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THE POLITICAL ECONOMY OF FRANCO-GERMAN RELATIONS: NATIONAL STRATEGIES AND COOPERATION IN THE EUROPEAN COMMUNITY

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1.0 INTRODUCTION

This paper analyzes the relationship between French and West German national macroeconomic policy patterns and Franco-German economic cooperation in the 1980s. I will argue that in some fundamental respects policy-makers in both countries had identified the same economic weaknesses and socio-economic disequilibria they had to eliminate after the two oil shocks in order to improve employment and growth performances as well as control inflation and achieve balanced external accounts. As a result, governments in France and Germany began to adopt broadly identical policy strategies to bring back high growth and full employment combined with internal and external stability. This identity of diagnoses and general policy patterns was based on the fact that--mutatis mutandis--the principal causes for the persistence of crisis symptoms after the first oil shock were common to both countries: In France and West Germany formerly stable income distribution trends had undergone significant change during the 1970s. High and inflexible real wages and an increasingly expensive welfare state had brought about a squeeze of the capital share in value added and a collapse of business profitability, which, in turn, led to an interruption of the flow of investment, persistent unemployment and inflationary pressures.[1] Thus, policy-makers in both countries

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[1] For a discussion of these points see Robert Boyer and Jacques Mistral, Inflation, Accumulation, Crises (Paris: Presses Universitaires de France, 1983); and "L'accumulation du capital de 1970 à 1988," in Institut National de la Statistique et des Etudes Economiques, Rapport Sur les Comptes de la Nation (Paris: INSEE, 1989), pp. 57-85. Also OECD, Economic Survey of Germany, 1978 (Paris: OECD, 1978), p. 39; and Martin Hellwig and Manfred Neumann,

were faced with the same broad challenge for the 1980s: to reconcile the financial claims of an expensive welfare state and the demands for steadily rising real wages with the viability of an internationally competitive market economy.

The breakdown of the "postwar settlement" in France and West Germany in the late 1960s had made it impossible to respond with labor restraint and consensual wage determination to the two oil shocks which put both economies under considerable pressure to adjust their domestic cost structures to less advantageous terms of trade.[2] The rising share of non-wage labor costs (financing the welfare state) in real wages compounded the problem. This double challenge of abruptly deteriorating income distribution trends and terms of trade shocks paralysed the supply side of both economies and began to dominate the choice of economic policies in France and West Germany after the first oil shock. Important in this respect was that the disruptive socio-economic conditions and the adverse developments of the terms of trade during the 1970s began to render formerly practiced incomes policies and demand management techniques not only less feasible but also less effective. The Keynesian-type stabilization policies which had been used to fine-tune unemployment and inflation in the 1960s no longer offered a

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"Economic Policy in West Germany," in Economic Policy, 5 (Cambridge: Cambridge University Press, 1987), pp. 103-147, p. 110.

[2] See John H. Goldthorpe, "The End of Convergence: Corporatist and Dualist Tendencies in Modern Western Societies," in John H. Goldthorpe, ed., Order and Conflict in Contemporary Capitalism. Studies in the Political Economy of Western European Nations (Oxford: Clarendon Press, 1984), pp. 315-343.

viable solution.[3] The consequence in West Germany was the reaffirmation of the Bundesbank's primacy in macroeconomic policy after the breakdown of the Bretton Woods monetary system in 1973. The Bundesbank's deflationary "show of force" after the floating of the Deutsche mark/dollar exchange rate contributed to the depth of the recession in 1974-75 and was a direct result of the ineffectiveness of the "neo-corporatist" efforts among labor, the state and private employers to settle their distributive conflicts.[4]

The idea of the Bundesbank's concept of a potentialorientierte Geldmengensteuerung, adopted in 1974, was to regulate the wage and price-setting behavior of labor unions and employers by announcing the target rate of growth of the money supply in advance for every year.[5] This target rate was determined such that the growth of the money supply fell in line with the estimated growth in the overall availability of goods and services in the economy plus a given "unavoidable" rate of inflation. If this is done and if the central bank can establish the credibility of its target, the scope for inflationary price increases is, of course, severely limited. All prices, profits and wages in the economy will then have to be

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[3] Ibid., p. 323.

[4] See Norbert Kloten, Karl-Heinz Ketterer and Rainer Vollmer, "West Germany's Stabilization Performance," in Leon N. Lindberg and Charles S. Maier, The Politics of Inflation and Economic Stagnation. Theoretical Approaches and International Case Studies (Washington, D.C.: Brookings, 1985), pp. 353-403, pp. 359-364.

[5] See Fritz W. Scharpf, Sozialdemokratische Krisenpolitik in Europa (Franfurt/New York: Campus Verlag, 1987), p. 175.

set such that supply and demand in the respective markets are brought into equilibrium. Consequently, excessive wage increases must lead to unemployment as employers find themselves unable to pass on higher costs in higher prices. The important corollary of this mechanism is that monetary policy becomes unavailable to "correct" excessive nominal wage settlements by allowing a reduction of real wages through higher inflation. Following John R. Hicks, one might say that monetary policy can thus avoid being put on a "labor standard."[6]

However, as it turned out, the reliance on this "quasi-regulatory" power of monetary policy in West Germany after 1974 did not suffice to permanently restore profitability, investment and employment trends in the 1970s to their pre-crisis levels. Part of the reason was, of course, the second oil shock since some improvement of all three indicators did occur before 1979. But furthermore, the adjusted wage share in national income would only in the mid-1980s return to its level of the boom years before the first oil shock;[7] and the real wage gap, which measures wage increases in excess of the rise warranted by prevailing productivity and terms of trade trends, remained substantial throughout the 1970s.[8]

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[6] See John R. Hicks, "Economic Foundations of Wage Policy," in The Economic Journal, September 1955, pp. 389-404.

[7] See Kloten, Ketterer and Vollmer, "West Germany's Stabilization...," op. cit., p. 358.

[8] See OECD, Economic Survey of Germany, 1983 (Paris: OECD, 1983), p. 53.

In France, the continuing growth of real wages after the first oil shock brought about an even sharper reduction of the profit share in value added than in West Germany, and the subsequent efforts of producers to rebuild their taux de marge led to persistent inflationary pressure.[9] In response, the government under Raymond Barre attempted a strategy in the second half of the 1970s which was conceptually quite similar to the stability policy pursued in West Germany at the same time. Here, too, the central bank began announcing the target rates for the growth of the money supply in advance. By fighting inflation, policy-makers hoped to be able to gain control over the distributive struggle between labor and capital. However, French monetary policy between 1976 and 1979 only succeeded in stabilizing the rate of inflation at a relatively high level.[10] And Barre's government had even less success than its West German counterpart in restoring profitability and improving the economy's rate of investment.[11] Moreover, the increasing "wedge" driven by rising social security contributions between the real after-tax wages of employees and the cost of labor for employers has been identified as one of the principal causes for growing unemployment in France in 1973-80.[12]

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[9] See Rober Boyer and Jacques Mistral, Inflation, Accumulation, Crises, op. cit., pp. 142-43.

[10] See OECD, Economic Survey of France, 1982 (Paris: OECD, 1982), p. 39.

[11] See INSEE, "L'accumulation du capital...," op. cit., p. 75.

[12] See Jeffrey Sachs and Charles Wyplosz, "The Economic Consequences of President Mitterrand," in Economic Policy, 2 (Cambridge: Cambridge University Press, April 1986), pp. 262-322,

Thus, it is clear that by the end of the 1970s persistent unemployment, low rates of investment and growth, and--particularly in France--high inflation challenged both the French and West German versions of European welfare capitalism to reconcile their continuing commitment to high levels of social spending with the restoration of the financial prerequisites for private investment. A redefinition of the distributive equilibrium between labor, capital and the state was necessary if both economies were to regain their former rates of expansion and strengthen their capacity to compete in the international marketplace.

But what policies would facilitate such a redefinition? How, in fact, could a new macroeconomic formula be found which would replace the former "postwar settlement," and discipline the claims of interest groups on national income in such a way that growth remained possible? Was it feasible, or even necessary, to cooperate internationally in order to implement economic policies leading both countries out of the crisis?

In the following, I will attempt to answer these questions and argue that, under the pressure of the crisis, the French and West German economies began a process of far-reaching <u>convergence</u> in the 1980s, as both the Socialist government in France and West Germany's center-right coalition struggled to find a new policy formula for the post-crisis period. I will develop my argument in three steps: In the second section of this paper (following this introduction) I will describe the evidence for increasing

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convergence of the two countries' economic policies and policy outcomes in the 1980s; in the third, I will discuss analytical perspectives helpful in explaining this convergence; and in the fourth, I will propose an interpretive analysis of the principal elements of the new macroeconomic formula which appears to have evolved in France and West Germany during the 1980s.

2.0 THE CASE FOR CONVERGENCE

Probably the most obvious element of the convergence of economic policy strategies in France and West Germany in the 1980s was monetary policy. Since 1982-83, monetary policy in both countries has become primarily concerned with the internal and external stabilization of the currency. But fiscal policies, too, were geared toward the same objective after 1982-83: consolidating government budgets. In addition, successful efforts were made in the two countries to hold labor costs in check in order to bring about a recovery of business profits from their decline during the crisis years in the 1970s and early 1980s.

Especially in France this convergence of the macroeconomic policy formulas led to a significant break with the traditional pattern of economic policy. Although France's postwar policy pattern had been quite successful in promoting growth and investment up until the mid-1970s, accelerating inflation and persistent unemployment during the 1970s made it obvious to policy-makers that a new approach was needed. The old formula had relied on three main elements: Rapid growth of domestic demand brought about by expansionary fiscal and, above all, monetary policy; cheap credit for the business sector, generated--in addition to the rapid growth of the money supply--by state subsidization of borrowing rates for industry; and finally, occasional devaluations of the franc in order to restore the international price competitiveness of French exporters.[13]

Since the first oil shock, however, growing dissatisfaction with economic performance has induced policy-makers to seek for ways to redefine France's macroeconomic "grand strategy." Among the arguments adduced two figured prominently: The first focused on the already mentioned growth of real wages during the 1970s which had brought about significant income redistribution from capital to labor and the welfare state as well as an acceleration of price inflation in response to the oil shocks. As industry was forced to shoulder most of the burden of the oil crisis, its profitability was squeezed and investment activity declined. This deleterious effect was compounded by the rise of real interest rates in the early 1980s and led to the subsequent weakening of the French productive system and sharp increases in unemployment.[14]

Secondly, questions were raised about the costs of the external element of France's traditional macroeconomic strategy: the regular devaluations of the franc. Even though the French

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[13] See Peter Hall, Governing the Economy (New York/Oxford: Oxford University Press, 1986), pp. 244-45.

[14] See Robert Boyer, "The Current Economic Crisis," in George Ross, Stanley Hoffmann and Sylvia Malzacher, eds., The Mitterrand Experiment: Continuity and Change in Modern France (New York: Oxford University Press, 1987), p. 33-53.

currency had been devalued repeatedly in the early 1980s with respect to the Deutsche mark, the bilateral Franco-German trade balance showed no signs of improving. It increasingly seemed as if France was suffering from the inflationary impact of its devaluation strategy without benefiting from the expected results of improving international price competitiveness.[15]

Reflecting the logic of these arguments, the new set of macroeconomic policies adopted by French governments since 1982-83 put particular emphasis on the commitment to reduce price inflation and the growth of real labor costs and to keep the franc pegged to the Deutsche mark in the EMS.

Since 1983, successful disinflation, a lower elasticity of wages with respect to price rises and rising levels of unemployment have contributed to a slowdown of the rate of growth of the purchasing power of wages. This has led to a reversal of the earlier trend in income distribution which had favored labor over capital.[16] Government and private consumption growth was also slowed down by a gradual reduction of the general government budget

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[15] See Patrick McCarthy, "France Faces Reality: Rigueur and the Germans," in David P. Calleo and Claudia Morgenstern, eds., Recasting Europe's Economies: National Strategies in the 1980s (Lanham, Maryland: University Press of America, 1990), pp. 25-79, p. 56.

[16] It should be mentioned that this policy, although necessary in order to correct earlier distributive disequilibria, is not without problems of its own. The "wage squeeze" involved may become excessive and weaken overall demand. See Edmond Malinvaud, "Jusqu'où la rigueur salariale devrait-elle aller?" in Revue économique, # 2, March 1986, pp. 181-205. Econometric evidence concerning the reasons for the slowdown in real wage growth is reported in INSEE, Rapport sur les Comptes..., op. cit., pp. 138 and 158-59.

deficit to around one percent of GDP in 1989.[17] The internal and external stabilization of the franc--which, as mentioned, has become the core element of the new macroeconomic policy strategy--was achieved through a close alignment of French monetary policy with the growth of the money supply in West Germany. This revolution in French monetary policy-making was paralleled by reforms of the financial sector during the 1980s. The reforms brought about the dismantling of older structures in financial markets which had been used in order to implement monetary policies through direct quantitative control over bank lending. After 1985 the transmission mechanism of monetary policy in France began to rely more on interest rates and central bank intervention in the interbank market, thus bringing French and West German monetary policy implementation techniques closer in line with each other.[18]

In the second half of the 1980s this new macroeconomic policy strategy has begun to show results. Following improvement in business profitability, investment has increased.[19] The inflation differential with West Germany has been practically eliminated and the franc/Deutsche mark exchange rate has remained unchanged since 1987.[20] Furthermore, real labor costs in France have risen less

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[17] See OECD, Economic Survey of France, 1989-90, op. cit., p. 49.

[18] See OECD, Economic Survey of France, 1988-89 (Paris: OECD, 1989), p. 81.

[19] See OECD, Economic Survey of France, 1989-90, op. cit., p. 29.

[20] Ibid., p. 16.

than in West Germany since 1986.[21]

In West Germany, on the other hand, broad economic policy patterns over the past decade have been similar in several important respects. The macroeconomic policy adopted by the center-right government after 1982 has been consistently geared toward price stability as well as the consolidation of government budgets and business firms' balance sheets. Budget deficits in West Germany had been quite high in the late 1970s and early 1980s, and the rate of return to capital in the business sector had fallen almost as much as in France after the two oil shocks.[22]

Therefore, in West Germany--as in France--higher rates of investment and employment creation could only be restored in the late 1980s after a protracted period during which the previous distributive disequilibria between the welfare state, labor and private industry were being eliminated. This is not surprising since both countries suffered from precisely the same crisis on the cost side of enterprises' balance sheets. As mentioned above, the crisis was primarily brought about by excessive real labor costs in the two countries during the 1970s and early 1980s which, in conjunction with the two oil-price shocks, depressed business firms' actual and expected profits.[23]

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[21] Ibid., p. 17.

[22] Ibid., p. 28.

[23] For data about the distributive disequilibria in France and West Germany during the 1970s and 1980s see OECD, Economic Survey of Germany, 1979 (Paris, 1979), p. 17-19; and OECD, Economic Survey of Germany, 1985 (Paris, 1985), p. 62. Also Charles Wyplosz, "La France en 1986: bilan et perspectives macro-économiques," in Revue

Of course, as far as other macroeconomic disequilibria were concerned, differences still persisted between the two countries during the 1980s. Most important in this respect were the high external surpluses of West Germany after 1985. France so far has not been able to eliminate its trade and current account deficits. The French economy has also been somewhat less successful in coping with mass unemployment. While the unemployment rate in France seems to have stabilized at around 10 percent between 1985 and 1988, West Germany was able to reduce it from 7.2 percent to 6.1 percent over the same period.[24]

Nevertheless, even though some differences in policy outcomes still persisted between the French and German economies, the patterns of their macroeconomic policy strategies during the 1980s seemed strikingly similar. And if we do not assume that this similarity was coincidental, the question arises how such a high degree of convergence of the two countries's economic policy patterns could come about.

3.0 ANALYTICAL PERSPECTIVES

An attempt to explain the convergence of French and West German economic policy strategies in the 1980s raises interesting theoretical questions. In particular, what are the factors that determine different economic policy patterns in different

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économique, # 3, May 1987, p. 677-702.

[24] See OECD, Economic Survey of France, 1989-90, op. cit., p. 148; and OECD, Economic Survey of Germany, 1989-90 (Paris, 1990), p. 119.

countries? As I will try to show in this section and the next, identifying the "independent variables" which determine national policy patterns and demonstrating their cross-country alignment during the 1980s can explain how the convergence of economic policies in France and West Germany could come about. An important aspect in this discussion will be the role of the European Community in this process of convergence. But there is another fundamental question: why did the independent variables determining economic policies converge in France and West Germany so that national policy patterns were aligned? In order to answer it, I will discuss what kind of policy strategies were available to French and West German governments during the 1980s in order to lead their countries out of the economic crisis brought about by the breakdown of the postwar settlement, the growth of expensive welfare states and the two oil shocks in the 1970s.

3.1 Institutional Constraints of Economic Policy Strategies

A by now standard explanation of how particular national patterns of economic policy-making can be explained has been given by Peter Hall.[25] Hall notices the "parallel persistence of [broad economic policy] patterns and specific organizational forms" distinguishing postwar French and West German macroeconomic policy strategies from each other.[26] His institutional approach to comparative economic policy analysis thus emphasizes the existence

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[25] Peter Hall, Governing the Economy, op. cit., chapter 9.

[26] Ibid., p. 254.

of a stable relationship between a particular institutional framework and a corresponding pattern of macroeconomic policies. Differences in organizational forms with respect to labor, capital and the state across countries account for different national policy strategies in response to identical challenges. Hall also adds the organization of the political system and a country's position within the international economy to his list of independent variables affecting national policy strategies.[27] Thus, for example, Hall points out the importance of the power of the independent Bundesbank and the close relationship between financial and industrial capital in West Germany in determining that the Deutsche mark remained undervalued in the 1950s and 1960s. Furthermore, organizational features of West German labor explain why wage inflation never became as serious a problem as in France or Great Britain in the postwar period.[28] Hall also links the traditional French postwar macroeconomic policy pattern to specific organizational features of the French political economy: In particular, he argues, the emphasis on growth and industrial investment brought about through expanding demand, cheap credit for business investment and occasional devaluations was a consequence of some aspects of the organization of capital and the state in France. Graduates of ENA and technocrats in the Planning Commission were focused on the achievement of high rates of growth and rapid industrialization; and a powerful Ministry of Finance had

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[27] Ibid., p. 232.

[28] Ibid., pp. 234-242.

gained enough control over fiscal and monetary policy in order to be able to instrumentalize macroeconomic policy in favor of French industry. Moreover, the financial sector was organized in a way which kept finance capital largely under the control of the state, so that the flow of funds into the economy could be manipulated according to the plans of technocrats and policy-makers.[29]

Thus, it is clear that the set of feasible economic policies in each country is bounded by institutional and organizational constraints. Policy-makers can only make conscious choices among alternative strategies within this given set. The Bundesbank, for example, could change its mind about the usefulness of a permanently undervalued currency under the impression of the collapse of the Bretton Woods system. The West German government could also adopt what has been called a "qualified Keynesian design" in the mid-1960s and later on, in the early 1980s, declare "budget consolidation" its top priority.[30] While changes such as these were possible within a stable institutional framework in West Germany, others which would for instance have necessitated a veto of the government over policy decisions of the Bundesbank obviously have not occurred.

On the other hand, the institutional architecture of a national political economy is not immutably fixed and policy-makers

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[29] Ibid., pp. 244-248.

[30] See Jeremiah M. Riemer, Crisis and Intervention in the West German Economy: A Political Analysis of the Changes in the Policy Machinery During the 1960s and 1970s (Ph.D. Diss., Cornell University, 1983), pp. 85-154. Also Martin Hellwig and Manfred Neumann, "Economic Policy in West Germany...," op. cit., passim.

always have at least the theoretical possibility of changing some of its elements in order to facilitate policy strategies which would be more difficult or impossible under the old structures. An example would be legislation to render the workings of the labor markets more flexible. Such attempts have been made with some success by French and West German governments during the 1980s. However, it is clear that some institutional and/or organizational changes are easier to bring about than others. The French and West German changes in labor legislation already involved considerable political risks and potentially serious costs in electoral terms for the governments. These difficulties notwithstanding, marginal changes in the workings of job markets have occurred. But more fundamental modifications of organizational patterns within a national political economy may be impossible to implement without a major crisis or an unusal commitment of policy-makers. Margaret Thatcher's frontal attack on the power of Britain's labor unions certainly belongs to this category.

In short, high political risk and a lack of necessary mobilization capability may make it impossible for governments to alter domestic institutional constraints, even if that means that policy-makers will have to accept a set of institutional constraints which is sub-optiomal with respect to their chosen policies. Given these impediments to domestic institutional reform, the existence of the EC ~~has important~~ implications for European governments: Today's dynamic institution-building process in the EC presents policy-makers with a unique opportunity to bring about policy-relevant institutional change reflecting their immediate policy concerns <u>in the absence of domestic institutional change</u>. In other words, the institution-building necessary to facilitate domestic adjustment to economic challenges can be circumvented and some of the political costs of unpopular decisions externalized.

This possibility has arisen because some of the régimes within the European Community impinge on national policies very directly. Instead of operating indirectly through the intermediation of markets, the immediate policy relevance of European Community régimes can be an intergral part of national policy-making processes in certain areas. It is in this sense that EC institutions may actually supersede national institutional constraints as far as their impact on economic policy is concerned. In other words, a so-defined group of "intrusive" régimes (i.e., international régimes <u>superseding</u> domestic institutional structures) must be distinguished from the less "intrusive" conventional régime type which influences national policy-making processes more indirectly through the regulation of (international) markets and the position of domestic producers within them.[31] Obviously, the direct influence of "intrusive régimes" on national economic policy-making within the European Community has important consequences for the analytical determination of the relevance of different institutional variables--domestic or international?--in

[31] See Peter Hall's definition of the external factors affecting national economic policies in Peter Hall, <u>Governing the Economy</u>, op. cit., p. 232.

national policy-making processes. The European Monetary System, for instance, is such an "intrusive régime" and the question arises which institutional variable, the domestic or the international, is policy-relevant with respect to monetary policy in EMS countries. In the case of France, the domestic organizational form determining monetary policy, the Banque de France, creates very different contraints for the policy-making process than the international, which is the EMS.

To conclude, the answer to the question of _how_ the convergence of economic policy patterns in France and West Germany could come about is that policy-makers can under certain circumstances change their economic strategies either within existing institutional structures (if the new policies are compatible with these old structures), or, if necessary, by changing domestic and/or international institutional variables. In particular, the adoption of the fiscal strategy of "budget consolidation" and the rejection of Keynesian-type _Konjunkturprogramme_ by the new West German government in 1982 happened within a stable institutional framework. On the other hand, when French governments wished to practice greater monetary discipline in the late 1970s and after 1983, they submitted themselves to the institutional constraints of a European régime, the EMS. Of course, they could also have tried to implement greater monetary discipline themselves (i.e. change their policies within a _stable_ institutional framework) or draft legislation which would have given more independence to the Banque de France (and thus change the _domestic_ institutional structure).

But these solutions were electorally risky and would have required a potentially costly exposure of the government vis-à-vis its domestic political critics. Given such constraints, it was much less complicated to create an intrusive international régime and impose domestic discipline in the name of the EMS.

3.2 The Economic Appropriateness of Policy Strategies

Having explained how crucial institutional variables determining economic policy patterns could be aligned across France and West Germany, and hence how the policy strategies themselves could converge, the question now arises: why did it happen? Can we make explicit according to which principles policy-makers exercise their freedom to chose between policy alternatives?

This question has been discussed by Fritz W. Scharpf who introduced the criterion of "economic appropriateness" into the debate about the strategic options of economic policy-makers during the crisis period of the 1970s and 1980s.[32] As Scharpf points out (and as mentioned in the introduction), the causes for both unemployment and inflation have changed after the oil shocks of the 1970s. In addition to inadequacies of aggregate demand, cost factors and profitability constraints began to affect the level of employment and the rate of inflation. Therefore, given the changes in the nature of the economic disequilibria which had to be

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[32] See Fritz W. Scharpf, "Economic and Institutional Constraints of Full-Employment Strategies: Sweden, Austria, and Western Germany, 1973-82," in John H. Goldthorpe, ed., Order and Conflict..., op. cit., pp. 257-290, pp. 268-274.

contended with, the economic appropriateness of macroeconomic policy strategies changed too. In particular, exclusively demand-oriented fiscal and monetary policies no longer could be applied as the locus of the problems shifted from the demand to the supply side of the economy. Ideally, Scharpf argues, a "two-track" policy would have to be implemented in which incomes policy would take care of labor costs (assuring a positive response of the supply side) while at the same time aggregate demand management based on coordinated monetary and fiscal policies could be used to induce entrepreneurs to increase output and employment.[33]

Unfortunately, such a two-track strategy could not be successfully implemented in either France or West Germany after the first oil shock. In both countries institutional constraints seem to have been the principal reason for this failure. In France organizational features of the labor market account for the non-existence of tripartite, or "neo-corporatist," concertation in order to bring about wage restraint in exchange for commitments by the state to achieve full-employment and/or expand the welfare state.[34] In West Germany both the independence of the Bundesbank and the institutional structures of collective bargaining help explain why effective concertation was impossible during the

[33] See also Jacques H. Drèze and Charles Wyplosz, "Une stratégie de croissance ambidextre pour l'Europe: l'autonomie par la coopération," in Revue économique, # 3, Mai 1988, p. 627-640.

[34] See Peter Hall, Governing the Economy, op. cit., pp. 247-48.

1970s.[35] The West German Konzertierte Aktion never developed the machinery necessary to exercise control over the wage settlements between labor unions and employers' organizations.

Thus, institutional constraints made it impossible for policy-makers in France and Germany to adopt the economically appropriate first-best policy strategy because the macroeconomic management in neither country could be based on a division of labor among monetary and fiscal policy on the one hand and incomes policy on the other. This meant that the development of substantial distributive disequilibria could be neither prevented nor easily corrected. The result was a misalignment of relative factor prices, lower profitability and a fall in the rate of growth of the capital stock leading to persistent "classical" unemployment.[36] Therefore, after the Keynesian-style demand management of the 1960s and 1970s (and the relance strategy in France in 1981-83) had been abandoned, policy-makers in France and West Germany had to settle for the second-best economic strategy: the reliance on the quasi-regulatory power of monetary discipline. As mentioned in the introduction, this approach had been introduced by the Bundesbank in 1973-74. Through the EMS French policy-makers were able to import it--a possibility the Socialists discovered after the

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[35] See Fritz W. Scharpf, "Economic and Institutional Constraints...," op. cit., pp. 282-84.

[36] See Edmond Malinvaud, "Wages and Unemployment," in Economic Journal, March 1983, pp. 1-12. Also Charles Bean, "Capital Shortages and Persistent Unemployment," in Economic Policy, April 89, pp. 12-53.

failure of relance in 1983.[37]

Following John H. Goldthorpe one can conclude that neither France nor West Germany was in a position to respond to the breakdown of the postwar settlement and the economic crisis of the 1970s with a successful inclusionary, or "corporatist," strategy. Therefore, the policy strategies in both countries were of an increasingly exclusionary, or "dualist," nature.[38] According to Goldthorpe, the major signs of dualist tendencies in contemporary West European nations are the wide-spread use of migrant, or foreign, labor; increased subcontracting through which large companies can tap the pool of non-unionized labor, enjoy flexible wages and escape restrictive health and safety regulations; and finally, the spread of part-time workers who are not entitled to the full range of benefits and protection granted to unionized full-time employees. Furthermore, intensifying dualist tendencies in France and West Germany in the 1980s are clearly reflected in the nature of the wage bargaining processes. The "insider-outsider" and "target-real-wage" models familiar from the economic debate about the workings of European labor markets today suggest that the wage setting process for insiders with jobs is only to a limited extent influenced by the fact that an increasing number of

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[37] For the economic argument underlying this policy see Francesco Giavazzi and Alberto Giovannini, Limiting Exchange Rate Flexibility (Cambridge Mass.: MIT Press, 1989). Also OECD, Economic Survey of France, 1989-90, op. cit., pp. 83-84.

[38] See John H. Goldthorpe, "The End of Convergence: Corporatist and Dualist Tendencies in Modern Western Societies," in John H. Goldthorpe, ed., Order and Conflict..., pp. 315-343.

outsiders cannot find employment at the going wage rates.[39]

In short, the changing economic appropriateness of policy strategies forced France and West German policy-makers to jettison Keynesian-type macroeconomic fine-tuning. Unfortunately, however, institutional constraints and the breakdown of the postwar settlement made it impossible to respond to the crisis with a first-best, inclusionary macroeconomic policy based on a two-track approach targeting both the supply and demand sides of the economy. The result was the adoption of a second-best solution which was based primarily on the quasi-regulatory power of monetary discipline. This policy strategy was transmitted by the Bundesbank via the EMS to other European countires, notably France.

4.0 TOWARD A NEW "GOLD STANDARD?"

Having shown how and why broad macroeconomic policy patterns could converge in France and West Germany in the 1980s, I will now turn toward some of the implications of these changes. In the course of this discussion I will deal with three major questions: First, in what way did the emphasis on monetary discipline provide a solution to the distributive disequilibria of the 1970s? Second, what are the broad features of the adaptation of industry to the new macroeconomic environment? And third, is it appropriate to

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[39] David T. Coe and Thomas Krueger, "Wage Determination, the Natural Rate of Unemployment, and Potential Output," in Leslie Lipschitz and Donogh McDonald, German Unification. Economic Issues, IMF Occasional Paper 75, December 1990, pp. 115-130. Also Jeffrey Sachs and Charles Wyplosz, "The Economic Consequences of President Mitterrand," op. cit., p. 280-83.

interpret these changes of the macroeconomic policy pattern and the ensuing adjustments of income distribution trends and industrial organization as signs that Western Europe's economies have broken with their postwar, Keynesian past, and are now moving toward a new paradigm which embodies elements of an even older version of the regulation of capitalism? Clearly, the way I will deal with these points in the following is far from being exhaustive. Substantial further research will have to be done before a clearer picture about the future of European welfare capitalism can emerge. In this sense my discussion here is meant to suggest possible directions of inquiry.

What then can we say about the impact of monetary discipline within the EMS on the distributive struggle between labor, capital and the state? Has the nature of the process determining relative income shares changed, and if so, how and why did it happen? A look at the evolution of real wages since the beginning of the 1980s in France shows the drastic slowdown in their annual rate of growth.[40] But what determines the rate of growth of wages in France? In order to answer this question, attempts have been made to specify and estimate a wage equation for France during the 1970s and 1980s.[41] According to this model, past inflation, unemployment and productivity growth affect the development of money wages. The

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40. See INSEE, Rapport sur les comptes de la Nation, 1989 (Paris: INSEE, 1990), p. 157.

41 Pierre Ralle and Joel Toujas-Bernate, "Les Salaires Désindéxés: Une Réalité depuis 1983," in INSEE Première, No. 59, April 1990.

critical question for the purposes of this discussion is how closely past rates of inflation and expected future price rises are reflected in the money wages employees demand. If in the past inflation has been chronic, money wages will grow at a rate closely linked to price increases. If, however, the government can convince labor and capital that it has the intention to reduce the future rate of price rises, the link between money wages and past inflation can be broken, and wage restraint can occur in anticipation of future disinflation. This, in fact, is what happened in France. P. Ralle and J. Toujas-Bernate have shown that the price elasticity of wages in France has changed since 1982-83. Price expectations in France before that were formed on the basis of past inflation. Following the second devaluation of the franc under Mitterrand in June 1982, however, price expectations began to reflect anticipated future disinflation. This significant modification of inflation expectations in France was the result of the increased credibility of the government's disinflationary policy, due to the strategy of pegging the franc to the Deutsche mark in the EMS.[42]

The alteration in the wage formation process had consequences for the distribution of national income in France. In 1974-82 the capital share fell at an average rate of 0.7 percent annually and the labor share rose by 1.6 percent per year. This pattern was reversed in 1983-87: capital could improve its income position by

[42] See Pierre Poret, "The 'Puzzle' of Wage Moderation in the 1980s," OECD Economics and Statistics Department Working Paper No. 87, 1990, pp. 13-14.

one percent annually whereas labor had to settle for half that annual rate of increase.[43] The development of wages and income shares in West Germany followed along broadly similar lines. The only significant difference was timing. The rate of growth of wages slowed down from the peaks at the time just before the first oil shock and continued to oscillate around 2 percent per year during the 1980s.[44] The slowdown in wage growth thus followed the adoption of published money supply targets by the Bundesbank in 1974. As a consequence of wage restraint, the labor share in national income fell very fast during the 1980s. By 1983 it had reached the level of 1967-69 and after 1985 it had shrunk below the levels of the 1950s.[45] Thus, it seems fair to conclude that in both France and Germany monetary discipline supplied either domestically by the Bundesbank or internationally, through the EMS, has helped to correct the distributive disequilibria of the 1970s. By the end of the 1980s high labor shares in national income no longer depressed business profitability. Consequently, investment again became responsive to rising demand pressure.[46]

Turning now to the second question mentioned at the beginning

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[43] See "Croissance et Répartition des Fruits de la Croissance," in INSEE, Rapport sur les Comptes de la Nation (Paris: INSEE, 1990), pp. 133-141.

[44] See Pierre Poret, "The 'Puzzle' of Wage Moderation...," op. cit., p. 43.

[45] See Thomas Mayer et al., "Economic Developments in the Federal Republic of Germany," in Leslie Lipschitz and Donogh McDonald, eds., German Unification..., op. cit., p. 20.

[46] See OECD, Economic Survey of France, 1989-90, op. cit., pp. 28-29.

of this section, I will briefly deal with the broad features of industry's adjustment in France and West Germany during the 1980s. It is well known that the European record in creating jobs since the first oil shock has been, to put it mildly, quite modest. Overall, jobs in the U.S. economy have increased by 27.6 percent between 1974-87. During the same period employment in France rose by 2.6 percent and in West Germany by 0.3 percent.[47] Taking industry alone, the United States could keep its level of employment roughly constant (+0.9 percent), while both France (-7.4 percent) and West Germany (-8.0 percent) were shedding labor.

These adverse development of employment trends in some European countries seem to be linked to a low sectoral dispersion of labor costs which prevents low-productivity labor from being employed. Such an interpretation of the European unemployment problem is suggested by a recent study which demonstrates the strong correlation between high inter-sectoral homogeneity of labor costs and rising unemployment since the first oil shock.[48] In other words only highly productive labor has a chance of finding employment under the prevailing cost conditions. This diagnosis corresponds to observable trends in labor productivity and productivity-enhancing capital-labor substitution in France and West Germany. In the first half of the 1980s output per employed person (a rough indicator of labor productivity) rose at almost

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[47] See INSEE, Rapport sur les Comptes de la Nation, 1989 (Paris: INSEE, 1990), p. 92.

[48] Ibid., p. 93.

twice the rate in France and Germany than it did in the U.S.[49] Furthermore, while the rise of total factor productivity alone explains this increase in the case of the U.S., in France and Germany almost half of the rise in output per employed person has been brought about by a higher capital/labor ratio. Thus, it is clear that industry in France and West Germany has reacted to the crisis of costs in the 1970s with an effort to raise the productivity of a smaller workforce in order to bring the efficiency of labor in the production process in line with the relatively high labor costs. This conclusion has also been reached by one other prominent analysis of the rationalization trends in West German industry in the 1980s.[50] It is also clear, however, that these European trends in productivity growth and capital-labor substitution reinforce the above mentioned exclusionary character of the post-crisis economic strategy. As H. Kern and M. Schumann point out, "modernization winners" among the labor force may not--and indeed, do not--ally with "modernization losers."[51] They prefer to form an alliance with mangement, financial capital and the state in order to consolidate their gains and avoid redistribution. The consequence seems to be a continuing societal split along dualist lines and a deepening of the gulf between

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[49] See OECD, <u>Economic Survey of Germany, 1985</u> (Paris: OECD, 1985), p. 26.

[50] See Horst Kern and Michael Schumann, "New Concepts of Production in West German Plants," in Peter Katzenstein, ed., <u>Industry and Politics in West Germany</u> (Ithaca: Cornell University Press, 1989), pp. 87-113.

[51] Ibid., p. 102.

insiders and outsiders.

The third question formulated at the beginning of this section was whether or not the evolution of European welfare capitalism (of which France and Germany are two representative versions) since the crisis of the 1970s has ceased to conform to its characteristic postwar pattern. Again, this paper is not the place to discuss such an involved subject exhaustively. I will therefore limit myself to the formulation of some preliminary hypotheses.

The postwar pattern of European welfare capitalism can be described with the help of three interrelated concepts: the 'postwar settlement,' the 'Keynesian paradigm' and--to borrow from the language of the French regulation school--a characteristic '<u>régime d'accumulation</u>.' The term 'postwar settlement' typically denotes a kind of "truce" between labor and capital in the first twenty-five years since the end of the Second World War.[52] The ensuing stability of income distribution trends brought about both growing purchasing power of wages and relatively small fluctuations of business profitability indicators. The 'Keynesian paradigm' has been used to describe the willingness of governments to commit themselves to the achievement of full employment, growth, low inflation and external stability. The willingness to take responsibility for these four macroeconomic variables was motivated on the part of European governments by the conviction that the demand management techniques and incomes policies at their disposal

[52] See Charles S. Maier, "Preconditions for Corporatism," in John H. Goldthorpe, <u>Order and Coflict...</u>, op. cit., pp. 39-59, pp. 47-59.

sufficed to smooth out business cycles and steer their economies toward a path of balanced growth.[53] Finally, the concept of a stable '<u>régime d'accumulation</u>' has been defined by R. Boyer and J. Mistral in their seminal study of the postwar European (particularly French) growth pattern: As they point out, this growth pattern embodied the following three characterstics which describe the evolution of effective demand, the financing of investment, and the monetary framework provided by public policy: Firstly, wage formation was guided by past inflation and productivity growth; secondly, price setting trends were determined by the efforts of businesses to keep profit rates at a stable, anticipated level; and thirdly, monetary policy was typically--but not everywhere--subject to the readiness of governments to "underwrite" the financing needs of the private and public sectors.[54]

As mentioned in the first two parts of this paper, both the postwar settlement and the Keynesian paradigm are no longer valid descriptions of the present state of affairs in France and Germany. The postwar settlement has been replaced by an intense distributive struggle during the 1970s which involved, in addition to labor and capital, the growing French and German welfare states. In the

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[53] See Christopher Allen, "The Underdevelopment of Keynesianism in the Federal Republic of Germany," and Pierre Rosanvallon, "The Development of Keynesianism in France," chapters 7 and 10 in Peter Hall, ed., <u>The Political Power of Economic Ideas</u> (Princeton, N.J.: Princeton University Press, 1989).

[54] See Robert Boyer and Jacque Mistral, <u>Inflation, Accumulation, Crises</u>, op. cit., p. 119.

second half of the 1980s a new distributive equilibria may have been established, but it is too early to judge whether or not this will be a stable solution. In any case, the convergence of the 1950s and 1960s has been replaced by the dualism of the 1970s and 1980s.[55] Furthermore, in the 1980s the Keynesian paradigm has, for reasons discussed in section three, given way to the reliance on the quasi-regulatory power of monetary policy in EMS countries. And finally, as far as the third concept--the postwar _régime d'accumulation_--is concerned, the 1980s have brought significant change in France and Germany with respect to all three characteristics: In both countries real wages have risen less than labor productivity.[56] Profit rates have fallen after the two oil shocks, and, especially after the second, policy-makers in West Germany _and_ France attempted, through monetary discipline, to limit the scope for price rises by business firms trying to rescue their profits. In order to do this, the "elastic" monetary policy of the postwar period was abandoned in France in 1983.

To conclude: given the arguments made here about changing income distribution trends, modifications of broad economic policy patterns, and alterations in the French and German _régimes d'accumulation_ during the 1970s and 1980s, a case can be made that French and German capitalism has over the last two decades lost many of its postwar characteristics. Based on this diagnosis, one

[55] See John H. Goldthorpe, "Corporatist and Dualist Tendencies...," op. cit., passim.

[56] See Pierre Poret, "The 'Puzzle' of Wage Moderation...," op. cit., p. 18.