Europe 1957 to 1979: From the Common Market to the European Monetary System*

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Working Paper No. 101

June 2019

Abstract

This essay deals with the contradictory dynamics that engulfed Europe from 1959 to 1979, the year of the launching of the European Monetary System. It focuses on how the macroeconomic framework of stop-go policies in the 1960s ended up privileging external – intra-European - exports at the expense of domestic demand. The paper offers a very tentative explanation as to why stop-go policies, by weakening domestic demand, did not put an end to the to the 'long boom' earlier as they should have. The French crisis of 1968-69 leading to the demise of De Gaulle is discussed at length, as is the renewal of the German export drive in the wake of a nominal revaluation of the D-Mark in 1969. Finally, the revival of labor struggles in Italy in the same year is put in the context of the structural weaknesses of the Italian economy as analyzed by the late Marcello de Cecco. The conclusion is that European countries

* I should like to profusely thank the Librarians of Fisher Library of the University of Sydney for providing me with all the help required for the research needed to carry out this project. In particular I am most grateful to Ms. Karen Chilcott for her superb professional support. I am also indebted to Dr. Pamela Cawthorne for our frequent discussions about European history, to Professors Peter Kriesler and Shaun Wilson, respectively of the University of New South Wales and of Maquarie University, for intellectual and moral support. Professors Riccardo Bellofiore of the University of Bergamo, Thomas Ferguson of the University of Massachusetts, Boston (Emeritus), Alain Parguez, of the University of Franche Comté (Emeritus), and Rédouane Taouil, University of Grenoble, provided, as always, the fundamental intellectual bastions for writing this essay. Professor Roberto Finelli of the University of Roma Tre (Emeritus) was crucial on many different levels stretching from politics to philosophy and even farther. I am grateful also for financial support for this research from the Institute for New Economic Thinking.

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had neither the political culture nor the institutional mechanisms to coordinate mutually advantageous policies. Their so-called cooperation was an exercise in establishing hegemony while defending the interests specific to the dominant economic groups of each country. The essay then deals with the formation of the EMS as an expression of efforts to establish and enforce economic dominance.

JEL Codes: E02, F02, F5, N14, N24

Keywords: European Monetary System, Common Market, France, Germany, Italy, Netherlands, currency depreciation, European Monetary Union

http://doi.org/10.36687/inetwp101

1. Introduction

Tibor Scitovsky was one of those exceptional Hungarian intellectuals who, after emigrating in the late 1930s, greatly enriched American mathematics, physics, and the social sciences. Scitovsky knew Europe very well.[1] In the late 1950s he published a small book called *Economic Theory and Western European Integration* (1958). That work is remarkable, since he wrote most of it in the crucial formative period between the 1955 Messina Treaty and the signing of the Treaty of Rome on March 25th, 1957, which established both the European Economic Community and Euroatom. Both came into force on the first day of the following year. Scitovsky's work is a purely speculative contribution and gets most of the crucial issues right. Perhaps the less convincing parts of that slim volume are the elaborate hypothetical discussions of the possible substitution and welfare effects likely to be induced by the newly formed Common Market.

More importantly, Scitovsky made the crucial observation that for integration to be effective, European countries needed to subscribe to a shared employment policy. This aspect, argued Scitovsky, ought to be given priority over the unification of capital markets. The book explicitly makes the case for a central European agency entrusted with the task of implementing the employment objective. The author's analytical point is that in an economic union employment policies cannot be decided by each single state, lest they give rise to conflicting tendencies within the union itself, thereby derailing those objectives. The European employment agency, he suggested, should be aided also by a European monetary institution. This is exactly opposite to the way in which actual political 'integration' has proceeded. In this context it is worth observing that Scitovsky's theoretical inclination was not overly Keynesian. He argued that although traditional monetary theory did not lose all its validity, authorities now understood that they faced bigger tasks than just regulating the flow of gold. Indeed, he added, the objectives of securing both employment and price stability have become the primary task of government. Scitovsky's position was, therefore, a rather moderate one. For that reason it can be viewed as establishing the minimal sensible requirements for a workable European economic integration.

Scitovsky's analysis of the balance of payments within a future European Union was particularly interesting and farsighted. He pointed out that regional payments disequilibria would not disappear. The European fiscal authority should then be given the role of ensuring by means of fiscal transfers (an absolutely forbidden thing in the really existing EMU) that the regions in deficit do not go through a negative adjustment which would jeopardize the goal of employment stability. At the same time the regional imbalances would require that the European monetary authority apply different rates of interest according the situation in each region. For this purpose there would still be a role for the national central banks in coordination with the main European monetary authority.

Since the Rome Treaties little systematic thought has been given to the regional — i.e. intra-union — balance of payments issues until very recently. Yet the external situation determined the economic policies of the Euro-Six countries of the EEC from the moment the European Payment Union, an American sponsored institution, ceased to operate at the end of 1958 when currencies returned to a fixed parity convertibility. The neglect over so many decades of the joint management of the external sector is not an oversight but rather stems directly from a point made by Kalecki (1969)– that the role of export surpluses is a central aspect for the realization of profit. The observation is particularly valid for the European

[1] Tibor de Scitovsky was born in Budapest in 1910 into an aristocratic family. He arrived in the USA before WW2, taught at Stanford University from 1946 to 1958 and then at Berkeley. His famous 1976 book *The Joyless Economy* is a testimony to his unconventional thinking. Scitovsky passed away in 2002.

countries rather than for the United States. To manage the external sector collectively would mean a de facto socialization of the profits realized through international trade, which for some countries, like Germany and Holland, are not at all secondary. During the Marshall Plan and the European Payment Union, a form of collective management did exist. Those were perceived as emergency years with non-convertible currencies. The return to convertibility annulled all that.

The collapse of the fixed parity regime following President Nixon's declaration on August 15, 1971 and the ill-fated patching up attempt at the Smithsonian Agreements in 1972 exacerbated the problems of exchange rates and external accounts in the context of inflation. This conjuncture created favorable conditions for the depreciation of the US dollar relative to the Yen and the Deutsche Mark, as well as a rapidly diverging path between the latter and several European currencies, notably the Italian Lira and also, but to a much lesser extent, the French Franc. Within the EEC, the solution adopted in December 1978 by France and Germany, was to create the European Monetary System (EMS) which lasted till the Summer of 1992. The present essay will be devoted to the discussion of these developments. It will cover the period from the founding of the EEC in 1957 to the formation of the EMS in 1979.

2. The beginning of political Europe and the contradictory role of France

Traditionally the inception of the process of political integration, christened by France's officialdom as *la construction européenne,* is dated to French foreign affairs minister Robert Schuman's public announcement on May 9, 1950 regarding the creation of the Coal and Steel European Community (CECA), comprised of precisely the same six countries that eventually formed the EEC in Rome.[2] However the actual path to the Treaties of Rome was rather contorted because of the ways France's determination to remain an imperial power shaped its politics and economics.

For France's colonial history 1954 turned out to be a most fateful year since it marked both the defeat to the Ho-Chi-Minh/Giap forces in Indochina and the beginning of the Algerian war. Unlike Indochina, which always had the status of a colony, Algeria had been incorporated into France, although in an apartheid fashion since the Moslem population was excluded from French citizenship[3]. Successive French Administrations did not want to consider the possibility of full Algerian independence and went straight to war against the National Liberation Front (FLN). In the same year a center-left government headed by the Socialist Party SFIO's Guy Mollet came to power. The persistent weakness of France's balance of payments and the new self-imposed colonial war, pushed the Socialist led government out of the European political integration process which had been started in 1950 by Jean Monnet with clear, albeit temporary, hegemonic objectives for France.

From the French side there were two main obstacles to the extension to the whole economy of the arrangements agreed for the European Steel and Coal Community. The first was the fear that the France's industrial sectors would suffer from German competition as well as from Italy's, which the French viewed as a low-cost producer. The second obstacle arose from the combination of the insecurity regarding the European viability of the French industry, and the attachment to imperialist interests. These fears produced a Parliament hostile to furthering political integration. The political forces opposed ranged from the Communist Party — that in those years was the largest political formation in France and considered

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[2] CECA came into effect in 1951 and was closed down in 2002.

[3]The decrees issued on October 24, 1870 by minister Adolphe Crémieux extended French citizenship to the non-French European settlers and to the indigenous Algerian Jewish population. Moslem indigenous Algerians were excluded.

both the Marshall Plan and European institutional integration as strategies devised by US big business supported by German 'revanchism' — to center-right and far-right parties.

From 1955 onward the French government stopped pursuing the objective of moving towards the creation of a common market. In 1956, while preparing the disastrous Suez adventure with Anthony Eden, France's Prime Minister Guy Mollet went so far as to suggest to the British government the creation of a unified Sterling-Franc monetary area; a proposal rejected by London and strongly opposed by Treasury, which argued, correctly, that it would compound the problems of the balance of payments of both countries (Lynch 1997, Ch.8). Rather than an integration involving the whole economy and the entire system of export/import relations, Paris, after much hesitation, aimed at a new Treaty for the development of the energy sector aimed at making the CECA countries less dependent on oil imports. In those years the focus was on nuclear energy. Hence the French government's goal was to proceed to the signature of the EURATOM treaty only. As pointed out by Frances Lynch, in continental Europe France's nuclear industry had an overwhelming superiority. Thus the EURATOM Treaty, involving the same six countries belonging to CECA, would have given France a commanding hegemony in the sector without exposing the weaknesses of its other industries. The push to give priority to the creation of a common market came from Holland and Belgium which were supported by Adenauer and, behind the scenes, by Jean Monnet, although West Germany's Finance Minister Ludwig Erhard was not in favor of it (Lynch 1997, Ch. 8). On March 25 1957, the Treaties of Rome, encompassing both the formation of the EEC and of EURATOM, were signed in the Michelangelo sculptured palace on the Eternal City's Capitoline Hill.[4] Just the same, the last French governments of the IVth Republic were not inclined to follow the guidelines for the schedules regarding the reduction of tariffs within the Common Market. In 1956-57 the country's external position deteriorated beyond the support it could receive from EPU, requiring the granting of a major loan by the IMF. In 1957 Paris proceeded to introduce import quotas which would be lifted, along with the implementation of tariff reductions as contemplated by the Treaties of Rome, after the devaluation of the French Franc in December 1958 upon De Gaulle's seizure of power.

Throughout the whole of the 1950s until the very beginning of the 1960s, France did not act macroeconomically as a pole for European integration chiefly because of the state of its balance of payments relative to the military budgetary commitments connected to the political choice in favor of colonial wars. Thus, while France was the main country on which depended West Germany's political insertion into Europe, its governments did nothing to build up the economy to a level capable of effectively counterbalancing the leading role played by the Federal Republic of Germany (FRG) in the process of cumulative causation which engulfed the Continent from 1951 till the Bundesbank's induced mini recession of 1966. France's position in Europe would change under de Gaulle's rule.

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[4] Lynch's (1997) is the best historical analysis to date on France's less than clear attitudes vis à vis the creation of the EEC. Her study is based on impeccable archival French ministerial documents. Actual history contradicts the European Union's ideology of a steady and enthusiastic advance toward political integration. In the French literature for students I did not find any in-depth discussion of the case. The difficulties encountered during the negotiations on the Messina Treaty, where the pathway to the abolition of internal tariffs had been mapped out, are mentioned in the important Berstein and Milza (2009) three volume textbook. However they present the Belgian and Dutch initiatives as if they were part of a flurry of excitement on how best to proceed with *La construction européenne*. The same angle is taken by Francesca Fauri (2001) in her economic study on Italy and the European Union. However, as Frances Lynch makes absolutely clear, those initiatives were diametrically opposed to the incoherent conduct of the Paris government just few months before it relented and decided to sign the Rome Treaty. Lynch refers also to the memoirs of Christian Pineau - France's Socialist Minister of Foreign Affairs both during the Suez crisis and during the signature of the Treaty of Rome - who wrote that the French government signed the Treaty of Rome because of the fear of isolation following the Suez war.

3. The German led Kaldor-Milward cumulative causation.[5]

From 1951 to 1966 West Germany acted as the main integrating factor in Europe. The process of cumulative causation started well before the formation of the EEC and continued at the same pace afterwards. In fact, Germany's dynamics affected the whole of the Western part of the Continent from Scandinavia to Italy. This fact explains the irrelevance of the European Free Trade Area (EFTA) founded in Stockholm in 1960 on the initiative of Britain as an alternative to the EEC. In addition to the United Kingdom, EFTA included Sweden, Norway, Denmark, Austria, Switzerland, and Portugal. Yet except for Portugal, all the other EFTA countries gravitated to the EEC through Germany and, as in the case with Switzerland and Austria, also, but to a lesser extent, through France and Italy.

The Bundesrepublik's cumulative impact on Europe up to 1965 may be divided into two phases. In the first one, going from 1951 to the end of the decade, Germany's pull operated through the dynamics of the country's internal capital accumulation. In that period, in which the Kindleberger view that the US financed NATO Plan extended ad infinitum the Marshall Plan played a pivotal role, Germany's policy makers and major companies were bent on the accelerated expansion and renewal of the capital stock with net exports being functional to the internal dynamics. Important relevant features of Europe's interlinkages took shape in that first phase.

The second phase coincided with the attainment of full employment due to the end of the influx of labor from East Germany, after the construction by the DDR of the Berlin Wall in 1961. Thus from 1960 to 1965 Germany's economic impact on Europe, and particularly on the rest of the EEC, manifested itself through a rise in imports while the country's growth rate of GDP slowed down significantly. The net export surplus dwindled in a cyclical manner up to the point of reaching by the middle of the decade a nearly zero trade balance. It is in this context that the Bundesbank clashed with the CDU-CSU government and ultimately defeated it. From 1966-67 Germany ceased to act as the "locomotive" of Europe: it grew less than the EEC average while the accumulation of external surpluses picked up again as, contrary to simplistic received wisdom, the rise in net exports occurred under conditions of successive revaluations of the Deutsche Mark. Let us now look at the two phases in more detail.

During the first phase, the dynamic impulses of the German led cumulative process were being propagated along a number of channels. Over the 1951-58 period the Bundesrepublik displayed a growth rate substantially higher than that of the rest of the then OEEC countries.[6] The larger share of the mechanical

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[5] I have coined the expression 'Kaldor-Milward cumulative causation' because in my opinion, and as I hope to make clear in the course of this essay, the crucial economic processes outlined by the late Alan Milward in his classic book *The European Rescue of the Nation State* (Milward 1992), sit rather well with Nicholas Kaldor's notion of cumulative causation and of the dynamics of export led growth. Nicholas Kaldor (1908-1986) was a Hungarian economist, who became a naturalized British citizen. Kaldor developed also the theory of export led growth where the expansion of exports generates positive feedbacks on the importing countries as well, provided they too aim at export led growth. Alan Milward (1935-2010) was Professor of Economic History at the London School of Economics. He wrote extensively on the economic history of modern France and produced two seminal books on postwar Europe (Milward 1989, 1992).

[6] The OEEC, Organization for European Economic Cooperation, was founded on a US initiative in 1948 in Paris, in order to coordinate the Marshall Plan's related activities. In September 1961 it became the OECD and today it includes 9 countries located outside Europe, excluding the United States.

and capital goods sectors in the composition of output of the Federal Republic of Germany (FRG) relative to the rest of Europe, implied that the high growth rate had to be supported by increasing the importation of consumption goods from the other European countries. Furthermore, the large-scale features and technological complexities of German corporations required a direct and indirect supply network of intermediate industrial products that stretched beyond the country's borders.

At home the supply network is provided by the companies belonging to the *Mittelstand,* a well-known untranslatable German word used to define the small and medium enterprises. The *Mittelstand's* firms in addition to constituting a thick input-output matrix within Germany, are themselves importers of intermediate products. Their external impact is not small since their average size is significantly bigger than that of the other European firms in the same category.[7] The requirements to supply the more advanced German markets with both intermediate and industrial consumption goods compelled the exporting firms from the rest of Europe to modernize their own stock of capital which, quite often, entailed the purchase of German equipment. Lastly, the fact that under the cover of US sponsored institutions such as EPU and NATO (as well as *NATO* in Thomas Ferguson's sense of the *New Automobile Treaty Organization*), European countries could set high investment levels – a phenomenon true even for financially wobbly France – helped Germany's exports of investment goods. The FRG growth rate was the highest in Europe thereby becoming the main factor in spreading wide the effects of cumulative causation. The late Alan Milward, who, in my opinion, put forward the best perspective on the German centered structural interlinkages in 1950s Europe, has provided a succinct characterization of the whole process:

> Ultimately it was not monetary and fiscal policies within the Federal Republic which were responsible for the export surpluses but the insatiable demand from Western Europe for German engineering goods and the interlocking demand in the Federal Republic for imports of metal and machinery, largely satisfied by other European countries, which sustained this trade (Milward 1992, pp. 147-8).

The dynamics of cumulative causation led by Germany from the Rhine's side. The shape of European post-war oligopolies took place in that first phase. In his 1958 book Tibor Scitovsky correctly envisaged the transformation of national oligopolies into European ones. This said, the leading companies achieving the transition were and remained mainly German in addition to the affiliates of the large American corporations (from the late 1980s onward also the Japanese and Korean companies established their own European branches). Those companies have not gone pan-European, their strategies and institutional foundations remain in Germany although they have plants and takeover operations in other countries as well.[8] Oligopolization has specific macroeconomic implications which were captured by Paolo Sylos

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[7] A very good book edited by Peter Katzenstein (1989), gives a lucid picture of the structural and institutional features of the West German economy up to the late 1980s when the issue was no longer that of expansion in a basic sense of the 1950s. In this context readers can appreciate the evolution of the *Mittelstand*.

[8] For quite a while US companies were the ones who in Europe had the most consistent multi-country-multi-plant location and production division strategies. In 1950 Italy's FIAT, as a minority stock holder in a joint venture with the Government of Spain, opened a plant near Barcelona thereby founding SEAT automobile company which would be taken over by the VW-Audi group in 1985. Other countries developed oligopolies as well: Holland in the oil (with Britain) and food industries as well as in electronics; France in the energy and aircraft industries as they were to being government owned, and also in the dairy sectors; Italy had a number of oligopolies in the auto, electronic computing (Olivetti), and tire industries, in addition to a large chemical and steel sector. None however stayed on the road (Gallino 2003). If we look outside the EEC we notice that Swedish capital and industries were among the most concentrated in Europe. However, barring perhaps the highly specialized Swedish ball-bearings multinational SKF, none of Sweden's companies could have acted as a leading oligopolist in Europe as a whole.

Labini (1960) in an essay on Germany's growth barely three years after the publication of the first Italian edition of his celebrated *Oligopoly and Technical Progress* (Sylos Labini 1957, 1962). The essay pointed out that the anti-monopoly laws promulgated with the 1951 reform included more exceptions to the rule than actual safeguards. To this we must add that the successor of the 1951 law, the *Kartelgesetz* of 1957, excluded banks from the new law's jurisdiction, guaranteeing the Rudolf Hilferding type of bank-industry connections. Public expenditure materialized at a high aggregate level. This intersected with government strategic preference in favor of exporting firms (Reich 1990), an area where large corporations dominate. On the whole the Bundesrepublik's growth rate in the first phase was propelled by public expenditure and exports which rose annually much more than GDP, already the fastest growing in Europe.

Before as well as after the formation of the EEC in 1957 the US sponsored EPU played a crucial role in the German driven process of cumulative causation. The FRG authorities were aware of the fact that EPU saved the country's external surplus from becoming a crippling constraint on the rest of Europe's macro-policies. The constraint would have been particularly damaging for the five other countries of the EEC which were forming a tight trade network with West Germany. This network was being supplemented by Switzerland and quickly joined by Austria, although neither were members of the Coal and Steel Community or of the EEC.[9] The German surplus could have indeed jeopardized the further development of that integrated trade web that, by the early 1960s, absorbed almost half of West Germany's exports while performing the role of sustaining the input-output matrix of Germany's productive system.[10]

This is the chief reason why eventually the auto division of SAAB was acquired by VW-Audi while Volvo turned to the Chinese. By the end of the day in the relevant industrial branches the leading firms in Europe have always been German, flanked by the American, and later, by the Korean and Japanese companies.

[9] Following the end in 1955 of the joint Allies' occupation (USA + UK + USSR), Austria was prohibited from joining any Western political and military organization. The formal agreement restoring Austria's sovereignty entailed the country's adherence to absolute neutrality. However Austria became one of the founding members of the OECD in 1961 by virtue of it being in the OEEC. In practical terms by the end of the 1950s Austria was already firmly integrated with the economy of West Germany. Moreover, in the wake of the successful solution of the nationalistic tensions over the Italian Alto Adige region - the pre WW1 Süd Tirol of Austria - integration with Italy proceeded at a rapid pace. By the early 1960s Austria was in trade terms part of the EEC and its membership in the British led EFTA turned out to be inconsequential. Austria, with Sweden and Finland, joined the European Union as late as 1995, that is, only after the dissolution of the USSR.

[10] In 1964 the seven European countries formed by the remaining five EEC nations plus Austria and Switzerland, henceforth E7, absorbed 48.5% of total FRG exports. In 2016 their share was reduced to the still relevant, but much lower size of 33%. The core of the advanced input-output network comprising the three Benelux countries with the addition of Austria and Switzerland (BAS) received 30% of total German exports in 1964, whereas in 2016 the BAS share was down to 19.6%. It is also interesting to look at the ratio of the E7 and of the BAS core countries in the FRG's overall imports. In 1964 the E7 group supplied 40.6% of total imports, with 22.2%, i.e. more than half, coming from the BAS group. In 2016 exports from the E7 group amounted to 34% of Germany's imports, i.e., down by a mere 6% relative to the share held in 1964 despite the geographical widening of the FRG trade. Remarkably the share of imports by Germany from BAS countries hardly budged over more than 50 years: in 2016 it was 21.7% of total imports, a drop of an insignificant 0.5%. In conclusion, while the relative position of the BAS group as a market for German products has declined significantly, its role as a crucial sophisticated provider for the German industry and economy has not. We will study the main features of these changes in later essays in this series as they are not only related to the worldwide expansion of Germany's foreign trade but also to the massive inclusion of some of the post-communist Eastern European countries into the FRG centered productive networks, as well as to the expanding structural links with China. The above percentages are calculated for the year 1964 from the annual Italian compendium *Calendario Atlante De Agostini* (for the year 1967; entry:

During the 1952-58 period the FRG kept accumulating net credit balances on EPU's accounts every single year. Of the 16 countries of the OEEC not one performed like Germany. Leaving aside the two old colonialist chums - France and Britain - who practically 'broke the bank' with their deficits, the balances of the other members had either a cyclical behavior or a tendency towards deficits. Italy for instance, whose export growth was second only to Germany's and by the end of 1958 and had a consolidated overall surplus with EPU, could not plan on a net EPU credit position given the highly volatile nature of its yearly balances.[11] In that context the quick transformation of surpluses into credits inherent in the working of EPU represented a shield against a hard external constraint. German corporations were cognizant of the radically asymmetrical position of the FRG and its implications for the other members should convertibility be reintroduced. Thus, as detailed by Milward, earlier in the decade Germany's industrial leaders and the bulk of Bonn's body politic fought successfully — despite Ludwig Erhard getting cold feet because of his own laissez faire ideology — against a British proposal for a gingerly move towards convertibility that would have involved a separation between trade with convertible currencies and trade through EPU accounts. The German exporters, Minister Erhard aside, immediately spotted the reasons for the British government's proposal: the internationalization of the Pound Sterling rather than the promotion of international trade (Milward 1992, ch.7, pp. 369-71).

It is at this point that the issue of oligopolization takes on a macroeconomic dimension. The outward oriented industrial policies of the German corporations were completely consistent with the large-scale oligopolistic structure of their industries. It is worth observing that in fighting the British position they opposed exchange rate flexibility obtaining the support of the Bank Deutscher Länder, the precursor of the Bundesbank. Considering the times, the Bank developed a rather sophisticated counter-argument to the British defense of the benefits ascribed to flexible exchange rates[12]. The Bank's view was, correctly I should say, that flexible exchange rates do not act directly on current account balances, but on capital movements instead. This, the Bank argued, may create a highly volatile environment making the situation worse. Oligopolies aim at stable exchange rates in order to organize their production and sales on many markets, which requires planning the mark-ups (profit margins) on their costs of production. The problem with oligopolies lies in their large productive capacities relative to the product markets they sell to, limiting their ability to generate endogenously a process of expansion. In other words, they need external stimuli by means of public expenditure and export growth. In his essay on Germany's postwar recovery and boom the late Paolo Sylos Labini put the connection between oligopolies and export growth in very clear terms:

> I maintain that, in an economic system dominated by monopolistic and oligopolistic formations, effective (or monetary) demand cannot grow *spontaneously* from within the system itself in such a way as to ensure, by means of economic development, a level of employment tendentially not far from the attainable maximum. To keep the system growing either a rising level of public spending is needed (Keynesian policies) or rising exports, possibly both. When competitive forms prevailed, these conditions were *not* required for the system's development: the increase in exports could

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GERMANIA) which reported in a compact form data from Germany's *Statistisches Bundesamt,* and directly from the latter for 2016.

[11] The 1951 to 1958 yearly balances with EPU of the member countries are shown on page 364 of Milward's (1992) book.

[12] It is difficult to understand why the British Government eulogized flexible exchange rates when the world monetary system was based on the fixed parities, adjustable every once in a while, established on the basis of the Bretton Woods agreements.

> favor or accelerate growth but did not condition it as, also with the case of public expenditure, is happening now.
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> If this is true we must conclude that the development of the German economy in recent years has depended precisely on the rise in public expenditure and of exports. In reality both have expanded at very high rates.[13] The further expansion of the German economy will depend on the additional expansion of public spending and exports (Sylos Labini 1960, pp. 154-55, my translation from Italian).

The formation of the EEC has enabled the creation of a tight German centered trade system based on the Euro-Six with the immediate de-facto absorption in it of Austria and Switzerland, without them being a part of the Common Market. A smoother process would characterize in the integration during the 1960s and beyond the Scandinavian countries, including Finland which until 1991 was tied to the USSR. That area had, and still has, very high intra-Scandinavian trade. It also displayed very strong commercial ties with Britain. Yet, in the light of the sophisticated requirements of the Scandinavian industries and, consequently, of their capacity to produce advanced industrial items, the dominance of the German pull was unavoidable. Britain lost its moderate net export position with the area and became a net importer instead, with Germany turning into the overwhelming net exporter to those countries (from the 1980s the exception was with Norway because of the importation of North Sea oil).

The Euro Six of the Common Market created the hot-house effect for the formation of a zone for Germany's oligopolistic capital, whereas the overall framework of the German led economic integration from Norway to Greece had been established by the United States during the reconstruction years of the Marshall Plan. The tight trade network was strengthened by the founding of the Common Market as it helped make Europe into the space of Germany's effective demand, its main and most secure area for the realization of profits in the strict sense of Michal Kalecki. During the 1960s it was already clear, especially to those who studied or were studying the macroeconomic implications of oligopolistic accumulation, that the net external position acquired by Germany through its merchandise exports, the majority of which were and are within Europe, was the result of the combination of the sectoral completeness and consistency of the productive apparatus of its economy with the oligopolistic large scale dimensions of its large firms. These factors were and are much more relevant than explanations based on either favorable, hence allegedly competitive, productivity to wage ratios, and/or on a favorable exchange rate.

The German powered Euro Six acted as an attractor for overall European trade. In this context European public expenditure sustained the process by fostering demand of both capital and consumption goods, strongly contributed to the rise of German exports. During the 1950s virtually all the 16 members of the OEEC had two external constraints. One was towards the United States and the Dollar area, and the other vis à vis Germany because of the latter's surpluses. The first constraint was practically annulled by the United States by means of a substantial transfer of purchasing power to Europe (De Cecco 1968, ch. 1). The second was greatly mitigated by the working of EPU. At the end of 1958 EPU ceased to exist and all the currencies became convertible. From that moment onward the external constraint, in practice determined by the external position vis à vis Germany, became strictly binding, thereby giving rise to *stop-go* policies.

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[13] The essay contains a table for Germany's economic performance where it emerges that against a 1951-58 yearly average nominal growth rate of 9% (7.4% in deflated terms), public spending increased by an annual average of 14% and exports by 15%.

Those policies had a twofold objective. In an initial stage, they aimed at cutting down domestic demand by tightening the budget and through credit rationing enforced by the Central Bank in order to reduce imports, on the assumption that their volume is related to the level of national income in a stable manner in the short run. This was the *stop* phase. In a subsequent stage exports were assumed to expand rapidly. This second objective was to be achieved thanks to the impact of the slowdown of effective demand induced by the first set of measures. The ensuing unemployment, or fear of it, was supposed to induce the Trade Unions to mitigate their wage demands as to engender a fall in the wage to productivity ratio in comparison with the rest of the EEC. At this point, given the mark ups, export prices would fall thereby increasing competitiveness. This factor coupled with the higher growth rate of the other countries, would surely, it was believed, pull up the whole economy again through an export led growth process, the *go* phase, with a much-improved position in the current account balance. The macroeconomic concepts marshaled for justifying the policies as well as the tools used to implement them were Keynesian, but the underlying social and economic rationale was not of course.

In my view there was one major flaw in this policy framework, which has been applied through most of the 1960s in Europe by Britain, Italy, France and, most importantly, by Germany after 1965. The policy framework assumed a sort of stable alternating pattern among the different countries: if Italy stopped, as it did in 1964-65, the others will pull it up and so on. But this view assumed that each country was small relatively to the whole of European economy; a wrong assumption. Since France also implemented a similar policy around the same time as Italy, one wonders why the EEC did not fall into a recession bringing the cumulative causation to a close. The reasons why the "boom" could continue were that (a) Germany, having reached full employment, making therefore possible for wages to increase above productivity growth, acted as a big importer up to the point of seeing its trade surplus whittled away by 1965, (b) exports to the United States were rising as in 1962-3 the country stepped out of the doldrums of the late 1950s and early 1960s (Vatter 1963)[14]; (c) most European countries, especially France and Italy, still had large infrastructural development projects both underway and forthcoming which they addressed in terms of functional finance, not subject therefore to cyclical budgetary considerations; (d) in Italy and France the nationalized industries operated by policy instructions in a countercyclical manner; (e) Several EEC countries reached the 1960 decade with very high employment levels for the male labor force, this factor may have limited the deflationary effect of stop-go policies because wage pressures could not be totally squashed. The drift away from high and stable levels of employment originated from the necessity of taking a neo-mercantilist stance which arose from the external constraint active on virtually all the European countries except West Germany. The latter, instead, is the natural permanent net exporter, since the 1970s regularly flanked by Holland.

From the standpoint of full employment in Germany, the cyclical decline in the net trade balance of the first half of the 1960s did not have to constitute a problem. It could have been simply an aspect of the adjustment to a lower rate of capital accumulation, in the light of the much lower full employment growth rate that ensued from the exhaustion of the surplus labor coming from East Germany as well as the completion of the economic absorption of German people expelled from Czechoslovakia and some other Eastern countries after 1945. Immigration from Southern Europe and from Turkey was large in absolute terms but did not prevent the decline in the rate of growth of labor supply[15]. The FRG's physical stock of capital was already more than able to employ all the existing population of working age, it was

[14] Thanks to the Kennedy-Johnson's Great Society program, to the massive increase in military spending augmented by the ICBM, and, last but not least, to the military Keynesian path to Vietnam.

[15] During the 1960-68 period the average yearly growth rate of population in the age bracket 15 to 64, was 0.1%, active labor force fell by-0.1%, while male labor force expanded by 0.1% per annum (OECD 1990).

certainly in a technical position to expand at a rate needed to guarantee full employment over time, while generating a flow of exports at least sufficient enough to cover for imports and the payment of the trade in services, where Germany usually exhibits a deficit[16]. The requirements of accumulation presented however a less idyllic picture. Under oligopolistic conditions where prices are cost determined and no tendency toward competitive positions exists, wage rises above productivity growth (made possible by the state of full employment) partly affect prices and increase imports. The first aspect reduces firms' profit margins, while the dwindling of net exports is tantamount to a slowdown in aggregate profits and therefore in capitalist accumulation[17]. For an economy with a significant part of its capital stock tied to the dynamics of external growth, such a prospect is to be avoided.

Thus, in my view, from the 1960s till 1966 a conflict between domestic demand and exports developed in Germany. It translated itself into a clash between the Bundesbank and Chancellor Ludwig Erhard of the CDU-CSU government. In light of the slowing growth rate and in the context of forthcoming elections, the Chancellor moved to increase public expenditure. The policy was opposed by the Bundesbank, which increased the interest rate as an anti-inflationary measure, with the objective to tame wages and refocus macroeconomic policies on export growth. In 1965 the trade surplus all but vanished and in 1966, the economy suffered a small recession causing the rate of unemployment to climb to a level still below 2%, but which in those years was considered unthinkable. The 1965-67 events signaled the birth in West Germany of a new mechanism of accumulation which would be enhanced by the revaluation of the Deutsche Mark in 1969 under the second grand coalition government formed by the CDU-CSU and the SPD (Halevi 1995; Valli 1981). In a nutshell the new 'model of accumulation' entailed the further transformation of the economy into an importer of consumption goods and of intermediate products while exports were being pushed up to higher technological levels. For the large German corporations the new regime turned out to be well suited to address both inflation and export policies under conditions of currency revaluation and more uncertain growth conditions (Steinherr and Morel 1979). As from 1965 the German driven European cumulative causation was gone for good. Yet this is a story that unfolded in the 1970s and will be treated in a separate section. To complete the picture of the 1960s we must still consider the decade from the Italian and the French perspectives.

4. The Italian story from the founding of the EEC in 1957, to the Nixon announcement in 1971

In the previous essay I rephrased a slogan from the Parisian students' movement of 1968 into *Allemagne et Italie même combat!* (Germany and Italy: same struggle!). Indeed, reconstructing Western Europe as an integrated economic space was absolutely vital to both countries, although the respective situations were very different. For West Germany, Europe was essential in order to relaunch its powerful oligopolistic industrial sectors that, once repaired and recast from their war features, would quickly find themselves in a position to shape the input output matrix of Continent according to their needs. US authorities understood quite well that their task, entailing many steps of accommodation with France especially on its unflinching imperialism, was to help restore Germany's economic hegemony.

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[16] A similar situation can be said to have existed in Sweden, the UK, the Benelux countries, and in Switzerland, with France as a borderline case. Italy, because of the still large share of agriculture employment and of southern urban underemployment, was yet to achieve a condition where the capital stock could more or less employ the whole of the existing population of working age.

[17] In Harcourt (2006) the reader can find an unsurpassable discussion of the Post-Keynesian theories of growth and distribution that underlie my arguments.

For 1950s Italy the participation in the process of European integration implied a safe pathway out of underdevelopment. This is the reason why, deep down, the idea of 'Europe' had not been opposed by the Communist Party of Italy (PCI)[18]. In the medium term the ruling center-right coalition led by the Christian Democracy viewed growth based European integration also as a way to get rid of several million people belonging to the labor surplus rural economy. Outmigration to France and Belgium but not yet to Germany, which would be absorbing Italian immigrants from the second half of the 1950s till the late 1960s, began in earnest as soon as those countries were about to near the completion of postwar reconstruction[19].

There was no alternative option to opening up the economy to European trade, but Italy's entrance into the process of cumulative causation had several problematical aspects which, as we will see, came to the fore with the economic downturn of 1964-1965, the first major "stop" in the Common Market's growth. The Italian government began to lower restrictions on import quotas from other European countries around 1950 so that by 1957 these had been already lifted on 99% of all imports from Europe (Fauri 2001; Graziani 1989). Hence Italy was much better placed than France whose government introduced imports restrictions in the same year of the creation of the Common Market. Alan Milward wrote in his book that:

> the growth of Italian exports was one of the more remarkable aspects of Western Europe's foreign trade in the period and to this growth the Six were particularly important. After 1955 the rate of growth of Italian exports was much faster even than those of Germany (Milward 1992, p. 171).

The Italian growth went through two phases before the sudden halt in early 1964. From 1951 to 1958 the expansion of the economy was mostly based on internal factors, essentially on investment, which was quite high, and also on public expenditure. Following the harsh restructuring undertaken by companies, and by FIAT in particular, around the early-mid 1950s, real wages lagged behind productivity so that mass consumption demand was not a driving factor in the growth process. In this phase exports played the role of covering in part the overall trade deficit which was a persistent issue till the boom. Because

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[18] During the period of formal strict adherence to the Soviet line there were certain rituals to be performed, so the formation of the EEC was criticized because of monopolies etc. However just a few years after 1957 Palmiro Togliatti, the highly respected Secretary General of the PCI, declared that the Common Market had proven to be a success in industry but not in agriculture. Before 1957 the PCI looked sympathetically at the fiscal program - Beveridge like, but not quite — presented by the ruling Christian Democratic Party in 1954. It was called the Vanoni Plan, after the name of the Finance Minister Ezio Vanoni. The Plan was conceived also to better prepare the country for participation in the European integration. Yet it has never been implemented since the major impulses came from the German led cumulative causation augmented by the creation of the EEC. This should be seen as a major failure of the Christian Democratic governments because Italy's social and welfare framework did not change until the late 1960s. An excellent analysis of how the rapid economic transformations occurred affecting only marginally the institutionally sanctioned archaic framework of Italy is the book by the historian Guido Crainz (1996).

[19] Marcinelle, in Belgium, has become a symbol of Italian migration to the mining regions of Northern France and Belgium: on the 8th of August 1956 a fire broke out in that coal mine killing 262 miners out of the 274 present on the site. 136 of them were Italian immigrants, 95 Belgian nationals and the remaining victims from several different nationalities. Many of the Italian workers were in Marcinelle on the basis of an agreement signed in 1946 by the Governments of Italy and of Belgium for sending to the mines a weekly contingent of 2000 young unemployed Italians in exchange for shipments of coal at reduced prices. The treatment and housing of the immigrant miners was well below acceptable standards. http://keynes.scuole.bo.it/ipertesti/europa/Marcinelle/ https://en.wikipedia.org/wiki/Marcinelle (accessed 21/03/2017).

of the weakness of the balance of payments, the main preoccupation of the government's macroeconomic policy was to ensure that the expansion of domestic demand stay within the limits imposed by the external deficits (Gualerni 1988, vol.2). The phase of accelerated growth began in 1958-59 and lasted till 1963. During that five year period GDP growth attained a yearly average of 6.6% as against 5.3% for the 1951-58 years. Even more relevant was the expansion of industrial output which during the second period was five percent points above that of GDP, while in the first phase the gap in favor of industry was only 1.5%.

The Six as a trade network, to use Milward's expression, were crucial in the second phase of the Italian expansion in which exports grew much more than industrial production and GDP. The mechanical and automotive industries were the most dynamic domestically and especially in terms of exports. Trade increased particularly with the rest of the EEC — +26% a year in export value and + 31% in imports (Ciocca and al. 1975). In 1963 the external deficit ballooned again leading the Bank of Italy to activate the breaks. In a seminal paper based on the input-output matrices of the Italian economy, three most distinguished economists of the Bank of Italy showed, in my view convincingly, that the boom years shaped the structural relations between Italy and the rest of the EEC also for the next decades. An important part of the mechanical industries became connected, both as suppliers and as buyers, to the same sectors in the rest of the Six, particularly to Germany, while Italy emerged as a crucial supplier of intermediate capital goods and of mechanical consumption goods like home appliances as well as of motor vehicles (Ciocca and al. 1975).

The process just summarized came to an end during 1963. The economy limped along for roughly two years and then recovered strongly more quantitatively than qualitatively. In Italy the 1964-65 biennium is called *La congiuntura*[20]. Its occurrence gave rise to a number of still relevant artistic and literary expressions that put forward a very critical view of the boom years, far more than economists did. Importantly the expansion that followed did not make the biennium of *la congiuntura* a thing of the past. In the recent years one of the country's most respected and internationally known economists, the late Marcello De Cecco, revisited the period arguing that many of Italy's persistent structural problems regarding its investment dynamic are traceable to those crucial years (De Cecco 2012)[21]. The crisis and its sequels had important implications at the EEC level since Italy became the major country to enshrine stop go policies in a manner that exuded export prowess out of weakness. In order to appreciate the European dimension of that phase of the Italian economy it is necessary to open a dedicated subsection.

4.1 The Italian congiuntura, its aftermath and its European relevance.

The Italian growth process of 1951-1963 had two intertwined flaws: (a) labor's bargaining power was extremely weak until 1961; (b) high growth and the rapid expansion of exports did not entail a major shift to advanced technological industries. Part of the low status of labor can be ascribed to the existence of a large pool of underemployed people in agriculture given that in 1951 the primary sector's share in total employment was still 43%. The underemployment in the rural areas got absorbed in roughly equal

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20 The term is equivalent to the German word "Konjunktur". In Germany the word was introduced in the late 19th/early 20th century in connection with short term phases of the business cycle; in Italy it refers more to short run dynamics. In French the term "conjoncture" is used as well. To employ it in English would be a plus since it is a very clear word conceptually.

21 Indeed the Italian title of De Cecco's paper translates as "A half a century long crisis: the deep causes of the Italian decline". Marcello De Cecco (1939-2016) was among the very best world economists of international finance and of economic history, an absolute Maestro with all the good qualities of an unassuming true savant. He was for many years Professor at the prestigious Scuola Normale di Pisa. His book *Money and Empire* published in 1977 by Blackwell is a classic of monetary history and analysis.

percentages by the growth occurring mainly in the Northern industrial triangle of the country — formed by Milan, Turin, and Genoa — and by emigration to the rest of Europe as well as, initially, to North America and Australia. Hence, the growth process did not create additional employment, which by 1961 was even slightly lower than in 1951 (ISTAT 2011), it rather changed the composition of employment from agriculture to industry and services. However the existence of such a big reserve army of labor explains only in part the extreme weakness of the trade unions.

A crucial element in labor's weakness was the fact that industrial relations were treated in the same package of "cold war" politics. To some extent this was true also in France, but there a number of laws had been passed during the 1945-47 period, i.e. with the Communists still in the government, that institutionalized labor's status. Perhaps the most important of these is the minimum wage law (SMIG) of 1947. In Italy by contrast, the participation of the Communist and the Socialist parties in government in the same biennium, did not bring significant changes in matters of labor relations, nor in the police code of conduct in industrial disputes and public demonstrations which remained that of the Fascist regime. Often labor struggles became battlefields in the literal meaning of the word, causing from the late '40s to the end of the 50s dozens of workers to be killed in clashes with the police. Furthermore - as confirmed by the recent official disclosure of US government's documents and by earlier historical research (Kogan 1966) - US authorities, through the Ambassador in Rome Ms. Clara Booth Luce, put great pressures on the companies to weaken the "communist unions", i.e. the unions affiliated to the CGIL, threatening to cancel industrial orders for US companies and, I suppose, for NATO contracts as well. These would have been mostly large firms and the more technologically advanced ones, where the CGIL had an overwhelming presence. Through most of the 1950s labor's share in the value of industrial output kept falling without an effective resistance from organized labor (Graziani 1989). Contractual wage increases were limited and a rising proportion of the actual pay-check was due to the wage drift, that is to non-contractual discretionary payments granted by management (Ammassari 1963).

The second flaw stemmed directly from the first in that to expand exports Italian industry counted on a persistent gap between the rate of growth of productivity and the rise in wages. Such a pattern pushed the sectoral composition of the country's output and exports towards price competitive products at the expense of developments in altogether new branches and technologies. This tendency has been well put by the late Augusto Graziani[22]:

> On the other hand, while the Italian industry was entering the production of mass consumption durables, the industrial sectors of the other European countries were shifting to even more advanced products. In essence, the modernization of Italian industry helped avoiding the widening of the gap, whereas in the global context of world industry Italy's productions remained concentrated in sectors requiring relatively simple technologies (Graziani 1989, p. 56, my translation from Italian).

In the last two years of the 1950s, the tightening of the labor market, also because of emigration, caused big rises in the wage drift. From 1961 to 1963 the industrial sectors became engulfed in unprecedented strike movements. By 1964 the decline in the wage share that started in 1951 had been completely reversed, recovering most of the lost ground. Many ascribe the beginning of the crisis of the Italian

[22] Augusto Graziani (1933-2014) was among the leading intellectual-economists in Italy along with Marcello De Cecco, Luigi Pasinetti, Paolo Sylos Labini and Claudio Napoleoni. He was the founder of the theory of monetary circuit in parallel with Alain Parguez in France. His contributions to the economic analysis of Italy and to macroeconomic and methodological issues are path breaking. He taught at the University of Naples Federico Secondo and later at the Sapienza University in Rome.

economy in 1964-65 to a profit squeeze effect followed by a harsh credit crunch applied by the Bank of Italy. Indeed, despite the ongoing export boom, investment growth by the large private companies slowed down as soon as contracts granting wage rises above productivity growth were signed in 1961 and 1962 (Sylos-Labini 1974). Wage increases did cut into profit margins, but it would be wrong to accept the view that they hampered Italy's competitiveness since in those years similar events happened in other EEC countries as well. The abrupt end of the boom was caused mainly by the credit crunch enforced by the Bank of Italy which had in its mind an open economy oligopolistic adjustment policy centered on the following steps. Firstly, by making investment more difficult companies were being compelled to resist wage demands. Secondly, and consequently, the fall in employment and/or the fear of unemployment would reverse the worsening - from the companies' point of view - productivity to wage ratio, thereby making exporting firms more competitive with restored profit margins as well. The rationale was that within the country the large firms enjoyed fairly strong oligopolistic positions, so that a decline in wage/productivity ratios did not have to be transferred onto lower prices. Hence if productivity increased, say, by 6% while money wages rose by 3%, export prices could still remain competitive, with profit margins being lifted up anywhere between 1% to 3% according to firms' strategies.

The Bank of Italy's tough gamble turned out to be extremely successful. The impact of the Central Bank's policy stance has been so drastic that from 1965 to 1969 contract wages hardly grew above inflation whereas productivity expanded by more than 5% per annum, exports boomed again but investment stalled completely. The intake of labor from the rural areas fell and migration resumed, mostly to Germany. Throughout 1966-69 Italy achieved remarkable trade and current account results[23]. On the surface the Italian economy did not stagnate since growth was substantial, not at the level of the boom years but not too far behind and still the highest in the EEC. In that context consumption did not stagnate either. In fact, both in the aggregate and in per capita terms, it too was the fastest growing among the Euro Six countries. Growth was generated by concentrating the composition of industrial employment in the central age groups extracting high productivity and long hours due to overtime and piece rate work. In this way actual earnings increased as well, pushing up private consumption. The core of the crisis was in investment because of the large and medium sized firms' strategies to squeeze out more productivity through the reorganization of the workforce. This state of affairs made Italy's industrial sectors heavily dependent on foreign demand on the rather problematical basis of price competitiveness. The economists of the Bank of Italy mentioned earlier summed up the implications arising from that particular dependence:

> It could, moreover, reveal itself to be a cause of instability of demand, to the extent to which Italian exports of goods, capital goods included, are not based on a stable technological lead, but on a strict price competitivity, artificially emphasized by low domestic demand (Ciocca and al, 1975, p. 315).

The end of the 1960s witnessed the emergence of two forms of mercantilism. One strong, based on the Europe-wide oligopolistic powers of German corporations and of the US multinationals located in Germany and elsewhere in Europe, and one, the Italian, weak because, as it will become apparent from the 1990s onward, it requires special conditions and is persistently exposed to the competition from low cost producers. In a politically configured quasi-integrated space like the EEC and the EU, these two forms of mercantilism cannot coexist side by side indefinitely. One has to give way to the stronger and must

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[23] According to new long run statistical series published by the Italian National Institute of Statistics ISTAT, the country still showed an external deficit during the 1965-69 years, although not a major one (ISTAT 2011, ch. 16). Yet according to the OECD publication *Historical Statistics* (1983) Italy exhibited a strong trade and current account surplus which, in proportion to GDP, was even bigger than that of Germany.

adjust accordingly. In Italy the adjustment manifested itself through the crisis and retreat of the large firms. For all the countries involved, the EEC was an external space. That is, a domain exogenous to the national economies treated as a place suitable for the realization of profits by means of export surpluses. In the case of France's elites the EEC as conceived by Jean Monnet was an institutional construct enabling France to exercise, step by step, political hegemony at least at an initial stage. Thus, for the French inventors of *l'Europe* economic issues were ancillary to the political ones. Yet since the end of reconstruction the current account constraint emerged as the main feature of Europe's political economy. It is around this question that power relations between the states have been played out till the formation of the European Monetary Union in 1999.

5. France: de Gaulle's transformation of country and of the economy. Germany and Britain once more.

It is preferable to approach the question of France in Europe for the period under consideration from a historical and political perspective rather than economic. In the previous essay as well as in the first part of the present paper I pointed out how from 1946, the year of France's reoccupation of Vietnam, to 1962, when Algeria won its independence, the whole trajectory of the country was defined by the quest for imperialism and by the objective of counterbalancing Germany. After the defeat at Dien Bien Phu in 1954 and the start of the liberation movement in Algeria in the same year, those two issues became incompatible unless reformulated. Thus France turned out to be, politically and financially, the problematical partner in a process that she herself started in 1950 with the (Monnet inspired) Schuman announcement regarding the forthcoming creation of the European Coal and Steel Community. The rise to power of General Charles de Gaulle who founded the Vth French Republic untied the knot. To understand how De Gaulle changed the institutional and political framework we must start from the French military in Algeria on May 1958. A brief review of the events of those days is instructive since it will show how deeply unprepared was France for any process of European integration. Indeed through those events we can see clearly that France was with more than one leg out of post 1945 Europe and with more than just one foot in Latin America.

Le Général's rise to power happened very quickly. On the 13th of May 1958 there was a military *pronunciamiento* in Algiers with the formation of a committee of national salvation headed by general Salan who, in front of a crowd formed by colonial settlers, called to stop the approval by the National Assembly in Paris of a Socialist-Catholic government. Pflimlin, the MRP's (Catholic Party) Prime Minister elect, had been favoring direct talks with the Algerian liberation front FLN. In his "speech" Salan hailed General De Gaulle. The next step of the putschists consisted in forming, on the 26th of May, a second committee of national salvation, this time in Corsica occupying also Ajaccio, the island's capital. The new committee issued an ultimatum to the Government to disband with the deadline set for May 29. The last stage would have involved the dropping of paratroopers on Paris. To that effect the Gaullists were in liaison with the putschists. The military takeover of Paris did not materialize because the highest constitutional authority of France caved in. On May 29 President René Coty made a public appeal to De Gaulle while in the same day the National Assembly passed a confidence motion in the legal government of Pierre Pflimlin. At this point President Coty threatened to resign. Most of the political parties at the National Assembly split with the majority of the deputies backing down. Only the Communist Party kept a united opposition to De Gaulle. Thus, on the 1st of June 1958 General Charles de Gaulle, who meanwhile was given by President Coty the task to form the government, received a vote of confidence as

Prime Minister with 329 votes in his favor and 224 against, of which 141 were from the Communist Party of France[24].

De Gaulle obtained from the National Assembly the power to govern by decree for a duration of six months and prepare a constitutional reform to be submitted to a referendum. The latter took place on the 28th of September in which de Gaulle's reform was approved by 79% of the voters, while the November elections gave a parliamentary majority to the Gaullists on the basis of a new electoral system that penalized working class constituencies. De Gaulle became President of France through an electoral college on the 21st of December and took office on the 8th of January 1959. The direct election to the Presidency of the Republic was introduced only in 1962 by means of an amendment. The whole dynamic reveals the appalling political state of France. It was caustically summed up by Pierre Mendès France, a well-known former Prime Minister and staunch opponent to De Gaulle's return to power: "It is because the Parliament buckled under that there has been no coup d'état" (my translation from French[25]).

Although supported by the putschists, De Gaulle knew that he had to shunt them aside. The politics of the relations between France and Germany on one hand, and the rejection of Britain - whose Conservative government was knocking on the door of the EEC - on the other, became instruments to refocus France onto Europe from, supposedly, a position of strength. The political steps of De Gaulle's were the decision to start in 1961 negotiations with the FLN for the independence of Algeria, the signature in 1963 of a friendship treaty with the Federal Republic of Germany known as the *Traité de l'Elysée,* the decision to change the Dollars in the Banque de France into gold ingots held by the United States - an act that signaled the beginning of the end of the 1944 Bretton Woods regime of fixed exchange rates - and, lastly, the withdrawal from the military wing of NATO in 1966 in order to give maximum autonomy to the developing nuclear strike force *Force de Frappe*. Let me now elaborate on some aspects of the steps listed above.

(I) The decision to negotiate with the FLN and eventually to accept the independence of the whole of Algeria did not mean forsaking the imperialist orientation especially toward Africa (Serfati 2015). It is the colonial aspect that was being abandoned. The new strategy entailed the formation of the *Force de Frappe* and, with it, the further development of the military industrial complex which, in the course of time, became the only effective industrial policy of successive governments. Along with the revamping of the military industrial complex Charles de Gaulle had to reposition the military in order to prevent it from acting on its own again. Hence he created a military-industrial *mesosystème* - intermediate system - which is little discussed when it comes to the French economy. The concept of *mesosystème* has been formulated by François Chesnais and Claude Serfati (1992) in their excellent study that will be extensively used in the coming pages.

(II) The *Traité de l'Elysée* formed the initial context for the so called "couple France-Allemagne" (the France-Germany couple) for leading Europe. In practice it was a way to establish a framework with Germany separate from the Atlantic ties, i.e. away from the influence of the United States and from a possible alliance between West Germany and Britain on European non-EEC issues. The Bundestag understood France's President objectives very well. After Chancellor Konrad Adenauer and President De Gaulle signed the treaty in Paris, the Bundestag made the approval conditional upon the inclusion of a long preamble reaffirming the Atlantic commitment of the FRG as its foremost priority. Incidentally, but

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[24] The full account of the crucial National Assembly session of June 1, 1958 can be accessed at http://www.assemblee-nationale.fr/histoire/de_gaulle.asp

[25] Mendès France's quote is from https://fr.wikipedia.org/wiki/Crise_de_mai_1958 (accessed 31st March 2017) which provides also a very detailed account of the events.

I do not think randomly, the day the *Traité de l'Elysée* was signed, De Gaulle rejected with a big 'NON' Britain's demand to join the EEC. The one thing that the President did not wish to have within the EEC was a possible British-German political alliance. I will later venture to explain why President Georges Pompidou made a complete about turn on the issue.

(III) The decision to exchange the dollars held by the Banque de France against the insufficient gold kept in the United States' official coffers uncovers the deeply monetarist thinking surrounding the French President's economic policies represented by Jacques Rueff, who saw in that move the beginning of the road back to a new gold standard. It follows that if Europe avoided finding itself trapped in a gold monetary madness in the middle of a boom, it was due to President Johnson's refusal to comply beyond a certain limit. The episode shows that while the French regime aimed at thrusting France into and onto Europe, there was absolutely no intention to jointly build something robust. Thus countries either wanted to reestablish an export wave (the FRG after 1965), or ride external growth at the expense of domestic demand (Italy after 1964), while one - France - played big power's games as a way to build a system of state corporate capitalism dominated by big business and military oriented oligopolistic capital.

5.1 Building state corporate capitalism and the meso-military system

In the last years of the 1950s external growth forces and the expectations regarding exports to the EEC were evidently very strong because the devaluation of the French franc by 17% relatively to the dollar in December of 1958, one of de Gaulle's and Rueff's first policy measures, is viewed in most textbooks as a successful operation (Eck 1988). The officially christened De Gaulle-Rueff plan, came on top of a 20% de facto devaluation undertaken in 1957 by the then Prime Minister Félix Gaillard and acknowledged as such only in the summer of 1958. The Gaillard operation had been called the "hidden devaluation" because the government instituted a multiple exchange rates regime[26]. It turned out to be a complete disaster while the economy was saddled with a growing toxic budget deficit caused by the colonial war in Algeria[27]. The Rueff devaluation was coupled with the swift reduction of the tariffs and quotas in line with the agreements signed in Rome that until then were deemed inapplicable. Aided by the strong growth in other EEC and non-EEC European countries, France's exports increased very rapidly. The policy was performed by installing a rather strict deflationary scheme based on de-indexing wages from inflation which, stemming from war expenditures, was quite high. Furthermore the government was also determined to achieve a budget surplus.

The combination of export growth - the latter due to external factors and to the price sensitivity of the demand for France's products - contributed to the repayment of the loan obtained in 1957. The IV and the V year plans were the main indicative frameworks for these policies. For the 1960-68 period the country's growth rate increased relatively to the previous decade while that of Germany and Italy declined relatively to the 1950s remaining however quite strong. In this way relatively to the EEC, France's growth rate became the second highest after Italy's. By 1963 the issue of France's balance of trade and payments deficit resurfaced precisely because the growth of the economy and the expansion of exports attracted a greater amount of imports. The government launched a two-year long stabilization plan based on deflationary policies again and curtailed the fiscal credits given to investment.

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[26] I am extremely grateful to Professor Alain Parguez for a most interesting elucidation regarding the 1957 multiple exchange rates policy in the context of the bad public and external deficits caused by the colonial war in Algeria.
[27] I am using here the view often expressed by Professors Alain Parguez and Riccardo Bellofiore that it is necessary to distinguish between good and bad deficits.

Thus, in the 1963-65 biennium two major European economies, France and Italy, adopted a negative Keynesian stance in the sense of Luigi Pasinetti (1974)[28], only to be replicated shortly afterwards by West Germany's mini-recession of 1966. These three events may legitimately be interpreted as an indication that faults in the mechanism of long run growth began to appear when, after 1958, countries had to deal with balance of trade and payments issues entirely on their own. Yet there is no evidence that the policy making bodies of the European countries were waking up to the general dimension of the problem. In reality they all too simplistically relied on their neighbors' continuing expansion and on the ability of internal restraint to exploit that source of external growth.

France's technocratic policy makers definitely looked for external expansion toward the rest of Europe as it was also needed in order to cut the dependency on colonial markets. Yet the main goals of De Gaulle's regime were those of the construction of state corporate capitalism with a central core formed by a military industrial system. The V[th] five-year plan of 1965 typified the building of such a corporate state. Within its framework a policy of industrial concentration was launched led by the State owned enterprises accompanied by measures favoring private sector's mergers. Alongside the State, the big banks - themselves the result of the concentration policies - participated in vast industrial acquisitions. In the long term the concentration strategy failed to produce internationally leading firms comparable to the German ones except in the aviation, rail transport and nuclear industries, all linked to the mesosystéme. In their book Chesnais and Serfati (1992) observe that the reliance on orders from the military sector led the main electronic companies to neglect the civilian economy leaving consumers' demand to be supplied by foreign multinationals. This despite the obsession with *l'informatique* (information and computer technologies) that for decades has characterized the thinking of France's elites, PDGs (CEOs), *cadres* (technocratic managers), and so on. In the 1980s the fixation with *l'informatique* would lead to obfuscation of the fact the economy was losing industrial momentum and employment because of lack of effective demand. It would contribute also to a complete misreading of the German economy, whose firms were more sober about the futuristic impact of I.T. on their production processes. Thus, a monograph published in the journal of the semi-official CEPII featured a truly 'farsighted' title whose English translation reads as: "Deindustrialization at the Heart of the German Model" (De Mautort 1981). According to that seriously flawed document the supposed slowness of the German economy in absorbing the new electronic and I.T. systems represented a factor of regress and de-industrialization. In the *mesosytéme* it has been a different story.

Chesnais and Serfati identified, in their work, the new tasks set out by De Gaulle in relation to the role of the army. The political task was to make the army, in its new nuclear strike force capability, an instrument for a foreign policy independent from US influences, whereas the institutional one consisted in creating the framework for the military to act as a pillar of the State rather than as a separate corps prone to mutinies. De Gaulle's emphasis on the military was also intended at "making the armaments industry and the programs in advanced technologies needed for the production of new weapons, into a major lever for the accelerated modernization of the economy" (Chesnais and Serfati 1992, p.57, my translation from French). Quite explicitly France followed both institutionally and organizationally the US military-industrial complex model. Well before Paris' 1966 break with the military wing of NATO, Washington - namely President Kennedy himself - was willing to help, offering to supply missiles to France's nuclear submarines. The offer was rejected since the government decided to build their own. The government created new centralizing institutions, like the General Directorate for Armaments, established in 1961, in charge of development programs to which are tied the corporations and their subcontractors

[28] "The 'Keynesian' management of total effective demand has by now become such a common Government policy as to be used sometimes not only for achieving full employment, but also for deliberately *causing* 'Keynesian' unemployment" (Pasinetti 1974, p.41n.).

participating in the military industrial complex. At the beginning of De Gaulle's rule France's armament exports were a limited proportion of the country's weapons output, no more than 8% according to the two authors. In the 1980s military exports rose to around 35% of the sector's production.

But the most important aspect of France's military industrial complex lies in that it integrates the large corporations, the institutions and the upper stratum of the elites in an economic and social monopolistic bloc whose actions and policies go virtually unscrutinized and unchallenged. It is the hard core of France's elite system. The post 1980 industrial decline of the country and the increase in budgetary constraints, did not entirely spare the military industrial complex, although a study reconstructing the process of capital formation of the military-industrial complex highlights its privileged and sheltered status for the period up the 1990 (Serfati 2015). However the role of the *mesosystème* as the heart of France's internal power relations has not changed. Furthermore, successive French governments have retained the freedom to conduct armed interventions abroad, mostly in Africa, so much so that since the end of the Algerian war Paris has undertaken 50 military operations beyond its borders (Serfati 2015).

The active projection of France's military position is the most significant legacy bequeathed by De Gaulle to the country's elites whom he himself radically restructured by providing them with a technocratic European hegemonic perspective channeled through *la France* and its power. The quest to unify the military strength with a parallel supporting economic prowess did not come about to the same extent. The political cohesion required to implement that junction began to wane at the end of the 1960s. It unraveled quickly throughout the 1970s, especially after the drastic Raymond Barre deflation in 1977 that started the process toward mass unemployment and social exclusion that has become an unchangeable feature of the country's social life. The Gaullist project cracked in 1968.

The most relevant shock of those events was the nearly month long workers' general strike in May 1968. Although triggered by the students' protests in Paris, its roots lay in the impact of the stabilization plan of 1963-65 which created a situation comparable to that of Italy, whereby wage increases depended mostly on the intensification of the work effort. Interestingly, the fact that wage rises broke through the productivity barrier, led only to a minor decline in gross accumulation, at least as measured by OECD reporting on gross operating surpluses in industry (OECD 1983, p. 75). Indeed, judging the economy's performance from 1968 to 1973, it seems that France behaved close to the lines broached by Michal Kalecki (1971) in his posthumously published paper "Class Struggle and the Distribution of National Income" which he wrote having in mind the wage increases that prevailed in Europe in the late 1960s. In each of the three years following that long strike, GDP growth, investment (measured in terms of the rate of growth of gross fixed capital formation), and employment expanded[29]. Indeed, it would be very difficult to make a case for a supposed crisis caused by the 1968 events. If one were to take the whole of the 1968-73 period one would notice that just about every macroeconomic component of GDP grew faster than during the big expansion of the 1960-67 years (OECD 1983, 1990). Only the trade balance

[29] In his 1971 article Kalecki presented a Marxian effective demand reproduction model with oligopolistic price functions. The model is based on three sectors: investment goods sector, wage goods sector and a capitalist's luxury goods sector. Then he assumed an increase in wages W by a certain proportion α of the total wage bill W. Thus: $\Delta W = \alpha W$, where: $W = W_1 + W_2 + W_3$
The level of profits is given by the difference between the value of output and the wage bill in each sector. Since all wages are assumed to be spent in the purchase of consumables from the second sector, the level of profits in this sector is given by $(W_1 + W_2)$. A general increase in wages will therefore entail that: "total profits remain unaltered, the loss of sectors I and II of $\alpha(W_1 + W_2)$ being counterbalanced by an equal gain of sector III. It follows that no absolute shift from profits to wages occurs and the argument based on Say's law would thus prove fallacious, at least in the short run." (Kalecki 1971, p. 2).

didn't do that well but for no more than a couple of years. At any rate, objectively speaking, the state of the trade balance did not do any harm since for the 1968-73 period the growth rate increased relatively to the previous eight years.

Just the same, such a massive social event, engulfing the majority of the working class, contributed to unseat *le Général* by throwing into disarray his *pouvoir personnel* (personal power, in the sense of centralizing power) which was the apex of the whole hierarchical structure and of the business-state-military networks. In parliamentary terms de Gaulle won the May 68 challenge since his party increased its majority in the early elections he called in order to stem the social upheaval. However the loss of political confidence by the Gaullists themselves had become deeply rooted. In fact the Gaullist State stumbled on three issues: on the world monetary system, on the external balances and on Germany.

The international monetary system was awash with US dollars arising from Washington's institutional spending abroad - heavily conditioned by the Vietnam War - as well as from net capital and liquidity outflows (Block 1977, table 3, p. 160). This situation while sustaining the level of effective demand in the West - especially in the little American-Japanese Asia formed by Japan, Taiwan, South Korea - was undoing the Bretton Woods pact whereby the US Dollar was to remain always convertible into gold. Furthermore, a part of the net outflows became "hot money" in the eurodollar market fueling speculation and a pressure on exchange rates, particularly on the Deutsche Mark. Jacques Rueff a true to gold economist - hence with far worse ideas than Milton Friedman's money neutrality views - considered these phenomena exclusively from the angle of pure monetarism, that is as inflationary only. On this basis the French President started to reclaim from Washington gold ingots against the dollars held by the Banque de France. For Rueff the remedy to the crisis of Bretton Woods could not have been but a process leading back to a new gold standard. De Gaulle's and Rueff's actions on international monetary relations made things worse and contributed, on the European side, to the world monetary disorder by actually foreclosing the possibility of elaborating a sensible alternative, for Europe especially, to the collapsing Bretton Woods regime. Such a behavior was the direct outcome of the thinking that dominated both Rueff and *le Général*. For the latter, the December 1958 devaluation represented a new kind of Franc Poincaré - launched in 1928 and linked to gold after a substantial devaluation. At the time, the Franc Poincaré became the cornerstone of the country's economic stance till 1936 thereby locking France firmly inside the Great Depression. Shortly after the December '58 devaluation a new Franc was introduced worth 100 units of the old denomination. The new Franc was meant to be so solid as to become the future monetary reference for Europe. It was part of the De Gaulle-Rueff ultra monetarism, thus consistent with their inconsiderate moves for the conversion of Dollars into gold[30].

The domestic side of the policy was given by the drive towards a balanced budget, a target over-achieved through most of the 1960s. All this was supposed to happen with a secure balance of payment position as prescribed by the markedly anti-Keynesian stabilization plan of 1963-65. The 1967 devaluation of the Pound Sterling, leading to a flight toward the US Dollar, and the 1968 events at home blew the whole strategy out of the water. Although the real economy had been gaining from the wage increases obtained through the agreements signed at Paris' Rue de Grenelle on May 27 1968 (as per Kalecki 1971 quoted in footnote 30), government and business leaders quickly became dominated by preoccupations regarding the balance of payments, the budget, the confidence in the Franc etc., etc. (as per Kalecki 1943, see Kalecki 1971a). De Gaulle refuser to devalue, clinging onto his own Franc parity. Yet it happened nonetheless, by 11% relatively to the Dollar, two months after the election of Georges Pompidou to the Presidency of the Republic which followed De Gaulle's resignation on the 28 of April 1969. The last stroke

[30]Alain Parguez (1998) has provided the best explanation of the deep attachment to austerity of France's policy makers and elites.

that broke the Gaullist scheme of things came unwittingly from Germany. One of the purposes of the nuclear *Force de Frappe* was not so much to be a deterrent against the USSR as officially claimed, but to act as an implicit pressure on the Federal Republic of Germany[31]. The strategy aimed at forming a nuclear armed and economically strong France, and at the same time at establishing unique ties with Germany in the context of a special relationship with the Soviet Union. The true meaning of De Gaulle's notion of Europe from the
Atlantic to the Urals was the sandwiching of Germany between France and the USSR. However in 1969 the FRG was on a rather different trajectory.

In Germany the recovery from the 1966 recession was very much based on the growth of exports and therefore on a renewed expansion of the current account surplus. From 1969 to 1972 also the FRG experienced a phase of intense wage demands, although without the politically radical character they had acquired in France. Those industrial actions - led by the metal workers union I.G. Metall - sprang up in particularly strong terms because of the profit boom that came with the big export led recovery (Markovits and Allen 1984). In Germany too, pay rises did not harm the economy. Indeed, upward pressures kept piling on the Deutsche Mark to the point that after the 1969 DM revaluation - opposed by the Bundesbank - the currency's exchange value vis à vis the dollar rose again in 1970 by about 10%. The event did not stifle exports, nor did wage rises harm economic growth. The situation will change after 1972.

The tale of Germany and France at the end of the 1960s is illuminating: one revalued the currency without losing - actually increasing - its export surpluses, notwithstanding wage rises, and one did exactly the opposite. There is also an important third case, Italy, which is more significant than the May '68 events in France since in the *bel Paese* the wave of labor struggles of the Fall of 1969, known as the *autunno caldo* (*hot Autumn)*, continued for a number of years stretching well into the 1970s. It will be discussed in the section dealing with that decade. In essence the chief reason for the diverging behavior of France and Germany lay in the profound differences concerning the sectoral composition and technical features of the respective capital stocks. In France, the framework of reproduction and accumulation required a particular State set up in order to counterbalance the long-term weakness in the array of capital goods industries and the consequent tendency for rentier strata to prevail[32]. Thus, depending on the historical circumstances, the State took upon itself the task of filling part of the structural voids in France's productive apparatus otherwise the country could not have possibly become a colonial imperialist industrial power.

Returning now to the period under consideration, the accession to office in Bonn of the Social Democratic SPD in 1966 (in a grand coalition with the Christian Democrats of the CDU-CSU), changed the terms of reference as to both the economic and foreign European policies of the FRG. The SPD technocratic economic minister Karl Schiller, a self-styled Keynesian, was in favor of revaluation and of boosting exports by changing the pattern of accumulation in favor of more advanced products as exports and for more imports in less advanced ones. In other words, the preference was for a more intensive form of accumulation. At the foreign policy level the SPD initiated the first steps toward the Ostpolitik, namely toward the USSR, which became in 1972, with Willy Brandt as Chancellor, the mainstay of Bonn's foreign policy. Hence Paris' coveted special relation with the USSR was being hijacked by Bonn on much more solid economic grounds. For France, whose political leaders looked, and still look, at European issues mostly in terms of balance of power between states, it was time to drop the opposition to

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[31] This is acknowledged, although *sotto voce*, by two rather mainstream French historians (Berstein and Milza 2009, vol. III).
[32] In the book by Frances Lynch (1997) the deep and pervasive weaknesses of France's capital goods sectors emerge rather clearly. The postwar Monnet Plan aimed at correcting the situation.

Britain's entry into the EEC. The dismantling of De Gaulle's approach was undertaken by the new President, Georges Pompidou, De Gaulle's former Prime Minister. Pompidou knew the City of London, the heart and lungs of Britain's international financial system, extremely well since he had been the Director of the Rothschild bank.

6. Conclusions for the 1960s

Twelve years into the EEC the member countries were less coordinated than during the Marshall Plan and EPU years. The most important stumbling block was the stop-go orientation that the balance of payments constraint for some (Italy, France and also the U.K.), and the absolute necessity to obtain net balances on foreign markets for others (Germany), was imposing upon the Western European States[33]. As countries took this stop-go stance one after the other, the likelihood that they would all end up behaving 'pro-cyclically' obviously increased. The lack of any cooperative framework on this matter made the mercantilist orientation into an objective necessity but a pernicious one all the same. If German policy makers wanted to ensure both substantial corporate profits and a high rate of utilization of productive capacity, they could not but favor a continuing expansion of (net) exports[34]. In turn the deficit countries were compelled to go into a recessionary mode in order to block further deteriorations in their external deficit and then hope to be taken in tow by those who were not in a stop mode. In Europe, there was no other mechanism to deal with external balances. Yet such a situation implied that 'Keynesianism in one country' was unlikely to succeed, while the EEC and the rest of Europe's countries were certainly not ready and they are not likely to ever be, for Trotskyite Keynesianism where global Keynesianism replaces Trotsky's notion of a global revolution.

The pernicious aspects of the stop-go policies consisted in their fostering a procyclical behavior, while at the institutional level they induced governments to think of them as perfectly acceptable, as purely temporary. In reality the EEC and the United Kingdom were off the full employment path before the collapse of the Bretton Woods arrangements in 1971. From this perspective there has been no golden age of capitalism and no *trente glorieuses,* as much as there would not have been a boom decade in the USA without the Vietnam war and other military programs. The same framework, i.e. the Kindleberger point that the Marshall Plan never ended because it became the NATO Plan, allowed Europe to prosper, albeit in a perverse way as fully understood by Michal Kalecki. Towards the end of WW2 Keynes did identify in the balance of payments the most vulnerable area for the implementation of economic policies aimed at full employment. For this reason Keynes advocated an international monetary system aimed at preventing the burden of adjustment from falling exclusively on the deficit countries. Yet stop-go policies did exactly that, only by stealth since they gave the illusion that the trick would work. By the end of the

[33]Evidence that during the 1950s policy views were more sensible is provided by the signature in Paris on August 5 1955 of the European Monetary Agreement. The aim was "the establishment of a European Fund and of Multilateral Settlements System" (http://www.webcitation.org/60DPr5qsf?url=http://www.federalreserve.gov/pubs/rfd/1955/259/rfd259.pdf accessed 15-4-2017). The Agreement was meant to come into force with the termination of EPU and the consequent return to convertibility. The founding document linked above explicitly stated that the purpose of the Agreement was to help European countries to maintain employment. It was intended to come into effect in 1956 the year EPU was deemed to end its operations. Instead EPU was closed down at the end of 1958. The Agreement itself was terminated in 1972.

[34] Here it is a matter of straight Kelecki's economics: if the price-cost relation is maintained, i.e. if the oligopolistic price functions are stable, a reduction in net exports is tantamount to a reduction in aggregate profits for the whole business system of the country concerned.

1960s the EEC was increasingly distant from Keynes' point of view and also from Scitovsky's more moderate version of it.

If Europe and the EEC didn't yet get into the swamps of joblessness, it was because the lapse of time stretching from 1968 to 1973 was a period of economic boom occurring concomitantly with a protracted increase in wages spread over several countries. According to the OECD long term analysis (OECD 1983) the boom was several decimal points above the average growth rate of the 1960-68 period. Of the constituent parts of EEC's GDP, consumption increased faster than gross domestic product, and gross fixed capital formation, that is investment, expanded at the same rate of GDP, whereas the increase of real government consumption fell well short of GDP growth. The rates of growth of both exports and imports were extremely high, with the external balance acting positively, but moderately, on the growth of GDP. In this context it is difficult not to observe that what sustained demand most was the continuing expansion of consumption strictly connected to the dynamic of wage increases. Among the members of the EEC Italy was the country where the rise in wages and in consumption did not latch onto a higher growth rate, which in fact fell. On balance, therefore, I tend not to accept the view put forward at the time by Andrew Glyn and Bob Sutcliffe (1972) concerning the profit squeeze resulting from wage rises as the primary cause of the end of the boom years. Their thesis may be valid for Italy and/or for Britain but not for the rest of developed Western Europe. I am much more convinced by the analysis undertaken by Fred Block (1977) who put the source of the crisis in what he called the international monetary disorder, to a large extent related to the American war in Vietnam.

7. The 1970s: The Deutsche Mark and the others.

The end of the Bretton Woods fixed parity regime in August 1971, and especially the end of the December 1971 Smithsonian agreement, created for Europe the need to address the issue of the impact of exchange rate variations. In light of the dominant role acquired by external accounts, the real preoccupation was to avoid competitive devaluations. To this effect an attempt was made to create a band regulating exchange rate fluctuations, the so called snake in the tunnel experiment involving several European currencies[35] The experiment was a total failure from the start, so that no common exchange rate framework existed in Europe until the launching of the EMS in 1979. For Germany the new post Bretton Woods situation opened up two monetary fronts: how to face the devaluation of the US Dollar, and how to tackle the many different fluctuations of the European currencies (Parboni 1981). As mentioned earlier, with the SPD in office the Bonn government was not afraid of revaluation. This attitude stemmed from the views of the economic minister Karl Schiller for whom an appreciation of the DM provided the opportunity for advanced industrial restructuring. True, it was argued, revaluation would hurt some industries, but it would also reduce imported inflation as well as significantly help many other branches within which a large segment of the exporting industries is to be found. It may, at this point, be useful to discuss the issue in some detail.

The strategy put forward by Karl Schiller viewed further industrial concentration as a means to increase efficiency. From 1972 onward the Federal Republic underwent a deep process of industrial restructuring having the following objectives. To begin with the German economy was pushed to generate a much higher level of foreign direct investment, particularly in the United States in order to circumvent the post 1971 depreciation of the American currency. Given that the country's monetary and banking authorities

[35] The snake in the tunnel was a European monetary arrangement made in 1972 in the wake of the Smithsonian agreement of December 1971. It was supposed to regulate the respective fluctuations of the European currencies within a definite band, hence the term 'tunnel'. It never really worked, as countries kept leaving and re-entering it. The collapse of the Smithsonian agreement early in 1973 also meant the end of the European 'tunnel'.

have been opposed to finance the international operations of firms by issuing liabilities against Germany itself (Parboni 1981), the financing of greater direct investment had to be secured by an expansion of net exports. Furthermore, it was deemed desirable that the German economy reduce the weight of the competitive price taking industries in the value of output. Currency appreciation joins the two objectives together by fostering greater concentration, thereby shifting the resources to the oligopolistic industrial branches. An interesting paper by Steinherr and Morel (1979) may now be used, in a somewhat modified way, to elucidate the process analytically[36].

The authors considered an economy made of two components: a competitive one formed by price-taking firms, and an oligopolistic concentrated one based on mark-up pricing. The oligopolistic sector is viewed as the largest exporter. In this context a revaluation of the DM, would reduce the costs of inputs, oil and intermediate products. Since these companies are price makers their exports strategies would not be much affected. If markups are given, export prices can be reduced by the relative proportion of the fall in the costs of imported inputs of raw materials and of intermediate products. In this way the negative impact of the rise of the DM is mitigated. If, instead, prices are not reduced because firms in the concentrated sectors are confident in their degree of monopoly over their market, the rise in profit margins may facilitate investment in R&D and/or the extension of commercial credits thus helping future exports. These routes are barred from the competitive sector which, being a price taker, is subjected to stronger price competition from foreign producers due to the higher value of the DM. On the whole, the competitive sector will experience a decline in profitability so that financial capital will move to the oligopolistic branches of the economy thereby augmenting their resources.[37]

We can understand here how important domestic price stability is for the export capabilities of the concentrated sectors. In the inflationary environment of the 1970s, price stability in the FRG also sustained the relation between the universal banking system and industry. This is because the universal banks' task is to borrow on a short and medium term basis in order to lend long-term to firms. Under inflationary conditions the term structure of the loans would tend to be shortened, going against the investment plans of corporations (Nardozzi 1983). Thus the Bundesbank's determined commitment against inflation is a guarantee of stability of the links between banks and industry.

The circle was closed by the formation of unemployment. Its rise in Germany as elsewhere in Europe can be read as the product of the stagflation typical of those years. It was obvious that the Government's restrictive fiscal and monetary policies after 1973 would generate unemployment, which in fact grew from 1% in 1972 to 4.4% in the following years. Unemployment, and with it, the incentive schemes to urge the departure of many immigrant workers (some 600 thousand returned to their home country), helped shifting the distribution of income away from wage earners. It strengthened profit margins and mitigated inflationary pressures. The last component of the 1973-78 strategy was to combine nominal revaluations with a tendency toward a real depreciation of the DM. For that to happen, it was necessary that when the DM rose, prices increased as little as possible and much less than those of the other countries whose currencies have devalued. To bring about such a conjuncture restrictive policies would not do: productivity growth, with an increase in the productivity to wage ratio to reduce direct costs per unit of output, is required. Considering the objective of moving the product range of Germany's industry onto a higher technological level, productivity gains compatible with nominal revaluation but tending to real

[36] Steinherr and Morel built what effectively today would be called an asymmetrical neoclassical model. I liked and appreciated their ideas and their conclusions, but I have chosen to recast the argument in a Kalecki and Sylos-Labini framework.
[37] Of course there is no guarantee that a rise in profit margins in the oligopolistic sectors will lead to greater R&D investment; here it is just an instance of best case scenario.

depreciation, could be obtained only by means of innovations and with new capital equipment. Here lies the absolute importance for Germany of having an advanced and large home-grown capital goods industry, and of being able therefore to operate systematically on the input-output matrix of the economy.

Germany's policy makers and industrial leaders addressed the depreciation of the US Dollar by expanding foreign direct investment in the USA, and they tackled both the inflationary pressures and the multiple fluctuations of the European currencies by making Germany act as an early deflator. Revaluation was used in order meet the challenges exclusively from the point of view of price stability and of exports, thereby sacrificing domestic demand and employment. In the 1973-78 GDP growth was the second lowest of the now nine EEC countries. The economy withstood very well the first oil shock, maintaining a hefty merchandise trade surplus, although the latter declined a bit in 1975 and in 1976. Germany also became an important supplier of capital goods to the oil industry, tilting in its favor the trade flows with the Arabian peninsula. This was not an option available to the other European countries as none, particularly France and Italy, had the capital goods sectors that, in bad and in good times, Germany had built up in just over a century. For the country the worst of the oil shock was over by 1976, leading Bonn to relax the hitherto tight fiscal policies. In the same year France was falling into the nasty Raymond Barre engineered recession from which, in terms of unemployment and social exclusion, it would never recover as things would get worse decade after decade. Germany's external surplus started to climb back to the 1974 level only to be halted by the new much tougher oil shock of 1978 induced by the Iranian crisis[38]. In this case the impact turned out to be much more severe as it nearly wiped out Germany's merchandise surplus and plunged the current account balance into a deficit for two years running. However, helped by the freshly minted EMS and by an even greater structural strength in the capital goods and technology sectors, the economy successfully pulled itself together by 1981, whereas France and Italy were reduced to two economic zombies as they received a second hit without having yet recovered from the first. Furthermore, the EMS, wanted and imposed by 'le couple France Allemagne', worked pretty well for Germany and the Dutch mates, rather badly for France, disastrously for Italy and even more catastrophically for Spain after Madrid joined in 1986. For Germany the 1970s have been essentially the years of successful defensive policies. Instead the 1980s was the decade of the establishment of the complete German economic hegemony in Europe, courtesy the EMS.

7.1 Towards the EMS: the clash between a strong and a week mercantilism.

Looking at the behavior of the EEC currencies after 1971 and especially from 1973 up to the launch of the EMS in December 1978, we would notice that the Dutch Guilder, Belgian Franc and the Danish Krone, fluctuated, nominally, comparatively little vis à vis the DM. Among these, the strongest devaluation accrued to the Danish Krone whose nominal value declined by around 25%, against 13% of the Belgian Franc and roughly 7% of the Dutch Guilder. Outside the EEC Austria's Schilling remained stable (relatively to the DM), while the Swedish Krone declined by 50% and the Swiss Franc rose by 25%. The countries most functionally tied to Germany, Holland, Switzerland, Austria, Belgium either experienced small depreciations or went through outright revaluations. By contrast, over the same eight years period, the value of the French Franc fell by more than 40% and that of the Italian lira by 130%. Leaving France and Italy aside, very few of the other countries could benefit from a devaluation of their own currency relatively to the German one. The Benelux, Austria and Switzerland, were, and still are, too deeply immersed in the network of Germany's productive matrix in order to benefit from exchange rate variations.

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[38] The first oil shock was not a shock because it originated from within the political economy of the Western world. The conditions for it to happen were laid down by the 1971 devaluation of the Dollar, the speculation on raw material prices and by Western inflation. Also, an important *Foreign Policy* article outlined the political dynamic that led the US Administration to play a major role in the oil price rise (Oppenheim 1976-77).

The two countries whose currency fluctuations could have jeopardized the German position in Europe were France and Italy. Although vastly inferior to the FRG in the capital goods industries, both had mass production lines in all the relevant consumption goods industries and related machinery sectors in the sense of Adolph Lowe's structural theory (1976). Of the two countries Italy turned out to be the more serious problem. France's elites with their impossible quest to be on a par with Germany in monetary terms were more concerned with inflation. Their intention was to implement quite harsh deflationary policies also as a social *reconquista* vis à vis the wage rises of 1968 but fears of a social backlash remained. An initial attempt to deflate occurred for roughly one year from the mid of 1974 with Prime Minister Jacques Chirac. It succeeded in creating the first postwar decline in industrial output as well as raising the unemployment rate without subduing inflation. The government backtracked, relaunching public expenditure. As stated in the 1977 OECD report on France, the strong growth of 1976 was due to that policy reversal although it was too short-lived to reduce unemployment. The real deflationary policies came with the monetarist Prime Minister Raymond Barre in 1976-1977. Barre was quite effective in bringing about full recessionary conditions. Under inflation-devaluation and a general weakening in demand, conditions no longer existed on the 'go' side. France just kept sliding into an ever-higher level of unemployment from which it would never ever recover. Let us now turn to Italy.

In Italy the *Hot Autumn* season of 1969 started a five year long wave of labor struggles not only about wages but also on working conditions, including the physical environment in and around the factories. As an example of the non-wage aspects of labor's demands one may take the fully funded 150 hours to be used in public educational programs won already after the first round of strikes leading to the contract renewals of the Fall of 1969. In the wake of the *Hot Autumn* a new labor legislation was passed preventing ad hoc and arbitrary firing of personnel in companies with more than 15 employees. The three official unions - CGIL, CISL, UIL - did not expect such an outburst of militancy and had to adjust to it while attempting to moderate the movement, not unlike what the CGT did in France in May 1968. The Italian *Hot Autumn* was incommensurably wider and deeper than the May 1968 events in France. The source of the militancy resided in the pressures that were being piled up on the industrial workforce during the recovery after *la congiuntura*'s phase. The entire production dynamics had been based on the extraction of productivity gains with little or no net investment. To obtain those gains companies focused on hiring people from the central age brackets where, in practice, full employment was attained. The younger cohorts of workers contained a large number of immigrants from South Italy who carried a significant load of additional social tensions because of the discriminatory attitudes that prevailed in many Northern areas, especially in Turin, because of the lack of adequate services, and so forth.

The wage rises pushed up inflation (Sylos Labini 1974), later merging with the oil price hike. In the new rounds of strikes and negotiations with the government and the employers' organizations, the reform of the indexation system to account for the inflationary environment became a big issue. It would be difficult now to explain the complexities of the indexation mechanism, now defunct, called *scala mobile* (sliding scale). To simplify things, suffice it to say that each rate of inflation, measured on a basket of goods the composition of which was also periodically negotiated, attracted a certain number of points on which the calculations for the actual wage and salary adjustments were made. Points were, however, weighted differently according to the skills and job qualifications of each category of employees as specified in the industry's contract. Hence the value of a point accruing to a clerical or a skilled worker would be higher than that of someone defined as a manual laborer. Come 1975, the chairman of Fiat, Avvocato Giovanni Agnelli who was also the head of the Italian Confederation of Industry, had the "brilliant" idea of making the value of every point equal to the top one. Given the way in which the sliding scale worked, the proposal implied that all the wages below the top ones would receive an inflation coverage greater than

100%. The suggestion could not be refused by the unions, yet it took the wind off the sails of wage negotiations since under those inflationary conditions all wages were guaranteed full indexation and many of them even more than that.

Agnelli's move aimed at deliberately ride the inflation wave in order to cut the grass underneath the feet of the labor movement. Some of the direct tensions between capital and labor got substantially diffused, as part were transferred within labor itself through the issue of wage relativities ironed out by the new indexation system. The Trade Unions - and the Communist Party of Italy - never wanted an extra institutional labor movement. In connection with the political situation - characterized by the kidnapping and assassination in the Spring of 1978 of the Prime Minister elect Aldo Moro, and by the a national unity government supported by the Communist Party - the unions drastically reined in their demands deciding, in the same period, to de-link wage increases from those of productivity. In 1980 FIAT - the hot point of the confrontations where, since 1919, Italy's industrial labor relations had always been decided - completely regained control of the factory floor through the mobilization of a large 'silent majority' march in the streets of Turin. It happened after a lengthy strike against management's dismissal of a large number of workers. The standoff was leading toward the occupation of FIAT's plants by the striking workers, yet the unions completely collapsed after the 'silent march', effectively accepting the layoffs. In 1984 in a referendum opposed only by the Communist Party, the sliding scale legislation was repealed with 54% in favor and 46% against. Thus ended the parable of the unique labor militancy that Italy displayed throughout the 1970s, despite all the attempts to divert it, even by using terrorist means. The Italian labor militancy constituted a social phenomenon hitherto unseen in postwar Europe; one that is still not properly assessed.

For our purposes the relevance of that period resides in three interconnected aspects. The first is that in Italy, at least in the large firms, management had lost control over the labor and production processes. The second aspect consists in that the situation could hardly be addressed in terms of Keynesian policies. At the bottom of labor's explosion was exactly what is shown in the famous movie *The working class goes to heaven*[39], that is, the intensification of the pace of work in lieu of higher investment and technological transformations. Here Keynesian policies would not do. Keynesians hardly ever talk about capital-labor relations except in terms of distribution, and then only if they are left-liberals. Furthermore, the Italian situation also excluded a Kaleckian solution. Let us remember that Kalecki considered that a big wage rise could be absorbed by an expansion of output, profits and employment, in the consumption goods sector while the capital goods sector would remain stable because it is assumed to be working on investment orders made in the recent past (Kalecki 1971). In Italy however the picture was much more problematic. Firstly, labor's actions were ongoing. On top of the industry based national contracts, the unions added a strategy of adaptation to specific firms[40]. Secondly, Italian industrialists have been running a very lean and mean investment policy for years so that the real problem to solve was how to increase real capital accumulation. Kalecki assumed also that investment was given by past orders, something which was totally out of the question as far as Italian industry was concerned, because of the rolling strikes which affected future investment decisions and therefore orders as well. This brings us to the third

[39]Directed by Elio Petri the movie was released in 1971. It portrays a worker glued to the machine assigned to him performing piece rate work at a very high speed until he loses a finger. Then he becomes a militant clashing also with the unions during a *Hot Autumn* style strike. Upon returning to the factory the workers find out that management has reorganized the production process changing the machines and repositioning them so that they can no longer communicate with each other.

[40] The criterion was that the better results dominated: if in a particular firm, or in a number of firms in a particular area or sub-sector, the negotiations with management led to better results relatively to the national industry contract, then they would be the ones to rule.

and most important aspect of the period: the use of inflation and devaluation by the Bank of Italy that, in those years, was the most stable and reliable policy maker. The essence of the policy has been masterly dissected in a paper by Augusto Graziani and Franca Meloni (1980) and again by Graziani in 1989.

Graziani and Meloni pointed out that the Bank of Italy's model was of a classical nature where profits, hence corporate saving, lead and determine investment. Given that the economy was experiencing wage increases far above the growth of productivity, the absorption of those increases could occur only in two ways: either by means of price inflation or by means of a profit squeeze. International competition prevented the full transfer of the higher wage costs onto prices, whereas letting firms take the full brunt of the greater costs would end up cutting investment further. When the labor explosion began in the Fall of 1969 fixed parities were still in existence. The economy did not sustain well the impact of the *Hot Autumn* industrial meteorite. The growth rate, after a small decline in 1970, fell to just 1.6% in 1971. In the following years it behaved erratically on low values, except for the 1973 big spurt (as everywhere else in Europe that year), until it went negative in 1975. Connected with the preoccupation of how to restore profitability in the classical sense, the Bank of Italy was also busy finding ways to protect the external competitiveness of firms. It is at this point that use of the link between inflation and devaluation came into being.

The impossibility of restraining wages while aiming at restoring a distribution of income in favor of profits, viewed as the main source of investment, led the Central Bank to accept cost inflation. Under a fixed exchange rate system such a move would have been disastrous. With the floating rates ruling after from 1973 it became a feasible proposition by allowing the Lira to devalue very substantially. The move represented an attempt to preserve share of profits over national income by allowing the increased costs to be charged onto prices in full. At the same time devaluation protected the external position of firms since they could increase their selling price in Liras knowing that it will depreciate roughly by as much. Let us recall that by 1973 European currencies became completely unhinged from each other and from the US$, with the latter being on a devaluation path. In this context, the Bank of Italy estimated that the Dollar affected some 50% of the country's imports and no more than 30% of its exports. The policy of the Italian Central Bank targeted therefore the differential between the Deutsche Mark and the Dollar. The objective was to have a devaluation of the Lira towards the DM but a lesser devaluation or even an appreciation relatively to the US currency. The benefit from the former was the maintenance of export price competitiveness, whereas the gain from the latter lay in the reduction, or in the lesser increase, of the costs of Dollar denominated imports, crucially of oil. It was clearly a policy of a weak economy which counted, unlike the German one, on the immediate price competitiveness of its products.

How successful was this policy? During the 1970s the real growth of Italy's exports was the same as that of Germany (7% annual average), both less than France that had a real boom (13% annual average). The important factors here are the behavior of, (a) the overall merchandise balance, (b) the balance with Europe which the Bank of Italy correctly treated as the area of German capital, implying that the policy of devaluation toward the DM was bound to affect the whole of Italy's European trade. Taking (a) and (b) together, we may say that on the external front the policy was quite a success. A good measure of the state of the overall merchandise balance is obtained by looking at the ratio between the trade balance and the sum of imports and exports:
(X-M)/(X+M). From 1965 to 1972 the ratio peaked at -0.5% in 1968 (this means that the situation was not bad because the deficit represented only a minute percentage of total trade) and bottomed at -6.3% in 1970. In the 1973 to 1978 period the ratio bottomed at -14.8% in 1974 and peaked at -0.4% in 1978. Italy has a longstanding deficit in energy products that weighs heavily in its overall trade position. The key to alleviate this burden was in the trade with the rest of Europe. Italy's exchanges with the rest of the

Continent moved into a surplus starting with *la congiuntura* in 1964. The positive balance lasted till 1972, then became negative for a couple of years. As the Bank of Italy fine-tuned the targeted depreciation of the Lira, trade with Europe returned a growing surplus until 1978[41]. The game was over the year after with the second oil shock, the new monetary policies by the Federal Reserve, and with the formation of the EMS.

On the whole therefore the policy was successful. The Bank of Italy's targeted depreciation policy in the 1970s constituted an action that in Italian football jargon is called 'contropiede', that is defending while looking for the opportunity to quickly send two players forward and scoring. The policy addressed short term emergencies not the structural issues that plagued the country's industries. In fact, as pointed out by Graziani, the interplay between inflation and depreciation weakened investment even further since firms could easily pass costs onto prices without fearing too much about their competitiveness because of the ensuing devaluation. Yet the Italian game bothered France and Germany quite a bit. In its surplus with Europe Italy achieved a net balance even with the FRG. However, the most vulnerable country was France whose industrial structure in the consumption goods and automobile sectors had many overlapping layers with Italy. Thus the Italian devaluation policy was hurting France. Its persistence would have put before Paris the unacceptable dilemma of either massively devaluing or losing to the transalpine cousins significant chunks of the markets for their own, still relevant, textile, furniture, footwear, and small mechanical industries. A massive French devaluation would have created a nightmare for Bonn given that France was by far the largest export destination of the FRG products. France joining Italy in the currency plunge, would not have been a pretty sight for German industry especially in years of declining growth.

8. Conclusions: the material reasons for founding the EMS

From the end of the fixed parity regime in early 1973 till the launching of the EMS nearly six years later, Europe exhibited very clearly the formation of a bloc made of the countries strictly tied to West Germany whose currencies vis à vis the DM either depreciated very little or not at all. Overall this bloc displayed substantial surpluses mostly through Germany's excess balances and also through the Dutch one. Facing this bloc there were two countries, France and Italy, with currencies subjected either to a substantial rate of depreciation vis à vis the DM or, as in Italy's case, to a very steep one. For France's elites this situation posed a host of political problems regarding the status of their power in Europe. The whole strategy inaugurated by the United States to nest the FRG into Western Europe had been based on France's willingness to comply. During the IV Republic compliance was obtained by supporting France's colonial imperialism. In the following decade De Gaulle set the balance between France and Germany first and foremost in terms of nuclear military power while also attempting an economic buildup with mixed results as to the comparative economic strength. There was never any concern for formulating a cooperative European macroeconomic framework specifically aimed at preventing the formation of unemployment and related issues.

The European Monetary System was presented by Chancellor Helmut Schmidt and President Valéry Giscard d'Estaing under the guise of greater European cooperation, but in reality it was an institution

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[41] The Italian trade data are taken from Istat (2011). *L'Italia in 150 anni. Sommario di statistiche storiche 1861-2010*, cap. 16. http://www3.istat.it/dati/catalogo/20120118_00/cap_16.pdf accessed 4-18-2017.

designed to protect the strongest mercantilist, that is German capitalism[42]. Conceived in a decade of a declining US Dollar, the EMS served Germany very well also in the following decade when the US Dollar appreciated all way till the 5 countries' finance ministers meeting at the Plaza Hotel in New York on September 22, 1985. For France the EMS meant being willingly put into an incubator from which, few years later, the Socialists hatched the policy of competitive disinflation to preserve *le Franc fort*. In other words, it implied no hope for the unemployed.

All things considered, the second half of the 1970s established a pattern that we will see repeated over and over again, analyzed by Alain Parguez (1998) in a truly remarkable essay. Germany appeared as the austerian country par excellence, but only to constrain the others. During the 1970s the FRG's average public deficit as a share of GDP was three times as much as France's. In the 1980s France will indeed become the epicenter of austerity with the invention by the Socialist government of President Mitterrand of the utterly regressive policy of competitive disinflation. The next essay will deal with the entire parable of the EMS until its collapse in 1992, as well as with the interregnum leading to the formation in 1999 of the EMU, the European Monetary System.

[42] In my opinion the EMS was instituted to bring Italy into a scheme which compelled the countries with weak currencies to strengthen them, i.e. to put them on an appreciation path, as we will see in the next essay. Funnily enough during the preliminary talks and declarations both French and German political leaders were warning Italy that it may not qualify for membership. But an EMS without Italy would have served no purpose. Italy was the country whose exchange rate policies were most unsettling for the rest of the EEC. During 1979 the scenario changed altogether with the start of Volcker's tight monetary policy and the consequent rise in the US$.

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