“Our social model is untenable”

France’s credit rating has just been downgraded by Standard & Poor’s, is this a catastrophe or a non-event?

It’s a very strong signal that everyone should take into consideration. It heralds the end of the era in which current account deficits and the repayment of past debts were easily achieved through the issue of new debt. The cost of debt financing has already significantly increased, because investors had anticipated this downgrade. This complicates the clearing of public deficits and will increase the cost of financing companies and households. This rating downgrade was accompanied by a negative outlook. We need to act quickly and firmly in order to avoid entering the vicious circle of increasingly costly, successive downgrades in which other European countries are finding themselves. We have lost a certain degree of freedom; let’s do everything we can to avoid losing any more.

The markets have not attached much importance to the downgrade. Is the worst of the crisis over?

With any illness, there are periods of remission in which the indicators improve. This downgrade came about as the ECB was injecting massive amounts of cash into the financial system, which has minimised its immediate impact. This injection is doing the patient some good, but it has not cured him. We have a long road ahead of us before the European economies return to healthy and sustainable growth. After ten years of widespread indebtedness for all economic players – nations, States, local authorities, companies and households – the accumulated debts are going to have to be repaid. The accumulated debt of all economic agents, in Europe as in the United States, has increased from 250% of GDP to a peak of 390% between 2000 and today! To return to an acceptable level of indebtedness, we need to reduce the debt by an amount equivalent to 1.5 years of GDP. This is a huge amount that won’t be paid back in a day. We are entering an era of generalised debt clearing. All economic players, without exception, will be affected. This will take time and will be painful.

Why are we in this situation?

Firstly, as a result of excessive recourse to debt over many years. The monetary policies followed between 2000 and 2007 facilitated this credit explosion. Unfortunately, a very large portion of this debt has not resulted in productive investments, which would have generated cash flows able to repay the amount borrowed with no problems. Greece is covered in swimming pools, not factories!
Secondly, the situation is the result of errors committed in order to manage the crisis from 2007 onwards. At that time, we believed we were facing a classic economic crisis that we could handle with a Keynesian response, i.e. by supporting business through budget deficit and an increase in public and welfare spending. In France’s case, everyone now knows that public debt has increased by more than EUR 500 billion over the past five years. It is less well known that, over the same period, public spending in France increased by more than 15%! Opting for this unsuitable policy has only aggravated the situation.

Finally, the new prudential standards in the financial world are going to speed up and amplify the debt-clearing phenomenon. They will lead to smaller, more expensive offers of credit. As for insurers, they will be dissuaded from investing in shares, and investments in corporate bonds will involve a capital charge that does not burden Treasury bond investments. All of this is going to limit growth and complicate debt-clearing strategies.

What are the possible solutions?

This debt-clearing phase must be managed very carefully so that it doesn’t lead to difficult consequences that are bad for everyone. It is critical for the State to significantly reduce its deficit, and in this respect the “golden rule” - although certainly far too late – is welcome. But that’s not enough. A second golden rule is needed, namely that the deficit be cleared first and foremost through the reduction of public and welfare spending rather than by increasing mandatory contributions. We need to make a rule to the effect that at least 70% of debt clearing should come from a reduction in public spending. This is the choice made by those countries progressively getting themselves out of the debt crisis – and keeping their AAA rating. Finally, the State must re-allocate its spending to support competitiveness, investment and innovation. Businesses need to pay attention to goodwill on their balance sheets, traces of past leverage, to the “covenants” that accompany loan agreements, in order to avoid violating them, and to cash flows and liquidity in order to avoid payment incidents. Faced with decreasing credit levels, companies will progressively have to substitute their own capital for loans. This is the main strategic challenge. In an era of generalised debt clearing, you need to make sure you have equity capital and cash. Our sources of capital, however, are insufficient.

So do we need to look for capital abroad?

If we don’t generate our own strategic resources, and if we can’t make ends meet with our own financial equations, we will have no other choice. We will have to turn to foreign sovereign wealth funds or to companies from emerging countries, which will make increasingly large investments in the share capital
of French companies. This, however, has significant consequences. In economics, there is only one real golden rule: the one with the gold is the one who, sooner or later, makes the rules, because the nationality of those refinancing you is not neutral. For this reason, one of the major issues of the coming years will no doubt be that of ownership rights. Our public debt is already largely held by foreign investors; it is fundamental that we restore to French and European business, as soon as possible, a capital base that is as large as possible. In this regard, the absence of pension funds in our country is a historic error, which has still not been corrected.

In this context, how do you view the presidential campaign that’s just beginning?

I would like the country to be ready to make a pact at the end of the campaign. I would like this pact to include not just the absolute necessity of lowering deficits, but also the ways in which this will be achieved. If the deficit reduction is mainly financed by an increase in contributions, we will not be able to repay the debt, because we will definitively damage the country’s competitiveness.

Will this be achieved through an overhaul of the social model?

Obviously, a social model financed on credit is not sustainable. We need to reinvent a social model that is tailored to our times. Those countries solving their debt problems are, moreover, all implementing far-reaching reforms of their social models. For the future, the most important thing is to find a new balance between accumulation and distribution. Our country has been obsessed with distribution issues for thirty years, which has led to a colossal amount of fiscal and welfare transfers, as shown by the level of public spending. And the 35-hour working week in France remains the symbol of these costly and groundless public choices. It is time to give priority back to accumulation in all its forms – human capital and productive capital -, it is time to make the production sector a priority once again, and to put the factory back at the centre of the village. This is the proper societal choice. We will get through the period of debt clearing that’s just beginning all the more rapidly if our country accepts the reforms to its collective structure that are vital in order to reinforce its competitiveness.

So when will the austerity begin?

In our history, discipline has nearly always been imposed on us from outside. We seem to be incapable of administering it to ourselves voluntarily, in good time. And, even today, we are taking too long to implement the necessary measures, with courage and determination. We think there will always be an escape route. At the moment, I see an increasingly urgent demand for the ECB to monetize public debt en
This would enable us, once again, to put off the necessary adjustments. And we know that that will lead to inflation, the traditional method used by our country – along with currency devaluation – to ease debt, to the detriment of lenders, investors and savers. We can’t devalue any more without leaving the Eurozone. So that leaves inflation, but our main partner in Europe is against it. This option is not open to the Eurozone, because Germany and other countries will not accept such a solution, which would be a headlong rush out of the frying pan into the fire and would destroy the credibility of the monetary zone, and consequently its stability.

**You don’t believe in the effectiveness of the facilities put in place by Europe to curb the crisis?**

If you are alluding to the European Financial Stability Facility, it was put into place too late, it still has to prove itself and its rating has just been downgraded... As for the three-year line of credit granted to the banks by the ECB, it’s a beneficial measure, but those funds should not be used to finance States, because that’s not the role of the banks. In any event there is no miracle tool: only the credibility of European countries in terms of reducing their public spending and strengthening their growth potential will enable us to overcome the current crisis.

**Do you think an implosion of the Eurozone is conceivable?**

I am convinced that 2012 will be disturbed by more shocks. If these are too violent, it could lead to a reconfiguration of the Eurozone to the benefit of the northern countries, including the Scandinavian countries outside the zone, and to the detriment of the southern countries. In a more general sense, we are moving towards increasing global fragmentation.

*Interview by Nicolas Barré, Henri Gibier, Laurent Thévenin and François Vidal*
DENIS KESSLER
SCOR CHAIRMAN & CEO

His career path

The architect behind the recovery of SCOR, which was at its lowest ebb when he arrived at the company in 2002, this economics agrégation holder, former HEC student and author of works on savings and wealth, has since established the French reinsurer in the major league. A key figure in the employers’ movement in the 1990s, the ex-No. 2 at the MEDEF ran the Fédération française des sociétés d’assurance from 1990 to 1997, and again from 1998 to 2002 after a brief interlude at AXA.

What he’s doing now

Despite a year marked by the extraordinarily heavy weight of natural catastrophes in 2011, the reinsurer run by Denis Kessler has demonstrated true resilience. SCOR will soon be publishing the results of its 1 January renewals, which it says are good. Following the 2011 acquisition of the mortality portfolio of Transamerica Re in the US, the Group now hopes to pass the EUR 10 billion premium income mark in 2013.