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## Troubles with the state budget

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### Summary

The state is expected to run a deficit of CZK 241 billion in 2025. Dynamic growth in expenditure by CZK 105 billion and the stagnation of the cyclical balance mean that no significant consolidation is taking place. The budget can therefore be described as pre-election. In addition, the irregularities in the draft amount to almost CZK 70 billion. The problematic consolidation of public finances under the currently valid rules can only be expected in the period after 2026.

### Highlights

- State budget revenues for 2025 are planned at CZK 2,086.1 billion. This represents an annual increase of 6.6% (CZK 120.4 bn).
- Expenditures increase by CZK 105 billion year-on-year to an unprecedented CZK 2,327.1 bn. of this amount, mandatory and quasi-mandatory expenditure will amount to CZK 1,796.9 billion.
- Discrepancies in the submitted proposal on the revenue and expenditure sides amount to almost CZK 70 billion.
- Significant budgetary consolidation will take place after 2026.

## Troubles with the state budget

Since 2022, there has been a significant increase in state budget expenditure, by almost a fifth. In this context, the proposed state budget deficit of CZK 241 billion. CZK for a non-crisis period is completely unprecedented. Finance Minister Zbyněk Stanjura (ODS) and Prime Minister Petr Fiala (ODS) call the submitted budget an investment budget, while experts and specialized institutions often assess it as pre-election. Its transparency in a number of controversial items is perceived as problematic.

## Record state budget revenues

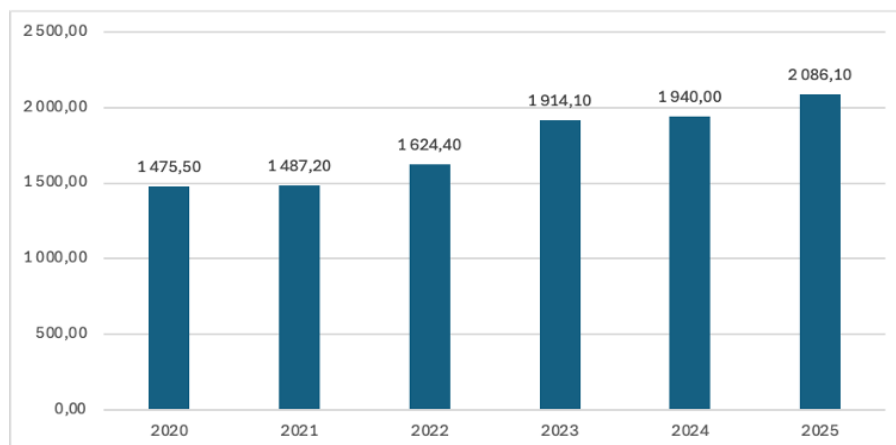
The total revenues of the state budget are not small. For 2025, they are planned to amount to CZK 2,086.1 billion. This represents a decent year-on-year increase of 6.6% (CZK 120.4 billion), well above the expected inflation rate (2.3%) and real economic growth (2.7%) (Ministry of Finance of the Czech Republic, 2024). The significant year-on-year growth in VAT collection (CZK 414 billion in total, i.e. 7.3% more than this year) is mainly due to increased nominal household consumption and VAT rate adjustments last year. An increase in revenues from EU budgets by CZK 25.8 billion is also expected. To CZK 153.2 bn. This growth masks the fact that dependence on European resources remains significant. The collection of excise duties, which is expected to reach CZK 157 billion, will be affected by a gradual increase in rates from the so-called consolidation package, especially for tobacco products (Ministry of Finance of the Czech Republic, 2024a).

As for corporate income tax, including windfall profits tax, its collection is estimated at CZK 244 billion, which is a slight increase compared to the planned collection in 2024 (CZK 215 billion). This relatively dynamic increase is due to the increased corporate income tax rate and the still higher-than-expected collection of tax on extraordinary profits. The question remains whether the increase in corporate taxes and the creation of an extraordinary tax do not significantly weaken the investment climate and economic growth, which is insufficient in the post-pandemic period.

Total revenues from social security contributions are expected to reach CZK 809.4 billion. This represents a year-on-year increase of 7%. From this point of view, it is good to ask whether the gradual increase in the levy burden on employees and employers will not lead to a further increase in "cash" salaries and a reduction in the efficiency of the labour market.

Looking at the longer term, it is quite evident that the last four years have been marked by dynamic growth in nominal incomes in terms of the state budget. Compared to 2021, these are to increase by a staggering CZK 599 billion for the following year, i.e. by more than a third of the nominal revenues available to the cabinet in 2021. This increase is not only a function of inflation and economic growth, because the consolidation package also had a significant impact on the increase in state budget revenues, which significantly increased the tax burden, but at the same time new taxes were created that the Czech Republic had not known before (Windfall Tax, levy on excess revenues, etc.).

**Graph 1:** Increase in state budget revenues in 2020-2025, in CZK thousands



**Source:** (Ministry of Finance of the Czech Republic, 2024a, Ministry of Finance of the Czech Republic, 2024b, own adaptation)

## Expenditures are growing, consolidation is not in sight

State budget expenditures for 2025 are planned in the amount of CZK 2,327.1 billion, which represents an increase of CZK 105 billion compared to the current amended budget. Of this amount, mandatory and quasi-mandatory expenditure will amount to CZK 1,796.9 billion, which means that 86.14% of total revenues are earmarked for liabilities arising from the law (Ministry of Finance of the Czech Republic, 2024a). The state budget's room for economic policy-making is therefore limited to less than 14% of revenues. Everything else is financed on credit. This maintains a long-term situation in which most state budget expenditures are tied up, without any real ambition to make fundamental changes in mandatory expenditures.

Capital expenditure for next year is proposed at CZK 249.6 billion, which represents CZK 65 billion more than in 2024. This increase is due to higher contributions from the EU and FM budgets, the share of which will increase by CZK 29.4 billion year-on-year, but also to an increase in the national share of capital expenditure (CZK + 35.6 billion) (Ministry of Finance of the Czech Republic, 2024a).

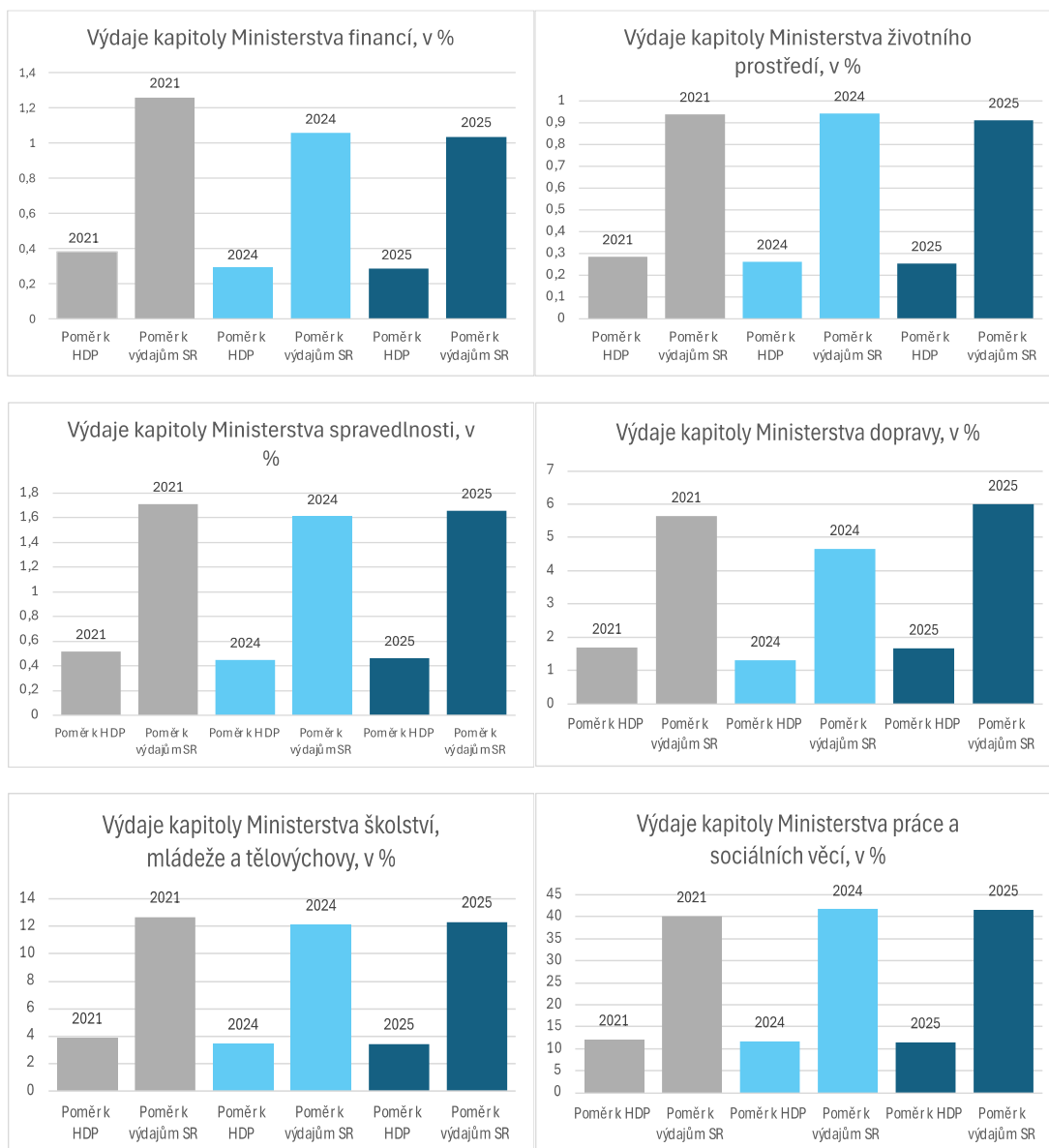
Expenditure on salaries and other payments for work performed is budgeted at CZK 286 billion. CZK, which is an increase of CZK 19.4 billion. CZK compared to 2024. This also reflects a renewed increase in the number of jobs in the state sector by 1,369 jobs (Ministry of Finance of the Czech Republic, 2024a). Promises to increase the efficiency of public services and reduce the number of employees are thus apparently postponed to the next period.

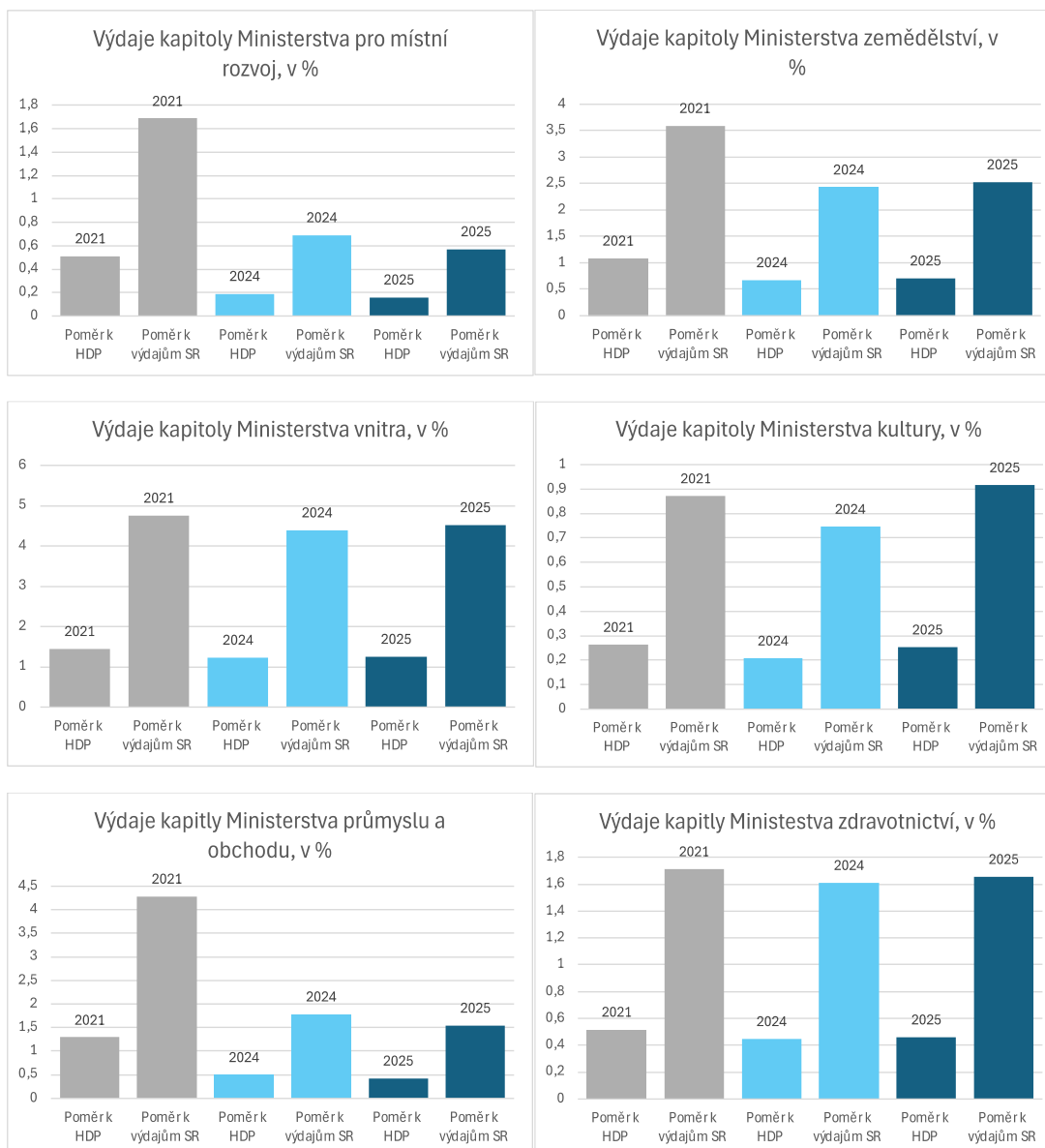
From the perspective of the main expenditure chapters, almost all of them recorded nominal year-on-year growth, with the only exceptions being the Ministry of Foreign Affairs, the Ministry of Regional Development and the Ministry of Industry and Trade. A more significant decrease is evident in the Ministry for Regional Development, in the nominal amount of almost CZK 2 billion. (a decrease of 13%). This ministry strongly objected to the submitted proposal and stated that in the current state of the approved budget, it will have to practically give up on supporting the stabilization and development of endangered areas, barrier-free access, the construction of elevators, the construction of infrastructure in tourism, etc. (Ministry of Regional Development, 2024). The Ministry of Foreign Affairs was also against it, stating that there may be restrictions on human

rights projects around the world, the closure of branches of Czech Centres abroad, the gradual cancellation of the organisation of cultural events abroad and further restrictions on the agenda (Chapter Booklet of the Ministry of Foreign Affairs, 2024).

The following graphs compare budgets in 2021, 2024 and 2025. As a result of runaway inflation, it was not possible to compare nominal variables. Therefore, the expenditures of the individual ministerial chapters are shown in the graphs in relation to GDP and to the total expenditure of the state budget in individual years.

**Graph 2 – 13:** Comparison of expenditures of selected chapters





**Source:** Ministry of Finance of the Czech Republic, 2024a, Ministry of Finance of the Czech Republic, 2024b, own calculations

## Problems of the state budget for 2025

The submitted draft of the state budget does not respect the basic principles of compiling the state budget, namely the principles of realism and completeness, in a number of items. Many items are underfunded or not precisely determined from the point of view of individual ministries. On the revenue side, the main problem is the calculation of revenues from emission allowances, which are planned at CZK 30 billion. Given the current price of allowances on the market, this estimate is extremely unrealistic and overestimated by approximately CZK 10 billion.

Similarly problematic is the increase in revenues from levies of organizations with a direct relationship to the state by CZK 8 billion. According to the Czech Fiscal Council, this is unlikely. If this income were to be realised, it would have to be partially included in the so-called super-dividend, which would mean that the state budget expenditure would have to be adjusted by approximately CZK 5 billion. while respecting the currently valid legislation (CFC, 2024).

The expenditure side of the state budget also contains several problematic items. The budgeted amount for pension insurance benefits is underestimated by CZK 5 to 7 billion. This repeats the situation from last year, when Minister Stanjura did not include the total expected amount of pension expenditure in his budget.

The budget also lacks CZK 27.8 billion for subsidies for renewable energy sources. The reduction of this amount to CZK 8.5 billion represents a serious risk factor, as the Ministry of Finance of the Czech Republic bases its predictions on unrealistic estimates of expenditure, which, moreover, are not supported by the currently valid legislation. The Energy Regulatory Office has quantified the need for a subsidy for next year at up to CZK 36.3 billion. The current solution proposed by the Minister of Finance, aimed at reducing the volume of funds for green subsidies, includes the introduction of individual checks on the internal rate of return and a change in the calculation of this percentage. These changes, together with the solution of negative prices (a situation where electricity does not find use), may partially reduce the necessary volume of subsidies, but a reduction of almost CZK 20 billion is extremely unlikely. In addition, the solution to negative electricity prices, when the market price falls to a negative value due to an excess of supply, should only be implemented from 1 January 2026 and therefore by its very nature cannot affect the budget for 2025.

Also, the expenditure limits of the chapter of the Ministry of Industry and Trade for 2025 in the submitted proposal do not include funds for repayable financial assistance intended for the construction of a new nuclear source. According to the current state of preparation, the drawing of this assistance is planned from April 2025. The launch of the project of a new nuclear power plant at the Dukovany site, based on data from the Dukovany II Power Plant, requires funds in the amount of CZK 13.5 billion, according to current assumptions.

Another problem is the insufficient provision of money for the salaries of non-teaching staff in the chapter of the Ministry of Education, Youth and Sports. The transfer of expenditure on the salaries of these workers to the founder, which should start from the new school year, is not part of the current legislation and should therefore be taken into account in the budget.

There is also a lack of funding in the chapter of the Ministry for Regional Development. The ministry lacks CZK 860 million needed to co-finance the drawing of EU funds, which may lead to the non-use of up to CZK 7 billion from European sources. Significant funds are also missing to help primary schools and address cyber security. In addition, the budget of the chapter for next year will have to be significantly increased for the implementation of the loan part of the affordable housing reform in the Czech Republic. Expenditure on this component is not included in the bill, but was promised by a government resolution in the amount of CZK 8.05 billion for 2025 and 2026.

The discrepancies in the submitted budget thus amount to almost CZK 70 billion, depending on the distribution over time. The only possible positive surprise may be financial resources from the European Union, especially funds from the Recovery and Resilience Facility (RRF), which are intended to support the recovery of the economy after the COVID-19 pandemic. However, even if the conditions for drawing funds from this instrument are adjusted, no additional funds can be expected, but only an adjustment of the timetable and extension of the eligibility period. From the point of view of the structural balance, any additional funds for the elimination of the consequences of the floods would have no effect, and therefore the risks of the submitted draft budget for 2025 are clearly negative.

## However, future budgets will hurt more

While the budget for 2025 is drawn up as a pre-election budget, it is highly likely that it will be defended at the end of the year by a government with a different composition than the current cabinet. Actual budgetary capabilities will be reflected in the preparation of the proposals for 2026-2028. The current level of the structural balance is planned for these years at -1.7% of GDP, but the limit of the structural balance will be reduced by 0.5 percentage points per year in this period until it reaches a maximum of 1% of GDP in 2028. This means that public finances must be consolidated by 0.5% of GDP (i.e. over CZK 40 billion) in the structural balance itself, i.e. adjusted for the economic cycle and one-off operations, by 2027 at the latest. In 2028, consolidation must continue by an additional 0.25% of GDP, again at the structural balance.

In addition, the management of municipalities and regions will still be in surplus in 2026 and 2027, but to a lower extent than in previous years. This will include, among other things, postponed investment projects that have to be reworked due to inflationary cost increases. These plans will be gradually implemented at significantly higher costs.

The future government also cannot count on such a dynamic growth in state budget revenues as in previous years. Between 2025 and 2026, there is to be a year-on-year increase in state budget revenues (excluding EU and FM) of only CZK 34 billion. In 2026, the collection of corporate income tax in the amount of CZK 212.6 billion will be at the level of the state budget. CZK, which means a decrease in collection by almost CZK 32 billion. (a decrease of 13%). The exemption of yields on government bonds issued after 1 January 2021 and the end of the windfall tax will also have a negative impact on collection. In addition, there will be a significant decrease in non-tax revenues, capital incomes and transfers received in 2026, by CZK 15 billion year-on-year. From this point of view, it seems that the budget for 2025 is only a preparation for the more demanding budgeting in 2026.

## Resources

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Martin Zeman graduated from the Faculty of Economics and the Faculty of Business Administration at the University of Economics in Prague. He also defended his dissertation at the University of Economics. He specializes in economic policy, fiscal policy and public finance. He is the author of several professional articles, speaks at international conferences and publishes commentaries in the media. For several years, he worked as an advisor to the Minister and also in other institutions dealing with public finance.

## Publisher



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