

France and Europe faced with the economic crisis

➤ PART 1. THE SUSTAINABILITY OF PUBLIC FINANCES DURING THE CRISIS : AN INTERNATIONAL ANALYSIS

Financial history teaches us that an international banking crisis often leads to a sovereign debt crisis. Even today, the rescue of the financial system in the wake of the subprime crisis, the plans to re-launch the economy that it necessitated and the damage to growth potential are putting a great strain on public finances in most developed countries. The speed at which the liquidity crisis on the financial markets has turned into a solvency crisis for the most vulnerable nations is threatening the others with the risk of contagion, which we now have to assess.

A study of the sustainability of public finances in European countries based on determining factors such as the fiscal effort required to stabilise public debt, the weight of additional social expenditures linked to an ageing society and the more global financial positions of countries with regard to the rest of the world, can be used to classify them in

terms of such risk. In fact, the issue covers the intrinsic financial situation of governments and the risk posed to the State by its position of “guarantor of last resort”, should private agents fail.

With this in mind, the Centre for Strategic Analysis has developed a synthetic sustainability indicator. This ranks France as 12th out of the 25 OECD countries studied (and 10th out of the 19 EU countries included). It would appear that Spain, Ireland, Portugal and, to a lesser extent, the United Kingdom, are in a difficult position. France also remains exposed to the risk of cumulative public debt, but has two notable advantages to temper this risk over the long term: a demographic dynamic that offers a more positive outlook in terms of the effect of an ageing population on the balance of public finances in relation to other countries and a global situation of contained debt for resident agents, which is in contrast to that of other countries. ■

**This note is a re-updated version of note No. 183 published in June 2010.*

As has often been the case throughout financial history, the recent international banking crisis has led to a sovereign debt crisis⁽¹⁾, which is now making the world economy vulnerable, particularly in Europe. This “episode” thus appears to be the third stage of a process that started with the subprime crisis in the second half of 2006, spreading round the globe with the massive crash in the autumn of 2008, due to a crisis of confidence in holders of securitised debt⁽²⁾ and a resultant drying up of liquidity on the interbank market. Whereas the setting up of the Euro led to the convergence of interest rates on the debt of the area's member States, the pooling of risk by the States taken to excess by private agents led to the reappearance of strong discrimination against the most vulnerable countries on the financial markets. The liquidity crisis on the money market in fact shifted to the public bond market as soon as governments assumed the role of insuring the banks and, through them, household assets.

The stabilising function and unavoidable nature of the massive mobilisation effort by all the governments to compensate for the effects of deleveraging by private agents are the subject of widespread agreement. But **the real issue today is to assess the consequences of these measures in terms of the sustainability of the various countries' public finances and the danger of a liquidity crisis turning into a solvency crisis.** The marked difference between the default premia⁽³⁾ of government bonds therefore makes us **question the objectivity of the various States' signatures and the risk for each one of being downgraded.**

The sovereign debt cannot be assessed as if the government were separate from the rest of the economy. Major crises tell us that the latter is less a lender than a guarantor of last-resort of private losses. This potential pooling means that a State cannot solely be judged on its own financial situation. Since it is acting as a guarantor of last-resort to cover all resident agents, the household asset situation and that of financial and non-financial businesses will have an effect on the quality of its signature. The case of Spain is a good example of this: the recent fall in its rating is less of a punishment for the current state of its debt or its public financing needs than for the narrow margin for manoeuvre signalled by the hyper-debt situation of certain households and financial and non-financial businesses (local banks in particular) as it is unlikely that all agents will be able to deleverage at the same time.

Beyond an assessment of public finances' sustainability on a case by case basis, the crisis has highlighted the lack of credibility of the solidarity and equalisation mechanisms between regions in the European Union. The financial vulnerability of some medium-sized States leaves room for the possibility of a “catastrophic” spread of the Greek crisis: for instance, the selective tightening of finance conditions in certain countries could tip other “borderline” cases over the edge in a process of cumulative debt. Whilst the search for risk-free investments has so far produced a situation that is positive overall as it meets the public financing needs generated by the crisis, **further default crises would completely change the face of the recovery currently underway** : might this recovery be just a brief respite in a chain reaction of crises, occurring closer and closer together ?

This note takes three aspects of the risk attendant upon sovereign debt into account :

- ▶ in the short to medium term, the immediate situation of public finances and the distance separating the primary balance (public deficit excluding interest charges) from the theoretical level that would stabilise the debt play an important part in assessing risks,
- ▶ in the longer term, the way in which governments provide for the additional charges caused by the ageing of the population is key to their credibility,
- ▶ finally, the financial solidarity of all the residents of a nation (not necessarily considered as an aggregate figure) would appear to be a decisive factor in terms of the margins for manoeuvre that a government has for ensuring the sustainability of public finances.

▶ THE PUBLIC DEFICIT POSITION IN FRANCE MAINLY SEEMS TO HAVE BEEN INHERITED FROM BEFORE THE CRISIS

The consequences of the financial crisis for public finances are spread via a number of channels. First of all, we need to consider **the mechanical impact of the drop in activity on the public coffers.** This element, termed “automatic stabilisers”, is due to a combination of three effects: the increase in certain types of social expenditures in a period of recession (especially unemployment

[1] Reinhart C. and Rogoff K. [2010], “From financial crash to debt crisis”, *NBER Working Paper*, No. 15795, March.

[2] Financial securities issued by ad hoc companies that carry debts of the same type, transferred by banks, which remove the risk from their balance sheets.

[3] Increase in interest rates designed to cover the investor against the risk of default.

benefit), inflexible government consumption and the reduction in tax revenue associated with the shrinking of the tax base. Added to this automatic element is the **impact of discretionary measures** designed to stabilise demand, prevent the destruction of effective production capacity and support the financial system. Finally, the reduction and **slowdown of potential growth** are having a permanent effect on the budget deficit, which cannot be reversed at the top of the business cycle. This third effect appreciably accentuates the fiscal effort required when coming out of the crisis in order to stabilise public debt. Countries are affected by these different factors in varying ways, and the impact also depends on their particular situation before the shock.

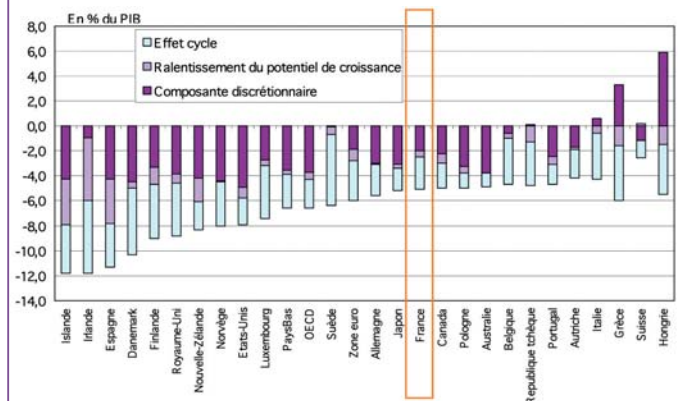
The ratio between the automatic, discretionary and permanent factors is not directly observable; it depends on the statistical approach and the interplay of the hypotheses applied. The main uncertainty lies in the ratio between what can be attributed to a slowdown or permanent loss of potential production levels and what is the result of the cycle itself. Uncertainty is at its highest level during periods of severe recession, such as the one that the world economy has been going through for two years, which may stall the technological growth engine and result in structures becoming outdated or lead to a proliferation of “zombie”⁽⁴⁾ banking and non-banking businesses that only survive through assistance.

The current crisis is bringing into play the same corrective mechanisms in terms of public finances as previous crises: it is understandable that we are seeing a distinct deterioration in the budget balances of various countries. However, in addition to automatic stabilisers that increase expenditure and reduce revenue, recognition should be given of the extent of the discretionary measures applied by certain governments to ward off too severe a decline in production levels, which would destroy production capacity and compromise a return to growth. On average, if we refer to data from international bodies, the **expected decline of the public deficit in the Euro area by more than 6 GDP points⁽⁵⁾ between 2007 and 2010 would be 55% attributable (3.5 GDP points) to structural effects (the result of discretionary measures and the slowdown in potential growth) according to the European Commission, 48% (3 points) for the IMF and 47% (2.8 points) for the OECD.** The remainder, more or less equal to 50%,

would be recoverable through the cycle. According to both the OECD and the IMF, for developed countries outside the Euro area, the structural element is the main factor contributing to the deterioration of public financing needs.

France, where automatic adjustments have been quite powerful in the past, has been able to restrict its discretionary recovery plans without experiencing too severe a slowdown in growth as a result. Budgets have therefore deteriorated to a relatively limited extent following the crisis (*graph 1*). The forecast deterioration of around 5-point of the deficit between 2007 and 2010 in fact puts France slightly below the median and the average for developed or EU countries. **France is not set apart by the extent of its discretionary recovery measures (around 2% of GDP), a more pronounced slowdown in potential growth than elsewhere or particularly strong inroads made by the business cycle on the public deficit. On the contrary, this first result highlights the fact that France was hardly in the best situation before the crisis.**

**Graph 1 :
Deterioration of the public deficit between
2007 and 2010 and breakdown of crisis-
and structure-related effects**



Source: OECD, Economic Perspectives, May 2010, CAS calculations

In fact, France entered the crisis with a budget balance that was already deteriorated, which underlines the **difficulty that the country repeatedly has returning to equilibrium at the top of the business cycle.** France ranks 18th out of the 25 economies in the OECD, with an average public deficit of -3.8% for the period 2005-2009 (i.e. the average length of a cycle). Only Greece, Hungary, Portugal, the United Kingdom and Poland are ranked below France



(4) www.paconsulting.com/introducing-pas-media-site/releases/banks-must-act-now-to-survive-the-new-zombie-reality-of-half-dead-banks-governments-consumers-and-companies-10-november-2009/.

(5) From 6 points for the OECD to 6.4 points for the European Commission.

(in decreasing order of deficit) in the EU. This analysis is corroborated by the rankings produced by comparing structural deficits as a percentage of GDP, even if such measures entail a significant margin of uncertainty, especially in the case of France (*appendix 1, table 1*). In 2007, the structural deficit in France⁽⁶⁾ was in the region of 3% for the OECD and the IMF, and even 3.7% according to the European Commission. For 2009, the evaluation of the French corrected business cycle deficit therefore ranges from – 4.9 % for the IMF to – 6.2% for the Commission. The latter is based on a hypothesis of weaker potential growth for France, which tends to minimise the economic impact of the slowdown and give more importance to the structural element. Such uncertainty has little effect on the relative position of countries. When the average of the various evaluations for each country is considered, France's structural deficit for the period 2009-2010 is ranked 16th in Europe, in decreasing order, ahead of Iceland, Poland, Portugal, Spain, the United Kingdom, Ireland and Greece.

▶ THE FISCAL EFFORT REQUIRED TO STABILISE DEBT IN THE MEDIUM TERM, WHICH IS PARTICULARLY LARGE IN FRANCE, IS TEMPERED IN THE LONGER TERM BY A MORE FAVOURABLE DEMOGRAPHIC TREND THAN OTHER COUNTRIES

The public finances of a country are governed by static behaviour in many ways, resulting from an institutional compromise and past economic trends, which explains the retrospective aspect of the analysis. However, an evaluation of the fiscal sustainability of any government also depends on the forecast (1) fiscal adjustments required to prevent the debt from reaching explosive levels in future (2) revenues and expenditures that society will have to cover collectively. Without wishing to overturn the hierarchies already established between countries, it would appear that, even if the medium term effort required to stabilise public debt may be considerable for some, countries that have seen a strong increase in social expenditures in the past seem less constrained by future increases.

◁ Liquidity, solvency and sustainability

Whilst the health of banks is assessed based on their liquidity and above all solvency, the concept of sustainability is given priority in the field of public finance. Solvency is a static concept: at a given time, an economic agent is solvent if it has enough assets to cover its liabilities. An agent may be solvent but illiquid at the same time (they may have enough assets to cover debts, but these assets cannot be sold quickly and easily enough to meet payment deadlines). A government may also be insolvent. In this case, the international community of lenders rallies round to cancel all or part of the debt.

However, a government is not subject to the same solvency constraints as a private agent (business or household) because it has an unlimited life expectancy and the power to levy taxes. In the case of States, sustainability is therefore a more useful concept because of its dynamic aspect : a public debt will be considered to be sustainable if, after taking public expenditure and revenue forecasts into account, the government is not in danger of facing an insolvency problem or having to make an unrealistic adjustment to public finances. In mathematical terms, this condition, which does not necessarily require a balanced budget figure, is a public debt that must be equal to the discounted total future budget surpluses, excluding debt servicing⁽⁷⁾.

Economic theory is therefore unable to define a limit above which public debt would be considered to be too high. In addition, theoretically the deadline used to calculate future primary surpluses is infinite, and it would be possible to tolerate serious levels of debt whilst still remaining true to the principle of sustainability. Nevertheless, deadlines must be set to guide public initiatives, and this has a not inconsiderable effect on results.

◁ Fiscal effort to stabilise public debt

Despite the controversy surrounding how it is measured and developed, the concept of potential growth has proved useful for assessing the fiscal effort required to stabilise

[6] The structural budget balance is used to assess a country's public finances in the medium term, independently of the transient effect of the business cycle. If there is no political intervention, the budget balance will fluctuate around this basic value. These figures should be considered as the deficit's hard core, requiring new discretionary measures in order to be absorbed.

[7] This condition, known as "transversality", is obtained when the hypothesis is applied that public debt will increase less rapidly than debt interest payments. This is referred to by economists as the "no-Ponzi scheme" condition. Ponzi, the infamous crook operating in 1920s Boston, who paid off his debts, including interest, by incurring new debts, regained popularity during the recent Madoff affair.

public debt⁽⁸⁾: this effort is the difference between the structural balance and the balance stabilising public debt (box 1). The extent of this is largely determined by the difference between interest and growth rates. It corresponds to the fiscal adjustment that a country must accept simply in order to avoid a “snowball effect”. This currently seems to be consistent in France, at around 5 GDP points, but is still lower than that of major developed countries such as the United Kingdom (8.8 points) and the United States (9.7 points). Given the structural imbalances referred to in the first section, France is ranked 18th among developed countries for its “stabilising balance”.

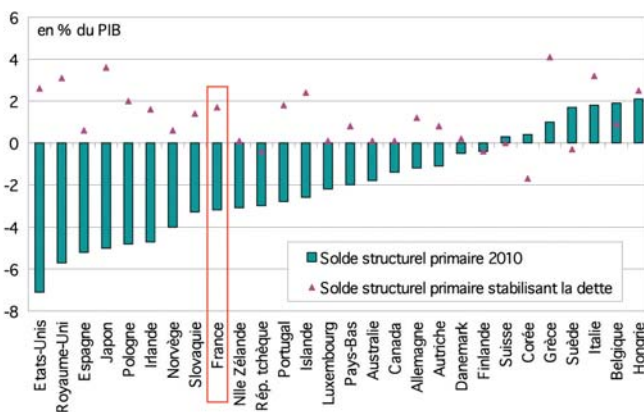
Box 1:

What deficit level is able to stabilise public debt ?

Debt is stabilised when the public balance excluding interest charges is equal to the difference between the interest rate and the economic growth rate, multiplied by the public debt share of GDP. Accordingly, for a debt representing 60% of GDP, a true interest rate of 3% and a growth rate of 2%, the stabilising primary balance is equal to $(3\% - 2\%) \times 0.6 = 0.6\%$.

Graph 2 :

Current primary structural balance and primary structural balance stabilising the debt, 2010



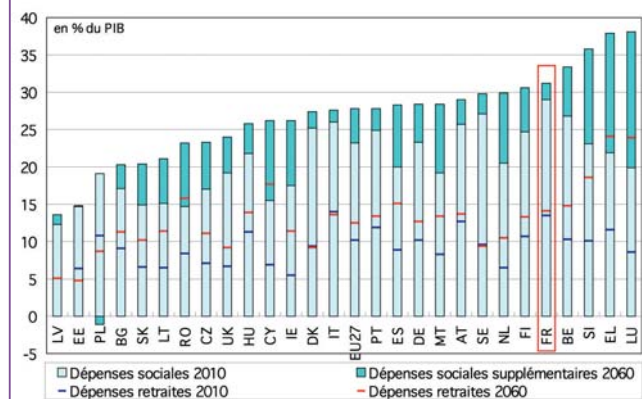
Source : OCDE

Anticipating social expenditures related to the ageing of society

Assessing the sustainability of public finances also requires an understanding of public revenues and expenditures over the longer term, beyond the bounds of the expenditures covered by the analysis of the stabilising structural balance. The potential increase in social expenditures partly depends on the degree of risk sharing already achieved by the major economies, and partly on the demographic trend, especially in terms of future costs or losses of revenue related to the ageing of the population. Several studies provide a forecast of the future costs in store for developed countries, especially the additional social expenditures related to the ageing of the population. Graph 3 produced from forecasts made by the European Commission⁽⁹⁾ shows that the European countries' positions vary greatly in terms of the financing of their future expenditures⁽¹⁰⁾.

Graph 3 :

Impact of ageing on pension expenditures and on all social expenditures with constant EU-27 legislation, 2010-2060



Source: European Commission

(8) Today, when taxes are not enough, public expenditure is financed through borrowing. The government sells debt securities to investors, giving them the right, for a specific period, to capital and interest payments established in the associated debt contract (debt servicing). The amount B_t , of securities issued every year by a State corresponds to the total borrowing figure at the payment deadline B_{t+1} , plus interest i_t , and reduced by the primary balance [i.e. excluding interest charges] for the current year S_t . This means that, if we apply the simplifying hypothesis that all public securities mature after a period of one year :

$$B_t = (1+i_t)B_{t-1} - S_t$$

If we convert the equation into GDP share, we deduce that :

$$b_t = (1+i_t)/(1+g_t) b_{t-1} - s_t$$

The lower case letters represent GDP share variables. $b_t = B_t/PIB_t$; et $s_t = S_t/PIB_t$. g_t is therefore the rate of growth and i_t the interest rate, both being nominal. The primary balance, s^* , stabilising the debt at its level $b = b_{t+1} = b_t$ in relation to potential production, which grows at rate g is defined by :

$$s^* = (i-g)/(1+g) b \approx (i-g) b$$

This equation reveals the importance of the public debt potential growth rate and interest rate variable. In fact, the primary balance needs to be in surplus if the potential rate of growth g is lower than the interest rate i . An estimate of these two parameters is used to determine the primary balance that stabilises public debt at a level set by agreement beforehand.

(9) Sustainability Report 2009.

(10) Estimates are made on the basis of constant legislation, and account for the impact of changes in the countries' demographic structures on pension and healthcare spending, as well as social dependency and education expenditures.

Due to the ageing of its population (and with constant legislation), France, which, now in 2010, has the largest social expenditure share of GDP of all the countries considered, should see an increase in its social expenditures of 2.2 points of GDP by the year 2060, which is one of the lowest figures⁽¹¹⁾. Italy is in a similar situation, with a global increase of less than 2 GDP points. On the other hand, social expenditures in Greece could increase by around 16 GDP points, including 12.5 points for additional pension costs. Likewise, in Spain and Ireland, forecasts predict that expenditures could increase by around 9 GDP points, over two thirds of which would be attributable to pensions. Nevertheless, the situation in Greece is the most critical, in that Spain and Ireland should reach social expenditure levels close to the EU-27 average, i.e. 28% of GDP by 2060, which is at least 10 GDP points below the Greek level, forecast at around 38% of GDP.

SOVEREIGN RISK IN FRANCE ALSO NEEDS TO BE PUT INTO THE PERSPECTIVE OF THE COUNTRY'S OVERALL FINANCIAL SITUATION

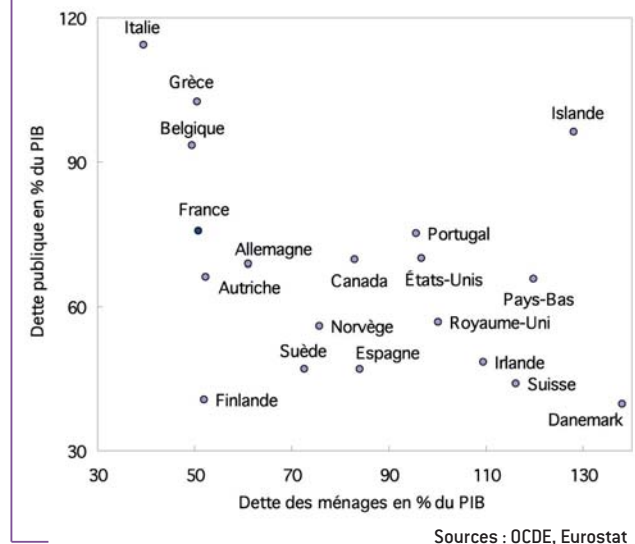
Public budget constraints cannot be explained by simply analysing the intrinsic financial situation of governments; it also requires an understanding of the financial situation of the entire nation, for which the government is the guarantor of last resort. **The interdependency of public and private agents must be considered in particular** : the “jaw effects” that can be seen between financial balances and public and private debt trends reflect the substitution mechanisms between public and private financing needs and/or capacity. Consequently, countries whose evaluation of their public finances' sustainability was somewhat negative before the crisis are often the ones where private agents are now less constrained by a requirement to deleverage. There is no doubt that France belongs to this category.

The potential for transferring risk from private agents to government varies greatly from one country to another

The stresses placed on public finances since 2007 are even greater because the finance requirements of private agents reached a considerable level over the preceding

period. A low level of public debt often goes hand in hand with a high level of private debt (*graph 4*). As revealed by the current accounts, public finances have a particularly negative correlation with the financial position of households. In order to be sustainable, the apparent deleveraging of governments should not conduce to mask a situation where other agents take excessive risks ; if considered in isolation, public debt can therefore be misleading if we do not look at the parallel risk of excessive private debt and the resulting deterioration of financial intermediaries' balance sheets.

Graph 4 : Correlation between household debt and government debt, 2008



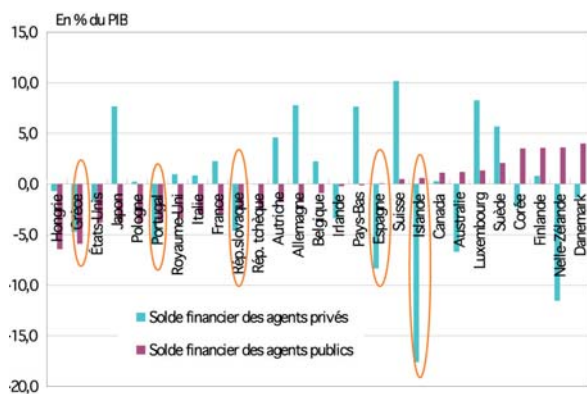
Note that over the last two business cycles, the varying public debt trends between countries also cover very different private debt scenarios, especially for households, in terms of level and variation.

Since 2003-2004, private deficits (*graph 5*) have increased considerably in countries such as Ireland, Spain and Greece, whilst governments have been showing surpluses, or minor deficits. Conversely, in countries such as France, Italy and above all Germany, private agents have been showing major lending capacity every year, while the public sector has been balancing its budget less actively than in Ireland or Spain (*appendix 2*). As a result, we can see a current account balance that is largely in surplus

(11) The additional expenditure associated with pensions differs here from the forecasts made by the *Conseil d'orientation des retraites*, in that the European Commission finds that a little less than one GDP point of additional expenditure per year is attributable to the increase in the number of pensioners.

for Germany, almost balanced out for France and Italy, and in serious deficit for Ireland and Spain, while the deficit in Greece is even worse. The autumn 2008 crisis and the contraction of credit have significantly raised household saving levels and reduced the level of business investment, which might have caused a major fall in growth if demand had not been shored up by major public deficits. Overall, the Euro area's⁽¹²⁾ current account has remained balanced even during the financial crisis. This dual dimension is now taken into account when differentiating between risks within the European area. Countries that have both resorted to public borrowing and have a strong deterioration in the financial situation of their private agents for a number of years are in a particularly exposed position. If we adopt this broad view of sovereign risk, France has largely escaped the increases in private debt observed in other economies.

**Graph 5 :
Financial balance of public and private agents
as % of GDP, average for 2004-2008**



Source : OCDE

Such considerations call for a **global approach to the assets of any economy**. The total financial liabilities, net of the financial assets held by the residents of the country, are summed up as the net external position. Here again, a number of countries that are indisputably having

medium-term problems related to the deterioration of their structural budget balance present not inconsiderable advantages if we look at their global level of debt⁽¹³⁾. France in particular is one of the few European countries, along with Germany and Belgium (and, outside the Euro area, Japan), that has a positive net external position.

THE CAS SYNTHETIC INDICATOR, WHICH AGGREGATES THE VARIOUS SUSTAINABILITY CRITERIA, PUTS FRANCE IN AN INTERMEDIATE POSITION

By grouping together the main variables considered in the paper, we can now create a **synthetic indicator** (table 1) that ranks countries in terms of the sustainability of their public finances⁽¹⁴⁾. The indicator represented here scores the combination of elements that increase the risk of a cumulative rise in public debt. This risk is particularly sensitive to :

- the situation of public finances at the outset,
- the gap between the primary balance and its debt-stabilising level,
- future expenditures relating to the ageing of the population that have not been provided for,
- and the risk borne by the other private agents, which may be transferred to the government in the event of a crisis.

Ten criteria are proposed for ranking the 25 countries according to the sustainability of their public finances (appendix 1, table 2). The criteria are divided into three sub-groups: short-term, medium- to long-term and global financial balance.

► To account for the short term, we have used the average of the budget balance for 2005 to 2009, the 2009-2010 structural deficit and the gross and net public debt for 2009.

► For the medium to long term, the fiscal effort required in 2010 to stabilise public debt and additional social expenditures relating to the ageing of the population between now and 2050⁽¹⁵⁾ have been used as indicators.

[12] Only thirteen countries in the euro zone are considered here: the six referred to above plus Austria, Belgium, Finland, Luxembourg, the Netherlands, Portugal and Slovakia.

[13] The various valuation effects make it impossible to consider the net external debt of countries to be an accumulation of the current balances.

[14] This type of indicator always includes an arbitrary component, which is linked to the selection of criteria and their weighting. In principle, an "objective" weighting should factor in the default probability associated with a deviation from one variable or another. Nevertheless, most defaults observed in the past concern developing countries, for which there is only partial data available for our current purposes.

[15] 2005-2050 for some countries outside the EU.

► Finally, the global financial situation of the country has been ascertained via the average current deficit for the period 2005-2009, the net borrowing/lending of private agents (2000-2009), household debt for 2008 and net external debt for 2007.

For each criterion, the position of the country has been evaluated in relation to the 24 other countries considered⁽¹⁶⁾. A mean rank is established for each sub-group, and it is the average of the three sub-groups that determines the composite sustainability indicator.

In ascending order of risk, the synthetic indicator (table 1, "average synthetic score") ranks France 12th among the 25 OECD countries studied (and 10th among the 19 EU countries covered).

The countries belonging to the first risk zone in terms of sustainability are, in descending order: Greece, Iceland, the USA, Spain, Ireland and Portugal, Japan and the United Kingdom. The variation between these countries in terms of the depth of the financial markets and the degree of internationalisation of their currency obviously means that they do not all face the same risk of mistrust.

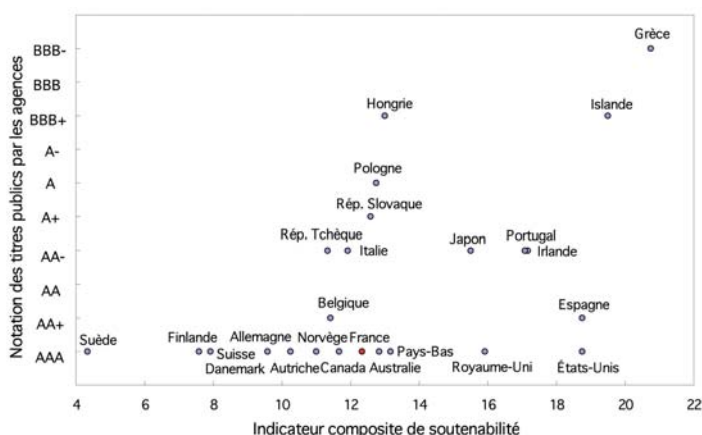
France appear to be less well positioned in terms of the criteria relating to the risks of excess short-term and medium-term public debt. In this respect, it is ranked 19th, ahead of Ireland, Poland, Greece, the United Kingdom, Japan and the USA, and close to Spain, which starts from a lower level of debt.

On the other hand, the long-term risk of excesses is reduced by relatively favourable demographic fundamentals and the relatively positive financial situation of resident agents. Here, France ranks 2nd among the 25 countries studied⁽¹⁷⁾.

It is interesting to examine certain countries in more detail, along with the criteria that distinguish them from the others. For example, household debt in Greece is still currently at one of the lowest levels in Europe, but this is

not enough to compensate for the other extremely negative criteria compared to the other countries. The USA's sustainability indicator has declined almost as much as Greece's, but without the same tension surrounding its possible downgrading reflecting the "exorbitant advantage" afforded by its currency. Spain is still experiencing fairly low levels of public debt, but other indicators are rather more critical. Ireland is slightly less constrained due its more positive net external position. Tensions are running high in the United Kingdom, requiring urgent deleveraging by households and a considerable fiscal effort to stabilise its debt. France in particular differs from these countries in having fairly good fundamentals: the limited extent of additional social spending forecast between now and 2050, a positive net external position and, finally, households with relatively little debt. However, heavily weighted short- and medium-term indicators, accounting for current imbalances and the fiscal effort required to stabilise public debt, are impinging on sustainability levels, and making fiscal adjustments necessary, even if these may be gradual.

Graph 6 :
Ratings of public securities⁽¹⁸⁾
and sustainability indicator



Source: Eurostat, OECD, Fitch Ratings, European Commission, IMF, calculations by the authors

[16] The rankings are therefore relative. The imperfect nature of such an indicator is also related to the fact that a single unit, the ranking of countries for each criterion, may under-estimate profound differences between two countries (the unit will be considered to be too small in relative terms) or the proximity of figures (and will therefore be considered to be too big in relative terms).

[17] This assessment has been confirmed by a recent study : "Ask not whether governments will default, but how", Morgan Stanley Research, 25 August 2010.

[18] The ratings were issued by the agency Fitch Ratings at end May 2010.

An overall look at the link between the synthetic indicator and sovereign debt ratings (*graph 6*) shows both the tensions that may affect the ratings and the limitations of such a tool. **The sustainability indicator is not enough on its own to describe the probability of a government default.** This is epitomised by the USA: the risk attached to debt in the USA is not as great as its position might lead us to believe. **The weight of history is a decisive factor in the confidence markets have in a sovereign issuer.** In fact, countries with a strong indicator but a very good rating, such as the UK and the USA, are countries with long-established financial and tax systems that have never defaulted (or which last defaulted a long time ago). Nevertheless, these countries are not without their vulnerabilities and the “too big to fail” concept has its limitations, as shown by the sovereign debt rating for Japan, which is still the world's number one creditor country. Likewise, countries with a median indicator, such as the Slovak and Czech Republics, Poland and Hungary, which are at the same level as France and the Netherlands, and whose ratings are quite low, all belong to the former Communist Block. **The depth of the financial markets, the international status of the currency (especially when considering reserves) and active debt management are also decisive criteria in terms of a country's rating.** On these points, especially the last, France does have acknowledged advantages⁽¹⁹⁾. The liquidity conditions enjoyed by the USA⁽²⁰⁾ and, to a lesser degree, the United Kingdom, minimise their cumulative debt risk in the form of an increase in spreads and, ultimately, their default risk.

CONCLUSION France's median ranking is the result of two contrasting characteristics : on the one hand, forces negatively impacting the short- and medium-term financial position; on the other, particularly solid long-term fundamentals.

Such a ranking also shows that the increase in financing costs for some States is not necessarily unrelated to fundamentals. The fear of a default crisis spreading throughout Europe is exacerbated by the fact that the countries at greatest risk are large or medium in size, i.e. Spain, Ireland, Portugal and the United Kingdom. Of these, only the last has the flexibility offered by a flexible exchange rate. This group of countries in a precarious position has a total debt representing 24.5% of the EU's public debt. This goes a long way towards explaining these countries' proactive approach to fiscal adjustments.



Thomas Brand and Olivier Passet,
Department of Economics and Finance



[19] Active debt and cash management by Agence France Trésor (AFT), introduced in 2001, is a particularly strong point for France because it minimises the net cost of government financing

[20] This does not protect against the local default risk, as shown by the repeated liquidity crises in California.

Table 1: Breakdown of the synthetic sustainability indicator
 (rank of each country for each criterion in decreasing order of performance, see data in appendix 1: tables 1 and 2)

	Indicateurs de court terme				Indicateurs de moyen-long terme			Équilibre financier global				Note synthétique moyenne (1), (2), (3)	Rang moyen (3)	Risque de dérive de court et moyen terme, moy.	Risque de dérive de long terme
	Déficit moyen 2005-2009	Déficit structurel 2009-2010	Dettes publique brute 2009	Dettes publique nette 2009	Effort budgétaire pour stabiliser la dette 2010	Dépenses sociales supplémentaires 2010-2050	Rang moyen (2)	Déficit courant moyen 2005-2009	Dettes externe nette 2007	Dettes ménages 2008	Besoin de financement des agents privés (2000-2009)				
	a	b	c	d	e	f	g	h	i	j	k	l	m	mo. (e, h, m)	mo. (g, m)
Allemagne	11	7	15	17	12,5	11	10	11	5	5	11	2	5,8	9,6	11,8
Australie	6	11	1	4	5,5	9	16	13	19	20	20	23	20,5	12,8	7,3
Autriche	10	8	14	15	11,8	10	9	10	9	13	10	6	9,5	10,3	10,9
Belgique	12	10	21	22	16,3	2	20	11	10	4	6	8	7,0	11,4	9,1
Canada	7	6	16	11	10,0	8	19	14	11	8	15	12	11,5	11,7	9,0
Danemark	2	4	6	5	4,3	6	3	5	8	10	25	17	15,0	7,9	5,1
Espagne	13	21	9	13	14,0	20	23	22	22	21	16	24	20,8	18,8	22
Etats-Unis	23	23	18	20	21,0	25	13	19	18	11	18	18	16,3	18,8	23
Finlande	3	3	4	2	3,0	4	14	9	7	16	9	11	10,8	7,6	2
France	18	16	19	18	17,8	18	4	11	12	6	8	7	8,3	12,3	12
Grèce	25	25	22	23	23,8	14	25	20	24	24	7	21	19,0	20,8	25
Hongrie	24	5	20	21	17,5	5	7	6	20	22	4	16	15,5	13,0	16
Irlande	15	24	11	9	14,8	21	18	20	17	12	21	19	17,3	17,2	21
Islande	9	17	23	14	15,8	19	17	18	25	25	24	25	24,8	19,5	24
Italie	16	9	24	25	18,5	7	5	6	15	15	5	10	11,3	11,9	11
Japon	19	18	25	24	21,5	23	15	19	6	3	12	3	6,0	15,5	18
Norvège	1	12	10	1	6,0	17	21	19	1	2	14	15	8,0	11,0	7
Pays-Bas	8	13	13	12	11,5	13	24	19	4	7	23	4	9,5	13,2	17
Pologne	20	19	8	10	14,3	22	1	12	16	18	3	13	12,5	12,8	14
Portugal	22	20	17	19	19,5	15	6	11	23	23	17	22	21,3	17,1	20
Rép. slovaque	17	15	2	7	10,3	16	11	14	21	19	2	14	14,0	12,6	13
Rép. tchèque	14	14	3	6	9,3	12	12	12	13	17	1	20	12,8	11,3	8
Royaume-Uni	21	22	12	16	17,8	24	8	16	14	14	19	9	14,0	15,9	19
Suède	4	2	7	3	4,0	1	2	2	3	9	13	5	7,5	4,3	1
Suisse	5	1	5	8	4,8	3	22	13	2	1	22	1	6,5	7,9	4

Note: each is ranked magnitude in terms of the GDP of the country concerned.

To complete column g (supplementary age-related expenditures), various documents were used: Ageing Report 2009, European commission (p. 34, 51, 55); Visco I. (2005), "Ageing and pension system reform: Implications for financial markets and economic policies", Financial Market Trends, November Supplement, p. 13; "From stimulus to consolidation: Revenue and expenditure policies in advanced and emerging economies", IMF Working Paper, 2010, p. 21; "Projecting OECD health and long-term care expenditures: What are the main drivers?", Economic Department Working Paper, No. 477, p. 31.

Sources: OECD, IMF, Eurostat, CAS calculations

APPENDIX 1

Table 1 : Evaluations of the structural budget balances of developed economies by international bodies, Spring 2010

2009					2010						
OCDE		FMI		Commission	OCDE		FMI		Commission		
Grèce	-11,7	Grèce	-13,1	Grèce	-14,1	Etats-Unis	-9,0	Etats-Unis	-9,2	Royaume-Uni	-10,4
Irlande	-9,9	Irlande	-10,0	Irlande	-11,4	Royaume-Uni	-8,1	Grèce	-8,9	Irlande	-8,7
Etats-Unis	-9,0	Espagne	-8,4	Royaume-Uni	-9,7	Irlande	-7,3	Irlande	-7,9	Grèce	-8,2
Royaume-Uni	-8,6	Etats-Unis	-7,9	Espagne	-9,6	Pologne	-6,9	Royaume-Uni	-7,6	Espagne	-7,8
Espagne	-8,3	Royaume-Uni	-7,8	Portugal	-8,3	Japon	-6,4	Japon	-7,5	Portugal	-7,5
Islande	-7,4	Portugal	-7,8	Pologne	-6,9	Espagne	-6,2	Norvège	-7,3	France	-6,6
Portugal	-7,4	Japon	-7,4	France	-6,2	Portugal	-5,7	Espagne	-7,3	Pologne	-6,5
Pologne	-7,3	Norvège	-6,8	Rep. Tchèque	-5,1	France	-5,5	Portugal	-7,1	Pays-Bas	-4,9
France	-5,7	France	-4,9	Belgique	-4,5	Grèce	-4,2	Pays-Bas	-5,2	Rep. Tchèque	-4,7
Japon	-5,5	Belgique	-4,8	Pays-Bas	-3,6	Pays-Bas	-4,2	Australie	-4,9	Belgique	-3,7
Rep. Tchèque	-4,6	Pays-Bas	-4,5	Italie	-3,3	Islande	-4,0	France	-4,6	Allemagne	-3,6
Pays-Bas	-4,5	Australie	-4,0	Autriche	-2,4	Rep. Tchèque	-3,9	Autriche	-4,3	Autriche	-3,6
Australie	-3,3	Italie	-3,9	Hongrie	-2,2	Allemagne	-3,5	Belgique	-4,3	Italie	-3,6
Canada	-3,2	Autriche	-3,0	Allemagne	-1,8	Autriche	-3,0	Allemagne	-3,8	Danemark	-3
Belgique	-2,8	Canada	-2,0	Finlande	0,3	Australie	-2,5	Italie	-3,5	Hongrie	-2,1
Italie	-2,7	Allemagne	-1,1	Danemark	0,6	Nlle-Zélande	-2,5	Canada	-3,0	Finlande	-1,4
Autriche	-2,4	Suède	-0,6	Luxembourg	1,2	Italie	-2,3	Nlle-Zélande	-2,0	Luxembourg	-1,4
Hongrie	-1,6	Finlande	-0,1	Suède	1,9	Canada	-1,8	Finlande	-1,9	Suède	-0,2
Allemagne	-1,4	Danemark	0,0			Hongrie	-1,7	Danemark	-1,7		
Nlle-Zélande	-1,4	Nouvelle-Zélande	0,4			Belgique	-1,4	Suède	-0,8		
Norvège	-0,8					Danemark	-1,4				
Danemark	0,1					Luxembourg	-1,2				
Luxembourg	1,0					Norvège	-0,9				
Finlande	1,1					Finlande	-0,3				
Suisse	1,3					Suisse	0,0				
Suède	2,3					Suède	0,8				

Sources : OCDE, FMI, DG ECFIN

Table 2 : Data incorporated in the synthetic indicator

	Indicateurs de court terme				Indicateurs de moyen-long terme		Équilibre financier global			
	Déficit moyen 2005-2009	Déficit structurel 2009-2010	Dette publique brute 2009	Dette publique nette 2009	Effort budgétaire pour stabiliser la dette 2010	Dépenses sociales supplémentaires 2010-2050	Déficit courant moyen 2005-2009	Dette externe nette 2007	Dette ménages 2008	Besoin de financement des agents privés (2000-2009)
	a	b	c	d	f	g	i	j	k	l
Allemagne	0,2%	-2,5%	77%	50%	2,4%	4,9%	6,2%	26%	61%	7,8%
Australie	-1,6%	-3,7%	16%	-6%	1,9%	6,0%	-5,1%	-65%	104%	-6,7%
Autriche	-2,0%	-3,1%	73%	38%	1,9%	3,9%	2,8%	-18%	52%	4,6%
Belgique	-0,1%	-3,6%	101%	81%	-1,0%	6,8%	0,8%	29%	49%	2,3%
Canada	-3,1%	-2,5%	83%	29%	1,5%	6,4%	0,4%	-2%	83%	0,3%
Danemark	-3,5%	-0,9%	45%	-4%	0,7%	2,5%	3,0%	-8%	138%	-1,4%
Espagne	3,1%	-7,9%	59%	33%	5,8%	8,7%	-8,3%	-85%	84%	-8,4%
Etats-Unis	2,7%	-8,8%	84%	56%	9,7%	5,7%	-5,0%	-17%	97%	-1,6%
Finlande	-3,8%	-0,4%	44%	-52%	0,0%	5,8%	3,3%	-29%	52%	0,8%
France	-1,6%	-5,6%	85%	53%	4,9%	2,5%	-1,3%	12%	51%	2,3%
Grèce	-7,1%	-10,0%	115%	86%	3,1%	15,2%	-11,8%	-104%	51%	-4,7%
Hongrie	-6,0%	-1,9%	85%	59%	0,4%	3,2%	-5,5%	-98%	36%	-0,7%
Irlande	-1,2%	-9,2%	66%	25%	6,3%	6,2%	-4,1%	-18%	109%	-3,4%
Islande	-3,4%	-5,7%	118%	35%	5,0%	6,0%	-15,7%	-113%	128%	-17,6%
Italie	-3,4%	-3,2%	124%	97%	1,4%	2,9%	-2,7%	-21%	39%	0,9%
Japon	-4,0%	-6,7%	189%	96%	8,6%	5,9%	3,7%	50%	66%	7,7%
Norvège	-0,8%	-4,0%	60%	-140%	4,7%	7,0%	16,0%	59%	76%	-0,5%
Pays-Bas	16,0%	-4,5%	71%	31%	2,9%	9,0%	7,1%	0%	120%	7,7%
Pologne	-4,1%	-6,9%	58%	26%	6,8%	-0,4%	-3,1%	-58%	31%	0,2%
Portugal	-5,0%	-7,3%	84%	56%	4,6%	3,1%	-10,2%	-101%	96%	-5,9%
Rép. slovaque	-2,1%	-5,3%	27%	7%	4,7%	5,0%	-5,9%	-61%	28%	0,0%
Rép. tchèque	1,7%	-4,6%	37%	0%	2,6%	5,1%	-1,7%	-45%	28%	-4,6%
Royaume-Uni	1,0%	-8,7%	71%	47%	8,8%	3,4%	-2,3%	-20%	100%	1,0%
Suède	-5,0%	0,6%	53%	-17%	-2,0%	1,9%	7,9%	-6%	73%	5,7%
Suisse	-5,2%	0,7%	44%	10%	-0,4%	7,2%	9,7%	141%	116%	10,2%
Source	Eurostat, OCDE	Moyenne FMI, OCDE, Commission	OCDE	OCDE	OCDE	Commission, OCDE, FMI	OCDE, Eurostat	FMI	OCDE, Eurostat	OCDE

Source : OCDE

AUTRES DOCUMENTS À CONSULTER

sur www.strategie.gouv.fr, rubrique publications

Notes d'analyse :

- N° 176 (mai 2010) ■ **Quel rééquilibrage pour les moteurs de croissance allemande ?**
- N° 173 (avril 2010) ■ **R & D et structure des entreprises : une comparaison France / États-Unis**
- N° 172 (avril 2010) ■ **Les choix énergétiques dans l'immobilier résidentiel à la lumière de l'analyse économique**
- N° 164 (janvier 2010) ■ **La croissance verte : quels impacts sur l'emploi et les métiers ?**
- N° 156 (novembre 2009) ■ **L'ajustement de l'emploi dans la crise : la flexibilité sans la mobilité ?**

Rapport :

- **“Sortie de crise : vers l'émergence de nouveaux modèles de croissance ?”** publié à la Documentation française, Rapports et Documents, n° 22, 2009

Tableaux de bord :

- **L'attractivité de la France 2010 - juillet 2010**
- **L'emploi public - juillet 2009 - mise à jour septembre 2010**



La Note d'analyse N° 191 -
Septembre 2010 est une publication
du Centre d'analyse stratégique
Directeur de la publication :
Vincent Chriqui, directeur général
Directeur de la rédaction :
Pierre-François Mourier,
directeur général adjoint
Rédaction :
Nathalie Bassaler
Secrétariat de rédaction :
Olivier de Broca
Impression :
Centre d'analyse stratégique
Dépôt légal : septembre 2010
N° ISSN : 1760-5733

Contact presse :
Jean-Michel Roullé, responsable
de la Communication
01 42 75 61 37 / 06 46 55 38 38
jean-michel.roulle@strategie.gouv.fr

The Centre d'analyse stratégique is a research and decision-making institution under the authority of the Prime Minister and the Secretary of State for Strategic Studies.
The Centre's mission is to advise the Government in economic, social, environmental and technologic policy issues.
The Centre provides the Prime Minister with briefs and forecasts concerning major national reforms. It also conducts independent research initiatives as a part of its annual working program.
The Center draws upon an 11 member Steering Committee that includes two Members of the Parliament, two Senators and a member of the Economic and Social Council.
It works in coordination with the main Councils of experts reporting to the Prime Minister :
le Conseil d'analyse économique, le Conseil d'analyse de la société, le Conseil d'orientation pour l'emploi, le Conseil d'orientation des retraites, le Haut Conseil à l'intégration.