French Monetary Policy (1981-1985): A Constrained Policy, between Volcker Shock, the EMS and Macroeconomic Imbalances

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Abstract

The election of François Mitterrand to the French Presidency in 1981 drastically changed French economic policy. The government launched a Keynesian-inspired stimulus plan in order to restore growth and fight unemployment, whereas the Bank of France was obliged to maintain high interest rates. In 1983, the government had to change its policy: this was the turning point toward austerity. Whereas the secondary literature focuses on the impact of external constraints on fiscal policy and underestimates the impact on monetary policy, this paper aims at investigating the factors that prevented a French Keynesian policy mix by emphasizing the elements that hindered the support of the Bank of France to the stimulus plan, and those which thereafter gave new margins of manoeuvre to French monetary policy. The consideration of new primary sources provides new insight into the decision-making processes of the central banks, and revises the standard analysis of this period.

1. Introduction

Any historical survey of the economic policies in the 1980s can hardly ignore the importance of the election of François Mitterrand to the French Presidency, and the economic policy subsequently put in place during 1981-82. This policy distinguished itself by its originality, compared to those pursued during this same period. The presidential and legislative elections of May and June 1981 are indeed a major turning point in French political history. In opposition for three decades, the Left finally came to power, after a series of successive failures in important elections following the adoption of the 1958 Constitution.

The Giscard years (1974-1981) can be characterized by the end of the golden age of the post-war years, and the beginning of a period of 'stagflation': a combination of economic stagnation, which increases unemployment, and an outbreak of inflation, in particular imported inflation, linked to the increase of oil prices. In keeping with campaign promises, the new socialist President Mitterrand and his Prime Minister Pierre Mauroy introduced, beginning in June 1981, Keynesian stimulus measures[1] intended to accelerate French economic growth and to fight against unemployment[2].

Some commentators presented the policy change that took place between May 1981 and March 1983 as the *Tournant de la rigueur* ('the turn towards austerity'), when the initial stimulus plan was gradually replaced by an austerity policy, because of the international economic environment. This interpretation suggests that austerity policies pursued by most major world economic powers like the United States of America, the United Kingdom and the Federal Republic of Germany completely counteracted the recovery policy pursued by the Mauroy government. For instance, Muet and Fonteneau (1985), Cameron (1988), Favier and Martin-Roland (1990), Christofferson (1991), Tiersky (2003), Bernstein, Milza and Bianco (2011) *et al.*, despite insightful contributions, tend to underestimate the relevance of monetary aspects in the explanation of the policy changes. Now, one can hardly ignore the monetary environment within which the French currency operates, and, therefore, how French monetary policy is implemented. The reason is that the external constraint has an impact not only on fiscal policy, but also on monetary

[1] Kindleberger (1984, p. 463) speaks about Mitterrand's 'proclivity for Keynesian intervention'.

[2] Favier and Martin-Roland (1990, p. 130) notes that the 'social' stimulus plan introduced in 1981-82 has a cost of 60 billion francs, that is to say approximately 2% of French Gross Domestic Product, less than Chirac's stimulus plan of 1975-76 (2.8% of French GDP). Asselain, in Bernstein, Milza and Bianco (2011, p. 399), speaks about 'dwarf stimulus' ("relance naine"). See also Muet and Fonteneau (1985).

policy. Using primary sources to complete the standard analysis, this paper focuses on the monetary aspects of the external constraint. In this perspective, it offers a strengthening of the analysis of the international monetary instability in the 1980s, highlighted by Kindleberger (1984), Eichengreen (2007; 2008; 2011) *et al.*, by focusing on the French case.

Moreover, the paper relies on new sources, such as the French central bank's Minutes of the General Council, and the Annual Reports of the central banks of the European Monetary System ('EMS'). The relevance of the Minutes of the Bank of France has been stressed by Plessis (1982; 1985) and a similar research method has also been used by Cavaterra (1998), Blancheton (2004) and Mouré (2012) to study French monetary policy during other historical periods. We thus provide new insights into the economic thought of the leaders of these monetary authorities, as well as their decision-making processes during the early 1980s.

The main purpose of this article is therefore to renew the analysis of the early 1980s. The consideration of new primary sources and the interlinking of the points-of-views from different central banks allow a new interpretation of the period under review, identifying three major elements of constraint for French monetary policy. In the light of these sources, it is claimed that French monetary policy could not be a reflationary policy of Keynesian inspiration for three major reasons: (i) the evolution of American monetary policy, (ii) membership in the EMS, and, finally, (iii) the macroeconomic imbalances which weighed on the French economy[3].

This characterization of the period corresponds to the main concerns of the European monetary authorities. They mainly focused on the direct consequences of American monetary policy during the phase of 'benign neglect' (§2.1) and underlined the new margins of

[3] For Lacouture (1998), three elements hindered the economic policy of the Mauroy government: 'prohibitive' American interest rates, announced growth in the second semester 1981 that would never come, and the transformation of additional purchase power of French households into imports.

manoeuvre arising from the phase of close cooperation (§2.2). The main European central banks were also concerned by the indirect consequences of the FED's policy on EMS' parities (§3). Moreover, the monetary authorities made scathing criticisms of the French stimulus plan (§4.1) and, thereafter, welcomed the turn towards austerity (§4.2).

2. American monetary policy: from the Volcker shock to the Plaza's agreements

The first element of constraint which prevented monetary policy from being a reflation policy, in support of the fiscal policy of the Mauroy government, is American monetary policy[4]. At the head of the American Federal Reserve since 1979, Paul Volcker targeted limits on the annual growth of American money supply and let interest rates rise as high as the market wanted to meet the strong reduction in liquidity in the United States, to break the inflationary spiral which has affected all the developed countries since the second oil crisis. One can speak about restrictive monetary policy, to decrease the quantity of money in circulation, that is to say to restrict the growth of the money supply[5]. Rather of technical supports, it is the orientation of the policy that is changing under Chairman Volcker. This policy is the exact inverse of the expansive Keynesian monetary policy[6].

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[4] President Mitterrand tried to convince others heads of states and government to change their economic policies, pleading for coordinated stimulus plans. He also tried to obtain a shift in U.S. monetary policy, especially at the G7 Summits of Versailles and Williamsburg, but without success. Pogorel (1984, p. 67) notes that these summits were totally ineffective and underlines the total lack of coordination among major economic powers, particularly in terms of stabilization of currencies.

[5] Kotlowski (2000, p. 158) speaks about 'Volcker shock', saying that all European currencies fell against the dollar from 1980 until 1985, because of the Federal Reserve's policy. According to him, the 'dramatic' rise in the dollar exchange rate has worsened the effects of the second oil shock for all Europe, except Britain and Norway, who were now exporting oil. Eichengreen (2008, pp. 144-145) speaks about 'dramatic appreciation' of the U.S. currency, and about the scant willingness to bring U.S. interest rates down and render the dollar less attractive to foreign investors.

[6] See Adda, Colin, Colange, Fouet, in Jeanneney (1989, pp. 54-69).

The American monetary policy has several consequences: it contributes considerably to the appreciation of the dollar (from FF 4.50 at the beginning of 1981 to more than FF 10.50 at its peak in February 1985), which makes the cost of French imports more expensive, in particular oil imports, that are denominated in dollars[7]; furthermore, FED policy considerably stimulated the movement of capital, which developed in the United States due to American interest-rate levels.

This massive movement of capital to the United States thus leaves the European countries generally, and France in particular, with investors being far from reassured by the election of the socialists and the communists[8]. The government had to deal with a 'wall of money', as under the Popular Front government of 1936 when the flight of foreign capital aggravated the financial deficit[9].

Figures 1 and 2 show the concordance between the key interest rates of the Federal Reserve, the German Bundesbank and the Bank of France. The interest-rate movements are coordinated, because these often take place at the same moments, follow the same directions and appear to be of similar amplitudes[10]. An important critical juncture is the fact that both French key and 'Lombard' interest rates became higher than American rates in 1981, the starting point of the particular period under review.

This aspect of the international economic, monetary and financial environment, connected to American monetary policy, was characterized by Quinn and Harvey (1998), Kotlowski (2000), Eichengreen (2008) et al., as being particularly binding for the European economies, as stated by Mitterrand (1996) and politicians themselves.

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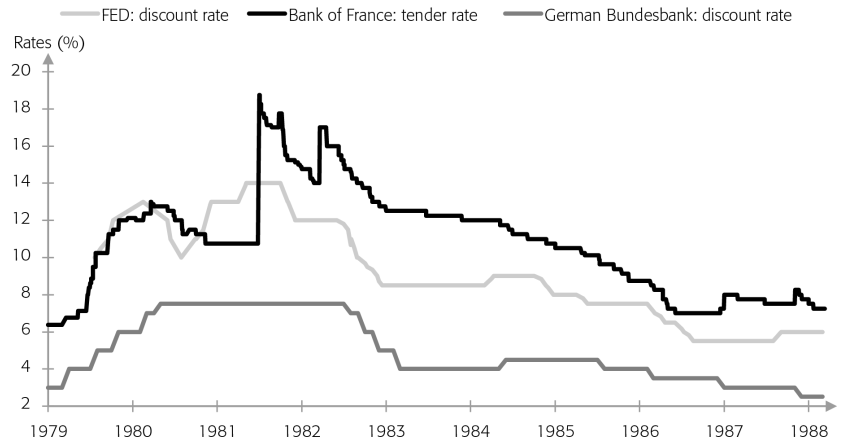
[7] Delors (2004, p. 167), Minister of Economy and Finance between 1981 and 1984, explains that the increase of the dollar, from 1981 until 1985, was the equivalent of a third oil shock.

[8] Battilossi, Foreman-Peck and Kling, in Broadberry and O'Rourke (2010, pp. 360-390), explain the turn towards austerity of 1982-83 especially by capital flight.

[9] See Duchaussoy (2011).

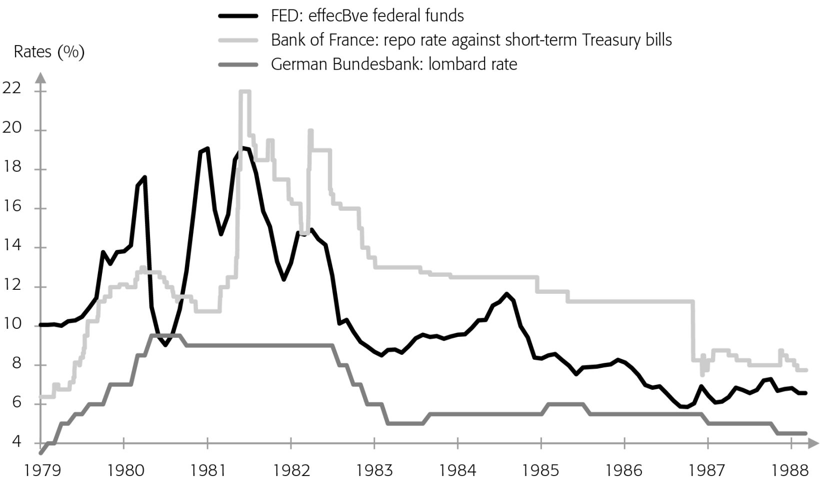
[10] Attali (1993, p. 26) notes that both nominal and real interest rates are, in all countries, close or equal to their historical summits, in May 1981. Fiscal cuts made by the Reagan administration tend to oblige the United States to maintain interest rates at 'unsupportable' levels.

FIGURE 1
Key interest rates of the American Federal Reserve System, the German Bundesbank and the Bank of France, 1979-1988



Sources: Bank of France: Annual Reports, Federal Reserve System: Federal Reserve Economic Data, Deutsche Bundesbank: Statistics.

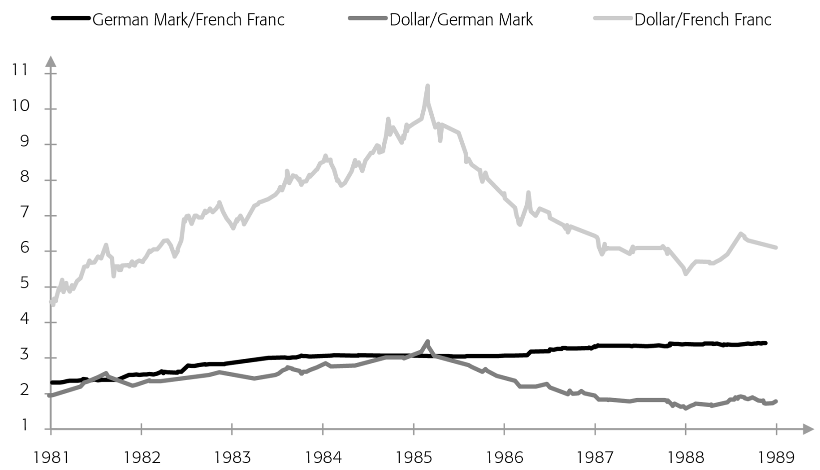
FIGURE 2
"Lombard" interest rates of the American Federal Reserve System, the German Bundesbank and the Bank of France, 1979-1988



Sources: Bank of France: Annual Reports, Federal Reserve System: Federal Reserve Economic Data, Deutsche Bundesbank: Statistics.

Figure 3 illustrates how the currencies of the United States, Federal Republic of Germany and France evolved between 1981 and 1988. The major turning point takes place during 1985, when the dollar, after having reached a historic summit, begins falling further after concerted operations by the central banks, decided upon during the New York agreements on 22 September 1985[11].

Figure 3
Exchange rates of the U.S. dollar, the German mark and the French franc, 1981-1988



Source: Minutes of the General Council the Bank of France.

The considerable rise in the dollar, from 1981 until 1985, is therefore a fundamental element of external constraint for the French economy, as well as for monetary policy led by the Bank of France. This is taken into account from the beginning of the period under review by the French monetary authorities.

[11] De Grauwe (2007, p. 72) explains that the appreciation of the American currency went much farther than the inflation differential between the United States and other industrial countries, saying that the dollar deviated substantially from its purchasing power parity.

2.1 *French Keynesian stimulus plan hampered by American monetary policy*

Even before the election of Mitterrand to the French presidency, this external constraint, being bound to American monetary policy and to the evolution of the dollar, can be seen.

During the session of the General Council of the Bank of France, on 8 January 1981, Renaud de La Genière, Governor of the French central bank from 1979 until 1984, specifies that any intervention tending to decrease the tensions in the EMS risks the weakening of the franc in the international monetary system, in particular with regard to the dollar, whether it is by the circulation of important quantities of liquid assets denominated in francs, or by a modification of its key interest rates[12].

On 16 April 1981, Governor La Genière summarizes the policy of the Federal Reserve stating: "The American monetary authorities recommend a completely clear policy, asserted for numerous months and rather reinforced by the arrival of the new administration. They try to control the internal money supply by a very strict supervision of the Federal Reserve System regarding the creation of central bank money and they show, at the same time, a very great reluctance to act on the consequences of this policy concerning internal interest rates or exchange rates. Given such a situation, we can understand that certain European countries are led to practise an interest rate policy which does not correspond to the necessities of their own internal situation, but to the necessities of supporting their currency on the foreign exchange market"[13].

There is a discrepancy between monetary policies dictated by

[12] Mitterrand (1996, p. 173) relates that, since April 1981, the rising dollar was stifling the French franc. The day after his election, there was panic on the stock exchange. In a few days, the decline reached 20% and the franc fells to its floor within the EMS. The government proceeded on a drastic strengthening of exchange controls and carried the Lombard interest rate of the Bank of France to 22%. The visit of the German Chancellor Schmidt and their agreement on monetary solidarity put a brake on the stampede.
[13] Bank of France, Minutes of the General Council (MGC), 1981, Minutes of 16 April.

the internal situation of European countries and policies that allow the maintenance of the external value of these European currencies, to the detriment of the former.

Three months later, La Genière, while discussing the appreciation of the dollar on the foreign exchange markets, declared: "This very worrisome situation can obviously thwart the efforts which can be made as regards French internal interest rates"[14].

The Bank of France wished, indeed, to proceed to regular decreases of key interest rates, when the successes in the fight against inflation are recorded, so as to decrease the credit charges for economic agents, companies and households, but this potential policy was prevented by American monetary policy[15].

This point-of-view is fully shared by the leaders of the Bank of Italy, who said: "Real interest rates remained at exceptionally high levels. In view of this situation and the continual appreciation of the dollar, the conflict between domestic and external objectives induced the other industrial countries to be especially cautious about modifying their monetary policy stance in order to avoid exacerbating the tendency for their currencies to weaken against the dollar"[16].

In essence, the external preservation of the value of the franc in the international monetary system, by maintaining an interest rate difference between France and the United States, overrides internal economic development, to the detriment of the evolution of the real economy, and at the expense of the implementation of a real Keynesian 'policy mix', where the monetary policy of the Bank of France would accompany the expansionary fiscal policy organized by the Mauroy government.

On 1 October 1981, Governor La Genière underlined the fact, that during the annual meeting of the International Monetary Fund, American monetary policy was the object of deep criticisms, by both developed countries and developing economies, which testifies to

[14] *Ibid.*, Minutes of 9 July.
[15] See also Frochen, Sterdyniak and Topol, in Jeanneney (1989, pp. 281-308).
[16] Bank of Italy, Report for the Year (RFY) 1982, pp. 11-12.

the problematic reach of this monetary policy and of its global influence.

On 27 May 1982, La Genière specifies that, for several years, the attention paid to the rise of U.S. interest rates and to their wide fluctuations, was because these developments could not be compared with what we had known till then in this domain, and had only a rather distant relationship with the relative situation of the American economy and other Western economies. He asserts: "The gaps between the situation of the fundamental elements which characterize the various economies and the interest rates entailed lead doubtless to very big uncertainties and very strong disturbances on the foreign exchange markets. The evolutions of the exchange rates and the strong appreciation of the dollar during the last few years were connected to credit spreads"[17].

During the usual presentation which he makes to introduce the debates during sessions of the General Council of the Bank of France, on 2 September 1982, the First Deputy Governor, Alain Prate, explained the reductions, during the last fortnight, by the central banks of numerous economic powers. The reduction in the American discount rate (decreased from 10.5 to 10%) was followed by similar measures taken in other countries: reduction in the discount rate from 19 to 18% in Italy; decreases in the discount rate, from 7.5 to 7%, and of the Lombard rate, from 9 to 8%, in West Germany; reduction of the Swiss and Dutch key rates; progressive reduction in the interest-rate in the interventions in the money market of the Bank of England; and finally reduction in the tender rate of the Bank of France from 14.25 to 14%[18].

After a modification of the intervention rate of the American Federal Reserve System, the European central banks act in unison, con-

[17] Bank of France, MGC, 1982, Minutes of 27 May.

[18] Giavazzi and Giovannini (1986) affirm that changes in European bilateral exchanges rates tend to be associated with fluctuations in the dollar: in particular, the mark tends to appreciate against other European currencies when the dollar depreciates. They add that most of realignments in the EMS usually take place after strong movements of the dollar.

ducting their modifications of intervention rates at the same moment, in the same direction and these variations seem to be of similar amplitude. American monetary policy determines, before all other considerations, the monetary policies of the European central banks.

Indirectly, the United States strengthened European monetary cooperation from 1982. This is even more obvious from 1984.

2.2 From 'benign neglect' to international cooperation

A new phase opens in September 1984 with the progressive awareness of the adverse effects provoked by the high level of the dollar on the American economy: the joint operations of the central banks to limit the appreciation of the dollar begin[19]. The dollar peaks in February 1985, and then begins to fall gradually, before the New York agreements, signed in September 1985, which officially define the cooperation to be led by the main central banks to organize this diminution[20].

The first signs of this major change are quickly understood by the managers of the French central bank, because, from 27 September 1984, La Genière asserted that European countries and Japan opted for joint central-bank action, an operation envisaged by the Americans, with, perhaps, a little less reluctance than usual. The Governor asserts: "The new presence of central banks for numerous weeks was found and, not knowing either the tactics or the degree of determination of the latter, the operators were led to take more careful positions. It remains however that these movements of capi-

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[19] Quinn and Harvey (1998) state that, from the Second World War, the U.S. exchange rate policy was cyclical, and except when urgent payments problems have emerged, U.S. policy makers have preferred an attitude of 'benign neglect'. Attali (1993, pp. 826-827) relates that he met Donald Regan, U.S. Secretary of Treasury, and Volcker, on Friday 7 September 1984, who announced to him that U.S. dollar and FED's interest rates will probably weaken.

[20] Eichengreen (2008, p. 145) states that after June 1984 the rise of the dollar is not explained by interest rates or macroeconomic fundamentals, but rather by a speculative bubble. From June 1984 until February 1985, the U.S. currency appreciates 20%, whereas U.S. interest rates begin to fall.

tal are the fundamental reason behind the differences between the interest rates of the currencies. As long as these differences are not absorbed, or at least reduced, by a reduction in rates in the United States, it will not be possible eventually to contain the amplitude of the dollar exchange rate inside narrow enough margins"[21].

Governor La Genière still imputes to American monetary policy the responsibility of the international economic, monetary and financial issues. He states that the reduction of key rates of the Federal Reserve must be strenghtened.

Michel Camdessus, Governor of the Bank of France from November 1984 until January 1987, while discussing on 14 February 1985 the 'changing of the guard' taking place in the United States, at the head of the Department of the Treasury or the Federal Reserve of New York, argues that the new American management team does not share the attitude of 'benign neglect' which characterized the previous one[22]. It shows that American authorities became more sensitive to public opinion. Camdessus asserts that the American authorities are henceforth inclined to manage a 'soft landing' of the dollar with their partners.

For its part, the Bank of Italy explains the turnaround in the dollar by highlighting the lower U.S. economic growth, and the concerted operations of the central banks: "The upward course of the U.S. currency came to a halt only when signs of a slowdown in U.S. economic growth appeared and only when […] concerted action by central banks of the main industrial countries reminded the markets that exchange risk is not a one-way proposition"[23].

The progressive depreciation of the dollar beginning in February 1985, gives the Bank of France new margins of manoeuvre, in parti-

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[21] Bank of France, MGC, 1984, Minutes of 27 September.
[22] Volcker, in Feldstein (1994, p. 150), asserts that: 'The dollar had reached a peak in early 1985, and there was continuing debate both in the United States and overseas about market intervention. Treasury Secretary James Baker and Deputy Secretary Richard Darman were more inclined to intervene than previous Treasury officials had been, and the meeting at the Plaza was largely at their initiative'.
[23] Bank of Italy, RFY 1984, p. 133.

cular in reducing its key interest rates, explains Governor Camdessus in July, asserting that the international interest-rate situation is now clearly prepared for reduction. This decrease in international rates allows the Bank of France to set up a more accommodating monetary policy, shaped to the successes obtained in the fight against inflation.

On 18 July 1985, while the dollar begins to fall over the course of a few months, Camdessus confirms this idea by specifying that: "The international interest-rate situation is now clearly in favour of reduction, which has driven Government of the Bank to consider that it was possible to lower the intervention rate again"[24].

This major turning point in the evolution of the dollar and American monetary policy is confirmed during the signing of the New York agreements, on 22 September 1985, in the Plaza Hotel, between the Ministers of Finance from five major world economic powers. The agreements specify that joint interventions from the five main central banks must be organized, to lower the exchange rate of the dollar. Quickly, the American currency loses approximately 8% of its value[25].

The Governor of the Bank of France explains as well that American public opinion brings the Reagan Administration to consider as indispensable the resumption of the operations of the Federal Reserve, by improving as much as possible the conditions of cooperation with the main central banks.

American monetary policy therefore exerts strong pressure on

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[24] Bank of France, MGC, 1985, Minutes of 18 July.

[25] Attali (1993, pp. 1012-1013) notes that a secret decision is taken, during the Plaza meeting, by the Ministers of Finance: the depreciation of the dollar should be on the order of 10-12%, that is to say that the American currency should reach 8 francs and 2.65 marks. The central banks will share the costs of intervention on exchange markets: 30% for the Federal Reserve, 30% for the Bank of Japan, 25% for the German Bundesbank, 10% for the Bank of France and 5% for the Bank of England. The French special advisor adds that these agreements launch coordinated interventions from the main central banks, for the first time since the end of Bretton Woods, in 1971. Attali attributes this ideological turn to the arrival of David Mulford at the head of the Department of the Treasury.

French monetary policy, the evolution of the intervention rates of the Federal Reserve exercising a strong effect on the intervention rates of the European central banks generally, and on those of the Bank of France in particular. The French monetary authorities thus aim to limit the interest-rate difference with the United States, so as to restrict the movement of capital, which is naturally attracted towards countries with higher interest rates.

The key role of the dollar in the international monetary system is widely highlighted in the reports of the General Council of the Bank of France, as well as the fatal consequences of its vertiginous rise, but these, of considerable importance between 1981 and at the beginning of 1984, seem to ease from the end of 1984 and the beginning of 1985, reflecting the change of attitude of American economic and policymakers, and the increased awareness of the fatal effects that a strong dollar could have for the American economy.

3. The indirect consequences of the fluctuations of the dollar on the European Monetary System

A second element influenced the monetary policy led by the Bank of France: it concerns certain indirect consequences of American monetary policy and the evolution of the dollar, in particular on the franc-mark parity within the EMS[26].

As the key-currency of the EMS, because of the hegemony of the German economy on the continent, as stated by Giavazzi and Giovannini (1986, 1988), Cohen, Mélitz and Oudiz (1988), Krugman and Obstfeld (2003)[27] *et al.*, the German mark constitutes a safe inve-

[26] Kotlowski (2000, p. 159) explains that realignments were frequent in the early years of the EMS, coerced by the Volcker shock. They thus took place in September and November 1979, again in March and October 1981, in February and June 1982, in March 1983 and finally in July 1985.

[27] Krugman and Obstfeld (2003, pp. 688-689) identify two main reasons why the EMS was created: the desire to defend more effectively the economic interests of Europe on the world stage and the ambition to achieve a stronger economic unit internally. The authors defend the theory of the credibility of the EMS: by fixing their exchange rate

stment during periods of occasional reductions in the American currency. The appreciation of the exchange rate of the mark within its fluctuation band, defined by the EMS, obliged the French monetary authorities to defend the value of their own currency, by exhausting their exchange reserves, as was the case in mid-September 1981

The First Deputy Governor, Prate, in his usual presentation, discussed a deep and continuous reduction in the American currency until Monday 21 September, which strenghtened the German currency, to the detriment of the weakest currencies.

On 18 February 1982, La Genière comments on the situation of the various major currencies on the foreign exchange markets: "The reasons for this situation are always the same. They are not fundamental economic reasons. The Deutschmark is not really weak […] but its position on the foreign exchange market is opposed by the level of American interest rates. The difference of interest rate between Germany and the United States became very important"[28].

There is thus a particular link between the American economy and the German economy which, first of all, determines the evolution of the parity dollar-mark[29]. Governor La Genière also explains that, when the mark weakens with regard to the dollar, the franc also weakens, but the latter resists better because the movement of capital between West Germany and the United States are disproportionately greater than those that occur between France and the United States.

The managers of the German Bundesbank assert, about year 1982: "Around mid-year the Bundesbank felt that no further interest-rate cuts were possible for a while. Heavy capital outflows to other countries and the renewed weakness of the Deutsche Mark against the dollar showed that the chances of a marked monetary

against the German mark, others EMS countries were reflecting the credibility of German monetary policy, especially concerning the inflation rate. They thus discouraged their own inflationary pressures.

[28] Bank of France, MGC, 1982, Minutes of 18 February.

[29] Denizet (1982, pp. 263-264) points out that, as soon as the early 1980s, one of the two main failures of the EMS was the lack of a common strategy with respect to the development of foreign currencies, mainly the dollar and the yen.

relaxation 'against the current' of international interest rate movements were slim"[30].

So, as it hinderd the conduct of French monetary policy and the exchange rate of the franc, American monetary policy opposes the holding of the mark on the foreign exchange market, as well as the conduct of monetary policy organized by the Bundesbank[31].

On 6 January 1983, La Genière explained that the franc is subjected henceforth to the consequences of the fluctuations of the mark with regard to the dollar: the movements of capital which leave the United States for West Germany, while the current transactions of this last country are now in balance, entail a considerable strengthening of the mark. As France does not benefit from such an inflow of capital, to preserve the parity of the franc with regard to the mark, it was necessary to bring currencies onto the market[32].

The interventions, which the Bank of France was obliged to make, during occasional phases of reduction in the dollar, caused additional draining on exchange reserves. One can understand the indirect, but inevitable action, on the relationship between the dollar and the mark, on the evolution of the franc-mark relationship and on French monetary policy, the Bank of France and the Exchange Stabilization Fund[33] exercises being, on numerous occasions, forced to sell currencies put in reserve to buy back francs and stabilize the exchange rate with the currencies of the community system.

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[30] German Bundesbank, RFY 1982, p. 32.

[31] Ullmo (1987, p. 315) notes that one could fear that the mechanism of fluctuation margins, the cornerstone of the EMS, could not resist to the backlash of the U.S. dollar, especially when the American currency fell.

[32] Giavazzi and Giovannini (1988, p. 659) argue that the EMS is just a 'mark zone'. They note, among the factors of asymmetry within the EMS: the argument of the "optimal weight adjustments" of Mundell (1968), as well as the motivations to align with a stable currency, which are the probable explanations that reinforce the relatively greater weight of West Germany in Europe and the reputation of its anti-inflationary policy. Cohen, Melitz and Oudiz (1988) declare that the EMS seems to have worked well as a relatively flexible way to impose German monetary policy. Authors say that negotiations surrounding parity readjustments provide the framework for greater coordination.

[33] The French name of this fund is "Fonds de Stabilisation des Changes".

From May 1981 until March 1983, the relative weakness of the mark with regard to the dollar leads to a relative appreciation of the franc, even if the preservation of the franc-mark parity, considering the cyclical gap between France and West Germany, and considering the inflation differential between these two major European countries, constitutes another element of external constraint, which places limits on French economic policy[34].

Once austerity policy is endorsed, the cyclical gap between both European powers diminishes, but the Bank of France had to maintain the parities fixed during the general realignment of the European currencies of March 1983[35].

The continued appreciation of the mark with regard to the franc was perpetuated, even if the French currency continues to be favoured by the firmness of the dollar with regard to the mark. The progressive reduction in the dollar, starting in 1985, was thus going to reinforce the mark's role as a value-refuge, the German currency appreciating then, to the detriment of the franc, which necessitate supportive interventions to maintain its course within the EMS.

From March 1983 until February 1985, the American currency continued its ascent. The leaders of the Bundesbank then explain the fall of the German currency: "After the realignment in the EMS the Deutsche Mark depreciated sharply, particularly against the U.S. dollar […] This loss in value of the Deutsche Mark was probably not an autonomous weakness attributable to economic developments in Germany, but primarily a reflection of the general strength of the

[34] Tiersky (2003, p. 139) notes that 'Keynesian socialism' in a single country had failed. European integration limited the margins of maneuver for all the EMS countries, with the partial exception of the Federal Republic of Germany. The German 'allergy to inflation' was the main constraint which the French government came up against, when attempting to use the old policy of "creeping devaluation" to boost exports and growth.

[35] Eichengreen (2008, p. 163) states that, thanks to changes in French economic policy, the second four years of the EMS were less turbulent than the first: as the European economy began to recover, austerity policies were 'more palatable', threats to policy convergence receded and the dollar's appreciation in the first half of the 1980s made it easier for European government to live with a strong exchange rate against the mark.

dollar, which manifested itself especially strongly vis-à-vis the Deutsche Mark as the most exposed currency. High interest rates in the United States, the favourable trend in the U.S. economy and political factors not only prevented any depreciation, which might otherwise have resulted from the growing deficit on the United States' current account, but also enhanced the upward movement of the U.S. dollar. The Deutsche Mark, as the main alternative to the U.S. currency, was particularly affected by its tendency to rise"[36].

Much more than factors pertaining to the German economy, it is American monetary policy which explains the evolution of the mark, in its reduction when the dollar increases, as is globally the case until February 1985. The managers of the Bundesbank blamed directly the level of the dollar and the American interest rates.

The Annual Report of the Bundesbank for 1984 mentions: "After the Deutsche Mark had distinctly gained ground at the beginning of 1984 […] the Deutsche Mark depreciated by 13.5% vis-à-vis the dollar during the year […] It is true that the turnaround on the Deutsche Mark/dollar market in March 1984 also affected the position of the Deutsche Mark in the EMS; since then it has declined again in the EMS against individual partner currencies, after having been at the top edge of the exchange-rate band at the beginning of the year"[37].

The managers of the Bank of Italy see the same inverse relationship between German and U.S. currencies: "Year on year, the mark appreciated by 2.3 per cent against the other EMS currencies but lost about 10 per cent against the dollar and the yen. The trend in the dollar/mark exchange rate reflects the substantial widening of the real interest rate in favour of the United States and the weaker performance of the German economy"[38].

The dollar-mark relationship has a significant impact on the exchange rate of the mark towards the member currencies of the com-

[36] German Bundesbank, RFY 1983, pp. 24-25.
[37] German Bundesbank, RFY 1984, p. 33.
[38] Bank of Italy, RFY 1984, p. 15.

munity system, and in particular on the mark-franc exchange rate, the effect of the appreciation of the dollar on the Deutschmark having the consequence of weakening the German currency within the EMS, as was generally the case between March 1983 and February 1985. Between February and September 1985, the dollar begins falling gradually on the foreign-exchange markets, the Plaza agreements of 22 September confirming officially the implementation of intervention policies, intended to weaken the price of the American currency.

On 28 March 1985, the Second Deputy Governor Philippe Lagayette notes that during the last fortnight, the dollar depreciated by 10% without the position of the franc within the EMS being affected and without draining exchange reserves: "It deserves to be underlined given the forecasts which were usually based on what would take place in the case of a reduction in the dollar"[39].

During the first few months of the diminution of the dollar, the French franc does not seem to be affected by an appreciation of the mark which would come to entail tensions within the narrow margins of the EMS.

On 1 August 1985, Lagayette notes, however, that the situation is characterized on the foreign-exchange market by the coexistence of two elements unfavourable to the stability of the franc: the strengthening of the mark resulting from the weakness of the dollar and the fact that certain operators considered that the devaluation of the Italian lira did not definitively solve the problems of the EMS. He specifies that, in this context, interventions were necessary to support the franc[40].

Thereafter, on 26 September 1985, Jacques Waitzenegger, First Deputy Governor of the Bank of France, specified that in the EMS,

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[39] Bank of France, MGC, 1985, Minutes of 28 March.

[40] Avouyi-Dovi and Laffargue (1994, pp. 74-75) believe that, within the EMS, Belgian and French francs, and the Irish pound, had been stabilized around informal central parities, which were revised from time to time. On the other hand, exchange rates of the Italian lira and the Danish crown had followed random paths, with occasional breaks.

the tensions remained relatively limited since the beginning of the week. The Bank of France had to proceed to some sale of dollars within the framework of the joint intervention of the central banks, in particular to maintain parity without big changes between the franc and the mark.

The Reports of the General Council of the Bank of France, as well as the Annual Reports of the Bundesbank, give evidence of the effects produced by the variations of the dollar on the relationship between currencies included in the narrow margins of the European Monetary System. If the EMS constituted a system of quasi-fixed exchange rates, with adjustable parities between currencies that serves as the element of stability for intra-European business transactions, nevertheless this system undergoes the consequences of the evolution of the U.S. dollar, the main reserve currency and the international transaction standard.

If the evolution of the rise of the dollar, beginning in 1979 and becoming more acute from 1981, constitutes an element of relative appreciation of the franc with regard to the mark, the French currency falling globally in relation to the German currency because of the macroeconomic imbalances of France, the reduction begun by the American currency from February 1985 was going to produce the inverse effect. The reduction in the dollar thus entailed a relative appreciation of the mark, which created tensions within the EMS as French monetary authorities that had to depend on exchange reserves to support the value of the national currency[41].

If the dollar experienced global appreciation from 1981 until 1985, nevertheless it suffered occasional phases of reduction, which unfailingly provoked an appreciation of the mark, that is to say a relative

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[41] Gubian, Le Cacheux, Milewski, Przedborski and Wind, in Jeanneney (1989, pp. 87-106), note that, within the EMS, the German mark kept the key-role it had already in the "snake", created in 1972. The EMS reduced nominal exchange rate volatility, and helped disinflation policies undertaken notably by France and Italy, thanks to fixed exchange rates with the mark.

[42] Kindleberger (1984, p. 463) says that the best chance for European monetary integration would be one in which German leadership achieved political integration, followed

depreciation of the franc, from which arose this accumulation of phases of tensions within the EMS[42].

Moreover, what could constitute beforehand an element of support to the franc in the narrow margins of the EMS was going to change gradually, from 1985, into a new element of exterior constraint for French monetary policy, as the element of drastic external constraint played by the progress of the dollar diminished.

4. The French macroeconomic imbalances and the turn toward austerity

The third element of constraint connected to the international economic, monetary and financial environment, which hindered French monetary policy, arose from the macroeconomic imbalances from which the French economy suffered: the permanent difference in inflation rates between France and West Germany, and the current account deficit.

4.1 Economic and political divergences

A first phase opened in 1982, when, because of the Keynesian expansionary policy organized by the Mauroy government, the inflation differential between France and West Germany became more marked, although the level of inflation was already in the order of 14% at the beginning of 1981 because of the second oil crisis of 1979, and by a crowding out effect, the rise in household consumption turned partially towards imports, stimulating the exports of the commercial partners of France, and strongly exacerbating the foreign trade deficit, which reached 140 billion francs in 1982.

These macroeconomic imbalances were very quickly taken into

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by German provision of the public goods in European money, a European Central bank and European institutions necessary to harmonize economic policy. If some European countries were ready for such a system, it was not the case for France or Britain, according to him. See also Wilson (2002). He adds that is only possible by sharing the costs of intervention.

account by the leaders of the Bank of France, because, from the session of the General Council of 15 October 1981, La Genière, who clearly disapproved socialist expansionist policy, as stated by Bouvier (1987), notes that the adjustment of parities within the EMS, operated in the beginning of October 1981, were ratified by the markets[43].

However, the Governor clearly asserts that the devaluation of the franc had to accompany a policy of drastic adjustment, to decrease both imbalances from which the French economy suffered, domestic and external, namely excessive inflation rates and the important imbalance of the French current account balance[44]. He called on the government to implement a stabilization policy, which prefigures the austerity measures introduced gradually, especially in times of devaluation in June 1982 and March 1983.

He specifies: "The preservation of monetary parity, whatever it is, cannot be only ensured by measures of legal fiat or monetary technique. It can be conceived only within the framework of an overall stabilization policy"[45].

For their part, the leaders of the Bundesbank note, concerning the general realignment of the European parities having taken place in October 1981: "The realignment of the exchange rate relationships within the EMS had become necessary, the price and cost discrepancies and external imbalances between the various partner countries had grown constantly larger over the course of time […] There was a correspondingly pronounced improvement in Germany's trade ba-

[43] Attali (1993, p. 156) notes that new forecasts from the OECD for the year 1982 are less optimistic than previously: French growth will be hindered by international recession and Mauroy seems to say that his stimulus plan could have been smaller, if OECD's experts had been less optimistic. Directly following the election of Mitterrand, some members of the government are trying to minimize the magnitude of the stimulus plan. Rocard, Minister of State, is pleading for a significant devaluation of the French franc. In October 1981, Delors, Minister of Economy and Finance, called for a pause in the reforms.

[44] Bouvier (1987, p. 24) notes that La Genière was totally opposed to the Keynesian inspired stimulus plan of 1981-82 and clearly asserts his opposition. See also Vesperini (1993).

[45] Bank of France, MGC, 1981, Minutes of 15 October.

lance, especially with France and Italy […] The French franc came under considerable selling pressures, especially in connection with the Presidential elections of April/May 1981, and had to be supported both in the dollar market and against the Deutsche Mark with massive interventions despite steep increases in interest rates and tighter controls on capital movements"[46].

Also, following the reactions of the French monetary authorities, the Bundesbank did not view in a positive light the economic policy organized by the French government, compared with the particularly rigorous efforts being undertaken in the Federal Republic: "While efforts were widely being made to fight inflation resolutely, to redress the balance of payments and to consolidate public finance, in France expansionary policies were adopted by the new government, with recourse being taken to dirigiste measures such as price controls and restrictions on outflows of foreign exchange and capital in order to lend support to the new policies"[47].

The macroeconomic divergences between France and West Germany, and their consequences for the EMS, are particularly clear for the Bank of Italy: "During the period under review severe pressures developed within the European Monetary System which resulted in the three realignments of central rates […] Beside factors outside the system – primarily the performance of the dollar – the divergences in the balance of payments and in inflation rates in member countries exerted a growing influence. In particular, the current external deficits of France and Denmark continued to worsen […] On the other hand, large surpluses were recorded in the Federal Republic of Germany and the Netherlands. The dispersion of inflation rates remained considerable, with Ireland and Italy above 16 per cent at one extreme and Germany and the Netherlands below 5 per cent at the other"[48].

On 18 March 1982, Governor La Genière noted that the franc ex-

[46] German Bundesbank, RFY 1981, p. 75.
[47] *Ibid.*, p. 79.
[48] Bank of Italy, RFY 1982, pp. 13-14.

perienced difficulties following the publication of a certain number of indicators, which made a bad impression on national or foreign operators, in particular, the obstinacy of the foreign trade deficit and an inflation rate that was markedly higher in France than for its main partners.

He asserts that all these factors provoked movements which quickly became difficult to handle. As a consequence, the Bank of France had to intervene in a substantial way, in particular by raising its interest rates.

La Genière asserts, on 29 April 1982, that, contrary to the previous month, the pressures exercised on the franc in April 1982 were not of a speculative nature, but seem rather bound to the fundamental imbalance of the balance of payments. He noted: "Such a situation is more worrisome, in a way, than a rough bout of fever against which we can fight by technical means, even if these are imperfect. A permanent imbalance must inevitably be financed by additional debts or by draining the reserves. We touch upon fundamental problems that must be handled by means others than banking, monetary or statutory technique"[49].

La Genière thus placed the blame for the responsibility of the fundamental fragilities of the French economy clearly on the political authorities of the country, making clear his opposition towards the economic policy of the Mauroy government since 1981.

The Governor asserted on 16 September 1982: "The return to equilibrium of the balance of payments is the only remedy that can allow the franc to recover its health. All other prescriptions are only painkillers"[50].

The Bundesbank concured with this analysis in its Annual Report of 1982: "The measures adopted by France to stimulate the economy led to a distinct increase in its trade deficit, while greater investment activity and higher employment failed to materialize […] The development of the French balance of trade clearly indicated that that

[49] Bank of France, MGC, 1982, Minutes of 29 April.
[50] *Ibid.*, Minutes of 16 September.

country was moving into growing external disequilibrium. This created considerable tensions within the EMS, and finally made a renewed adjustment of exchange rates within the system unavoidable in March 1983"[51].

The German monetary authorities thus accused the French executive for the tensions that reappeared within the EMS over the course of 1982, while pointing to the poor performance of French economic policy, particularly in terms of foreign trade.

After austerity measures undertaken at the time of the second devaluation of the franc, in June 1982 in addition to drastic measures already taken, such as the wage-price freeze for a duration of four months and the abolition of the automatic indexation of salaries to inflation, the third devaluation of the franc, in March 1983, ended all debate within the executive on the direction of economic policy and confirmed the turn towards austerity[52].

During the session of the General Council of the Bank of France of 31 March 1983, La Genière declared, referring to the realignment of exchange rates of the EMS on 21 March 1983: "The realignment of European currencies was imperative. Neither France, nor Germany could escape it. Due to the political calendar, both countries had waited for too long to perform the operation. One can also appreciate that it is reached soon after the elections. Regarding the rate of revaluation, that is to say the difference between the franc and the deutsche mark, we can say that it roughly corresponds to the inflationary gap existing between both countries. Indeed, the annual rate of inflation is currently around 3.5% in Germany and 9.5% in France, that is to say a difference of about six points[53].

The turn towards austerity, confirmed during the third devaluation of the franc, in March 1983, thus confirms the implementation

[51] German Bundesbank, RFY 1982, pp. 70-71.
[52] Bliek and Parguez (2008, pp. 106-8), say that the Mauroy government was not obliged to abandon its first policy and therefore acted quite deliberately. To be elected, Mitterrand had to give people hope, but neither he nor his advisers really believed in the chances of success of such a policy.
[53] Bank of France, MGC, 1983, Minutes of 31 March.

of an economic policy in compliance with the views of the Bank of France and its Governor, who, on numerous occasions and in particular in the Annual Reports to the French President, warned against the macroeconomic imbalances which threatened the French economy.

The macroeconomic imbalances, from which the French economy suffered, diminish gradually, as the fight against inflation and efforts made towards the reduction of the trade deficit were met with success[54].

4.2 *The fight against both inflation and current account deficit*

From March 1983 until September 1985, once the policy change was endorsed, that is to say maintaining the franc within the EMS in return for an alignment on the cyclical policies led by the other member states[55], priority was given to restoring the internal and external balances, particularly in the fight against both inflation and the trade deficit[56].

From this point on, the Bank of France welcomed, following the successes obtained by the austerity measures, and called on the government to maintain its efforts, while reminding them of the budgetary discipline which it had to force itself to respect, as was the case on 24 November 1983, the Governor La Genière asserting that

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[54] Favier and Martin-Roland (1990, pp. 503-527) remark that the real turn was in 1982: the additional austerity measures introduced in 1983 had just accentuated the austerity, and reinforced European monetary rigour.

[55] Eichengreen (2007, pp. 288-289) explains quite rightly that France was unable to leave the EMS, because of deeper relations between France and European Community: French exporters feared the damage to their trade, farmers feared the risk to the Common Agricultural Policy, and, politically, it would have prevented Mitterrand from influencing the evolution of European integration, and becoming an equal partner with Germany.

[56] Delors (2004, p. 166) explains that the policy of disinflation is a historical task, as inflation was a French 'disease'. He explains that the stimulus plan of 1981-82 could not be successful, because of the ageing of the French production system, linked to an obvious lack of investment over the Giscard years, which helped widen the trade deficit.

the very low rate of expansion, even the recession in production, was not specific to France: "All other countries, even those who had weaker inflation rates and exterior imbalances, have been in the same situation since the second oil crisis. The United Kingdom, West Germany and the United States […] have all experienced, over several years, a reduction of purchasing power and stagnation or a recession of activity, and it is the same at present in Belgium. The economic or political inspiration of these countries was diverse, but the consequences of the decisions which were taken were identical in a period of deflation […] France cannot escape the same constraints, the same disciplines and the same consequences in the phase of deflation that it entered later than the other countries"[57].

The German Bundesbank welcomed, in its Annual Report of 1983, the progress registered by the most fragile countries of the EMS, while pleading for a greater convergence of the economic policies to be followed: "It is true that progress has been achieved, especially with respect to current account positions. The five EMS countries of France, Italy, Belgium, Denmark and Ireland, which still had large current account deficits in 1982, have meanwhile improved their positions considerably. Their aggregate deficit on current account has fallen from $24 billion to $5 billion. In other major fields, however, there continues to be a lack of comparable progress in the direction of a greater convergence"[58].

In 1984, the Bank of Italy made exactly the same observation: "The cohesion within the System over the last two years was due partly to the strength of the dollar, which tends to weaken the mark within the EMS, but also to the progress towards internal and external adjustment by the countries with relatively high inflation rates […] These developments permitted a further convergence of inflation rates"[59].

On 10 May 1984, La Genière noted that the international context

[57] Bank of France, MGC, 1983, Minutes of 24 November.
[58] German Bundesbank, RFY 1983, pp. 68-69.
[59] Bank of Italy, RFY 1984, p. 16.

was temporarily favourable to the franc which benefited from the progressive rebalancing of the French economy, with respect to both the reduction, now definitely under way, of the inflation rate, and the decrease of the current account deficit that began one year ago.

On 5 July 1984, La Genière specified that, in an atmosphere which is psychologically rather prone to an increase in the interest rates, because of the evolution of the American rates, the Bank of France acted, for its part, the other way round, for nearly two months. The drop of a quarter point in its key rate on the money market was the third since 10 May 1984.

This moderated reduction was made possible by the good behaviour of the franc on the foreign exchange market and by the considerable success registered in the fight against inflation since the beginning of the year: "It was logical, since no problem arose for the moment on the foreign exchange market, to accompany this success by a reduction in the intervention rate of the Bank"[60].

Concomitantly with the change in attitude of the American monetary authorities, the accentuation of the French disinflation allowed the Bank of France to gain new margins of manoeuvre which allowed it, gradually, to lower its key interest rates, bringing down the cost of credit for economic agents, households and companies.

On 25 April 1985, Michel Camdessus, Governor of the Bank of France between 1984 and 1987, specified, about the reduction from 10.5% to 10.25% of the intervention rate of the Bank of France: "It thus seems that it is not such an excessive risk that to try now to translate, into the Bank's intervention rate in the money market, the deflation which was noticed during the last months"[61].

The inflation differential between France and its partners and commercial competitors, in particular West Germany, and current account deficits were, as the reports of the General Council of the Bank of France show, elements of external constraint which the French economy had to face. The inflation differential between France and West

[60] Bank of France, MGC, 1984, Minutes of 5 July.
[61] *Ibid.*, 1985, Minutes of 25 April.

Germany required that the intervention rates of the Bank of France was permanently superior to the rates of the Bundesbank, so that the difference of real interest rates was as small as possible, to attract capital to France, at the same time as French interest rates curbed inflation[62].

However, with the gradual change in economic policy undertaken in 1982-83, under the pressure of international events, France managed to get out of the inflationary spiral sparked by the second oil shock, and to regain some balance in its foreign trade, in 1985-86.

5. Concluding remarks

It has been shown that the external constraint on French monetary policy was composed of three major elements.

Firstly, American monetary policy, with its high key interest rates, entailed both massive movements of capital to the United States and a significant rise of the dollar on the exchange markets. The Bank of France was therefore forced to maintain high interest rates to prevent capital flights and protect the level of its currency.

Secondly, the relationship between the German and American currencies led to tensions within the EMS, causing the German mark to rise against the French franc, whenever the U.S. dollar fell. The Bank of France was thus obliged to defend the parity of the French currency drawing on its foreign exchange reserves and maintaining interest rates higher than those of the Bundesbank.

Thirdly, macroeconomic imbalances prevented the French monetary authorities from decreasing key interest rates before the improvement of the current account and the success of the disinflation policy[63].

[62] Attali (1993, p. 1084) notes that the inflation differential between France and West Germany was about 8 points at the end of 1980, and in 1985 reduced to 3 points, and the differential between France and the average of the EEC countries had in 1985 totally disappeared. The trade deficit was four times lower than in 1980, and the current account became positive.

[63] Asselain, in Berstein, Milza and Bianco (2001, pp. 385-431), states that around 1984,

Consequently, starting from a strictly monetary perspective, the socialist government was unable to implement a Keynesian policy mix, as the monetary policy of the Bank of France could not support the fiscal policy launched in 1981-82[64]. Politically, the program of the Left was clearly abandoned in order to restore the internal and external equilibriums disrupted by the economic recession in the early 1980s following the Second oil crisis in 1979[65].

Due to the inability of the government to implement a true Keynesian policy mix, the austerity measures organized progressively in 1982-83 by the socialist government restored margins of manoeuvre for the Bank of France, month by month, when the inflation differential between France and West Germany became less accentuated and when the trade deficit became unsubstantial. As a result of these changes, both in internal and external conditions, the Bank of France was able to reduce progressively and gradually its key interest rates.

The emphasis laid on this particular episode allows reliable conclusions to be drawn concerning monetary policy and its link with fiscal policy.

On the one hand, if the policy of a major central bank like the Federal Reserve is freely implemented, it appears that the monetary policies of the other central banks are carried out with low margins of manoeuvre. This paper underlines that the changes in the interest

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the gap between France and other industrialized countries was reversed: the French economy, in a phase of "sanitation", saw a marked delay in global recovery.

[64] Prate (1987, pp. 230-231) speaks about the end of 'simplified Keynesianism'. Rocard (2011, pp. 63-75), thanks Mitterrand for having woken up from his 'dream' and taken drastic and necessary measures. Fabius (2011, pp. 57-63) relates that he alerted President Mitterrand, as soon as the end of 1981, to the trade deficit problem. Moreover, he says that he had argued for maintaining the French currency in the EMS. This fact is contested, notably by Favier and Martin-Roland (1990), Attali (1993), *et al*.

[65] Eck (1998, p. 57) notes that Mauroy's stimulus plan was a mistake for several reasons: errors of judgment, such as the belief in a recovery in global economic activity since the end of 1981 (due to over-optimistic forecasts, especially from OECD), choice of a stimulus though consumption, which was more inflationary than major infrastructural works, and the deliberate choice of a policy provoking a cyclical gap with other major industrial powers.

rates of the Federal Reserve were followed by similar modifications implemented by the European central banks, and finally that the key interest rates of the central banks are strongly interdependent. This could suggest that no central bank could apply an autonomous policy in a globalised economy characterised by the free movements of capital, with the exception of the leading power.

On the other hand, this paper stresses that fiscal and monetary policies must be coordinated to be successful. The implementation of a stimulus plan of Keynesian inspiration should be completed by an expansionist monetary policy: the decrease in interest rates is consistent with the aim of the fiscal policy, i.e. stimulate economic growth in order to fight unemployment. The inability to apply such a Keynesian policy mix advocated in this paper echoes the current European economic crisis. Whereas the French policy mix in the early 1980s was characterised by fiscal stimulus and a restrictive monetary policy, the current European policy mix appears to be exactly the opposite. The European Central Bank has decreased its interest rates, even launching a quantitative easing programme, while the governments of the European Union maintain policies of budgetary rigour, due to external constraint characterized by macroeconomic balances and political issues, and reinforced by the growing influence of financial markets.

As stated by Keynes (1936), monetary policy cannot by itself ensure recovery: "If a reduction in the rate of interest was capable of proving an effective remedy by itself, it might be possible to achieve a recovery without the elapse of any considerable interval of time and by means more and less directly under the control of the monetary authority. But, in fact, this is not usually the case"[66]. He therefore pleads for an active fiscal policy: "For my own part I am now somewhat sceptical of the success of a merely monetary policy directed towards influencing the rate of interest. I expect to see the State, which is in a position to calculate the marginal efficiency of capital-

[66] Keynes (1936, ed. 1949, pp. 316-317).

goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organising investment"[67].

Economic History and History of Economic Thought could therefore enlighten us about the role of external constraints in macroeconomic imbalances and the results of contradictory policies[68].

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[67] *Ibid.*, p. 164.
[68] For further reading, see Reichart (2014).

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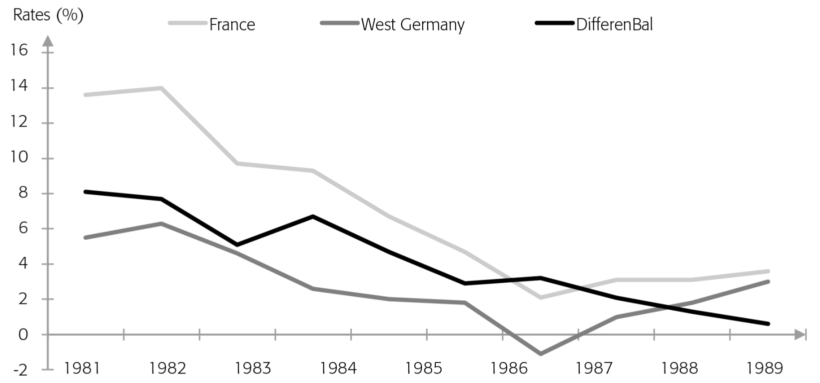
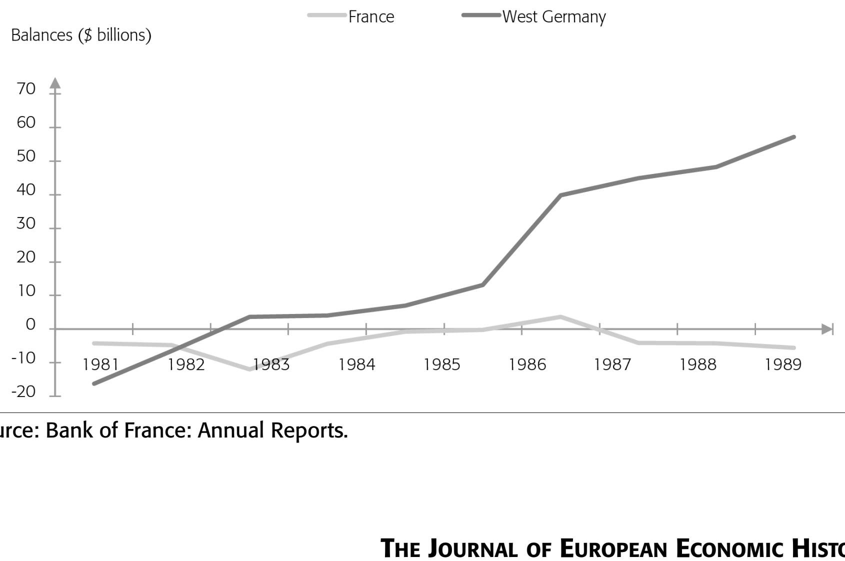
Appendix

FIGURE 4
Inflation differential between France and West Germany, 1980-1989



Source: Bank of France: Annual Reports.

FIGURE 5
Current account positions of France and West Germany, 1980-1989



Source: Bank of France: Annual Reports.