Is Public debt a brake for international competitiveness and a burden for future generations?

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Public debt is always seen as the result of mismanagement of public funds and as a burden that future generations will have to bear. This obviously depends on the type of debt and the economic circumstances of its development. In a crisis situation, the state is the economic agent capable of reviving national activity by investing and thus preparing the future of future generations. The weight of the debt, its spread over time, the nationality of the creditors, the investments effectively undertaken by the State or public administrations are all factors that deserve to be studied in order to analyse the interest of the public debt. Several methods exist which have been applied in economic history and which show that debt has often been the pragmatic and effective solution to combat national economic stagnation.

Résumé : L'endettement public est toujours considéré comme le résultat d'une mauvaise gestion des fonds publics et comme un fardeau que les générations futures auront à supporter. Tout depend évidemment du type d'endettement et des circonstances économiques de son essor. En situation de crise, l'Etat est l'agent économique capable de relancer l'activité nationale en investissant et donc en préparant l'avenir des générations futures. Le poids de la dette, son échelonnement dans le temps, la nationalité des créanciers, les investissements effectivement engages par l'Etat oet les administrations publiques sont autant de facteurs qui méritent d'être étudiés pour analyser l'intérêt de la dette publique. Plusieurs méthodes existent qui ont été appliquée dans l'histoire économique et qui témoignent que l'endettement a souvent été la solution pragmatique et efficace pour lutter contre le marasme économique national.

Dette publique, croissance économique, taux d'intérêt, charge de la dette publique
Public debt, economic growth, interest rates, public debt burden

The rapidly growing public debt is the subject of many analyses, suggestions and proposals. However, private corporate indebtedness continues to grow worldwide, and the effect of pandemic-related lock-ins will increase the fragility of the economic system as a whole. In its Financial Stability Report of 16 October 2020, the IMF considers that 40% of corporate debt in the Big Eight economies is at high risk of default, which would cause a tidal wave, a tsunami, over the global economy. Globally, the debt of this private sector is larger than the corresponding public debt and 50% larger than that of households. According to Victor Gaspar, Director of Fiscal Affairs at the IMF, these debt levels often lead to financial recessions that are longer and stronger than business cycle recessions. Cheap money and accommodative government monetary policies are seen as the main causes of this situation.

The Commission for the Future of Public Finance presented its report in March 2021. It highlights the content of its conclusions with this lapidary analysis of Pierre Mendès France according to which "a country which is not capable of balancing its finances is a country which abandons itself". The Covid-19 crisis has severely shaken the national economy, with periods of containment and constant protection affecting the productivity of those who maintain a recognised economic activity. The response to the pandemic was immediate. 40 billion of which will be financed by European funds, in addition to the financing of partial unemployment and aid to businesses. The violence of the economic and social crisis justifies a strong massive support of the State to the productive apparatus, by a significant support in particular by the channel of partial unemployment.

The Commission's position

The report does not contest the usefulness of state action in support of private and public economic activity, but it questions the origin of public money based on debt, even though the drift of the state's public finances had already been noted. It is a question of issuing new debts to cover all the deficits. The question of the sustainability of the debt, now widely accepted by all international operators, will then arise, thanks in particular to the massive financing provided by the European Central Bank. If the indicator of the ratio of public debt to GDP (60%) seems to be (provisionally) considered obsolete, the report highlights three major risks of such a situation, namely the possible rise in short- and long-term interest rates, the stability of the euro zone due to the heterogeneity of Member States' debt, and the difficulty of finding new resources to revive the economy and meet the challenges of the ecological transition. It is a plea for the control of public expenditure. Sound public finances are needed to revive the economy, even if, in the immediate future, the public effort cannot be reduced in a crisis situation. A solution that is sustainable in terms of maintaining economic growth, combating the pandemic and ensuring the long-term sustainability of the debt must be envisaged. Three major solutions envisaged by heterodox economists have not been retained.

- The cancellation of the debt held by the ECB would mortgage the future, it would make France lose credit with international investors and would call into question the credibility of the ECB, generating a major political crisis with the countries of the European Union.
- Perpetual debt makes it possible to issue debt without a time horizon, in order to protect against the risks of rising interest rates. However, the demand for this type of investment is too low; instead, it would be better to retain the extension of repayments over time.
- The government has considered "ring-fencing" the part of the public debt linked to the pandemic crisis by allocating a dedicated tax resource to its repayment. This solution echoes Germany's adoption in July of a plan to repay its Covid debt over twenty years, but in essence it does not resolve the issue of the sustainability of public debt in the medium and long term.

The solutions proposed in this report are based on the rules of liberal economics, namely the impossibility of increasing compulsory levies. It is therefore a question of controlling (reducing) expenditure and targeting its development at a level lower than that of public revenue. This reduction in debt is difficult to envisage in the short term, but the budget for 2030 should lead to an intensification of efforts to return to a balanced public finance. Politically, this is the easiest solution, allowing future governments to solve the problem themselves. New European rules and indicators will have to be set between the countries sharing the same currency, the euro. In the face of short-term government governance, structural reforms are neglected. It is therefore necessary to set rules impacting on public finance strategy, with a public finance programming law setting a multi-annual spending target for all public administrations, favouring spending favourable to economic growth, with a perimeter and a minimum level of spending for the future (innovation, green spending, human capital). In this context, the High Council of Public Finance would become an independent budgetary institution, with a view to ensuring greater transparency of the budget and highlighting the sustainability of the debt in relation to the multi-annual programme. Finally, the challenges of public finances should be the subject of a genuine democratic debate, particularly with regard to the multi-annual trajectory.

According to Olivier Blanchard[1], in the face of the crisis, debt is justified for stimulus or transformation investments, considering the very low interest rates of the debt, which should be the case for the years to come, given the ageing of the population and the propensity to save. In fact, with almost negative interest rates, savers are paying the state to protect their savings in a situation of potential economic crisis. The potential for debt repayment is questionable. However, if interest rates start to exceed the growth rate of the economy, then the stock of debt must be tackled because it would be more expensive to refinance. However, when the national economy is euphoric with effective treatments and widespread vaccination against the pandemic, national economies will experience high growth rates, thanks to accelerated digitalisation. This will result in high levels of tax revenue. The challenge will be to keep debt stable and then to reduce it without undermining economic growth.

Several methods have been used in the past to fight public debt, such as inflation, financial repression, tax increases or rescheduling, but none of them is economically and socially neutral. Public finances are a battleground for social struggles, with the government itself rarely neutral.

Challenges

Several analyses by economists challenge this analysis of liberal orthodoxy.

- The Commission proposes an accounting approach to debt, without questioning its interest and its capacity to develop new forms of sustainable development. Not all debt is to be condemned; it sometimes supports innovation and economic and social progress. If the United States is the sanctuary of capitalism, Washington continues to increase its indebtedness to fight the crisis (Washington has a public debt of 27,000 billion dollars and an annual public deficit of 3,600 billion dollars), without questioning, as the international role of the dollar allows, the future repayments. Faced with this situation, China controls politically and economically the entire national banking system and uses it for its economic development, whereas the ECB is obliged, in the face of the crisis, to allow itself less rigidity in its actions. When we talk about a stock, we should also look at its content. For France, for example, what is the nature of the loan, fixed rate, and variable rate, to be repaid tomorrow or in thirty years? Who are the creditors, the French, the Europeans or others? Japan, with more than 240% of its GDP in public debt, is not bothered by having to repay the vast majority of its debts

[1] https://www.challenges.fr/economie/olivier-blanchard-l-etat-doit-lancer-un-plan-d-urgence-pour-eviter-la-catastrophe-des-faillites_718788

to Japanese people, which is also the case for Denmark (74%) and Italy (63%). In contrast, only residents only hold half of the debt, denominated in euros for France and Germany (which is much less indebted). The US is also heavily indebted and the President's stimulus plans will increase this debt by at least 15% over the coming year to finance infrastructure. By comparison, the Eurozone's stimulus package looks very weak, due to the clash between frugal and spendthrift states. Everything depends on the state's ability to repay, which will depend on economic growth, particularly the ability to raise taxes and the consent of citizens, but also on the stability of the political system. But above all, the degree of this public debt's dependence on international markets is essential, because if creditors doubt, they will increase interest rates in line with the perceived risks. This "snowball effect" can lead to a drying up of international credit available for government operations and a likely economic crisis.

- But as always, the question of the content of public spending is not asked. Should spending on education, the army, internal security, infrastructure or social security be reduced? Should civil servants' salaries continue to lose purchasing power, at the risk of losing competence? If so, does egalitarian citizenship narrow its scope by directly affecting the less well off? Should we limit aid to companies, which the government considers more useful for growth? If taxes cannot be used, should we consider raising the retirement age and pensions, as well as reducing unemployment benefits? How can we repay the debts incurred to support the French economic and social system of solidarity funds or partial unemployment benefits while financing a budget deficit widened by the collapse of tax revenues? Today, the focus is more on reducing public services to support the most disadvantaged populations, rather than on an additional contribution from the richest 1% of the population, which was done in both the US and France at the end of the great world wars. The trickle-down theory does not work, as the 40 years of its "Reagan innovation" has demonstrated, with the rich getting richer and the middle class effectively crushed by taxes and public, but also private, wage restraints. Nor is there any question of tackling the tax evasion and optimisation[2] of the richest to reduce public deficits. However, to commit a country to the fight against global warming, it is also necessary to change its behaviour, since the unbridled and short-term competition of the market economy never concerns itself with the natural heritage and the deleterious effects of their actions as a reward for their income, unless they find something to profit from.

[2] Fontanel, J., Suschcheva, N. (2019), La puissance des GAFAM : Réalités, apports et dangers. Annuaire Français des Relations Internationales.

The recommendations of the Arthuis report are outdated, will prevent ecological transformation and will increase social fractures. We must use the monetary weapon to rebuild another sustainable development and refuse the degradation of public services by an investment plan to meet the social, ecological and health needs of citizens. The main risk is not indebtedness, but the anaemia of the national economy, its industrial and health dependence and its inability to invest the necessary social and technological innovations. We must believe in a new growth, but in order to adhere to it, the States must change the immediate search for profit, which is valued by a capitalism that is less and less concerned about social problems and the future of the younger generations. The experts, who often support liberal ideas and are chosen for this very reason, fear inflation and public debt, the two often being correlated, which has not been the case for at least a good decade. It is therefore a question of seeking to limit the debt. Despite negative interest rates, the fear of debt prevents governments from investing. However, today, France's credit rating is not threatened. The State has to roll over its debt by constantly re-borrowing and repaying. Today, sovereign debt rates are negative for France for 20-year maturities, and close to zero beyond that. There is no apparent critical debt threshold.

- In the face of the economic crisis caused by the fight against global warming and pollution, there has even been talk of questioning the very repayment of public debt. The example of the FRG (London Conference), which benefited from the non-repayment of two thirds of its public debt in 1953, enabled this economy to become prosperous again rapidly. Similarly, Russian loans were never really liquidated more than a century after their issue. The political and strategic situation today is different. States' creditors are powerful in the financial markets and their response is likely to be rather unfriendly, especially in court and with their own governments. Moreover, French financial institutions hold 24% of this debt, which could lead to the bankruptcy of several national banks, insurance companies and pension funds. In addition, a significant part of our debt is in the accounts of other central banks, which invest in the safest securities, the government bonds of other countries. But a unilateral decision would immediately lead to reciprocal default, and the loss of national assets abroad, which is about the same amount. Finally, the quality of the signature of the Eurozone states would be called into question. This is why European governments are against any proposal to cancel the debt of a member country. This strategy could lead the State to increase its propensity to indebtedness, to the point of having, in the long term, difficulties in repayment, but above all in financing on the national and international financial markets. It could then resort to inflation, restructuring or financial repression, which are not conducive to the confidence of the financial markets.

- The policy of austerity is therefore not necessary. Some economists, notably Thomas Piketty and Paul Mignette[3],, are calling on the ECB to cancel the public debt securities (3,000 billion euros of government bonds held by the European Central Bank) that it holds, at least the "Covid debt", which would make it possible to regain budgetary leeway. If this type of liability (25% of the debt) has to be repaid, then taxes must be increased; spending cut or the debt must continue to be rolled over. Instead of responding to this demand from the financial markets, it would be preferable to encourage the ECB to cancel the public debts it holds in order to invest the same amount in social and ecological reconstruction. In fact, the state is both debtor and creditor of an asset and a liability, obviously equivalent. The debt held by the Eurosystem is the asset of the nationalised Banque de France. The State borrower would be enriched by the loss of the State shareholder, without any financial advantage, at least in the short term. In this framework, the State could unilaterally cancel this part of its liabilities without cost to anyone. All financial institutions can waive their claims, which are not explicitly forbidden by the European treaties. However, although the ECB is independent of political powers, it is nonetheless dependent on the financial markets. On the other hand, the cancellation of this debt would increase the risk premium that the markets will attribute to the signature of the members of the euro zone, for a benefit that is difficult to determine. Furthermore, debt cancellation would have a negative impact on the credibility of the European Central Bank. Such a measure could lead to the break-up of the euro zone. For Christine Lagarde, President of the ECB, the cancellation of the Covid-19 debt would constitute "a violation of the European treaty which strictly prohibits monetary financing of states". However, this provision should be questioned, as Europe is punishing itself, while at the same time the United States, China and Japan do not hesitate to use the monetary weapon to support economic activity and their national companies. Money creation seems to be the key to making the investments necessary to finance sustainable development and research and development of modern technologies.

The proposals concerning perpetual bonds are interesting, because they are never repaid; only the annual interest is paid. In this framework, large sums could be borrowed, which would allow for a real European policy to face the challenges of sustainable development. However, the European Union is not in a position to issue perpetual bonds, because of the division of its members on future policies, which could, in the long run, call into question European solidarity and union. Divergent interests are growing, both on the vote on the European budget and on the recovery

[3] Le Monde (2021), Appel concernant L'annulation des dettes publiques que la BCE détient constituerait un premier signal fort de la reconquête par l'Europe de son destin », Le Monde, 5 Février 2021

plan, in the face of the five frugal countries (Austria, Denmark, Finland, the Netherlands and Sweden) whose demands for austerity and thrift highlight the lack of interest in the economic problems of their allies. In this context, the Eurozone countries remain in recession, despite the increase in the central money supply, which seems to be of less interest to the real economy than to the financial markets.

- Joe Biden's new economic policy is to revive the economy by all means, including fiscal and monetary policy. Several decisions are being made or could be made in the public interest of the world's citizens. These would include:
- taxing high wealth and multinationals, which have seen their taxes fall over the last forty years;
- increasing the proportionality of income taxes, while also increasing the alliances of states to better recover the tax debts of their nationals;
- to establish real coordination between the budgetary and monetary policies of States, and in particular to demand a minimum tax rate for companies in all countries belonging to the IMF and the WTO, in order to avoid the counterproductive "game" of tax competition which only benefits large companies and the wealthy;
- tax the extraordinary profits made by certain activities as a result of the pandemic;
- transform government securities into low-interest perpetual bonds;
- impose a floor on bank holdings of government securities;
- to better regulate the speculative games of international finance;
- to modify the European treaty to make the ECB a buyer of last resort for government securities; the Eurosystem of European central banks has in fact bought three quarters of the public debt issued since the beginning of the pandemic, thus softening the human cost of the fight against Covid-19.

The European Court of Justice now considers that an issuing State may be tempted to renegotiate a principle if unforeseen circumstances limit the State's financial capacity, which could ultimately affect the human rights of its citizens. Thus, under certain conditions, private creditors cannot invoke the Vienna Convention against a state that imposes losses on them. It is therefore possible to rely on this case law to help citizens in serious difficulty.

Debt should not be analysed only in terms of its cost. It is not a burden left to future generations, but rather an investment when it comes to financing schools, the ecological transition and health. The debt is first and foremost an investment, that of a state that protects freedoms and controls inequalities of income and wealth that reduce freedom and solidarity for the benefit of a few people who are too well endowed.

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