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Systemic Explanations, Divergent Outcomes: The Politics of Financial Liberalization in France and Spain

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This article challenges the adequacy of prevalent market-driven models of regulatory change, and more specifically, the stipulation that international market integration will lead governments undertaking financial liberalization in formerly interventionist states to carry out adequate market reforms. It does so through an analysis of financial regulation in two European countries: France and Spain. The article offers an integrated historical perspective on regulatory change which suggests that the market-driven convergence thesis does not adequately capture the political dynamic behind financial interventionism and liberalization in the two countries. The introduction of *dirigisme* and its later-day abandonment were driven less by the "state vs. market" dynamics emphasized in much of the literature than by macroeconomic policy choices on the part of postwar elites. Focusing on similarities and differences in the timing and pattern of reform, the article argues that *dirigisme* was abandoned in France and Spain not because of changing sectoral pressures or the lack of viability of external controls, but because it raised the political costs of monetary austerity for elected authorities. This link between regulatory choices and the politics of macroeconomic adjustment has implications that are likely to be critical in any country undergoing financial liberalization.

One of the most prevalent themes in contemporary political economy involves the relationship between international market developments and national regulatory institutions. Market integration, in particular the integration of financial markets, is commonly cast as the principal driving force behind recent regulatory reforms in both advanced and newly industrialized countries. This is particularly true of reforms that involve the dismantling of postwar regulatory practices which allowed state authorities to direct the allocation of resources in their economies. Described as "deregulation" or "liberalization," such anti-interventionist reforms are often interpreted as evidence that we are experiencing a systemically driven process in which markets are compelling convergence in national regulatory institutions by undermining the capacity of national governments to insulate their economies from international price signals.

The stipulation that international market integration necessarily leads to the convergence of national regulatory institutions is by no means accepted by all political economists. A number of authors have argued, to the contrary, that different national models of capitalism are resilient to market forces and that institutional divergence may even be bolstered by competition and integration (see Zysman, 1994, and the contributions to Berger and Dore, 1996). However, where

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regulatory change across countries reflects an anti-interventionist or anti-statist trend—as in the case of financial liberalization in formerly interventionist states—the market-driven convergence thesis is readily accepted as the explanation. The causal relationship between domestic financial liberalization and international financial integration presents a problem of endogeneity because the decision by governments to abandon controls over their financial systems itself contributes to the international integration of financial markets. Nevertheless, systemic forces are almost always presumed to hold causal primacy. Thus, it has become a conventional wisdom to attribute recent liberalization efforts in formerly activist states to the force of international financial markets.

The acceptance of this conventional wisdom also generally involves the acceptance of a particular set of arguments as to the domestic politics of anti-interventionist reform: a set of arguments that center on the efficiency-oriented mechanisms of capital market arbitrage and changing sectoral interests in a world of global markets. These arguments are often accepted as explanations of how liberalization comes about without direct empirical investigation. Yet they have important implications for our expectations of liberalization efforts. They lead us to expect that—whatever its distributional consequences (and on this there is debate)—the abandonment of financial interventionism will be carried out in a manner that supports the competitiveness and capacity for adjustment of national economies. Financial interventionism often has the side effect of eroding domestic capital markets and supporting oligopolistic arrangements in the financial sector. Explanations that give primacy to efficiency-oriented market dynamics thus lead us to expect that governments choosing to abandon controls over financial flows will be equally motivated to reform financial market structures: that is, to create markets for corporate finance where there previously might have been none and to ensure that the structure of those markets is in fact a competitive one.

This article challenges the pervasive acceptance of the market-driven view of regulatory change, and more specifically, its adequacy in explaining financial liberalization in formerly activist states. It does so through a comparative analysis of the abandonment of financial *dirigisme* in two European states, France and Spain. Contrary to the emphasis on efficiency-oriented market forces and sectoral interests that characterizes market-driven accounts of liberalization, the analysis developed here highlights the centrality of macroeconomic (specifically monetary) policy objectives on the part of state elites. The primacy of monetary policy considerations in bringing about the regulatory turn away from interventionism, it is shown, had important implications for the manner in which liberalization was carried out in the two countries. It produced considerable divergence in regulatory outcomes precisely at the moment when market-driven explanations would lead us to expect greater convergence. Thus, whereas the abandonment of government controls over credit flows was accompanied by extensive and simultaneous reforms of financial market structures in France, it failed to be accompanied by such measures for well over a decade in Spain.

The comparison of the French and Spanish experiences suggests that the abandonment of financial interventionism (i.e., liberalization) does not necessarily result in the kinds of financial market conditions that support an economy's ability to adjust. This is so not just because liberalization may be carried out in the absence of properly functioning prudential regulation—a point amply illustrated by the experiences of southern cone Latin American countries (Haggard and Lee, 1993:13–15)—but also because the political dynamic behind liberalization can militate against adequate reform of financial market structures. Political authorities agree to abandon interventionist practices, I suggest, largely because they want to extricate state authority (i.e., themselves) from the role of allocating the costs of monetary rigor. The economic and political conditions that lead to such a decision,

however, do not provide politicians with any similarly urgent incentive to reform financial markets. A balanced move away from interventionism hence requires an independent political will to accompany deregulation with the creation of new and competitive market structures. Yet such a will can be absent in formerly activist states because the members of the policymaking community most likely to act as advocates and overseers of liberalization (monetary authorities) face conflicts of interests that encourage them to postpone fundamental market reform.

The comprehensive approach to liberalization observed in the French case therefore may well represent the exception rather than the rule. The French outcome, I suggest, was dependent on a particular configuration of relationships within the French policymaking bureaucracy that had the effect of countervailing the primary political dynamic described above. This configuration was the consequence of the state's tutelage of the country's major commercial banks in the postwar period. In Spain, by contrast, the financial sector remained in private hands in spite of the imposition of extensive state controls over financial flows. The comparison of the two countries thus suggests that liberalization is more likely to conform to the pattern that the market-driven view leads us to expect in countries where the state has a direct and significant presence in the financial sector. However, the relationship between state ownership and other forms of interventionism across countries is a fairly loose one, and Spanish reformers had a number of options at their disposal for imposing more fundamental market reform. The fact that such options were foregone in Spain suggests that what mattered in the liberalization process was not so much the state's direct control of the financial sector as the manner in which that control had shaped the character of the French policymaking bureaucracy in the period leading up to liberalization.

One of the prerequisites for understanding how the motivations of various state elites come to play in the process of liberalization is a more careful understanding of the political underpinnings of interventionism itself. To illustrate this, I focus on liberalization as part of an historical sequence that is demarcated by two major moments of regulatory change. The first is the adoption of a distinct kind of financial interventionism—which I refer to as "selective credit regulation"—during the first part of the postwar period in France and Spain, but not in two other European countries (Germany and Italy) which serve as shadow cases. The second is the abandonment of selective credit regulation in France and Spain during the 1970s and 1980s. In both instances, monetary policy considerations of a largely political nature played a much more central role in bringing about regulatory change and determining its direction than is commonly recognized. This observation forces us to think of interventionism and liberalization less in terms of the dichotomy between state and market (or in terms of an inherent tension between these two modes of regulation) and more in terms of the macroeconomic strategies that different postwar regulatory choices were meant to serve. It shows liberalization to have been the consequence *foremost* of the domestic politics of disinflation rather than of the unsustainability of state controls or the demands of capital market players. It also requires that we unpack "the state" and consider how the motivations of politicians interact with those of other state elites in the regulatory move away from interventionism.

In what follows I first discuss the principal causal mechanisms that are commonly postulated to underpin the market-driven view of liberalization: increased capital mobility and changes in sectoral coalitions. I point out a number of ways in which the experiences of France and Spain, and the contrast between the two cases, are not consistent with these explanations. In the following section I turn to an analysis of interventionism itself. I show that the *dirigiste* regulatory regime first contrived in France and later adopted in Spain under the Franco regime was linked to the choice of a postwar growth strategy that hinged on the use of monetary expansion to defuse

social conflict (a point that is commonly overlooked in statist and rent-seeking interpretations of interventionism). Building on this insight and focusing on the timing and pattern of reforms of later decades, I argue in the third section that selective credit regulation was abandoned in France and Spain not because it was compelled by powerful sectoral pressures or rendered impossible by uncontrollable capital flows, but because it raised the political costs of disinflation for political elites. This political choice left substantial room for variation in the particular course of reform that was to be followed in the two countries. It brought to the fore the tension between credit deregulation and aggressive market reform and made particular outcomes highly dependent on the character of the domestic policymaking elite.

The comparative historical analysis of the two cases suggests that financial liberalization in formerly interventionist states, even when representing a cross-national trend and correlating with the growth of international financial markets, may be driven *in a first order* by the politics of macroeconomic adjustment. Regulatory changes that are commonly explained in terms of efficiency-oriented market forces and cited as evidence for the systemic convergence thesis, this perspective shows, can be the result of a political dynamic that is not adequately captured in standard market-driven accounts. This political dynamic is influenced by international market developments (to the extent that these affect the macroeconomic problems faced by state elites). But it has different implications than the market-driven view. It means, most importantly, that we should not expect liberalization to result in the kinds of financial market conditions that support the competitiveness and capacity for adjustment of nonfinancial firms in an economy.

The European cases on which this article focuses are not the only countries to undergo a shift away from financial interventionism in recent years. As has been documented in an extensive literature, selective credit regulation was also a central feature of postwar regulatory regimes in Japan, the East Asian NICs, Latin America, and Scandinavia (see the contributions to Haggard, Lee, and Maxfield, 1993; Loriaux, Cumings-Woo, Calder, Maxfield, and Pérez, 1997; and Forsyth and Notermans, 1997). The effects of these regulatory regimes have varied in accord with other features of national political economies. In the Scandinavian cases, the inflationary externalities of selective credit policies, including their impact on the external account, were neutralized for a long time through effective centralized wage bargains, postponing the move to liberalization. In Japan, such policies were translated into export power and a growing independence by nonfinancial firms from financial institutions (Calder, 1993, 1997). Among the East Asian NICs, preferential credit arrangements also seem to have been channeled into improved export performance more successfully in some countries than in others (Haggard and Lee, 1993).

France and Spain, nonetheless, represent useful cases for exploring general arguments about liberalization in formerly interventionist states. When interventionism was introduced in the early postwar period, both countries were still in the process of completing the transformation from agrarian to industrialized societies (with Spain lagging France). By the time they undertook liberalization, their political economies had matured (although Spain still lagged France in terms of income per capita). By that time, Spain was also undergoing a transition to democracy. The two countries thus offer a historical link between middle-income countries in Latin America and Asia and the advanced industrialized economies. They also allow us to consider the dynamics of financial liberalization in the context of a competitive political system. Although this may set them apart in some ways, it helps to highlight some of the underlying issues that may be at work more obtusely in other countries undergoing a shift from *dirigisme* to liberalization.

The position of the two European countries in the world economy and the timing of their liberalization efforts also has other analytic advantages. Unlike most of the

Latin American cases, financial liberalization in France and Spain was not undertaken in the face of extreme external debt or capital dependence. Unlike most of the East Asian cases, on the other hand, the French and Spanish liberalization efforts can be said to have come full circle by the early 1990s. These features allow us to gauge and qualify various explanations from a perspective that the other cases do not (either because liberalization was overdetermined by debt dependence or because we do not yet have a clear picture of its outcomes). Lastly, and as I will seek to illustrate in the next section, the French and Spanish cases offer a most-similar-case scenario that allows us to draw important insights from the differences in their liberalization processes. The most important of these insights is that the politics of financial regulation are intimately linked to the politics of macroeconomic adjustment, and that this is likely to produce patterns of regulatory reform that differ substantially from the expectations created by the market-driven convergence view. Although the particular implications of this point may vary with the problematic of adjustment in different parts of the world (inflation and disinflation in most cases, deflation and/or financial crisis in others), the link between macroeconomic objectives and regulatory outcomes is likely to be of central importance across cases.

My use of the term *market-driven view* coincides in principle (though not in detail) with what Cohen (1996) refers to as the "liberal" view of globalization. It encompasses two of the categories of explanations (the market-driven and institutional-technological) proposed by Cerny (1993). The argument that I develop here fits Cerny's category of "political" explanations and is closer to the state-centric view taken by Loriaux (1991) and Helleiner (1994). However, it departs from the analyses of the latter authors in focusing less on states as strategic actors in the world economy and more on differences in the motivations of various groups of state elites who interact in the process of liberalization. My analysis resonates, in this sense, with the emphasis placed by Pauly (1988) on the importance of domestic politics in the process of financial liberalization and on the continued likelihood of variance in the outcomes of that process. Yet it also seeks to highlight ways in which that variance may be a predictable result of the politics of liberalization in formerly interventionist states.[1]

Systemic Explanations and Divergent Outcomes: The Empirical Puzzle

Perhaps nowhere is the market-driven convergence thesis as consistently postulated as in analyses of contemporary changes in financial regulation. The growth of international financial markets can affect the ability of governments to regulate their economies in a number of ways. Yet it appears to hold a particularly direct bearing on the way governments regulate their domestic financial systems because it alters the nature of global competition for financial institutions as well as the potential sources of financing for large borrowers. A wave of major regulatory overhauls of domestic financial systems carried out under the banners of "deregulation" and "liberalization" in recent years is therefore easily construed as evidence for the hypothesis that market integration is driving convergence in national regulatory institutions.

[1] In what follows, I sometimes group specific arguments in a different manner than is proposed by some of the other authors listed above. This is because my analysis focuses on a phenomenon (the abandonment of interventionism in formerly activist states) that is more concrete than the broader phenomena that these authors focus on (the rise of global financial markets). The implication of my analysis for this broader literature is that we need to differentiate among various regulatory trends commonly subsumed under the "globalization of finance" label if we are to understand their consequences and evaluate the validity of competing explanations.

The specific changes instituted under the label of financial "liberalization" or "deregulation" have varied significantly from country to country, and, as a number of authors have documented, such regulatory overhauls commonly involve an intensification of regulatory authority (or re-regulation) rather than its reduction (see Moran, 1991; Cerny, 1993; Vogel, 1996). One trend that is nevertheless clearly discernible is the abandonment of a particular kind of postwar regulatory regime in which state authorities selectively regulated the price and availability of credit so as to shape the national pattern of capital allocation (Loriaux et al., 1996). I will refer to this mode of financial regulation as "selective credit regulation." In the earlier political economy literature on financial systems, selective credit regulation was seen as one of the most powerful instruments that a state could have for shaping economic outcomes in the context of a capitalist economy (see Zysman, 1983; Johnson, 1987). For this reason, and because selective credit allocation curtailed the role of prices in the allocation of capital, its abandonment is commonly cited as evidence for the market-driven convergence thesis. Yet the tendency to assume the causal primacy of market pressures in the turn away from selective credit regulation is rarely accompanied by serious exploration of the actual political process that lies behind such a regulatory turn in interventionist states.

There are two principal causal mechanisms that are commonly postulated by political scientists to support the market-driven view of financial liberalization. Both center on the preferences of financial asset holders and on their ability to compel regulatory changes that will allow them to reap the benefits of more efficient capital markets. And both constitute systemic explanations in the sense that they stipulate domestic political processes that are determined by international market developments. However, the nature of the unit-level (domestic) process that the two arguments imply, and hence their empirical implications, differ in important ways. The first involves changes in the balance of sectoral interests available for political mobilization and coalition-building. The second hinges on the way in which the growth of international financial markets affects the viability of external capital controls. Thus, while the first implies a process in which politicians respond to sectoral demands for liberalizing reform in order to maintain or garner political support, the second implies a process in which reluctant governments are forced to give up regulatory tools by the uncoordinated economic behavior of financial market agents.[2]

The first of these arguments has been offered in at least two versions. In the first version, the growth of international financial markets leads national financial institutions to seek reform—including a breakdown of national barriers to capital mobility and deregulation of domestic financial flows—so as to enhance their ability to compete internationally (Cohen, 1989; Dollar and Frieden, 1990). In a second, broader version, the existence of international capital markets alters the preferences of holders of financial assets (not just banks, but also investors and multinationals) and strengthens their position relative to holders of fixed assets (national industry and labor). This change in the matrix of sectoral pressures in turn encourages governments to espouse liberalization (Frieden, 1991). Foremost among the changes sought by the holders of financial assets, according to this view, is the abandonment of international capital controls. Yet, as Frieden and Rogowski have argued more recently (1996), the argument extends to any domestic institutional arrangement that impedes the ability of financial asset holders to reap the benefits

[2] This is a different distinction than the one between "outside-in" and "inside-out" explanations drawn by Sobel (1994) and emphasized by Cohen (1996). Whereas that distinction refers to the source of change in international financial markets (domestic vs. systemic), I am here referring to differences in the unit-level political processes whereby systemic forces are postulated to produce regulatory changes.

of capital mobility. Institutions that give governments control over domestic capital flows represent such a barrier and can therefore be expected to become the target of sectoral opposition.

The second argument serves the same general hypothesis (the abandonment of interventionism is caused by the growth of international capital markets) and is commonly used to reinforce the first. Yet its emphasis is on uncoordinated exit and evasion by financial market players rather than on organized political pressure (or voice) from economic sectors. As the growth of international financial markets and accompanying technological innovations increase the exit options for economic agents and facilitate evasion, external capital controls become increasingly untenable. Holders of financial assets find ways to invest their assets offshore, and this capital flight forces governments to alter their practices so as to raise the return to investors. This involves changes in taxation and labor market policies but also freeing the domestic financial system so that investors can receive the benefits of efficient capital market allocation. International financial markets also make it easier for financial intermediaries and large firms to evade domestic restrictions on lending and borrowing by raising financing abroad (Goodman and Pauly, 1993:51; Haggard and Maxfield, 1993:316; Laurence, 1996). Thus, in this picture, governments are led to give up on attempts to regulate domestic credit flows even in the absence of political pressures because external capital controls become untenable and internal controls ineffective.

The two ways in which international financial markets may bring about liberalization—organized political pressure by sectoral actors and uncoordinated evasion by economic agents—imply different domestic political processes (even if not mutually exclusive ones). However, they coincide in ways that often lead them to be conflated. Regulatory reform, in both pictures, responds to the interests of economic actors who are seeking the efficiency benefits of international capital markets. Policymakers are postulated to be acting as political entrepreneurs who seek to internalize the aggregate efficiency gains afforded by liberalization (Frieden and Rogowski, 1996) or to be capitulating to the search for efficiency by economic actors (Goodman and Pauly, 1993). To the extent that the abandonment of interventionism is explained in this way, reform is expected to conform to the logic of creating a wider, more competitive, and efficient domestic financial market. Both arguments thus lead us to expect that, other things being equal, the abandonment of interventionism will support an economy's competitiveness because (whatever its distributional consequences) it is expected to render aggregate efficiency gains. Variation from such an outcome is certainly possible, but it is conceptualized as residual in nature and as independent from the systemically driven process of change.

The sway of this conceptual model among contemporary observers is not difficult to understand. Systemic explanations are uniquely compelling in accounting for cross-national trends in domestic outcomes. The market-driven view of liberalization, moreover, links up with a rent-seeking model of interventionism and fits well with the view of politics taken in much of the contemporary economics literature. It offers an explanation of political decisions (actual liberalization measures or the lack thereof) that is derived directly from the normative implications of economic models. However, as compelling as such cross-disciplinary congruence may be for those seeking a powerful explanation of contemporary regulatory trends, we have to ask just how well the model captures the political dynamic that has led to financial liberalization in formerly interventionist states.

The experience of the two countries that will be considered here (France and Spain) challenges the adequacy of the market-driven model of liberalization in a number of ways. First, if financial liberalization was the result of the causal mechanisms cited above, then we should find evidence for at least one of several empirical implications. One implication would be that liberalization was actively being promoted

by members of the financial sector and that the decision to liberalize was a response to these sectoral pressures. Another would be that external capital controls were becoming so ineffective as to undermine attempts to regulate credit selectively, and that internal and external liberalization formed part of an integrated regulatory move. Neither the Spanish nor French case offers support for the first of these stipulations. The principal agents behind the regulatory turn in both countries were public officials, and there is little evidence of a connection between the timing of financial liberalization measures in the two countries and political pressure from the kinds of sectoral actors spelled out in the market-driven model. Indeed, the most powerful sectoral actors—large commercial banks—adamantly opposed liberalization at the time of its initiation in Spain, and held serious apprehensions about it in France. This seems to eliminate one of the causal avenues through which liberalization is linked to the growth of international financial markets (active sectoral pressure) but not the other (the undermining of selective credit regulation through increased cross-border capital mobility).

The latter explanation, however, also fails to be supported by the empirical facts of the French and Spanish experiences. If, as its proponents argue, internal credit liberalization is compelled by the inability of governments to sustain external capital controls at a reasonable cost, then we would expect the dismantling of external controls to be carried out in close relation to the dismantling of selective credit regulation. In both France and Spain external capital controls were not dismantled, however, until the very end of the eighties and early nineties—well after domestic credit liberalization had been initiated. Indeed, in both cases external liberalization was carried out in response to EC directives rather than as part of the domestic liberalization drives. The notion that external capital controls were becoming effectively obsolete at the time when internal financial liberalization was instituted also fails to be supported by the empirical evidence. The persistence of substantial differentials between offshore and domestic interest rates in the ERM through the late 1980s demonstrates that capital controls in fact remained quite effective in shielding weak currency economies such as France, Italy, and Belgium from having to adjust fully to the monetary policy course set by the German Bundesbank (de Grauwe, 1990). This was also illustrated by the dramatic rise in cross-border flows that followed the decision by EU countries to dismantle controls after 1989 (Artus and Bourguinat, 1994). Indeed, the connection between the two kinds of financial liberalization (internal and external) in Europe seems to have been the opposite of that implied in the market-driven model of liberalization: the dismantling of external controls was part of a broad effort by countries such as France to capitalize at the EU level on domestic reforms that had been initiated for reasons that are different from those emphasized in the standard systemic view.

There is also another way in which the experiences of France and Spain contradict the market-driven model of liberalization. The model leads us to expect broad convergence toward regulatory patterns that support the competitiveness of national economies. The liberalization processes in France and Spain, however, varied very significantly in their timing, content, and structural outcomes. The most succinct manifestation of this is the differing extents to which financial liberalization transformed the domestic markets for corporate finance in the two countries. The French reform effort gave firms substantial alternatives to credit-based financing at the same time as privileged financing was phased out. The Spanish reform process, by contrast, failed to produce any comparable expansion of domestic financial markets for almost two decades after its initiation; this despite a massive foreign investment boom in the late 1980s (see Table 1).

These differences had important economic implications. While reform in France resulted in a significant moderation of the financial costs faced by firms during the 1980s, the financial costs faced by Spanish firms rose substantially with credit

TABLE 1. Net Funds Raised by Nonfinancial Enterprises (Percentages of Total)

	1977	*1982*	*1989*
France			
Loans	79	72	47
Securities, bonds, shares	21	28	53
Spain			
Loans	82	82	77
Securities, bonds, shares	18	18	23

Source: OECD Financial Accounts (France 1990, Spain 1992).
1989–1990 Average for Spain

deregulation in the late 1970s, and thereafter remained stubbornly high (Table 2). Spanish firms as a group experienced a very strong negative leverage effect (i.e., a negative difference between the average economic rate of return and the real cost of external financing) from 1978 through the early 1990s. Although French firms also experienced a negative leverage effect in the mid-1980s, this effect was far smaller and more short lived than in Spain. Some of this difference in the relation between financial costs and the return to investment may be accounted for by differences in macroeconomic policy. However, the financial costs of Spanish firms exhibited very little downward variation in the second half of the 1980s in spite of a strong record of disinflation and fiscal consolidation. This limited variation in financial costs can ultimately only be explained by the persistence of an essentially unchanged supply-side structure in the Spanish market for corporate finance during this period, an outcome that contrasts markedly with developments in France (Pérez, 1997:10–25).

Such divergence in the process and outcomes of liberalization is particularly striking because the institutional starting grounds in the two countries were very similar. The *dirigiste* regulatory framework adopted in Spain in the early sixties was modeled directly upon that developed in France in the immediate postwar period, and by the early 1970s the two systems displayed a remarkable degree of similarity. The one important difference was that the French banking sector had been placed largely under state control at the end of World War II, while the Spanish banking sector was dominated by a cartel of private commercial banks. Spanish policymakers nonetheless had a number of important institutional tools at their disposal to break the banking sector's oligopoly without resorting to nationalization when they decided to abandon interventionism in the late 1970s (Pérez, 1997). These included public credit institutions that could have been reorganized to give the state an oligopoly-breaking presence in the banking sector, as well as the options of instituting rapid stock market reform or allowing foreign banks to operate in Spain with less discriminatory regulatory restrictions. Thus the state's control of the banking sector in and of itself does not explain the divergent effect of liberalization in the two countries.

The contrast in the French and Spanish liberalization experiences is explained rather by a domestic political dynamic that fails to be captured in the market-driven view of liberalization. The move to abandon interventionism in these countries was driven in a first order not by sectoral pressures nor by the lack of viability of controls, but rather by the decreased utility of financial interventionism as a political tool once governments had committed to an anti-inflationary economic policy course. This common political dynamic allowed for much greater variation in how the abandonment of interventionism was carried out than market-driven explanations of liberalization would lead us to expect. And at least in one of the two cases (Spain) it militated directly against the kind of comprehensive reform process that the

TABLE 2. Apparent Rate of Interest on Financial Debt (Ratio of Financial Costs to External Financing), Manufacturing Industry

	1982	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
Spain	13.5	12.9	13.5	12.3	11.2	11.1	9.9	10.2	10.5	13.8	15.1
France	14.1	12.8	10.6	10.8	10.0	9.5	8.8	8.9	9.7	9.3	10.1

Source: European Commission, *European Economy, Supplement A*, no. 2, 1995, p. 10.

market-driven convergence thesis predicts. To understand these outcomes, we must, however, first turn to the political origins and nature of interventionism itself in these countries.

The Political Nature of Financial *Dirigisme* in Postwar Europe

The widespread acceptance of the market-driven view of financial liberalization reflects the general appeal that systemic explanations have in explaining cross-national trends. Yet this view is also compelling because it responds to a particular conceptualization of interventionism itself. Whether the story told is one of public officials choosing deregulation in response to market-induced societal pressures or one of capital flows undermining the ability of governments to sustain interventionist forms of regulation, most observers assume that the dominant source of tension behind liberalization lies in an inherent conflict between the alternative regulatory models of state and market. This assumption reflects the association made in the earlier political science literature between financial *dirigisme* and the "strong," "strategic," or "developmental" state. And this association, in turn, makes it difficult to understand why state elites would choose to abandon such policy instruments if they were not being compelled to do so by sectoral political pressures or by the obsolescence of external capital controls. A different understanding of the political nature of financial interventionism in these countries, however, brings us a step closer to understanding such an outcome.

In the political economy literature of the 1970s and 1980s, financial interventionism was often associated with the concept of "state capacity." The ability to regulate credit was seen to be the "strong" state's ideal policy instrument because it allowed officials to alter the overall structure of investment incentives in an economy. Some form or other of it was adopted in many countries during the postwar period, both in Europe and elsewhere. However, the scope and method of financial interventionism varied significantly even within Europe. Some countries, such as Germany, limited the state's role to that of subsidizing credit to a limited range of users. In others, notably Italy, political authorities exercised direct political discretion through nationalized financial institutions but did not seek to establish comprehensive controls over financial flows. In yet other countries, such as France and Spain in Europe (but also South Korea and Japan in Asia, and Mexico and Brazil in Latin America), governments set up extensive circuits of "privileged financing" through which state authorities could structure the entire pattern of credit allocation in the economy. This extensive form of financial interventionism, which I will refer to as selective credit regulation, differed from the traditional form of direct political control over credit through nationalized institutions (exemplified by Italy) in one particularly important way: it subsumed the main policy instruments of the central bank, in particular the rediscounting mechanism, through the selective rediscounting of credit, and later, through selective credit rationing. It was therefore not just

an instrument of development or industrial policy but also a specific mode of monetary management.[3]

The emergence of this "soft but extensive" form of interventionism in countries such as France and Spain is commonly explained in terms of one of two factors: institutional legacies and the transformative or developmentalist objectives of postwar elites. Each of these explanations is problematic. Institutional precedents for the adoption of selective credit regulation were present in many countries and by themselves do not predict the postwar pattern of regulatory divergence in Europe. For example, a large part of the banking sector had been nationalized by the beginning of the postwar period in both France and Italy (in France the major commercial banks were nationalized in 1945, in Italy the state had taken over much of the sector as a result of financial crisis in the 1920s and consolidated it in the *Instituto per la Ricostruzione Industriale (IRI)*). Yet, while Italian governments in the postwar period chose to exercise direct political control over credit through the IRI, French governments chose to maintain the managerial autonomy of the nationalized commercial banks, foregoing the option of direct political control. Italian authorities, by contrast, refrained from imposing the comprehensive type of selective credit regulation that was instituted in France and Spain. On the other hand, in Spain the banking sector remained in private hands after the war (as in Germany) and enjoyed an unrivaled position of privilege and influence under the Franco regime. Nevertheless, in the 1960s the regime did not refrain from imposing the kind of comprehensive interventionist regulatory framework that had been developed in France in the 1950s. Lastly, in Germany, where the state left credit allocation in the hands of the private (and semi-public regional) banks after the war, institutional bases for interventionism were also available, as illustrated by the Kreditanstalt für Wiederaufbau (established after the war to channel Marshall Plan funding for reconstruction) and by the *Hermes* export-credit program.

The developmental goals of state officials also constitute an insufficient explanation of postwar regulatory divergence in Europe. To be sure, the introduction of selective credit regulation in France and Spain coincided with the adoption of indicative planning and was spearheaded by individuals who had a clear developmentalist vision. The criteria whereby credit was regulated were also set in accordance with planning or industrial policy objectives. These facts often lead to the conclusion that interventionism was the consequence of the transformative agenda of postwar elites. Other observers following a rent-seeking model suggest that *dirigisme* served primarily to extend political patronage and that it is therefore to be explained in terms of the clientelistic nature of particular regimes such as the Franco regime in Spain (Lukauskas, 1994).

These ways of conceptualizing interventionism, however, also fail to explain the pattern of regulatory divergence noted above. Many of the goals emphasized in either the statist or rent-seeking views—from favoring strategic sectors to rewarding political supporters—could have been achieved through more traditional means, such as direct political control of nationalized financial institutions. The use of the IRI as a tool of development and political patronage in Italy is a clear illustration of this. More importantly, these explanations mistake the uses to which the regulatory system was put with its causes while overlooking other factors that were critical in bringing about the turn to selective credit regulation in France and Spain. The

[3] Both the French and Spanish systems also included a more coercive circuit, whereby a portion of resources of financial institutions was channeled to public credit institutions. Selective (or special) rediscounting, however, became the qualitatively more important mechanism over time, because it created a global incentive for banks to shift their resources to tagged users and sectors.

most important of these other factors lies in the connection between postwar financial regulation and macroeconomic policy choices in postwar Europe.

Postwar Regulatory Divergence in Europe and Macroeconomic Growth Strategies

The connection between financial interventionism and macroeconomic policy has been noted by a number of authors writing on France who indicate that selective credit regulation in that country was linked to a political strategy of defusing social conflict through monetary expansion. Michael Loriaux (1990) suggests that the interventionist framework that developed in France after the war was designed to render the banking sector "a willing and able partner in the . . . expansionist policy orientation" adopted by French governments in the immediate postwar period in response to social unrest (p. 111). John Zysman (1983) attributes a strategic role to this combination of monetary expansion and regulatory institutions. "Inflation," he writes, "served to reduce the real value of the nominal level of protection and subsidy accorded to declining sectors," thus "silently facilitat[ing] an erosion of the position of traditional France which would not have been attempted by more open means" (p. 143). By increasing the supply of credit selectively beyond the level that would have been required to maintain domestic price-stability, he suggests, French planners were thus able to undermine the political ability of traditional sectors (in particular agriculture) to oppose the shift of resources to more productive sectors. Flanagan, Soskice, and Ulman (1983:593–616) argue that such selective monetary expansion coupled with devaluation of the currency was later also used to restore the profitability of French firms following nominal wage increases.[4]

A cross-national look at the pattern of regulatory divergence that emerged in Europe after World War II suggests that the expansionary monetary stance noted by these authors was critical in bringing about the new regulatory framework and in determining the particular form that it took. We can distinguish broadly between two stylized macroeconomic growth strategies pursued by European governments in the postwar period: (1) an export-led growth strategy that prioritized domestic price and wage stability as the basis for international competitiveness, and (2) a cheap credit-driven strategy that placed the rate of investment above the objective of domestic price-stability and relied on periodic devaluations in order to restore competitiveness.[5] The inflation averages in Table 3 and the evolution of current account balances in Table 4 suggest that, in the first two decades after the war, economic policies in Germany and Italy conformed to the first strategy, while policies in France and Spain conformed to the latter.

Figure 1 combines this observation with the three kinds of postwar regulatory frameworks that we find in countries with credit (rather than capital-market) based financial systems in Europe: (1) the private bank–organized framework reestablished in Germany after World War II; (2) the traditional or "hard but circumscribed" form of financial interventionism established in Italy, in which officials exercised direct political discretion over credit through nationalized financial institutions (but in which discretion did not subsume monetary policy); and (3) the "soft but extensive" model of interventionism that I have termed *selective credit regulation,* in which state control over capital allocation was exercised indirectly but also broadly through the selective regulation of bank credit, whether the banking

[4] Devaluations to restore external competitiveness were carried out in France in 1958 and 1969, and in Spain in 1959 and 1967.

[5] I use the term *strategy* for simplicity's sake to denote the broad orientation of the policies pursued by a country over time, and the kind of logic that might turn such policies into a growth formula. I do not imply that policymakers had a clear vision of these formulas at the start of the period.

TABLE 3. Inflation Averages for 1950s and 1960s

	Italy	*FRG*	*France*	*Spain*
1950–1959	2.8	1.2	6.2	5.8
1960–1969	3.4	2.4	3.9	5.8

Source: IMF Financial Statistics.

TABLE 4. Evolution of Current Account Balances (Annual Averages in $ Million)

	1950–54	*1955–58*	*1959–64*	*1965–69*
France	219	–250	–171	–405
Spain	—	–86	90	–428
Germany	558	1,091	480	1,189
Italy	–79	107	270	2,178

Source: Adapted from Llewellyn and Potter, 1982, pp. 137, 141.

sector was in private or public hands. Selective credit regulation was adopted in those countries that pursued cheap-credit policies in the first two postwar decades, France and Spain. The two countries whose policies conformed to the alternative strategy of export-led growth adopted one of the two alternative frameworks: Germany its traditional private bank–organized model, Italy an extended version of the direct political control initiated under fascism. While the regulatory divergence between Germany and Italy raises important questions of its own, the point here is not to claim a one-to-one correspondence between macroeconomic policies and regulatory outcomes. It is simply to note that the extensive form of financial interventionism commonly hailed by political scientists as the stamp of a "strong state" was only developed in those countries pursuing a macroeconomic growth strategy in which monetary expansion (or "cheap credit") played a central role. This correlation can also be observed in other regional contexts. Thus, for example, in East Asia, many countries relied on preferential credit schemes to promote industrialization, yet the use of such schemes remained far more circumscribed in Thailand, a country that pursued price-stability oriented policies backed by a powerful central bank, than in South Korea, which pursued a more expansionary credit stance and where the central bank was clearly subordinated to the planning bureaucracy. And a similar relationship is observed in Latin America, where selective credit regulation was taken farthest in Brazil, a country whose economic policy course was heavily dominated by the planning bureaucracy, while it was used in a more limited and intermittent fashion in countries such as Mexico and Chile, where central bankers were able to exert greater influence over the course of economic policy (Haggard and Maxfield, 1993:305–12).

Explaining the Relationship

What explains this correlation between selective credit regulation and an expansionist monetary stance, and what does it tell us about the political nature of financial interventionism? One answer is that the relationship between an expansionary monetary stance and selective credit regulation was essentially a functional one. A choice to allow credit growth beyond the level that preserved price-stability entailed a gamble that such expansion would produce the necessary productivity increases to maintain international competitiveness and avoid severe balance of payments problems in the long run. Selective credit regulation held the promise of allowing governments to address this imperative by channeling resources to the most

	Regulatory Outcome		
Macroeconomic Growth Strategy	*Private Bank Organized*	*Selective Credit Regulation*	*Direct Political Control*
Cheap-Credit Driven		France, Spain	
Price-Stability Oriented	Germany		Italy

FIG. 1. Macroeconomic growth strategies and regulatory outcomes.

productive sectors. Conversely, the commitment to an export-led growth strategy that centered on price-stability—such as pursued in Germany and Italy—precluded the adoption of this kind of regulatory framework. As noted above, one of the principal aspects of selective credit regulation was that it subsumed traditional monetary policy instruments such as the rediscount mechanism. An economic strategy that gave primacy to domestic price-stability required that monetary policy be geared specifically toward that goal, and spoke against giving planning authorities a say in it. Thus, while the German and Italian regulatory regimes were juxtaposed across a state-market divide, they shared a key characteristic: they left monetary policy in the hands of the central bank. The relative independence of monetary policy that this allowed for is captured in Table 5, which shows the differing magnitudes of claims on domestic financial institutions among central bank assets in the four European countries.

These functional links, however, do not tell us which of the two postwar choices (growth strategy or regulatory framework) held causal primacy. The desire by technocratic planners in France and Spain to determine the pattern of credit allocation might have been the primary factor behind the introduction of selective credit regulation. The availability of this regulatory framework in turn might have made an expansive credit policy more feasible, and hence, more probable. The historical record, however, suggests that monetary policy decisions played a determining role in the development of the regulatory framework (rather than vice versa). It also suggests that these monetary decisions—and the choice of macroeconomic strategy more broadly—were strongly influenced by domestic political concerns in the immediate postwar period.

The Defining Role of Early Postwar Policy Choices

The adoption of financial *dirigisme* in some European countries but not in others was closely linked to the way in which governments chose to deal with the inflated currency-pools left over from wartime (in the Spanish case, the Civil War), and more precisely, to whether or not governments chose to implement radical currency stabilization in the immediate postwar period. In both Germany and Italy, government elites chose decidedly to do so. In France and Spain, governments under sharply different political regimes chose not to, placing political stabilization ahead of economic stabilization.

The German postwar model of bank-organized industrial finance was built on the success of the 1948 currency reform (*Währungsreform*) which drastically cut a wartime currency overhang that had been exacerbated by the issuance of allied currencies. The German reform was characterized by its "indisputable intensity and absence of compromise," so much so that, in the opinion of one of its architects, it "could hardly have been possible outside of a military regime" (Möller, 1976:437).

TABLE 5. Claims on Banks and Savings Banks as Percentage of Total Central Bank Assets

	Italy	*FRG*	*France*	*Spain*
1955	3	10	24	21
1960	1	2	27	12
1965	3	5	19	14

Source: IMF Financial Statistics.

The reform is widely touted for allowing Germany to reverse its war-end trade deficit in little over three years and for setting a policy course that made possible a progressive undervaluation of the deutsche mark under Bretton Woods. Coupled with the statute of independence granted to the Bundesbank, it thus set the basis for Germany's price-stability centered export-led growth strategy in the postwar period.

A similar set of decisions marked the initial course of postwar policy in Italy. As Sassoon (1986) notes, the debate in Italy was not "between 'central planners' and neo-liberals but rather between the latter and the supporters of Keynesian intervention" (p. 18). In 1947, with the expulsion of the Communists from government and the appointment of Luigi Einaudi (governor of the Bank of Italy) as Budget Minister, this debate was settled in favor of those opposing any policies that would encourage wage growth. Although an outright currency conversion (backed by the Social-Communists) had been shelved a year earlier, the new de Gasperi government imposed a "ruthless dose of credit control" to end inflation. It even went so far as to allocate a large portion of Marshall Plan funding to build up central bank reserves against the objections of the European Reconstruction Program (Foa, 1949; Mammarella, 1966:130–32). This radical stabilization initiated the so-called Einaudi line: a policy course centering (as in Germany) on domestic price-stability, which for almost two decades remained the cornerstone of Italy's export-led growth. These monetary policy choices were also reflected in Italy's postwar model of financial regulation. The Banca d'Italia, although not given statutory autonomy, was placed in a position of de facto control over monetary policy. Party elites, who were thus deprived of the monetary lever, meanwhile centered their attention on the direct control they could exercise through the IRI's credit institutions (see Shonfield, 1965:181–83; Nardozzi, 1983:60–61; Sassoon, 1986).

The course of French and Spanish postwar policy was shaped, in contrast, by the early decision *not* to impose radical monetary stabilization. In France, radical currency reform was advanced by Pierre Mendès-France, who had been the finance commissioner of the Liberation Front in Algiers and was appointed to head the Ministry for National Economy in the provisional government of 1944. Mendès's recovery scheme mixed socialist and technocratic ideals, calling for heavy taxation of illicit profits, a coherent nationalization program, strict rationing, and a program of wage and price controls. Its centerpiece, however, was a currency reform scheme that would have withdrawn part of the existing wartime currency pool. For Mendès, this was the only way to redress the severe inequality in purchasing power that the existing distribution of bills and the dynamic of the black market produced. In 1945 de Gaulle, however, rejected Mendès's proposal, accepting instead the plan of his Minister of Finance, René Pleven, to convert all bills on a one-to-one basis "without freezing or retention" (Werth, 1956:248; see also Loriaux, 1990:99–106).

De Gaulle's decision to reject currency reform led to the adoption of a policy logic according to which price increases were a means to encourage production and disinflation could be expected to "come by natural processes as soon as production could be expanded" (Wright, 1948:55). This logic not only justified the original decision to avoid currency reform but became "France's financial policy for years to

come" (Werth, 1956:246). The choice not to deflate in 1945 was thus transformed into a long-term strategy premised on the notion that it was possible "to respond to the demand that excess liquidity generated by hastening the production of a commensurate supply of goods" so as to "bypass the need for monetary stabilization" (Loriaux, 1991:106).

The defeat of radical currency reform and the adoption of this expansionary policy course in turn set the stage for the introduction of selective credit regulation. Mendès's resignation in 1946 ended the prospects of the radical alternative that had been advanced in the Resistance's reconstruction program and that had called for direct political control of the financial sector. The avoidance of full stabilization at the same time meant that productivity would have to rise in line with credit growth in order to avoid an even harsher stabilization in the future and make the currency gamble of 1945 pay off. Part of the answer to this imperative was found in the neoliberal model of planning championed by Jean Monnet and adopted in 1945, which claimed a fundamental role for the state in creating the proper incentives for modernization while preserving the place of private capital (Kuisel, 1981). Yet the rapid surge in prices and balance of payments problems that followed the government's 1945 decision soon made it clear that more direct mechanisms would be needed to ensure that cheap credit went into productive investments rather than fuel a simple inflation. Selective credit regulation—as justified by the principle of indicative planning—became the instrument of choice. Much of the technical finesse that the French regulatory framework eventually came to exhibit was thus the result of piecemeal regulatory innovations introduced in the late 1940s and early 1950s, as French officials sought to reconcile their expansionary policy choices with the constraints of an open economy (see Loriaux, 1991:113–15).

Perhaps the clearest illustration of the relationship between macroeconomic decisions and the adoption of selective credit regulation, however, is offered by the Spanish case.[6] The Franco regime did impose a currency conversion plan to tackle the overhang from the Civil War. Increases in Republican-zone bank account balances were converted to "national" pesetas according to a regressing scale immediately following the end of the war in 1939. Whatever stabilizing effect this conversion might have had, however, was negated by the simultaneous reestablishment of a practice known as *pignoración automática* (automatic collateral lending) whereby the private banks were allowed to monetize up to 80 percent of their public debt purchases with the central bank at their own discretion. While the new regime opted in favor of this extremely lax mode of money creation, it forewent any attempt to impose selective credit regulation during its first two decades. The result was a virtually uncontrolled pattern of monetary expansion that served to finance the regime's autarkic industrialization drive (1940–1959). This course, however, was only sustainable in an economy that was not yet subject to a strong external balance constraint. As industrialization proceeded, import requirements rose, and in 1959 a severe balance of payments crisis forced the Spanish government to accede to an IMF-sponsored stabilization plan with a number of major consequences. The *pignoración* was abolished, and the Franco regime abandoned its stance of economic nationalism in favor of new economic strategy that centered on the liberalization of prices, foreign trade, and inward capital flows. At the same time it committed to currency convertibility. This reversal in the regime's development strategy was accompanied in the regulatory sphere by the adoption of indicative planning and

[6] This section is based on Pérez, 1997.

a framework of selective credit regulation that closely resembled the one that had been developed in France over the previous decade.[7]

Selective credit regulation in Spain thus came as a corollary of product market liberalization. Yet if the thrust of the policy change in 1959 was market conforming, why did it lead to interventionism in the financial sphere? The answer parallels the analysis offered above for the French case. As in France, indicative planning represented a neoliberal alternative to a more radical modernization strategy that held significant sway among some supporters of the political regime. In Spain, such a strategy (centering on calls for the nationalization of the banking sector and a less inflationary policy course) was advocated by national-syndicalist members of the *Falange*. However, also as in France, this ideological struggle was accompanied by other, more specific reasons for the adoption of *dirigisme*. The technocratic planners who gained control of economic policy during the balance of payments crisis of 1957–59 needed to find a way to avoid the experience of the past, when untamed credit growth had failed to produce sufficient productivity gains to avoid severe inflationary episodes and a balance of payments crisis. Yet they were unwilling to adopt a policy strategy that gave priority to price-stability because this might well have undermined the stability of the political regime. Selective credit regulation came as the corollary of external trade liberalization because, in finding a way to integrate Spain into the world economy, the regime's technocratic planners had strong political reasons to opt for the expansive policy strategy exemplified by France rather than the anti-inflationary strategy followed in Germany and (until the sixties) in Italy.

In both France and Spain, the choice against radical stabilization and in favor of cheap credit thus led to the adoption of a regulatory framework that could rationalize such a policy course. Yet, if differing macroeconomic choices by conservative elites set the parameters within which regulatory developments took place, the question remains as to what explains these differing choices. This is not the place for an extensive investigation of this question. It seems fair to suggest, however, that the early choice to impose radical currency reform or forego stabilization had much to do with perceived threats to the established political and economic order. The German case is unique in this regard because currency reform was carried out in the context of military occupation. A comparison of the other three cases suggests several aspects of the domestic political configuration in the immediate postwar period that can be adduced to explain the differing choices of government elites.

In both France and Spain, calls for radical currency reform came originally from members of the incipient political regime who advanced radical modernization models. These advocates (the political left, which had dominated the CNR, in France; the radical, national-syndicalist wing of the *Falange* in Spain) enjoyed an important voice thanks to their role in bringing about the victory of the new regime in each country. In both cases, the radical alternatives with which currency reform was associated also entailed socializing ideals that directly challenged the existing distribution of power in the economy. Moreover, monetary stabilization itself had redistributive implications. Proponents of currency reform in both countries favored stabilization because they saw inflationary policies as benefiting monopolistic capitalists while hurting popular constituencies. The character of the political debate over economic models was thus remarkably similar in France and Spain in the

[7] The first step (selective rediscounting) was introduced in 1960 as part of the decision to begin reflating the economy. This was followed by a more comprehensive overhaul in 1962, which established separate categories of financial institutions and the principle of selective regulation in accordance with the criteria set out in the National Development Plans.

immediate postwar period, despite the difference in political regimes. And in both cases, monetary stabilization was connected to radical alternatives.

Yet if monetary stabilization was so threatening to established economic interests in France and Spain, why did a conservative government in Italy opt in favor of it? Most analyses of Italian politics during this time attribute the adoption of the Einaudi line to backing from Italy's northern industrialists, the main constituency of the Liberal Party to which Einaudi belonged (Sassoon, 1986:18–20). The sectoral configuration of postwar economies in and of itself, however, does not offer a sufficient explanation for the divergent economic policies adopted by postwar governments. The French economy's ability to generate an exportable surplus was far greater than that of the Italian economy in the immediate postwar period (Llewellyn and Potter, 1982:137–38). And even if ruling coalitions in France and Spain were dominated by more protectionist constituencies than in Italy, many of those constituencies stood to lose from an inflationary policy course.

Other aspects of the domestic political configuration in the immediate postwar period set the Italian case more clearly apart from the French and Spanish. The political Left was effectively marginalized in Italy with its expulsion from the ruling coalition in 1947. From that point on, the ruling DC was "able to confine working-class political forces to a role of hopeless opposition" (Salvati, 1985:513). The conditions for this outcome had ironically been created by earlier collaboration between the DC and the PCI. A special indemnity for industrial and agricultural wage earners agreed to by the two parties in 1946 accelerated inflation, severely hurting other wage earners with fixed salaries. This was interpreted by large segments of the middle-class electorate as evidence of collusion between the two parties, costing the DC heavy electoral losses in administrative elections later that year (Mammarella, 1966:137–38). By 1947 conservative elites in Italy thus had less to fear from imposing anti-inflationary measures than their French counterparts,[8] who perceived a greater threat from the Left and decided that the country was "not in a mood to accept austerity" (Werth, 1956:247–49; see also Rioux, 1987:65–66; Loriaux, 1990:108–11). The ability of Italian conservative elites to establish their political hegemony in the context of democratic institutions also contrasts with the situation in Spain, where a rise in worker militancy during the 1950s presented a serious threat to a regime that lacked any democratic means for legitimation, inclining technocratic elites to seek to defuse social conflict through monetary expansion. These differences also help to account for the paradox of an expansion in direct state control over the economy under right-wing governments in Italy. "After the expulsion of the Left from government and their electoral defeat in 1948," writes Sassoon (1986), "there were sufficient political guarantees for the private sector to tone down their opposition which was essentially a political one: not against state intervention as such but against an intervention in which the forces of the Left would have had an important say" (p. 23).

Financial interventionism in France and Spain thus came about largely as a means to rationalize early monetary policy choices which ultimately reflected either the precarious political position of conservative elites (in France) or the general precariousness of an undemocratic political order (as in Spain). This link between regulatory and monetary policy choices in the postwar period gives us a rather different understanding of the political nature of interventionism than the one offered in much of the traditional literature, where *dirigisme* is interpreted primarily as a reflection of state strength. As I will argue in the next section, it also serves to

[8] The exclusion of labor would eventually backfire, and the Italian strategy would fall victim to labor militancy, producing the high inflation rates of the late sixties and seventies.

clarify why state elites may choose to abandon interventionism in the absence of compelling market pressures.

Explaining the Abandonment of Interventionism and Its Consequences

So far, I have argued that the development of financial *dirigisme* in Europe was linked to politically motivated monetary policy choices made by government elites in the immediate postwar period. Three decades after its appearance, the pattern of postwar regulatory divergence among European countries captured in Figure 1, however, began to unravel, as the decision to abandon selective credit regulation was made first in Spain (in the 1970s) and later in France (in the 1980s). By contrast, the two regulatory regimes represented by Germany and Italy exhibited greater historical endurance. The Italian system experienced change in the early 1990s with the privatization of several of the banks held by the IRI. Yet this came as part of a general privatization drive that responded to the fiscal crisis of the Italian state rather than an independent project of financial reform. Most of the other changes that have been introduced in Italian financial regulation recently have been instituted in compliance with EC legislation (the Second European Banking Directive and the Maastricht Treaty) (OECD, 1995:52–53). This also holds for the German regulatory framework, which has experienced far less change than any of the interventionist cases.

France and Spain were not the only countries in which selective credit regulation was abandoned or downplayed as a regulatory principle in the eighties. Similar moves occurred in countries as diverse as South Korea, Norway, Mexico, and Japan (Maxfield, 1993; OECD, 1993; Tranoy, 1996; Calder, 1997; Woo-Cumings, 1997). This cross-national trend is what leads observers to presume that the abandonment of interventionism is driven by systemic market forces. However, as set out in the first section of this article, several features of the French and Spanish experiences conflict with the causal models advanced by proponents of this market-driven view. These include the fact that liberalization was advanced by public officials without clear support (and even with opposition) from key sectoral actors and evidence that capital controls in Europe were far more effective through the end of the 1980s than the market-driven convergence thesis implies. Given the similarity in the institutional starting points for reform in the two countries, the most striking challenge, however, comes from the different effects that liberalization had on the structure of the domestic financial market.

The proximate reason for this divergence in outcomes is that financial reform in the two countries differed greatly in its timing, sequencing, and scope. In France, the first major change was the shift from selective rediscounting to selective credit rationing in the early 1970s.[9] The so-called *encadrement du crédit* (quantitative credit controls with selective exemptions) which had been used only as a stop-gap measure in the sixties was institutionalized after 1971 in order to respond to inflationary pressures. This change, however, simply limited the expansive nature of credit policy. It did not alter the basic *dirigiste* premise of selective credit regulation. In fact, the turn to rationing appeared to maximize the statist qualities of financial regulation in France because it allowed policymakers to reconcile apparently contradictory policy objectives such as limiting credit growth, keeping interest rates down, and sustaining the availability of funds to favored sectors (Cohen et al., 1982).

The decision to abandon selective regulation in France was made only after the failure of the Socialist experiment with redistributive Keynesianism in 1982–83. The commitment to dismantle credit controls in favor of a market-based system of

[9] This section is based on the overviews offered by Melitz (1990), Loriaux (1991), and Cerny (1989).

industrial finance was made by the Fabius government of 1984–86 and was carried out in little over three years. The overhaul entailed three key elements: (1) a reform of the banking sector that desegmented the credit market by abolishing remaining distinctions among credit institutions; (2) the abolishment of quantitative credit controls; and (3) a wholesale revamping of the domestic capital markets that greatly expanded the sources of financing for French firms as privileged credit financing was phased out. Thus credit deregulation was undertaken in conjunction with fundamental market reform. The system of corporate finance that has resulted from this effort is a hybrid of the Anglo-Saxon capital market–based model and traditional French banking practices, rather than the "German model" of universal banking that inspired French reformers. Nevertheless, the pattern of liberalization pursued in France addressed the needs of nonfinancial firms by vastly expanding the sources of financing available to them.[10]

The comprehensive manner in which reform was carried out in France contrasts markedly with the course of reform in Spain. As in France, the first regulatory change in Spain was a shift from selective credit rediscounting to a form of selective credit rationing. In Spain, this took the form of a compulsory investment ratio that obliged banks to dedicate a prescribed proportion of their credits to favored sectors at regulated rates. This was accompanied by a series of measures that strengthened the regulatory authority of the central bank, which favored a wholesale liberalization of the financial system. During the last years of the Franco regime, central bank reformers were stalled by opposition to liberalization from the private banking cartel. Thus only those measures were passed that the banks assented to: notably, the liberalization of bank branches and that of commissions charged by banks on credit. In the oligopolistic context of the time, these measures produced a dramatic expansion of bank branches and, consequently, a sharp rise in operating costs that was passed on to credit recipients in the form of higher commission charges.

The political regime transition of 1976–77 propelled members of the central bank's policy network into key governmental positions and allowed them to pass a major package of reform in July 1977, only days after the first democratically elected government had taken office. The package set in motion the dismantling of the compulsory investment coefficients. Yet this early turn to credit deregulation was not accompanied by any significant measures to alter the oligopolistic structure of the Spanish financial market. Capital market reform was postponed for a whole decade, and foreign banks (although allowed to open offices in Spain in 1978) were made subject to restrictions that severely limited their capacity to exert competitive pressure in the credit market. The same was true of official credit institutions, which were kept from attaining an independent deposit base until the end of the 1980s. And even when capital market reform was finally instituted in the late 1980s, the private banks were allowed to exercise a degree of control over the stock market that seriously limited its role as a source of corporate finance into the 1990s (Pérez, 1997).

Despite their almost identical institutional starting points, liberalization in France and Spain thus differed strikingly in the combination of priorities that it was made to serve and in the extent to which it produced a transformation of the domestic market for corporate finance. What political dynamic can account for such a divergent pattern of reform? The interests of sectoral actors (specifically the banking sector) are central to the differing outcomes. In Spain the reform process preserved the oligopolistic position of the banks in the credit market to a much greater extent and for far longer than it did in France. Yet the role that these interests played is

[10] The basis for this expansion had been laid in the 1978 *loi Monory*, which offered French citizens a substantial tax deduction for stock purchases and produced a dramatic growth in mutual funds (*SICAVs*).

not the central one postulated in the market-driven model. In neither country did sectoral pressures provide the principal impetus for reform. The main market players in France (the large commercial banks) proved reluctant partners in the early stages of reform because it would end the fixed apportionment of the credit market. And in Spain, the private banking cartel that had dominated the banking sector since the early 1920s opposed any significant alteration in the old regulatory framework when the major liberalization measures were passed in 1977 (Pérez, 1997).

A stronger case can be made for the second argument linking liberalization to the growth of international financial markets (that emphasizing evasion by economic agents rather than political pressure from sectoral actors). The French policy U-turn of 1983–84 was precipitated by a balance of payments crisis that involved speculation against the franc and a serious loss of foreign reserves. The Spanish regime transition also represented a moment of increased external vulnerability because it created a climate of political uncertainty. However, if capital flight was a threat at these points in time, this was principally a constraint on the macroeconomic policies that governments were able to pursue, not on the mode of domestic credit regulation. A go-it-alone macroeconomic course such as that pursued initially by the French Socialists did invite currency speculation and capital outflows. Yet this was not caused by the regime of selective credit regulation per se. Stated differently, while a changing international context may have limited the room for credit expansion in these countries, it did not require governments to abandon the principle of selective regulation of credit. It simply required further credit restriction. Both the French and Spanish governments had already altered their policy instruments to make this possible in the early 1970s without giving up their discretionary powers.

What, if any, common political dynamic then explains the abandonment of selective credit regulation across these cases? As has already been indicated, selective credit regulation did not only constitute an instrument of industrial policy for governments. It also constituted a mode of monetary management, one which I have argued was instituted originally to rationalize an expansionary monetary stance in the immediate postwar period. Although the reform efforts of the last two decades in France and Spain differed widely in the extent to which they transformed the domestic financial market, they both entailed a similar change in the framework of monetary control: a move away from selective controls and toward a more orthodox mode of monetary management through routine central bank operations.

Central bankers commonly advance a number of technical reasons as to why monetary control is better achieved through indirect central bank operations than through direct credit controls. Administrative credit controls are relatively crude instruments when it comes to controlling short-term liquidity fluctuations, and this was seen as a significant problem by monetary policy officials in both France and Spain during the 1970s. Credit controls also interfere with the development of a money market in which the central bank can exercise indirect control over monetary magnitudes and can give rise to regulation evading financial innovation, complicating monetary management (Raymond, 1992). Whatever their technical merits, these arguments do not, however, constitute a very compelling explanation of the decision by political (or elected) authorities to forego their discretion over credit allocation. Nor do they seem to explain the timing of that decision in France and Spain. Both the French and Spanish governments were relatively successful at imposing monetary rigor through selective controls at those points in time when they chose to abide by their targets. In the late seventies, the French government, for example, came just as close on average to meeting its monetary targets as the German Bundesbank (OECD, 1983:40, 1984:30). Indeed, the superiority of orthodox central bank instruments in achieving liquidity control was all but established at the time that

regulatory reform was initiated. Monetary aggregate targeting was being undermined by unpredictable changes in money demand and by financial innovation even in those countries (the U.S. and the U.K.) where central banks operated in well-developed money markets (Cobham, 1992). It is also unclear why the technical considerations advanced by central bankers would carry so much more weight in Spain than in France in the mid-seventies as to explain the difference in the timing of reform, or why they would suddenly become so critical as to catalyze the largely unexpected wholesale reform effort that took place in France in 1984–86.

A more persuasive explanation of the political decision to abandon interventionism is offered for the French case by Loriaux (1991), who argues that selective credit regulation produced an "overdraft economy" that rendered banks and industrial firms so vulnerable to assertive monetary measures as to tie the government's hands in the fight against inflation.[11] French officials were therefore continually under pressure to expand the exemptions granted to specific users under the *encadrement du crédit* system. This explains the strong effort to increase noncredit-based sources of financing for firms in France once the decision to deregulate credit had been taken. Yet it requires some additional factor to explain the timing of the sudden French regulatory reversal in the mid-eighties. More important from a comparative perspective is the fact that the financial vulnerability of nonfinancial firms did not preclude post-transition governments in Spain from imposing a combination of credit deregulation and monetary restriction that produced massive bankruptcies and spectacular unemployment levels in the eighties.

Loriaux's argument is nonetheless instructive beyond the French case because it suggests that the fundamental reasons for the abandonment of interventionism were political rather than technical in nature. If the French state became the hostage of its own powers of discretion in the economy, this was because of the manner in which financial *dirigisme* had been used to defuse social conflict through the selective expansion of credit in the postwar period. Once there was less room for macroeconomic expansion, that same regulatory framework injected the state into the tough distributive issues that macroeconomic adjustment implied. Thus, if interventionism limited the capacity of French and Spanish officials to fight inflation, it did so not so much for technical reasons as because it raised the political costs of monetary rigor for governments.

These political costs constitute an important incentive for elected authorities to embrace the arguments of advocates of liberalization at a particular point in time. Selective credit regulation politicizes the task of disinflation by requiring governments to openly make the hard distributive choices that monetary adjustment implies. By contrast, when credit growth is controlled by a central bank (ideally a formally autonomous one) through routine operations in a money market, monetary rigor is politically easier because it leaves the allocation of hardship to the presumed neutrality of the market. Hence, when elected authorities become convinced that economic austerity is necessary yet perceive that this entails substantial political risks, proposals for market-oriented financial reform offer a way to depoliticize the task of macroeconomic stabilization. Such an explanation fits the differing timing with which the commitment to abandon selective credit regulation was made in France and Spain. In Spain, the fundamental package of measures was pushed

[11] The concept of an "overdraft economy" was developed by the British economist John Hicks and later expanded upon by French central bankers. It refers to an economy that is characterized by an underdeveloped financial market and high dependence on "institutionally allocated credit" and that contrasts with the "auto" or asset-based economy, which is characterized by a well-developed and active financial market, in which "firms and banks, when faced by liquidity shortfalls, sell securities previously purchased and held in reserve in order to confront monetary emergencies" (Loriaux, 1991:56). In an overdraft economy, economic agents act on the basis of a "presumption of assured borrowing," and consequently choose not to hold precautionary assets.

through in the throes of the political regime transition (1977), when elected authorities (the centrist government of Adolfo Suárez) faced the dual tasks of thwarting an explosion in wages while simultaneously inaugurating a democratic process of policymaking. In France, on the other hand, the decision to abandon selective credit regulation was made only after 1983, when elected authorities (Mitterrand) decided that austerity could not be avoided.

Seen in this light, the abandonment of selective credit regulation in the two European countries appears intricately linked to the origins of interventionism several decades earlier. In both cases, monetary policy considerations of an essentially political nature lay behind regulatory shifts that were justified in terms of national economic strategy (the logic of shaping national comparative advantage when *dirigisme* was adopted; the allocative efficiency attributed to market-based capital allocation when it was abandoned). In the first regulatory shift, elites were operating in an environment of perceived monetary policy latitude. The policy decisions that lay behind the introduction of selective credit regulation (avoidance of radical currency reform) can thus be described as a political choice that was in turn rationalized through the regulatory framework. In the second shift, political elites were operating under the perception of reduced latitude. Their political choice therefore lay not in the area of monetary policy but in that of financial regulation.

It might be argued in response that the political dynamic described above is simply a different expression of international market integration because capital mobility affects the monetary policy latitude that governments operate under (Andrews, 1994), and hence, that the analysis confirms the market-driven convergence thesis. Such a conclusion, however, would miss two important points. First, although increased international constraints may have abetted the process, the expansionary growth strategy that interventionism was contrived to support displayed clear signs of internal exhaustion in both countries well before changes in the international context had acquired a compelling character. This endogenous exhaustion of the "cheap-credit" growth strategy had two components. One was the completion of the structural shift of resources from the primary (agricultural) to the secondary (industrial) sector, which inevitably reduced the productivity gains that could be had from selectively expanding the money supply (Zysman, 1985:140–71).[12] The second was the self-limiting nature of credit expansion as a political tool. In France, the use of credit expansion coupled with devaluation to neutralize nominal wage increases resulted in a highly unstable labor market marked by heightened worker militancy and wage explosions (in 1962–63 and again in 1968) which simply outpaced the government's attempts to restore profitability by allowing domestic prices to rise faster than world prices (Flanagan et al., 1983:595–624). In Spain, the legalization of collective bargaining and the depenalization of strike activity in the early sixties also produced a rise in working-class militancy which, by the late sixties, was undermining the government's ability to diffuse nominal wage increases through credit growth (Maravall, 1970:93–100, 1977:23). Even without change in the international context, the policies that interventionism had been created to serve were thus producing the domestic political conditions for its abandonment. The point, therefore, is not that increased capital mobility did not also affect the monetary policy leeway under which governments operated. It is rather that there are other explanations for the regulatory turn

[12] In Spain, the shift of labor from agriculture to industry, compounded by high rates of emigration to the EEC, had by 1967 significantly depleted the pool of available labor for both agriculture and industry. The results were a decline in agricultural productivity, and a rise in industrial wage rates which "sustained an inflationary process that ultimately halted expansion" (Román, 1971:4).

away from interventionism that are overlooked when authors automatically read causation into the correlation between liberalization and the growth of international financial markets.

Second, the political incentives that derive from the relationship of financial regulation to monetary policy have different implications for the outcomes of liberalization than the efficiency-oriented pressures emphasized in the market-driven view. The motivation to abandon interventionism that disinflation creates for political (or elected) authorities is essentially a negative one; it ends at the point at which state authority has been extricated from the task of credit allocation. Political authorities in formerly interventionist states thus face far stronger incentives to abandon interventionism than they do to undertake structural reform of the domestic financial system. Indeed, this economic shortsightedness is reinforced by international financial integration because the principal way in which such integration impinges on governments is through the operation of very short term markets (in particular currency markets) that respond to expectations about a few key macroeconomic outcomes (such as interest rates, budget deficits, and inflation) but are often indifferent to underlying structural conditions.

This asymmetry in the incentives faced by political authorities means that it is far less certain that financial liberalization (i.e., the abandonment of interventionism) will result in the kind of competitive financial market conditions that support an economy's competitiveness. It is unclear that the common trend away from activist credit policies will be accompanied by the kind of reform of financial market structures that is required for the efficient and optimal use of capital in an economy. Political authorities face no similarly poignant or urgent incentive to pursue such far-reaching reforms as they do to abandon selective credit regulation. Far more will depend, therefore, on other factors that are likely to vary from country to country. Contrary to the efficiency-oriented pressures emphasized in the market-driven view, the macroeconomically centered explanation of the choice to abandon interventionism offered here therefore leads us to expect greater variation in the structural outcomes of financial liberalization in formerly activist states. Nevertheless, we may be able to understand some of that variation by considering how the decision to abandon interventionism by political authorities interacts with the preferences of other state elites.

Explaining Divergence in Outcomes: Why the Abandonment of Interventionism May Militate Against Structural Reform

Behind the negative choice to extricate the state from the function of credit allocation, the politics of liberalization also involves other actors whose agendas may differ substantially from that of elected officials. Foremost among these are groups of policymakers whose influence over economic policy is a direct function of the mode of financial regulation. The decision by political authorities to extricate the state from the task of credit allocation, more specifically, creates opportunities for anti-interventionist reformers. Because of the ideological dichotomy between "volontarisme" and "monetarism," and because of the problems that credit regulation poses for monetary policy, such reformers are likely to be institutionally anchored in the central bank. The French and Spanish experiences suggest that it may well be the balance between such reformers and other members of the domestic policymaking community that determines the outcomes of reform.

Most treatments of the role of central banks by political scientists conform to what Beck (1988:368) refers to as the " 'public interest' theory of monetary policy" in assuming that central bankers are politically neutral actors. There are, however, two reasons to expect that a reform process dominated by central bankers may not produce the kind of reform that supports an economy's capacity for adjustment by

creating a competitive market for corporate finance. Financial interventionism limits the policy influence of central bankers by subjecting the financial system to the authority of other state actors. The abandonment of interventionism (i.e., credit deregulation) thus implies a shift in influence away from planners and industrial policy authorities and in favor of central bankers. This shift is likely to become an objective of its own in any financial reform process spearheaded by central bank authorities and not counterbalanced by other state actors.

To the extent that financial reform is dominated by central bankers, it is also likely to become the subject of the search for accommodation between central bankers and their "natural constituency," the domestic financial sector (Woolley, 1985:338). Indeed, the search for such an accommodation is likely to be intensified by a fundamental tension between the two institutional imperatives of central bankers: maintaining price-stability and ensuring the stability of the domestic financial sector. The monetary rigor that credit deregulation is intended to facilitate politically also places pressure on the profitability of banks and brings to the fore a potential conflict of interest between the financial sector and firms in other sectors of the economy (in particular firms in competitive sectors that cannot pass on costs). If banks are to remain profitable, they either have to become more cost efficient or be allowed to exploit oligopolistic market conditions that allow them to pass on the higher cost of rediscounting to credit users. Given that increased competition can threaten a shake-out in the financial sector (in particular where banks have become accustomed to operate under limited competition and guaranteed liquidity), there is likely to be considerable pressure for central bankers to opt for the second solution, i.e., continued protection. A reform process dominated by central bankers therefore is likely to entail an accommodation between the former's monetary policy objectives and the interests of the domestic banking sector that militates against assertive market reform.

These considerations go a long way in explaining the differing outcomes of financial reform in France and Spain. In Spain, the early commitment to financial liberalization was the direct result of a subtle shift within the state bureaucracy in which the regime's technocratic planners were displaced by a network of academic economists anchored in the central bank's Research Service (Pérez, 1997). These central bank reformers, some of whom had participated in drafting the IMF-sponsored stabilization plan of 1959 only to be displaced by the more politically minded planners, defined themselves in opposition to the planning bureaucracy. Their main objective was that of giving the central bank control over monetary policy by eliminating those regulatory practices that gave other state agencies a say in the regulation of the financial system (i.e., selective credit regulation). The political transition of 1976–77 presented these reformers with both an opportunity and a threat. On one hand, it allowed them to gain much greater influence, as several of their leading members were placed into leading policymaking positions. On the other hand, however, it also threatened to dislodge control over the reform process from the central bank and open it up to the parliamentary process that was being inaugurated. The urgency with which the major package of reforms was passed in 1977 reflects the reformers' determination to preempt this latter possibility.

The political contest among state elites still under the Franco regime, and the political calculations of central bank reformers at the time of the transition, explains the early turn away from interventionism in Spain. Yet, in order to propel their agenda of institutional reform, the reformers also sought a working alliance with the domestic banking sector, which was firmly opposed to any radical alteration of the regulatory framework in 1977. The course of reform in Spain thus became a function of the search for reciprocal consent between central and private bankers. From the initial package introduced in 1977 through subsequent steps in the 1980s, the reformers salvaged those aspects of liberalization that were critical to their

objective of strengthening the central bank's control over monetary policy while avoiding, or critically postponing, those reform measures that might have imbued a greater measure of competition in the credit market. The outcome was credit deregulation in the absence of market reform.

In France, by contrast, the abandonment of interventionism occurred in a context that made it less likely that liberalization be carried out at the expense of market reform and the needs of nonfinancial firms. Much of this difference had to do with the particular character of the French policymaking elite. Although the intellectual groundwork for financial reform was, as in Spain, done by central bankers, the actual reform process was controlled by the Ministry of Finance and coordinated by the office of the Treasury, which combined responsibility for monetary and industrial policy. Moreover, the Bank of France itself remained embedded in a policymaking community in which large nonfinancial firms were connected to the financial sector through a network of state elites that centered on the Treasury rather than the central bank (Hayward, 1986; Goodman, 1992:109). This also applied to the French commercial banks, which, having been effectively nationalized in 1945, had spent four decades under the tutelage of the Treasury and were commonly headed by state-appointed directors with strong ties to both the Treasury and French industry. This interpenetration of the industrial and financial policy communities through the career paths of state elites made it less likely that the central bank would become (as in Spain) the base of a contending network of policymakers who viewed financial reform foremost as a vehicle for altering the institutional bases of macroeconomic policy. The "general vision" that inspired the comprehensive approach to liberalization in France (Melitz, 1990:397) may thus ironically have been a result of the subordination of the financial sector, and of the fact that no sectoral actor was particularly well represented in the French liberalization process.[13]

The comparison of France and Spain thus suggests that financial reform is more likely to fit the pattern postulated in the market-driven view where the state has tutelage over the financial sector than where the financial sector remains in private hands. However, it also suggests that this is less a matter of the direct control that public ownership affords to public officials than of the way in which it may shape the character and outlook of the policymaking elites. Public officials in Spain had several important options at their disposal for imposing a more competitive market structure (none of which required nationalization). Yet they forwent these options because the central bank reformers who dominated the liberalization process were principally concerned with securing the central bank's control over monetary policy and with ensuring the stability of the financial sector. As monetary adjustment tends to place pressure on the margins of financial institutions, and as central bankers are likely to play an important role in any liberalization process, such a compromise is likely to be a feature of financial liberalization in other formerly activist states as well.

Conclusion

The market-driven view of regulatory change offers a powerful systemic explanation that is intrinsically appealing to political economists when it comes to explaining cross-national trends. Yet the comparative analysis of the French and Spanish experiences offered here shows that such a view can obfuscate the domestic political dynamic behind the abandonment of financial interventionism in formerly activist states. Part of the problem lies with the way in which political scientists conceptualize interventionism itself. The tendency to view interventionism in terms of the dichot-

[13] I owe the latter point to an anonymous reviewer.

omy between state and market, and the belief that these are intrinsically opposed modes of regulation, lead to the conclusion that, if there is a trend away from interventionism, it must be driven by efficiency-oriented market forces. Such an understanding, however, overlooks the central role that postwar macroeconomic choices, and the distributive politics of inflation and disinflation, played in the creation of an interventionist regulatory framework and its eventual abandonment in the two countries. The way in which the objective of disinflation leads governments in formerly activist states to opt for liberalization has different implications from the political dynamics postulated by proponents of the market-driven view. It gives primacy to credit deregulation over other aspects of financial reform and makes the kind of divergence that we observe in the liberalization processes of the two European countries far more likely than the market-driven view leads us to expect.

The primacy of monetary policy considerations in bringing about the political choice in favor of liberalization does not mean that efficiency considerations and financial market competition played no role in the politics of regulatory reform in the two countries. Those considerations were important in justifying the regulatory turn, both publicly and in the minds of officials, and they allowed state reformers to tap support among some of the sectoral actors emphasized in the market-driven view. In the French case, they were also reflected in the way reform was carried out, once the political choice to abandon interventionism had been made. Yet, while market pressures and sectoral interests may have been important in defining the landscape in which regulatory reform took place, they did not play the decisive role in the decision to abandon interventionism that is commonly attributed to them. As the Spanish case (marked by strong opposition to liberalization from key sectoral actors) suggests, such factors were in fact more important in determining variation in the process of liberalization than in explaining the common choice by governments to abandon interventionism. This causal pattern is the opposite of that postulated in much of the literature, where cross-national changes in sectoral preferences explain the common trend away from interventionism, while variation in outcomes is attributed to secondary differences in domestic institutions.

The experiences of France and Spain thus suggest that we need to pay far more attention to the manner in which different modes of financial regulation are linked to the politics of macroeconomic (and in particular monetary) adjustment. This insight is likely to be of significance well beyond the two European cases. As noted above, the historical connection between interventionism and a credit-driven postwar growth strategy can also be observed in East Asia and Latin America. The political dynamics that this connection engenders, on the other hand, can vary substantially depending on the particular way in which cheap credit policies are used by governments. In France and Spain, such policies were heavily relied on to defuse social conflict (i.e., to compensate employers for nominal wage increases). This strategy ultimately led to higher labor militancy and to a wage-price dynamic that forced governments to focus on the problem of disinflation. In some of the Scandinavian countries, such an outcome was averted for a significant period of time through effective, centralized wage-bargaining. In some of the East Asian countries (in particular Japan but also Korea) wage restraint was achieved by other means, and cheap credit was more successfully used to bolster external competitiveness. The political exhaustion of the cheap-credit strategy observed in France and Spain, and the relationship of financial reform to the politics of disinflation in these countries, nevertheless offer an important point of reference for understanding the issues that may drive financial liberalization in other cases.

The link between regulatory reform and macroeconomic adjustment in the two European cases also has more specific implications for our understanding of anti-interventionist reform. It suggests that, even when it is abetted by international

market competition, the domestic politics of financial liberalization may militate against the kind of reform process that supports the capacity for adjustment of national economies. For liberalization to result in enhanced economic performance, credit deregulation has to be accompanied by reforms that create the kind of competitive (and complete) market conditions that serve as assumptions in the economic literature. The market-driven view leads us to expect that the same political dynamic that produces the abandonment of interventionism will also instigate such market reforms. The comparison of the two European cases, however, suggests that the attainment of such an outcome in France was dependent on a set of conditions—state control of the banking sector and the interpenetration of the financial and industrial policy communities—that are exogenous to the market-driven model.

Taken together, the similarities and differences between the two cases suggest that financial liberalization in formerly activist states is best understood as entailing choices and motivations by at least two different sets of actors. The first involves the choice by political (or elected) authorities to dismantle selective credit regulation in order to extricate the government from the role of allocating the costs of macroeconomic adjustment (or, elsewhere, financial crisis). The second entails the agenda and motivations of other parts of the policymaking elite who play a role in the promotion, design, and implementation of financial reform. It is the first choice (that by political authorities) that accounts for the cross-national trend away from interventionism. The fact that the incentives faced by political authorities in making this choice are predominantly negative, i.e., require only the abandonment of interventionism, makes other aspects of financial reform dependent on the motivations and relationships of the second set of actors. It is this complex character of the political process behind liberalization that accounts for the divergence in outcomes that we observe in the European cases.

The comparison of France and Spain suggests, more specifically, that a key dimension in the regulatory shift away from selective credit regulation is the extent to which the reform process is dominated by the agenda of central bankers and the search for accommodation with the domestic financial sector. In the absence of countervailing pressures, such as the interlocking nature of the French policymaking elite, the politics of disinflation, macroeconomic adjustment, or financial crisis—all of which place pressure on the profitability and stability of financial institutions—make such an accommodation a likely outcome. Financial liberalization efforts may therefore fail to produce competitive markets for corporate finance for an extensive period of time, placing a heavy burden (as in the Spanish case) on the real sectors of an economy.

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