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Renaud du Tertre
Associate Professor, Paris Diderot – Paris 7 University
Research Laboratory: LADYSS / UMR 7533 – CNRS
r.dutertre@univ-paris-diderot.fr

Hélène de Largentaye
King's College, PhD University of Cambridge
Helene2largentaye@gmail.com

When, why and how France gave up Keynesian policies

Abstract

The 62-year period (1954–2016) in France can be divided into three sub-periods relating to two growth regimes (a concept designed by the French regulation school using institutional features as well as Keynesian long-term analyses) separated by a period during which the structures of the first growth regime disappeared and the foundations of the second growth regime were laid.

The **"**Fordist growth regime" (1954–1973), as it is called by the French regulation school, is characterised by strong state involvement and weak exposure to global markets. It provided high growth rates of real wages and fuelled aggregate demand to reach a quasi-full employment level.

In the subsequent period of ruptures (1974–1992), fixed exchange rates were abandoned and inflation accelerated. Policymakers chose greater European integration (single market, future monetary union), but without fiscal policy coordination, as well as deregulation (wages, banks, financial markets) and privatisation.

The "neo-liberal growth regime" (1993-2015) as it is dubbed by the French regulation school, in its "ordo-liberal" brand specific to the Eurozone, has been mainly characterised by a strong aggregate demand constraint, by financial globalisation and by greater international exposure. As a result, output has stagnated and unemployment has risen.

Recovery from this depressed situation in France would require Eurozone authorities to boost investment so as to establish the conditions of a new "sustainable development regime".

Key Words: Keynesian policies, regulation, growth regime, Fordism, neo-liberalism
JEL code: E00

Introduction

Policy choices and structural changes

The theoretical framework of this paper is twofold.

It is first based on J.M. Keynes's *The General Theory* according to which aggregate demand plays the key role in determining economic results (*i.e.* national income, unemployment, etc.). Secondly, it refers to the French Regulation School, which analyses structural features of growth regimes (Aglietta, 1976; Boyer, 2015). These two theories complement each other insofar as we consider that policy choices interact with institutional, economic and social structures of growth regimes. The first is a short-term theory, whereas the second a long-term one. Both are necessary when studying policies and appraising economic performance over several decades – in the case of our subject, the decades overlapping the 20th and 21st centuries in France.

"Neo-liberalism" is a concept that we will often use in this paper. It encompasses at least three meanings: an economic theory centred on the alleged clearing virtues of markets (Milton Friedman in the 1970s); secondly, an economic policy based on "deregulation" and withdrawal of state intervention (*e.g.* Margaret Thatcher in the UK, 1979–1990, Ronald Reagan in the USA, 1981–1989); and finally, a "growth regime" characterised by specific social-institutional conditions that have prevailed in many capitalistic developed countries from the 1990s onwards (Aglietta and Rebérioux, 2005). It is this last meaning in particular that we will be using in this paper.

"Neo-liberal growth regimes" vary from one country to another (Amable, 2005). The model is the Anglo-Saxon model with deregulated finance and markets in general (including the labour market), privatisation of public companies and a low degree of state-intervention. German neo-liberalism, "ordo-liberalism", requires strictly balanced budgets and prioritises inflation control. It also gives a prominent role to collective bargaining and to dialogue between employers and wage-earners. In this regime, banks and firms work with close ties. In the French regime, public intervention remains strong (tax and social contributions represent 44% of GDP) and social protection – with social safety nets and health insurance for all – is high. Collective bargaining is partly regulated by the State, but finance is deregulated and economic policy, especially fiscal policy, is subject to Eurozone ordo-liberal rules.

Outline

This paper is divided into five sections:

1) 1954–2015: the long-term trend of rising unemployment and slackening growth;
2) 1954–1973: the "Fordist" growth regime under Keynesian policies;
3) 1974–1992: the "period of ruptures" and the end of full-employment;
4) 1992–2007: the triumph of neo-liberalism;
5) 2008–2015: financial crises.

The conclusion gives a European perspective for a return to Keynesian policies.

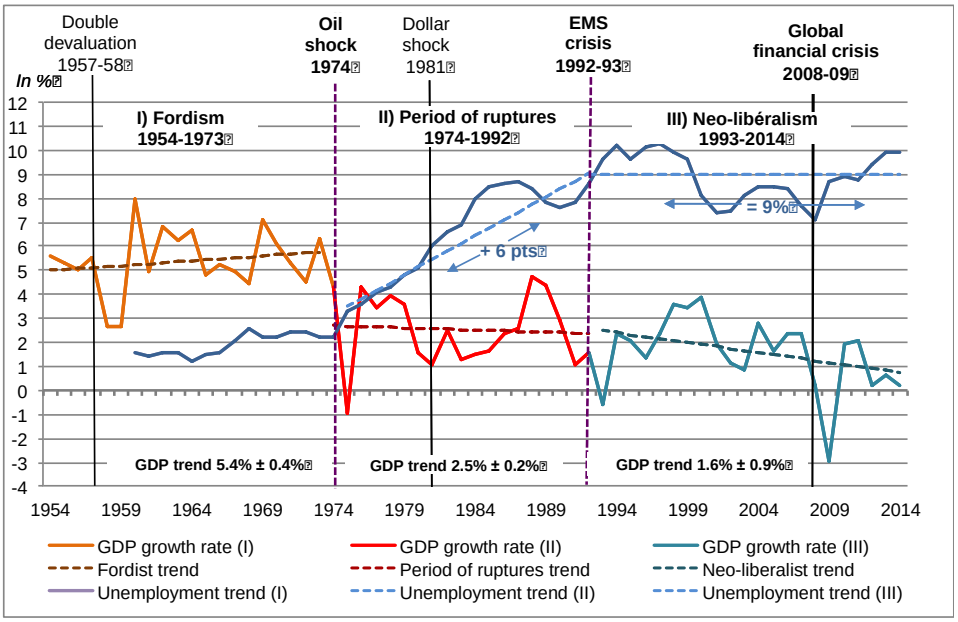
1. 1954–2016: the long-term trend of rising unemployment and slackening growth

In 1967, President Pompidou declared: "If one day we reach 500 000 unemployed people, we will have a revolution". In 1993, President Mitterrand stated that "in the fight against unemployment, we have tried everything". In 2007, recently elected President Sarkozy announced: "I want to commit myself to full employment: a 5% unemployment rate at the end of my 5-year mandate." In 2012, recently elected François Hollande declared: "We must reverse the unemployment curve within one year." In July 2017, the unemployment rate was a little under 10% (9.5%).

Graph 1 shows how the unemployment rate rose from under 2% in 1960 to nearly 10% in 2014. Over this same long period, growth rates slackened from an average 5% in the 1950s–1960s to below 1% in 2014.

Three main sub-periods are discernible during this 60-year period. We have called them (Boyer, 2013): "Fordism" (1954–1973), "Period of ruptures" (1974–1992) and "Neo-liberalism" (1993–2014). The end of the first sub-period is framed by the 1973 oil shock, while the second sub-period of ruptures is brought to a close by the European Monetary System crisis (1992–1993).

Graph 1. GDP growth and unemployment rates in France (1954–2014)



Main source: INSEE:

- Annual growth rate (GDP, volume) *Comptabilité Nationale,* 2010 base.
- Unemployment rate (ILO definition), annual average, 1975–2014 series.

Additional source: Annual Macro-Economic, European Commission (Ameco) database.

- Unemployment rate (Eurostat definition), annual average, 1960–1974 series.

2. 1954–1973: The "Fordist" growth regime under Keynesian policies

In the aftermath of World War II, which had massively destroyed buildings, industrial plants and agriculture, France reconstructed its economy in a context of strong state intervention (rationing, price controls, freeze of rental leases, etc.). No doubt the high growth rates between 1945 and 1954 and the full employment that characterised the post-war years owed much to a catching-up process. The industrial production index was 62% below its pre-war level. If we set aside this catch-up period spanning five to eight years (1945–53), the "Fordist" growth regime only lasted a little less than 20 years (from 1954 to 1973).

Many civil servants holding key positions in the Ministry of Finance and other economic public bodies (*Commissariat général au Plan)* had read *The General Theory* and were eager to carry out public policies targeting full employment (as stated in the preamble of the 1946 Constitution of the Fourth Republic) and setting up a national social security system. In this respect, their aim was to do away with the deflationary economic policies of the 1930s.

At the same time, the structural features of the French economy (discussed below), in the framework of the construction of the European Common Market, made it possible for the "Fordist" growth regime to prosper.

2.1. Public institutions and public policies aimed at full employment

To regulate economic activity and thus control market mechanisms, the State took action in five different directions.

1) It set up a welfare state providing health insurance, family allowances, pension systems, unemployment benefits. There were some exceptions to this welfare system for all: the agricultural sector, tradespeople and some other sectors had their own insurance systems.

2) The State took over industrial policy and set up a collective bargaining framework. Five trade unions were recognised at the national level. A "social dialogue" was organised on a hierarchical basis: negotiations concerning all professions were conducted at a national level and supplemented by negotiations at branch and company level. In fact, the State was the arbitrator in many cases. For example, in 1968 after the June strikes, the "Matignon agreements" centred on wage increases were conducted by Prime Minister George Pompidou.

3) The State had a strong control over credit. The Bank of France and the country's five largest banks were nationalised. Under the 1944 Bretton Woods agreements, the franc-dollar exchange rate was fixed but revisable by government decision and capital flows were controlled so that monetary policy could be domestically monitored in favour of full employment.

4) State-owned firms dominated key sectors including energy (particularly nuclear), transport, telecommunications, shipbuilding, aeronautics, and the Renault car industry (as a legacy of the war).

5) The *Commissariat général du Plan* brought together "social partners" (employers and trade unions) to define production targets announced in 5-year plans and which on the whole were met.

In 1957, France, as well as five other European countries, signed the Treaty of Rome, establishing the European Common Market so that exports to European markets replaced those to former colonies, which had become independent in the post-war period (Tunisia and Vietnam in 1954, Morocco in 1956, Algeria in 1962, etc.).

2.2. The "Fordist" growth regime based on the rise in real wages and a strong domestic demand

Two economic features characterise the French "Fordist" growth regime:

- The decisive role of the relationship between the rise in real wages and the labour productivity gains anticipated by corporate leaders, thanks to collective bargaining aimed at a compromise at the "macro-social" level.
- This tight linkage is at the origin of a favourable interaction forming a virtuous circle between mass production and mass consumption. Thanks to the low level of trade openness of the

French economy (under 15% of GDP), to the possibility of implementing controls on international capital flows and to the convertibility of the franc (which was devalued several times), domestic demand was the real engine driving domestic production.

However, difficulties appeared towards the end of the 1960s: demand for durable consumer goods (cars, household equipment, etc.) gradually became saturated and prices began to soar (by over 6% in 1969) after the 1968 student crisis and workers' strikes.

In August 1971, President Nixon's announcement of the suspension of the dollar/gold convertibility ushered in a period of international instability in developed countries' currency and capital markets. A flexible exchange rate system replaced the previous fixed exchange rate system in March 1973 and the Bretton Woods international monetary system was abandoned altogether in January 1976 (Jamaica Agreements).

The first oil shock in September 1973 aggravated this instability.

3. 1974–1992: the "period of ruptures" and the end of full employment

Compared to the previous period (1954–1973) and to the following one (1993–2016), this 18-year period (1974–1992) was not as homogenous in terms of the social, economic and institutional conditions underpinning growth. To highlight the transformations that impacted France's growth regime, we first look into economic policy decisions taken by the different governments.

We then examine how these decisions brought about a long-lasting change in the way wages were settled and global income was distributed between wages and profits – a share which, in the long run, has an impact on growth. The only economic parameter that unifies this 18-year period is unemployment, which increased inexorably (from 2.1% in 1973 to 9% in 1992). And this, of course, is an indication of a major failure of the economy!

To explain this rise, we need to distinguish between two sub-periods that are clearly different.

- The first (1974–1982) is characterised by a succession of external shocks that force public authorities to give absolute priority to inflation control;
- The second (1982–1992) is characterised by changes in the social, economic and financial structures of the economy; these changes ushered in a new growth regime.

3.1. New economic policies

3.1.1. Priority given to inflation control

As we have already highlighted, it is the combination of domestic factors and external shocks – the latter having an aggravating impact on the former – that jeopardised the "Fordist" growth regime in 1974. In this respect, two phenomena forming what at that time was called "stagflation" (allying stagnation and inflation, which were hitherto considered as antithetical) should be emphasised:

- Starting from 1974, the average annual GDP growth rate was halved, falling from 5.5% over the 1960–1973 period to 2.5% over the 1974–1982 period.
- At the same time, inflation accelerated: the average annual rate in the first sub-period, 5.2%, doubled to reach 11.4% in the second sub-period.

In these circumstances, Raymond Barre's economic policy from 1976 to 1981 relied on two complementary pillars that announced the advent of neo-liberalism:

- Absolute priority was given to price stability, which implied a wage stringency policy and constraints on public expenditure, and to measures designed to favour a balance of payments equilibrium.[1]
- At the same time, the international competitiveness of French firms improved due to a "competitive disinflation"policy, or in other words, a policy aimed at defending a "strong franc" on currency markets. As a result, most large firms focussed their activities on profitable sectors. This specialisation led to massive lay-offs and a sharp rise of unemployment in the abandoned sectors, particularly in the northern, eastern and central regions of France.

However, it is worth noting that, during this first sub-period, wage earners' share of national income rose given that increases in the workers' nominal wages were indexed to price rises. Their share of GDP gained 2.5 points, increasing from an average 62.7% in the first sub-period to 65.2% between 1974 and 1982. Accordingly, there was a drop in corporate profitability – measured by profit share.

3.1.2. The creation of an exchange stability zone within the European Economic Community

The choices made by the Barre government are inseparable from the fact that President Valéry Giscard d'Estaing and Chancellor Helmut Schmidt both sought to promote a closer Franco-German relationship, which ushered in a new stage in the two countries' cooperation and inevitably deepened European integration. Setting up the European Monetary System (EMS) from March 1979 to July 1992 was the most important innovation of this new phase. The objective of the EMS was to create a zone of fixed exchange rates (but which could be revised under an intra-European agreement signed prior to the EMS) within the European Community so as to avoid erratic fluctuations of the dollar.

The French government's purpose was to peg its inflation rate to the German rate and, more importantly, bring about a fall in short- and long-term nominal interest rates, which were in fact much higher in France than in Germany. Conversely, the French government expected a stimulating impact on French exports and domestic investment, which would have triggered economic growth.

This expectation was partly satisfied – but only partly. In fact and more importantly, the EMS embedded the hegemony of the deutsche mark and led to a strict harnessing of French monetary policy. This was the first step in aligning French monetary policy on the "ordo-liberal" rationale that reigned in Germany. And again, it was employment that was the first to be sacrificed.

3.1.3. The March 1983 U-turn after the dollar shock

March 1983 is a crucial turning point for economic policy in France. On this date, President François Mitterrand decided to put an end to the global demand-led reflation policy that he himself had implemented just after his election in May 1981, together with a series of nationalisations of large corporates and prominent banks. Turning his back on his political platform, Mitterrand decided to commit himself to a policy of wage "stringency" mainly aimed at maintaining the franc within the EMS. The old post-war rule of pegging wages to prices (*indexation des salaires sur les prix*) was abandoned in 1982. As a result, the first steps towards "ordo-liberalism" taken by Valéry Giscard d'Estaing were confirmed by his socialist successor.

The change in France's economic policy in March 1983 cannot be understood without mentioning the dramatic rise in the dollar exchange rate in 1981, which caused a major international shock. This sudden rise followed a ten-year period of erratic fluctuations (*vis-à-vis* all European currencies), both

[1] An "Incomes policy" had already been advocated in the 1960s.

upwards and downwards.[2] The rise was due to a fundamental reorientation of the United States' monetary policy, decided by Paul Volcker in 1979 subsequent to his appointment as President of the Federal Reserve Bank. The policy aimed to raise nominal interest rates well above the inflation rate in order to restore positive real interest rates. Real interest rates thus continued to rise as inflation decreased. As a result, capital was attracted towards assets priced in dollars, first in the banking sector and afterwards in all financial markets.

Against this backdrop, the "strong franc" policy not only sought to stabilise the franc on currency markets in order to reduce inflation. It also had a corollary – a set of legal measures to liberalise financial markets and modernise the French stock exchange. In view of this, public authorities adopted the 1984 banking law that ended state control over short and long interest rates; they fostered the development of financial markets through measures taken in 1985 and 1986 by the Fabius and Chirac governments to increase competition between banks; and they gradually lifted exchange controls, which favoured international capital flows.

In other words, socialist and moderate right-wing governments (Mauroy, Fabius and Chirac) laid the foundations for the advent of a new growth regime that gave a predominant role to financial markets. Yet, these financial markets could only fully play their role if another condition was satisfied – the return to corporate profitability. This required that firms' profit rates be increased, which is what we shall now examine.

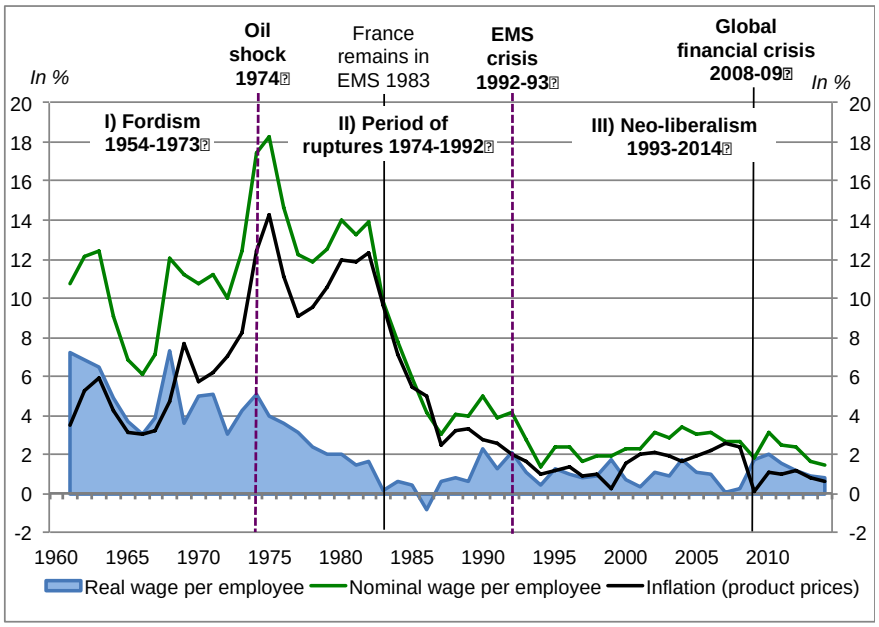
3.2. Disconnecting the rise in real wages and labour productivity gains

As we can see in Graphs 2 and 3, there is a striking contrast between two fractions of the "period of ruptures": 1974–1982 and 1983–1992.

a) Lower inflation and slowing nominal wage growth (1974–1983)

During the 1974–1983 period, inflation and nominal wage growth rates remained high (see Graph 2). However, the deceleration of the rate of nominal wage growth was greater than the pace at which

Graph 2. Inflation rate, nominal and real wage growth rates in France (1960–2014)



Source: Ameco database.

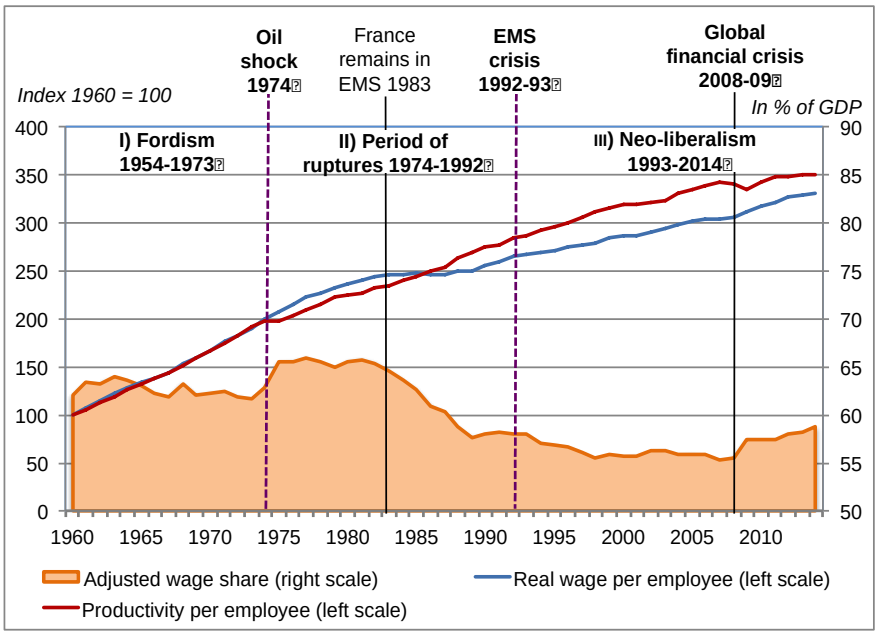
[2] The dollar exchange rate vis-à-vis the French franc fell by 20% during the 1970s, then suddenly rose by 100% between 1980 (FF 4.5) and 1985 (FF 10.5).

inflation declined. A disconnect between these two rates appeared at the beginning of this period and led to a steady reduction of the real wage growth rate. What was most important was that inflation decreased sharply between 1983 and 1986. From 1986 onwards, inflation remained under 4% and real wages increased at an average annual rate of less than 2%.

b) A new share of value-added in favour of corporate profits since 1983

Above all, the share of value-added between wages and profits began to change in 1983 (see Graph 3).[3] After the first oil shock in 1974 and until the dollar shock in 1981, real wages grew faster than productivity gains, so that the wage share increased and, conversely, the corporate profit share decreased. But from 1983 onwards, the opposite occurred.

Graph 3. Real wage and labour productivity growth: the wage share in France (1960–2014)



Source: Ameco database.

We should lay particular emphasis on the fact that the decline of the wage share between 1983 and 1993 was clearly greater than its increase over the previous period (1974–1982). At the beginning of the 1990s, the wage share reached – long-lastingly – a lower level than the level it had attained during the "Fordist" period.

Table 1. Inflation rate; nominal wage, real wage and labour productivity growth rates and the evolution of the wage share in France (1960–2014)

	1960-1973	1974-1982	1983-1992	**1974-1992**	1993-2008	2009-2014	**1993-2014**
Average annual rate of variation (in %)							
Nominal wage per employee	**10.1**	14.2	5.2	**9.5**	2.5	2.1	**2.4**
Inflation (product prices)	**5.2**	11.4	4.4	**7.7**	1.6	0.8	**1.4**
Real wage per employee	**4.9**	2.8	0.8	**1.7**	0.9	1.4	**1.0**
Productivity per employee	**5.1**	2.2	2.0	**2.1**	1.3	0.4	**1.0**
In % of GDP							
Adjusted wage share	**62.7**	65.2	60.3	**62.6**	56.1	57.8	**56.6**

[3] Graph 3 is an updated graph of Michel Husson's graph (2012, p. 238).

Source: Ameco database.

In other words, the lasting decline in the wage share since the early 1990s and, conversely, the lasting increase in the corporate profit share should be interpreted as a significant reversal in the balance of power between wage earners and capital owners in favour of the latter. And as we shall see later, the new income distribution must be understood as a key characteristic of the neo-liberal growth regime that became established in France at the beginning of the 1990s.

4. 1993–2007: The triumph of neo-liberalism

In this section, we highlight the specific features of the neo-liberal regime in France during the 1993–2007 period, *i.e.* from the advent of the neo-liberal regime in France until the outbreak of the global financial crisis (GFC) in the United States.

We thus examine three points: first, the socio-economic foundations of the "neo-liberal" growth regime that differentiate it from the "Fordist" growth regime; secondly, the impact of the European Union (EU) construction on the French economy; and, lastly, four characteristics of the neo-liberal growth regime in France.

4.1. Socio-economic foundations of the neo-liberal growth regime

Two closely intermingled trends can be considered as the pillars of a neo-liberal growth regime and they have indeed been present in the French economy for a couple of decades.

The first trend is the financialisation of the economy, whereby market-finance dominates bank-finance. This is visible in at least three different ways. In addition to the banks, institutional investors (pension funds, hedge funds, OPCVMs[4]…) play an increasingly important role. Secondly, there are constant financial innovations such as derivatives, securitisation of bank credits, etc. And lastly, the financial component of the banking profession develops rapidly (*e.g.* asset management departments are created in deposit banks), contrary to the former legal separation of bank activities between credit allocation and custody of deposits on the one hand, and investment banking on the other.

The second trend is globalisation, which leads to greater international competition. This is driven by world-wide deregulation of financial and currency markets (as national currencies become freely convertible), as well as by deregulation of foreign investment – making it easier for multinational companies to operate and for national firms to relocate. The fact that emergent countries (Brazil, China, India, etc.) entered the world economy amplified this phenomenon.

The economic mechanism that governs neo-liberal regimes is the crucial relation between corporate investment and the returns expected by security holders. It confers a key role on security market values in the economy and to "shareholders" in corporate governance, subordinating industrial and commercial strategies to the latter's expectations.

As a result, employment and wages become the adjustment variable for economic activity even though, in the case of France, it is still the government's responsibility to find a socially acceptable compromise between labour market liberalisation and social protection (jobs, retirement, minimum wage, etc.).

4.2. The adoption of the euro and the concessions made to German "ordo-liberalism"

France's participation in the European construction during the 1990s and at the beginning of 21st century explains to a large extent why neo-liberalism has replaced the previous growth regime. No

[4] "*OPCVM, Organismes de placement collectif en valeurs mobilières*": Entities for collective Investment in transferable securities.

doubt it was France's commitment to European construction and, in particular, its involvement in the European Monetary System that caused economic activity to fall into a severe recession in 1993, as we shall see. First of all, however, we briefly outline the three stages of European integration during this period (1993–2007).

4.2.1. European construction during the 1990s

European integration became tighter over the last decade of the 20th century.

1) The "single market", one of Jacques Delors' major contributions to the shaping of 21st-century Europe[5] was supposed to be completed by 1992, according to the "Single Act" signed in 1986, which committed the 12 Member-States to implementing the four freedoms stated in the Treaty of Rome (free movement of goods, people, services and capital). Approximately 250 directives or regulations had to be adopted by European institutions and then transposed into national legislations to achieve the single market.

2) The Maastricht Treaty, the founding treaty of the European Union (replacing the EEC), which includes the European Economic and Monetary Union (EMU), was signed in 1992 (it is worth noting that, in the case of France, the referendum was voted by a tiny 51% majority). The treaty provided for strict coordination of fiscal policies, including caps on public debt (60% of GDP) and budget deficits (3% of GDP) for all member countries (except for UK, Denmark, Sweden [6]) that agreed to give up their national currencies in favour of the euro in 1999.[7] This is an example of "ordo-liberalism", the concept prevailing in Germany as mentioned earlier, centred on free-markets, free and undistorted competition, no public bail-outs, an independent central bank, and balanced public budgets (Bibow, 2017).

3) Finally, in 1997, the Growth and Stability Pact (GSP) was signed by EU members, obliging them to strengthen monitoring and coordination of national fiscal and economic policies and to enforce deficit and debt caps set by the Maastricht treaty.

In the years 2000–2002, the euro began to replace the franc in France and eight other European countries, becoming the single currency for nine European Union Member Countries forming the new eurozone.

These legal acts were adopted at the same time as the membership of the EEC (later the EU) was expanding, from 6 in 1957, to 9 in 1973 (UK, Ireland, Denmark), to 10 in 1981 (Greece), 12 in 1986 (Spain and Portugal), 15 in 1995 (Austria, Sweden, Finland), 27 in 2004 and 2007 (several East European countries plus Cyprus and Malta), and finally 28 (Croatia) in 2013.

4.2.2. The EMS crisis (1992–1993) and the lack of policy coordination within the EU in the 1990s

In 1993, France went through the severest recession it had known since the first oil shock in September 1973. This recession was caused by a crisis in the European Monetary System which broke out on 16

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[5] The single market was influenced by the European Round Table, a group of businessmen representing the main European multinationals and led by Etienne Davignon.

[6] Sweden dropped out immediately after it had agreed to adopt the euro.

[7] The other three "convergence criteria" dealt with inflation rates, interest rates and exchange rates. Inflation was not supposed to be higher than 1.5% compared to the average inflation rate of the three Member States with the lowest inflation rates; long-term interest rates were not supposed to be 2% over the average interest rate of the three Member States with the lowest interest rates; and the margins of fluctuation of national currencies compared to pivot rates specific to each Member State had to be respected (before 2000).

September 1992 (Black Wednesday) and lasted until July 1993.[8] This crisis was followed for several years by slow growth and increasing unemployment.

With the benefit of hindsight, we can suggest the following explanations for this major crisis. First of all, some currencies, particularly the sterling pound and the Italian lira, were clearly overvalued. Secondly, the fall of the Berlin Wall in 1989 called for expansionist budgetary policies but at a European and not simply a German level. After all, the fall of the Berlin Wall – and the perspective of German unification – was a shock for Europe and not only Germany. Yet, in the early 1990s, France remained stuck in deflationary policies ("*désinflation compétitive*"), with high real interest rates and cuts in public expenditure designed to keep the franc pegged to the DM.

This leads to a third institutional explanation. France and Germany were searching for a compromise for the adoption of a single currency (euro). Germany was reluctant to agree to the single currency as it was unwilling to sacrifice the stability of the DM or its monetary policy, or more generally its "ordo-liberal" principles. France ceded ground and only one part of the initial European integration project was kept, namely the monetary union, while the two other parts (budgetary and social) were excluded. The initial European project as laid out in the Werner Plan[9] comprised three dimensions (monetary, public finance, social), but only monetary integration was achieved. Furthermore, Germany imposed its "ordo-liberalism" principles with the strict budgetary rules enshrined in its Constitution as a prerequisite to adopting the single currency. European integration turned into a "one-legged beast", (*i.e.*, monetary policy), as Jacques Delors put it.

In 1997, following the social unrest in France caused by restrictive budgetary measures, legislative elections were called and, in May, the left-wing coalition led by socialist Prime Minister Lionel Jospin was voted in. During Jospin's five-year mandate (1997–2002), the economic situation recovered: growth picked up and unemployment fell to under 8%, notwithstanding the replacement of the franc by the euro. There was no acceleration of inflation and public debt decreased.

The ambitious youth employment programme implemented at the beginning of Jospin's mandate and the enforcement of the Aubry laws on the 35-hour week in 1999[10] both explain some of this success.

It is worth noting that despite the left-wing orientation of the Jospin government, privatisation of large public enterprises (telecommunications, Air France, Aerospatiale, etc.) continued, at least for a significant fraction of these companies' capital. The government had no choice. It had to comply with its European commitments and these, as we have seen, were of neo-liberal inspiration – encouraging free competition within the single market.

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[8] On 16 September 1992 (Black Wednesday), the sterling pound, the Italian lira and the Spanish peseta fell below their floor rates within the EMS, forcing the pound and the lira to leave the EMS and the peseta to devalue. Despite speculative attacks (encouraged by the fact that the economic policies were considered unsustainable), the French franc remained anchored to the DM but fluctuation margins were widened.

[9] The Werner Report (October 1970) was commissioned at the The Hague Summit (1969) by the Heads of the six EEC Member States (Belgium, France, Germany, Italy, Luxembourg, the Netherlands). It advocated a transfer of national sovereignty to European institutions for budget and monetary policy. The fluctuation margins of the six currencies were supposed to be narrowed. Taxes on capital would be harmonised. Social systems were also supposed to converge as economic integration was thought to work only if it included a social dimension. These measures were to be rolled out from 1971 to 1979 and implemented in three stages. However, following the collapse of the Bretton Woods system in 1971 and the first oil shock in 1973, the Werner Plan was postponed and later abandoned (Robert Marjolin, a high-ranking French civil servant, chaired a group of experts in 1974 to officialise the virtual death of the Werner report).

[10] For most authors, 350,000 jobs were created thanks to the Aubry laws.

The successes of the Jospin government in terms of employment and public debt only lasted for a little over four years. We shall see why in the next section.

4.3. Four features of the neo-liberal growth regime in France (1993–2007)

We now show how financialisation and globalisation, two intermingled pillars of the neo-liberal growth regime, were at the origin of a structural transformation of the French economy in the early 1990s. We compare features of the neo-liberal growth regime (1993–2007) with those of the Fordist growth regime (1954–1973) so as to highlight the contrasts between the two growth regimes.

This comparison brings out four structural changes that had a major impact on employment.

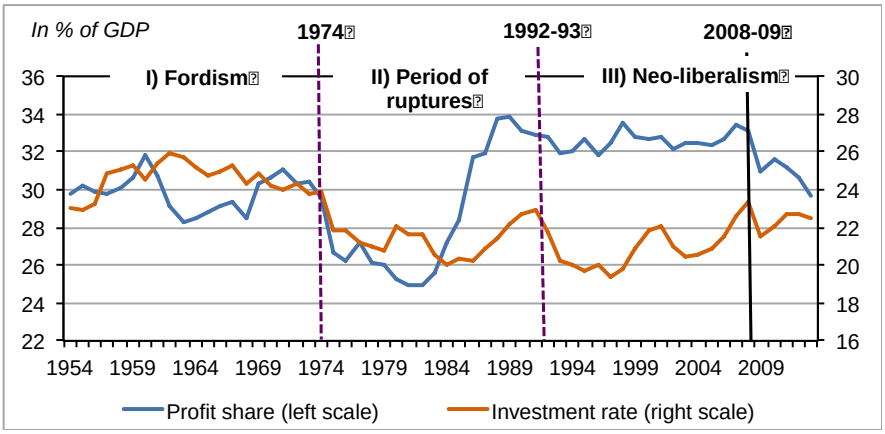
- The aggregate demand constraint on output became stronger and exerted a deflationary pressure on economic activity and employment.
- The corporate governance model changed insofar as it gave shareholders a major role in defining corporate strategy, particularly, regarding investment choices.
- Market finance came to prevail over bank finance; consequently, market share prices now played a crucial role in determining the level of investment and thus the level of economic activity, with the result that wages and employment became adjustment variables.
- The globalisation of the economy acquired new characteristics for several reasons: firstly financial globalisation; secondly, the unprecedented expansion of multinational firms; and lastly, the entry of emergent countries on world markets. These phenomena intensified international competition and strengthened external constraints on economic activity.

In the following series of graphs illustrating these four features, we focus our comments on the differences between the Fordist period (1954–73) and the neo-liberal period (1993–2007).

4.3.1. A new constraint exerted by aggregate demand on aggregate supply

Graph 4 shows that whereas the corporate profit share and the investment rate evolved in a similar way from the early 1950s until the mid-1980s, this was no longer true after 1985.[11]

Graph 4. Profit share and investment rate (1954–2014)



Source: *Insee*, *Comptabilité Nationale*, 2010 basis.

N.B. The corporate profit share scale (on the left) and the investment rate scale (on the right) are different: the latter starts 6 points below the former (16% instead of 22%).This is because the purpose of the graph

[11] The profit share (P/Y) is strictly the complement of the wage share (W/Y) that we have analysed in Graph 3 and Table 1 p. 8, so that: P/Y = 1 – W/Y, which holds good when we ignore the tax levy on total income (T/Y). The investment rate (I/Y) measures the share of investment expenditure in aggregate demand.

is to show the widening of the gap between the two ratios when we compare the Fordist period (1954–1973) with the neo-liberal period (1993–2007).

1) The profit share (in blue, left scale) fluctuated around 30% GDP between 1954 and 1973. After declining to 25% in 1980–81, it rose sharply to 32.5% in 1993 and fluctuated around this rate between 1993 and 2007, which is equivalent to an increase of 2.5 GDP points from the Fordist period to the neo-liberal period.

2) The investment rate (in red, right scale) fluctuated around an average of 24.5% GDP between 1954 and 1973, then fell to 20% in 1982. It finally remained slightly above this level, averaging 21% GDP between 1993 and 2007, which is equivalent to a decrease of 3.5 GDP points from the Fordist period to the neo-liberal period.

To summarise, when we compare the neo-liberal growth regime (1993–2007) with the Fordist growth regime (1954–1973), the gap between the corporate profit share and the investment rate increased steadily by 6 points of GDP. This fact is problematic because it implies looking not only at the counterparts of this increasing gap in terms of demand, but also its consequences in terms of economic activity and employment. In other words, we need to examine how the changes affecting aggregate demand lead to an increase in the constraint on the aggregate supply.

To answer these questions, we adopt an approach similar to the one developed by Kaldor to analyse the impact of income distribution on growth (Kaldor, 1955–1956). However, we introduce a new breakdown of aggregate demand in order to take account of its new characteristics under the neo-liberal growth regime.[12]

According to the applied macroeconomic analysis, we assume an open economy and introduce government expenditure, so that:

- the balance of foreign trade (X – M) represents the first demand counterpart of the excess profit on investment,[13]
- the reverse of the government budget balance (G – T) represents the second counterpart.[14]

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[12] On one side, total income (Y) is divided into three categories: profits (P), wages (W) and taxes (T)
[1] $Y = P + W + T$

On the other side, in an open economy:

- The aggregate supply has two components: domestic supply (Y) and importations (M).
- The aggregate demand is broken down into four components: consumer goods (C), investment expenditure (I), government expenditure (G) and exports (X).

The balance of aggregate supply and aggregate demand is:

$$Y + M = C + I + G + X$$

so that the macroeconomic equilibrium is:
[2] $Y = C + I + G + (X – M)$.

By difference between relation [1] and relation [2], the macroeconomic equilibrium becomes:

$$(P – I) = (C – W) + (G – T) + (X – M).$$

If we reason in variations, we obtain:
[3] $\Delta(P – I) = \Delta(C – W) + \Delta(G – T) + \Delta(X – M)$.

To simplify the writing, we keep the same notation for the variables, whether these are measured in absolute value or in proportion to GDP, noting that Y = 1 according to the second measure.

[13] A surplus of the foreign trade balance ($X – M > 0$) increases the profit (P) available in the economy and conversely a deficit ($X – M < 0$) reduces it.

[14] In practice, the public deficit ($G – T > 0$) is financed by household savings, whether household incomes are received in the form of distributed profits or of wages. But to the extent that, by construction, wage incomes

But the most important innovation with respect to Kaldor's analysis is to break down consumption expenditure into three components:

a) consumer goods financed by wage spending, noted C_W,

b) luxury consumer goods financed by spent profits (these profits come from the distribution of interest and dividends), noted C_P,

c) the purchase of durable consumer goods, real estate in particular, financed by bank loans, noted C_L, *i.e.* financed by a transfer of income collected by banks in the form of investment by high-income households and redistributed in the form of loans to low-income households.[15]

In this reasoning, by construction, wages distributed to households are subtracted from consumer spending, so that the surplus of consumption on wages (C – W) represents the third counterpart of the excess profit on investment. This third counterpart is necessarily positive in contrast to the first two counterparts and thus plays the most important role in the macroeconomic equilibrium. Given the relative stagnation of the purchasing power of wages in the neo-liberal growth regime, the increasing gap between total consumption and the total wage bill (C – W) can have only two origins:

- the purchase of luxury goods financed by profits distributed to households,
- the purchase of durable goods financed by banks' investment of part of distributed profits.[16]

In the case of France, if we consider each of the three potential counterparts of the excess profit on investment,[17] we can identify three reasons to explain why the increase of this excess exerts a deflationary pressure on output in the neo-liberal growth regime:

1) Exports cannot expand for lack of competitiveness.

2) Government expenditure is restricted by fiscal discipline.

3) Consumption is tightly limited by the new distribution of global income.

This third point is the most concerning. Certainly, the demand for luxury goods and the purchase of durable goods through increased indebtedness mitigate the decline in the propensity to consume due to a greater share of profits (or a smaller share of wages) in the new income distribution. However, these two factors weaken the growth regime. On the one hand, companies producing luxury goods will find sufficient domestic outlets only if the wage hierarchy changes significantly in favour of high wages. On the other hand, the expansion of durable consumer goods through indebtedness can only take place if borrowers are solvent in the long run, thus ensuring that bank profits and consequently company profits continue to be generated. But this is less and less the case when there are more and more low-wage borrowers.

In short, we have a good reason to think that during the 1993–2007 period, the growing inequality in income distribution is at the root of the fragility and instability of the neo-liberal growth regime in France. During the 1954–1973 period, the close link between real wage growth and expected

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have been subtracted from consumer spending in our reasoning, the purchase of Treasury bills constitutes an outlet for the excess of profit on investment.

[15] It was this third component of consumption expenditure which was at the root of the subprime crisis strictly speaking in July 2007 in the USA, and which subsequently triggered the global financial crisis in autumn 2008.

[16] According to assumptions of the Keynesian analysis, bank investments take place once the interest rate is fixed and thus do not influence this rate.

[17] See the right-hand side of relation [3] in footnote 12, p. 13.

productivity gains ensured strong coherence and stability for the Fordist growth regime. On the contrary, during the 1993–2007 period, the high level of expected profits in contrast to the weakness of the average wage and, in practice, the volatility of realised profits inherent to the large business cycle fluctuations both spell a permanent threat to the ability of aggregate demand to absorb aggregate supply dynamically and, thus to ensure the long-term coherence of the neo-liberal growth regime.

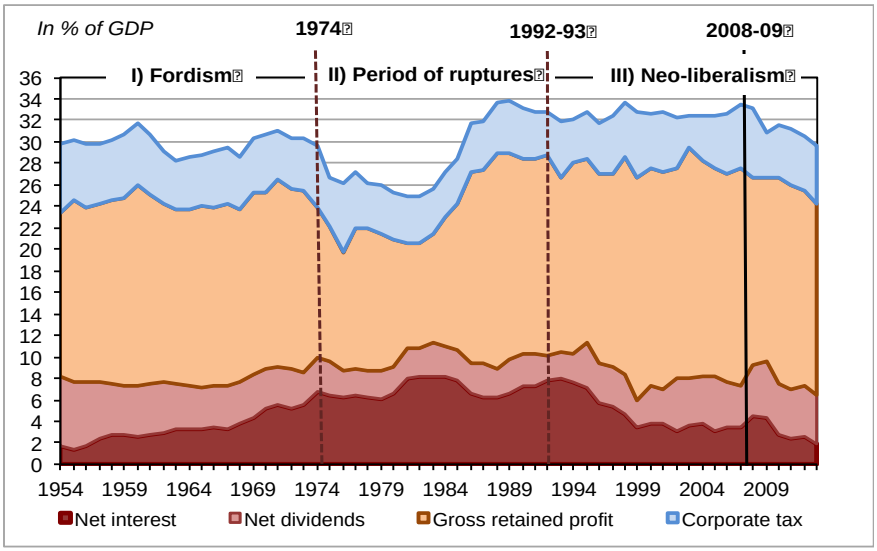
4.3.2. The shareholder model of corporate governance and the greater share of dividends in distributed profits

The second structural change that we examine is the transformation of the corporate governance model, when we move from the Fordist growth regime (1954–1973) to the neo-liberal growth regime (1993–2007) (Aglietta and Rebérioux, 2005).

In the Fordist regime, corporate governance is of a stakeholder type, meaning that managers hold power in the company and play a central role in defining the company's strategy (Galbraith, 1967).[18] In a debt-based economy, managers favour external financing through bank credit, while stock markets play a secondary role.

In the neo-liberal growth regime, corporate governance moves towards a shareholder type, which gives decisive power to shareholders in defining the company's strategy (Lazonick and O'Sullivan, 2000). In an economy based on market finance, companies no longer seek to increase their activity (thereby increasing the wage bill as well as profits) but aim to create shareholder value for the sole benefit of shareholders.

Graph 5. Distribution of profits between net interests, net dividends, gross retained profits and corporate tax in France (1954 - 2014)



Source: *Insee*, *Comptabilité Nationale*, 2010 basis.

Notes: The graph measures the break-down of the gross operating profit of non-financial companies relative to GDP. This means that for a given year, the amounts of interest and dividends add up, the sum being equal to the amount of distributed profits. And if we add gross retained profit and corporate tax to this result, we obtain the profit share of companies (see Graph 4, p. 12).

[18] John K. Galbraith introduced the concept of technostructure that applies to the governance of large firms and designates all salaried managers who, through their specialties and experience, participate in decision-making regardless of shareholders' expectations.

Given this opposition between two corporate governance models, three comments can be made based on Graph 5:

1) Noting that the corporate tax share is practically identical (about 5% of GDP) during the Fordist (1949–1973) and neo-liberal (1993–2007) periods, we can highlight that the rise of the gross retained profit share[19] starting in the early 1980s is strictly the same as that of the corporate profit share previously observed (Graph 4, p. 12). Therefore, we can conclude that the net distributed profit share, whether interest or dividends, hardly changes when moving from one period to the other.

2) However, if we look at how the net distributed profit share is split between interest and dividends, we observe a massive substitution of interest for dividends during the 1993–2007 period, i.e. the opposite of what happened during the 1954–1973 period. This opposite movement is to be interpreted as the sign of a shift in the balance of power in favour of shareholders (who are risk-takers) against lenders (who prefer the lesser risk involved in bank investment), the first group requiring higher yields than the second.

3) Moreover, a closer look shows that dividend distribution acquires a counter-cyclical character over the 1993–2007 period compared to the fluctuations of economic activity (see Graph 1, p. 3). This new feature, characteristic of the neo-liberal growth regime, can be explained by the fact that paying dividends becomes a constraint instead of an adjustment variable as it was in the Fordist growth regime, due to the fact that in the neo-liberal regime, corporate strategies involve creating shareholder value. Dividends thus decrease when stock prices boom in an expanding economy (namely in 1996–2000 and 2003–2007). Conversely, dividends increase in the case of falling stock prices, when the economy slows down (namely in 2001–2002 and 2008–2009).

The change in the type of corporate governance plays a major role in the emergence of the neo-liberal growth regime: it is in fact the institutional mechanism at the centre of the interlinks between microeconomic and macroeconomic phenomena. In the Fordist growth regime, this relationship was governed by collective bargaining between social partners, which linked the increase in real wages with the expectations of corporate productivity gains. But in the neo-liberal growth regime, this relationship is based on the shareholder type of corporate governance, which establishes a close link between corporate investment and stock prices. This is what we need to examine now.

4.3.3. The supremacy of market finance over bank finance

The evolution leading to the third characteristic of the neo-liberal growth in France is the result of profound changes in the institutional framework for finance introduced by the socialist and conservative governments in office during the second half of the 1980s (see above pp. 6-7). Both the reform of the banking system (notably, the 1984 law) and the liberalisation of financial markets (notably, the 1985–1986 laws) modified the structure of the financial system and increased the role played by finance in economic activity and hence in employment. Clearly, it was in the area of finance that French economic policies deviated the most from Keynes' teachings, ignoring in particular his vigorous warnings against the intrinsic misdeeds of finance in Chapter 12, "The State of Long-term Expectation" of his *General Theory*.

[19] Gross retained profit (or profits that are not distributed) represents the part of total corporate profit that is mainly intended to self-finance gross investment.

a) The questions raised by the instability of the marginal efficiency of capital in Keynes' analysis

One of the most important lessons of Book IV of the *General Theory*, "The Inducement to Invest", which is generally ignored in Post-Keynesian analysis with the notable exception of Minsky (1975, 1986), is to consider that in modern capitalism, capital needs to be examined from three different standpoints: real assets in Chapter 11, "The Marginal Efficiency of Capital"; share securities in Chapter 12, "The State of Long-term Expectation"; and debt securities in Chapter 13, "The General Theory of the Rate of Interest". Each category of assets has its own price, namely the marginal efficiency of capital in the case of real assets, the stock market price in the case of share securities and the rate of interest in the case of debt securities (bank loans or corporate bonds). However, Keynes does not fully explain the links between these three types of asset prices, in particular the impact of stock prices on the marginal efficiency of capital.

In Chapter 12, Keynes suggests that the marginal efficiency of capital is subject to wide and abrupt fluctuations due to fluctuations in stock prices, so that changes in the marginal efficiency of capital are larger than those of the interest rate.[20] But there are two objections to this statement. First of all, facts indeed show that the marginal efficiency of capital (i.e. the expected total returns on a new investment) tends to decline when stock prices rise and vice versa, but the magnitudes of these variations have nothing to do with those of stock price fluctuations.[21] Secondly, in his analysis, Keynes suggests that there is a direct link between the evolution of stock prices and entrepreneurs' expectations of profits in the long run. However, it is unclear why the amount of profit that an individual entrepreneur expects in a particular activity is likely to be largely modified upwards or downwards depending on the state of confidence in the business world.

Indeed, pointing out the radical nature of uncertainty that weighs on the future in a monetary production economy, Keynes explains why a speculative rationale prevails over a corporate rationale on a stock market and why asset prices, of whatever type (marginal efficiency of capital, stock price or interest rate) are based on subjective assessments and consequently on conventions. Certainly, the relationships between them are more complex than those that Keynes broadly outlined. Minsky's contributions to this topic are fundamental.

b) Minsky's contributions to the investment price theory

Minsky seeks to fill the gaps in Keynes' investment price theory by introducing two major innovations.

- The first is to show that the origin of the financing of investment (i.e. equities or debts) has a decisive impact on its amount, to the extent that the differentiation in asset prices associated with a debt ratio has the effect of modifying the weighted average cost of capital through leverage.[22]

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[20] Most Post-Keynesians adopt the position taken by Keynes in his Chapter 12: the schedule of marginal efficiency of capital shifts abruptly and significantly to the right when stock prices surge, or to the left when they fall. But most authors do not explain the mechanisms that cause such shifts.

[21] The share value on a stock market varies inversely with its expected rate of return, since the latter is used to evaluate the former as the discount rate of the sum of yields expected by the market operator in a more or less distant future.

[22] By definition, investment expenditure represents the acquisition of fixed capital ($I = \Delta K$), which appears on the assets side of a firm's balance sheet, and its amount is financed partly by equity (ΔE) and partly by debt (ΔD), which both appear on the liabilities side, so that:

[1] $\Delta K = \Delta E + \Delta D$ (*continued next page*)

In other words, the way of financing investment can be defined by the debt ratio (d) of the firm: the increase in its debts(ΔD) divided by the increase in its equity (ΔE):

[2] $d = \Delta D/\Delta E$

- The second is to explicitly borrow the distinction made by Keynes without precise definition between the "margins of safety" taken by the entrepreneur to counter the increasing risk linked to the volume of his investment and the "margins of safety" taken by the lender to cover the rising risk associated with the volume of his loan. In Minsky's approach, this distinction plays a decisive role in the formation of the asset price system because the first risk that appears through a variation of stock prices due to a change in the state of confidence in the business world has an impact on the marginal efficiency of capital, while the second risk causes the interest rate to vary as a result of a change in liquidity preference.[23]

In short, Minsky's approach focuses the analysis on the conditions governing the financing of investment that are based on the separation of the financial system into two kinds of finance: on the one hand, bank finance or intermediated finance, which captures the savings of households that are averse to risk and, on the other hand, market finance or direct finance, which collects savings of households prepared to incur high risks. These two compartments of finance are closely linked because banks grant loans to firms only on condition that the latter provide them with collateral, in other words with capital goods that have been previously acquired through equity financing. Banks thus limit the amount of credit they allocate to firms by taking the debt ratio of firms as the main criterion.[24]

c) Minsky's paradox of "economic tranquillity"

The firm's expected operating profit (ΔP) is distributed between interest (ΔInt) paid to the creditors and net profit (ΔRn) belonging to the shareholders, so that:

[3] $\Delta P = \Delta Int + \Delta Rn$

At the accounting level, the net profit owned by shareholders appears as the balance of the operating profit after payment of interest to creditors:

[3bis] $\Delta Rn = \Delta P - \Delta Int$.

In this approach, we have to distinguish between three rates of return:

a) The financial rate of return (r_f) on equity: [4] $r_f = \Delta Rn/\Delta E$.

b) The economic rate of return (r_e) on capital invested: [5] $r_e = \Delta P/\Delta K$;

c) The interest rate (i) of debt: [6] $i = \Delta Int/\Delta D$;

If we integrate these different rates of return on assets [4], [5] and [6] into the expected profit sharing relationship [3bis], then divide this relationship by the amount of equity (ΔE) and finally take into account the investment financing conditions given by the relationships [1] and [2], we obtain the leverage that determines the financial rate of return expected by the shareholders:

[7] $r_f = r_e + (r_e - i)\, d$

In short, the function of leverage is to increase the financial rate of return on equity (r_f) compared to the economic rate of return on capital invested (r_e) through two factors:

a) First, the difference between the economic rate of return on capital invested (r_e) and the interest rate (i) of the firm's debts: ($r_e - i$) ;

b) Second, its debt ratio: (d).

[23] The originality of Minsky's approach is to show that stock prices and therefore the state of confidence in the business world act, not on the amount of profits expected by the entrepreneur over the whole life of the investment, as Keynes suggested, but on the discount rate that the entrepreneur applies to the sum of expected profits. As for the liquidity preference, this influences the interest rate according to the principles laid down by Keynes.

[24] The equilibrium price, which fixes the amount of investment, is determined by the equality between the marginal efficiency of capital and the average price of financial assets (*i.e.* equities and debt), weighted by the firms' debt ratio which allows banks to maximize their own profits for a given state of the credit risk they agree to incur. According to the leverage effect, the gap between the marginal efficiency of capital and the rate of interest, associated with a given debt ratio of firms, determines the rate of return on equity for shareholders.

According to Minsky, the financial system is intrinsically unstable and the unbalancing forces of capitalism are endogenous to its functioning. Driven by a general climate of confidence in the future, investors take increasing risks, whether they are entrepreneurs, bankers or institutional investors. The rise in stock prices encourages companies to invest, reassures bankers about the value of the collateral that protects them against credit risks, and sharpens appetite for gains in the stock market. The corporate indebtedness rate increases in a climate where risk premiums are underestimated.

Periods of economic tranquillity lead to an increase in the fragility of the balance sheets of agents, whether they are financial or non-financial actors. And a financial crisis breaks out when the expected yields shrink and agents begin to have doubts about their return forecasts. Panic then supplants euphoria.

The "tranquillity paradox" described by Minsky played a more decisive role in the neo-liberal period than previously, because the structural change in the financial system in the second half of the 1980s led to the supremacy of market finance over bank finance. We now take a closer look at this upheaval.

d) The decline of the interest rate and the surge of stock prices

Minsky introduces a precise distinction between two financial actors: first, asset managers, who act on behalf of financial securities holders, and second, bankers, whose function is to pool the risks of the credit they grant in order to protect depositors. However, the relationship between the two components of the financial system changes over time. We move from a "debt economy" (*i.e.* an economy dominated by bank loans) during the Fordist period to an economy dominated by market finance in the neo-liberal period.

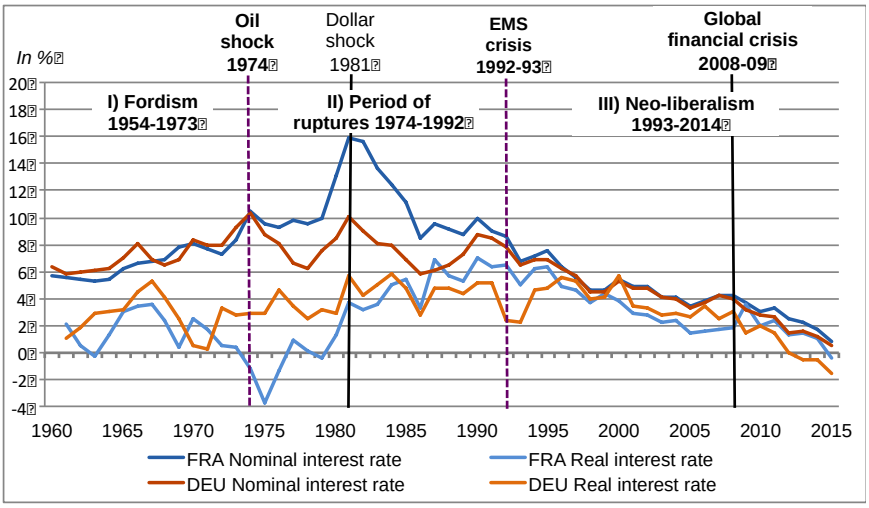
To highlight this change, we show that over the 1960–2015 period, long-term interest rates and share prices moved in opposite directions. In both cases, the same turning point occurs in the early 1990s, but the two variables follow opposite trends. On the one hand (see Graph 6), after a relatively sharp rise in the 1970s and 1980s, the real interest rate declined steadily in the 1990s and 2000s. The reversal that occurred in the early 1990s marked a decline in the business sector's recourse to bank credit. On the other hand (see Graph 7), the share valuation on the stock market remained confined within narrow margins and at a low level in the 1970s and 1980s, while, by contrast, stock prices surged in the 1990s and 2000s, an uptrend that was however periodically broken by sharp falls. The sudden rise and the large fluctuations of share prices starting in the early 1990s reflect the dominant role played by market finance in firms' activities. Let us examine these changes more closely.

When we look at Graph 6, we can see two turning-points.

The first turning-point appears in 1981 shortly after Paul Volcker, who had been appointed as head of the US Federal Reserve Bank in 1979, decided to raise short-term and long-term interest rates, triggering a sharp rise in the dollar exchange rate (see p. 7). After 1981, the nominal interest rate declined steadily in France and Germany but with large fluctuations in the latter country.

Yet even though inflation was being brought under control in France in the early 1980s, real interest rates continued to rise until 1990. In Germany, however, where inflation was lower, real interest rates stabilised at around 4% in the same period.

Graph 6. Nominal and real long-term interest rates in France and Germany (1960–2015)



Source: Ameco **(**(Annual Macro-Economic, European Commission) data base

A second turning-point occurs in 1990. After this date, all interest rates, nominal and real, declined in in France as well as in Germany. And after 1995, there are practically no differences between French and German interest rates, whether nominal or real, due to the convergence of monetary policies in both countries under the new European Monetary Union (p. 10). In other words, starting from the mid-1990s, France's monetary policy followed Germany's ordo-liberalism principles that governed European monetary integration.

At a deeper level, the low interest rates in France and Germany are the source of a major leverage that increases the financial profitability of large firms to the benefit of shareholders. The magnitude of the leverage can be explained both by a significant gap between the economic return rate and the interest rate on the one hand, and by a high debt ratio of firms on the other. As might be expected from Minsky's teachings, the high level of financial profitability of large firms has the effect of increasing the value of shares on the stock market.

This is what we now need to examine by looking at the stock markets' behavior in the long run in four different countries: France, Germany, the United Kingdom and the United States (Graph 7).

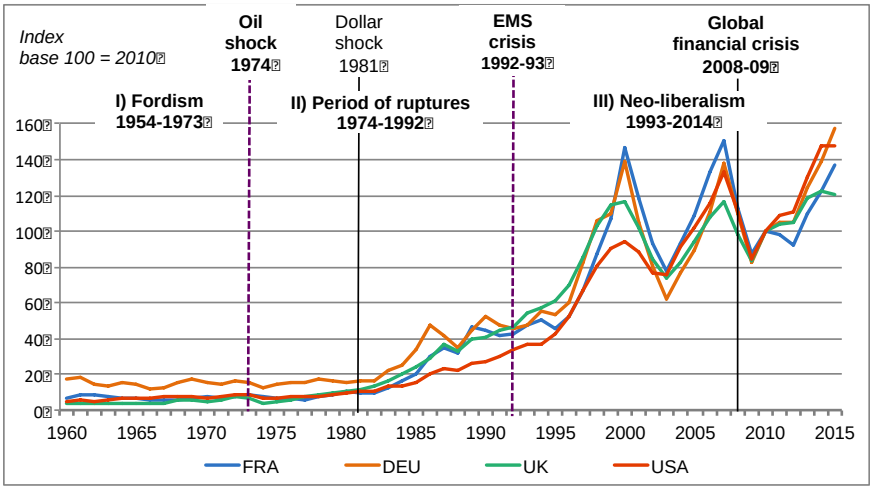
Graph 7 shows the same turning-point in 1981 as the one in Graph 6 (dollar shock):

1) For 20 years (1960–1980), share prices did not change much, remaining at a low level and playing practically no role in any of the four countries' economies.

2) An uptrend, following large cyclical fluctuations, began in the four countries in 1981; we recognise the peaks before the stock market's 2001–2002 internet crisis and before the GFC (subprime crisis) in 2008–2009.

When we compare Graph 6 and Graph 7, it appears that a structural change took place during the 1981–1990 period in the field of finance. On the one hand, nominal and real interest rates fell dramatically, while on the other, stock prices soared. We can draw the conclusion that, starting from the beginning of the 1990s, market finance prevailed over bank finance. When we compare these trends with the fluctuations of the rate of investment starting from the same date (*i.e.* the early 1990s; see Graph 4 p. 12), it seems quite clear that market share prices are the variables that determine companies' investment decisions. In other words, as in Anglo-Saxon countries, the supremacy of market finance is what causes financial instability and gives a highly cyclical character to economic activity.

Graph 7. Evolution of stock market prices in France, Germany, the United Kingdom and the United States (1960–2015)



Source: OECD (2016), Share prices (indicators).

This financial instability was a direct consequence of government decisions to deregulate banks and financial markets in the mid-1980s (see p. 7). Ignoring Keynes's warnings about the harms of financial instability, which he describes in particular in Chapter 12 “The State of Long Term Expectation” of his *General Theory*, various government economic policies were based on the "efficiency of financial markets" creed, which assumes that financial markets are able to ensure the optimal allocation of capital within the economy. Yet this postulate, which encourages governments to give free reign to market forces, is in total opposition to the postulate of radical uncertainty introduced by Keynes, which, on the contrary, suggests the need for strong regulation of the banking and financial sectors by public authorities.

The impact of financial markets on economic activity is closely related to globalisation, that is to say, to stronger international competition. The supremacy of market finance on the one hand and globalisation on the other, are indeed the two pillars of the neo-liberal growth regime, as we shall now see.

4.3.4. Globalisation of the French economy

At the beginning of Section 4.3 (p. 11), we highlighted four major changes characterising the neo-liberal growth regime: the aggregate demand constraint, the change in the corporate governance model, the prevalence of market finance over bank finance and globalisation. The last-mentioned change is a complex one and by nature multidimensional. It involves at the same time an increasing openness of national economies to imports and exports, the globalisation of financial markets, the unprecedented growth of multinational firms and the emergence of new major countries on the world market (Michalet, 1982, 2004).

During the neo-liberal period (1993–2007), the integration of a national economy into the world economy must be understood from three different angles. The first two relate to the real economy and the third one relates to the financial sphere.

In terms of activity in the real economy, it is necessary to look at the competitiveness of a national economy compared to the main developed countries, particularly Germany in the case of France, and to the strong price competition exerted by emerging countries, including China and East European countries in the case of the European Union.

The third angle involves the external financing requirement (or capacity) of the economy as a whole, which is visible in the balance of payments in a context of free movement of capital and free convertibility of currencies.

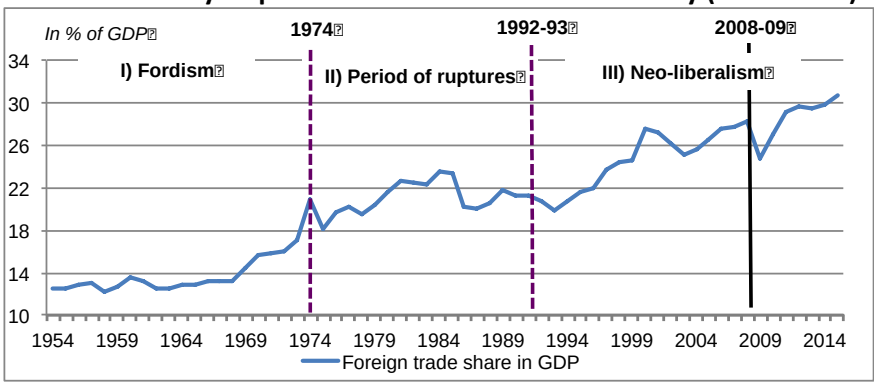
Naturally, these three perspectives are closely linked as the growth of multinational firms implies a redeployment of international trade and contributes to the rise of emerging countries on the international stage, while international flows of financial capital lead to a reallocation of resources at the international level.

To simplify, we have selected only two synthetic indicators to highlight the decisive break brought about by neo-liberalism compared to Fordism. The first is the ratio of foreign trade to GDP, which measures a national economy's trade openness to the world market (see Graph 8a). The second shows the evolution in the structure of the balance of trade (see Graph 8b). The evolution of these two indicators clearly distinguishes three different periods that are consistent with the durations of the two growth regimes (Fordist and Neo-liberal) separated by a period of ruptures. We now go on to examine these three periods more closely.

a) Fordist growth period (1954–1973)

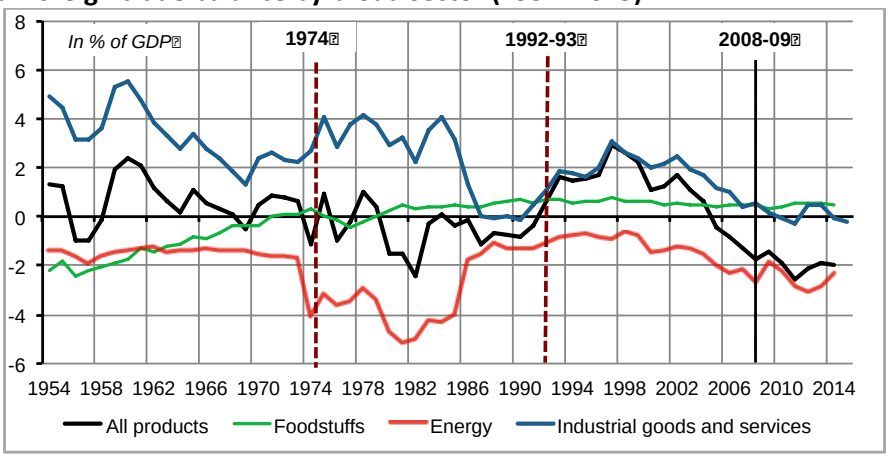
At the international level, the Fordist period can be divided into two sub-periods. From 1954 to 1969, the openness ratio remained low, at under 14%, with the economy remaining centred on domestic demand (Graph 8a). After 1969, the French economy's openness to the world market grew steeply to reach 20% just before the first oil shock in 1974.

Graph 8a. French economy's openness ratio to the world economy (1954–2015)



Note: The openness ratio is equal to half of the sum of exports and imports divided by GDP, all variables being measured in current prices.

Graph 8b. Foreign trade balance by broad sector (1954–2015)



Source: Insee, *Comptabilité nationale*, 2010 basis.

The same two sub-periods appear when examining the structure of the balance of foreign trade (Graph 8b).

- First, from 1958 to 1969, the progressive abolition of customs duties following the creation of the Common Market in 1957 caused a drop in the industrial goods and services surplus. But there was also a strong recovery in the foodstuffs trade balance.
- Second, the 1969 devaluation increased the competitiveness of the national economy and stimulated foreign trade. A strong export effort made it possible to maintain a surplus in industrial goods and services, which paid for the energy bill (1970–1973).

In the early 1960s, under the presidency of General de Gaulle (1958–69), who was not dogmatically against state intervention (*e.g.* national plans and public ownership of large firms), and as a result of France's integration into the European Economic Community (EEC), the economy and especially its manufacturing sector underwent change. French industrial groups became larger and more international, to the extent that in the late 1960s these new multinational firms were the real engines of foreign trade. This led to a gradual destabilisation of the Fordist growth regime at the end of the period (see p. 5). In addition, the progressive abandonment of the international monetary system as from 1971 and the 1973 oil shock both jeopardised the very existence of Fordism.

b) Period of ruptures (1974–1992)

Graph 8 shows that from 1974 to 1993, the openness ratio fluctuated around an average 20%, *i.e.* its 1974 level. Throughout this period, various external shocks (oil and dollar shocks in 1980) took place and France lost its competitiveness within the European Community, particularly relative to Germany, a deterioration that required regular exchange rate depreciations under the European Monetary System (EMS). If we look at the sectoral components of the balance of trade (Graph 8b), the most striking features are the very sharp reduction of the energy deficit after 1986 and the simultaneous collapse of the industrial goods and services surplus.

c) Neo-liberal growth period (1993–2007)

After 1993, the opening-up of the French economy accelerated. Despite the Internet crisis (2001–2002), the openness ratio gained 8 percentage points from 1993 (20%) to 2007 (28%).

However, what this ratio does not account for, is the extraordinary growth of French multinational firms abroad, primarily in Europe but also in the major emerging countries in the late 1990s. Yet, a disconnect existed between these firms' high levels of performance and the deteriorating competitiveness of the French national economy as a whole.

The external surplus for manufactured goods declined after 1996, at the time when economic activity was increasing following the stagnation resulting from the 1992–1993 crisis of the European Monetary System. The manufactured goods surplus tipped into deficit from 2005 onwards, again during the years when economic activity was rising following the 2001–2002 Internet crisis. This dramatic loss of competitiveness was partly compensated, but only partly, by the dynamism of services exports.[25]

In brief, French companies exporting from the national territory suffered from a lack of "non-cost competitiveness", particularly in relation to Germany. For greater insight into the problem, we need to look at the asymmetrical foreign trade situations of Germany and France. Germany's external surplus continued to rise throughout the entire 1993–2007 period, even after the 2008 global financial crisis, while the French balance shifted from a fragile surplus position to a persistent deficit. The specific evolution of each country a few years before and after the global financial crisis shows that the adoption of the euro in 1999 amplified this asymmetry since French companies were handicapped

[25] For the sake of simplicity, Graph 8b breaks down the external balance into three sectors, thus aggregating the balances of industrial goods and services.

by an overvalued currency (the new euro), while German companies were able to take advantage of the single currency (Duwicquet, Mazier, 2010–11).

5. 2008–2016: Financial crises

The 2008–2016 period is marked by a series of crises. After some brief remarks on these crises to identify the main issues related to indebtedness, we focus our analysis on two subjects:

- The austerity policies that were adopted by France after the global financial crisis and which were intended to reduce the country's public debt in order to comply with its eurozone commitments, condemning the economy to long-lasting stagnation.
- The absence of real deleveraging in both the private and public sectors in France and in most of other developed countries except for Germany.

5.1. Some remarks on financial crises during the 2008–2016 period

The analysis of the global financial crisis set out by André Orléan in *From Euphoria to Panic* (2009) uses Hyman Minsky's theory to explain how the business world went from euphoria to panic in the early years of the 21st century. The author highlights the endogenous forces at the root of the subprime crisis in the United States and explains how this evolved into a systemic crisis in the aftermath of the Lehman Brothers bank's bankruptcy on 15 September, 2008.

This return to the origins of the crisis during the period of "economic tranquillity", as Minsky puts it, is crucial because it shows that the securitisation of bank loans was a major financial innovation enabling banks to benefit from a powerful leverage. The securitisation mechanism allowed banks to eliminate some of their credit from their balance sheet, which in turn enabled them to increase the volume of their loans to the economy, in particular loans to the real-estate sector. In order to function, it was necessary for securitised assets to find a large number of buyers, particularly institutional investors and the banks themselves through their assets management departments. On this count, it should be emphasised that the large dissemination of securitised assets on financial markets was based on an underestimation of the risk involved, which was perpetuated by the rating agencies.

The "Minsky moment", as current terminology has it, denotes the time when the confidence of financial operators was shaken. This occurred after a series of credits had been issued to cover debt defaults, first in the real estate sector and then in a wide range of sectors, leading operators to question the value of their securitised assets. As contagion set it, the business world shifted from euphoria to panic

Triggered by the real-estate credit sector in the United States, the "subprime crisis" turned into a "systemic crisis" that affected all major developed countries. The distrust of the banks among themselves disrupted the functioning of the interbank market, with banks no longer willing to discount their interbank claims, and thus the banks' ability to supply the economy with money. In this context, central banks in the major developed countries were forced to inject massive liquidities into the economy, *i.e.* to absorb the money market shocks into their balance sheet.

The impact of the financial crisis on economic activity transited through two main channels. The first, the credit channel strictly speaking, involves credit restrictions that the banks imposed on the private sector, either by raising interest rates or through limits on volume. The second, the broad credit channel as it is commonly called, relates to firms' need to repair their balance sheet by deleveraging. It is this second mechanism that has the most dampening impact on economic activity as it means using corporate profits not to invest but to repay debts prematurely. This is a prerequisite for them as their deleveraging determines their access to future loans or, quite simply, to the renewal of loans that

they had already got. But, debt financing is granted by banks at a lower debt ratio compared to its previous level.

In the context of a downtrend in the prices of goods and services, the debt reduction constraint weighing on firms creates a risk of deflation that public authorities must ward off through expansionary monetary and fiscal policies that can bolster economic activity. This risk has remained particularly prevalent in Europe, because the 2008 great financial crisis was followed by the sovereign debt crisis that hit several European countries in 2010–2011, in particular Ireland, Portugal, Spain and Greece. Despite the European Central Bank's energetic intervention, the threat of deflation has never been totally eliminated given the Maastricht rules, which impose deleveraging policies on all countries in the eurozone (Mazier, Petit, 2013).

We now turn to the austerity policies pursued in France after 2008 and show that no real deleveraging occurred (either in France or in most other eurozone countries) as a result of these policies.

5.2. Austerity policies and the risk of a deflationary deadlock (2008–2015)

The policies implemented under President Sarkozy's and President Hollande's mandates were similar in that they favoured supply-side reform and neglected aggregate demand stimulus.

President Sarkozy, elected in 2007, began his mandate by cutting taxes for the rich and dismantling the 35-hour working week. As a result, inequality between capital revenues and wages deepened. Low- and middle-class households increased their indebtedness to maintain their purchasing power. It was in this context that the 2008 subprime crisis hit Europe.

A few years later, President Sarkozy's government (led by Prime Minister François Fillon) reduced public expenditure in order to reduce the public budget deficit and thus comply with the criteria of the "Stability and Growth Pact" (1997). However, French public debt instead increased due to the slowdown in economic activity.

In 2012, France signed the Treaty on Stability, Coordination and Governance (TSCG), which is another fitting example of "ordo-liberalism**"**. The TCSG, mirroring the wording of the German Constitution on budget balancing, requires eurozone governments to run structural (cyclically adjusted) fiscal deficits of less than 1% of GDP if their debt is under 60% and 0.5% if it is over 80%.

After President Sarkozy's five-year mandate (2007-2012), the socialist François Hollande was elected. He pledged to bring unemployment down significantly ("to reverse the unemployment curve"). During his campaign, he declared his hostility toward finance ("the enemy"). His mandate (2012–2017), was supposed to follow two successive stages; first of all, restore public finance balances and set the economy back on a growth track ("*redressement*"); secondly, reflate the economy and create jobs ("*relance*"). The aim was to tackle four types of deficit: competitiveness, employment, aggregate demand and debt but only the first was dealt with seriously and at an early stage, as we shall now see.

The "Tax credit for competitiveness and employment" (*Crédit d'impôt pour la compétitivité et l'emploi – CICE)* and the "Responsibility and Solidarity Pact" (*Pacte de responsabilité et de solidarité – PRS*), which were implemented in 2014 and 2015, granted huge tax and social contribution deductions to companies. The implicit deal was that firms were to create employment thanks to these cuts, but in reality few jobs were created.

Underpinning this major bonus to firms was a "supply-side" rationale. Cheaper labour costs were intended to increase the firms' "margin of manoeuvre", thus improving competitiveness through investment, research and development, and innovation. These cuts to fiscal and social contribution levies were also intended as an incentive enabling the hire of more workers. However, the demand side failed to materialise, as the "fiscal gift" to firms was financed by heavier taxes (an increased VAT

rate and heavier taxes on households, which reduced their purchasing power), while wages and social transfers stagnated. The financing of both these supply-side programmes (CICE and PRS) was intended to be compatible with France's European commitment to respect public finance targets (*i.e.* fiscal deficit capped at 3% in 2015). But as faced with a shortage of demand, economic activity remained anaemic.

The French government's neo-liberal policy aiming at redressing its public accounts and therefore the country's economic situation following the 2008-2009 crisis, is based on two obvious errors regarding diagnosis and recommendations (P.A. Muet, 2015). First, public expenditure reduction in a recessionary context, far from triggering a recovery, aggravates the recession and has no impact on the level of public deficit which persists insofar as, under the effect of the Keynesian multiplier, aggregate demand and tax revenues fall in parallel with expenditure cuts. Likewise, to seek to reduce wage costs in order to improve the economy's international competitiveness in a context where all Eurozone members which are facing the same difficulties are adopting the same economic policies, not only fails to have any positive result on the external position, but continues to deteriorate domestic demand and hence economic activity. As P.A. Muet highlights it: "It is the replica 80 years on of what had already happened in the 1930s."

At the beginning of 2016, as unemployment remained high, handouts to encourage job creation and vocational training were offered to small and medium-sized enterprises. Again, this measure in favour of firms was financed by cuts in public expenditure.

When President Hollande ended his mandate in May 2017, unemployment was as high as it had been when he took office.

5.3. Debt without deleverage

The global financial crisis of 2008 was not followed by non-financial private sector deleveraging, which would normally have resorbed the expansion of credit that had sustained growth during the "boom" period preceding the crisis (Aglietta and Coudert, 2016).

Corporate and household private debt increased markedly in developed countries from 2000 to 2007, except in Germany and Japan (Graph 9a). From the banks' perspective, an increase in asset prices is considered as an increase in the value of the collateral provided by borrowers to guarantee the loans that banks have granted them, so that they increase their loans to the private sector. Under these conditions, asset prices have a pro-cyclical impact on the private sector's debt ratio, which thus amplifies the financial cycle and hence the business cycle. In short, wide fluctuations of asset prices increase the instability of the economy as a whole. Rocketing stock prices during the first decade of the 21st century led to an overestimation of collateral taken by banks as guarantees against the loans they granted. As a result, the collapse of stock prices during the 2008 financial crisis brutally revealed, *a contrario*, the over-indebtedness of the private sector.

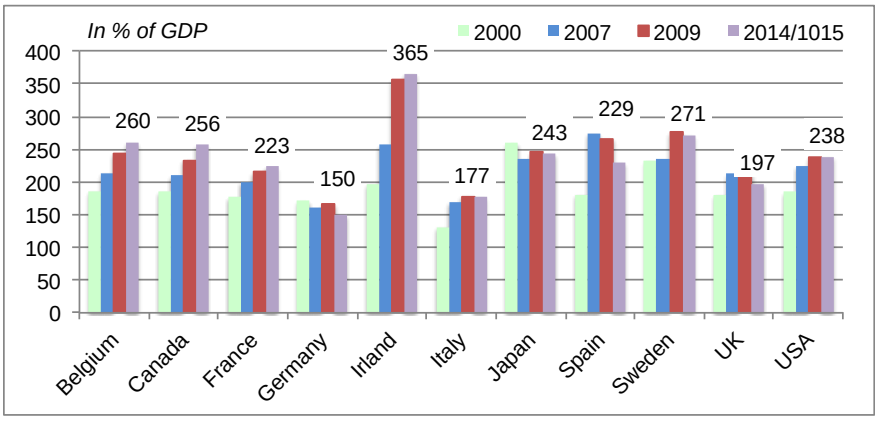
We can analyse the overall increase in debt as the "excessive granting of credit" (given that no account was taken of the borrowers' capacity to reimburse over the long run) due to a boom on the stock markets and, consequently, in the activity of the real economy. This excessive credit did not lead to a deleveraging after the 2008 crisis, contrary to what most commentators expected on the basis of a traditional analysis of the financial cycle. As we can see in Graph 9a, the level of indebtedness was higher in 2015 than in 2007, except in three countries: Germany, Spain and the United Kingdom.[26]

[26] Japan's situation is particular because the deleveraging that took place from 2000 to 2007 did not correspond to a period of economic growth as it did in Germany but followed a long period of stagnation that started in

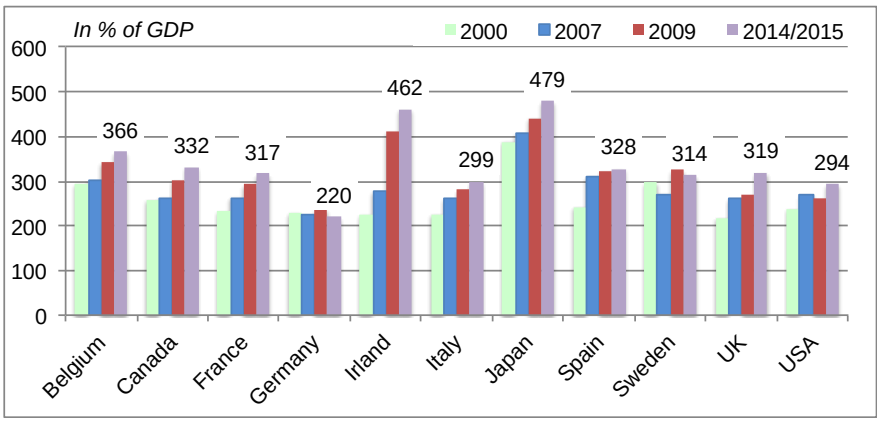
However, these exceptions disappear when the public debt is taken into account. In fact, total debt increased everywhere except in Germany (Graph 9b). In the two other countries, Spain and the United Kingdom, the state helped the private sector to avoid a severe recession in 2009. In other words, debt was transferred from the private sector (which had started to deleverage) to the public sector. State aid to bolster private sector activity led to a transfer of private sector debt (which deleveraged) to the public sector (which increased its debt). As a result, from 2007 to 2015, the ratio of total debt increased in every country, including Japan, but with the exception of Germany.

Graph 9. Debt in the main developed countries before and after the GFC (2008–2009)[27]

9a. Debt of the non-financial private sector



9b. Total debt (non-financial private sector and public sector)



Source: OECD (2016), *Comptes nationaux*, Financial Indicators.

Note: Data are for the year 2015 for Belgium, Canada, Germany, Spain, Sweden, the United Kingdom and the United States, and for the year 2014 for France, Ireland, Italy and Japan. For Ireland, data for the year 2000 have been replaced by data for the year 2001.

This situation is due to the central banks' massive injections of money to offset the drying-up of liquidities on the interbank market and thus avoid a systemic crisis. Following this, central banks kept interest rates at very low and even negative levels to prevent deflation. In doing so, they encouraged private actors in the non-financial sector – households and private companies – to continue

the mid-1990s. Consequently, the increase of debt from 2009 to 2015 offset only part of the 2000–2007 deleveraging.

[27] Updated graph first drawn by M. Aglietta and V. Coudert (2016, pp. 40-41).

contracting debt and company managements to use profits to remunerate capital by distributing interest and dividends, instead of allocating it to the self-financing investment.

Yet it is clear that as long as debt persists, the end of the debt crisis has simply been postponed since, paradoxically, keeping interest rates at very low levels distorts the relative prices of assets (spreads flatten and risk premiums are underestimated, particularly in the equity market). Hence, there are serious concerns weighing on finance, a situation that both penalises investment and jeopardises the sound recovery of growth. The time-bomb is still with us. France, like several other European countries, is mired down in what looks like long-lasting stagnation.

Conclusion

Slow growth and high unemployment characterise the French neo-liberal growth regime, contrasting with the successes of the "Fordist" regime in France from the 1950s until the first oil shock. It is difficult not to associate these poor performances with the abandonment of Keynesian policies and with the structural changes (analysed by the French Regulation School) resulting from economic policy choices made by governments in specific socio-institutional contexts and, in particular, France's choice to enter the eurozone.

What are the solutions?

Most French citizens are reluctant to give up the euro, which replaced the franc 17 years ago. So the question is: can France achieve full employment while remaining in the Eurozone, which has so far been harnessed to rules at odds with Keynesian policies? And can these employment policies be pursued in an international context subject to financial instability? We believe it is possible under two conditions.

First of all, there must be greater coordination of national economic policies at the Eurozone level aimed at a full employment "policy mix". This would imply further changes in the European monetary institutions and practices. The European Banking Union should be completed. The European Central Bank should guarantee the sovereign debts of Eurozone countries. It would also be necessary to set up a new European institution in charge of coordinating Member States' public finances (taxation, budgets, public debt) geared to employment targets at the Eurozone level, not only at national levels.

However, we would also need a "European New Deal" inspired by Keynesian ideas – *i.e.* a large-scale investment programme (Aglietta, Brand, 2013). The "Juncker plan" – a 4-year investment programme (2015–2019) totalling €315 billion (this amount was doubled in September 2016) – is a first step in this direction. Its goal is to fill the 15% gap in Europe's investment (compared to its 2008 level).

Additional projects aimed at "decarbonising" Europe and developing renewable energies could be integrated into the initial programme on the lines set out by the Paris Climate Conference in December 2015. In addition to private finance and Eurobonds, innovations in finance such as "green money''[28] could provide interesting ways of funding these projects and bring about a major breakthrough in credit and finance.

Solving the climate change problem at the European level could also be the solution to the economic and social problems of France and Europe. These new European policies could perhaps usher in a "sustainable development" growth regime for the upcoming decades of the 21st century.

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[28] As shown on pp. 282–289 of *Un New Deal pour l'Europe*, an example of green money would be a system of certificates guaranteeing reductions of greenhouse gas emissions (and thus dependent on an internationally agreed price of a CO_2 unit).

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