

# Selected Issues of Public Finance in the Protectorate of Bohemia and Moravia

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## Abstract

The paper looks into selected issues of public finance during World War II, i.e. the period of the Protectorate of Bohemia and Moravia. It focuses on the fiscal, tax and monetary policies and, subsequently, the fiscal, tax and monetary sovereignty of the Protectorate. The aim of the paper is to confirm or disprove the hypothesis of the non-existence of fiscal, tax and monetary sovereignty of the Protectorate of Bohemia and Moravia.

## Keywords

public finance; financial sovereignty; the Protectorate of Bohemia and Moravia

## 1 Introduction

Even though the paper covers one of the darkest periods in the history of our country, it is free of any emotional prejudice to the historical context and is of a purely apolitical nature. The paper can be described as partially financial-legal and partially historical.

The scientific purpose is to clarify selected issues of public finance in the Protectorate of Bohemia and Moravia, specifically the fiscal, tax and monetary policies. In connection with this scientific purpose, the following three hypotheses have been defined:

Hypothesis 1 – The Protectorate of Bohemia and Moravia did not meet the conditions of fiscal sovereignty.

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Hypothesis 2 – The Protectorate of Bohemia and Moravia did not meet the conditions of tax sovereignty.

Hypothesis 3 – The Protectorate of Bohemia and Moravia did not meet the conditions of monetary sovereignty.

For this purpose, the paper applies the method of analysis and synthesis, description and historical description. As for the current literature, the work of Jiří Novotný is of some interest (Novotný, 2006) where he describes in a comprehensive way both the public (or rather state) finance in the Protectorate of Bohemia and Moravia and the state finance in Czechoslovakia during the so-called Second Republic and in the post-war period. The publication *Public Finance in the Protectorate* (Bartes, 2016) is believed to be the most coherent publication dedicated to public finance in the period of World War II. This publication describes the condition and development of public finance (including local government finance) both in the period before the Protectorate of Bohemia and Moravia (i.e. the so-called Second Republic) and the subsequent post-war development, reflecting all Beneš Decrees that had an impact on the later development and, thus, the continuity or discontinuity of public finance after the war. This publication became the basic point of reference for this paper.

## 2 Fiscal Policy in the Protectorate

In terms of the theory of financial law, the fiscal part represents an incorporated set of financial and legal norms defining the social relations that arise, are implemented and vanish in the process of creating, distributing and using public funds (Mrkývka, 2014: 111).

State budget is the most important public fund. In the Protectorate, the state budget was necessarily affected by the introduction of the war economy, and therefore, it was hardly feasible to maintain the principle that the economy should be based on the relative benefits of money, time, space, etc. (Engliš, 1929: 56). During the occupation, the state budget deficit was high all the way, mainly due to the need to pay the so-called matricular contribution to the Reich. The amount of these contributions exceeded all scales existing thus far. It was the maximum amount that, according to the Germans, could be transferred from the Protectorate budget in this manner. However, the elevated taxes were not enough for the contribution and therefore it could never be made in cash. That is why it had to be covered by a loan which meant further indebtedness of the Protectorate. This was the reason why banks were forced to issue more money and this raised inflation in the Protectorate.

Since the state budget of the Protectorate was permanently in red numbers all through these years, the state debt naturally deepened. The budget for 1939 was initially governed by the budget provision adopted during the Second Republic. The “fully-fledged” budget for 1939 was subsequently adopted by a government regulation. In 1940, the budget was once again provisional because the Germans did not allow

the preparation of a proper budget. The main reason was the fact that the Germans anticipated the proclamation of a customs union between the Protectorate and the Reich which eventually happened on 1 October 1940. The budget process was different from the usual usage. At first, the budget was proposed as usual but its approval was being postponed while it was still being adjusted and the final approval took place only at the close of the budget period. For this reason, the economy was based on the so-called interim financial management which was adopted in the form of a government regulation. The first official Protectorate budget could not be prepared until 1941. In the last year of the war, the economy was managed without an official budget and a provisional budget was applied instead.<sup>2</sup> Due to the non-existence of Parliament or another similar institution, the approval of the state budget was in the remit of the Protectorate President even though the Reich Protector had the final word.

## 2.1 Fiscal sovereignty

Fiscal sovereignty *“is a situation where a community organised in a state is able to regulate public finance, manage its own resources autonomously and independently, to create its own fiscal policy, to decide on its public revenues and expenditures, and to organise its own centralised and decentralised funds”* (Mrkývka, 2014: 110).

Following such a definition of fiscal sovereignty, it can be stated that the fiscal policy of the Protectorate did not fulfil a single feature of this definition. The Protectorate cannot be “suspected” of being able to regulate its own public finance. Everything had to be adjusted to suit the war economy or rather the military needs of the Reich. As such, the Protectorate could not manage its finance autonomously, not to mention independently. After all, this fact is clear from the way in which the Protectorate budget was drafted. During the budget year, the financial management was absolutely “informal” according to the needs and instructions of the Reich. Then, the budget itself was prepared and adopted at the very end of the budget period without any influence by the Protectorate Government. For this reason, the Protectorate budget can be described as a mere formality.

All this is further illustrated by the fact that basically all resources of the Protectorate were transferred to the Reich in the form of a matricular contribution.

This confirms the validity of Hypothesis 1.

## 3 Tax Policy in the Protectorate

Many legislative changes and amendments of existing taxes took place over the period of the Protectorate but the tax collection system also changed. Some taxes were

<sup>2</sup> Budgets in the First Republic and Protectorate were made for a calendar year.

completely abolished and replaced by others; some were modified according to the Reich model. All changes took place in a gradual and sophisticated manner, always with the aim of strengthening the Reich budget at the expense of the Protectorate. The immediate administrative transition to the Reich–German tax system would have been too radical a measure. At first glance, the German tax collection system looked simpler but in fact when it was applied in the Protectorate, it proved to be less efficient than the Czechoslovak system. One reason was that our officials were familiar with the original system and there were not as many changes as there were in the later stages of the war.

As far as customs duties and indirect taxes (including state financial monopolies) are concerned, from the year 1940 on, they were paid straight to the Reich Fund and were no longer a part of the Protectorate budget revenues. The more important were the direct taxes for the Protectorate as they remained the revenue of the Protectorate budget.

Direct taxes have undergone a major reform during the occupation, resulting in not only a transition to the Reich system but also in an increase in individual taxes. For this reason, direct taxes became an important revenue of the Protectorate budget and their importance further increased. It was the only group of taxes that was increasing throughout the war. This was ensured mainly by the revenue tax which prevailed among taxes with a 62.5% share. As mentioned above, the employment was (namely in industry) almost full. By 1944, it had increased by 1/3 compared with the pre-war period (however, this was due to Germany's need to maximise the usage of production capacities). The second most important direct tax was the corporation tax which replaced the special income tax coupled with corporation income tax. These two taxes not only replaced the former special income tax but their collection managed to outperform it significantly. It should be made clear that although direct taxes were the income of the Protectorate budget, they were ultimately transferred through a matricular contribution to the Reich budget.

The public revenue of the Protectorate budget consisted of 95% *sensu largo* taxes which was the function of the Protectorate financial administration that followed up on the First Republic financial administration and it can be said that there were no revolutionary changes in the financial administration at the beginning of the occupation. Certain changes occurred only after 1 October 1940, i.e. after the customs union was introduced between the Protectorate and the Reich. The Financial Guard (the executive financial authority representing an armed and uniformed component of the financial administration carrying out the border guard service where it mainly prevented the evasion of customs duties) was abolished and the administration of duties, excise taxes and state monopolies was distributed between the Protectorate authorities and the Reich authorities. While the Reich authorities managed the administration of customs duties, excise taxes and state monopolies in contact with foreign countries, i.e. on the borders of the Protectorate and the Slovak State, the Protectorate authorities operated within the Protectorate. The Protectorate tax authorities were subordinated

to the Chief Financial Officer as regards the administration of taxes, excise taxes and monopolies; at the personal level, they were subordinated to the Protectorate Minister of Finance. The authority of the Ministry was largely curtailed though.

### 3.2 Tax sovereignty

Tax sovereignty is defined as *“the ability of the State to impose, collect, recover, and exact taxes and allocate them in funds designated by the State”* (Mrkývka, 2014: 110).

Although the Protectorate was able to impose, collect and exact taxes, by analysing the flows of individual tax revenues in the Protectorate tax system, it is impossible to describe the subsequent Reich-imposed allocation and management of these revenues as liberal. Everything was subordinated to the war economy and the necessity to satisfy Germany’s needs. The Protectorate of Bohemia and Moravia could only stand by and see how its tax money was being decided about and distributed.

This chapter confirms the validity of Hypothesis 2.

## 4 Monetary Policy in the Protectorate

In the past, there have been cases where the occupation administration used the method of issuing so-called military money, which was intended exclusively for the occupied territory.<sup>3</sup> However, due to the previous, not positive, experience with this method, the German administration decided not to apply it, and instead, from 22 March 1939, the Czech Korunas were exchanged for Reichsmarks brought in by the occupying army. The reason for the exchange was to prevent double currency circulation on the territory of the Protectorate. Less well-known is the fact that Austrian coins and Groschen were also a legal currency in the Protectorate until 1942.

In the Protectorate, the Reichsmark became the basic currency and the Koruna was used in parallel or rather as the second in order until its withdrawal. Germany reckoned on introducing the Reichsmark from the beginning of the Protectorate because it was mentioned in Hitler’s declaration on the establishment of the Protectorate (in Art. 10 of Hitler’s order no. 75/1939 Sb. z. a n., on the Protectorate of Bohemia and Moravia) that the legal currency in Bohemia and Moravia would be the Czech Koruna but only as a subsidiary currency of the Reichsmark. At the same time, the Reichsmark was put into circulation at the rate 1 RM = 10 K. However, this internal rate did not apply to the Koruna’s rate with respect to other foreign currencies, so in the international currency markets the Koruna was recorded separately until the customs border was abolished. However, this rate favoured the Reichsmark by more than a third because the actual rate should have been six Korunas for one Reichsmark. This underscored

<sup>3</sup> For example, during World War I the Austrian administration in the occupied Italian territory issued military currency which the local citizens used only if forced to do so.

rate of 1:10 became realistic as late as in 1941, i.e. after three years of the Protectorate's existence. The position of the Koruna toward foreign currencies changed on 1 October 1940 with the introduction of a customs union when the same exchange rate of the Koruna was established for foreign currencies. Thus, the Koruna was deprived of its status as a separate currency in foreign exchanges. It was the ultimate move of the Reich to deprive the Protectorate of autonomy in its dealings with foreign countries. From that moment on, the Koruna became only a domestic currency. At the same time, however, its value was increased and its gold content grew by 14.8%, from 31.21 mg to 35.84 mg (Olšovský, 1963: 552). This appreciation resulted from the fact that the exchange rate of the Reichsmark to the Koruna was relatively high 1 RM = 11.84 K. By that time, the Koruna's exchange rate against foreign currencies was more real than that of the Reichsmark's that was deliberately overvalued (Novotný, 2006: 19). Until 1 October 1940, the Protectorate had the opportunity to monitor the quantity of goods exported and imported from and to the Reich and thus, knowing the difference between the actual and dictated purchasing power of our Koruna against the Reichsmark, it was able to calculate the difference of which it was deprived by the dictate (Chmela, 1946: 29). With the loss of the Koruna's autonomy vis-à-vis foreign countries, the trade treaties of the Protectorate with other states became invalid.

A gradual devaluation of a state's currency is a frequent way in which the occupation administration uses the occupied state to finance its war needs. In case of the Protectorate, the occupation administration did so right from the start in such a significant way that further devaluations would not have been feasible. Notwithstanding the fact that the Czech people were already quite outraged at German interventions, not only in economic affairs of our country.

The introduction of the Reichsmark as an official currency had another, albeit transitory, aspect at the beginning of the Protectorate. For all German citizens, our territory was very cheap at that time. It is not surprising that after 15 March, German civilians and members of the Wehrmacht swarmed to Prague and other Czech towns buying everything that they could put their hands on (Olšovský, 1963: 571). Everything was extremely cheap for the Germans in the Protectorate. From March 1939 until the war began, there was enough merchandise in shops and the Germans or German soldiers bought almost anything they could. They had to be served preferentially and were able to sit in sweetshops and cafes almost all day long. This did not last long, though, because a few months later they had to go to the front and fight in Poland. This behaviour of the Germans during this short interim period brought great prosperity to many establishments, especially restaurants, sweetshops and pubs.

This was accompanied by another thought-out move by the Germans, who managed to freeze the purchasing power of the Czech population. This was related to the introduction of the controlled war economy, the rationing system and the wage or price caps. As the population had money (though almost worthless) with which there was nothing to be bought during the war, in fact it became another source for

the financing of the war. This value of deferred purchasing power at the end of the war was estimated at 120 billion K.

As far as inflation was concerned, its level was best observed in some consumer goods. While in the rationing system, the official price of raw pork lard, for example, was 19 K for the whole six years, in the black market in 1945 it was as much as 1,800 K (Novotný, 2006: 20–22). It was in the last two years of the war that black market elements interfered with the strictly regulated prices and rationing economy. Money had lost its function and was replaced by barter exchange (mainly cigarettes were traded that were rationed to each adult citizen) (Vencovský, 2003: 100).

The National Bank for Bohemia and Moravia was the central bank of the Protectorate. The Bank was given a specific task for which the Germans allowed its existence as a Czech financial and monetary institution. The task was to be an efficient tool for draining any resources from the Protectorate for the needs of the Reich's war economy. Already on 15 March 1939, a representative of the German Reichsbank, Friedrich Müller, accompanied by a large group of SS members arrived at the building of the Bank for Bohemia and Moravia. He announced that they would take over the institution and under the threat of death, forced the representatives of the bank František Peroutka and Josef Malík to sign the transfer of gold deposited in London to the Reichsbank.

#### 4.1 Monetary sovereignty

Monetary sovereignty is the power of the state to exercise exclusive legal control over its currency (Mrkývka, 2014: 94).

In view of the above, it can be stated that the Protectorate was unable to fulfil this necessary condition of monetary sovereignty. The Protectorate was not only unable to control its own currency but it was forced to accept a foreign currency.

For these reasons Hypothesis 3 can be confirmed.

## 5 Conclusion

The scientific purpose of this paper was to clarify selected issues of public finance in the Protectorate of Bohemia and Moravia, taking into account the fiscal, tax and monetary policies of the Protectorate. This was achieved mainly by the overall analysis and synthesis, and historical description of fiscal, tax and monetary policies during the Protectorate period. As a result, all three hypotheses set out in the introduction of the paper could be confirmed.

Within the framework of the fiscal policy of the Protectorate, we clarified the issue of budgeting during the war period which was based on the “informal principle” and was fully subordinated to the German war needs. In addition, the role

of the matricular contribution as a forced payment was mentioned which was the Alpha and Omega of the Protectorate economy. The Protectorate tax policy then served to drain funds from the Protectorate into the Reich budget, either in the form of direct transfers (in case of indirect taxes and customs) or indirect transfers (in case of direct taxes which were the revenue of the Protectorate budget but ultimately transferred to Germany through the matricular contribution). Also subject to the war needs or rather the war economy was the monetary policy of the Protectorate in which the Reichsmark was introduced as the basic currency with an artificially undervalued exchange rate of 1:10 in favour of the Reichsmark against the Koruna. The central bank was practically in the hands of the Germans.

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