

THE MONTHLY MAGAZINE FROM THE iFRAP FOUNDATION

SOCIÉTÉ CIVILE

Investigating to reform N° 200

PUBLIC DEBT

How to avoid reaching 100 %

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April 2019 - € 8



FONDATION POUR LA RECHERCHE
SUR LES ADMINISTRATIONS ET
LES POLITIQUES PUBLIQUES

Public debt

STATE OF AFFAIRS

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Since 2010, Germany's debt has fallen drastically, possibly to below 60% (61.5% in the 2nd quarter of 2018¹). This ceiling was initially set by the European Union in the Treaty of Maastricht in 1992. In contrast, the curve of France's debt has grown without showing any real signs of change. For 2018, the gross public debt amounted to 2,315.3 billion euros², i.e. 98.5% of GDP. The latest stability program indicates that the government has abandoned its ambitions: France is heading for 100% debt with a debt target for 2022 increased to 96.8% instead of the 92.7% originally announced during the presidential campaign... And the recent announcements by the President of the Republic following the demands of "yellow vests" movement should help to further increase the deficit (announced increase in public spending and lower compulsory levies) and hence, the debt continues to grow.

In the European Union, Belgium (103.1%), Portugal (124.8%), Italy (131.2%) and Greece (176.1%) have a debt that exceeds 100% of their GDP.

Over the last few years, thanks to the policy of the European Central Bank (ECB), France enjoys very low interest rates. To the point that the question of the debt is now debated. In this case, why do Switzerland, Germany and Sweden see their public debt decrease through debt braking mechanisms?

The iFRAP Foundation considers that it is essential for France to control its debt, as our room for manoeuvre is becoming increasingly restricted. This relates to the diagnostics of the rating agencies: hence, "*if France's rating is downgraded and followed by the financial players, it could obviously have consequences on our financing conditions*".³ The situation is urgent: these agencies consider France as being "*very robust from an economic and institutional point of view and has a strong resilience to shock risk*", but it must tackle a public finance situation that seems to be more "problematic".

■ France benefits considerably from low interest rates: by keeping rates at their 2010 level, France has saved nearly 19 billion euros between 2010 and 2016; the Government announces that 10 billion will be further saved up to 2021;

■ Unfortunately, successive governments have not seized this opportunity to give themselves room for manoeuvre in the event of a new crisis, notably by tackling our recurring deficits and our record level of public spending;

■ European rules are a first step in reducing our deficit: other countries, such as Switzerland, Sweden or Germany have gone further by introducing a debt brake;

■ The interview with Valérie Plagnol, economist and member of France's High Council of Public Finances (HCFP);

■ The of the iFRAP Foundation's recommendations.

■ 1 Toute l'Europe, "La dette publique des États de l'Union européenne" (The public debt of the European Union States), November 2018.

■ 2 Insee, In 2018, the public deficit amounted to 2.5% of GDP, whereas the reported debt amounted to 98.4% of GDP, March 2019, <https://www.insee.fr/fr/statistiques/3899153>.

■ 3 Nathalie Goulet, report n° 147, volume III, appendix n° 13 engagements financiers de l'État, Sénat (financial commitments of the State, Senate), 22 November 2018.

THE TRAJECTORY OF FRANCE'S DEBT

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“French public debt is now the fifth highest debt in the European Union. *Since 2017, this trend is the opposite of that of all the Member States of the Union and Euro area, whose debt / GDP ratio has fallen.*”⁴ The Court of auditors notes that, until 2008, the French public debt compared to GDP was comparable to that of Germany, whereas today, the difference represents 34.4% of GDP. So, according to the magistrates of rue Cambon, “*the prospects of reducing France's public debt as planned in the public finance programming act for 2018-2022 and the 2018-2022 stability program seem fragile*”. As such, even if the trajectory defined as part of the 2018-2022 public finance programming act (LFPF) highlights a return to 92% of GDP in 2022, i.e. a drop of almost 8 points of GDP, this would imply “*higher growth from 2017 to 2022 than the potential growth, which has never happened over such a long period*”. Furthermore, in the French Treasury's latest stability program (PSTAB), the multi-annual public finance trajectory predicts a debt ratio significantly higher than that projected in the 2018-2022 LFPF, which stands at 96.8% in 2022.⁵ For 2017, the gross public

debt stands at 2,315.3 billion euros.⁶ The State alone accounts for 80% of the French public debt.

The debt burden

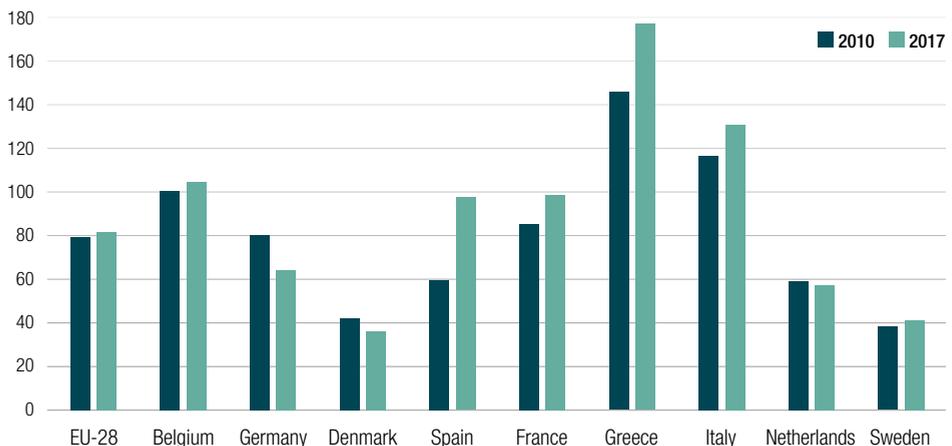
For France, the 2019 finance bill predicts a debt burden of 42.5 billion euros. There are three main factors that can affect the debt burden: interest rates, inflation and growth. Since 2015, European countries have benefited from historically low interest rates, which contribute to a relatively stabilized debt burden. The interest rate directly impacts the amount of the burden. In an information report to the Senate in 2017, Serge Dassault underlined: “*If the apparent rate of 2016 had remained at the level of 2010, the interest rate on the French sovereign debt would have been 19 billion euros higher than its current level! In total, the drop in interest rates has saved France nearly 67 billion euros since 2010.*”⁷ Conversely, growth has no impact on the value of the debt burden, but on the proportion of debt to GDP (volume effect). So, growth increases GDP. If the debt burden remains stable, then its ratio to GDP diminishes.

■ 4 Court of auditors, “La dette des entités publiques” (The debt of public entities), statement to the Senate finance committee, January 2019.

■ 5 Direction générale du Trésor (French Treasury), Stability programme 2019-2022, April 2019.

■ 6 Insee, In 2018, the public deficit amounted to 2.5% of GDP, whereas the reported debt amounted to 98.4% of GDP, March 2019, <https://www.insee.fr/fr/statistiques/3899153>.

Public debt of European countries in 2010 and 2017 (% of GDP)



Source: Eurostat

The drop in the cost of the public debt until 2021, an opportunity

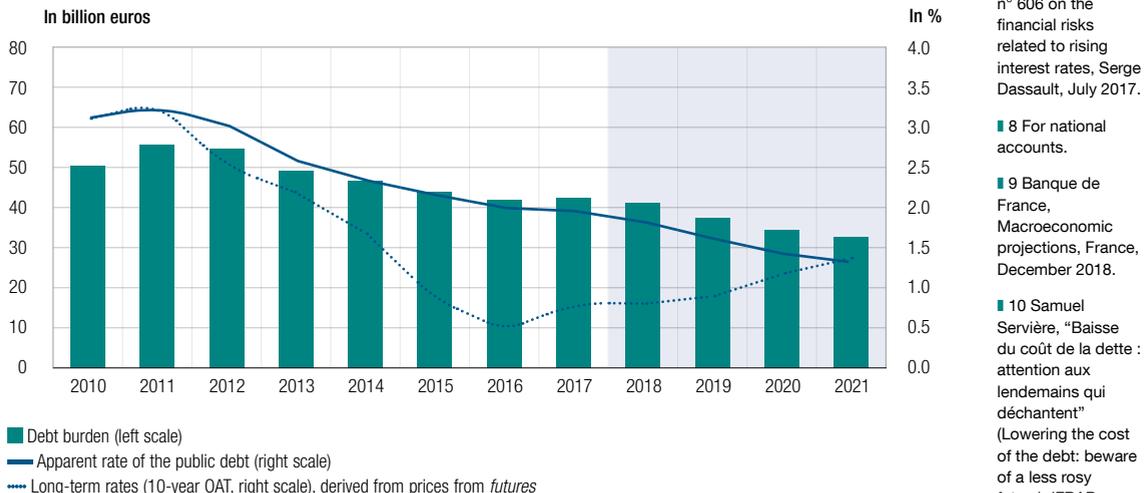
In its macroeconomic projections for France in December 2018, the Banque de France insisted on the rate effect largely linked to *quantitative easing* that in its view, presides over the gradual decline in the burden of the French public debt. As we can see in the graph below, “from 2011 to 2017, the public debt burden (as a % of GDP) steadily dropped⁸, from 2.7% of GDP in 2011 to 1.9% of GDP in 2017”.⁹ Furthermore, according to the projections of the Banque de France, this reduction should continue. “Up to 2021, we expect a further decline in the debt burden from 1.9% of GDP in 2017 to 1.3% of GDP in 2021, along with the decline in the apparent debt rate.” This decrease in debt burden would lower this burden from 42.4 billion euros in 2017 to 32.4 billion euros in 2021, i.e. a drop of 10 billion euros. Still according to the Banque de France, the rate should stabilize in 2021, before rising from the moment when “the average rate at issuance would become higher than the apparent rate” The ECB’s monetary policy gives the State an

opportunity to make structural savings and reform public finances. If interest rates had not fallen thanks to the ECB’s policy, France’s debt burden would be considerable. This cut in interest rates creates room for manoeuvre for the State. It is necessary to take advantage of this short window of opportunity to push on with the reforms and revise the mechanisms to reduce public debt.¹⁰

International comparison of the public debt burden

This advantage has not benefited France alone, and in most European countries, the burden of interest on debt relative to GDP has tended to decline since the 2000s. In 2018, the French debt burden amounted to 1.85% of GDP. The debt burden is expressed in the national accounts, which explains its continuing decline due to the different treatment of premiums and discounts on emissions on old stocks and the effect of negative rates.¹¹ However, regarding the evolution of the debt burden in several European countries, the burden for some countries is falling much faster than for others. For example,

Evolution of the debt burden and interest rates since 2010

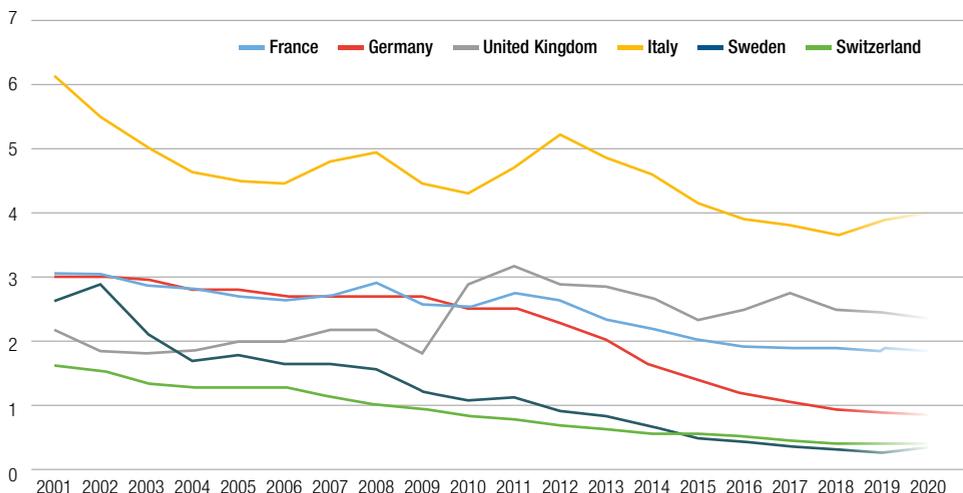


Source: Banque de France, Macroeconomic projections, France, December 2018

between 2011 and 2017, the German debt burden fell by more than 33 billion euros, i.e. a drop of 49.9%. Over the same period,

the French debt burden fell by only 13 billion euros, or 23.4%.

Interest burden of the debt as a % of GDP



Source: AMECO Database, European commission, iFRAP Foundation

MANAGING THE DEBT AND RELATED RISKS

Agence France Trésor (hereinafter AFT) manages all financial flows (expenditure and revenue) of the State and the “Treasury’s correspondents”¹² via a single account system centralized at the Banque de France. This account, held by the Banque de France, must have a positive balance at the end of each day as the Banque de France is prohibited from granting credit to the State. In fact, the State must always have the financial means to fulfil its commitments. Hence, *“outstanding amounts deposited by the Treasury’s correspondents are a resource for the State’s treasury. Therefore, they can be used to limit them from resorting to loans”*.¹³

Securities issued by the AFT

Fixed rate treasury bills (BTFs) are short-term State debt securities with a maturity of less than one year. Fungible Treasury bonds (OATs) correspond to medium and long-term State financing. These securities have a maturity of 2 to 50 years. Furthermore, OATs may be indexed to France’s consumer price index (CPI), called OATi or the Euro area’s consumer price index, OAT€i.¹⁴ In this way, at the end of 2019, the OATs (and Treasury bills with interest paid annually, BTANs) would represent 91% of the State’s tradeable debt and BTFs would represent 7%. Consequently, the vast majority of the State’s tradeable debt is comprised of medium or long-term securities (91%), whereas the short-term securities (BTFs) represent only 7%.¹⁵

11 In commitment accounting, premiums are a relief from the debt burden in the year of issue and vice versa for discounts, whereas in national accounting, premiums and discounts are smoothed over the entire duration of the loan. When we are in the massive issue phase with premiums, it adds up year after year.

12 Treasury correspondents are entities that deposit their treasury in the single account of the Treasury, essentially local authorities and public institutions.

13 Agence France Trésor, cash management by the AFT.

14 Agence France Trésor, <https://www.aft.gouv.fr/index.php/fr>.

Evolution of the composition of the State's tradeable debt (in billions of euros)

	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016	End 2017	End 2018 (P)	End 2019 (P)	Evol. 2011-2019	Part 2011	Part 2019
OAT&BTAN	1,116	1,199	1,264	1,332	1,405	1,467	1,540	1,619	1,685	51%	85%	91%
BTF	178	167	174	175	153	133.9	127	119	134	25%	14%	7%
Indexation supplement at the date considered	13.1	20.7	19.6	20.4	18.9	19.4	20.1	24.2	26.7	40%	1%	1%
Entire debt - capitalized value	1,313	1,386	1,457	1,528	1,576	1,621	1,686	1,762	1,845	41%	100%	100%

OAT: fungible treasury bonds; BTAN: Treasury bills with interest paid annually;
BTF: fixed rate discount treasury bills.

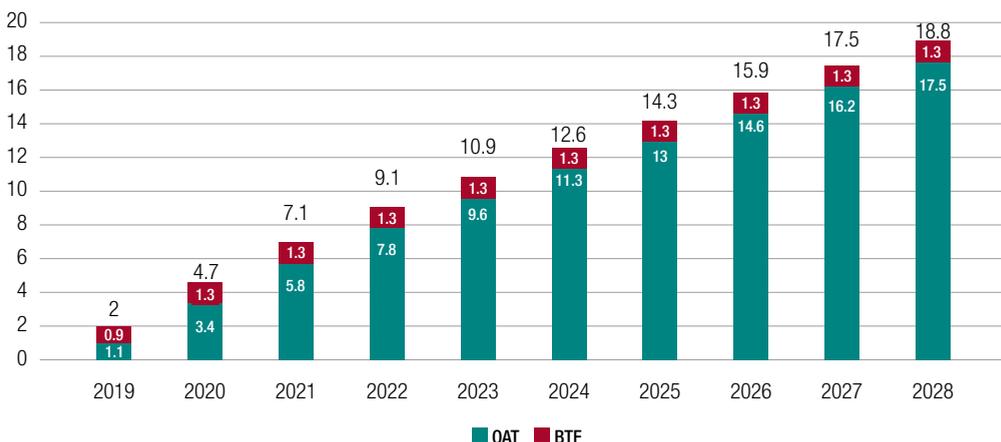
Source: The State's financial commitments, National assembly, report n° 1302, Joël Giraud, appendix n° 23

Rate shock and debt burden

The graph below shows the impact of a potential 1% interest rate shock on the debt burden.¹⁶ In this simulation, only BTFs and OATs (non-indexed) are taken into consideration. It is not unlikely that an interest rate shock will be accompanied by an inflation shock. Considering an increase in inflation has an effect on the State's bonds indexed

to inflation. The combined effects of the two shocks produce a global interest burden that is always greater than the impact of a simple interest rate shock. Hence the importance of managing index-linked securities. If the proportion of index-linked securities is extremely low, inflation is beneficial to the debt burden, not the opposite.

Impact of a 1% rate shock on the State's debt burden (in billion euros)



■ 15 The State's financial commitments, National assembly, report n° 1302, Joël Giraud, appendix n° 23

■ 16 General budget, annual performance projects, appendix to the finance bill 2019, The State's financial commitments, p. 32.

Source: General budget, annual performance projects, appendix to the 2019 finance bill, The State's financial commitments; IFRAP Foundation

Stock-flow effect and snowball effect:

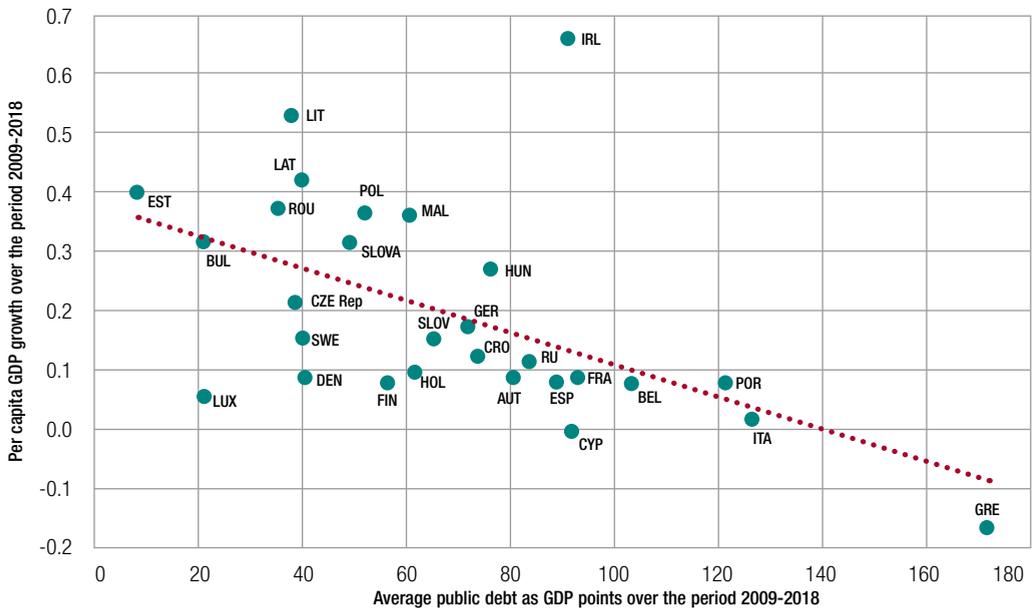
The debt level is not only sensitive to interest rates and inflation. The stock-flow adjustment and the snowball effect must also be taken into account.

■ **Stock-flow effect:** this corresponds to the change in debt that does not depend on the debt burden. This is the case with public deficits, as well as the impact of privatization on debt. Revenues from privatization do not lower the deficit (financial operation), but enable the debt to be reduced.

■ **Snowball effect:** this represents the differential between the average government interest rate and the nominal growth rate of the economy. Hence, for a given debt level (debt as a % of GDP), the numerator changes based on the amount of the debt burden (interest rate), while the denominator chang-

es with the growth rate. If the interest rate is higher than the growth rate, the debt ratio increases even though the primary balance, the budgetary balance before the payment of interest on the debt, is reached. The stabilizing balance (which stabilizes the burden of the public debt) is higher than the primary balance. Otherwise, the stabilizing balance may be lower than the primary balance. This is referred to as a positive snowball effect. We are temporarily in this situation. All the more reason to introduce debt reduction mechanisms. The impressive amounts borrowed by France in 2019 must also be highlighted: 195 billion euros net of securities issued, in the medium and long-term. In OATs alone, net issues will be 70 billion according to the AFT, placing France ahead of Italy, Germany or Spain.

Per capita GDP growth over the period 2009-2018 in relation to the average burden of the public debt as GDP points



Who holds the French debt?

It is interesting to ask who France borrows from, or rather, who are the creditors of the French debt. Indeed, are they actually French? Are they banks or insurance companies?

It is difficult for the State to know exactly who its creditors are. As such, the law does not allow the State (public corporation) to request the identification of the holders of its securities. Article L228-2 of the Commercial Code, amended by ordinance in July 2014¹⁷ states that "*Unless stated otherwise in the contract of issue and notwithstanding any provision in the articles of association, any corporation issuing bonds, other than public corporations, may request the identification of the bearers of such securities under the conditions and in accordance with the terms set out in the preceding paragraphs.*"

According to the *Les Échos* newspaper, the aim of this legal guarantee of anonymity would be to make the French debt attractive and competitive.¹⁸ Therefore, arbitration was made between the identification of creditors and the attractiveness of the debt.

Consequently, it is impossible to find out the identity of the final holders; however, we can still get some information from the AFT data. It appears that 53.7% of the debt was held by non-residents in the third quarter of 2018. This may seem high, especially when compared to Japan whose debt amounts to more than 230% of its GDP, but is held almost entirely by Japanese residents.

The rest of the creditors are divided into four categories of holders: French insurers hold 18.5% of the debt, credit institutions hold 6.2%, undertakings for collective investment in transferable securities (UCITS) hold 1.5% and finally, the remaining 20.1% are held by French nationals, but we do not have any further information (natural persons, corporate bodies, or other).

Regarding non-residents, some information is available on their origins. According to a report by the National Assembly,

*"Nearly 60% of non-resident investors are European, 52% of whom are from the Euro area; 13% are Asian investors; 9% are American and the remaining 18% held by international organizations or foreign exchange reserve investments".*¹⁹

This proportion of holdings by non-residents has significantly decreased since 2009, down 14.1 points between 2009 and the third quarter of 2018 (67.8% compared to 53.7% held by non-residents today). This decrease can be explained by the European Central Bank's (ECB) policy of buying back sovereign securities as part of *quantitative easing*. This mechanism strengthens the share held by residents because the ECB buys French assets through the Banque de France, which is normally prohibited. In fact, the Banque de France held nearly 20% of the French debt in April 2018.²⁰ However, this buyback program, launched in 2015, was discontinued at the end of 2018. At the beginning of the 2019, it is legitimate to question some points as to why this program was discontinued. To begin with, the consequence of this policy was a drop in interest rates. With the end of this buyback program, rates could rise²¹, which could change who holds it. However, the assumption of rising rates seems increasingly remote. At the beginning of March, the ECB announced that it would keep the current low interest rates until the end of 2019 and no longer until the summer of 2019 as originally planned.²²

Public debt and growth

According to the graph opposite, the question can also be asked as to whether debt has an impact (positive or negative) on a country's economic growth. According to several consistent studies, including the study by Benjamin Carton²³, economist at the French centre for research and expertise on the world economy (CEPII): *"The link between economic growth and debt is twofold: in the short term, an increase in debt supports domestic demand and growth. [...] In the longer*

■ 17 Article 18 of ordinance n° 2014-863 of 31 July 2014.

■ 18 Isabelle Couet, "Pourquoi l'État ignore qui détient sa dette" (Why the state doesn't know who holds its debt), *Les Échos*, July 2016.

■ 19 The State's financial commitments, National assembly, report n° 1302, Joël Giraud, appendix n° 23.

■ 20 Isabelle Couet, "La banque de France détient près de 20 % de la dette de l'État" (Banque de France holds nearly 20% of the State's debt), *Les Échos*, April 2018.

■ 21 report n° 147, volume III, appendix n° 13 engagements financiers de l'État, Sénat (financial commitments of the State, Senate)

■ 22 Pauline Houédé, "Face au ralentissement, la BCE prend les devants" (In the face of the economic slowdown, the ECB is taking the lead), *Les Échos*, March 2019.

■ 23 CEPII, *L'économie mondiale 2014* (The global economy 2014), La Découverte, Paris, 2013.

term, a level of debt that is too high hinders the potential for growth".²⁴ The American researchers Reinhart and Rogoff have tried to demonstrate this double link. Their main assumption was that a public debt exceeding the 90% threshold would have a negative impact on growth, whereas if it was below this threshold, the relationship would be positive. However, their controversial study, together with the lack of empirical evidence, does not enable us to conclude that causality has been proven.²⁵

Another recent study by the Senate²⁶ suggests that a significant level of debt severely impairs the economy's resilience to shocks. Hence, for a financial crisis of the same magnitude, countries with significant fiscal room for manoeuvre (debt ratio of 25% of GDP) experience a sustainable loss of GDP of less than one point on average, whereas countries for which the debt is already high (debt ratio of 95% of GDP) face a loss of about seven points of GDP, all things being equal.

Recently, Olivier Blanchard, chief economist at the International Monetary Fund (IMF), commented on the link between interest rates and GDP growth rate. According to him, we should not have to worry too much about the level of debt today²⁷. In theory, to stabilize the debt in relation to GDP, a **primary balance** that must be proportion-

al to the difference between the interest rate of the debt and the GDP growth rate must be achieved. What we traditionally see is that the interest rate is higher than the GDP growth rate. However, the opposite is currently happening, including in France: which makes Olivier Blanchard say that even a **primary deficit** can stabilize the debt.²⁸ This theory is obviously valid if the interest rates remain below the GDP growth rate (at least in the short term), but the growth forecasts for the year 2019 are not excellent and the end of the ECB's *quantitative easing* increases the probability of a rise in interest rates. Furthermore, this postulate does not take into account a possible economic crisis, which would greatly increase the debt ratio.

In a statement from the Court of auditors, it appears that "*control of public debt must be reinforced by means of objectives and rules that will clarify public decisions and better reflect the results achieved*". In fact, the magistrates of rue Cambon highlight the failure to comply with the debt criterion set in the European treaties and the absence of a specific national rule.

Considering these observations, the State must revise its debt management system and this would seem to be the right moment, given the favourable situation caused by historically low interest rates.

COUNTRIES THAT ARE REDUCING THEIR DEBT

In France, "*the increase in public debt results partly from the absence of binding debt reduction mechanisms, but above all from an insufficient reduction in public deficits*", says the Court of auditors.²⁹ While the public debt for the vast majority of European states increases

year by year, some have found the solution to reverse the trend. Sweden's debt has declined since the 1990s. The debts of Switzerland and Germany are also decreasing. What are these mechanisms?

■ 24 CEPII, L'économie mondiale 2014 (The global economy 2014), La Découverte, Paris, 2013 p. 26.

■ 25 Reinhart and Rogoff, "Growth in a Time of Debt", 2010.

■ 26 Ch. D. Romer and D.H. Romer, "Why some times are different: Macroeconomic policy and the aftermath of financial crisis", NBER Working Paper No. 23931, October 2017

■ 27 Jean-Marc Vittori, "Et si la dette publique était un faux problème ?" (And what if the public debt was a false problem?), Les Échos, February 2019

■ 28 BFM Business, Les Experts, 19 February 2019.

■ 29 Court of auditors, "La dette des entités publiques" (The debt of public entities), statement to the Senate finance committee, January 2019.

The debt brake

The debt brake is a mechanism to reduce public debt, which is based on the business cycle principle. The economy operates through cyclical effects and fluctuations. The business cycle is made up of several phases: expansion, recession, depression and recovery.

The diagram below shows the debt brake mechanism. The blue arrow represents the potential or trend GDP, i.e. the GDP that represents the production supply that an economy can sustain without a spike in inflation. The grey curve shows the effective or actual GDP. The first grey area (above the blue arrow) corresponds to a business cycle expansion phase, enabling productivity at a more sustained rate than normal and consequently, a surplus to be produced (the cyclical factor is less than one). Conversely, the second grey area below the blue arrow represents a business cycle recession phase that generates a deficit because productivity is at a rate lower than its potential (the cyclical factor is then greater than one).

The output gap is the difference between the potential GDP and the actual GDP. (see graph below).

The Swiss debt brake mechanism

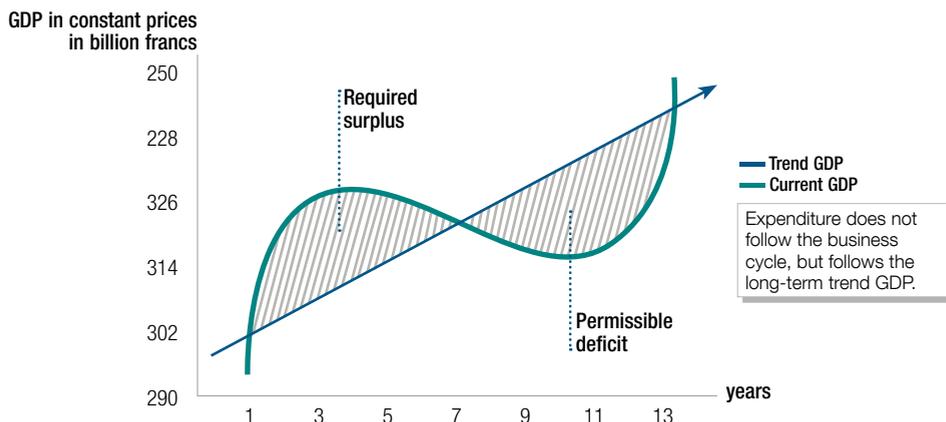
The debt brake compensates for additional expenses in times of crisis by using the surpluses saved during the expansion phase of the cycle. The relationship between trend GDP and current GDP gives the cyclical factor needed to calculate the ceiling for total expenditure.

The debt brake tends to balance a State's public accounts over the period of a business cycle. The Swiss Parliament (a State that introduced a debt brake) defines this device as "A budgetary mechanism aimed at eliminating the structural deficit of federal finances. The debt brake is based on a simple rule: over an entire business cycle, total expenditure must not exceed total revenue".³⁰

In other words, a cyclical deficit is tolerated, whereas a structural deficit is prohibited.

The table below is an extract from the budget account of the Swiss Confederation for 2007 to 2012. This table shows how the expenditure ceiling is set. By multiplying current revenue by the cyclical factor, the amount of the expenditure ceiling is obtained. It should be noted that for 2007 to 2009, the cyclical factor is less than one, which indicates that a cyclical surplus must be saved because these years correspond to an expansion phase in

Debt brake mechanism



■ 30 Swiss Federal Assembly, lexicon of Parliamentary terms.

the business cycle. Years 2010 to 2012 correspond to an economic recession phase. The cyclical factor is greater than one, so a cyclical deficit will be tolerated for these years.

Substantial surpluses saved in Switzerland

Over the last few years, the Swiss Confederation has experienced large surpluses to repay the public debt, to the extent that some political parties would like to relax the debt brake rules in order to use the money saved for other purposes.³² The surpluses generated are consistently higher than those projected, for example, in 2018, the budget projected a surplus of 300 million Swiss francs, whereas a surplus of 2.9 billion Swiss francs was achieved...³³

The introduction of the debt brake has led to a change in the budget process. By setting of a maximum ceiling of expenditure, a *top-down* approach is introduced instead of a *bottom-up* approach because the rule applies to the entire budget.³⁴ Thus, to draft the budget, the Federal Council uses “*an updated financial plan from the previous year*”. By using the debt brake formula and in particular, the cyclical factor, the Government looks at whether the updated expenditure is lower or higher than the revenue corrected by the cyclical factor. If expenditure is lower than revenue, then the Federal Council “*instructs the departments to draft their budgets on this basis*”. Conversely, if expenditure is higher than revenue, the Federal Council imposes making savings.

“*In the remainder of the budget process, the main steering instrument remains the expenditure ceilings of the departments derived from the financial plan and the general expenditure ceiling set by the debt brake.*”³⁵

Hence, with the introduction of the debt brake, it is customary for “*the Federal Council to submit a budget of a few tens or hundreds of millions of francs to Parliament, so that Parliament can, if necessary, set or adjust priorities in the short term without having to look for compensation*”. Lastly, “*the debt brake encourages more precise budgeting by eliminating any systematic incentive to overestimate revenues when the budget is drafted, because the resulting structural deficits would be charged to the compensation account and subsequently, would have to be offset*”.

Other European countries and France

Sweden was one of the first States to introduce this type of mechanism, which plans a rolling three-year estimate of expenditure and revenue. More recently, Germany adopted a mechanism very similar to the Swiss model, which operates on the same principle of balancing public finances over time.³⁶

In France, such a mechanism with a golden rule and binding value does not exist (apart from the European Union’s treaty on stability, coordination and governance, see box). According to Article 34 of the 1958 Constitution, “*the multi-annual public finance guidelines are defined by programming laws. They are part of the objective of balancing*

■ 31 “Extraordinary income amounted to 90 million francs in 2018. They result from the reimbursement by CarPostal SA of the subsidies collected in excess. In total, the Confederation recorded revenues of nearly 100 million for this matter.” Federal Finance, Federal Department of Finance, <https://www.efd.admin.ch/efd/fr/home/themen/finanzpolitik/les-finances-federales/fb-die-bundesfinanzen.html>

■ 32 *La Tribune de Genève*, “Le frein à l’endettement ne sera pas assoupli” (The debt brake will not be relaxed), June 2018.

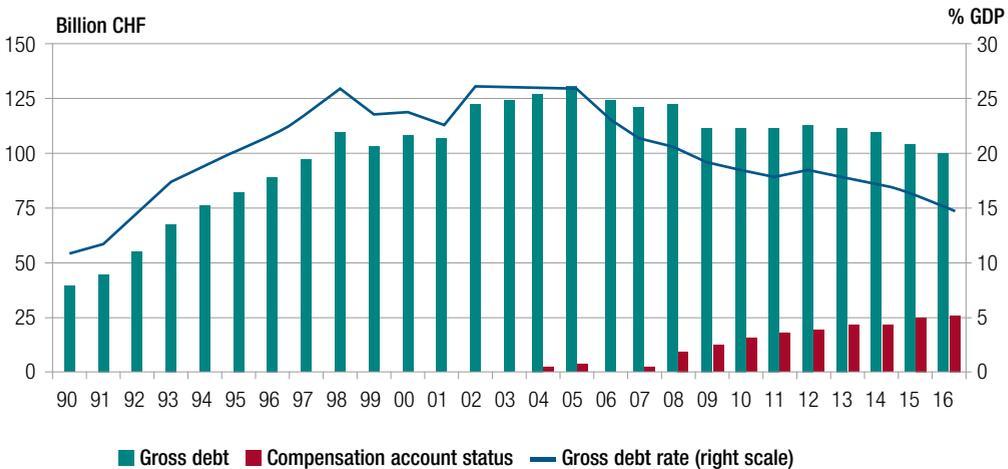
■ 33 *Le Temps*, “La Confédération a dégagé un excédent de 2,9 milliards en 2018” (The Confederation achieved a surplus of 2.9 billion in 2018), February 2019.

Swiss financing account

In billion CHF	2007	2008	2009	2010	2011	2012
Current revenue	56,011	57,976	59,968	58,208	62,423	64,117
Cyclical factor	0.991	0.987	0.995	1.042	1.013	1.007
Expenditure ceiling	55,507	57,223	59,668	60,653	63,234	64,565

Source: Swiss Federal Council, “*Confederation debt brake report: experiences and perspectives*”, November 2013. Current revenue in Switzerland consists of direct federal tax, VAT, federal withholding tax, non-tax revenue, taxes levied on mineral oil, tax on tobacco, stamp duty and other tax revenues. Extraordinary income consists of income from financial participation (dividends, capital gains by definition non-recurring or not stable over time)³¹

Evolution of the Swiss Confederation's gross debt since 1990



Source: Expert group on the debt brake, "Expertise sur la nécessité de compléter le frein à l'endettement" (Assessment on the need to complete the debt brake), 28 August 2017.

the accounts of public administrations".³⁷ On reading this article, it can be seen that the Constitution sets a balance objective, but it is in no way binding for the authorities. Therefore, the iFRAP Foundation had already proposed reformulating this article 34 as follows: "The accounts of public administrations must balance out over time. Programming laws define the multi-annual guidelines for public finances. The finance laws, excluding exceptional expenses, are derived from them."³⁸ This formulation would give a binding scope to the accounts balancing principle. In a statement to the Senate Finance Committee, the Court of auditors emphasizes this absence of a binding rule. "While complying with the debt rules laid down by the European treaties would be likely to ensure that they are kept under control, national law has not built a mechanism to achieve this. Control of the public debt must be reinforced by means of objectives and rules that will clarify public decisions and better reflect the results."³⁹ The Court opportunely proposes introducing an expenditure objective that covers all public expenditure. It would be set based on potential growth

and expressed in euros at current value and in the national accounts, and broken down by level of administration. This is more or less an approach comparable to that of the Swiss financing account, as the cyclical factor is replaced by an approach based on potential growth.⁴⁰

The compensation account

Budgeting has long been based on the State optimistically estimating the levels of growth, spending and revenue. Governments seem to have made a binding rule of systematically overestimating economic growth, and there is elasticity that is difficult to calculate on the revenue and expenditure levels that lead to deviations from the target. However, since the 2018 budget, a "sincerisation" process is underway. An interesting solution to overcome this uncertainty would be that when preparing each budget, the Government pays a sum into a compensation account. Consequently, if there are negative budget differences, the difference would be deducted from the resources of the compensation account. Conversely, if there are positive

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■ 34 The departments in Switzerland, which correspond to French ministries, of which there are seven: the federal department of foreign affairs, the federal department of home affairs, the federal department of justice and police, the federal department of defence, civil protection and sport, the federal department of finance, the federal department of economic affairs, education and research the federal department of environment, transport, energy and communications.

■ 35 Swiss Federal Council, "Confederation debt brake report: experiences and perspectives", November 2013.

■ 36 See iFRAP Foundation, "Allemagne: La stratégie du schwarze Null" (Germany: The schwarze Null strategy), Louis Marty, 22 July 2015

■ 37 Extract from article 34 of the 1958 Constitution.

differences, the surplus would be credited to the account. At the end of the budget year, the remaining credits on the account are cancelled and devoted to reducing the debt.⁴¹ However, a neutral diagnosis of the position of the French economy in the economic cycle would still be required. Like Germany, which has “an independent advi-

sory council”⁴² in economics, it is important to strengthen the prerogatives of the High Council of Public Finance in the immediate short term so that it has the capacity to produce independent cyclical economic figures and the power to provide an autonomous alert based on the British OBR (Office of Budget Responsibility) model.

CONCLUSION

France still does not comply with the European convergence criteria (structural effort and compliance with the MTO (medium-term objective) in terms of programming limit), even though our country left the corrective part of the Pact to join its preventive component (including the obligation to reduce its debt by one twentieth per year to 60% of GDP).

Admittedly, some mechanisms have been introduced, but these are not binding or are only moderately effective. Neither the previous Government nor the current Government seem to really want to take structural measures to reduce the country's debt, nor to sustainably strengthen how we integrally manage our public finances. Above all, the debt reflects the endless slippage of our deficits due to the growth of our public expenditure. Governments for affairs have seemed and seem to prefer a more “political” approach to managing the debt and have therefore, not taken advantage of opportunities to reform their management methods. Strong and necessary measures must therefore be taken:

- include a **debt brake** in the Constitution: this can be achieved by simply amending article 34 of the Constitution: “*The accounts of public administrations must balance out over time. Programming laws define the multi-annual guidelines for public finances. The finance laws, excluding exceptional expenses, are derived from them*”;
- set up a **compensation account** that aims

to retrospectively correct over expenditure;

- make it impossible to finance operating expenditures with provisions planned for capital expenditures, based on the **gross production** principle; this would imply that in the medium term, the State is obliged to abide by the golden rule that it imposes on its own local authorities;

- pass the public finances programming law at the constitutional level to derive financial laws from it (new wording of article 34 of the Constitution);

- adopt a **three-year global budget** and introduce a **rolling annual ceiling on expenditure** based on the debt brake model;

- make ministers the chief authorizing officers and the senior accountants of their departments;

- make ministries responsible for their budget and the budget of the operators that they govern, reintegrated into the zero-value standard (excluding the debt burden reclassified in the zero-volume standard);

- make automatic productivity cuts in budgetary appropriations widespread practice;

- reform the High Council of Public Finance to make it truly independent and to make it a major counterpart of the budgetary procedure;

- create a body attached to Parliament responsible for producing cross-checked figures for bills in the perspective of a **management “trialogue”**;

- merge the inspection bodies into a **National audit committee**;

■ 38 iFRAP Foundation, Société Civile, n° 165, “Objectif zéro déficit” (Zero deficit target), February 2016.

■ 39 Court of auditors, “La dette des entités publiques” (The debt of public entities), statement to the Senate finance committee, January 2019.

■ 40 iFRAP Foundation, Samuel Servière, “Baisse du coût de la dette : attention aux lendemains qui déchantent” (Lowering the cost of the debt: beware of a less rosy future), 1st March 2019.

■ 41 iFRAP Foundation, Société Civile, n° 165, “Objectif zéro déficit” (Zero deficit target), February 2016.

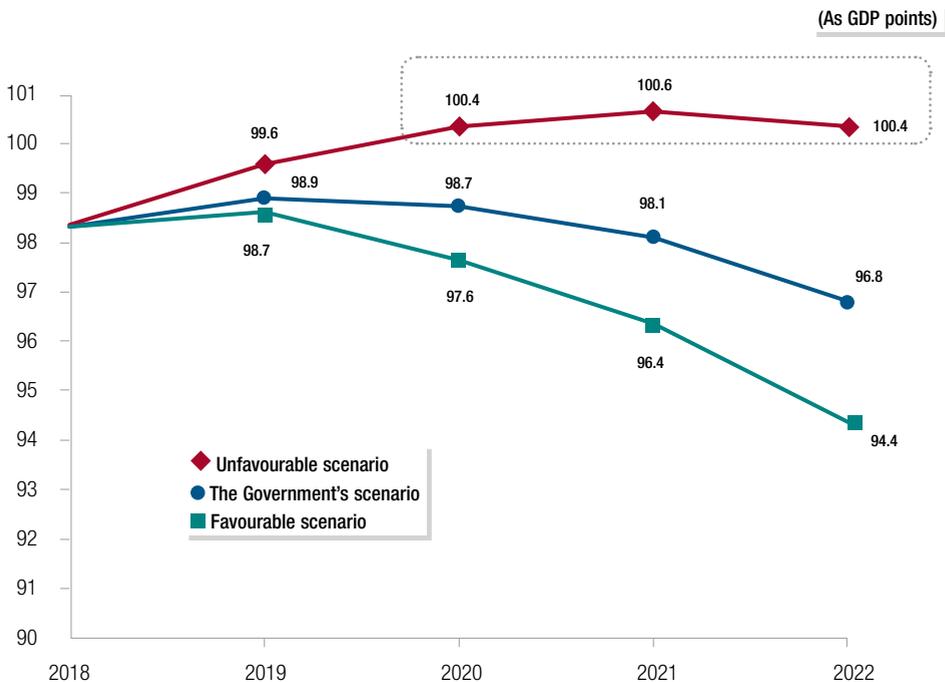
■ 42 Der Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 38 43

merge the budget proposal (PLF) and social security financing bill (PLFSS) to ensure that the public finance strategy is coherent; or alternatively, extend the social security financing bill (PLFSS), no longer to the Social security level, but to the compulsory basic social security schemes (ROBSS), to include Unemployment insurance and complementary schemes;

associate local authorities more closely with public finance management policy by perpetuating over time the contractual agreements made with the State based on the Italian model (*fabbisogni standard*) and introduce management dialogue through a financing law for local authorities.

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As we can see, France remains at the mercy of crossing the 100% public debt threshold should an unfavourable scenario arise before the end of the term of office.



Note: Senate, 2019-2022 stability programme report. The Senate has evaluated the effects of "unfavourable" and "favourable" shocks on the public debt. For the first: 1% growth in 2019, 2020 and 2021 increasing to 1.1% in 2022. With elasticity on compulsory levies based on growth of 0.9 instead of 1 over the entire period. For the second, the growth path would be 1.5% over the entire programming period with elasticity on compulsory levies of 1.1.

The Swiss debt brake calculation method

"The debt brake restricts the level of expenditure to the estimated amount of the structural revenue (i.e. estimated cyclically-adjusted revenues). The cyclical factor allows adjustment based on how the productive capacities of the economy are used."⁴³ Hence, the ceiling for total expenditure (G) can be defined using this factor. The expenditure ceiling must be equal to the estimated revenue (R) multiplied by the cyclical factor (k) that, in turn, "corresponds to the ratio between the trend value of the real gross domestic product (Y^*) and the actual real gross domestic product expected for the year concerned (Y)". This factor is determined by a statistical filtering procedure. The Hodrick and Prescott filter (HP filter) is based on time series in order to estimate a trend value. If the cyclical factor (k) is greater than one, a cyclical deficit is tolerated, and the economy is in recession. Conversely, if this factor is less than one, a cyclical surplus is required, and the economy is booming. $\bar{G}_t = k_t R_t$ with $k_t = \frac{Y_t^*}{Y_t}$

■ 43 Swiss Federal Council, "Confederation debt brake report: experiences and perspectives", November 2013.

■ 44 Expert group on the debt brake, "Expertise sur la nécessité de compléter le frein à l'endettement" (Assessment on the need to complete the debt brake), 28 August 2017.

■ 45 "Exceptional financing needs may be invoked in the event of "extraordinary events beyond the Confederation's control" such as severe recessions or natural disasters." Report by the Federal council, "Confederation debt brake report: experiences and perspectives)", 29 November 2013. P. 12

■ 46 Swiss Confederation, Federal finances administration, The debt brake.

In Switzerland, there is a compensation account and an amortization account

The compensation account

Once the State budget has been approved, budget variances, whether positive or negative, are listed and recorded in a compensation account that is managed separately from the State account. "It is not an account in the actual accounting sense, but a statistic that records deviations from the debt brake requirements."⁴⁴ If the compensation account has a negative balance, it must eventually be offset by a cut in expenditure. Conversely, a compensation account surplus cannot be used to finance an increase in the expenditure ceiling, but must be used to reduce the debt. For these reasons, the compensation account is said to be managed asymmetrically, "shortfalls must be corrected by lowering the expenditure ceiling", whereas a surplus can only be allocated to reducing the debt.

The amortization account

"The extraordinary budget⁴⁵ is also subject to the debt brake. The principle of the supplementary rule is to offset in the medium term the deficits of the extraordinary budget through the regular budget. For this purpose, an amortization account is used as a steering instrument for the extraordinary budget. This account includes extraordinary income and expenses. Surpluses should be eliminated by surpluses in the regular budget over the next six accounting years. If the shortfall is foreseeable, corresponding savings can be made in advance."⁴⁶ In the same way as in Switzerland, an amortization account allows structural surpluses that were intended to reduce the debt via the compensation account to be used, if necessary, to amortize shortfalls in the extraordinary budget via this amortization account.⁴⁷

Valérie Plagnol's opinion



Economist, independent consultant, strategy and market research consultant, Valérie Plagnol has been the director of economic studies for major financial institutions in France and abroad. She is a former student of the Paris Institute of Political Studies and Keio University in Tokyo. In 2015, following the proposal by the President of the Senate, she joined the High Council of Public Finance, chaired by the First President of the Court of auditors.

The French debt stands at 99% for 2018. Are you worried that France will soon exceed the 100% threshold?

The growth of primary deficits (excluding interest costs) mechanically increases the debt.

Isn't the current low cost of the debt burden double-edged? Is it not likely to slow the pace of reform in France?

Since 2014, long-term yields (ten-year reference rate) have been lower than the nominal growth in France. This opportunity, with zero growth in spending, would stabilize and then reduce the public debt, through the "natural" progression of revenues.

The low cost of the debt has been virtually the only real savings made in recent years on the State budget. This "opportunity" has not been taken advantage of to reduce operating expenses in order to restore sustainable margins of manoeuvre, reduce tax pressure, invest in infrastructures, or to redirect expenses towards governing missions, etc.

What priority objectives do you see to manage the debt? Stabilizing balance? Primary surplus?

In the current context, a stabilizing balance is the objective - still rejected - that the Government must stick to. The notion of a structural deficit in the light of the Maastricht objectives, which aims to reduce the structural deficit by 0.5% a year, is far from being achieved. In fact, by 2022, according to the stability program sent to Brussels, the structural deficit would no longer be diminishing.

A primary surplus enables the debt to be reduced more quickly in a context of maintaining nominal growth above the level of the interest rates. The period is the most favourable for this type of arbitration.

■ 47 Expert group on the debt brake, "Expertise sur la nécessité de compléter le frein à l'endettement" (Assessment on the need to complete the debt brake), 43 Toute l'Europe, "Qu'est-ce que le "pacte budgétaire" européen ?" (What is the European "fiscal compact"?), July 2015.

■ 48 Toute l'Europe, "Qu'est-ce que le "pacte budgétaire" européen ?" (What is the European "fiscal compact"?), July 2015.

The European Union's budgetary golden rule

In 1997, in anticipation of creating the euro, the countries in the Euro area signed the treaty on stability, coordination and governance (hereinafter TSCG) aimed at imposing budgetary discipline on the States. In particular, it introduces a budgetary golden rule principle, which requires States to have public accounts that balance out or that have a surplus over an entire business cycle. This rule also requires the States to contain their structural deficit below 0.5% of their GDP. This treaty was strengthened in several legislative acts in 2011 with the aim of encouraging States to adopt binding rules on complying with the TSCG⁴⁸. In Switzerland, the term golden rule refers to the financing of net investments; it is permissible to go into debt to finance net investments, but not to finance current expenditure.