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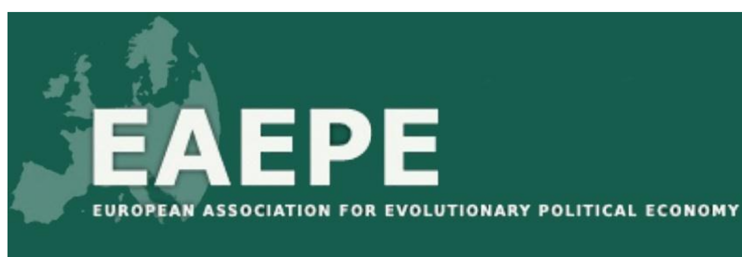

The rationale for different exchange rate policies:
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1. Introduction

After the Second World War, and until the mid-1960s, France and Italy adopted two different monetary and exchange rate policies as a consequence of the relative degree of commitment to the opening of their respective domestic economies. While the Italian economy was oriented to a gradual opening of the domestic market, which indeed implied a substantial strengthening of the national manufacturers and producers, the French economy was less clearly committed to open her domestic market, with some consequences on the exchange rate policy. After the World War both Italy and France stabilised rather shortly, even though at slightly different times, in 1947 and 1948. Notwithstanding, in 1949, in the wake of the Marshall Plan aids and US confronting a recession phase, all the European countries devalued against the US dollar to a very different extent. If Great Britain and the sterling area devalued strongly, by 30 per cent, Italy was less prone to adjust her currency to such a hard measure, whilst France opted for a rather robust rate in between: thus, Italy devalued by a modest 8 per cent and France by 22 per cent (Milward, 1984; Eichengreen 2007). In the ensuing decade the Italian central authorities, especially the Bank of Italy, engaged themselves in stabilising prices and gradually pegging the currency to the dollar on a stable basis. A relatively low exchange rate was adopted and Italy successfully pegged her currency to the dollar in 1950 at nominal 624,8 liras against the US dollar. Such an exchange rate and the parallel trade liberalisation policy favoured a subsequent export-led growth period with positive effects on the output and industrial dynamics. Instead, until the late 1950s France adopted a strong currency policy in order to preserve the national *grandeur*, even if this had some relevant effects on the price stability and the macroeconomic performance. In 1957, finally, France devalued and shifted towards the dismantling of domestic barriers to foreign manufacturers. According to the existing literature this

difference in the exchange rate policy had an important impact on investments and on the related productivity growth rate in these countries. The deferred exchange rate adjustment in France entailed a parallel deferred increase in investments and technological updating of the industrial sector in the country (Boltho, 1996a). As observed, indeed, the French economic growth gained momentum after the 1958 substantial change in economic policies, with the significant currency depreciation of 1957-58 and the upsurge in competition stemming out from the gradual opening of the domestic market and from the rise of the infra-European trade (Sicsic and Wyplosz, 1996).

Even at a first sight the increase in per capita growth rates both in France and Italy is related at the exchange rate policy, even if the role jointly played by the other relevant policy of economic opening is not always assessed as a part of the same bundle of coherent economic policies. Thus, it may be useful to compare exchange rate policies and trade policies in these couple of countries which experienced a similar economic 'miracle' in the 1950s-1960s, although they started to grow at a significant pace at different times as a consequence of a lag in the change of economic policies. In a way, the French choices of the late 1950s seem to follow and replicate what the Italian central authorities decided to reach almost a decade earlier: the integration in a regional European market through the dismantling of tariffs and restriction to imports, the price stabilisation and convertibility of the currency after having reached a low depreciation in real terms. Such a policy produced a long term effect on the productivity growth rate as a result of conspicuous investments and technological transfers, on one side, and a reallocation of factors, both by sectors and regions, on the other one.[1] The Italian economy started growing at a high rate from the mid-1950s, after a prompt stabilisation and a robust anchorage of the lira to the dollar at a favourable real exchange rate. Such a choice was arguably responsible for an upsurge in exports and investments with relevant gains in productivity. A similar scheme was adopted by French authorities only in the late 1950s, after a period of price instability and rationing.

[1] The sectoral reallocation of factors entangled a reduction of the relative weight of the agricultural production as GDP share. The geographical reallocation of the workforce, especially via infra-national migration from the largely agricultural South to the industrialized Northern regions, was particularly relevant from the mid-1950s, only weakly counterbalanced, after 1957, by industrial and infrastructural investments in the South by State-owned enterprises.

In the long run France and Italy have had some similar patterns of growth, such as a similar low volatility over business cycles (Backus and Khoe, 1992; Solomou, 1998 and 2001), a long-run relevant State intervention in the economy (Bellini, 2000), a persistent dependence on (dollar denominated) imports for an ample range of raw materials. Thus, relatively different exchange rate policies in the first post-war decade could explain differences in their macroeconomic performances in the 1950s and 1960s, although a quite similar scheme may be considered responsible for exceptionally high income and productivity growth rates during the Golden Age in either countries. The differences in the exchange rate and trade policies may be caught by looking at the institutional and political environment. On the one hand, in Italy a political environment rather stable from the late 1940s and, above all, ready to adjust the regulatory frame to the specific international context successfully fostered changes in economic policies with a positive outcome in terms of competitiveness and convergence. From 1948-49 Italian political elite was conscious of the opportunity represented by the American effort to reconstruct a European-wide economic frame to boost effectively the output and productivity recovery in a reasonable time. On the other hand, on the contrary, in France a quite idiosyncratic political environment, indeed rather unstable, was longer determined to maintain a tight rationing scheme and a system of import and export licensing, as well as a high exchange rate of the franc against the dollar, with negative effects on aggregate growth via investment and competition. In 1957-58 president De Gaulle, facing a current account deficit in 1956-57 ($1 billion) and a high inflation (15 per cent), opted for a monetary reform which paved the way for a radical change in exchange rate and trade policies (Sautter, 1982):[2] as a result, investments and productivity growth rates started increasing significantly in the subsequent decade strengthening competitiveness and convergence. In the peculiar international context of the 1950s and early 1960s the Italian and French (although lagged) currency devaluations provided permanent productivity gains in sharp contrast with standard models (typically, Krugman, 1989), according to which depreciation could provide only short-term and price/cost competitiveness: in such models, in a very few years, any price advantage depending on currency devaluation is to erode by increase in other costs, typically wages. Unlike the standard assumption, these two cases provide

[2] It was the so-called Rueff Plan of 1958-1959. The Plan was delivered while Minister of Finance being Antoine Pinay.

evidence of permanent productivity advantages via investments and related technological changes depending on depreciation choices, even if, as it will be stressed, in a very specific, and maybe exceptional, international context (Boltho, 1996a). Nevertheless, the point is still controversy, as Eichengreen has recently observed that positive effects of the French devaluation were rapidly and entirely eroded by increases in wages and rising inflation (Eichengreen, 2007, pp. 102-104), whilst other authors do not emphasize, or even distinctly take into account, such a choice as a co-determinant factor of the ensuing Italian 'miracle' during this period (Zamagni, 1993; Rossi and Toniolo, 1996; Cohen and Federico, 2001). Besides, this comparison between France and Italy could help assessing in a better way an measure why the French post-war catch up was delayed by a decade (Sicsic and Wyplosz, 1996, p. 217) and why, instead, the Italian miracle' started earlier, in the mid-1950s, with a strong component of export-led growth.

The paper is organised in a first section (§2) dedicated to the understanding of the rationale for the exchange rate policies in which institutional and political factors are considered quite relevant. The second section (§3) deals with the macroeconomic effects in terms of income and productivity growth of such exchange rate policies in the specific monetary context provided by the Bretton Woods Agreements and by the US 'benign neglect' of imbalances in their balance of payments. The third section (§4) presents the main findings offered by our estimates. Finally, the last section (§5) draws some very tentative conclusive remarks.

2. The rationale for exchange rate policies: institutions and politics

As Boltho has implicitly observed, both France and Italy were able to fulfil some fundamental macroeconomic goals related to currency parities in the 1950s and 1960s, even if a significant lag in the adoption of balanced or favourable exchange rates occurred, by contributing thus to shaping (at least partially) specific patterns of growth in the Golden Age (Boltho, 1996a). This view suggests a quite common and, in a way, a parallel story for these two countries, although a different timing could be seen as partially responsible for some differences in GDP growth rates during the period. In fact, during the period 1950-1973 Italy GDP per capita grew at a 5% average rate per year, whilst France GDP per capita grew at a more modest 4%. Likely, gross fixed non-

residential investment as a percentage of GDP had a higher pace in Italy in comparison with France in the decade of low lira and strong franc: the ratio was on average 15.1 per year for Italy and 13.7 per year for France in the period 1950-1960 (Eichengreen, 2007, tables 2.2 and 4.5). Other indicators follow an analogous pattern in the post-war years: TFP growth rate was significant higher for Italy (an average of 4.3 per year) than for France (3.5) in 1950-1962, whilst it slightly converged after the franc devaluation in the following decade: 4.6 for Italy and 4 for France in the period 1960-1973 (Crafts and Toniolo, 1996, table 1.7). These indicators (per capita output, non-residential investments, total factor productivity) may be mutually compared with regard to the exchange rate policies as they are usually related to relative costs of factors and competitiveness. Exchange rate choices are also related to possible imbalances such as current accounts. In fact, France and Italy experienced two dissimilar current account paths in the 1950s and 1960s, only partially connected to the domestic demand dynamics. From the mid-1950s Italy became a surplus country, together with Germany, and maintained this position until the first oil shock in 1973. On the contrary, France suffered a rather continuous deterioration of her current account from the mid-1950s and upheld such a position through the following decade. Even if some authors tend to reduce the importance of this imbalance (Sicsic and Wiplosz, 1996), in a domestic capital market in which liquidity constraints could dwarf investments, this may be seen as a further constraint on the economic growth. Apparently, a lasting surplus position in current balances could alleviate the overall impact of this liquidity constraint. As Maddison has stated about the importance of the liberalisation process after the Second World War in fuelling increases in growth rate in those countries which "chose to benefit from the opportunity" (Maddison, 1994, p. 50). And France did chose to benefit from this opportunity with an appreciable delay in comparison to the more prompt response and adjustment of Italy.

How may we explain such differences in economic policies in these two cases? Why did France fail to adjust her exchange rate policy to the changing environment? Why, on the contrary, did Italy succeed to chose both a realistic and lasting exchange rate and a pro-liberalisation trade policy? Were these differences in economic policies responsible for dissimilarities not only in the current balance but also in growth rates? Are longer-term outcomes of the exchange rate policy observable? The rationale behind exchange

rate and trade policies in France and Italy after the World War is probably depending on the institutional and political context. Such differences in shaping economic policies are related to the extent to which central authorities and governments were able to cope successfully, or not, with the changing international environment. Thus, institutions and politics are relevant in heading economic policies towards different objectives and benchmarks. In other words, if France in the 1950s, unlikely, Italy in the same years, "failed to align domestic arrangements with the evolving international framework and to exploit the economies by the external sector", as stated by Eichengreen (Eichengreen, 1996, p. 41), political instability and institutional arrangements were largely responsible in not providing an adequate response. Even if political instability and unfitting institutions exerted a conspicuous influence on the growth pace of the French economy in the 1950s (on this, for instance, Saint Paul, 1993; Sicsic and Wyplosz, 1996), the relevance of idiosyncratic economic policies – and, in particular, exchange rate choices – is hardly recognised as a cornerstone of the explanatory frame of the relatively less brilliant French performance of that period. Yet, as emphasised by Eichengreen, institutional responses did matter in adjustment processes to a quickly changing environment (Eichengreen, 1996) and such responses may include choices with longer-run effects on the macroeconomic performance of a country.

The rationale for at least partially divergent exchange rate choices in the 1950s is related to two institutional factors: i) the government stability and political bargaining schemes; ii) the regulatory framework, both in relation to the domestic sector and the external sector, that is, in particular, the attitude to trade liberalisation. In the late 1940s and early 1950s France was characterised by highly unstable governments and by a system of shortages and rationing. The French political elite as a whole appeared not too much inclined to accept a pro-market regulatory scheme and, at the same time, preferred to pursue a strong currency policy, even if such a goal was to cause recurrent reserve losses and balance of payments crises. Indeed, in the following years current account deficits and reserve losses multiplied without significant currency adjustments through devaluations. Only a more stable government and a trans-national commitment in 1957-58 with the return of De Gaulle to office and the signature of the Treaty of Rome (1957), after a severe instability phase, induced French authorities to devaluate and to opt for a coherent trade liberalisation policy. On the contrary, Italian governments

became relatively stable, even if under the form of a composite coalition, after the forced split of the Communist Party in May 1947 and opted for a pro-liberalisation policy. From 1948-50 the Italian political leaders, prime minister Alcide De Gasperi and president Luigi Einaudi, were eager to open the domestic economy to a wider economic community, according to a realistic currency stabilisation, and to take promptly a reliable and long-term commitment to European trade and payment agreements. Thus, after the harsh reserve crisis of 1947, governments and Bank of Italy committed themselves to recreate large and stable reserves, by devaluing to a feasible level, coherent with the option of gradually liberalising and pursuing the currency convertibility (Cotula, 2000).

Once we have accepted such a view, the other point to explain is why France and Italy opted for different exchange choices in the early 1950s? For instance, may we explain institutional and policy preferences as a result of non homogenous political systems? Were more unstable governments France responsible for a strong currency which influenced negatively current balances, particularly exports, as well as for rationing and quotas in foreign trade which produced a lower degree of openness of the French economy than Italy's? As we will see beyond, the French investments over real GDP ratio followed a less positive tendency in the 1950s in comparison to Italy's, as well as the degree of openness in constant prices did. Such preferences may be seen as a result of the attempt to stabilise expectations, in a political environment characterised by turbulence and instability, through a strong currency and constraints on the external factors. But, in fact, these economic policies had a negative impact on the pace of investments and growth via liquidity constraints.

The Treaty of Rome in 1957 and the creation of the European Economic Community (ECC) in 1958 were the institutional points of convergence of France and Italy towards trade liberalisation and currency convertibility. In fact, overcoming a severe balance of payments crisis and an upsurge of the inflation, in 1958 with the Rueff Plan France devalued the franc and started to stabilise her currency with a monetary reform (from 1st January 1960). In 1958, after almost a decade of low inflation rate and favourable exchange rates, Italy anchored the lira to the convertibility against the dollar attaining the initial objective. Since then both French and Italian investment and growth rates converged after about a decade of relative difference in levels. Annual

percentage changes in GDP growth from 1951-52 to 1960-61 were, on average, equal to 6 in Italy and to 4.5 in France, whilst they became substantially converging in the following decade, from 1961-62 to 1969-70, when average annual percentage changes were equal to 5.8 in Italy and to 5.2 in France (Boltho, 1996a, tables 5.3 and 5.6).

After the end of the Second World War Italy and France stabilized at different times, the former in 1947 and the latter in 1948, according to specific conditions existing in their respective political scene. Either stabilisation policies required the previous defeat of the leftist parties as a prerequisite (Casella and Eichengreen, 1993). In the Italian case a though price stabilisation was obtained, even if such a political objective was not openly declared by monetary authorities, also in order to reduce the burden of the public debt in real terms (Conte, 1998). Some authors emphasize the effects of the very restrictive monetary policy then adopted by the governor of the Bank of Italy, the economist Luigi Einaudi, on the ensuing downturn of the industrial sector production and on the sharp upsurge of the unemployment rate (De Cecco, 1968; Daneo, 1975; De Cecco and Giavazzi, 1993). This critical view differs from a more positive assessment of the stabilisation choice by the Bank of Italy as an unavoidable prerequisite of the successive pegging of the lira to the dollar according to the Bretton Woods system. According to this view the monetary and credit squeeze had an ultimately positive longer-term effect on the overall growth rate, essentially because it reduced environmental uncertainty helping to stabilize long-term expectations (Cotula, 2000).

The stabilisation manoeuvre successfully deployed by the governor Einaudi in October 1947,[3] just a few months after the announcement of the Marshall Plan, had an impact on the amount of credit to businesses through the adoption of reserve requirements and credit controls. This technical measure to fight the high inflation had, however, a permanent effect on the banking system because insofar the Bank of Italy maintained heavy controls on the aggregate supply of credit to the economy via stringent and even increasing reserve requirements on banks' total assets (Baffi, 1958; De Cecco and Giavazzi, 1993). The restrictive monetary manoeuvre sounded rather tough in a short-term perspective, in terms of output and employment, but enabled

[3] Luigi Einaudi was then the minister of the Budget, a new Ministry created especially for him, while maintaining the governorship of the Bank of Italy and Donato Menichella acted in a strict cooperation as general director of the central bank.

central authorities to shape a substantially stable monetary context by contributing in this way to foster investments in the following years, after the Korean War partial falling back (as depicted in Fig. 1). In terms of real growth in the second half of the 1940s the Italian economy followed a quite similar pattern: after a strong conjuncture in 1945-47, due to the full exploitation of the productive potential, the economy suffered the monetary squeeze operated by the Bank of Italy and hence suddenly and significantly slowed. Nevertheless, from 1947 both governments and monetary authorities adopted some relevant decisions affecting the long-term frame in which economic actors would have operated in the following two decades. Thus, even if there were some negative short-term repercussions, in 1947-49 Italy was able to deliver a prompt response to the new international context provided by the Marshall Plan and the Bretton Woods Agreements: political decisions appeared intimately entwined with economic decisions at that time. As clearly remarked by Rossi and Toniolo, between 1947 and 1949 "a bold pro-market, pro-trade liberalization decision was made as far as international economic relations were concerned" (Rossi and Toniolo, 1996, p. 439).

Such a kind of decision was coherently pursued in the ensuing decade. In March 1947 Italy, applying to membership of the International Monetary Fund (IMF), committed to fixed exchange rates and currency convertibility.[4] This commitment to Bretton Woods Agreements was cautiously tempered afterwards, through recurrent adjustments, in order to maintain a realistic and favourable exchange rate that allowed to boost exports and preserve a balanced current account. Indeed, in 1949, when Great Britain and France devalued as a consequence of a particularly high exchange rate, Italy depreciated but to a minor extent. In the following years the Bank of Italy, being the governor Donato Menichella, was strongly engaged in recovering the total reserve through a severe policy towards firms and house-holdings. Total reserves, after the lowest peak reached in July 1947 ($132 million), soared in a few years to $870 million in December 1950, jumping to more than the double within a year ($320 million) and multiplying rapidly in 1949-50 as a consequence of a fitting currency parity chosen in the second half of 1949 (Asso, Biagioli, Picozzi, 1998, table 20). In 1950 Italy adhered to the European Payment Union (EPU) and, the subsequent year, to the European Coal and Steel Community established by the Treaty of Paris signed by France, Germany,

[4] In November 1947 Italy signed also the GATT in Geneva.

Italy and Benelux. To adhere successfully to the European Coal and Steel Community a good exchange rate choice was necessary, a part improvements in the industrial potential and productivity, otherwise reserve losses should have followed inevitably for the expected upsurge in imports. Investments in physical capital in steel plants by IRI, the State-owned company holding, provided improvements in the basic sectors' productivity (Toniolo, 1984; Amatori, 2000). At the same time, in prospect, it was necessary to reinforce the overall reserve amount (US dollars, British pounds, and gold) at the Bank of Italy through a stringent mechanism of capital and currency controls. Such arrangements were stubbornly pursued by the Bank of Italy led by the governor Menichella over the 1950s. But, in fact, even the most rigid system of capital and currency controls would have failed if an inadequate exchange rate choice had been chosen. A fitting currency parity was adopted as early as 1949 and adjusted in the subsequent years. As a result the real exchange rate of the lira against the US dollar had a low and favourable level during the period. Whilst the nominal exchange rate appears to be rather stable during the 1950s,[5] Italy's real exchange rate dropped consistently in the early 1950s and lowered further in the decade until 1961, when slightly grew in the overheating conjuncture of 1962 and 1963. The real exchange rates dynamics could be ascribed both to subdued wage increase and productivity growth (Boltho, 1996a, Fig. 5.2; Rossi and Toniolo, 1996).

A relatively low real exchange rate (from 1952 to 1961 decreased 10-15 per cent) provided increasing reserves, stabilised the balance of payments while imports augmenting, and boosted investments by reducing significantly liquidity constraints. Decreasing liquidity constraints allowed firms to foster investments and update technology by increase productivity. On the other hand, the Bank of Italy led by Menichella was rather sparing in the money supply (from 1952 to 1957 the money supply growth rate lowered). Such a monetary policy was mainly committed to stabilise the domestic environment and expectations. The Bank of Italy succeeded in attaining these fundamental macroeconomic goals over the period, at least until 1962-63 (Fratianni and Spinelli, 1997; Cotula, 2000). A virtuous circle of low inflation rate, low

[5] In 1946 the exchange rate against the US dollar was on the yearly average at 308; in 1947 the Italian currency fell to an average of 488 and gradually stabilised in the following years: at 575 in 1948 and at 589 in 1949. On average, in the 1950s and 1960s the lira was valued at 624,8 liras against dollar, with some lower peaks to 620,8 in 1959 and 1962.

exchange rate, balance of payments surpluses after 1950, shrinking liquidity constraints, higher investment rate, high productivity and income growth rate took place. As recently observed by Eichengreen a realistic commitment in terms of exchange rate choices depended on the coherence of national decisions within the international context, as well as within specific domestic conditions (Eichengreen, 2007). Even though capital controls, tough reserve requirements and administrative measures were adopted by the Bank of Italy to manage effectively currency reserves and avoiding capital outflows, it was essentially because a low exchange rate was chosen that the balance of payments remained in surplus over the period and convertibility could be achieved at the end of the decade. Currency convertibility was really feasible only within a trade policy committed to open the economy to the infra-European competition and free goods flows. To reach such a goal was not easy neither immediate. It was first necessary to create fitting monetary arrangements such as a stable exchange rate and a low growth rate of money supply. In the 1950s the Bank of Italy applied a number of different exchange rates according to specific purposes and monetary areas (Asso, Biagioli, Picozzi, 1998). If the real exchange rate was around the 85-90 as average percentage of the 1950 exchange rate, the real effective rate was higher and reached its lowest peak, on average, in 1959-61 at 94, from 98.5 in the previous years (1950-58) to 98.3 in 1964-65. The real effective exchange rate was equal to 97.2 in 1950-61 and 96.9 in 1962-65: in other terms, it was slightly favourable to a competitive parity (Cotula, 2000, table 5).

On the contrary, the French political elite was less prompt to react to the emerging international scenario shaped on the Bretton Woods Agreements and France failed to reach a good exchange rate from the early 1950s. It was only after some serious problems emerged from a strong exchange rate, such as the emergence of a flourishing black market in which dollars were changed against French francs at more realistic rate, that in the 1957-1958 central authorities decided to devaluate and, at the same time, to reform the national currency by adopting the 'nouveau franc' by the end of 1958. Such institutional rigidities may be considered as responsible for the delay in the adjustment of the exchange rate to the international context as well as to the actual competitiveness of French firms and producers. This point is only superficially taken into account by some authors (Sautter, 1982; Saint Paul, 1993; Sicsic and Wyplosz, 1996) when the

timing in convergence processes is pondered, but more recently is acknowledged as a factor of impediment in adopting adequate macroeconomic policies when new opportunities stemmed out from the reorganization of the international scenario in the late 1940s and early 1950s (Eichengreen, 1996 and 2007). In particular, the pursue of a strong currency for political *grandeur* and the rationing and quota system in international trade have been judged as negative factors of the efforts in adjustment processes in the 1950s (Llewellyn and Potter, 1982; Sautter, 1982; Boltho, 1996a and 1996b).[6]

Yet, one of the most relevant problem to surmount was the highly unstable and volatile political scene. Governments changed at a very fast pace and coalitions were quite unstable over the 1950s, until the return to office of president De Gaulle. The so-called Monnet Plan was not sufficient *per se* to foster investments to an appreciable extent, even if investments in some basic sectors were successfully attained in the recovery phase of the late 1940s and early 1950s, alongside the Marshall Plan aid. In 1946 the French government established the Commissariat general du plan led by Jean Monnet (the Monnet Plan), that endured from 1949 to 1952. The Commissariat was committed to reinforce above all basic industries in coal, steel, electricity, cement, transportation and machinery. These investments were relevant for some industrial sectors but insufficient to produce an impact in aggregate terms on the dynamics of investments as a whole. French governments opted for a strong currency and capital controls, reinforced by a system of quotas and rationing, in a sharp contrast with the Italian option. We can argue that such policy was related to the ambitious *grandeur* deeply rooted in the French elite or whether it depended on the need to stabilise expectations, at least in terms of target, in a very turbulent political system through imposing an external anchor, even if this produced unexpected negative results. Such a view could be coherent with the possibility to rely on the franc area foreign trade and with the counterbalancing State intervention. Nevertheless, liquidity constraints were hugely operating in the 1950s as governments controlled banks and capital flows via administrative instruments. After the back to office of president De Gaulle a bold policy became feasible for French authorities as the new government obtained a large and

[6] However, the first three authors tend to assume as not determinant such factors even if they argue that a misalignment in exchange rate and a restrictive trade policy could be relevant in a minor measure in shaping the relatively unsatisfactory performance of the French economy in the 1950s.

lasting electoral support and thus gained stability in the following decade. Although orthodox minister Antoine Pinay and economist Jacques Rueff maintained the guidance of the French monetary policy in the late 1950s, other more complex figures, such as that of Wilfrid Baumgartner, had influential audience at that time. The stance that a weaker franc could be useful to reinforce in the medium term the economic growth through an increase in exports and foreign trade became more accepted in the French elite in the 1950s (Feiertag, 2006).

3. Macroeconomic effects: positive outcomes in a specific context

As we have said above, France and Italy experienced a common pattern of growth, even though with a temporal lag, in the post-war Golden Age. Either countries reached convergence towards the income and productivity levels of the leading country, the United States, through a high growth rate of investment and the import of innovative technologies. Yet, this common path of growth occurred with a substantial lag in the 1950s. Even though literature has not reached a consensus on the causes of such a difference in timing and thus performance, we argue that exchange rate choices played a relevant role, because they exerted a significant influence both in determining balance of payments imbalances and in shaping or simply allowing a more open foreign trade policy. Although Andrea Boltho seems to suggest that exchange rates had some influences on differences in growth rates between France and Italy in this period (Boltho, 1996a), the relationship between exchange rates and other relevant macroeconomic variables has not been assessed yet. If we assume that exchange rates may influence investments via liquidity constraints and possible imbalances in the balance of payments, in fact, we have also to recognise that a low or high exchange rate choice in the early 1950s favoured or preclude balance of payments stability in the mid-term or, even, in the very short term. As said, in the early 1950s French central authorities opted for a strong currency, even after the partial devaluation in 1949, whilst the Italian lira was constantly undervalued since the early phase of the recovery. As depicted in table 1, this currency parity choice was in sharp contrast with the Italian exchange rate policy, largely oriented to a low parity. The differential in the relative currency parity is not stable but even strikingly increasing during the first half of the 1950s, when the French franc became more and more overvalued. The overvaluation of

the French franc grew against both the dollar and the Italian lira. Besides, it augmented steadily even in relation to the real exchange rate of the European countries members of the OEEC (cf. Table 1).

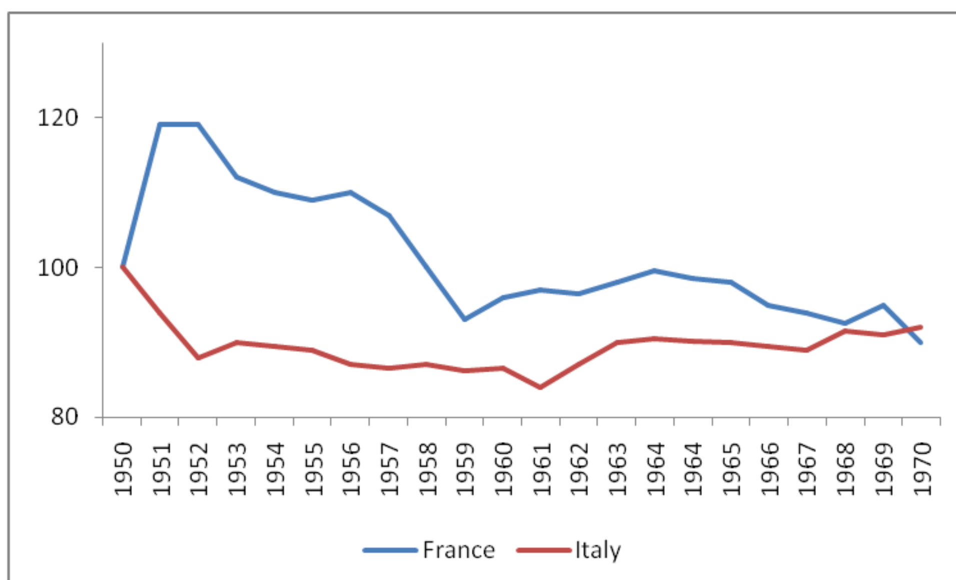
Table 1. Real exchange rates in France and Italy in 1947-1955 (1938=100)

	1947	1948	1949	1950	1951	1955
France	176	119	111	97	107	122
Italy	98	88	85	82	82	86
OEEC Europe	96	91	87	71	73	78

Source: Triffin, 1957, p. 324.

The real exchange rates moved along different trends in the 1950s and 1960s in France and Italy. As Figure 1 shows the real exchange rate of Italy was consistently undervalued all over the period and rather stable until the early 1960s, when some minor revaluation took place as inflation commenced to exert some pressures through increases in wages. Instead, the French real exchange rate appeared overvalued until 1956-57 as a result of a prolonged strong currency policy pursued by central authorities. Nevertheless, since 1953-54 a minor change is observable in the series, even if it was not sufficient to produce some positive effects on the balance of payments: on the contrary, in 1955 and 1956 the real exchange rate experienced an upward swing. A robust convergence emerged only after the French depreciation in 1958, when De Gaulle and Pinay introduced relevant changes in the monetary policy and the Rueff Plan permitted to devaluate. Since the late 1950s and early 1960s, however, margins started to be eroded by a partial revaluation of the currency (Figure 1).

Figure 1. Real exchange rate, France and Italy, 1950-1970 (1950=100)



Source: IMF, International Financial Statistics, *ad annos*.

Such an exchange rate choice had directly negative outcomes at least in terms of balance of payments. As Table 2 suggests, French current balances suffered losses from the mid-1950s, even if it has been observed that losses were not above 2 per cent of the GDP for the whole period (Sicsic and Wyplosz, 1996). The current account losses even became growing in the 1960s, that is after the devaluation of the franc in 1958, but not in the immediate aftermath of the French franc devaluation in 1959-1964. The Italian current accounts were steadily in surplus from the mid-1950s and, above all, this indicator is particularly increasing in values after the early 1960s, when imports exerted a minor role in defining the external constraints frame. Such data suggest that the Italian economy became largely, even if not exclusively, an export-led economy since 1955, at the eve of the starting of her 'miracle'. The level of surpluses and exports, however, did not reached the German ones. Under such circumstances, the Italian economy may be regarded only partially as a case of export-led growth, whilst this is certainly a main feature of the German path of post-war growth. In fact, the domestic aggregate demand played a significant role, as yet observed (Rey, 1982).

Table 2. France's and Italy's current balances, 1950-1973 (annual average, $ million)

	1950-1954	1955-1958	1959-1964	1965-1969	1970-1973
France	219	-250	-171	-405	45
Italy	-79	107	270	2178	604
OECD Europe	1430	1385	260	2048	4314

Sources: Llewellyn and Potter, 1982, pp. 137 and 141.

Current account tended to depend on currency parities but on capital controls as well. Of course, they could depend on the trade balance trends and mirror productivity fundamentals. As we will see, we might argue that an improved balance of payments could depend on improvements and gains in productivity driven by a number of changes, such as capital accumulation, technological transfers, economies of scale, and factors reallocation. As either the countries could not shift to the currency convertibility before 1958, they built up a more or less complex system of capital controls granted by their central banks in order to preserve parities and pre-empt reserve outflows. Yet, the exchange rate was unsuccessfully fixed by French authorities and reserve losses occurred in several times. In fact, in order to fulfil their purposes capital controls and reserve requirements needed to be supported by convenient exchange rate in real terms. From the late 1940s the Bank of Italy decided to strengthen capital controls in order to preserve the reserve accumulation which would have allow to maintain the liberalisation progress in foreign trade. As governor Menichella clearly stated after the reaching of currency convertibility capital controls and currency reserve were managed pursuing a twofold goal: i) obtaining a current account in substantial balance which would allowed maintain import flows of capital goods and intermediates in the phase of recovery and growth in the 1950s; ii) recreating currency reserves which would allowed to keep up a durable and low exchange rate with positive effects on expectations and investments (Bank of Italy, 1959).

The point stressed by governor Menichella in 1959 is quite relevant both for understanding the long-term policy adopted by central authorities and for finding out which variables could be affected by exchange rate policies in that decade. In the words of the Italian central authorities the pro-liberalisation policy was constantly associated

to the currency policy. Thus, the currency parity choice was conceived to be consistent with such a policy in the medium or even in the long run. A plausible exchange rate would have allow to open convincingly in the long-term national borders to free flows of goods. As Table 3 shows Italy committed to free trade, at least infra-OEEC, early in the 1950s, whilst, at the same eve, central authorities pegged the lira to the dollar at a plausible and relatively low exchange rate. On the contrary, France was less prompt to open the domestic market to imports and preferred to maintain restrictive quota restrictions until the mid-1950s, when France gradually reduced quotas and tariffs. Such a tendency was still more pronounced in the regard of the commercial policy towards the dollar area.

Table 3. Trade liberalisation in France, Italy and OEEC countries as a percentage of imports freed from quota restrictions, 1952-1958

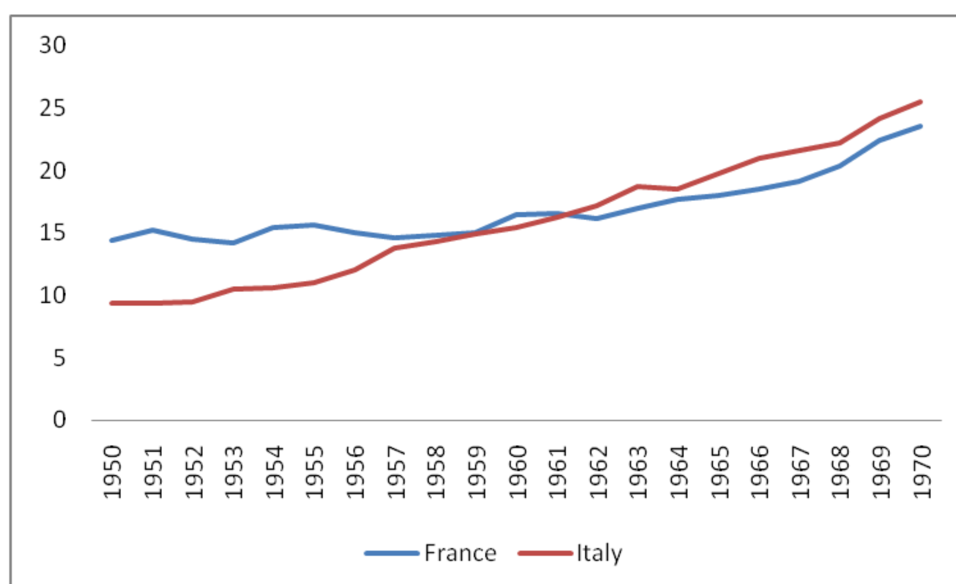
	1952	1954	1956	1958
infra-OEEC trade				
France	0	65	82	90
Italy	100	100	98	98
OEEC average	65	83	89	89
trade with dollar area				
France	0	0	11	51
Italy	0	24	39	68
OEEC average	11	44	61	72

Source: Boltho, 1996, table 5.5.

In the 1950s France and Italy converged in the degree of openness, as illustrated in Figure 2. Both commercial policy and consistent exchange rate choices allowed Italy to grow at a brightest pace in comparison to the France's decelerating or stagnating rhythm. It is worthy to note that the openness degree of France encountered some difficulties and even some backings in the mid-1950s, when suffered significant reserve crises and current account imbalances. Between 1957 and 1961 Italy was able to catch up France in this regard. We can argue that a promptest institutional response to a

changing environment pushed Italy towards an highest degree of openness by reducing barriers to imports and favouring exports via a low exchange rate. Instead, France was less prompt to react conveniently to the same changing conditions and suffered in terms both of aggregate growth and competitiveness in the international market, even when such a competitiveness was related to temporary cost/price advantages which, nevertheless, produced longer-term effects via investments allowed by easing liquidity constraints in an age of financial repression. Nevertheless, a major change in the French foreign trade was a reorientation of flows from the franc area to the EEC area: the share of exports to franc area was equal to 38 percent in 1950-51, 35.9 per cent in 1957-58, to 13.4 per cent in 1967-68, whilst the share of exports to the EEC area ascended from 17.5 per cent at the beginnings to 23.6 per cent in 1957-58 and to 42.2 per cent at the end of the period (Boltho, 1996, tab. 5.8).

Figure 2. Openness at constant prices of France and Italy, 1950-1970

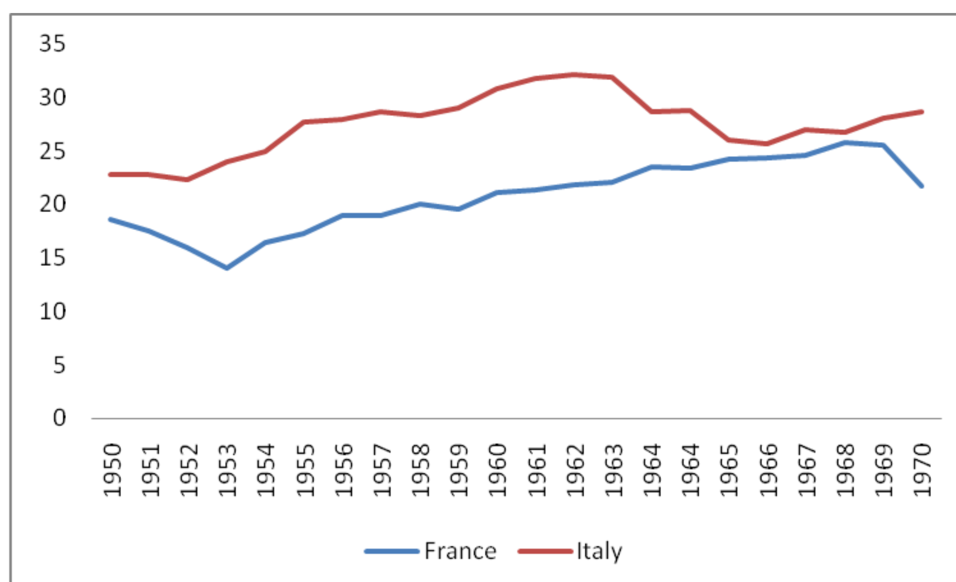


Source: A. Heston, R. Summers and B. Aten, Penn World Table Version 6.2, Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania, September 2006.

In the Italian case Boltho's conclusion that a low currency parity boosted investments and, consequently, productivity in the 1950s and 1960s is almost immediately clear. Yet, such a relation is not equally clear if we look comparatively at France, which did not decide to follow this kind of trade and exchange rate policy, at least in a first time. If we look at a common and simple measure of the investments'

dynamics in the first post-war decades, such as the investments over real GDP ratio, we can observe that some differences in growth rates emerged between these two countries in 1950s and also in the 1960s. The comparative observation suggests that France and Italy had both different levels in the ratio and different trends of the ratio. French investments as a percentage of the real GDP were definitely at a lowest level in relation to Italy's in the first half of the 1950s and the ratio remained lowest until the mid-1960s, when France converged to the Italian level because the trend was more stable and the Italian ratio decreased rapidly from 1962-63. From 1953 to 1968 the French ratio is steadily increasing, except for minor slowdowns. On the contrary, the Italian ratio seems to be definitely more sensible to fluctuations over the whole period and, especially, it became decreasing in its trend in the 1960s (see Figure 3).

Figure 3. Investments on real GDP ratio in France and Italy, 1950-1970



Source: A. Heston, R. Summers and B. Aten, Penn World Table Version 6.2, Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania, September 2006.

How to relate exchange rate choices to investments and, thus, to different performances of these countries? France and Italy strengthened their productivity even if this outcome arrived by a delay in the former country, which adopted a tough currency parity in the early 1950s by suffering some imbalances afterwards. Both countries had a very (pro)active big government and followed a similar model of growth, in which scale economies and factor reallocation played an important role. Yet,

in the 1950s they had a macroeconomic context in which investments were constrained in a dissimilar way and measure. In fact, although capital controls and reserve requirements to banks were equally imposed, a low exchange rate allowed Italy to have some initial (price) competitive advantages with a positive outcome in terms of profits and market shares. Such a result soared self-financing and eased liquidity constraints. The commitment towards the plausible exchange rate was perceived as a affordable commitment and oriented positively expectations on the prospect of convertibility. The strong currency policy was a damage *in se*, as it reduced price competitiveness of French firms by weakening their profitability, and produced recurrent reserve losses. The differential between the French and the Italian ratio of total investments on real GDP was about 5 per cent and it could be considered as a factor of the growth gap accounted for a one per cent point on average in the 1950s. The back to office of De Gaulle may be interpreted as a watershed in the exchange rate policies by French authorities after the World War. The Rueff Plan and the parallel devaluation of the franc removed such constraints, stabilised expectations and fostered a higher investment ratio (Sautter, 1982; Boltho, 1996). The exchange rate policy could be seen as a part of the institutional responses to changes in the international context.

4. Conclusions

The paper deals with a diverging evolution in the exchange rate choices amongst France and Italy after the Second World War. These countries reacted in a different way to a changing context and adopted similar macroeconomic policies in relation to the external side but by a consistent delay. The specific institutional framework and dissimilar preferences on the government side may be considered responsible, at least to some extent, for providing or not failing to provide, in the due time, an adequate response to external changes. Both exchange rate choices and trade policies could be seen as part of the French failing in reacting to the changing international environment.

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