“The French welfare state is doomed”

Interview with Denis Kessler
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For the Chairman & CEO of SCOR, the fiscal shock “unleashed” by the government will not be enough. France can no longer delay the structural reforms needed to reduce its public spending.

Denis Kessler belongs to the very exclusive “BOSSES IN THE BLACK” club, comprising the few fortunate CEOs to have seen their companies’ share prices rise since the 2007 crisis. And with good reason: the Chairman and CEO of the reinsurer SCOR acted with acute foresight by liquidating the Group’s shares before the subprime crisis and selling off its government bonds before the sovereign debt crisis. His new head office on avenue Kléber in Paris seems, moreover, to be designed to anticipate the future, with its vast, ultra high-tech board room. Indeed, he is already thinking about the next political and social upset.

L’Expansion: You felt the wind change in 2007 over the share markets and again in 2010 with regard to State bonds. So what will the next calamity be?

Denis Kessler: Back in 2007, I already felt that we were entering a long structural crisis. At this stage of the crisis, economic policy instruments have virtually stopped working. Budgetary tools are less effective than before and are even having a negative impact. In an open economy, and especially when economic policies are badly or not all coordinated, a consumption stimulus will sooner or later be lost in the sands of globalisation. This has the adverse effect of increasing State debts to unsustainable levels. Nor will monetary easing produce any miracles. The ECB has injected EUR 1000 billion in less than a year, but this has not stopped Europe from entering a recession. The central banks have certainly prevented a systemic crisis, but they have no impact on the real economy. Although their policies of very low rates help States and the banking system, they penalise long-term savers and investors, insurers and pension funds. In actual fact, what we are witnessing is a massive transfer of wealth to the benefit of those in debt and to the detriment of investors. Once the monetary drip-feed ends, there is a high risk that interest rates will rise sharply and inflation will return.

How would this happen?

For the central banks, the main way to sterilise liquid assets is to sharply increase their deposit interest rates. Monetarists, anxious to avoid a resurgence of inflation, tend to use this kind of policy. Look at what happened after Reagan was elected in 1980. We could soon experience another episode like that, for example if Mitt Romney is elected in November. In Europe, the Bundesbank is increasingly opposed to the policy of the ECB. Only structural reform will lead to recovered stability and then to growth.
So, we need to start cleaning up public finances and getting tough on monetary policy right now?

Obviously. As soon as possible. We have put the patient on a budgetary and monetary drip, but the disease is stubborn...and it’s getting worse. The eradication of public debt is absolutely crucial, and the golden rule should have been written into the Constitution during the transition to the euro! Nevertheless, I find it regrettable that the deficit in France is for the most part being reduced by a massive increase in mandatory contributions, when these have already reached record levels. The reduction of State spending – in the broad sense of the term – should be the main thrust of the public finance recovery policy.

But wouldn’t a temporary period of austerity to cure the crisis run the risk of inflaming the situation?

The Anglo-Saxon countries talk about “austerity fatigue”. The public finds the necessary auditing of the public accounts exhausting, particularly where there has been long-standing laxity and the truth about the country's financial situation has been covered up. When debts have to be repaid, the wake-up call is brutal and painful. Demonstrations become more frequent, blaming those trying to tackle the problems, like Mario Monti, rather than those who have let the deficits get out of hand. If the governments of the countries in crisis do not carry out these reforms, however, the disparities within the European Union and the Eurozone could jeopardize this historic integration.

You’re all for strong-arm measures. Basically, we have reached a point where we need to make a fundamental choice, because we can no longer cheat by borrowing...

For several years now, I have been saying that we urgently need to clean up public finances and reform the country. All the problems were identified and the solutions were known. But we chose to deny reality and invoke the superiority of our model, when we should have been reforming it from top to bottom so that it could survive. The final error is being committed right now: the government has unleashed a fiscal shock without implementing the reforms that would enable us to structurally reduce public spending. But I think we are nearing the end, and will be forced to reform...

Nevertheless, some people are demanding a postponement of the budgetary commitment made in Brussels not to exceed a 3% public deficit in 2013...

The temptation of procrastination again. If France requests a new deadline to avoid implementing crucial reforms, we run the risk of a sharp rise in interest rates. For the moment, the country is borrowing cheaply, since it is doing its best to act in concert with Germany. The day when France appears to abandon its commitments or to be incapable of keeping them, its interest rates could increase dramatically. And given our significant external debt and weak growth, the risk of edging closer to the situation in Italy [interest rates of more than 5%] is real. In the long term, a rise like this would put the interest payable on public debt on the same scale as income tax revenue. But let’s not be defeatist: a deficit of less than 3% of GDP is entirely possible, so long as we reduce public spending without caving in to corporatism.
Let’s take this reasoning even further: in the event of a quasi-recession, the country would need to find EUR 55 billion. According to your breakdown of where to make savings, this would mean cutting EUR 35 billion of public spending. Would we therefore also need to attack social services and the welfare state?

That’s what the Italian and Spanish governments are currently doing. And before them, Sweden, Canada and Germany also reformed their social systems. The French welfare state is doomed, because it is financed on credit. Financing the contributory pension system (which is already a transfer between generations) through debt amounts to transferring an additional financial burden to future generations, which already have to face the consequences of an aging population. People are wrong to claim that the French welfare system cannot be reformed. We need to push the 2010 pension reforms even further and get rid of the 35-hour week, which costs at least EUR 12 billion per year. And we need to finally reform the way in which the welfare system is financed.

Do you think that the 75% rate of tax on very high incomes will lead to an exodus of talent and wealth?

At a certain level of contributions, increasing the tax rate changes behaviour relating to savings, labour market participation, risk taking…and the location of businesses. Capital and talent blow around like the wind. High pressure zones move to low pressure zones, and the greater the pressure difference, the stronger the wind! The conditions seem right for an exodus to me.