“How can we, in all conscience, leave debts for our children?”

When a qualified economics professor has no hesitation in saying out loud what too few are thinking.

If you thought Denis Kessler was nostalgic and disillusioned, his intensity would soon convince you otherwise. Because he knows just what it would take to achieve effective public risk management. He does not claim to be the only one holding the keys to this. As an aside, he mentions Raymond Barre who, before entering the business world, gained international experience at the European Commission. Just like a certain Dominique-Strauss Kahn at the IMF today. Denis Kessler would love politicians to lower their rate of time preference, and to understand that “we can no longer think in terms of national, or even regional economic policy. Opting for extremely varied economic policies will lead to an impasse”. In the meantime, he consoles himself by proving with SCOR that recovery is possible. By Jean-Michel Lamy

“We can no longer think in terms of national, or even regional economic policy. Opting for extremely varied economic policies will lead to an impasse.”
The crisis was caused, above all else, by errors in economic policy. There was the major mistake of the Fed’s artificially low interest rate policy following the attacks on the World Trade Center. This policy was totally out of line with the economic situation in the U.S., and created a debt bubble. Households got heavily into debt, companies got heavily into debt, financial institutions got heavily into debt and States got heavily into debt. All of this was designed to maintain economic growth following the recessionary impact of the attacks on the World Trade Center in a climate that had already deteriorated since the explosion of the internet bubble in 2000, and to cope with a sharp increase in military spending in the U.S. budget. This credit bubble burst. Until then, it had followed the classic course of a debt crisis. What was new was that we were witnessing the first global crisis in History. There has never been anything on this scale before: even in 1929, the crisis took around three or four years to cross the Atlantic. What everyone needs to understand is that we have entered a world in which all markets are interconnected, commodity as well as capital markets. We can no longer think in terms of national, or even regional economic policy. Opting for extremely varied economic policies will lead to an impasse.

**Total happiness?**

For those who manage to do it over the long term, living on credit is wonderful! You can consume more than you produce. In the U.S., people were buying second homes before the crisis with 120% mortgages! Not 70 or 80%, but 120%, consisting of a 100% loan on the property plus another 20% to finance fixtures and fittings such as a bathroom, fitted kitchen and so on. As long as these kinds of credit facilities are on offer, there is no reason for individuals and households to go without them: on the contrary, they will
tend to abuse them. In economics, utility functions are still positively correlated to immediate consumption for a large number of households, with the exception of those households – a minority – that take the utility of future generations into consideration. Moreover, the State itself seems very happy to live on credit as well! It stops being quite so happy from the point when it realises that it no longer has access to cheap credit, and that it will even have to start repaying its debts. Repaying a large debt is not a spontaneous act, it is an effort: repaying a loan means saving and not consuming. I believe this was one of the first things I taught on my economics course in 1976. Repaying a loan means giving up the higher level of consumption that it allowed you, so it really does mean saving. We tend to forget this too easily.

**Accumulation**

My university research dealt with savings, asset accumulation, the choice of assets and their transmission between generations – in other words, household microeconomics. A society develops when it saves and invests, whether it is investing in human capital or in physical and financial capital. The primary responsibility of leaders is to encourage the development of human capital, to promote its accumulation through education and scientific and applied research, and to encourage long-term savings and their investment in the production sector. The State needs to send clear messages: educate yourselves and educate your children, accumulate knowledge, accumulate material assets, accumulate physical assets, and do your best to pass it all on to the generations after you. Accumulation lies at the heart of humanity’s development. I believe in the complete opposite of what the Keynesian revivalists want, which is to sustain consumption
through public deficit in order to facilitate growth, and to reduce working hours to absorb unemployment.

Deficit

Deficit does not bring long-term growth, most of the time it is a soft solution that allows adjustments to be deferred by transferring them to future generations. The battle between the rigorists, who are against deficit, inflation, external debts and the illusion of a revival of consumption through public deficit, instead backing savings, private investment and so on, and the laxists, who take the opposite stand, is unfortunately still going strong. And the rigorists are well and truly in the minority! The adjustments needed have been put off for far too long. Procrastination is a French art! Public debt has certainly exploded over these past three years of crisis, but it has been added to a public debt that was already increasing during the growth years. When debt is not repaid in periods of strong growth, it is obviously going to be even more difficult to face in a recession. It is during the growth phases that certain States totally lack discipline. In the dozen or so years before the crisis, States should have been taking advantage of a period of expansion to reform public finances and regain a primary budget surplus that could be used to absorb debt. To achieve this, there should have been a number of structural reforms along the lines of what Gerhard Schröder did in Germany. Instead of which, after the deficits of the growth years, we had the extreme deficits of the crisis years!

Thirty years on the wrong track

France has not managed to put its public finances back into order since the oil crises of the 1970s. The Treasury, moreover, should have been renamed,
since its title implies that there actually is some treasure in the coffers, when really there is none... Our country is currently paying for more than 30 years of under investment in key areas such as the production sector, education and knowledge. A lot of public property, through lack of upkeep and new investment, has begun to deteriorate. We messed up our entry into the knowledge society, which represented the only route to success in an increasingly globalised world.

**DIY**

Germany is in a different situation to us, and is currently reaping the benefits of efforts made by successive governments over the past ten years. Germany has continued to amass technological knowledge. Unlike France, Germany has not stacked up great quantities of successive reforms, for example concerning national education, revival plans, crisis plans or plans to clean up the social security system, with which we have so much experience. One of the weaknesses of our country is the absence of in-depth reform and long-lasting solutions. We must have the courage to rebuild systems, because they are no longer as effective or dynamic as they need to be, and because their finances are no longer in good health.
**David Cameron**

The new English government seems once again to have taken the path of in-depth reform, after the errant Gordon Brown years of wait-and-see policy and passivity. The United Kingdom felt the full impact of the crisis and has come out of it very much weakened. Since his election in the spring, David Cameron has tackled the problems head on and has shown courage by promising his compatriots ten years of belt-tightening ahead.

**Time horizon**

One of the basic economic variables is the time horizon. Every economic player has an impatience level. Some are short sighted when it comes to time and live from one day to the next, others think in terms of life cycles and take their entire existence into account when making their choices, while others finally see into the distance and consider the well being of their children or of future generations. Economic choices may be diametrically opposed depending on whether you are short sighted or far sighted. In France, the average impatience level seems very high. The State sometimes gives the impression of living from day to day, both with its announcements of new spending and in the search for ways in which to finance it. Its rate of time preference is so high that too often it gives the impression of seeking only to satisfy an immediate political demand. The epoch in which Colbert planted oak forests for the Royal Navy of the 20th century is long gone! For an individual, managing the long term means saying to oneself: “I am managing my life for future generations, for my children and grandchildren”. In the same way, the State needs to tell itself: “I am managing things for the interests of the country in 20, 30, 40 years’ time and beyond”. With its short-term outlook, France thus accumulates emergency and crisis plans.
However, the primary objective should be to avoid all crisis plans, to anticipate problems and to deal with them in time. The efficiency of public management should actually increase in the absence, or at least with the scarcity, of imminent crisis or emergency plans.

**Intergenerational injustice**

Notions of justice like that of solidarity must be precisely defined. I would describe solidarity as follows: “something that you force yourself never to depend on, but that you should always exercise with regard to others”. Public solidarity “on credit”, however, is the opposite of solidarity, since future generations will have to pay for it, thus constituting the most unfair of transfers. Nevertheless, in France, “solidarity” is currently partly financed on credit. This is the case for contributory pension schemes, which are currently in deficit. This is particularly serious. We distribute money that is being contributed now, without constituting proper reserves, and we leave bills for future, sparse generations. Let’s start with the basics: no contributory pension scheme should be allowed to be in deficit. On-credit solidarity is the opposite of solidarity because it means that we create invisible bills of exchange. How can we, in all conscience, leave debts for our children? The Civil Code of 1804 enabled children to escape from the debts of their parents by allowing them to refuse their inheritances if the “inventory” was negative. For a country it’s the other way round! At the other end of the scale to on-credit solidarity, which leads to debt being thrown onto future generations, I believe in intergenerational justice, which involves each generation leaving a positive intergenerational balance sheet behind it. Each generation should have a high “intergenerational rate of accumulation”, which would mean leaving behind more than it has received from previous generations. Each
generation receives infrastructure, bridges, and all kinds of amenities. If you leave future generations with a net debt, however, you should not be surprised if they do everything they can to evade it.

**Redistribution**

Contribution and redistribution have their limits. In France, they represent around half of the national income. Increasing this level of redistribution when public finances are not balanced would be like a company massively increasing its salaries when it has been in debt for years. Such a company would not attract many investors and its risk of bankruptcy would significantly increase. Capital taxation in France? It’s very high. It comes, moreover, in many different forms: tax on personal assets with the French wealth tax or ISF (*Impôt de Solidarité sur la Fortune*), currently the only tax of its kind in Europe, as well as tax on capital gains, dividends, transmission, real estate and so on. Fiscal competitiveness in France is very weak.

**Public risk management**

The public authorities are responsible for implementing regulations. In order to work properly, the markets need rules. When the rules are inappropriate there is a cost to society as a whole. Regulations are often behind the times. When a problem crops up, we legislate. In the world of finance, many of the regulations being adopted today might have enabled us to avoid the current crisis if they had been implemented 10 years ago, but they will probably not prevent the crises that will take place in ten years’ time. Public risk management is all too often lacking. The existence of a crisis plan means that no effective risk management existed prior to the crisis in question. The 21st century must be the century of public risk management. This applies to
technological, ecological, social, financial and geopolitical risks, amongst others. Genuine risk management is not about finding ways in which to manage the crisis that has just occurred, it is about preventing the occurrence of another one. This is a Copernican reversal. The 20th century was marked by a posteriori State intervention, designed to absorb some of the consequences of crises once they had taken place. In the 21st century, we now expect economic agents to do everything in their power to avoid crisis, at all levels of society, at the State level as well as in industry. Curative regulation, accompanied by compensation, makes far less sense than preventative regulation, which is what States should be drawing up over the coming years.

The scapegoat markets

The markets have become an easy scapegoat, and their fluctuations are wrongly stigmatised. They are cyclical in nature and in essence. If a market is not cyclical, it is not a real market. If it is constant, it is abnormal. By definition, there are shocks that generate cycles: good agricultural years are followed by bad ones; a new oilfield is or is not discovered; the birth rate fluctuates, new technology is updated, etc. Whether you are talking about capital markets, goods and services markets or the job market, the market fluctuates. To call the market into question each time there is a crisis or a fluctuation, as if it were malfunctioning, is to make a mistake about the nature of the market. As for claiming to abolish such fluctuations, that is a high-risk, demiurgical undertaking, and a kind of Faustian bet. Of course the State can soften cycles, but it cannot eradicate them. All too often in politics we have heard the promise of ending crises and preventing recessions. And
some citizens may be seduced by this rhetoric, believing in a utopian world of growth whose rate is fixed by the State.

**Flows and reserves**

There has been an obsession with flows for too long now. Distribution has become the focal point of public debate: we take from Jules to pay Jean, then from Jean to pay Jim, and so on. We take from the rich to give to the poor, from the young to give to the old, from city dwellers to give to those who are more isolated, etc. The redistributions are so complex as to be opaque. This obsession with flows prevents us from concerning ourselves with accumulation, i.e. with reserves. Reserves are neglected because they are not easy to measure. Knowledge reserves, for example, cannot be measured. A child who leaves the education system well trained represents a major investment by societies because that child will then have 40 years of working life ahead of him, during which he can put into practice, maintain and enhance his stock of knowledge. Conversely, an unstructured young man of 20 who can barely read or write represents a burden for the society that has to integrate him.

“**Radical employee-management reform**”

When I was at the MEDEF (*Mouvement des Entreprises de France* – French employers’ union), we drew up a plan to fundamentally redefine employee-management relations in France, which we deliberately called a “radical employee-management reform”. With a vision that was notably shared by the reforming trade unions (CFDT, CFTC), the plan was designed to “calmly” reconstruct, outside of a crisis situation, representativeness, employee-management relations, co-management, profit sharing and financing, etc.
We felt that we needed to adapt all of our post-war structures to a world that was now global, an aging world, and, for our country, an economic space marked by European construction. It was a coherent and ambitious plan – you can re-read it now, it still shows which path to follow! The alternative with which we are confronted consists of seeking either to manage or repair the existing system, which does not work, or to fundamentally transform it. And the latter would take a whole lot of energy. What role would the employers’ union have to play? Its primary objective, which was also ours when the MEDEF was created, should be to give back to companies, because they are at the relevant level, more involvement in defining the rules to be applied through updated employee-management relations. I believe in negotiated contracts and agreements, not in uniform, collective rules. Except when defining an ordre public social (a set of minimum, binding conditions applied as a matter of general law to employment relationships in France), which is a basic foundation common to all companies. The parties concerned can agree on the rest. This is what is known as an inversion of the normative pyramid. A vast programme indeed, as the General would have said!