Monetary and credit policy in postwar Western Europe.

Some working hypotheses.

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Europe, 1945-1973

- How did domestic monetary policies work in Europe during Bretton Woods/“Golden Age/”embedded liberalism”/roots of european monetary cooperation?
- Why were these policies so different across nations?
- How did they influence growth/financial stability/european cooperation?
- Can they still explain today's differences?
• A comparative approach is needed.
• But difficulties: very complex and “unconventional” policies (quantitative controls)
• Few communication at that time between central banks about their domestic policy.
• European negotiations and cooperation operated at a different level... except when a national problems....
This paper

• Overview of main differences on institutional characteristics, banking & financial supervision, interventionist credit policy, instruments of monetary policy.

• (still work to be done on stabilizations plans, banking systems, capital controls, fiscal policies etc.)

• Focus on West Germany, Italy, Belgium, Netherlands, France, UK (Switzerland and Scandinavia are next). Includes UK.

• Focus mainly on 1957-1973.

• Some explanations: federalism, structure of the banking system, political views on state intervention, foreign exchange/export policies.
Institutions/status

- Common feature/theme: non independence
- Extremes: Bundesbank vs Bank of England
- Variations: practices varied overtime (different balance of powers), divisions of tasks between gov. and CB (ex: Italy – Belgium vs Uk – France -Germany), nationalizations etc.
- Differences led to difficulties for negotiations >> role of experts at the international level.
- A long way to converge to Maastricht...
Banking & financial supervision

• Common feature: integration of monetary policy and banking/financial regulation.


• Variations:

• a) segregation between commercial, investment banks and public credit institutions. Italy-France vs Germany (1961). Belgium vs Netherlands.

• b) use of banking regulation as monetary policy instruments (ex: legal interest rates, liquidity ratios)
Credit policy – selective credit controls

- Common feature: strong connection between credit policy and monetary policy.
- Except in Germany....
- Reasons for selective credit controls:
  - Variations: Italy and France (strong links with economic planning). Netherlands & Belgium. UK (pb with banking controls). Difference in credit to private sector (discount)
France

Balance sheet: assets

Banque de France
millions of francs

- other
- gold
- foreign assets (advances to the exchange stablisation funds)
- foreign assets (sight balances abroad)
- credit to the government
- credit to the economy
Germany

Balance sheet: assets.

Bank deutscher Länder / Bundesbank
millions of DM
### Table 1: Central banks' balance sheets and economic activity

<table>
<thead>
<tr>
<th>Country</th>
<th>Central bank's balance sheet in percentage of GNP in 1958</th>
<th>Credit to the economy by the central bank. % of GDP, 1958</th>
<th>Credit to the government by the central bank. % of GDP, 1958</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>14.4%</td>
<td>0.01%</td>
<td>7.2%</td>
</tr>
<tr>
<td>Belgium</td>
<td>25.6%</td>
<td>0.5%</td>
<td>8.3%</td>
</tr>
<tr>
<td>France</td>
<td>17.00%</td>
<td>10.2%</td>
<td>4.6%</td>
</tr>
<tr>
<td>Germany</td>
<td>15.4%</td>
<td>0.3%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Italy</td>
<td>19.5%</td>
<td>2.5%</td>
<td>6.2%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>18.7%</td>
<td>0.02%</td>
<td>1.0%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>10.8%</td>
<td>0.2%</td>
<td>10.6%</td>
</tr>
</tbody>
</table>

Sources: BIS; “monetary and economic situation” by country.
Italy

Balance sheet: assets
Banca d'Italia
billions of lira

Graph showing the increase in assets from 1955 to 1964. The assets are categorized as follows:
- Other
- Gold
- Foreign asset (account with Italian exchange office)
- Foreign assets (foreign exchange)
- Credit to the government
- Credit to the economy (bills and advances)
 Were interest rates relevant?

- Estimations of monetary policy reaction functions.

Table 2. Monetary policy reaction functions: determinants of interest rates. 1957-1971 (quarterly data).

<table>
<thead>
<tr>
<th></th>
<th>France</th>
<th>Germany</th>
<th>Italy</th>
<th>Netherlands</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output gap (-1)</td>
<td>-0.77 (0.58)</td>
<td>0.41*** (0.09)</td>
<td>-0.00 (0.04)</td>
<td>0.21 (0.13)</td>
<td>0.13 (0.087)</td>
</tr>
<tr>
<td>Inflation gap (-1)</td>
<td>-0.04 (0.07)</td>
<td>3.33 *** (1.96)</td>
<td>2.77 (3.51)</td>
<td>1.09 (0.70)</td>
<td>2.26 (2.07)</td>
</tr>
<tr>
<td>Fed rate</td>
<td>0.87*** (0.14)</td>
<td>0.51*** (0.09)</td>
<td>-0.01 (0.03)</td>
<td>0.54*** (0.06)</td>
<td>0.69 (0.10)</td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.56</td>
<td>0.58</td>
<td>0.01</td>
<td>0.66</td>
<td>0.55</td>
</tr>
</tbody>
</table>

- Only Germany did not disconnect foreign exchange policy and domestic monetary policy. Relied also more on capital controls (Holtfrerich 1999). Surplus country starting 1956.
August 1964: a franco-german discussion

- Bundesbank's note: why Germany should not adopt French credit controls system?
- Context: successful French credit controls episode 1963-1965
- Different views on competition. Germany controls are distortionary. France: they protect the weaker banks and thus foster competition
- French *dirigiste* culture
- In Germany, because of universal banking, credit selectivity would be impossible and useless.
Some explanations

- Federalism vs centralized state. (Denton et al. 1968 on economic planning & credit policy)
- Political views/ideology. Keynesianism, ordoliberalism, colbertism....
- Structure of the financial system. Despite institutional shake up, governments had to adapt. Ex: universal banking in Germany, public credit institutions and big banks in France & Italy, private banks in the UK.
- Ability to use other policies: wage policy, fiscal policy, export policy, capital controls in Germany (Holtfrerich, 1999)
Conclusion

- Some important differences remain today (Germany vs France). Path dependency...

- Importance of strong connections between financial regulation and monetary policy

- Good news: countries managed to overcome their differences. Fiscal differences today are maybe smaller than monetary & financial differences in the 1960s... (Monetary convergence had been the result of both political will and financial liberalization).

- Bad news: these differences (credit policy) gave them important flexibility/autonomy which were important for growth.