Metamorphoses: the relationship between banking and economic modernisation in post-World War II France

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SUMMARY: After World War II, France's economic growth was the strongest in its history and the country broke out from the trap of middle-income countries. The "thirty glorious years" was accompanied by the modernization of the economy, in which a strong state control banking system, called the goal-oriented banking system, played a significant role. Through the transformation of the French banking system after World War II, we prove that in the case of a middle-income country, the deepening of the financial intermediary system promotes the modernization of the economy. On the other hand, after a while the too strong state regulation on the banking system will become a limitation because the financial system cannot fulfill its task of economic modernization, as state intervention will limit the deepening of financial intermediation and thus the further modernization of the economy. Finally, we will also examine whether the actors of the financed industries become "lazier" due to the active state intervention in the lending policy, which brings with it the issue of moral hazard.
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1. The banking system and economic modernisation

“*”If we do not face this deadline, we shall inevitably become like Spain.”* “(*Kuisel 1984:397*), Jean Monnet wrote it to his colleague, René Mayer, in 1948 about the utilization of Marshall aid, suggesting that France would either join the developed countries or fall in the trap of the middle-developed countries. Since the 1930s, the country has had a competitive disadvantage vis-à-vis its Western competitors. According to *Eck (2009)*, France didn’t have large, capital-intensive and innovative companies in the Taylorist sense (Table 1), while, in terms of GDP, it also lagged behind many other developed countries (Table 2).

Table 1: Number of large enterprises in 1929 and 1953 in Germany, France and the United Kingdom

	Germany		France		United Kingdom	
	1929	1953	1929	1953	1929	1953
The company has a share capital of more than £3 (1929) or £5 (1953) million	55	67	2	12	186	150
Companies with more than ten thousand employees	27	26	22	20	39	65

Source: Eck 2009:111.

After 1945, however, the decision-makers, according to *Kuisel (1984) they meant* primarily the French administrative elite, took the necessary decisions to bring France into the ranks of the developed countries. After the economist Jean Fourastié’s 1979 essay *Les Trentes Glorieuses, ou la révolution invisible de 1946 à 1975,* the period from 1945 to the mid-1970s is known as the ‘*thirty glorious years*’. The name is no coincidence because the French economy grew at an unprecedented annual rate of 4% during this period (Table 2). This growth led to a significant modernization of the economy, the industrial sector became more important, the productivity rising and living standards rising sharply, and at the end of the period, the services sector began to play an increasingly dominant role in the economy. *(Eck 2009; Braudel-Labrousse 1993)* During this period, France not only achieved significant GDP growth compared Western European peers, but comparing to other countries, productivity growth was much more important in French economy growth than the inclusion of additional factors of production, accounting for about 75% of GDP growth GDP growth (*Diederiks – Lindblad – Noordam et al 1995:255*).

Table 2: GDP per capita of the major Western European economies in a given year and average GDP growth between 1950 and 1973

	1935 (8)	1945 (9)	1950 (8)	1973 (5)	Average annual GDP growth between 1950 and 1973 (%)
Austria	4 634,00	2 750,00	5 907,00	17 908,00	4,94
Belgium	7 801,00	6 907,00	8 706,00	19 399,00	3,54
Czechoslo-vakia	3 841,00		5 581,00	11 223,00	3,08
Denmark	8 735,00	8 075,00	11 067,00	22 228,00	3,08
Finland	4 930,00	5 499,00	6 779,00	17 669,00	4,25
France	6 513,00	4 101,00	8 266,00	20 441,00	4,04
Germany	6 567,00	7 195,00	6 186,00	19 074,00	5,02
Italy	4 670,00	2 831,00	5 582,00	16 950,00	4,95
Netherlands	7 857,00	4 281,00	9 558,00	20 851,00	3,45
Norway	6 057,00	6 344,00	8 655,00	18 050,00	3,24
Sweden	7 160,00	8 201,00	10 742,00	21 509,00	3,06
Switzerland	9 478,81	8 839,32	11 541,04	26 003,72	3,08
United King-dom	9 244,00	11 247,00	11 061,00	19 168,00	2,42

Note: Highlighted in green are the top five countries with the highest GDP per capita in a given year; in parentheses behind the years is France's ranking in that year. Data are in Geary-Khamis (international) dollars, calculated in 1990 base year.

Source: www.ourworldindata.org and Sastre Castro (2020)

However, during these 30 glorious years, not only the French economy (and society) but also the French banking system underwent a profound transformation. Indeed, the decision-makers of the time gave the French banking system a privileged role and made it entirely subordinate to the modernization of the economy, which was to facilitate reconstruction and the modernization of industry through its credit policy. However, this was not trouble free and over time, despite the deepening of financial intermediation, the banking system was less and less able to fulfil its original role: modernizing the economy and promoting innovation (*Kuisel 1984; Nord 2016*).

The decision-makers of the time interpreted in a Schumpeterian sense the role of the banking system in the economy. Although the opinions in literature is diverged how the banking system can contribute to the modernization of the economy. Following *Mérő (2003)*, three groups can be distinguished in this respect:

1. There is no causal link between financial intermediation and economic growth.

2. The development of the financial intermediation system follows the developments of the real economy.
3. The development of the financial intermediation system is crucial for economic growth.
4. For Schumpeter, the direction was clear. He thought that the deepening of financial intermediation causes the growth in the corporate sector, and most of the experts who worked on this issue adopted this view. According to Schumpeter, economic growth is characterized by a kind of cyclicality in which innovations created by entrepreneurs play a key role, which is inconceivable without the active involvement of banks in its financing, because financing these innovations would be too risky and costly for individual investors, and banks evaluate enterprises and select innovations that worth for financing *(Schumpeter 1980).* Others researchers argue that the relationship should be seen in the opposite direction, that the development of the intermediation system can be seen as an inherent part of economic growth. For example, according to Joan Robinson, the development of the corporate sector is accompanied by the development of the financial sector, the development of the real economy creates demand, which stimulates the development of financial services, so that the intermediation system only serves the needs of companies and investors *(Shan et al. 2001).* Moreover, there are authors who doubt the causal relationship between the two factors, which is prominent in endogenous growth theories where technological progress is the basis of the economic growth, e.g. Lucas considers the role of financial institutions and the depth of intermediation in economic growth to be neutral *(Durusu et al. 2017).*

From a historical point of view, it is interesting to note, for example, Hicks's observations who stated that the industrial revolution in England was not paved by technical innovations – the industrial products and technologies that marked the industrial revolution had already existed – but by the emergence of appropriate forms of finance, in particular the joint-stock company, which allowed for the concentration of capital and the risk-sharing. France and Germany, on the other hand, did not develop the conditions for a well-functioning financial system until the mid-19th century. Although French public finances stabilized after the Napoleonic Wars and the French central bank was established, the development of the banking system and capital markets was not able to take off for a long time due to strong state controls and restrictions *(Mérő 2003).*

However, important research has also addressed the question of the impact of the depth of financial intermediation on economic growth for a given level of economic development. Thus, in many cases, no significant relationship can be found for low-income countries and a strong relationship is found for middle- and high-income countries, but the strongest relationship is found for middle-income countries *(Rioja – Valev 2004).* Beyond a certain threshold, the development of the intermediation system is no longer able to have such a significant impact on economic growth, and the link between the two factors strengthens at a slowing pace for a while, and

then starts to weaken (*Ductor – Grechyna 2015*). Research has also focused on the importance of quantitative (assets) or qualitative (efficiency, activity) parameters of financial intermediation. In a less developed economy, an absolute increase in the intermediation system can achieve significant economic growth by expanding the stock of assets, but in a developed economy, an absolute increase can no longer stimulate the economy to the extent that the damaging effects of making the system more vulnerable can be felt. Thus, in these countries, qualitative, activating improvements to the financial system are needed, which can allow for faster adjustment, more specific investment financing and thus higher value added (*Beck et al. 2014*). This naturally brings to the fore the issue of the regulation of the financial institutional system, which can determine the effectiveness of the intermediation system's contribution to economic growth.

Schumpeter's hypothesis has already been supported by several studies (*Hick 1969; Rousseau-Sylla 2001; Rousseau-Wachtel 1998*), so *our first hypothesis is based on the* assumption that in the case of a country with a medium-developed status, which was the status in which France "suffered" after the World War, the deepening of the financial intermediation system promotes economic growth and modernization. However, the French case is also interesting from this point of view because the policy makers and economists of this time wanted to achieve the modernization of the economy through a rather strong state regulation, in which the actors of economic policy, such as the Central Bank, the Treasury and the Ministry of Finance, largely shaped the structure of the banking system, forcing specialization of the banks, on the one hand, and the direction of the lending channels (to which sectors and companies should be directed the available financial resources), on the other. This has led to the transformation of the pre-war *market-oriented banking system into* a *target-oriented banking system*, where targets are set by the state rather than the market.

Over time, however, the development and modernization of the economy and existing industries requires the existence of an advanced banking system based on market principles, leading to a qualitative deepening of financial intermediation, which, as we will see in the French example, French public policy makers have also faced with this crossroads. *Our second hypothesis* is that, after a certain time, this over-regulation will become a barrier and it will be counterproductive, as the financial system will not be able to fulfil its modernization role, as state intervention will limit the further deepening of financial intermediation and thus the modernization of the economy. A more sophisticated financial system that manages risks and economic innovations better, is needed for further development of the economy.

But intense state intervention is not only a problem for the banking system, but also for the corporate sector. *Our third hypothesis* is that active state intervention in lending policy will lead to the impoverishment of the actors in the supported industries and to a lower market adjustment pressure on their part, which will bring with it the issue of moral *hazard*. According to *Loriaux (1991),* the efforts of the state to provide adequate credit to industrial operators due to the current industrial policy are accompanied by the disintegration of financial markets, while firms becoming

increasingly dependent on financial institutions. Not to mention the fact that, after a while, firms become accustomed to institutionalized credit policies and interpret them as a quasi-entitlement, so that the credit policy provided by the state also has an impact on the adjustment of the economy and the behavior of economic agents. On the one hand, the moral hazard does not motivate economic agents to prevent or mitigate the impact of certain economic shocks because the state will help them by loans. On the other hand, as a result of moral hazard, economic agents do not implement appropriate crisis management measures and adjustments in the event of an economic crisis but expect the state support through the financial system. Finally, the existence of moral hazard keeps available capital, labour and other resources in the hands of economic agents that are unable to adapt to a changing environment, while preventing these resources from flowing to innovative companies that are growing and could help the whole economy to adjust. Thus, to close the circle and return to Scumpeter, *Aharoni (1981:106)* argues that '*too much insurance and ris-reduction does not allow the Schumpeterian constructive destruction to operate; there is much less incentive for innovation either in new products or in cost-cutting methods*'.

In this paper, we seek to answer the hypotheses formulated above through the development of the French banking system after World War II, in which state intervention was particularly strong. This is illustrated by a descriptive analysis of the changes that took place in the French banking system between 1945 and 1984, where we examine the evolution of lending in the light of the available data, recall the criticisms of the banking system during this period and show how the inadequacy of certain reforms required further liberalization of the banking system. Finally, it is worth highlighting that in our study we explore a topic – the history of the French banking and financial system after World War II and its impact on the growth capacity of the real economy – and introduce it into Hungarian economic thinking, which is currently hardly studied in Hungary, although the development and stability of the current French banking system cannot be understood without knowledge of its historical background, while the monetary and credit policy solutions applied by the Banque de France during this period can also serve as a testimony for the present. *Artner (1995)* examined the impact of the concentration of real economy companies, noting that French companies have spent considerable resources on acquisitions and this concentration process has been organised and financed by the state since the 1960s, especially in the case of state-owned companies. As Voszka notes, French experts pointed out as early as the 1980s that, while the activities of private companies were becoming increasingly regulated, governments were trying to force some state-owned companies to operate in a market-oriented way (*Voszka 2020*). Gál has examined the merger waves in the French – and other – banking system, highlighting the integration trends between states and at the corporate level. The more and more unified European markets have led to increased competition, encouraging banks to increase their size, as growing competition has improved the position of banks which have large customer base and a broad range of activities, and encouraging smaller financial institutions to merge or be merged into larger banks. Concentration has also been motivated by the growing importance

of multinational corporations, and concentration in the real sector has also had an impact on the activities of financial service providers (*Gál 1998*). According to *Harbula (1999),* the structure and ownership of French companies is linked to two aspects: firstly, state-owned enterprises played a much more important role in economic life than in other advanced capitalist countries and, secondly, the changes of the 1980s saw the emergence of a system of cross-ownership among large companies, which overturned not the corporate but its ownership structure, especially in the area of corporate governance. The foundations were laid by system that was dominant before the nationalization, dominated by the so-called financial groups. This was a group of companies centered on an investment or commercial bank with a broadly diversified portfolio in different sectors of the economy. The roots of these financial groups date back to the early 19th century, and the first financial groups emerged between 1830s and 1850s, when certain banking houses, next to their traditional commercial banking activities (asset management, building up precious metals portfolios, currency and gold conversion), began to invest in industrial companies during the Industrial Revolution (*Harbula 1999*). *Kovács and Bartók (2022),* on the other hand, have worked on the paradigm shift in French economic and economic policy thinking after the World War II, which played a major role in redefining the role of banking system in the economy.

In this paper, we present the – mainly French – literature concentrating to the French banking system its changes during this period and we also present the descriptive institutional analysis, supplemented by statistical data, in the context of the above-mentioned link between the depth of financial intermediation and economic growth, which is also a major theme in the international literature, in order to support the hypotheses formulated above.

2. From extreme to extreme: the road to the direct public credit policy

The idea of stricter regulation of the French banking system had already been mooted in the late 1930s, and it has been written (Kuisel 2016) that the administrative foundations of the Fifth Republic rested on the Vichy system, and that the same was true for the banking regulation as well (Monnet 2018).

Background: the French banking system before World War II

Before we turn to our examined period, it is useful briefly describing the French banking system before the World War II, whose liberal approach is illustrated by the status of the French central bank, the Banque de France (BdF). Until 1936, the BdF operated as a private limited company with a Board of Directors made up of the bank's main shareholders, so-called '*200 families*', mainly from the industrial and banking sectors. When the state was faced with a financing shortfall, it turned to the BdF for a loan, and the interest rate was set by representatives of these 200 families,

which gave rise to many conflicts between the state and the central bank. The French central bank of the time, like the market players, considered the profitability of the institution as its main objective and did not take an interest in maintaining price stability or the stability of the financial system (*Tristan – Trichet 1999*).

It took until 1936 for the French state to change the structure of the bank's operations, reducing the role of shareholders while increasing the state's involvement in the bank's operations. The law stipulated that the Board of Directors should be composed of persons appointed by the State and not of delegates of the individual shareholders. The main objective of the bank was no longer profitability, but the institution was placed at the '*service of the public*' (although the precise objectives were not specified) and the bank was given a supervisory role over the banking system *(Duchaussoy 2017).*

According to *Laufenburger (1940),* the French banking system was the most liberal among the advanced economies in the 1930s. Accordingly, there was no regulation of the financial system and credit institutions were not accountable. In contrast, in most of the developed countries, notably Germany, the United States and Britain, banking regulation had already begun in the nineteenth century, and the Great Depression of 1929-33 led to an expansion of banking supervision in these countries *(Thiveaud 1997).*

According to *Eck (2009)*, the French banking system in this period was characterized by a paradox: while French banks were highly capitalized, their operational structure was less suited to serving the modernization of the economy. The strength of the banking system is illustrated by the fact that the leading French banks of the period (Table 3) were among the largest in Europe in terms of total assets, while their structure was characterized by a high degree of stability, mainly due to a self-regulating mechanism. In France, there was no question of universal banks in the German sense, since the Council of Interest for Banks introduced self-limitation during the financial crisis of 1880, thus effectively prohibiting for banks from doing both commercial and investment banking activities. The separation of these two types of banks was not codified, and many regional banks began to combine commercial and investment banking activities from the 1920s. However, these banks were the first to be hit by the 1929-33 crisis *(Thiveaud 1997; Eck, 2009).*

Table 3: Largest banks in France, Germany and the United Kingdom in 1929 by balance sheet total

	Equity capital thousand pounds	Country
Barclays Bank	15 858,00	United Kingdom
Lloyds Bank	15 810,00	United Kingdom
Midland Bank	13 433,00	United Kingdom
National and Provincial Bank	9 479,00	United Kingdom
Westminster Bank	9 320,00	United Kingdom
Deutsche Bank	7 500,00	Germany
Disconto company	6 750,00	Germany
Société Générale	5 000,00	France
Dresdner Bank	5 000,00	Germany
Commerz- und Privat Bank	3 750,00	Germany
Crédit Lyonnais	3 264,00	France
Comptoir d'Escompte	3 200,00	France
Darmstatter and National Bank	3 000,00	Germany
Banque de Paris et des Pays-Bas	2 400,00	France
Banque de l'Indochine	576	France

Source: Eck 2009: 174-175

Although the banking system in the 1930s was rich in capital, its operational structure was characterized by a high degree of inflexibility and was not well suited to financing the modernization of the economy and promoting industrial development through long, but mostly medium-term loans (*Monnet 2018*). Unlike in other countries, the use of banknotes was low and the bulk of the money supply was mainly banknotes issued by the central bank and coins minted by the state. While demand deposits in Anglo-Saxon countries usually accounted for four-fifths of the available financial assets (disponibilités monétaires), in France they reached only 56% in 1929, the year of the peak, and then fell rapidly due to the crisis and the war, reaching 37% in 1944 and only 62% in 1962. The French banks were also unable to 'compete' with the inflation that returned many times, i.e. bank deposits were usually remunerated at rates below inflation, which did not encourage the population to keep their savings in banks (*Eck 2009*). Bank deposit-taking was further hampered by the creation of many *state and parastatal specialized institutions* which targeted not just individuals but the corporate sector also, such as small and medium-sized enterprises (*Crédit mutuel*), peasant farmers (*Crédit agricole*) and the working class (*Banques populaires*) (*Thieveaud 1997*).

Nevertheless, the inflexibility of the banking system between the two world wars was paradoxically of little concern to either the state or the corporate sector.

Indeed, the real economy financed its investments from its own resources, because they wanted to avoid that the bank management taking control of its business in the event of insolvency. The financing of investments from own resources thus reached 70%-80% (*Eck 2009*). However, one of the main problems of the French financial system was the low share of long- and medium-term lending, which could have helped to stimulate investment in the real economy (*Monnet 2018*). There were attempts by the state to promote medium-term lending. Thus, the state has set up a number of institutions specifically dedicated to medium- and long-term lending, in partnership with commercial banks. Despite these efforts, medium-term lending has not yet taken off, partly because of the corporate sector's aversion toward the banking system and partly because banks have not been committed to longer-term lending, as an economic crisis can cause significant losses in their loan portfolio. The lack of trust between the real sector and the financial sector can also be largely attributed to the lack of regulation of the banking system. It is therefore no coincidence that one of the key issues in the post-war period will be the tighter regulation of the financial system, while the promotion of medium-term lending will also become a central concern as contemporary policy makers realize that France is lagging far behind its competitors in terms of economic development . (*Kuisel 1984; Nord 2016*)

Banking regulation in 1941 and criticism of the financial system after Liberation

The 1945 Banking Act has its roots in the Banking Regulation Act of June 1941 that not just created the State Banking Supervision *Commission* (*Commission de contrôle des banques*) and other bodies supervising lending operations (*Comité permanent d'organisation des banques and l'Association professionnelle des banques*), but attempted to separate banks from so-called financial institutions and financial enterprises (*les entreprises et établissements financiers*). The legislation meant under the definition of banks these "*companies and institutions whose regular activities include the collection of deposits and other financial resources from the public, which they* use to f*inance their own operations or to carry out discounting, lending and financing processes*"[3] Banks were required to prepare a certified financial report to regulators each year. By contrast, financial institutions and financial firms were "*prohibited from* accepting *deposits on demand or for a period of less than two years*"[4] , while they had specific functions: trading in securities; clearing government and commercial bills and cheques; granting short- and medium-term loans; and foreign exchange operations. Although the legislation tried to draw a line between the two banking activities, it was still rather loose (*Thieveaud 1997*).

3 13 June 1941 41-2532 Act, paragraph 1: https://www.legifrance.gouv.fr/loda/id/LEGITEXT000006075122/

4 Act No 41-2532 of 13 June 1941, paragraph 2: https://www.legifrance.gouv.fr/loda/id/LEGITEXT000006075122/

After the Liberation, the members of the transitional government, both right and left, clearly supported and advocated in their speeches dirigiste economic policies, the role of the state in economic planning, and nationalizations, which they believed would facilitate the reconstruction and modernization of the country (*Kuisel 1984*). In the opinion of the liberal politician René Pleven, the lack of economic modernization was clearly the cause of the failures of the past and could only be clearly encouraged by nationalization in certain sectors of the economy and a more active economic policy, while he stated that he was *in favor of* '*the construction of a dirigiste economy, a liberal and democratic dirigisme*' (*Kuisel 1984, p. 318*). A significant number of economists also advocated a more active role for the state after the world war. Thus, for example, the liberal economist Albin Chalandon, in an article published in the journal Esprit in 1946, advocated the nationalization of credit institutions (*Claire – Le Van – Prost 1987*, *Kuisel 1984*).

The socialists – led by Mendès France, André Philipe, Jules Moch – continued to support these theories, they had developed during the war. They envisaged a full planned economy, where part of the economy would be nationalized and the other part would be subject to strong state regulation, and a new Ministry of National Economy would be created to develop the main national economic objectives.

The need for the state to play a greater role in economic life was reinforced by the emergence of Keynesian theories in French economic thought. Thus, almost without exception, "*all French economists cited Keynes*" (*Etner-Silvant 2017:41*), while *Arena (2000:972)* argues that "*Keynes's influence on thinking is inescapable in post-war France*". The British economist's book, General Theory, was not only a theoretical foundation work for a new economic thought system and a paradigm shift, but also a clear break with the liberal theory that had prevailed between the two world wars and the economic ideas and techniques that had been built on it (*Etner-Silvant 2017*)

The French communists took a mostly wait-and-see position. The party's strategy being to create a united popular front that would in time weaken the position of the capitalist class and, by carrying out the necessary communist reforms, build an anti-capitalist coalition with broad support by the society (*Loriaux 1991).* Thus, according to *Kuisel (1984)*, the difference with years of 1918-1919 is that after the World War II., there was no one in or out of government who wanted a return to the pre-war liberal conditions. Economic liberalism was supported only by business and the peasant farmers.

In 1944, during the transitional government, the socialist politician Mendès France became the government's Minister of Economy, who was a supporter of the planned economy and nationalizations and one of the first French advocates of Keynesian economic policy (*Etner-Silvant 2017*), but unexpectedly he presented a draft of a deflationary, austerity policy to General de Gaulle, who headed the provisional government. He saw that financial consolidation was essential in order to build a financially and economically stable, modern, democratic system in France. The plan outlined by Mendès France was aimed at reducing purchasing power, eliminating inflationary pressures and reducing inequalities in consumption. Thus, on the one hand, it proposed a currency exchange and, on the other, it would have frozen 75% of the money in current accounts, with only the remaining 25% to be used for financial

transactions. At the same time, all securities would have to be deposited in order to prevent the emergence of a parallel financial system (*Loriaux 1991; Kuisel 1984).*

However, Mendès France was soon forced to leave the interim government. His successor, the Liberal René Pleven, said that the large amount of money in the economy was merely a symptom and not the cause of the existing imbalances. He saw the root of the problem as a mismatch between supply and demand, and rejected the government's attempt to reduce output by rationalizing the fiscal situation through austerity. He therefore called for the French economy to be modernized and for productivity to be increased in order to catch up with the more advanced industrialized countries as soon as possible, which would require mobilizing the necessary financial resources, not cutting them. However, the policy solution outlined by Pleven foresaw the problems that France would facein the future: high inflation, persistent budget deficits and the ossification of the so-called *overdraft economy.*

In November 1945, Jean Monnet had already realized that the modernization of the country could not begin without a well-constructed and elaborate economic plan. In November 1945, he said to the General: "*You talk about greatness (…) but at the moment France is small (…)* (To become great again) *We need to modernize, it because France is not modern at the moment. We need to promote production and productivity. (…) But to do this, it is essential to develop an economic plan*." (*Nord 2016:124)*. In 1946, Monnet succeeded in setting up the General Plan Commission (*Commissariat général au plan – CGP*), which operated independently from the Ministry of Economy and Finance, with the aim of increasing output, developing foreign trade, raising productivity to the level of developed countries, promoting full employment and raising living standards. Within the framework of a five-year economic plan, the areas for development important for the national economy have been identified, such as coal mining, electricity, iron and steel, cement, transport and agriculture. All this required a sacrifice on the part of the population, so the production of consumer goods was limited, and preference was given to products that contributed to the modernization of the economy. The second five-year plan, launched in 1952, included just a program for the construction of houses and flats for the public because it was also postponed in the first plan. Monnet's priorities are best summed up by *Kuisel (1984:373)*: '*The drafters of the economic plan put investment before consumption, modernisation before reconstruction, the future before the present.*'

Monnet succeeded that the US Marshall Aid would use to modernize the economy rather than welfare programs. However, in order to finance the five-year plans, longer-term financial resources were needed. Thus, in addition to foreign and budgetary sources, the Planning Council wanted to rely primarily on private savings and bank loans and on the equity of companies to help make the necessary investments. However, after Liberation, it became clear that private capital was unable to make the necessary investments. The state must therefore help banks to become capable of meeting the credit needs of the real economy, and a comprehensive new lending policy is needed, based on a new basis, in which the state has a major role, and it is no coincidence that banks and insurance companies were among the first to be nationalized (*Kuisel 1984; Monnet 2018*).

The 1945 banking regulations

After the World War II, the government fundamentally overhauled the French banking system with the law of 2 December 1945, in which the state played a greater role than ever before. Thus, one of the most 'spectacular' measures was certainly the nationalization of the Banque de France and four large French commercial banks, '*the law making the network of branches of the credit institutions that had become state banks national property and their activities a public service*'. (*Thiveaud 1997:45*)

The BdF lost its status as a joint stock company and came under the full supervision of the state. Although the law provided for the bank's independence, in many cases the monetary policy was set in the Ministry of Finance. According to the law, the central bank's task is to maintain price stability, which it must protect against emerging threats from economic inefficiencies, credit demand, changes in the balance of payments or the state budget. This shows that, if necessary, the central bank should have acted even vis-à-vis the state, but since the state became the bank's main shareholder and the members of the Monetary Council were appointed by the government, the independence of the institution was no longer so clear. The central bank's tasks also included ensuring the issuance of money, operating payment systems, lending to commercial banks, ensuring the stability of the financial system and regulating and supervising financial institutions.

The National Credit Council (Conseil national du crédit – CNC) became one of the key players in the financial system, chaired by the Minister of Economy and vice-chaired by the Governor of the Banque de France, with 36 other members gathered from the banking sector and the real economy (*Besse 1951*). With its recommendations and decisions, the CNC was the main monetary policy and banking regulatory body between 1945 and 1984, while also actively shaping credit policy (*Monnet 2018*). It determined the number of branches that credit institutions could open and the sectors in which they could lend, set the interest rates on loans and regulated the financial operations that banks could carry out on the financial markets. The CNC also set the minimum interest rates for rediscounting loans and the interest rates that credit institutions could charge on deposits, mainly in an attempt to control the process of money creation and thus inflation (*Thievaud 1997; Patat-Lutfalla 1986*). For a similar purpose, the *minimum reserve for government bonds* (plancher de bons du Trésor) was introduced in 1948, whereby credit institutions were obliged to always keep government bonds on their books, thus helping to finance the state (*Bussiere 2005*; *Patat 1993*).

One of the most important elements of the legislation was the specialization of the banking system. It made a sharp division between commercial and investment banks and introduced the medium- and long-term lending banks. *Commercial banks* were '*charged with the collection of deposits for a period of one to two years*' (*Patat 1993: 54*), and could provide discounting and short-term lending to their customers, but '*could not have participation more than 20% in companies that are not closely related to their banking or financial activities or not necessary for their daily basis operation,*

such as real estate property management or research activities related to their banking activities'[5].

By contrast, *'the main activity of investment banks, in addition to lending, was to acquire stakes in and manage existing or newly emerging businesses'*[6]. They were restricted in their ability to collect demand deposits and could not use them, or *'deposits with a maturity of less than two years, for their investment banking activities'*[7]. They were allowed to use mainly deposits with a maturity of more than two years to acquire shares in companies (*Patat 1993*). Investment banks were not nationalized, but they were subject to strong state supervision (*Thievaud 1997*).

The law distinguished a third category, the *medium- and long-term lending banks,* whose main activity was "*the provision of loans with a maturity of at least two years*."[8] , while they could also collect deposits more than two years. They could only accept deposits for less than two years with the permission of the Banking Control Commission. They were subject to similar restrictions as commercial banks as regards participation in enterprises. It is important to note that these institutions were all state-owned. However, these banks were mainly involved in the assessment and provision of long- and medium-term loans, which could be discounted at the central bank. They had to be registered on list of the CNC and were therefore subject to significant state control.

In order to further examine the banking system, we need mention that the *state-owned savings banks with special status,* which met the financial needs of a specific economic sector, such as the aforementioned *Crédit Agricole*, *Crédit Mutuel* and *Banques Populaires,* were exempt from CNC control. These credit institutions were able to expand their branch network rapidly in the 1950s and 1960s. This subsequently gave them a significant competitive advantage over credit institutions that could only open new branches with the approval of the CNC (*Eck 2009*).

5 2 December 1945 Law No. 45- 15: https://www.legifrance.gouv.fr/loda/id/LEGITEXT000006072686#:~:text=Tous%20ceux%20qui%2C%20à%20un,sont%20tenus%20au%20secret%20professionnel.

6 2 December 1945 Law No. 45- 15: https://www.legifrance.gouv.fr/loda/id/LEGITEXT000006072686#:~:text=Tous%20ceux%20qui%2C%20à%20un,sont%20tenus%20au%20secret%20professionnel.

7 2 December 1945 Law No. 45- 15: https://www.legifrance.gouv.fr/loda/id/LEGITEXT000006072686#:~:text=Tous%20ceux%20qui%2C%20à%20un,sont%20tenus%20au%20secret%20professionnel.

8 2 December 1945 Law No. 45- 15: https://www.legifrance.gouv.fr/loda/id/LEGITEXT000006072686#:~:text=Tous%20ceux%20qui%2C%20à%20un,sont%20tenus%20au%20secret%20professionnel.

3. The banking system after World War II

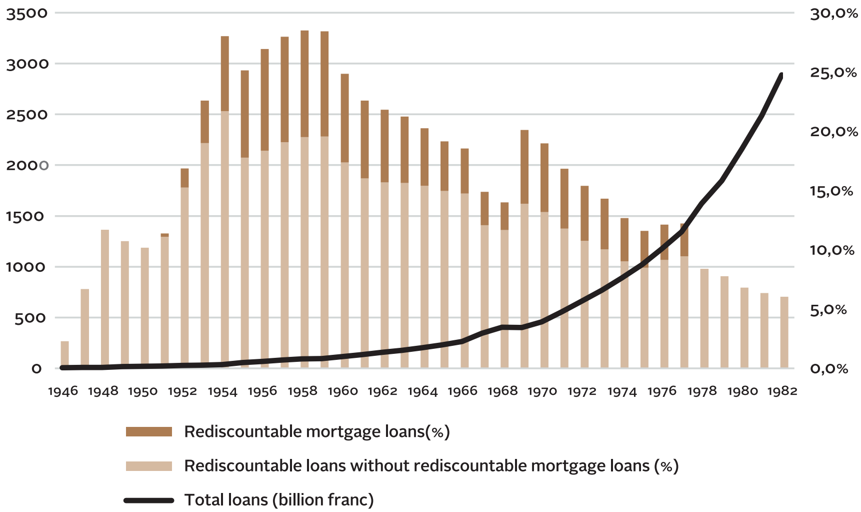
After the law, France had a total of 391 commercial, 45 investment and 8 medium- and long-term lending banks (*Thievaud 1997*). The initial aim of policy makers was to keep lending fully under state control, to regulate monetary creation and to channel available savings towards appropriate investment, and the state also wanted to control inflation by lending centralization. The law also ensured the liquidity and stability of the banking system, because each bank could only carry out these kinds of financial operations for which it had the necessary available financial resources for the given time period (*Patat- Luftalla 1986).*

The functioning of the banking system after the World War II

Facilitating medium-term lending was essential to finance the necessary investment projects. Thus, while before the war banks could only rediscount loans with a maximum maturity of three months at the central bank, the first measures of the interim government included the possibility for banks to discount loans with a maturity of five years. In the medium-term lending process, the company submitted a loan application to a bank (commercial or investment), which examined the application and, after approval, forwarded it to the competent public or semi-public lending institution specializing in medium- and long-term lending, which examined whether the loan application met the conditions for rediscounting. If it did, it was approved and declared eligible for rediscounting (*accord de réescompte*), which was finally discounted by the BdF (*Patat 1993).*

This led to a post-war boom in medium-term lending, as shown by the fact that, in absolute terms, the amount of this type of credit rose from 0.14 billion francs in 1946 to 1.76 billion francs in 1949. While the share of medium-term loans was 2.3% in 1946, it rose to 10% in 1949 and reached 21.7% by the mid-1950s (Figure 1).

Figure 1 Evolution of total lending (billion francs) and the share of discountable medium-term investment and mortgage loans (%)



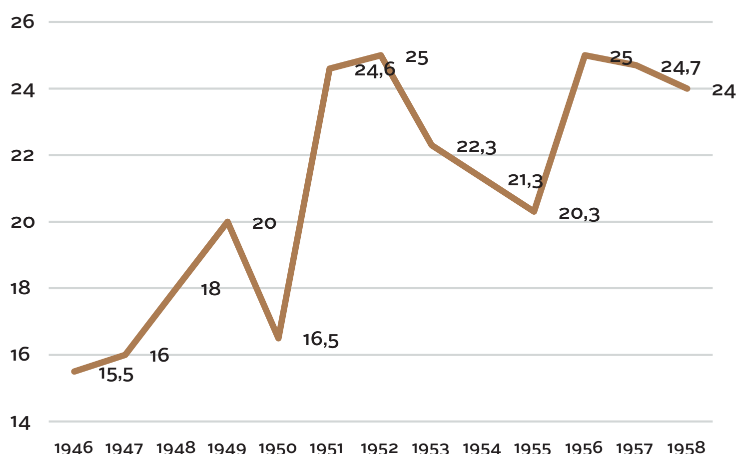
Note: Based on data available from CNC's annual reports. Values are in 1958 French francs

Source: based on CNC annual reports[9]

However, the rediscounting of medium-term loans was accompanied by an increasing role of the central bank in lending to the economy (Figure 2), so while in 1946 the central bank's share was 15.6%, it rose to over 20% from 1951 and reached 24% in 1958 (*Feiertag 2006*).

9 https://gallica.bnf.fr/ark:/12148/cb343983331/date.r="Rapport+annuel+du+Conseil+national+du+crédit".langFR

Figure 2: Change in the central bank's share of total loans between 1946 and 1958 (%)



Source: CNC report 1955:87 and 1966:166

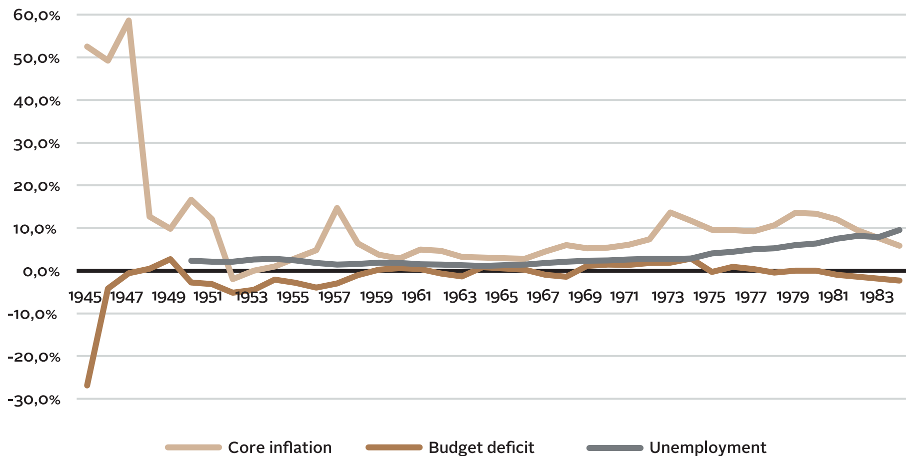
The lending guidelines were set by the CNC under the current five-year plan, so that the loans were usually granted to these economic actors in the industry sector that were given priority in economic planning. In addition, the state provided additional financial resources to the real economy through the Treasury and its subordinated financial funds (Modernisation Fund, Social and Development Fund, etc.) in the form of direct loans or interest rate subsidies. Thus, during the 1950s, the state financed 40-50 % of total loans and 80 % of investment loans through the Treasury and its subordinated financial funds (*Patat 1993*).

This investment and development policy generated large budget deficits, which successive governments usually tried to deal with in two ways: by mobilizing savings and by creating money (*création monétaire*), to which end the so-called treasury financing *circuit* (*circuit du trésorerie*) was set up. Within the framework of the circuit, the state forced financial institutions to deposit part of their available financial resources with the Treasury, which thus reclaimed part of the liquidity that it had made available to the various economic agents through direct loans or interest rate subsidies. This branch of the financing circuit mainly concerned financial institutions which were under the direct control of the State, i.e. nationalized banks and savings banks, or which had current account relations with the Treasury. Banks with which the Treasury did not have a direct link were forced to purchase government bonds from part of their resources (representing 25% of the available resources) under the *minimum government reserve* requirement. Finally, the central bank was indirectly involved, alongside banks and savings banks, through the refinancing of medium-term special development loans by the Caisse des Dépôts et Consignations (*Patat 1993; Loriaux 1991*).

Critical views on the banking system after the war

The aim of the post-war restructuring of the banking system was to break down "*the financial walls existing between the two world wars*" (*Luftalla-Patat 1986: 121*) and to provide adequate liquidity to the real economy, facilitating its modernization and development. However, this was not without danger. The first major challenge was almost the permanent struggle against high inflation. Initially, double-digit inflation (Figure 3) was driven not only by the government's lending policy, but also by the emergence of war savings in the economy and the additional liquidity provided by the Marshall Plan, but later on the credit system was clearly the main factor driving inflation (*Eck 2009, Braudel-Labrousse 1993*).

Figure 3 Evolution of core inflation, budget deficit and unemployment between 1945 and 1984 (%)



Source: macrohistory.net

Successive governments have been forced to resort to price controls and wage bargaining, and although they have tried to curb price increases by regulating the rediscount rate and the interest rate on government bonds, in many cases the rediscount rate has increased only slightly (for example, between 1947 and October 1948 the rate was raised from 2.5% to 3%, while inflation was around 58%) (*Patat – Luftalla 1986*). Instead, according to *Loriaux (1991),* in many cases they resorted to the instrument of selecting medium-term loans, i.e. fewer loans of this type were approved for rediscounting, which was a precursor to inter-firm preferential treatment. The effect of price controls and wage bargains, however, was undermined by the provision of credit that was always available '*after each wave of increases in wages and prices, since a higher nominal sum of operating funds was required, the volume of credit accorded invariably grew… The businessmen knowing that they could count on additional credit that they needed, may have opposed less resistance to nominal wage and*

price increases' (*Loriaux 1991:113).* The above observation, however, foreshadows the emergence of moral hazard on the part of firms as early as the 1940s, caused by the loans granted by the state.

In addition to the above, the banking profession itself was completely transformed, the constant money creation by the state and the quasi top-down lending policy relegated the role of bankers to a comfortable, risk-free executive position, and as one critic of the period put it "*bankers sometimes behaved not as businessmen but as agents of the paymaster*" (*Thiveaud 1997)*

The only outspoken critic of the existing system came from a classical liberal-conservative economist and politician Jacques Rueff, who pointed out weaknesses of the system to the Social and Economic Council in 1952: the present system "*works as if someone were constantly giving you* (to the conference participants) *banknotes for nothing, which generate false income, because it is not at all linked to real production, to value creation, while creating an unnecessary stock of cash. (...) In other words, the central bank gives you money for nothing or for something whose value is far below the value of the money you receive*' (*Feiertag 2006:556*) By the early 1950s, it had become clear to Rueff that one of the central problems of the system was the rediscounting of medium-term loans by the central bank, which he calculated would reduce the efficiency of the financial system by a factor of 20 compared to the efficiency of the central bank if only three-month loans could be discounted. On the other hand, however, his opinion indirectly pointed to the danger of moral hazard, whereby the State is lending for activities whose value and usefulness is questionable. According to Rueff, fiscal policy is only a secondary actor behind the factors that cause inflation: 'the *central bank is clearly responsible for the current inflationary policy and should therefore be immediately and strictly prohibited from discounting long-term loans*' (*Feiertag 2006:558*). His opinion was aimed at the heart of the credit-based economy, which provoked opposition from the central bank on the one hand and created political dissent on the other.

However, Rueff, together with former Prime Minister Antoine Pinay, drew up a comprehensive reform plan at the dawn of the Fifth Republic in 1958, which included full liberalization of the banking and capital markets, while also pointing out the problems caused by the system. On the one hand, the plan included mobilization of the household savings, i.e. liberalizing the constraints on the banking system, but most importantly it would have reduced the role of the central bank. It would have prohibited the rediscounting of medium- and long-term loans by the central bank, while also giving a greater role to financial markets. However, this would have entailed a complete dismantling of the existing lending-based economic policy system and a reduction in the role of the central bank (*Feiertag 2006).*

Although the Pinay-Rueff plan failed in terms of the financial system, it introduced significant budgetary cuts. In 1958, the franc was devalued twice, social spending was cut by 275 billion francs and 200 billion francs in new taxes were imposed. Politicians have learned that fiscal conservatism, keeping the budget deficit under control, helps to achieve public policy goals. Thus, in order to balance the budget, from the 1960s, the corporate sector and the wages were subjected to an increasing tax burden,

making the French corporate sector the most heavily taxed in Western Europe in the 1970s (Table 4) (*Loriaux 1991; Patat 1993*).

Table 4: Tax and contribution burdens for households and the corporate sector between 1970 and 1977

	France	United Kingdom	Germany	Netherlands	United States
Companies	17,00	12	12	14	10
Households	22,00	24	26	32	20
Total	39,00	36	38	46	30

Note: Values are expressed as % of GDP

Source: Patat 1982: 226

The increasing tax burden has contributed to the ossification of an economy built on debt, not to mention hampering innovation and modernization of companies. On the one hand, the tax burden worsened the financial position of industrial firms and increased their dependence on credit institutions; on the other hand, it increased the role of public and parastatal financial institutions in financing the economy, thanks to their major role in the rediscounting of long and medium-term loans (*Loriaux 1991).*

Modernization of the economy between 1952 and 1972

The question is, however, whether the expansion of credit and the deepening of financial intermediation, in which, as we have seen, the state has played an active role, has contributed to the modernization of the economy, has improved productivity, and has in short achieved the goal that policy makers set for the financial intermediation system. Our study based on the of the French statistical office covers the period from 1952, the end of the first five-year plan, which was still defined by reconstruction, to 1972, the last real 'peace year', that was beginning of the oil crisis (*Duby 2007*). The average growth rate for the analyzed sectors was 5.5%, with the fastest growth in the technical equipment industry (7.4%), energy (7.2%), intermediate goods (6.9%) and construction and public works (6.55%). In addition to the output of each sector, labor productivity also increased. It rose above average (5.5%) in energy (8.8%), intermediate goods (6.7%), agriculture (6.3%), consumer goods (6.2%) and machinery and equipment (5.7%) (Table 5).

The modernization of the economy is shown by the fact that, according to *Braudel-Labrousse (1991),* not only has productivity increased, but the structure of the French economy has also been greatly transformed. Thus, new key sectors emerged, which by 1972 had a much larger role in the national economy. In particular, the energy sector, intermediate goods, construction and technical equipment industries made significant inroads, while the share of agriculture alone and the food industry fell significantly (by 5.3 and 1.7 percentage points respectively) (Table 5).

Table 5: Changes in sectoral value added, labour productivity and their distribution by sector

	Increase in added value	Breakdown of value added by sector		Increasing labour productivity
Year	1952-1972	1952	1972	1952-1972
Agriculture	2,50	12	6,7	6,3
Agriculture and food industry	4,25	7,6	5,9	4,4
Energy industry	7,20	6,6	9	8,8
Industries producing intermediate products	6,90	6,4	8,3	6,7
Technical equipment manufacturing industries	7,4	11,4	16,1	5,7
Consumption industries	4,7	10,5	8,8	6,2
Housing	4,85	3,3	2,8	
Transport and telecommunications	5,2	6	5,7	4,3
Construction and public works	6,55	8,2	9,9	3,8
Services	5,3	13,1	12,5	2,7
Trade	5,35	14,9	14,3	3,3
National Economy	5,47	100	100	

Note: Values are based on 1959 base prices

Source: INSEE (Duby 2007)

As the French economy shifted towards the secondary sector, the post-war objectives and the public policy instruments – credit policy and a target-oriented banking system – achieved their goal and the country fully entered the industrialized world and, as Table 2 shows. France was among the five most developed countries in Europe by the early 1970s. Thus, we can state that our first hypothesis, i.e. that the deepening of the financial intermediation system in a country with a medium-developed status promotes economic growth and modernization, is correct. However, it is important to note that French industry produced mainly for its domestic, possibly less demanding, ex-colonial markets, while exporting little to developed countries, and the expansion of the European Economic Community increasingly intensified competition, raising questions about whether French products would be able to compete internationally (*Braudel-Labrousse 1993; Duby 2007).*

4. The road to reform: the 1960s, the "great moment" of the Fifth Republic

The reform of the banking system had been on the agenda since the establishment of the Fifth Republic but it was not implemented either because of political will or because of divergent views between the public policy actors (the central bank and the Ministry of Economy and Finance), but over time the political and the international environment have created the need for reform (*Feiertag 2006; Loriaux 1991*).

By the mid-1960s, the economy boom after 1958 seemed to be fading and inflationary pressures were rising again. On the private sector side, demand for credit continued to rise, while the new wave of repatriates from Algeria (1962) caused an unexpected and dramatic increase in demand, and the government was forced to raise wages to suppress increasingly violent labor's movements and strikes. To curb inflation, the central bank had to raise the discount rate, but the most radical step was the introduction of a credit limit system *(encadrement du crédit)* for banks. The CNC set a credit limit for every credit institution that define how much credit they could lend to the corporate sector. The goal of the government with this public policy measure was to keep a lid on lending. At the same time, the Treasury coefficient (*coefficient de trésorerie)* was introduced, obliging banks to hold at least 30% of their assets in Treasury bonds or in medium-term loans submitted for rediscounting. In addition, the *minimum reserves for government bonds* was maintained, but the required level of reserves was reduced from 25% to 17.5% (*Loriaux 1991*).

However, the demand for credit from the corporate sector continued to grow, as the scarcity of available financial resources was the main obstacle to growth for the corporate sector. Indeed, in the annual surveys of managers carried out in several consecutive years (1957, 1962, 1963 and 1964, and 1966 and 1969), in that more than 20% of the managers surveyed complained that they could not growth faster because they did not have sufficient production capacity, which they would need to raise additional financial resources to develop. *Carré-Dubois-Malinvaud (1973),* in their analysis of the evolution of investment and savings, concluded that there was a chronic excess demand, driven mainly by physical investment. However, in order to meet the expanding demand, it was essential to improve the savings rate of the population, while reducing public intervention in lending.

This made it clear that the liberalization of the French financial system was inevitable, that the state's role to financing the economy had to be reduced and banks had to be put in a position to allocate financial resources in the most appropriate way (*Bussiere et al 2005*).

The Debré-Haberer reform

The arrival of former Prime Minister Michel Debré at the Ministry of Economy and Finance has brought the necessary turnaround. He invited Jean-Yves Haberer to work together, who not belonged to the post-war stratum of high officials socialized in dirigisme, but he had a much more liberal approach to public policy affairs. He had

studied the American banking system, and therefore the Anglo-Saxon approach also became decisive for reform: '*three quarters of the reforms (...) were aimed at introducing in France the solutions that were native to North America*'[10] , Haberer remembered. (*Bussiere et al 2005*)

Debré was also urged by the approach of 1968, which marked the creation of the European single market. The government, too, felt that without a more competitive corporate sector, France would be vulnerable to German, Italian and Benelux competitors. It also wanted to improve the competitiveness of French companies by reforming the financial system. But it was essential to create a sound and modern financial intermediation system that could adapt quickly to changes in the economy. In addition to liquid savings, there were few financial resources available to financial investment, while the French capital markets were underdeveloped, and the government's fiscal austerity was also putting a strain on public investment financing schemes. The finance minister thus outlined the following lines of reform plans:

1. improving the financing of investment, especially in terms of allocating savings more efficiently and channeling them to business sector;
2. easing restrictions on bank specialization;
3. fostering competition in the banking sector, in particular the development of banks' branch networks, which would also help to better allocate savings;
4. promoting the development of financial technologies used by French banks (*Bussiere et al 2005*)

The first step of the reform (decree of 25 January 1966) was to reduce the barriers between commercial and investment banks. Thus, both commercial and medium- and long-term lending banks were allowed to invest more than 20% of the capital of non-financial corporations, and the former were also allowed to collect fixed-term deposits with a maturity of more than two years. The decree of 7 September 1967 authorized commercial banks to invest to 100% of their own capital in commercial and industrial companies. At the same time, investment banks were also allowed to accumulate fixed-term deposits of less than two years. The introduction of a compulsory central bank reserve requirement, modelled on the Anglo-Saxon one, replaced the less transparent treasury ratio introduced in 1960 and marked a transformation in the control of bank liquidity (*Bussiere et al 2005*).

One of the most important changes in the mobilization of household savings was that from 1967 onwards, all banks, without exception, were allowed to open branches anywhere in the country, so no CNC authorization was required. The bank branches hardly increased between 1946 and 1966, from 3 550 in 1946 to 4 070 in 1966, making it very difficult for banks to collect deposits and thus to deepen financial intermediation. This reform step firstly was initially met with strong protests from commercial banks, including the French Banking Federation, the central bank and

10 https://books.openedition.org/igpde/4663

the Treasury, who believed that it would mean a significant increase in banking costs (*Thievaud 1997*).

The channeling of private savings into the banking sector was facilitated by the liberalization of banking conditions (defining the minimum interest rate, commission system and value dates), following the CNC decision of 18 March 1966. A further change was that, while interest rates on demand deposits were abolished, while the state regulation of interest rates on long-term deposits was abolished, thus the government liberalized the setting of interest rates on deposits in order to channel savings into longer-term deposits. Debré continued his '*policy of savings mobilization*'. Housing savings accounts were introduced to finance real estate investments directly from private savings rather than through public funds (rediscounted long and medium-term loans) as provided for in the five-year plans, thus reducing the banks' dependence on the state (*Bussiere et al 2005 and Feiertag 2006).*

The Debré-Haberer reform has helped to increase the average maturity of loans from 5 years to 7 years, not to mention the fact that banks are obliged to finance three fifths of their loans from their own resources. Another important change was that the discretionary nature of the state over individual loans was removed, i.e. it was no longer necessary for the state to approve individual loans, which made lending faster and cheaper.

The reform wanted to increase the concentration of the banking system, as "*many banks, many costs*", so the goal was to create large credit institutions. As early as the 1950s and 1960s, the idea was mooted that there was a need for large domestic banks, which would then "*mean better productivity and lower costs*"[11]. Although only one merger took place during the reforms in 1966 and 1967, but in the 1970s it was a significant increase in mergers and acquisitions in the French banking sector (*Bussiere et al 2005 ; Muldur 1991*)

Impact of the Debré-Haberer reform

The Debré-Haberer reform fundamentally changed the French banking system. One of the most spectacular advances was the increase in the number of bank branches, which tripled between 1967 and 1974. There was a real competition between banks to open branches, helped by the fact that not only commercial banks and specialized financial institutions such as *Crédit Agricole* could open branches in any part of the country, but also investment banks (*Bussiere et al 2005*).

Credit institutions also expanded the range of services they offered, with the launch of home savings and, soon after, the first debit cards and ATMs. These new services were a clear sign that banks were turning their attention from the corporate sector to the retail sector, which in time bore fruit: while only two-thirds of households had a bank account in 1965, by 1990 95% did. At the same time, banks'

11 https://books.openedition.org/igpde/4663

internal administrative processes and financial markets were increasingly digitized, requiring significant investment by players of financial sector. This has meant a shift in the depth of financial intermediation from a quantitative to a qualitative approach.

The efficiency of deposit collection has improved greatly, as shown by the fact that while the volume of long-term deposits represented 26.5% of the banking system's liabilities in 1968, it had risen to 41.4% in 1973 and 49.7% in 1979. This increase in the volume of long-term deposits was accompanied by a sharp rise in the banking system's ability to finance the economy, which was accompanied by a 23% investment rate between 1961 and 1973: bank lending increased from 14 billion francs in 1967 to 85.2 billion francs in 1973 (*Bussiere et al 2005*) (Although lending was helped by the government's temporary abolition of the credit limit framework in 1970). The corporate sector turned even more to bank lending to finance investment and the amount of investment financed by bank loans quadrupling between 1970 and 1979 (Table 6). The advance of the banking system's lending is illustrated by the fact that the share of bank loans in the total loans increased from 61% in 1965 to 85% in 1974, including loans from specialized public institutions. (*Thievaud 1997*)

Table 6: Gross fixed capital formation and its financing between 1970 and 1979 (billion francs)

	1970	1974	1979
Gross fixed capital formation	103,7	164	263,8
Distribution of funding:			
Corporate savings	67,8	73,7	158,9
Share and bond issues	20,3	24,2	41,5
Bank loan	15,6	66,1	63,4

Source: Patat 1982:214

Not only the amount of credit has changed, but also the way of finance, due to a reduction in regulatory orthodoxy, which before the reform obliged banks to finance long-term loans only with long-term deposits. Thanks to the reform, short-term loans were displaced by medium- and long-term loans in banks' loan portfolios, so that the latter increased from 30% to 50% of the corporate loan portfolio in 1979. Another important change was the reduction in the role of the medium- and long-term lending banks and treasury to finance corporate investments. However, the rediscounting of medium- and long-term loans remained and even increased in the 1970s, as shown that they accounted for almost half of the central bank's assets by 1972 (Table 7) (*Bussiere et al 2005; Loriaux 1991*).

Table 7 Changes in the assets of the Central Bank between 1962 and 1972 (%)

	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
Bank refinancing	30	27,7	25,5	27,7	27,4	26,7	45,5	55	52,4	61,3	49,7
Treasury funding	30,2	29,2	27,9	23,7	23,2	27,6	30,8	33	20,4	18	10,1
Bank reserve	39,8	43,1	46,6	48,6	49,4	45,7	32,7	12	27,2	40,7	40,2

Source: Loriaux 1991:196

Although no large mergers had taken place by the time when reform was introduced, from the 1970s onwards market concentration began to take hold. *Muldur (1991)* points out that the expansion of the branch network, the digitalization and the financing of advertising campaigns and other services to attract consumers were associated with substantial costs that many credit institutions could no longer recover. This is illustrated by the two major banking groups that emerged during the period, Paribas and Compagine de Suez, which have steadily expanded the range of banks under their control over the years. The former group thus included five major credit institutions, the latter three, while a large number of regional and local banks were under their control. The degree of concentration in the market is shown by the fact that, while in 1965 there were 276 French-owned credit institutions in the French banking sector, in 1985 there were only 214. The concentration of the banking market mainly affected regional and local banks, some of which either went bankrupt or were integrated into a larger bank or banking group through acquisitions or mergers (*Thievaud 1997*).

The reduction of state intervention and market liberalization in the banking system generated the necessary competitive processes, which culminated mainly in technology, marketing, efficiency and competition for depositors, and pushed the financially less strong banks under the big banking houses, increasing market concentration and efficiency. The market restructuring that took place during the 1970s led to four French banks being included in the list of the world's ten largest banks by the 1980s. The liberalization processes described above show a reduction in state intervention in the banking system, which ideally would be accompanied by a reduction in moral hazard, as firms would be more likely to trust market processes and decisions rather than relying on state intervention alone, due to reduced state intervention. However, as far as our hypothesis is concerned, it is precisely in the area that the state's interference would not have decreased, which would have been associated with a reduction in moral hazard, because "*this level of concentration in the banking system did not affect bank interest rates, which were still under strong state control and were only marginally affected by the increase in competition between banks.*" (*Thievaud 1997:54*). In fact, in 1973, in the face of recurrent inflation caused by the symptoms of the crisis in the international financial system, the double devaluation of the franc and the introduction of the floating dollar, the government reintroduced

the credit limit framework, which again implied significant state intervention in credit policy (*Eck 2009*).

5. End of a story

Following the reform, criticism of the role of the French banking system in the economy became increasingly strong from the 1970s onwards.

The state-controlled banking system as a barrier to development

There is no clear view of the above reforms in the literature, but before examining the different positions, it is worth typifying each financial system. All economists agree that a '*state-based system*' of finance emerged in France after the World War II because the state decided which company or sector, or type of company (large exportable companies, small and medium-sized enterprises, high-tech companies or industries in difficulty) would receive the bulk of the financial resources. In addition to the state-led banking system, a distinction can be made between the German, so-called *bank-based system*, where the economy is financed primarily through bank lending, and the Anglo-Saxon model, where companies are financed primarily through the issuance of corporate bonds on the financial markets (*market-based system*) (*Bussiere et al 2005*).

According to John Zysman, the French banking system, despite the reforms of the 1960s, remained a state-controlled banking system in the 1970s. In fact, according to Zysman, the state-owned financial institutions that promoted medium- and long-term lending remained dominant, still accounting for more than a third of this type of lending in 1975, compared with the commercial and cooperative banks, which accounted for 48.3%. These banks continued to maintain their special status, which significantly distorted competition in the market, not to mention the fact that the transparency of the resources provided to these types of parastatal and public financial institutions was in question (*Andrews – Hoffman 1980*).

Contrary to Zysman's view, *Loriaux (1991)* argues that the reforms of 1966-1967 greatly strengthened the position of French banks "vis-à-vis" the state and increased the financial dependence of the corporate sector on the banking system through increased bank lending. The reform of the banking system has facilitated the banks' greater role in finance of the real economy, largely due to the reduction in the banks specialization. Thus, the French banking system has clearly moved towards a bank-based system and even the regulatory tightening of the 1970s did not change this trajectory.

However, even though the necessary reforms were made in the late 1960s, the state still had a significant role to shape the lending policy through the CNC: it could continue to set lending and rediscount rates and in 1973 it reintroduced the credit limit framework. Thus, according to *Loriaux (1991),* state-directed lending policy, together with (and in spite of) the reforms of 1966-1967, further increased bank

lending and thus the dependence of firms on the banking system, which helped the dirigiste state to flourish. Indeed, critics (*Loriaux 1991; Stoffäes 1978; Duby 2007*) have argued that the state channeled credit to the most exportable firms through credit limit frameworks and interventionist interest rate policies to balance the current account, but that this did not mean that these firms had the greatest potential for innovation and growth. On the contrary, there were no successful large French companies in sectors that had experienced significant growth in the 1970s, such as household electronics or the innovative computer sector. Moreover, government industrial and credit policies often siphoned off resources from viable and innovative small and medium-sized enterprises. The main criticism, however, has been that the French government, armed with a range of instruments to regulate credit policy, have been unable to prevent that financial resources flowed to firms in declining or less competitive industries, due to the close links that have developed between firms and government officials over the past decades (*Hayward 1986*; *Loriaux 1991*).

A similar conclusion is reached by *Stoffäes (1978)*, who examined the competitiveness of the French economy, and within it the industrial sector, in the 1970s. He concludes that '*the crisis highlighted the weaknesses of the structure of foreign trade and the French industry, which was virtually pinched by its main competitors (Germany, Japan, the United States and the new industrial countries of Taiwan, South Korea, Hong Kong, Singapore, Mexico, Brazil, etc.)*' (*Duby 2007:357*). Thus, exports of technical equipment and consumer durables to developing countries and Eastern Europe, usually guaranteed by interstate agreements, were the main source of rapid growth, while French products were less competitive in developed markets, not to mention the dominance of German, Italian and Japanese consumer durables. In many cases, French industry relied on products such as textiles, clothing, leather and footwear, which were under threat from emerging countries. It is true that there were industries such as machinery, intermediate products and high-tech equipment (defense, aeronautics and nuclear products) which were internationally competitive, but these benefited from substantial state support from the French government. Thus, *Stoffäes (1978)* identifies the main obstacles to the development of French industry, apart from expensive labour, high taxes on companies by OECD standards and misused R&D expenditure, as being the failure of public industrial policy, including inefficient and often damaging lending policies. Rather than encouraging the emergence and development of companies in new industries, this policy perpetuates bad practices and, in turn, makes French products less competitive and hinders the modernization of the product structure.

A similar conclusion is reached by *Loriaux (1991)*, who argues that bank financing and strong state intervention have also helped the survival of declining sectors, which could have been eliminated much sooner by the complete abolition of the latter and a financing model based on corporate bond issuance. Thus, as we hypothesized, the banking system has become more of a cog in the wheel of modernization than an engine. Thus, the Mayoux report of 1979 envisaged changes in the 1980s, such as the decentralization of the banking system, the creation of universal banks, the abolition of the credit limit framework and interest rate controls, while also giving a greater

role to capital markets, not to mention questioning the usefulness of central bank rediscounting of medium-term loans (*Thievaud 1997* , *Loriaux 1991*)

Full banking market liberalization

The complete liberalization of the French banking system was carried out by a left-wing government, imposed by their own misguided left-wing economic policy reversal. In 1981, the socialists embarked on a major fiscal loosening, including wage increases, drastic increases in social and family benefits (between 12% and 81%) and increases in pensions. Such a rapid increase in purchasing power has been accompanied by a rise in inflation, driven not only by this but also by tax increases on the French corporate sector because the government wanted to finance social benefits by raising taxes on companies. This led to a fall in investment by the French business sector (investment rates fell by 10% in 1981). Thus, although the high social subsidies generated extra demand, they were eventually eroded by inflation, while the high tax burden left the French business sector unable to respond to the increased consumer demand, which, combined with high inflation, put imported products in a favorable position and posed a major challenge to the French business sector, undermining its competitiveness.

The new government also nationalized credit institutions with total deposits of more than one billion French francs. This affected 38 credit institutions directly, but as in many cases a parent bank had been nationalized, the scope of state control was much wider through subsidiaries. As a result, 116 of the 197 banks remained independent from the state, but they held less than 9% of total deposits, leaving the French state, directly or indirectly, dispose above 91% of total bank system deposits. The government's goal with the banks nationalization was to facilitate the financing of key industrial development projects, to control banks' lending policies and to reduce companies' borrowing costs by regulating banking costs. Banks were obliged by the CNC to lend as much as possible to small and medium-sized enterprises. However, wave of bank nationalization in the 1982 proved to be a short-lived interlude, as by the 1980s global economic conditions had changed. The French economy had become much more deeply integrated into the international economy, and the solutions devised for such closed economies were no longer having the desired effect (*Eck 2009, Hall 1986*). Thus, according to *Thievaud (1997),* the goal of the reform approved in 1984 was to standardize, renew and reduce the regulations affecting the banking system; to promote greater competition in the sector and to simplify the bankers' job. To this end, uniform regulations were introduced for all credit institutions, supervised by the same supervisory bodies. Although the CNC remained in place, its role was significantly reduced, and its main task was to give opinions on new credit products, and it lost its right to regulate the credit market directly, not to mention the complete abolition of credit limit policy and lending rates were defined according to the market. The legislation finally abolished any legal distinction between commercial and investment banks, paving the way to universal banks. Finally, it opened the capital markets to companies, which were

allowed to issue short-term bonds up to 10 million francs, among other things, that gave a helping hand to reduce the dependence of the corporate sector on bank loans (*Eck 2009; Loriaux 1991).*

From 1986 onwards, the state began privatizing the nationalized banks, and in 1987 six banking groups were privatized, bringing the total to 33 banks. In the first round of privatization, the best-performing and most marketable banks were offered to investors, while the remaining six were sold by the state only later, in the 1990s. But whether this late liberalization of the banking and credit markets contributed to further modernization of the economy, or whether companies voted with their feet because of the increasing tax burden and the rising cost of labor, is beyond the scope of this paper (*Eck 2009*).

6. Conclusion

The post-war deepening of financial intermediation, in which state intervention and regulatory policy played a major role, helped France to avoid the trap of the middle-income countries and to join the advanced industrialized countries through the modernization of its economy. So according to our first hypothesis, a link between deepening financial intermediation and economic growth can indeed be established. Over time, however, it was the banking system itself, and within it the strong state intervention, that prevented further modernization of the economy, as the latter hindered the further deepening of the financial system and the more efficient allocation of credit toward the corporate sector, thus approving our second hypothesis. Moreover, state intervention in the credit system has increased moral hazard from the beginning, creating a dependency from the part of the corporate sector on state-subsidized and discounted credit, which has not been helped by the partial liberalization of the system. On the contrary, it has only deepened dependence on bank lending system, while reducing companies' propensity to innovate, not to mention draining resources away from more innovative small and medium-sized enterprises, so this approves our third hypothesis. All these deficiencies were amplified by the oil crisis in the 1970s, which highlighted the lack of competitiveness of the French corporate sector; the insufficient French presence in the leading technological industries; and the strong dependence between bank lending and the state, whereby companies turned to state-regulated lending system rather than restructuring themselves, while the state was confident that this would prevent redundancies and mass unemployment.

The history of the transformation and reforms of the French banking system can also provide lessons for today's challenges. As the economic modernization and catching-up process in France after the World War II required the deepening of financial intermediation and banking system and state regulation served the modernization process, so the catching-up process of the Central and Eastern European states after the regime change and the current European reindustrialization efforts have made it essential to create an appropriate financing background and to

develop an proper regulatory framework for the banking system. The Hungarian credit policy of the past decade, including certain phases of the Loan Program for Economic Growth and the preferential credit facilities offered by special state banks such as the Hungarian Development Bank and Eximbank, can also be interpreted in this context. At the same time, there is a risk in the current banking and financing system that, on the one hand, excessive state intervention in the lending system may discourage market-based lending by banks and, by the time, limit the access of the corporate sector to financial resources; on the other hand, the permanent nature of financing based on preferential credit facilities may also impoverish companies, limiting their innovative capacity and their efforts to improve efficiency. ■

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