

France and European Macro-economic Policy Coordination: From the Treaty of Rome to the Euro Area Sovereign Debt Crisis

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Abstract

French support for European (EC/EU)-level macro-economic policy coordination has been driven by remarkably consistent preferences since the 1950s. With the exception of the de Gaulle decade (1958-68), French governments have sought European-level mechanisms for balance of payments support. This article sets out to explain these remarkably stable French preferences on European-level macro-economic policy coordination over time through a combination of an interest-based analysis referring to structural and competitive weaknesses of the French economy and an ideational explanatory analysis focused upon French Keynesian thinking on symmetrical adjustment of both deficit and surplus countries. French preferences align largely with the concept of 'embedded liberalism'. This article also interprets a number of developments in EU-level economic governance in response to the banking and sovereign debt crises that provided a policy window for France to move European-level mechanisms and institutions towards long-held French preferences.

Keywords: France and European Integration, Macro-economic policy coordination, Economic and Monetary Union, Sovereign Debt Crisis

La politique française en faveur de la coordination des politiques macro-économiques à l'échelle européenne est dirigée par les préférences remarquablement constantes depuis les années 1950. À l'exception de la décennie de Gaulle (1958-68), les gouvernements français ont cherché des mécanismes au niveau européen pour soutenir la balance des paiements nationale. Cet article vise à expliquer ces préférences françaises consistantes au fil du temps avec l'aide d'une analyse basée sur les intérêts économiques se référant à des faiblesses structurelles et la compétitivité de l'économie française combinée avec une analyse idéationnelle focalisée sur la pensée keynésienne en faveur d'un ajustement symétrique des pays déficitaires et excédentaires. Ces préférences françaises s'alignent largement avec le concept de 'libéralisme enchâssé'. Cet article interprète également un certain nombre de développements en matière de gouvernance économique au niveau de l'UE / la zone euro en réponse à la crise de la dette souveraine et qui a fourni la France d'une ouverture politique de transformer les mécanismes et des institutions au niveau européen.

Introduction

French support for European (EC/EU)-level macro-economic policy coordination has been driven by remarkably consistent preferences since the 1950s. With the exception of the de Gaulle decade (1958-68), French governments have sought European-level mechanisms for balance of payments support. French proposals came in the form of a European Reserve Fund (ERF) (conceived by the Belgian-American economist Robert Triffin); the creation of a balance of payments support mechanism in 1969; monetary support for weak currencies in the Werner Plan, the Snake mechanism and the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS); and — since the outbreak of the euro area sovereign debt crisis — financial support for the purchase of sovereign debt on primary and secondary markets — with the aim of breaking the sovereign debt / bank doom loop that risks to undermine the solvency of both sovereigns and banks in the euro area periphery and, through contagion, undermine international confidence in French sovereign debt. French support for the creation of the Macro-Economic Imbalances Procedure (MIP) — agreed in 2010 — should also be seen in terms of French preferences on mutual adjustment. In the negotiations on Banking Union (from 2012), the French Socialist-led Government supported the use of European-level funds to prop up ailing banks and the Europeanisation (and thus mutualization) of national deposit guarantee schemes and resolution funds. Fears of moral hazard — of great importance in German government and Ordo-Liberal thinking and discourse on European-level support mechanisms — rarely appeared in French government discourse.

This article sets out to explain these stable French preferences on European-level macro-economic policy coordination over time through a combination of an interest-based analysis referring to structural and competitive weaknesses of the French economy and an ideational explanatory analysis focused upon French Keynesian thinking on symmetrical adjustment of

both deficit and surplus countries. We argue that this consistency is remarkable and puzzling notably because other important features of French political economy, its model of capitalism and its macroeconomic policies experienced profound changes from the 1980s (Boyer 2002; Levy 1999; Schmidt 2002; Vail 2010). French preferences align largely with the concept of ‘embedded liberalism’. This article also interprets a number of developments in EU-level economic governance in response to the banking and sovereign debt crises that provided a policy window for France to move European-level mechanisms and institutions towards long-held French preferences.

The ideas behind French preferences: ‘embedded liberalism’, ‘embedded currency area theory’ and Keynesianism

The concept of ‘embedded liberalism’ has likely never been explicitly adopted by French policy makers. Nonetheless, it describes effectively French preferences on European integration, generally, and European-level macro-economic policy coordination specifically, and provides an analytical framework through which to understand these preferences. ‘Embedded liberalism’ has also inspired the concept of ‘embedded currency area’ (McNamara 2015) which is relevant to our examination of French preferences on macro-economic policy coordination in the context of the euro area. John Ruggie’s concept of ‘embedded liberalism’ (1982) describes the post-war Bretton Woods monetary and trade regime of gradual liberalisation and largely fixed exchange rates — designed to prevent participating countries from engaging in competitive devaluations. The founding provisions of the monetary system included a temporary escape clause for participating countries facing a situation of ‘fundamental disequilibrium’ — a condition in which a country faced a significant balance of payments deficit (not specifically defined) and downward pressure on its currency —

allowing a national government to adjust its currency (devaluation) and introduce temporary capital controls. Balance of payments support (both precautionary and in the context of crisis) was provided notably through the International Monetary Fund. Ruggie describes embedded liberalism in the Bretton Woods regime as one of ‘intergovernmental collaboration to facilitate balance-of-payments equilibrium, in an international environment of multilateralism and a domestic context of full employment’ (1982: 394-95). This was an economic order that encouraged liberalization (opening of countries to international trade) but also allowed for national interventionism to achieve domestic macro-economic stabilization which was assigned legitimate social purpose. The concept of ‘embedded liberalism’ is based on an older concept first developed by Karl Polanyi (1944) of ‘embedded versus disembedded economic orders’.

It is important for the purposes of our article to point out that the bulk of the burden of readjustment of the ‘embedded liberalism’ of the Bretton Woods System rested with the deficit countries. This reflected US government preferences at the time of the 1944 negotiations establishing the regime. However, many government participants in and observers of the Bretton Woods negotiations (notably John Maynard Keynes, the British government representative) sought the introduction of provisions ensuring the obligation of mutual readjustment for both creditor and debtor countries (Skidelsky 2000). Keynes furthermore wanted a clearer definition of the point at which mutual readjustment should have to take place: he suggested a surplus or deficit of 3 per cent. Keynes sought to highlight the pernicious influence of the gold standard as it had operated in the interwar years. He argued that trying to achieve internal balance by deflating in response to a loss of reserves was not only harmful for the country itself but also had the external effect of depressing economic activity in other countries — leading to the race to the bottom seen in the Great Depression (Vines 2003; Skidelsky 2000). Keynes wanted surplus countries to be required to curtail their

imbalances in more or less the same way that deficit countries were obliged to curtail their imbalances under the gold standard. In his Clearing Union proposal developed during the Second World War, Keynes sought to impose taxes and sanctions on chronic surplus countries (Eichengreen and Temin 2010). Burdens upon creditor countries were, however, avoided due to US government opposition. However, of particular relevance for future discussions on monetary cooperation and integration in Europe, Keynes insisted that an exchange rate system created obligations on both sides of the exchange rate relationship to contribute to its stability and smooth operation. The actions of surplus as well as deficit countries had systemic implications. Their actions mattered for the stability and smooth operation of the international system; they could not realistically assign all responsibility for adjustment to their deficit counterparts.

Keynesian thinking had strong currency in France after the Second World War especially among the modernizing technocratic elites and it was firmly anchored in the French *grandes écoles* where the bulk of the political, administrative and economic elites was trained.¹ French policy-makers could easily find arguments provided by Keynes when asking for a more symmetrical approach to macro-economic imbalances in the global and European currency systems. Of course, the general importance of Keynesian thinking for French economic policy-making changed over time. Starting with the 1970s' stagflation and the Barre adjustment plan in 1976 and later with the Socialist-led government's policy U-turn of 1983 towards a policy of 'competitive disinflation', Keynesian ideas lost currency in France as in other wealthy industrialized countries (Cameron 1995; Hall 1986; Uterwedde 1988). In the aftermath of the international financial and euro area crisis, when Keynesian economic ideas gained renewed attention, both the centre-right president Nicolas Sarkozy and the center-left president François Hollande made only selective use of Keynesian ideas and instruments to

¹ Rosanvallon (1987) retraces the history of Keynesian ideas in France. For a comparative view on the impact of Keynesian ideas on economic policies, see Hall (1989).

reflate the economy (Clift 2012; 2014). However, little change can be observed over time as regards to French preferences for a sharing of the burden of adjustment between current account deficit and surplus countries in order to reduce macro-economic imbalances and in its support of instruments of mutual support. In this respect, Keynesian thinking never lost its appeal. Indeed, Prime Minister Raymond Barre — who eschewed Keynesianism in his domestic economic policy — was very much in favour of the creation of a more symmetry exchange rate mechanism and a European Reserve Fund in order to help make domestic adjustment easier to manage economically and politically (Howarth 2016).

The economic interests behind French preferences: tackling French deficits and challenging unilateral adjustment

French support for sharing the burden of adjustment between deficit and surplus countries was not only anchored in economic ideas but also in economic interests. With only occasional exceptions, from the last third of the 19th century through to the start of Stage Three of EMU in 1999, France faced overall trade deficits. France faced significant current account problems in the 1950s, 1970s and 80s and again from the late 1990s (Figure 1). France enjoyed an improving current account position in the 1990s — with a record surplus at the start of Stage Three of EMU in 1999 — but this owed largely to the success of the French policy of competitive disinflation, with record high real interest rates, and the negative then slow French GDP growth.

Prior to EMU, current account deficits combined with periodic inflationary pressures to make the French economy vulnerable to currency crises and speculative attacks — especially as international capital movements gained in importance from the 1970s. Frequent devaluations

of the franc or revaluations of stronger European currencies such as the deutschmark and the Dutch florin against the franc served only as temporarily measures to cope with imbalances. Despite a gradual weakening of the franc versus the deutschmark from the 1950s (Figure 2), France never enjoyed an annual trade surplus with Germany. From limited amounts in the 1950s and 60s, the French trade deficit with Germany increased significantly in the 1970s and 80s. Even in the 1990s, despite the improving French current account position, the trade deficit with Germany only stabilized prior to ballooning from the late 1990s and reaching a peak of 39 billion euros in 2012 (Figure 3). From 1999, declining French wage competitiveness in relation to Germany (see Figure 4) contributed to both the deteriorating French trade deficit with Germany and French current account deficits.

Macro-economic interests directed French preferences in favour of support mechanisms for weaker currencies in the Bretton Woods system, in the European Snake and the ERM of the EMS. More recently these interests drove French preferences in favour of support mechanisms for sovereign debt. Economic interests also encouraged French governments to push for more symmetry in the operation of currency systems in which the franc took part — with more obligations for surplus countries in addition to support mechanisms. These consistent preferences in regard to European macro-economic policy coordination were driven by the search for greater room to manoeuvre in the pursuit of domestic macro-economic policies aimed at reducing unemployment.

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The decline of ‘embedded liberalism’

It is widely acknowledged that the Bretton Woods system worked thanks to the United States which assumed the central burdens of the system, opening its markets to the goods of a number of West European and East Asian countries, and providing liquidity. The United States also enjoyed the exorbitant privilege of being able to print unlimited quantities of dollars without fear of devaluation in relation to gold. The Triffin dilemma eventually brought down the Bretton Woods system, whereby the central currency of the system — the dollar — which was needed to provide liquidity in the system also was subject to inflationary pressure and thus devaluation in relation to other currencies in the system. A dollar overhang was created as other countries exporting to the US ended up holding large quantities of devaluing dollars. The French, under de Gaulle in particular, had issues with the dominant position of the United States and its exorbitant privilege in the Bretton Woods system. De Gaulle sought to replace dollars with gold.

The decline and then collapse of the Bretton Woods system has been widely discussed in the literature. For some, this decline and collapse reflects the relative decline of the American hegemon — and its decreased willingness to assume the main burdens in the system (Keohane 1984). This collapse of the ‘embedded liberalism’ rooted in the Bretton Woods system was followed by the rise of the ‘Washington Consensus’ with structural adjustment programmes inspired by neo-classical economics imposed by the IMF on governments facing large current account deficits and in need of emergency finance.

Features of ‘embedded liberalism’ can also be identified in a range of European Community (and then Union) policies — reflecting French (and other) government caution with regard to trade liberalization (Lynch 1997; Krotz and Schild 2013). Thus trade liberalization was very gradual — starting with manufactured items first and extending to labour, some services and capital only later. Regional policy was inserted into the Treaty of Rome officially condoning

government assistance to disadvantaged regions of the Community — assistance that might otherwise contradict European Competition Policy. European-level Structural funds were created to help these regions. The Common Agricultural Policy (CAP) created a significant carve out to European rules on market integration and government assistance. Yet there were clear limits to the ‘embedded liberalism’ of the European Community. For French governments, reinforced EC-EU macro-economic policy cooperation and coordination was meant to supplement the Bretton Woods system and then replace it (as much as possible).

Some scholars have also pointed to the central banker and German government designed EMU project in terms of creating a euro area that must be seen as “disembedded” from the broader social institutions needed for adjustment when a currency is removed from national control’ (McNamara 2015: 22). According to McNamara’s (2015: 26) ‘Embedded Currency Area’ (ECA) approach, four elements constitute the ‘minimum, rather than an optimal foundation for monetary union’: a ‘legitimated generator of market confidence and liquidity’; ‘mechanisms for fiscal redistribution and economic adjustment’; ‘regulation of financial risk and uncertainty’; and ‘political solidarity’. This vision — implying a Fiscal Union that includes fiscal distribution and sovereign debt pooling — aligns largely with the economic ideas held by French decision-makers (Krotz and Schild 2013).

Neglected European macro-economic policy coordination in the Treaty of Rome

The European Community (and then Union) provided minimal balance of payments support. This absence initially reflected the existence of the Bretton Woods system. Furthermore, the current account position of the EC member state with the largest economy (Germany) was the reverse of the situation within the Bretton Woods system. The US government supported

Bretton Woods by providing liquidity (dollar overhang) and by running a large current account deficit. Germany — with its almost constant trade surplus in relation to other EC / EU member states from the 1950s and, from the early 2000s, massive overall trade and current account surpluses and large surpluses in relation to all but a few euro area member states — was in a very different position. German governments consistently rejected a greater role for fiscal policy either at the national level — through reflation — or European level — through transfer mechanisms beyond the limited funds provided through European policies. Therefore, during the EC's first decade, there was a near absence of macro-economic policy coordination and the complete absence of mechanisms to assist member states needing to adjust — not to mention mutual adjustment mechanisms.

This state of affairs existed despite explicit French preferences expressed in the discussions and negotiations leading to the Treaty of Rome (Lynch 1997; Kaplan and Schleiminger 1989). In the context of a difficult French balance of payments situation in the final years of the Fourth Republic, the French government explicitly endorsed Robert Triffin's 1956 proposal for a European current account fund (Triffin 1957). Triffin, the Belgian-American economist based at Yale University, inspired by Keynes, called for the creation of a fund to which all EC member states would be required to contribute. Triffin called for mutual commitment to the system which would in effect have posed obligatory burdens upon surplus countries to support those with deficits (Maes and Buyst 2004; Bussière and Maes 2016). The Mollet government at the time — a coalition of socialists, Christian democrats and centrists — supported Triffin's proposal and shared the economist's concerns on the need to prolong the European Payments Union (EPU) (Triffin 1954; Lynch 1997). The Mollet government saw a European Reserve Fund (ERF) as a vital mechanism to achieve the consolidation and permanence of the EPU because it ensured that — in the event of an economic crisis in the United States and a return to US protectionism — an ERF would protect Europe from the

asymmetric effects of a dollar shortage and resulting intra-European tensions. The French (like Triffin) queried the usefulness of international mechanisms and looked to a regional ‘amortisseur des chocs’ where ‘strong economic interdependence and a proximity of interests would facilitate political economy compromises’ (Triffin 1954). Few in the French government shared Triffin’s federalist vision of economic and monetary coordination. However, the French government did support Triffin’s ERF proposal which would have worked to prolong the EPU through a regional mechanism responsible for transfers among participating European countries.

Leading members of the Mollet government also shared many of Triffin’s concerns with regard to the limited scope of balance of payments support mechanisms created in the context of the European Monetary Agreement (EMA) signed in 1955 — which was to come into effect after the dissolution of the EPU (Bussière and Maes 2016). According to the EMA, a European fund provided EMU-members access to non-automatic credit facilities in case of temporary balance of payments difficulties, and a Mutual System of Settlements created to encourage the settlement of international payments through the foreign exchange markets, rather than through central banks as had often previously been the case. The Mollet government found that these EMA-arrangements were not ambitious enough (Kaplan and Schleiminger 1989). The French advocated the transformation of EPU into what Triffin called a European Clearing House that would also pool a certain percentage — Triffin had recommended 20 per cent — of the total gold and foreign exchange reserves held by European central banks. The European Clearing House would use these reserves to intervene in international exchange markets, approximating the open market operations performed by national central banks in their domestic markets. Therefore, this clearing mechanism could have been a powerful collective European instrument to fight against speculative currency movements (Kaplan and Schleiminger 1989). For Triffin — a view not shared by the French

government or by a significant number of French government officials — the European Clearing House would have been a predecessor to a European Monetary Authority (Triffin 1957).

Upon its creation, the European Commission was preoccupied by the French balance of payments crisis in 1958, the weak franc, and the potential for French economic difficulties to undermine European economic integration (Bussière and Maes 2016). Moreover, with the dissolution of the EPU imminent, the return to convertibility of European currencies, and the creation of the CAP, many in the Commission feared the impact of currency instability. Robert Marjolin, the Keynesian French head of DG II (Economic and Monetary Affairs) sought greater balance of payments and currency support at the European level (see Seidel 2016).² As both a former junior minister for economic reconstruction in France and the first head of the Organisation for European Economic Cooperation (OEEC) from 1948, Marjolin was very knowledgeable on both the difficult situation of the French economy and the importance of the EPU. Marjolin was convinced that the clearing and credit facilities of the EPU contributed to the liberalization of trade among European countries, strengthening them both economically and thus (in a period of intensifying Cold War) politically (Seidel 2016). In May 1958, Marjolin presented his first Memorandum to the Commission, focusing on need for the coordination of national economic policies (Seidel 2016; see Annexes 4 to 8 in Ferrant and Sloover, 1990). Marjolin started from the observation that the EEC Treaty provided for the basic principles of the coordination of economic policies, but that the details of this coordination needed to be supplemented and made more explicit. To put into practice economic policy coordination, Marjolin proposed to undertake regular critical surveys of member state economies. Moreover, he proposed that the Community institutions could

² Robert Marjolin was ‘the first French economist who can really be called a Keynesian’ and wrote a doctoral thesis on Keynes’ theory in 1940 (Rosanvallon 1987: 30, our translation).

formulate policy recommendations. In Marjolin's view the weight of these recommendations would be stronger if the Community had at its disposal resources to facilitate financial solidarity — although he did not initially clarify the structure of this facility (Bussière and Maes 2016; Flory 2014).

Marjolin envisaged balance of payments support as an inherent part of the move to 'European Monetary Union' (Seidel 2016). In the first of three stages, member states would benefit from financial solidarity if they followed a code of good conduct. In the second phase, member state governments would be obliged to follow the recommendations by the Council, taken by qualified majority voting. All member states would be required to make available a certain percentage of their currency and gold reserves to provide credits to those member states with balance of payments difficulties. This could eventually — in a worst-case scenario — be extended to a 'total' solidarity in which member states would use larger parts of their reserves to support a member state in need. This 'total' solidarity reflected Keynesian thinking on mutual obligations for both deficit and surplus countries. By the end of stage two (duration left unspecified), Marjolin considered member states would be in a 'state of monetary union'. His stage three was not spelled out.

In his second memorandum of 7 November 1958 — written with the assistance of Triffin who had become his advisor in DGII — Marjolin was more explicit and detailed about the structure of the ERF. However, he was also more cautious on supranationalism than in his May memoranda, and Commission policy recommendations were no longer to be binding for member state governments. Financial solidarity was still on the agenda but the situation in France had improved and was less threatening so Marjolin placed less emphasis on this issue. Each member state would pay into the ERF a minimum of 10 per cent of national foreign reserves. The fund would have numerous functions and its reserves could be used for all

settlements between the central banks of the member states as well as with EPU members and the rest of the world. The memorandum also proposed to use a unit of account for managing the fund, as suggested by Triffin.

The Commission discussed Marjolin's proposals at its meeting of 20 November 1958. The Commissioners agreed in principle with the need for balance of payments support, but postponed the discussion of the specific details to a future meeting (Bussière and Maes 2016). The proposals were subsequently pushed aside. National central banks were sceptical about the unit of account and the design of the ERF, and the German government did not approve of the potential support obligations imposed on surplus countries (Bussière 2007: 394). Most importantly, the French political context had changed with Prime Minister and then President de Gaulle pushing through a devaluation of the franc, austerity reforms, and a broader liberalization of the French economy through the Pinay-Rueff Plan. EPU member countries subsequently restored the external convertibility of their currencies in the framework of the Bretton Woods system. The need for an ERF became less pressing, and was downplayed or absent in Marjolin's subsequent proposals on European macro-economic policy coordination. While Triffin served as an 'eminence grise' at the European Commission throughout the 1960s, his influence was limited (Bussière and Maes 2016; Seidel 2016).

With the Bretton Woods system nearing collapse, in 1969, the EC member states agreed to a regulation 'Establishing a facility providing medium-term financial assistance for Member States' balances of payments' (1969/88). The adoption of this regulation also reflected the influence of the leading French economist Raymond Barre, the new Commissioner responsible for Economic and Financial affairs, who was aligned with neither Marjolin nor Triffin on the need for macro-economic policy coordination and mutual readjustment involving obligations for both deficit and surplus countries (Howarth 2016). Barre

nonetheless recognized that balance of payments support mechanisms were crucial for some member states (notably France and Italy) to accept more trade liberalization — and notably the liberalization of short-term capital movements. In response to French concerns, a below market interest rate was to be attached to loans provided through the mechanism and no conditionality was to be applied. However, the financial assistance facility agreed by the member states only had a limited loan ceiling which in 1988 was set at 16bn European Currency Units (ECUs) and Community loans were to be financed exclusively with funds raised on the capital markets and not by other member states. Prior to the 2000s, no member state made use of the mechanism. In 2002, the member states adopted a new regulation (332/2002) applying balance of payments support only to non-euro area member states — reflecting the view that balance of payments problems would cease to be relevant for euro area member states (see below). The 2002 regulation also lowered the loan ceiling from 16bn to 12bn euros. Subsequently, Hungary and Latvia received balance of payments of support from the facility.

Macro-economic imbalances in the first EMU discussions from 1969

Until the final collapse of Bretton Woods in 1973, French calls for a closer European-level coordination of monetary policies served the primary purpose of stabilizing and reforming the ‘embedded liberal’ order of the International Monetary System which provided room for domestic economic policy autonomy, economic interventionism and the pursuit of domestic stability goals (Howarth 2001). In the dominant French view, steps towards European monetary co-operation had to deal with two asymmetries. First, they should reduce or set an end to the ‘exorbitant privilege’ of the dollar as the world’s leading reserve currency (see Bordo *et al.* 1993; Howarth 2001). Second — of greater relevance to our discussion — French

governments saw European monetary co-operation as a mechanism to serve the purpose of symmetrically sharing the burden of adjustment between EC member states with weak and strong currencies in case of balance of payments and currency crises induced by huge dollar fluctuations. The end of the Bretton Woods system then led to a shift in French attention away from reform of the International Monetary System towards renewed interest in European monetary integration.

An 'embedded liberal' European monetary order suiting French interests and reflecting its economic ideas would have comprised the following four core elements: fixed, but adjustable exchange rates between EC currencies providing for monetary stability; a coordination of national monetary policies in order to give France a say over German policy and shielding it from the negative impact of unilateral German decisions; mutual support mechanisms to handle balance of payments and currency crises, to provide for a symmetric distribution of the burdens of adjustment and to avoid deflationary domestic adjustment in France; and a common European exchange rate policy towards the US dollar reducing the power asymmetries in the International Monetary System. For French governments, mutual support mechanisms were a key prerequisite for the creation and maintenance of any regime of fixed but adjustable exchange rates. French governments advocated mutual financial support and symmetrical obligations to intervene in the markets to support exchange rate parities. At The Hague European summit in December 1969, President Georges Pompidou advocated the creation of a European Monetary Union. His main immediate goal was to set up what the French labelled a European Reserve Fund that pooled member state central bank foreign reserves as 'a means of achieving concerted action in relation to the US dollar' (Dyson and Featherstone 1999: 106) and was to be used for short term support measures as part of a first stage of monetary cooperation. The then German Chancellor, Willy Brandt, supported the idea of pooling reserves in an ERF, but only after an initial period of economic convergence.

This German ‘economist’ approach prevailed over the French ‘monetarist’ approach: The Hague Summit’s conclusions envisaged the creation of an ERF only after a period of significant economic policy convergence.

In January 1970, the ECOFIN Council reached a formal agreement on the system of short-term monetary support. Through this facility, the participating central banks provided each other unconditional, ‘quasi-automatic’ credits for up to three months in situations of balance of payments deficits, renewable for an additional three months (Ungerer 1997: 90). In April 1973, the member states agreed to establish the European Monetary Co-operation Fund (EMCF) to coordinate Community monetary policies and manage existing short and very short term financing mechanisms created to support the exchange rate parities of weaker Community currencies.

Regarding the maintenance of fixed exchange rates inside the EC, the turbulent fields of international monetary relations after the demise of Bretton Woods only allowed for the abortive experience of the Snake mechanism which began operation in April 1972. This system of exchange rate parities allowed only half the fluctuation margins permitted in the International Monetary System — thus the so-called Snake in the Tunnel. From March 1973, with German government refusal to stem the appreciation of the mark in relation to the dollar, the Snake floated free of its tunnel. Asymmetry characterized the Snake, the deutschmark serving as its anchor currency. The burden of economic adjustment lay fully with the deficit / weak currency countries, and all participants — save Germany — had to sacrifice their monetary autonomy in order to maintain their currencies within the mechanism. France proved neither willing nor able to do so and the franc was forced to withdraw from the Snake twice — in January 1974 and in March 1976. France sought to shield Community member states from international monetary instability by defining narrow margins of fluctuation

between their currencies. To achieve this goal, both reliable European-level monetary support mechanisms and the convergence of economic policies and inflation rates were necessary. France advocated the former but refused the latter because concerted economic policy convergence would have necessarily limited the autonomy of French macro-economic policy-making.

In September 1974, the French Finance Minister Jean-Pierre Fourcade, came up with the ‘most important French proposal on European monetary reform prior to the Balladur Memorandum of 1988’ (Dyson and Featherstone 1999: 113). The Fourcade plan’s main goal was to address the issue of asymmetry and to ‘spread the burden of intervention more fairly’ (Dyson 1994: 88). The plan called for a concerted float of the Community currencies, joint interventions in the exchange markets including intra-marginal interventions to underpin an exchange rate system and the extension of Community credit facilities as well as the issuing of Community loans (Howarth 2001: 28). Although this proposal was quickly blocked due to German and Dutch objections, it served as a blueprint for later French ideas and proposals for the design of the European Monetary System (EMS). The French government thus persisted with the Keynesian objective of imposing readjustments on both deficit and surplus countries with the aim of achieving a more durable exchange rate regime, while allowing for continued margin of manoeuvre in national macro-economic policy.

The European Monetary System: bold plans, modest outcomes

In the negotiations leading to the creation of the EMS in 1979, the French sought to eliminate the asymmetry of the Snake through several mechanisms. First, the French wanted the new system to be built around a currency basket, with the ECU serving as pivot and a means of

settlement between EEC monetary authorities. Second, the French wanted unlimited intra-marginal interventions by strong currency central banks once a weak currency crossed a ‘divergence threshold’ (Howarth 2001: 40-41). Third, the French sought the creation of a European Monetary Fund, pooling the foreign reserves of participating member states, to replace the existing European Monetary Cooperation Fund (Ludlow 1982: 165).³

At the insistence of the Bundesbank and the Federal Ministry of Finance, the EMS design that was finally adopted turned out to be much less symmetrical than envisaged by French authorities (Kaltenthaler 1998: 53-54). A bilateral parity grid system along the lines of the Snake was finally adopted and the deutschmark once again performed the function of an anchor currency — as in the Snake (James 2012). Central banks were only required to intervene in situations when their own currency reached the upper or lower ceiling of the fluctuation band. Central banks of surplus countries were not legally bound to intra-marginal interventions which were necessary to nip currency crises in the bud. Indeed, in the EMS, the German Bundesbank’s interventions to defend currency parities turned out to be limited (Giavazzi and Giovannini 1988). Furthermore, the European Monetary Fund was never created. As in the Snake, France was forced to follow the monetary policy choices of Germany or risk the forced departure of the franc from the ERM. From its economic policy U-turn in 1983, the French Socialist government adopted its strategy of the strong franc (*franc fort*) and competitive disinflation, becoming ever more determined to avoid the devaluation of the franc. Ultimately though, the asymmetric functioning of the EMS and the dominant role of the Bundesbank led to renewed French interest in EMU from 1988.

³ Cf. Conclusions of the Presidency of the European Council on 6 and 7 July 1978, Bremen, 18 July 1978 (final version).

The French made several attempts to address the asymmetry of the EMS and improve macro-economic policy coordination — notably the Basel-Nyborg Accords of 1987 and the creation of the Franco-German Economic and Financial Council in 1988. The limited success or failure of these efforts increased French interest in a bold move towards EMU. So too did the liberalization of short term capital movements. The Commission made the removal of capital controls a core element of its 1992 Single Market Programme and the German government was strongly in favour of capital liberalization. However, removing capital controls meant dis-embedding markets. Under the condition of free capital movements, the only option to combine fixed exchange rates and some French influence on monetary policy appeared to be the irrevocable fixing of exchange rates and a centralization of monetary policy, delegated to a supranational central bank — Mundell's (1961) 'Unholy Trinity'. In the early 1970s, French governments had advocated the use of capital controls to stabilize exchange rates and preserve national monetary and macro-economic policy making autonomy (Howarth 2001: 32). In the late 1980s, French governments made a different choice.

The move towards EMU and macro-economic coordination as fiscal consolidation

The January 1988 memorandum of the French minister of finance, Edouard Balladur, was unusually explicit in expressing key French concerns regarding EMS asymmetry: 'It must be avoided that one single country [i.e., Germany] has, de facto, the responsibility to fix the objectives of the economic and monetary policy of the entire system' (Balladur 1988: 18 and 20). The memorandum advocated a two track approach: short-term EMS reforms combined with reflections on further steps in monetary integration to create 'a single currency', 'a common central institution', and 'federal banks in the individual countries'. Balladur saw

these steps as being the logical consequence of the liberalization of capital markets, making the status quo untenable (Balladur 1988: 18 and 20; see also James 2012: 228).

In the Delors Committee — tasked by the Hannover European Council in June 1988 to report on monetary union — the Governor of the Bank of France, Jacques de Larosière, raised the issue of balance of payment problems. In his comment annexed to the report, he called for a European Reserve Fund with significant powers to intervene in exchange markets to be established during the transition to monetary union (de Larosière, interview, June 1995). This was not adopted. The dominant view in the Committee was that balance of payments problems would cease to exist with the economic convergence required during the second stage of the EMU project (Klaus Regling, interview April 2014; Nils Thygesen, interview March 2015). In their draft treaty on monetary union, the French continued to push the idea of a European fund intervening in international exchange markets in the transition to the single currency (Palayret 2009: 207-211). Prime Minister Pierre Bérégovoy also insisted on embedding the single currency in a political framework: the creation of a European economic government as a political counterweight to the European Central Bank and as an institution able to coordinate an appropriate policy mix between monetary and fiscal policies with the ECB (Howarth 2001 and 2007: 1067; Palayret 2009: 207). This French preference for *ex ante* policy coordination — that is prior to central bank monetary policy decisions ran counter to the German approach. In the German view, governments' fiscal policies and social partners' wage setting had to take the ECB's stability-oriented single monetary policy as 'given,' which would 'lead to *implicitly* coordinated policy outcomes *ex post*' (Issing 2002, 346; emphasis in the original).⁴

⁴ Issing was serving as the ECB's chief economist when he published this article.

The problem of European macro-economic imbalances and coordination, and mutual support mechanisms lost the attention of policy makers following the start of EMU's Stage III in 1999. Currency crises were effectively ended inside the common currency area and current account imbalances in the euro area only built up over time and were disguised by the Target II Payments system. However, with the euro area crisis — a case of 'rapid unwinding of economic imbalances' (Baldwin and Gavazzi 2015: 19) — the issues of both macroeconomic imbalances and mutual support mechanisms for members states made a forceful comeback.

The banking and sovereign debt crises: A window of opportunity for France on macro-economic policy coordination?

From the start of the euro area's sovereign debt crisis in 2009, familiar topics returned to the European agenda. French preferences on the stabilization of the euro area and reforms of its governance framework displayed a number of similarities with its preferences during the 1950s (prior to de Gaulle), 1970s and 1980s when the focus was the stabilization of international and European exchange rates. Just as the French wanted support mechanisms to undermine disruptive speculative attacks against the franc and other weak European currencies back in the 1970s and 80s, they now advocated the creation of instruments to discourage speculation on euro area periphery sovereign debt and to reduce bond yields, with the fear of contagion to France. As in the pre-EMU past, French governments tried to find ways to avoid an economic policy convergence towards German 'austerity' policies, thus leaving room for French national policy autonomy and fiscal policy discretion. French governments thus, yet again, sought mechanisms to bring about a symmetrical adjustment of both surplus and deficit member states — instead of the asymmetrical adjustment of deficit countries, the deflationary macro-economic effects of which French governments feared.

French governments also tried to avoid, now as in the 1970s and 1980s, the growing power asymmetry inside Europe in favour of Germany, the macro-economic policy choices of which French governments were unable to influence — putting France in a situation of a ‘policy taker’ suffering from the negative economic consequences of Germany’s unilateral decisions. Nonetheless, the French also proved more successful than in the past in achieving reforms to economic governance which in effect softened the asymmetry of economic relations in the euro area and created more macro-economic policy margin of manoeuvre for deficit countries.

The focusing event of the twin banking and sovereign debt crises opened a window of opportunity for French governments. It enabled them to advocate successfully a number of steps towards the construction of an ‘embedded currency area’ — as defined by McNamara (2015). Euro area member states agreed new policy instruments and institutions to coordinate fiscal support for illiquid or insolvent member states and to prevent banking crises from fueling sovereign debt crises thus breaking the sovereign debt / bank doom loop. The successive French presidents, Nicolas Sarkozy and François Hollande, actively advocated strong euro area support mechanisms, the preventive set-up of financial facilities (rescue funds) and their purchase of sovereign debt to ward off speculative pressures. They followed what the anti-euro German economist Hans-Werner Sinn called the ‘money-in-the-display-window theory’ (Sinn 2014: 5), signaling to investors and speculators that the euro area governments were able to mobilize huge amounts of money and guarantees to counter speculative attacks.

Throughout the crisis, French governments, of the right and then left, displayed a clear preference for vigorous and decisive crisis management action — including rescue schemes for Greece and, later, Ireland and Portugal, to prevent contagion to Spain, Italy and ultimately to France. In May 2010, in addition to a bilateral loan facility for Greece, the EU member

states agreed upon the establishment of the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM) backed by the Union's budget. Together with the IMF, they were able to mobilize up to €750bn to purchase sovereign debt on primary markets (IMF: €250 bn., EFSF: €440bn., EFSM: €60bn.). The French government (and others) argued that this amount was far from sufficient, as the crisis deepened in 2011. In calling for ever more fiscal and monetary 'firepower', the French government found itself aligned with the Commission, the IMF and the ECB, the Troika institutions. As part of their Deauville compromise of October 2010, the French and German governments jointly promoted the establishment of a permanent lending facility, the European Stability Mechanism (ESM), which was inaugurated in October 2012.⁵ President Sarkozy also supported assigning to the EFSF a banking license and hence unlimited access to ECB funds (*Le Monde* 2011), an idea shared by his successor François Hollande who called for a banking license for the European Stability Mechanism (ESM), the permanent successor to the EFSF (*Spiegel online international* 2012). Moreover, President Hollande was a fervent advocate of a European Banking Union to sever the link between banking and sovereign debt crises (Howarth and Quaglia 2013). This involved, notably, the creation of the Single Resolution Fund which supranationalized financial support for the resolution of banks (Howarth and Quaglia 2016). However, Germany was able to set limits to these rescue funds and operations — on the EFSF and ESM see Krotz and Maher 2016; on Banking Union see Howarth and Quaglia 2016.

Finally, French governments actively promoted and then supported all the nonconventional monetary policies adopted by the ECB to tackle the banking and sovereign debt crises, thus compensating in part for the inadequacy of the support mechanisms agreed by the member

⁵ For an overview over the Franco-German bilateralism during this crisis, see Schild 2011; 2013.

states. Indeed, the clearest changes to the economic constitution of the euro area away from German preferences involved the effective violation of the ‘no-bail-out’ logic of the Maastricht Treaty — most clearly symbolized by the ECB President Mario Draghi’s promise in July 2012 to do ‘whatever it takes to preserve the euro’ — and the de facto violation of Treaty provisions prohibiting the monetization of public debt, through the range of nonconventional monetary policies adopted.

There is a strong parallel between French preferences since the outbreak of the sovereign debt crisis and the French ‘monetarist’ approach during the first half of the 1970s. At that time, France pursued the goal of increasing monetary stability without sacrificing domestic macro-economic policy autonomy to German ‘economist’ demands for convergence. During the twin sovereign debt and banking crises, France pursued the goal of improved stability of banks and sovereigns without economic policy convergence towards the macro-economic policy preferences of surplus and creditor states (notably Germany). Hence the repeated French government calls for more symmetrical obligations for both deficit and surplus countries and, specifically, reflation by surplus member states in the euro area and for stronger elements of mutual support, embedding the euro area in a new set of political institutions and policies.

One politically significant — albeit ultimately limited — success of French efforts to achieve greater symmetry in macro-economic policy coordination was the adoption in 2011 of the Macroeconomic Imbalance Procedure (MIP), part of the so-called ‘Six Pack’ legislation (EU Regulation No 1176/2011). Through the MIP, current account imbalances, *both* huge deficits and surpluses, triggered an in-depth review by the Commission and could ultimately lead to sanctions. However, the German government succeeded in watering down initial Commission proposals regarding the level at which a surplus triggered the Commission’s review. The Germans successfully insisted on setting the surplus threshold indicator at 6 per cent of GDP

(averaged over three years) — well in excess of the 3 per cent recommended by Keynes to trigger mutual adjustment — while the deficit threshold was set at 4 per cent.

In 2016, the institutional framework and macro-economic policies of the euro area were still a far cry from the ‘embedded currency area’ approach and from French preferences. The full mutualization of risks, seen by French policy-makers as crucial, was not (yet) in place. There remained strong constraints on the use of ESM funds to recapitalize ailing sovereigns and banks, and the Single Resolution Mechanism for banks was to have limited funds. The German government remained firmly hostile to the establishment of a European Deposit Insurance Scheme and Commission plans to eventually replace national schemes (Howarth and Quaglia 2016). During his presidential election campaign and immediately after entering office in 2012, François Hollande called for the mutualization of public debt through the introduction of Eurobonds. However, such proposals — keenly supported by euro periphery member states — were still-born in the face of German hostility. Other ideas aired by the French government to promote a fiscal union and a common macro-economic stabilization function,⁶ that might take the form of a specifically euro area ‘fiscal capacity’ (Gabriel and Macron 2015) or a European-level unemployment insurance scheme,⁷ found support in principle from the Commission and the ‘Five Presidents Report on the Future of EMU’ (Juncker *et al.* 2015), but not from the German government. Despite the new MIP, Germany accumulated ever higher current account surpluses (8 per cent of GDP in 2015), and rather

⁶ The French and Italian ministers of finance, Michel Sapin and Pier Carlo Padoan, called for a European-level fiscal instrument for anti-cyclical macroeconomic stabilization (see their joint statement of the at the occasion of the 33th Franco-Italian summit in Venice on 8 March 2016; URL: <http://www.economie.gouv.fr/files/files/PDF/33e-sommet-italie-france2016.pdf>; last accessed: 10/3/2016. In September 2015, the French economics minister, Emmanuel Macron, called for a permanent transfer mechanism that provided funding in exchange for real member state commitments to reform (*Financial Times*, 24 September 2015). Macron proposed that member states contribute part of their VAT tax receipts and unemployment insurance to fund these transfers.

⁷ This idea was aired by the Direction du Trésor of the French Ministry of Finance. For an overview of the debate, see Assemblée nationale 2016.

than using its room for countercyclical fiscal policy, it achieved a surplus of €12bn in its 2015 federal budget (Handelsblatt 2016).

The German reluctance to make more symmetric the burdens of adjustment (Bulmer and Paterson 2013) cannot only be explained by a material interest. This reluctance was also deeply rooted in ideas of Ordo-liberal inspiration. The German government emphasized the close association between private risk-taking and private liability, advocated the role of market pressure to reduce the moral hazard both of states and financial market actors thanks to market pressures⁸ and sought institutional reforms to impose strict and enforceable rules upon member state fiscal policies. In French discourse on EU / euro area economic governance, moral hazard arguments — so central to German thinking and preference formation — were almost inaudible. In effect, French governments wanted Germany to undertake the heavy-lifting in providing support for member states with high public or current account deficits. However, French governments also repeatedly refused or sought to undermine the fiscal and macro-economic policy terms that the Germans attached to the provision of their support. For French governments, short-term crisis management considerations and the reduction of contagion risks through both fiscal support mechanisms and the ECB's nonconventional monetary policies prevailed over considerations of the destabilizing potential of these fire-fighting measures.

Conclusion

French preferences in favour of European level balance of payments and currency / sovereign debt support proved remarkably stable from the negotiations leading to the Treaty of Rome to

⁸ The 'no-bail-out' clause was an example in kind; as was the orderly sovereign default procedure advocated by Germany.

the sovereign debt crisis — with the exception of the decade of the de Gaulle presidency. In addition to the flexibility and support offered through the Bretton Woods form of ‘embedded liberalism’, French governments sought to impose support obligations upon surplus countries and even readjustment. French governments sought to avoid the huge currency fluctuations that would result from trade and capital liberalization, while also preserving a degree of autonomy in domestic macro-economic policy. In line with these preferences, French governments of both the right and left responded to the euro area crisis that erupted in late 2009 by advocating the creation of new support instruments — in order to avoid transnational contagion, the deflation of austerity policies and, ultimately, euro area disintegration. We explain the stability of these French preferences on European macro-economic policy coordination in terms of the lasting influence of Keynesian economic thinking in French policy making circles and the long-term economic interests of a country with almost constant trade and current account deficits, and — through to the early 1990s — difficult to master inflationary pressures and repeated experience with currency crises and devaluation.

French governments failed to bring about a more symmetric International Monetary System. They only achieved limited success in creating more symmetric forms of European monetary and macro-economic policy coordination. The euro area crisis provided a window of opportunity and French governments succeeded to some extent in moving European-level mechanisms and institutions towards long-held French preferences with the creation of rescue funds (notably the EFSF and the ESM), core elements of Banking Union and the MIP put into place. The French were vocal supporters of ECB nonconventional monetary policy. The French also resisted greater German influence in shaping the design of the euro area, blocking German government efforts to create a revised EMU architecture (Maastricht 2.0) which involved both limiting common liabilities and shifting control to the European level where

some common European liabilities for risk were accepted.⁹ French governments failed, however, to build a strong framework of ‘embedded liberalism’ in euro area macro-economic policy coordination, failing to gain German support on crucial elements of an ‘embedded currency area’ approach, including the mutualization of euro area member state liabilities.

Establishing institutions of monetary cooperation without sufficient economic convergence and without the political will to create generous support mechanisms at the European level proved an unstable solution in the Snake mechanism, the EMS framework and — it turned out — EMU. Following the outbreak of the euro area sovereign debt crisis, France pushed for another uneasy combination of ever more joint European liabilities without the corresponding shift of control to the European level, as national budgetary autonomy remained jealously guarded. The erosion of the main pillars of the original EMU project, French unwillingness to accept the supranational implications of the German proposed Maastricht 2.0, combined with only some watered down elements of an ‘embedded currency area’ left the euro area in a dangerous in-between-territory. ‘Any half-baked implementation of this option, however, with substantial national control remaining vis-à-vis joint liability, would be the worst of all worlds’ (Feld *et al.* 2016: 3).

⁹ For an in-depth elaboration of this argument, see the approach developed by the German Council of Economic Experts (2012: 37-43).

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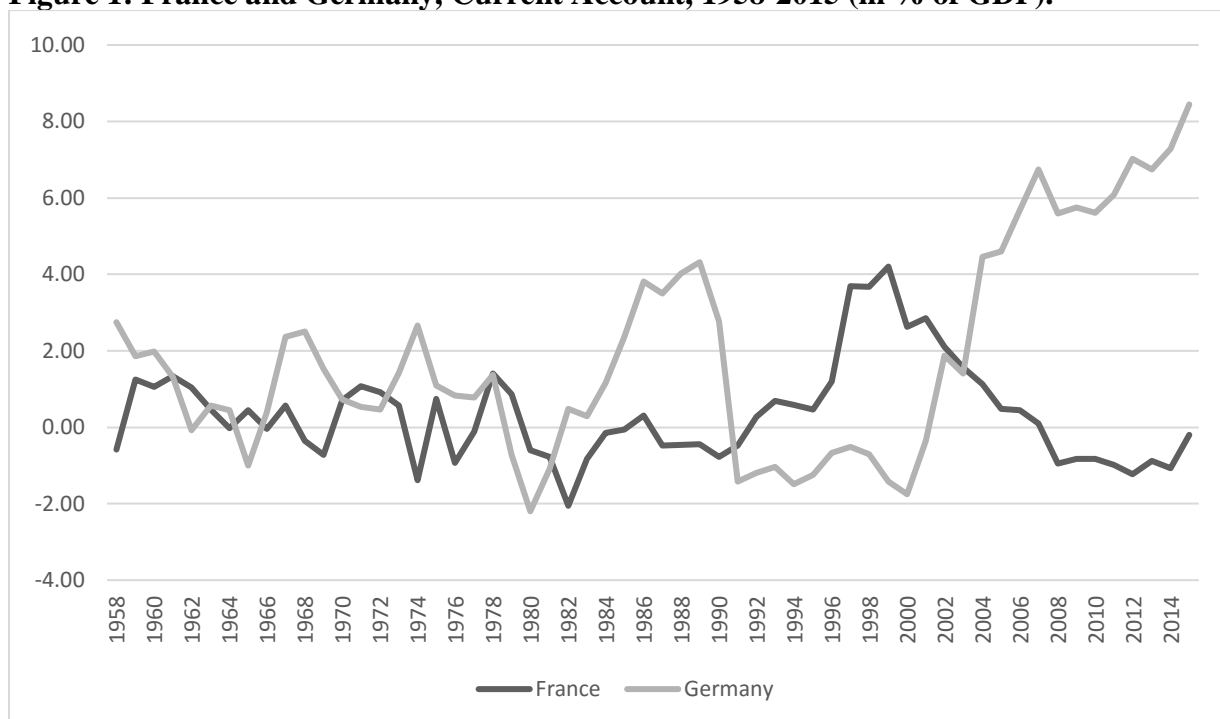
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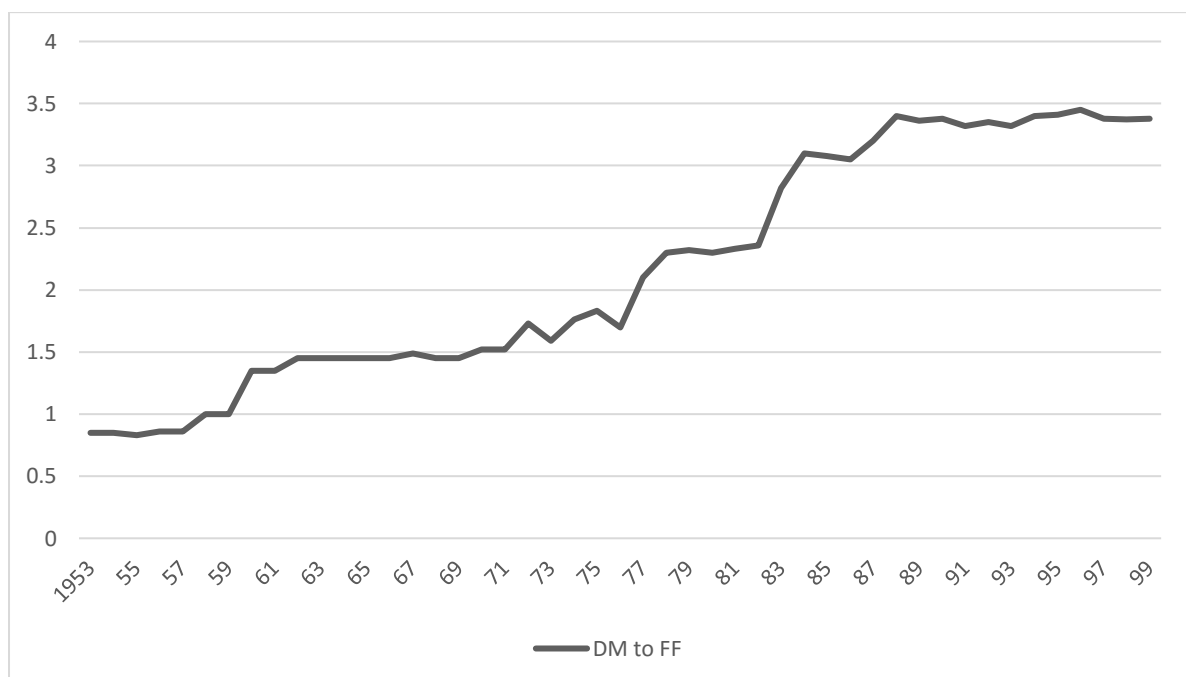
Appendix: Graphs

Figure 1: France and Germany, Current Account, 1958-2015 (in % of GDP).



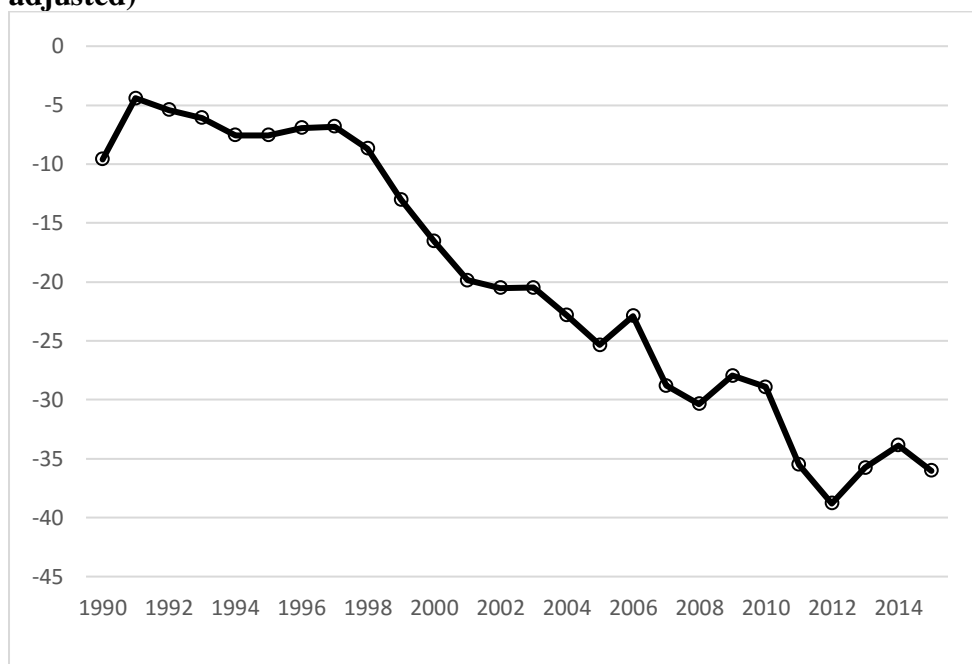
Sources: 1958-1979: Banque de France and Deutsche Bundesbank; 1980-2015: International Monetary Fund, World Economic Outlook Database, October 2016

Figure 2: German mark to French franc, exchange rate, 1953-1999



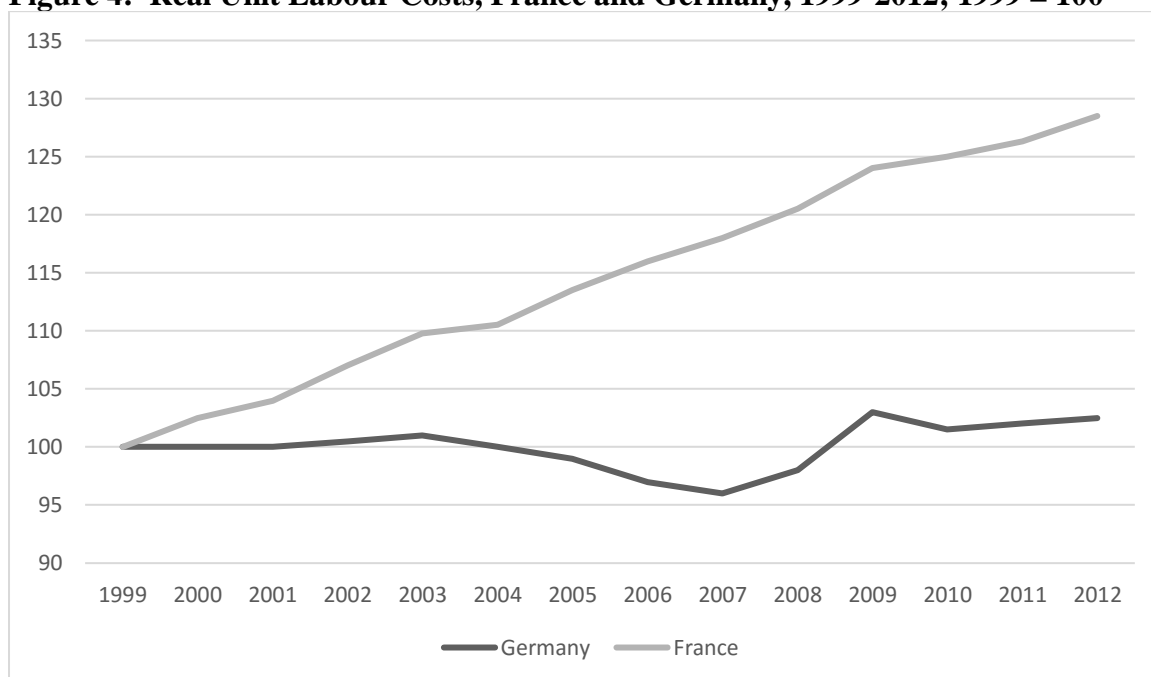
Source: FXTOP. <http://fxtop.com/>

Figure 3: French bilateral trade balance with Germany 1990-2015 (in bn. €, not adjusted)



Source: Federal Statistical Office of Germany

Figure 4: Real Unit Labour Costs, France and Germany, 1999-2012; 1999 = 100



Source: OECD, stats.oecd.org