Public debt

**Key facts**

Administering a country leads the state and public administrations (central and local government and social security bodies) to provide public services.

Initially, this consisted in carrying out so-called sovereign functions, notably maintaining law and order. The emergence of the “welfare state” then resulted in involvement in new areas such as healthcare, education and research. These services generated additional spending.

In France, nearly half of the wealth produced is the subject of “tax and social security contributions” by the state and public administrations, before being injected back into the economy in the form of operating or investment spending.

The state is thus present in very varied activities; to fund these, it has a budget. Tax revenue enables it to incur expenditure. If, over the course of a year, a state’s spending is higher than its revenue, there is a fiscal deficit. The state then has to borrow to fund its activities.

So public debt is the total sum of public administrations’ borrowing over the years that remains to be repaid. In France, public debt has grown continuously since 1974: having been equivalent to 20% of GDP (gross domestic product, i.e. a country’s annual production of wealth) at the end of the 1970s, public debt reached the threshold of 60% of GDP in 2002, and stood at nearly 96% of GDP in 2015.

However, managing a country’s debt is not exactly comparable with that of a household or a business: a state has a lifespan that is in principle infinite and is not intended to generate profits. Thus, it is not only the level of debt that is important but also its cost, use and trajectory, taking account of the characteristics of the economy (notably its competitiveness) and the quality of fiscal management (ability to raise taxes, investment for the future, etc.). Public debt that grows and gets out of control is dangerous. On the other hand, well-managed debt can be beneficial, provided that the spending it funds creates wealth for the future (see “Understanding Public Debt”).

**A brief history**

In the Greek city states, temporary borrowing for the city was a frequent occurrence, notably to fund wars.

The concept of public debt appeared in the Middle Ages, but people tended to confuse it with the monarch’s borrowing from the kingdom.

Under the Ancien Régime, debt was used to cover extraordinary spending, notably wars.

In 1797, the French Republic decided to cancel two-thirds of the stock of public debt: this was the “bankruptcy of the two-thirds”.

During the 19th century, the French state took on debt above all to invest in major projects, particularly the railways.

Income tax was introduced in France in 1914. It appeared in 1842 in the United Kingdom, in 1893 in Germany and in 1913 in the United States.

In 1920, in the wake of the First World War, France’s public debt reached 110 billion francs (90% of GDP). Similarly, the reconstruction efforts that followed the end of the Second World War substantially increased public debt.

Value added tax (VAT), the main revenue for France’s budget, was introduced in France in 1954. It was subsequently adopted by all the other European countries.

Since 2010, in the wake of the public debt crisis, the European Union has strengthened its common rules with respect to public finances and has created new institutional mechanisms.

**Key figures**

- **95.7%** of GDP
  - France’s debt at end-2015
- **2,097 billion euro**
  - France’s debt at end-2015
- **3.5%** of GDP
  - France’s budget deficit in 2015 (2.2% for the euro area)
- **44.5%** of GDP
  - Rate of statutory deductions in 2015

Source: Insee.
**THE BANQUE DE FRANCE’S TASKS WITH RESPECT TO PUBLIC DEBT**

In France, since 2001 government debt has been managed by the Agence France Trésor (AFT). The Banque de France contributes to managing this debt in several ways:

- It organises the auctions where government debt securities are issued. These public debt securities are instruments that can be traded on financial markets (bonds and Treasury bills for example).

- It compiles the statistics on public debt, in collaboration with INSEE and the Ministry of Finance.

- The Government’s cash position (as well as that of national public institutions, regional and local authorities, their local public bodies and a number of other bodies) is centralised by the Banque de France, in its role as the “state’s banker”, in a single account known as the “Treasury account”.

In addition to this accounting function, the financial crisis has led central banks to take on an active role in public debt securities markets. Since the Maastricht Treaty (Article 104), central banks in the European Union have not been permitted to fund governments. Nonetheless, in order to encourage banks to expand their lending to businesses and individuals to give stimulus to the economy, since 2010 Eurosystem central banks, in coordination with the ECB, have intervened in secondary public debt markets: they buy public debt securities from banks.

---

**UNDERSTANDING PUBLIC DEBT**

**Debt dynamics and the issue of sustainability**

The great disparity in public debt situations across the world shows the difficulty in defining a threshold for the insolvency or unsustainability of public finances; such a threshold represents a level of debt where the country is deemed to be no longer able to repay its borrowing, i.e. it is bankrupt. Japan (with public debt at 229% of GDP in 2015), the United States (104%) and Germany (71%) are regarded as solvent countries. But Greece, with public debt at 146% of its GDP in 2010, saw its cost of financing on the markets rise to levels where it became impossible for it to refinance itself, hence the assistance from the other European countries (conditional on the implementation of economic and tax reforms). This disparity illustrates the fact that debt “sustainability” depends first and foremost on a country’s economic situation.

An economic agent (an individual, firm or government) can take on debt in order to invest. This rationale leads public administrations to borrow in order to finance investment spending, which is a promise for the future provided that it increases the competitiveness of the national economy (for example, investing in transport infrastructure makes it cheaper to transport goods).

By contrast, when public debt starts to soar, for example as a result of excessive regular operating spending or costly and unprofitable investment, we speak of a “snowball effect”. Each year, the government has to determine its financing requirements, which cover maturing debt that must be repaid, as well as the fiscal deficit for the year. If the cost of financing these requirements (in other words, the interest rate on the debt) is greater than the growth in the country’s wealth (the rate of growth of the economy), the debt will tend to increase. If this trend persists, the debt will get completely out of control.
PUBLIC DEBT IN EUROPE

According to the Maastricht Treaty, public debt covers all of the debt taken on by public administrations within the framework of national accounts: central administrations (in other words, the government), local public administrations and social security bodies.

With the adoption of the Treaty in 1992, the European Union introduced for the first time a set of rules governing the management of public finances in a Member State wishing to adopt the single currency. Two of the five “Maastricht criteria” concerned public finances: an upper limit of 3% of GDP for the budget deficit and 60% of GDP for public debt. The Stability and Growth Pact adopted in 1997 with the Treaty of Amsterdam consisted in extending the obligation to comply with these criteria for countries that have adopted the euro.

The European Commission is responsible for ensuring compliance with this fiscal discipline. Improved in March 2005, the Pact has since emphasised the objective of “public finances in balance or in surplus over the medium term”, which is equivalent to imposing “virtuous” management of public debt. Subsequently, faced with the sovereign debt crisis in the euro area, nearly all of the European countries ratified a treaty on stability, coordination and governance, more commonly known as the European Fiscal Compact, which came into force on 1 January 2013. This sets the rule of a balanced budget for all public administrations across Europe.

To learn more

Suggested reading
- Financial Stability Review
- Economical financial and social report 2016
- Cour des comptes (French national audit body)

Useful links
- Data on public debt
- European Commission