electorate has turned away from traditional parties.

**The expected impact on business and the economy**

Considering that the Socialists are likely to govern in a coalition of parties, and the possibility of cooperation with the pro-business ANO party, they will need to water down their tax proposals. These proposals aim to considerably increase taxes on banks, utilities and high earners. On the other hand, the Socialists’ plan to keep the country’s budget deficit below the EU’s prescribed level of 3% of national GDP is likely to be a success.

Regarding the budget itself, the new Parliament will also need to approve the budget for 2014 so as to avoid a provisional one, which could damage investors’ confidence in the Czech Republic. A subsequent budget for 2015 could also reflect an anticipated decrease in the lower rate of value-added tax.

Given the stability of the Czech Republic, achieved through low public debt and the lowest borrowing costs in emerging Europe, the financial markets have, for the time being, not been impacted by the election results. Lengthy negotiations on the formation of the government could however rattle investors’ confidence and negatively impact the country’s prospects for economic growth.

Ahead of the election, the majority of parties voiced their support for investment policies. Investment is highly significant for the Czech Republic as it makes up 20% of GDP. Czech Socialists have highlighted that any new investment incentives should be structured to support the production of value-added goods and research and development. We can also expect a more proactive employment policy.

Given that the Czech state holds a majority of shares in the Czech energy group ČEZ, the new government will also need to agree on a 10-billion Euro tender to expand the Temelín nuclear plant. It remains to be seen whether the government will be more open for business opportunities with Eastern Europe and specifically with Russia, as some commentators expect.

**A new approach towards the European Union?**

Throughout the election campaign, EU-related topics played a minor role. They were overshadowed by issues such as proposed reforms of healthcare, pension and education systems, church restitution, the new Civil Code as well as new Civil Service Code and related anti-corruption measures.

Nevertheless, the new Czech government is likely to be more pro-European, and Euroscepticism will be weakened given the poor result of the Civic Democrats (ODS). The current unpopularity of the ODS could also influence the outcome of the 2014 European Parliamentary elections. Nine ODS members are currently affiliated with the European Conservatives and Reformists Group.

Also, the ANO party is expected to be pro-European, since the negotiator of the Czech Republic’s EU membership and former EU Commissioner Pavel Telička acts as the party’s advisor on EU affairs. According to analysts, the new government could also re-launch its accession procedure to join the Eurozone.

**What next?**

The success of new parties in the election has confirmed the fatigue of many Czechs after months of political turmoil, corruption scandals and slow recovery from the economic crisis. This has also been confirmed by the second lowest turnout for elections (59.5%) in Czech history. The vote has sent a clear signal that the development of the Czech Republic falls short of post-1989 expectations.

However, the results may not provide the required political stability, as lengthy coalition talks are likely to take place before a new government is formed. Furthermore, a prolonged political crisis could ultimately strengthen populist parties, particularly if another early election takes place, as some analysts predict. This would be a threat to both the democratic system and business environment.

Negotiations around the new coalition are expected to progress before the plenary meeting of the Parliament’s Lower House, scheduled for 26 November 2013, during which politicians will clarify their next steps.

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