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Re:
•Downgrading by S&P of France's credit rating from "AA" to "AA-"[1]
•Are French public finances in trouble?[2] https://worldview.stratfor.com/article/frances-budget-troubles-bode-ill-macron-ahead-eu-elections

France is in the news for running a government deficit of 4.9% of GDP and a public debt of 111.6% of GDP.[3]

It seems that the infinitesmal credit downgrading, justified or not, has had little effect on France's financing conditions.[4]

That could translate a mistrust in the rating agencies' reliability, or more likely that bond prices had already discounted the event, which has been brewing for months, if not years.

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1 https://www.reuters.com/markets/europe/what-sps-ratings-downgrade-means-france-2024-06-01/#:~:text=Days%20ahead%20of%20a%20June,euro%20zone's%20second%2Dbiggest%20economy.
2 https://worldview.stratfor.com/article/frances-budget-troubles-bode-ill-macron-ahead-eu-elections.
3 https://www.imf.org/external/datamapper/profile/FRA.
4 https://www.lemonde.fr/en/politics/article/2024/06/02/standard-poor-s-downgrade-of-france-s-credit-rating-a-wake-up-call-for-the-government_6673494_5.html.

In this report, I have summarized some comments on these questions:[5]

- is excessive significance attached to countries' deficit/GDP ratios and to their public debt/GDP ratios,
- are public finances are in a state of "bankruptcy",
- is public spending is by definition wasteful,
- would it make sense for the public finances to be managed as would a "bon père de famille",
- whether a trade or current account deficit is necessarily a negative for the economy as a whole?

Leaving aside the fundamental conflict consisting for rating agencies in relying for their revenues on their reports on the companies that issue and trade the securities they evaluate (that got them into controversy over the validation of the debt instruments securitized on mortgage loans, all of which blew up during the Great Financial Crisis of 2008), here are the Standard & Poor's ratings of selected countries:[6]

Singapore	AAA
Canada	AAA
US	AA+
France	AA-
UK	AA
Japan	A+
China	A+
India	BBB-

<u>**About the debt to GDP ratio**</u>

It's not how much you owe that matters most, it's what you do with the loan that counts.

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[5] Over the years, I have discussed these issues in international finance classes for MBA students.
[6] https://www.spglobal.com/ratings/en/research/articles/190807-sovereign-ratings-list-11099434.

In other words, if you can earn a higher rate of return with the loan than the rate of interest, then you borrow all you can.

At some point, of course, that can entail the assumption of risk that makes the return not worthwhile.

Anyway, the discussion at the outset should be less about how much is owed than whether we will use it well (and, as proof, that we have used it well in the past).

The debt/GDP ratio is just one of many measures of development, and stability. Its variances cut across a wide range of countries with different socio-economic regimes.

Other criteria of appreciation may be far more important.

Who would want to live in Russia because the public debt/GDP is about 19.6% rather than in Japan where it is 264%?[7]

This is not meant to deny the debt/GDP ratio any significance or to ratify any ratio, but simply to put the use of the ratio in a more complete context.

A technical issue is just what numbers are taken into account; for example, it is important to distinguish long-term and short-term debt, private debt from public debt, central government debt from local government debt, domestically held debt from debt held by foreigners, as well as in which currencies the debt is denominated.

In the end, a country's public debt to GDP ratio taken in isolation may be less important its relation to those of other countries, this in terms of

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7 https://www.imf.org/external/datamapper/d@FPP/USA/FRA/JPN/GBR/SWE/ESP/ITA/ZAF/IND.

coordinating fiscal policies among trading partners to avoid disequilibria, distorsions and disputes.

The debt to GDP to GDP and government deficit to GDP ratios are mostly important on a comparative basis

It bears remembering that the so-called Maastricht rules imposing limits on government deficits to GDP (3%) and government debt to GDP (60%) were most important during the period leading up to the implementation of the Euro primarily to bring about convergence of the economies adopting the Euro and less to enshrine the numbers as such.[8]

Here are some numbers for purposes of comparison drawn from the IMF's DataMapper and relate to 2022.[9]

	DEFICIT	**PUBLIC**		**CENTRAL**	**PRIVATE**	**INTEREST**
	/ GDP	**DEBT**		**GOVT DEBT**	**DEBT**	**PUBLIC DEBT**
		/ GDP		**/ GDP**	**/ GDP**	**/ GDP**
France	4,9%	111,6%		92,2%	219,3%	1,9%
US	6,5%	129,0%		110,0%	269,0%	2,8%
Canada	1,1%	104,7%		49,0%	215,0%	2,7%
China	7,4%	88,6%		NO DATA	195,0%	0,9%
India	7,8%	82,5%			87,9%	5,2%
Japan	6,5%	264,0%		214,0%	186%	1,4%
Singapore	5,1%	162,5%		NA	179%%	NO DATA
UK	4,6%	104,3%		NA	150,7%	4,0%

A first observation is that, even though Japan has the highest debt ratios, public and private, it has the lowest interest expense as a percentage of GDP.

Secondly, the US's private sector has accumulated twice as much debt as the public sector and it ranks

[8] Jan Priewe, Why 60 and 3 percent? European debt and deficit rules – critique and alternatives, 2018, https://www.boeckler.de/pdf/v_2019_10_26_priewe.pdf.
[9] https://www.imf.org/external/datamapper/profile/GBR.

as most indebted among the countries under consideration.

Still, those IMF numbers may not tell the whole story, as other sources on quantifying the total debt to GDP ratio put forward different results:

	TOTAL DEBT
	(definition[10])
	/ GDP
France	929%
US	730%
Canada	937%
China	NA%
India	NA
Japan	1290%
Singapore	NA
UK	911%

On a different level, to make cross-country comparisons, all things must be equal.

As an example, health care in France is 12.1% of GDP versus 16.6% of GDP for health care in the United States.[11]

Given the different allocations of health expenditures among the public and private (including patients) sectors in France and the United States:

In %	**PUBLIC**	**PRIVATE**	**PATIENTS**
France	77	16	7
US	45	30	24

[10] "Total Debt is calculated as sum of Liabilities for Non-Financial Business, Federal Government, State and Local Government, Households & Non-profit Organizations and Financial Business less Mutual Fund Shares. Federal Reserve Board provides Total Debt in local currency." https://www.ceicdata.com/en/indicator/united-states/total-debt--of-gdp.

[11] OECD, https://stats.oecd.org/Index.aspx?DataSetCode=SHA

then, if France were to reduce its share of public expenditure for health care (77%) to the US level (45%), it could reduce its public health care share of GDP by 32%, or one third of its allocation to the public sector, that is 4% of GDP.

In other words, France’s overall excess of spending as a percentage of GDP (17%) is partly explained (4%) by the public sector’s assumption of health expenditures that would have been borne in other countries by their private sectors or their patients (often uninsured).

To be more accurate in making comparisons among countries, each budget line, for instance, education, or transportation, should be compared with the split between public and private in every country giving rise to similar adjustments.

In the end, France’s choice of social system might not yield a public debt/GDP ratio or government deficit/GDP ratio, as adjusted, very distant from those in countries such as the US.

Are countries at risk because the Government finances are in a state of “bankruptcy”?

While he was Prime Minister of France and speaking of his own Government, François Fillon made headlines for being the highest official to level this charge.[12]

It is repeated *ad nauseam* in France.

Except that it is a misuse of language, which is culpable when made by people who should know better.

“Bankruptcy” occurs when one’s liabilities are greater than one’s assets.

[12] https://www.lemonde.fr/societe/article/2007/09/22/les-propos-de-m-fillon-sur-la-situation-de-faillite-de-la-france-suscitent-la-polemique_958517_3224.html.

If one actually looks at what are the assets of the French Government, or of most any other for that matter, States' assets are generally greater than their liabilities.

The French State is not bankrupt. The French Government possesses assets in excess of its liabilities.[13]

States, even developed, can from time to time and for different reasons face liquidity (insolvency) crises, such as did South Korea during the Asian Financial Crisis of 1997.[14]

But France's interest payments to GDP ratio (1.9%) is among the lowest of the countries surveyed above.

The French Government (or Sate) is not near a liquidity crisis.

Public expenditures are wasteful

Of course, one can find public expenditures that are wasteful, but that is not the same thing as saying any expenditure by the government is necessarily less productive than private investment.

As an example, the return on expenditures on education is estimated by the OECD to be 9% per year for students over their entire active lives; and that does not include the social benefits from "positive externalities", namely the benefits accrued to all those who come into contact with the educated person (family, colleagues, enterprises, etc.), which are estimated at 1% per year as well, so a total of 10% per year for decades.[15]

13 https://fr.wikipedia.org/wiki/Patrimoine_des_administrations_publiques_fran%C3%A7aises.

14 http://www.lapres.net/coree.html.

15 https://documents1.worldbank.org/curated/en/442521523465644318/pdf/WPS8402.pdf

The rate of return on public investment in transportation infrastructure has been estimated to be 17%.[16]

The average annualized return on the Standard & Poor's index after adoption of the 500 stocks format in 1957 through 2023 is 10.26%.[17]

Whether a certain service is better delivered by the public or the private sector ought to be a question of equity and efficiency, not of ideological conviction or political affiliation.

In managing their finances, governments should act as would a household (a "bon père de famille" approach).

The differences in scale, in breadth of consequences of the decisions, and in terms of accountability suffice to show the inappropriateness of the analogy.

In addition, the logical extension of the idea shows its invalidity.

If for the sake of discussion, the recommendation were followed, then the public debt to GDP ratios would pale in comparison to those implemented by private households, in particular when the latter buy real estate with financing over 20-30 years, which might well correspond to debt to annual income of 6-10 times (assuming annual repayment corresponded to 33% of income).

Is running a trade or current account deficit on its balance of payments necessarily a negative sign for a country?

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[16] https://www.epi.org/publication/the-potential-macroeconomic-benefits-from-increasing-infrastructure-investment/.
[17] The average annualized return from 1928 to 2023 is 9.90%, https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp.

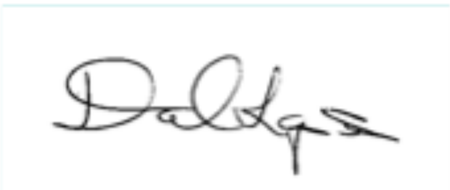
The trade balance concerns exports and imports of goods, whereas the current account includes as well trade in services and flows of income on foreign investments.

The impact of an excess of imports over exports does after all depend on the nature of the goods or services in question.

For example, imports of machinery entail investments that fuel growth, so a trade deficit explained by a surge in imports of machinery and capital goods might reflect a positive outlook for the economy.

Or, exports of low value-added goods (such as primary and artisanal products) or services (travel) are worth less for the economy as a whole than meets the eye, and trade or current surpluses on those accounts would not be optimal signs for the economy.

Yet again, since excesses of exports over imports of goods and services have in the end to be financed in multifarious forms by the granting by the exporting country of credit to the importing country, risks as well as opportunities are engendered in the process.



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