2012-12

THE DEBT: a bridge between the past and the future

République Française
Liberté - Égalité - Fraternité
Conseil économique social et environnemental

France's public debt has reached 1,717 billion Euros: it requires a long term, appropriate and determined, balanced and objective approach. This demands that a clear and courageous approach must be taken by the whole of society. If the national debt is kept at a sustainable level in relation to the public finances, and as long as the level of debt is warranted, we will see the benefits in the future.

As there is no time limit on the State, external factors and the inter generational dimension can be taken into account. The public debt can therefore be useful, particularly in funding investment.

Since the oil crisis, national debt has increased everywhere. The change in economic policy in the mid 1980s led to an increase in real interest rates, and therefore to higher borrowing costs. Due to competition, businesses have had to limit salary levels and unemployment has increased. As a result, the distribution of added value has worked mainly to the advantage of those who own capital. Employment and growth have been penalised. States have therefore pushed the banks to increase the availability of credit and have increased public spending. In France, all the governments since 2000 have reduced tax rates.

It is in this context that the 2007 2008 crisis emerged. The recession has further contributed to the national debt burden.

On the other hand, private debt in France is still under control. Household debt remains modest (57% of GDP) and the personal savings rate is quite high (16% in 2011). Debts incurred by non financial businesses are at 131% of value added.

Among the lowest in developed countries in the 1980s (22% of GDP), the public debt reached 86% of GDP in 2011.

This debt is now mainly financed by the capital markets, and in France's case, non residents fund almost 70% of the total. Therefore, lender confidence is key and ratings agencies have an important role to play.

On the other hand, it is expedient to remember that France has assets in the form of national cultural wealth, infrastructure, public service use, the social welfare system etc. The use of these assets, along with the payment of the debt, constitutes the bond of solidarity between generations. In France, At the end of 2010, these assets were worth 132% of GDP. Hence, according to the OECD, France has one of the highest levels of net wealth among developed countries. However, these assets cannot simply be used to pay off the national debt; many components of this wealth can neither be valued nor sold.

A number of factors must be brought to bear to the difficult task of measuring the sustainability of the debt:

- The primary budget balance (before interest)
- The level of debt
- The rate of growth in GDP
- The real rate of interest on the debt.

The problem of the public debt must be dealt with in a timely manner, by articulating urgent measures and an ambitious strategy to stimulate sustainable growth. The rate at which the State can borrow can be used as a stress indicator, along with the level of debt measured against international criteria. The risks involved also depend on the proportion of the debt that is financed by non residents.

The introduction of the euro has led to a general reduction in interest rates, which have converged towards the German rate. The euro has therefore facilitated the painless (or almost) financing of the public debt: the burden of the debt is currently less than 3% of GDP. However, the amount of interest paid reached 47 billion Euros in 2010 which, along with the refinancing of loans, means that France has to borrow 180 billion Euros in 2012. This amount will continue to increase in 2013 2014. France must reduce its deficit if it wishes to retain some margin for manoeuvre.

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How can the national debt be reduced without damaging economic activity or calling into question social welfare or working conditions?

A debt reduction can be achieved through a combination of measures: an increase in revenue (tax reform and increased revenue generated by economic growth), a reduction in spending while protecting sectors that generate economic activity, jobs and structural reform.

The ESEC recommends a combination of short term action to maintain the confidence of the financial markets and a six part strategy to stimulate sustainable growth:

DECIDE QUICKLY, SET OUT POLICY, MAKE MAJOR CHANGES, SEE THEM THROUGH

An indication of the France's intention to reduce the deficit and public debts should be given soon. To that end, it is suggested that a rebalancing of income and expenditure should be undertaken, in a thorough review of the French tax system and expenditure, which must be carefully evaluated. The reform must lead to more effective, fairer, and therefore more acceptable taxation. The fight against tax fraud must be strengthened. Decisive action must be taken on spending, while avoiding disruption of economic activity. Although this will take time, the objectives must be clear and their implementation must be subject to periodic evaluation.

AVOIDING THE PITFALLS OF INDISCRIMINATE AUSTERITY LIKELY TO LEAD TO RECESSION

The pursuit of austerity policies in several eurozone countries are contributing to the risks of a contraction of the whole European economy. Future investments risk being sacrificed.

The ESEC recommends discussion on a new form of development integrating environmental and social needs and on the details of such a transition.

In the short term, measures must be taken to reduce debt, for example by tackling "tax loopholes" by systematically evaluating them.

THE EUROPEAN DIMENSION IS A KEY ELEMENT OF SUCCESS

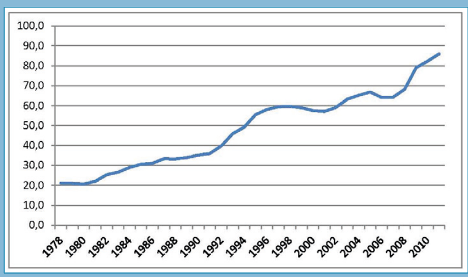
As the world's largest economic power, the European Union possesses many advantages, France should capitalise on this. European cooperation is the key to overcoming the crisis.

However, the crisis has exacerbated doubts about the way in which the eurozone functions. European governance must be reviewed in order to achieve a better balance between the various objectives: prioritising sustainable growth and employment and fighting against the factors that contribute to imbalances within the eurozone such as differences in competitiveness. Strengthening the legitimacy of decisions taken at European level is an equally important objective. The work of the European ESEC should carry greater weight in decision making.

Greater solidarity must be promoted, accompanied by strict rules in order to avoid moral hazard.

Greater tax and social welfare harmonisation should also be pursued. Beyond that, Europe must undertake common projects, funded by "project bonds". More generally, the European Union budget must be increased.

Public debt in Maastricht terms



Source : National accounts - Base 2005, INSEE

Consensus has not been reached on the "golden rule" in budgetary policy: arguments both for and against are being expressed successively.

A new monetary policy will have to be introduced and the Council must exercise its responsibility in setting objectives for change.

RATIONALISING PUBLIC EXPENDITURE

This involves taking action on the expenditure by various categories of government departments:

- For the State, a proper evaluation of public policy and resources must be undertaken;
- The costs of social welfare must be subjected to critical analysis while rembering that social welfare is the best way of reducing the impact of the crisis;
- Local and regional government bodies must seek to reduce their expenditure.

CHANGE THE ROLE OF RATINGS AGENCIES

The role of these agencies has grown significantly over the past few years. The ESEC recommends the creation of a watchdog to monitor the activity of rating agencies.

STIMULATE THE PURCHASE OF FRENCH SECURITIES BY RESIDENTS

The ESEC recommends "domestication" of the national debt, 70% of which is currently held by non residents. This would involve offering Treasury Bonds, tax free savings (Livret A) or creating a provision within employee savings plans.

Reat the full text (in French) on www.lecese.fr