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The Long Shadow of Vichy

The Economic Consequences of Occupation

Eugene N. White

Although France had capitulated once before to Germany in 1871, the military and political collapse after defeat in 1940 left Hitler with the power to dictate peace terms. Germany's subsequent failure to invade Great Britain meant that there would be a long, protracted war, one where the efficient extraction of resources would play an essential role. Control of the second largest continental economy, with its large industrial base, thus gave the Nazis an important advantage. The general collaboration of the remaining French political and economic elite and the passive acquiescence of most of the population ensured a steady flow of resources to the Reich. Occupation payments extracted over a quarter of GDP annually, and a draft of labor to Germany reduced the productive potential of the economy.

The occupation resulted in a large drop in French living standards, and the bitter fight that drove the Germans from the country left a broad swatch of destruction. Liberation delivered France from its oppressors, but occupation had profound longer term consequences for the French economy. The devastated economy, the unbalanced budget financed by printing money, and the huge debt burden left the new governments of the Fourth Republic with few palatable choices for stabilization. Rapid inflation eroded the real value of the debt, but continued deficits were funded by money creation. Fear of the political consequences of a return to a market economy in the face of massive imbalances led the leaders of liberated France to maintain and expand Vichy's controls as they directed production, focusing on heavy industry at the expense of consumption. The Fourth Republic did not fully confront the political legacy of Vichy, re-absorbed some of Vichy's political elite, and retained much

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of its *dirigiste* leanings in economic policy. By most standard indicators, France enjoyed rapid growth in the early 1950s; yet, it was hounded by repeated crises because of its failure to fully address its inherited problems. The move to a more market-based economy and an escape from the economic legacy of Vichy that began only after the political and economic crisis of 1957–1958, coupled with the signing of the Treaty of Rome, forced a radical change in regime.

The Creation of Vichy

After Hilter's invasion of Poland on September 1, 1939, Britain and France declared war on Germany. Although there was fierce fighting in Norway and on the high seas, the French only briefly probed Germany's western defenses. In spite of its advantageous position and its commitments under the Franco-Polish military alliance, the French army pulled back and did not undertake any significant operations for the next several months, leaving Poland to its fate. This "Phony War" on the Franco-German front continued until the German army was repositioned and launched its May 10, 1940, assault. By June 14, Paris was occupied, and the government had retreated to Bordeaux.

Although the Prime Minister Paul Reynaud wanted to continue fighting, most of his cabinet did not and he resigned. President Albert Lebrun then appointed the 84-year-old Marshal Philippe Pétain as the President du Conseil of the Third Republic. On June 16, the government asked for an armistice, which was signed on June 22. When Parliament met in Vichy on July 1, 1940, Pierre Laval persuaded the senators and deputies to vote plenary powers to Pétain. They voted 569 to 80 to do so, granting Pétain the power to write a new constitution that gave him legislative, judicial, and executive powers. The Third Republic was terminated and the French State proclaimed, with Pétain receiving the title of Chef de l'État français.

This new political regime governed a smaller and divided France. The northern departments of the Pas de Calais and the Nord along the Belgian border were handed over to the German military government in Belgium; the departments of Moselle, the Bas Rhin, and the Haut Rhin were annexed to the Reich; and small zones near the Italian border were handed over to Italy as a reward for joining in the war. The rest of France was split into two zones. A Germany military government ruled the "Occupied Zone" in the north and west, and the new French government headquartered in Vichy governed the "Free Zone" in the southeast.

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Despite the political division of the country, economic policy was set by Vichy and was largely uniform across the two zones, though its laws when implemented in the Occupied Zone were subject to the approval of the German authorities in Paris. This limited independence was terminated in November 1942, when the Germans, deeming the Allies in North Africa a threat to southern France, marched into the Free Zone.

Economic Collaboration

Long overlooked or denied, French collaboration with the German occupiers is now acknowledged to have been extensive. Vichy broadly and sometimes eagerly cooperated with the social and economic dictates from Berlin. Early historians of Vichy portrayed the regime as adhering to a minimal collaboration of the state according to the terms of the armistice agreement. While this amnesiac view served postwar Gaullist political interests, it denied the widespread voluntary collaboration that enabled the Germans to extract vast resources from France.[1] This willingness to cooperate with the onetime deadly enemy was a consequence of the change in the French worldview after the military and political collapse of the Third Republic. Unlike France's dramatic and quick defeat by Prussia and its allies at Sedan in September 1870, which was followed by a spirited but ultimately doomed resistance to a superior invading force, defeat in 1940 led to resignation. Most officials and the public accepted Germany's victory as establishing a new European order centered in Berlin.

Marshall Pétain and his chief ministers – Pierre Laval and Admiral François Darlan – believed that Britain would eventually surrender, leaving Germany master of Europe. Hence, cooperation with Germany was, in their view, essential. Collaboration with the Nazis was broad and ranged from the enforcement of anti-Semitic policies to production of material for the German war machine. Like the roundups of French and foreign Jews, where French police and some members of the public actively assisted, economic cooperation was voluntary and sometimes enthusiastic.

Pétain's willingness to collaborate suited Hitler well, as it ensured the passivity of the French population. As a result, few German troops

[1] For surveys on the historiography of Vichy, see Robert O. Paxton, *Vichy France: Old Guard and New Order* (New York, 2001); Julian Jackson, *France: The Dark Years, 1940–1944* (Oxford, 2001); and Stanley Hoffmann, "Vichy Studies in France: Before and After Paxton," in Sarah Fishman, Laura Lee Downs, Ioannis Sinanoglou, Leonard V. Smith, and Robert Zaretsky, eds., *France at War: Vichy and the Historians* (New York, 2000).

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were required to maintain control. French fascists were held back as they would have alienated many otherwise acquiescent French, and Germany was assured of a neutralized state from which manpower and resources could be extracted.[2] Although racist ideology often led Germany to vary its treatment of the conquered nations of Western Europe and its satellites in Southern Europe, the extraction of resources was roughly comparable.

Resources from conquered states were essential to the German war machine's success. Even at the outbreak of the war, Germany was severely constrained by its resources. Foreign exchange reserves were miniscule compared to its need to obtain the raw materials for rearmament. Blitzkrieg can be seen as a policy designed to bring Germany a quick victory before its opponents could mobilize their much greater resources. Britain's victory in the Battle of Britain and its naval blockade meant a long war, with much higher demands for raw materials and labor than Germany initially anticipated.[3] The need to exploit the conquered realms to the West and the East impelled the Germans to siphon off coal, iron ore, oil, food, and other supplies from its defeated foes at the same time that the German military and military contractors were placing orders with firms in the occupied countries. With the continent's second largest industrial economy, France was a prize. French manufacturing was reoriented to supply the country's new Nazi masters and their war machine. In addition to war material ranging from small arms to aircraft, the Germans took astonishing quantities of other capital goods, including trucks and locomotives.[4] The needs of the German war machine rose after its defeat at Stalingrad, and its demands on France quickly increased. Ultimately, it is difficult to conceive of how Germany would have been able to supply a two front war without the resources it extracted from the vast regions of Europe it occupied.

Occupation Payments and Their Consequences

As the Germany army advanced across France, it issued an occupation currency, the *Reichskreditkassenschein*, that its troops used as legal tender. To prevent any inflation in Germany from its issue, the currency could not be used in Germany or exchanged against the Reichsmark. In France, the Banque de France was forced to redeem *Reichskreditkassenscheine* for

[2] Yves Durand, "Collaboration French-style: A European Persepective," in Fishman et al., *France at War*.

[3] Adam Tooze, *The Wages of Destruction: The Making and Breaking of the Nazi Economy* (New York, 2006).

[4] Jackson, *France: The Dark Years*, 234.

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francs. Altogether, 50 billion francs' worth of *Reichkreditkassenscheine* were issued and charged in the Banque's accounting as a liability of the French government. Consequently, they are treated as part of occupation payments, as they had the same monetary consequences as the occupation payments that superseded them. The *Reichkreditkassenscheine* were overvalued relative to the franc by at least 50 percent, making French goods extraordinarily cheap for the German army.[5] When France allowed its trade to be controlled by the Reich by accepting a bilateral clearing agreement with Berlin, the same exchange rate was applied to the Reichsmark exchanges. While German importers could buy goods at this overvalued rate, imports were subject to strict government controls and foreign exchange was tightly regulated. By 1944, the result was a French trade surplus of 111.4 billion francs that represented a vast transfer of resources to the Reich, which was paid for by a monetary expansion in France.

Even bigger were the occupation payments. The occupation payments were not just to pay for the costs of the occupation forces and the German administrative machinery but also to enable Germany to buy weapons and civilian goods. At the armistice talks, the French delegation was informed that these payments would be set at 20 million Reichsmark, or 400 million francs, per day. This transfer of purchasing power was put into effect by the establishment of an account for the German authorities at the Banque de France. This pure augmentation of the money stock fueled inflation, leaving Vichy to confront its consequences or to try to offset it by raising taxes or selling bonds. This daily transfer was even more than the Germans could spend, and they began to accumulate unspent credits. Consequently, in May 1941, the daily payments were reduced to 15 million Reichsmark, or 300 million francs, per day. But when the disasters on the Eastern front produced increased demand for resources, the payments were raised to 25 million Reichsmarks, or 500 million francs, per day.[6]

Table 1 records the total annual payments made to Germany during the occupation and the payments as a share of GDP.[7] They are given in current French francs to avoid adding in distortions encountered by

[5] See Alan S. Milward, *The New Order and the French Economy* (Oxford, 1970), 55.

[6] See Banque de France, Assemblée Générale des Actionnaires. *Compte Rendu* (Paris, various years) for the years 1940–1944.

[7] A detailed description of how these payments were assembled and the measures of GDP is given in Filippo Occhino, Kim Oosterlinck, and Eugene N. White, "How Much Can a Victor Force the Vanquished to Pay? France under the Nazi Boot," *Journal of Economic History* 68 (2008): 1–45, here, 7–8.

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TABLE 1. *French Occupation Payments*

	French GDP (current FF billions)	Occupation Costs (current FF billions)	Costs as a Share of GDP (%)
1939	433		
1940	419	81.6	19.5
1941	392	144.3	36.8
1942	424	156.7	36.9
1943	493	273.6	55.5
1944	739	206.3	27.9

Source: Occhino, Oosterlinck, and White, "How Much."

measuring the inflation in the presence of price controls and other restrictions. These figures omit the looting that initially followed the German invasion in 1940. Those seizures were estimated to total 154 billion 1938 francs, of which approximately one-third was military equipment.[8] The shares of GDP may somewhat overestimate the size of the payments because of the large but difficult to measure black market, which was thought to reach be as high as 15–20 percent of GDP.

From just under 20 percent of GDP, payments to Germany rose to over a third of output in 1941 and 1942. After the defeat at Stalingrad, German demands increased and the French economy contracted further, raising the funds at the disposal of the German authorities to over half of GDP. If the percentages given in the right-hand column of Table 1 are converted to 1939 franc values and added up, the total comes to 111 percent of France's GDP in the last prewar year. If looted goods are included, the total rises to 147 percent. To give a sense of the burden this placed on the French economy, some comparisons are useful. The reparations demanded from the French by the victorious allies after 1815 amounted to about 18–21 percent of GDP; those imposed after the Franco-Prussian war in 1871 reached 25 percent. The Third Reich felt it was entitled to levy a crushing burden on the French after 1940 because of the reparations Germany had to pay after World War I, which the best estimate puts at 83 percent of GDP. In the end, Germany did not pay, whereas Vichy France did.[9]

[8] Milward, *New Order*, 82–83.

[9] Eugene N. White, "Making the French Pay: The Costs and Consequences of the Napoleonic Reparations," *European Review of Economic History* 5:3 (2001): 337–365; Adam Klug, "The Theory and Practice of Reparations and American Loans to Germany, 1925–1929," Working Papers in International Economics, G-90-03, International Finance Section, Princeton University 1990.

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What kind of cost did these occupation payments place on the French? The first step to answering this question is to make an estimate of the welfare burden in terms of reduced consumption based on the least costly means. The optimal way to pay a large one-time imposition, whether it be a nation's payment to a foreign power or a family's payment for a house, is to spread it out over a long period of time so that consumption is not drastically reduced in a single or a few years but "smoothed" over time. In the case of payment to a foreign country, the efficient means is to contract a long-term foreign loan.[10] Under the most favorable circumstances, typical of the late nineteenth-century French economy, of 2 percent real annual growth and an interest rate of 4.4 percent, the debt service on such a loan – assuming that it would be feasible to borrow the full amount in this optimal world – would be 2.6 percent of GDP, which is also the annual reduction in consumption.[11] Although seemingly small, that reduction, it must be emphasized, is the absolute minimum and that it is larger than the burden of reparations imposed after the Napoleonic wars (1.2–1.4 percent), the Franco-Prussian War (0.7 percent), and World War I (2.5 percent).[12] However, in those earlier cases, there was access to the international capital markets and so the actual or potential (in the case of Weimar Germany) costs were much closer to the minimum. Vichy France was cut off from the rest of the world economy, and, therefore, its payments would be substantially more burdensome – still assuming that all occupation costs could be borrowed.

To make the occupation payments using internal resources, the French government had three choices: money creation, taxation, or debt issue. Given the means by which the Germans gained resources – by using the *Reichkreditkassenschein*, by accessing funds from their account in the Banque de France, and by the bilateral exchange agreement – the Germans' actions would lead to money creation and an inflation tax if the French authorities did not intervene. The French government could have accepted this outcome, but it was determined to minimize the inflationary effects of the occupation payments by raising taxes to reduce domestic consumption or by selling bonds to retire the money created and spread the burden over future years. During the years 1940–1944, money creation, taxation, and debt issue accounted for 34 percent, 30 percent, and 36 percent, respectively, of France's transfer of resources to Germany.[13]

[10] See Occhino, Oosterlinck, and White, "How Much," for a complete description.
[11] If one includes the looting, this would rise to 3.4 percent.
[12] White, "Making the French Pay."
[13] See Occhino Oosterlinck, and White, "How Much," 9–10.

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Although Vichy was able to reduce some of the inflationary potential of occupation payments, the distortionary character of these methods raised the costs and reduced French consumption far more than the theoretical minimum.

Containing inflation was no simple task in a shrinking economy, and the government in Vichy found it hard to raise taxes. Instead, the primary approach of both Vichy finance ministers, Yves Bouthillier and Pierre Cathala, was to attempt a *politique de circuit*, a "policy of closing the circuit," by mounting a vast campaign of bond sales to obtain the cash with which the French state could reduce its liabilities on the balance sheet of the Banque de France from the creation of German funds. The large-scale sale of bonds would, of course, cause bond prices to drop and yields to rise – producing an unacceptable increase in Vichy's borrowing costs – and so this policy was complemented by one of financial repressions to compel financial institutions to buy bonds and restrict the asset choices of the public. The rationing that accompanied price controls also left the public with funds that they had little choice but to deposit in financial institutions, adding to banks' ability to absorb bonds. As a result, the yields on *rentes* (French long-term bonds) were kept at about 3 percent even though inflation was higher. Policymakers considered it of vital importance to limit inflation so the postwar French economy would not have to cope with the disequilibrating effects of a rapid inflation, as experienced after World War I.[14] The willingness of policymakers to accept this policy of sacrifice was predicated on the assumption that France would be integrated into a Europe dominated by victorious Nazi Germany.

The yearly shares that taxation, debt, and money (inflation) resulting from the *politique de circuit* contributed towards occupation payments are shown in Table 2. As the table makes clear, the *politique de circuit* was vigorously pursued. Higher taxes covered over 30 percent of occupation payments for all but the first year. Debt soaked up between a quarter to half of occupation costs, but that was not enough to prevent very substantial increases in the money supply that drove a rising rate of inflation. Money growth was inevitable given the difficulty of raising taxes in a shrinking economy and of selling bonds when yields were purposely kept low.

However, there were limits to the ability of bond sales to soak up the vast monetary expansion and keep interest rates low. Wage and

[14] Ibid., 13–14.

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TABLE 2. *Share of Occupation Costs Financed by Taxes, Debt and Money 1940–1944*

	Taxes (%)	Debt (%)	Money (%)	Occupation Costs (billions of francs)
1940	25	27	44	81.6
1941	30	34	34	144.3
1942	36	26	40	156.7
1943	30	35	37	273.6
1944	30	52	15	206.3

Source: Occhino, Oosterlinck, and White, "How Much."

price controls that had been introduced in 1939 were expanded. The results were inevitable: shortages, rationing, and a large black market. Wages fell far behind prices, and when coupled with extreme rationing, the public suffered. Based on rations, the adult daily intake of calories fell from 2,500 in 1939 to a low point of 1,200. Those who could afford to buy food on the black market were able to make up some of the caloric shortfall, but, on the whole, nutrition declined and mortality rose.

The Shrinking Economy: Capital and Labor

The ability of the French to transfer resources to their German masters was substantially reduced by losses of capital and labor. Estimates of the capital stock, including production capital and housing stock, are fragile, but they indicate dramatic declines in productive capacity from destruction and depreciation. In 1956 prices, the average value of gross productive capital fell from 59 billion francs for the years 1931–1940 to 15 billion francs for 1941–1945.[15]

The labor force also experienced a significant decline. In 1938, France's population stood at 42 million. Out of a total labor force of 19.5 million, 16.4 million people were employed in the productive sectors.[16] The loss of territory to Germany and German-occupied Belgium lowered the population by 1.9 million. If the labor force participation rate was constant across regions, the labor force would have fallen by 750,000.

[15] Jean-Jacques Carré, Paul Dubois, and Edmond Malinvaud, *French Economic Growth* (Stanford, 1975), 534.

[16] The latter exclude unemployed, draftees and government officials; Carré, Dubois, and Malinvaud, *French Economic Growth*, 59.

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Approximately 300,000 French perished in the brief war, and 1.2 POWs remained interned in Germany, lowering the productive work force to 14.1 million. Conditions in Vichy France led to a further annual shrinkage of the labor force of 100,000.[17]

Faced by the need to send more and more men from its factories and fields to one and then two fronts, Germany drew upon the POWs in its custody and then drafted foreign civilian labor to fill this void. In addition, Berlin was increasingly concerned that production of war goods in occupied Europe was not as efficient as in Germany, and therefore decided to draft foreign nationals to work in German factories and at German construction sites. Fritz Sauckel, the General Plenipotentiary for Employment of Labor, was put in charge of drafting labor from all over the Reich's empire. Although some officials, such as Albert Speer, wanted to limit this transfer because they feared it would provoke flight and armed resistance, the program proceeded.

The French draftees were part of a pan-European draft. By 1944, 20 percent of Germany's labor force, 7.9 million workers in all, was drawn from abroad.[18] The total number of French workers sent to Germany equaled 3.3 percent of the French population. Belgium (3.4 percent) and the Netherlands (3.0 percent) sent similar shares of their populations.[19] France supplied far fewer workers than Poland or the Soviet Union, but a larger portion of them were the skilled and semi-skilled workers German industry desperately needed.

The labor draft to Germany under the program of the Service de Travail Obligatoire (STO) cut the working population further, although some POWs were permitted to return in exchange for civilian workers. The composition of this captive French labor force, which crested at nearly 1.4 million, changed over time (Table 3). This labor draft, largely of male workers, would have driven up wages under normal circumstances and have caused more elderly people, women, and children to enter the labor force; it was mitigated somewhat, however, by wage and price controls. In spite of Vichy's propaganda efforts, the STO was correctly perceived as dangerous forced labor by the segment of the population at risk of being drafted. Rather than be drafted to Germany, many young French men and women chose to flee, joining the swelling ranks of the Resistance. The loss in labor alone was very costly for France and led to a continued

[17] Occhino, Oosterlinck, and White, "How Much," 23–24.
[18] Tooze, *Wages of Destruction*, 517.
[19] Jackson, *France: The Dark Years*, 234.

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TABLE 3. *French POWs and Civilian Workers in Germany*

	May 1939	September 1941	November 1942	Fall 1943	August 1944
French Civilian Workers in Germany	6,669	48,567	134,518	649,000	654,782
POWs	None	952,000	931,000	739,000	599,967
Total	6,669	1,000,567	1,065,518	1,388,000	1,254,749

Source: Occhino, Oosterlinck, and White, "How Much."

fall in GDP even as German demands for greater transfers of resources placed increased strain on the standard of living.

The Burden of Occupation

The fragile nature of reconstructed national income accounts makes a precise measurement of the decline of GDP difficult, but it is clear that the magnitude was enormous. In the first comprehensive attempt to measure the shrinkage of Vichy's economy, Alan Milward found that by 1943, output had fallen by about a third of its 1938 level.[20] Newer GDP data shows that GDP had fallen by 25 percent by 1943 and 47 percent by 1944,[21] although these numbers should be revised upwards by 15–20 percent because black market activities are not included. This overall collapse produced a profound fall in living standards, and the population had to make do with very limited rations. Milward found that, at the war's end, rations for bread, meat, and fat were at 70, 18, and 31 percent, respectively, of prewar consumption.[22]

Taking a different approach to assess the effects of Germany exactions on France, Occhino, Oosterlinck, and White use a neoclassical model to estimate the overall effects of policy on aggregate.[23] Their model makes the extreme assumption that the economy is frictionless except for policy interventions that create costly distortions. Although this is certainly not realistic, it guarantees that the costs of occupation are not overestimated because any market imperfections would only increase them. Even with

[20] Milward, *The New Order*.

[21] Pierre Villa, "Séries longues macroéconomiques," http://www.cepii.fr/francgraph/bdd/villa/mode.htm.

[22] Ibid.

[23] Occhino, Oosterlinck, and White, "How Much."

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its strong downward bias, their model – which allows for occupation payments, the retention of POWs and the STO labor draft, increased taxation, and wage and price controls – produces estimates of the costs of occupation that are still huge.

Occhino, Oosterlinck, and White emphasize that no matter how the war turned out, the conquered nations of Europe faced the prospect of still having to pay the costs of Nazi occupation long into peacetime because of the huge debt overhang. Whether liberated or under German tutelage/hegemony, no postwar government would be able simply to return to a balanced budget with lower expenditures and taxes. In such circumstances, the size of the debt would prevent the government from running a surplus capable of covering its interest payments and would produce a growing, then explosive, increase in debt. For either an Axis- or an Allied dominated future, a stabilization program or plan would be needed.

The *politique de circuit* used inflation, limited tax rate increases plus the sales of bonds to shift the German-imposed burden to the future. The consequences of Vichy's policy choices are reflected in the rise of the debt-to-GDP ratio from 98 percent in 1939 to 216 percent in 1944. The willingness of Vichy to assume this burden was predicated on the belief that France would remain within the Nazi empire and on a vision of the postwar Vichy economy. Pétain and the leaders of Vichy were backward looking, envisioning an idealized pre-World War I France, more agricultural and rural and with a smaller government. Taking that vision as Vichy's stabilization goal, the Occhino–Oosterlinck–White model assumes the most favorable circumstances of a traditional growth rate of 2 percent and an interest rate of 4 percent and no inflation, with the price level anchored by a gold standard. A balanced budget of taxes and expenditures equalling 11 and 10 percent of GDP, respectively, would produce a surplus that could fund a sustainable debt-to-GDP ratio of 86 percent – very close to the average of 80 percent for both 1910–1913 and 1929–1930. If the debt level were any higher, the surplus could not fund interest payments and the debt would eventually grow explosively. To bring the ratio down from 216 to 86 percent would be very costly, even in a frictionless economy with non-distortionary lump-sum taxes. For a five-year stabilization plan, the annual cost would be 53.7 percent of consumption. If the plan were spread out over 20 years, the cost would be 19.9 percent of annual consumption, far higher than the unattainable optimal rate of 2.6 percent cited earlier. Given that there are frictions and that taxes are distortionary, the actual burden would be even larger. Moreover, the

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wartime costs implied in the huge drops in GDP and consumption must also be taken into account. The fate of Vichy France in a Europe dominated by a victorious Reich would have had a dismally low standard of living.

Liberated France's Inheritance

In the eyes of Vichy, Charles de Gaulle was a traitor; and although he was welcomed into Britain, the Allies considered his government-in-exile, the Comité National Français (CNF), to represent no more than the French troops on their side. The Soviet Union recognized the CNF quickly, but the British and Americans accepted de Gaulle's new Comité Français de Libération Nationale (CFLN) only for the liberated French colonies in August 1943. When the Allies invaded Normandy on June 6, 1944, de Gaulle was not consulted; but on July 11, 1944, the CFLN, renamed the Gouvernement Provisoire de la République Française, was acknowledged as the legitimate authority for Metropolitan France. The imposition of an Allied military government was thereby avoided. De Gaulle, the anointed head of the provisional government, expected that a strong presidential system of government would be established in the new Fourth Republic's constitution. When it became clear in 1946 that Constitutional Commission favored a parliamentary system in which the president would have relatively little power, de Gaulle abruptly resigned – only to see 53 percent of the voters approve the new constitution in a referendum. The elections of 1946 led to the formation of a government of the Rassemblement des gauches républicaines, an alliance of the Radicals, Socialists, and Communists, which now faced the immense economic challenges.

At Liberation, the French economy was devastated, industrial production was at 40 percent of its prewar level, and much of the economy's productive capital lay in ruins or had been requisitioned. The country was left with few trains, autos, or usable ports.[24] Vichy bequeathed the new Republic a huge debt that amounted to 216 percent of GDP in 1944 and a monetary overhang more than double the level of real 1938 per capita income. Although Vichy France had been committed to repaying the debt that it had accumulated during the occupation, liberated France had no such obligation. Bonds issued by the Third Republic

[24] Barry Eichengreen, *The European Economy Since 1945: Coordinated Capitalism and Beyond* (Princeton, 2007), 54–55.

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carried a lower interest rate than those issued by Vichy, which was indicative of the more tenuous nature of the wartime regime's legitimacy – they required a premium to entice investors. For early 1943, this premium was small, well under 2 percent. However, as the prospects of the Third Reich diminished, the premium rose.[25] Interest rate volatility was a reflection of the multiple possible outcomes that might arise if Germany were defeated: a liberated France ruled by an American occupation force, a liberated country ruled by French forces under de Gaulle, and a liberated nation under communist rule. The threat of the first and third outcomes worried the *rentiers*, as there was no assurance that the debt issued by Vichy would be honored. But when it became clear that de Gaulle would govern a freed France, the premium collapsed.

What is perhaps surprising is that debt-holders did not realize that liberated France would be in no condition to fully honor its commitment to them and pay interest and principle in full. Adopting the most efficient five-year stabilization program capable of fulfilling that commitment would have required a 53.7 percent drop in consumption. Even a 20-year program would have entailed a 19.9 percent reduction in consumption.[26] Neither of those options was politically feasible, but that was not immediately obvious to all. The provisional government initially intended to follow Commissioner of Finance Pierre Mendès-France's plan for a rigorous deflation, similar to the one put into effect in Belgium that had reduced its monetary and debt overhangs. Tried out in Corsica, this bold approach was rejected by the new finance minister, René Pleven, in 1945.[27] There was no solution to the unbalanced budget, and consequently unchecked deficits fed money growth and inflation in the four years following Liberation (Table 4).

Inflation and the Persistence of Price Controls and Financial Repression

The pent-up demand for goods, exacerbated by a highly overvalued currency, led to a burst of inflation in liberated France. The cost of living increased only 22 percent in 1944 but then jumped by 49 percent in 1945.

[25] For a fuller discussion, see Kim Oosterlinck, "The Bond Market and the Legitimacy of Vichy France," *Explorations in Economic History* 40, 3 (2003): 327–345.

[26] These figures were estimated by Occhino, Oosterlinck, and White, "How Much."

[27] Michel Mitzkis, *Principaux aspects de l'évolution financière de la France 1936–1944* (Paris, 1945); René Sédillot, *Le franc: Histoire d'une monnaie des origins à nos jours* (Paris, 1953).

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TABLE 4. *Income, Deficits, and Inflation 1945–1958*

	National Income (billions FF)	Budget Deficit (billions FF)	Deficit/NI (%)	Retail Inflation (%)	Wholesale Inflation (%)
1945	1,259	311	24.7	49	41
1946	1,935	338	17.5	53	72
1947	3,395	308	9.1	49	52
1948	5,582	554	9.9	58	72
1949	6,728	642	9.5	13	12
1950	7,640	565	7.4	10	8
1951	9,200	399	4.3	16	28
1952	10,690	769	7.2	12	4.7
1953	11,180	698	6.2	−1.7	−4.5
1954	11,930	346	2.9	0.4	−7.8
1955	12,960	495	3.8	0.9	−0.1
1956	14,380	938	6.5	4.2	4.3
1957	16,080	1,019	6.3	3	5.7
1958	18,510	690	3.7	15	11.5

Source: Jean-Pierre Patat and Michel Lutfalla, *A Monetary History of France in the Twentieth Century* (New York, 1990).

To establish its legitimacy and control the money supply, the new government exchanged the Vichy-issued currency for new Republican money as one of its first acts. Although there were those who wanted to follow the Belgian example and reduce the value of the notes in an exchange, de Gaulle opposed this option, and a one-for-one exchange occurred in June 1945. Fearful of retribution, collaborators, war profiteers, and black market operators failed to present their notes, leaving 30 billion francs unexchanged and hence demonetized. To assist with its funding needs, the new government pressured those exchanging notes to subscribe to new treasury bills or to deposit their new notes in banks that would in turn buy the bills; in other words, the government was essentially following Vichy's *politique circuit*. But, given the vast political pressures arising from the public's wartime privations, policy was hardly consistent, and the government, still controlling prices and wages, granted significant wage increases. Between Liberation and October 1945, wages for professional workers were raised an average of 135 percent and for manual workers 127 percent; controlled prices were also substantially increased, however.[28]

[28] Patat and Lutfalla, *Monetary History of France*, 113.

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Vichy France had needed the Banque de France to keep interest rates low to ensure that it could cheaply finance its persistent debt. The Fourth Republic failed to escape this dependence on the Banque, which kept rates extremely low in the first years following the war. But when the Banque began to move away from its cheap money policy in 1947 and slowly raised its discount rate from 1⅝ percent to 1¾ percent, direct credit controls were imposed to ration funds; credit restrictions were further tightened when the discount rate was increased to 2½ percent.[29] New credits were to be granted only for essential business, and credit for "nonproductive purposes" was prohibited. In 1948, to prevent banks from reducing the huge portfolios of government debt that they had been forced to accumulate by Vichy, commercial banks were instructed to keep liquid reserves, which included treasury bills, equal to 50 percent of their liabilities; and they had to maintain fixed levels of specific government securities if they were to participate in government-sponsored reconstruction programs. This increased financial repression prevented a further surge in inflation but did little to lower inflation, which had reached 50 percent.

If France were to return more completely to a market economy, three basic corrections were necessary: (1) the budget needed to be balanced so that deficits did not crowd out private investment or lead to money creation, (2) prices and wages needed to be decontrolled so that resources could be allocated more efficiently, and (3) the franc needed to be devalued to eliminate the persistent balance of payments deficits and replenish the nation's international reserves. But the governments of the Fourth Republic proved incapable of making these changes and thus remained dependent on inflationary finance. Both the Blum government of 1946 and the Ramadier government of 1947 tried to suppress inflation by fiat. On New Year's Day 1947, a decree was issued ordering that all retail prices should be reduced by 5 percent; a second decree, issued on March 1, established citizens' committees to monitor the controls. Although these measures held down prices temporarily, severe shortages emerged and inflation surged in the second half of the year.[30] Food riots broke out, and the government attacked speculators for sabotaging economic recovery.

[29] See Albert O. Hirschman and Robert V. Rosa, "Postwar Credit Controls in France," *Federal Reserve Bulletin* 35 (April 1949): 348–360; and M.A. Kriz, "Credit Control in France," *American Economic Review* 41, 1 (March 1951): 85–106.

[30] Alessandra Casella and Barry Eichengreen, "Halting Inflation in Italy and France after the Second World War," in Michael D. Bordo and Forrest Capie, eds., *Monetary Regimes in Transition* (Cambridge, 1993), 312–345, here, 316.

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The Ramadier government had to call up 80,000 men from the army reserves to put down civil disorders arising from demands for higher wages. But when confronted with a strike by government workers, the government increased their pay by 100 billion francs.[31] In 1948, the government again moved to curtail inflation by imposing a capital levy that raised 150 billion francs and impounded all 5,000 franc notes. This intervention briefly gave the Treasury a surplus but halted inflation only temporarily.

Although these policies were disastrous from the point of view of restoring economic growth, they contributed to a reduction in the real value of the debt. By itself, inflation drove the debt to GDP ratio from 216 percent in 1944 down to 102 percent by 1948. But most of the remainder of its decline, to 51 percent in 1950, would be accomplished by a return to growth following the Marshall Plan.[32] In spite of this favorable outcome, the inability of successive French governments to raise taxes and rein in expenditures continued the cycle of deficits, money creation, and inflation, leading to increased demands for more stringent price controls. It soon became increasingly difficult to sustain controls and promote reconstruction, however. Heavily dependent on the ability to import coal and capital goods, France's plans for modernization were constrained by shrinking international reserves; by 1947, the remaining reserves had to be devoted to importing food.[33] Intimately tied to France's recovery was the question of how defeated Germany should be treated; and only an infusion of American aid, conditioned on major domestic policy changes and a change in French policy towards Germany, prevented a further economic collapse.

Resolving the German Question

The Allies initially planned for an economically weak Germany. While the American Morgentheau Plan called for a deindustrialization of Germany, the Soviets seized industrial plant from their zone to the Soviet Union as reparations and France sought to place the Ruhr and Rhineland under international control and to absorb the Saar. The start of the Cold War in 1946–1947 altered this blueprint. The impulse for punitive measures to limit Germany's economic recovery and military revival gave

[31] Casella and Eichengreen, "Halting Inflation," 325.

[32] For how this estimate was obtained, see Occhino, Oosterlinck, and White, "How Much."

[33] Eichengreen, *The European Economy*, 60.

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way to European economic integration as a means to direct Germany's reconstruction. The Truman Doctrine encouraged European integration to build a counterweight to the Soviet Union and an open market for American goods; and the Marshall Plan transferred the funds that eased the budgetary and international reserve constraints that had crippled Europe's recovery.

As in other Western European countries, the Marshall Plan provided France with an opportunity to balance the budget, decontrol prices, and devalue the exchange rate. Between 1948 and 1952, the United States delivered $2.4 billion of European Recovery Program funds to France. These Marshall funds were equal to 11 percent of France's 1948 GDP and covered a quarter of the government's budget deficit in 1948 and half of it in 1949. The French government used some of the funds to support nationalized industries and to retire a part of the debt, thus reducing the interest costs in the budget and supporting public enterprises. The budget deficit declined to 4.5 percent of national income and inflation to 16 percent by 1951 (Table 4).[34] The Marshall Plan also produced a major shift in French politics. De Gaulle and much of the Left had looked to the Soviet Union to protect French interests, but the Marshall Plan seemed to offer a much better chance for French recovery; the Communists were pushed out of government and the strikes and disruption they promoted were defeated. American aid persuaded the French to drop reparations claims, raise the limits on German industrial production, and accept the combination of the British and American zones of occupation.

By 1948, the French were ready to agree to the creation of a western German state at the London Six Power Conference. Marshall funds capitalized the European Payments Union, enabling multilateral clearing after years of fruitless negotiations. But, more central to the project of tying Germany to European integration was the formation of the European Coal and Steel Community in 1951 that released the newly founded Federal Republic of Germany from the ceilings on industrial production. By establishing a free market for its six members in the essentials of heavy industry, the European Coal and Steel Community guaranteed France's steel industry access to high-quality coal. The German menace was to be checked by a Joint High Authority in which member states of the community held a veto. The lifting of constraints on growth and the

[34] Ibid., 66–67.

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enactment of reforms supported by Marshall funds opened the way for West Germany's "economic miracle" (*Wirtschaftswunder*) of the 1950s.

L'économie Concertée

In the aftermath of the humiliation of 1940, France sought to ensure that its economic performance matched that of its historic rival. This essential fact of political life colored French economic policy in the critical postwar years, prompting successive governments to exercise both direct and indirect control over the economy. Combined with a distrust of the market that was one of the important legacies of the Great Depression and war years, this policy approach was supported not only in France but across Europe, leading to "neo-corporatist" solutions for recovery. Coordination of labor and capital by government was viewed as a necessity. While this stance certainly can be viewed as a rejection of the market, it might also be considered a response to the existence of multiple equilibria, where coordination was vital to ensure a high growth rather than a low growth outcome.

The government coordination of industrial production pioneered by Vichy was broadly embraced after the war and supported by de Gaulle, who favored a strong interventionist state. In 1946, a planning commissariat was created with Jean Monnet at its head. Monnet drew up a plan for reconstruction and modernization for 1947–1952, designed to finish with the end of the Marshall Plan. The goal was to create a coordinated economy, an *économie concertée*, for heavy industry and transportation. To manage the program, the Commissariat général du Plan was created to allocate resources with management and labor union participation.[35] Even before the Monnet Plan was put into place, the financial sector had been co-opted. In December 1945, the Banque de France and the four largest commercial banks were nationalized. To control the distribution of credit, the Conseil National du Crédit was established. Its members included representatives from the Banque de France and other big banks, government, business, and consumer organizations. Its purpose was to ensure that the lending policies of the banks were in line with the government's monetary policy. To induce cooperation by business, the government not only directed credit but also rationed foreign exchange for imported inputs. To channel Marshall Plan funds to the numerous

[35] Ibid., 106.

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nationalized industries, the Fonds de Modernization et d'Équipment was founded in 1948 to deliver long-term credits. For other investments, the big nationalized banks had to receive approval by the Banque de France and the Commissariat before handing out loans; sales of bonds by businesses were subject to approval as well.

There is considerable controversy over whether planning and intervention boosted or retarded France's recovery. Herman van der Wee contends that government direction prevented supply bottlenecks from halting industrial growth; Jean-Jacques Carré, Paul Dubois, and Edmond Malinvaud see intervention as having ensured consistency of decision-making in the medium term.[36] On the other hand, government intervention may have been distortionary, emphasizing heavy industry at the expense of consumer goods and agriculture, where France had a strong comparative international advantage. Gilles Saint-Paul believes that investment was depressed because of controls on borrowing and high interest rates, causing investors to fear nationalization.[37] Consequently, the investment boom that occurred elsewhere in Europe was delayed in France until the late 1950s. Considering the political dimension, Barry Eichengreen argues that it was essential to provide reassurances to the French public and the French political class, who distrusted the market and worried that France's economic and military might would be overshadowed by the German phoenix.[38] In this sense, government intervention complemented the Marshall Plan and European integration, and eased the transition to a market economy.

Overall, intervention prolonged France's transition from a controlled, occupied economy and distorted its development, but it did not derail growth. In the "golden years" of the 1950s, output per worker in France grew at an impressive 4.31 percent annually, well below West Germany's 6.40 percent but much better than the UK's 2.51 percent. The biggest constraint on overall growth may have been the labor force, which recovered to 16.8 million in 1946 but then fell to 16.4 million by 1957.[39]

[36] Herman van der Wee, *Prosperity and Upheaval: The World Economy, 1945–1980* (New York, 1986); and Carré, Dubois, and Malinvaud, *French Economic Growth*.

[37] Gilles Saint-Paul, "France: Real and Monetary Aspects of French Exchange Rates Policy under the Fourth Republic," in Barry Eichengreen, ed., *Europe's Postwar Recovery* (Cambridge, 1995), 292–322.

[38] Eichengreen, *The European Economy*, 107–109.

[39] Ibid., 88.

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The Balance of Payments Barrier

Although France moved quickly to develop and implement plans for a managed economy, its performance in the first decade of the European "growth miracle" was hampered by chronic balance of payments problems. Exchange rates were officially fixed during the war by inter-Allied agreements and changed very little. In 1940, the dollar and pound sterling rates were $1 = 43.80 francs and £1 = 176.62 francs; five years later in 1945, they stood at $1 = 49.63 francs and £1 = 200 francs. However, the franc was seriously overvalued as prices had increased four-fold in France but had not doubled in either the US or Britain. As a signatory to the Bretton Woods Agreement, France had to declare its parity on January 1, 1946, to join the International Monetary Fund. The new parities for the franc were set at what were thought to be realistic rates: $1 = 111.107 francs and £1 = 480 francs. But this correction was soon dissipated by inflation, which climbed to 5 percent a month, quickly leaving the franc overvalued again.[40]

By the end of the decade, similar problems in most Western European countries resulted in exchange rates that left them uncompetitive and unable to earn dollar reserves. The solution to these problems was deep devaluations, which were finally undertaken in 1949. France's devaluation, at 22 percent, was relatively modest compared to Austria's 53 percent and the 30 percent devaluations for the Netherlands, Sweden, the UK and the sterling area. Devaluation restored competitiveness to some extent, but the improvement for France was not long lasting. The government's failure to tackle the budget deficit, with its inflationary impulse, led to price and wage increases that undermined the devaluation within two years.[41] In spite of later devaluations, the French economy was hindered for a decade by an overvalued currency, as measured by a black market rate for the franc that remained well above the official rate until 1959.

Following the temporary lift the 1949 devaluation gave the economy, the resources of the Marshall Plan provided France with an opportunity to correct its budgetary imbalances. The budget deficit was reduced, though not eliminated, and inflation was largely tamed (Table 4). Stabilization saw a pick-up in economic activity between 1952 and 1955. Yet Jean-Pierre Patat and Michel Lutfalla discern no coincident structural

[40] Patat and Lutfalla, *Monetary History of France*, 115–116.
[41] Eichengreen (2007), 77.

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improvements behind this favorable façade.[42] They see the government milking the *circuit* even more intensively, channelling private savings to public projects, and continuing to control prices of such important goods as wheat, coal, steel, and electricity. To stimulate the economy, there was a general easing of credit conditions. The discount rate was lowered from 4 percent in 1952 to 3 percent by 1954, and regulation of consumer credit was relaxed. Facing new international reserve losses, the government responded with a variety of exchange and trade controls that made France one of the most protected economies in Western Europe. France partially liberalized its import quotas and currency restrictions in the early 1950s, in response to pressure from European trading partners but then quickly reinstituted them when the balance of payments worsened. Even in 1954, when it relaxed these regulations, the government feared reserve losses and imposed a "special provisional compensatory tax" of 10–15 percent on many imports. An ambitious new housing program was begun, described by Patat and Lutfalla as "monetary financing of property investments" with a "distortion and impenetrability of the financing circuits that resulted from it."[43] The budget deficit was only manageable so long as the American government helped pay for the Indo-China war.

The failure to correct the chronic budgetary imbalance produced a new inflationary surge by 1957–1958 that contributed to the collapse of the Fourth Republic. Foreign exchange reserves were exhausted, and France was forced to seek assistance from the International Monetary Fund. The rise in the budget deficit and inflation were amplified by the expansion of military operations in Algeria. Matters were worsened by the 1956 Suez Crisis with its blockade of the Suez Canal and fuel shortages. In attempt to control the monetary expansion, the Banque de France raised its discount rate from 4 to 5 percent in 1957 and its special rates to 7 and 10 percent. Another devaluation was attempted in 1957, but again the government continued to run budget deficits and failed to face down strikes for increased wages. The advantages of a cheaper franc evaporated.

The economic crisis arising from the failure of French policymakers to meaningfully address the underlying budgetary problems was amplified by the expenses of the Algerian War. The political and economic crisis led to the return of de Gaulle to power in 1958. The new Fifth Republic had the strong presidency that de Gaulle had desired in 1946, but now it

[42] Patat and Lutfalla, *Monetary History of France*, 143–150.
[43] Ibid., 150.

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was not used to reinforce the policy norms inherited from Vichy. Instead, policies moved towards establishing a more market-based economy centered on the 1957 Treaty of Rome that founded the European Union. The internal and external imbalances were tackled in by the Rueff stabilization plan with a new devaluation of 17.5 percent, trade liberalization, tax increases, and expenditure cuts. In addition, this plan imposed cuts in subsidies, big increases in controlled prices, and depreciation allowances to encourage capital formation – in other words, France was adapting to the investment- and export-based model of the faster growing nations of Europe.[44]

In Retrospect

The long occupation of France by Germany during the Second World War helped the Third Reich to fight a two-front war with the resources it extracted. Not only did production for the Reich entail a severe reduction in living standards during the dark years of 1940–1944, but it also left a terrible burden for the future. Deaths on and off the battlefield shrank France's labor force. Combined with the theft and destruction of capital, the economy's potential was reduced. The distortions in economic and financial structure left the governments of liberated France with difficult policy choices. The failure to quickly address the debt and monetary overhangs and the budgetary imbalance at war's end created a legacy that required continued financial repression, using many of the methods employed by Vichy. Unable to restrain wage and price inflation and distrustful of the market, the Fourth Republic further developed Vichy's corporatist interventions to guide and finance reconstruction. In spite of repeated devaluations, these policies could not ensure the competitiveness of France in a newly emerging global economy. Although Vichy still cast a shadow on the French economy late in the twentieth century, France began to escape following the 1958 reforms and its embrace of the European Union.

44 Eichengreen, *The European Economy*, 112.

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