14 Key Measures to Set up New Bases for Public Action

Closing Statement by Le Cercle des économistes

Aix-en-Provence, 10 July 2011

The economic crisis has revealed the fragile nature of States, as well as the decisive role they play. Today, their very status is permanently questioned by the markets. These three days of debates have led us to draw up proposals so that new forms of public intervention emerge out of the crisis, in order to take up the urgent challenges of global imbalances and poverty, and re-establish strong and sustainable growth.

Strengthening governance at all levels of the global economy

1. Assign a permanent secretariat to the G20.
2. Appoint a European Minister of Finance.

Supervising and regulating global finance

3. Re-open negotiations on a sovereign debt-restructuring mechanism.
4. Amend Basel III and Solvency II so that financial regulation is less pro-cyclical and does not discourage investment in long-term projects that are economically promising yet risky and illiquid.
5. The credit rating of sovereign countries is a public asset. For sovereign States, the only impartial and competent authority in this respect is the IMF. Credit-rating agencies are free to express their opinion except when a country benefits from IMF support programmes.
6. Create a common bond issue within the Eurozone (Eurobond).

Fighting poverty

7. Offer substantial, rapid, and unconditional economic aid to Tunisia and Egypt, e.g.: the 40 billion promised by the G8 as part of a "sustainable partnership".
8. In developed countries, the reduction of public deficit in the next few years will automatically bring about a decrease in average available household income. The lowest 20% of incomes need protecting.

Gaining on potential French growth

9. Grant beneficial tax status to long-term investors.
10. Rule out tax exemptions which have had no proven or discounted effects on growth. This does not apply to the French research tax credit *Crédit Impôt Recherche*.
11. Target public aid not to specifics companies but to growth-generating sectors in which competition is already operating.

12. A diversified energy mix is essential for strong growth:
    - Nuclear power: strengthen the resources of supervisory authorities in order to guarantee transparency of information and safety of the activity.
    - Renewable energies: ensure long-term and reliable funding.
    - Re-open the debate on shale gas.

Placing youth back at the heart of exit-strategy public policies

13. Redirect intergenerational transfers towards the young, making them more favourable in terms of inheritance tax.
14. Introduce a single employment contract.

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Rencontres Économiques d'Aix-en-Provence

Setting New Bases for Public Action

Aix-en-Provence, 10 July 2011

Emergency

The crisis has revealed the fragile nature of States as well as the decisive role they play. Today, their very status is questioned by the markets quasi permanently. However, in developed countries, after thirty years of question, criticism and transformation of the role of States, we have witnessed, due to the crisis, a massive and sudden revival of public intervention via the support to the banking and financial sectors and stimulus plans. The international public deficit, loans and guarantees excluded, has grown from 1% to 6% of the global GDP. Even if most stimulus measures were classical, the central banks' interventions on the other hand were more heterodox. Moreover, the term "industrial policy" moved back into the debate. Public powers are indeed still searching for new means of action in order to channel the markets and organise the recovery.

It is urgent that we ask ourselves three questions.

Is this return to State intervention in developed countries a mere passing movement for the restructuring of financial systems, of economies and societies in danger or, on the contrary, are the imperfections of the markets, as revealed by the crisis, a sign of deeper failures which call for a long-lasting reaffirmation of the role of public institutions in order to discipline the markets and adapt to the new economic and geopolitical context?

A second question arises from the three constraints which the States are now confronted with: the financial constraint (degradation of public finances and weight of the debt), the constraint of political legitimacy (risk of capture of the States by private interests and scepticism of the citizens towards public institutions) and finally the international constraint (increased need for coordination in order to avoid the protectionist mistakes of the 1930s and a "currency war"). In this context, what are the optimal methods of State intervention? The model of the Provider State, with its 'Colbertist' industrial policies in strategic sectors, adapted to developing economies and which therefore remains valid for emerging countries, is of no interest to developed countries. Should we therefore move towards a strategy-orientated and redistributing State or turn towards a State that is only sovereign and regulatory? Or further, can the withdrawal of the State lead to a delegation of sovereign functions to the private sphere?

Finally, public powers and public policies must now be thought, in part, beyond the borders of the Nation-State. Globalisation indeed forces the States to build cooperation buffer-zones around themselves. But there is an imbalance in the current nebula of international coordination. How can an efficient cooperation between States be reached and, at European level, the principles of subsidiarity be revised?

In view of the slow-down of the economic situation, risks of new imbalances and permanent financial and monetary tensions, and of a certain extinction of traditional regulatory measures at an international level, States must reinvent themselves and conceive new ways of cooperation and regulation, integrating new actors. Public powers, whether they be at Nation-State level, or at an extended semi-international one such as Europe, or at international level, can only rely on the civil society to demand and encourage the necessary changes in order to reassert their power over markets, and to curb the risks of invasion by private interests. Moreover, the example of a few Scandinavian countries or Canada, despite the weight of the public debt, proves that it is possible to reform the State and to reconcile public interventionism and budgetary recovery, whilst convincing populations to agree with these changes.

Ten projects and twenty-six clauses

Inspired by this crisis, here are ten projects and twenty-six proposals for new methods of public intervention, capable of standing up to the challenges of global imbalances and poverty and of retrieving a strong and sustainable growth.

A. At international level

1. G20 must bring a shared vision of the global economic challenges to the foreground

The Cercle des économistes has supported G20 but expectations remain high. Founded in 1998 in Washington around financial regulation issues, it reached its full scope with the 2007 financial crisis but it cannot sustainably restrict itself to these subjects. In order to play its role as true global economic coordination authority instead of G7/G8, G20 must, as suggested by the French presidency, become a market-place for global negotiation on financial issues as well as on environmental policies, global imbalances, on the reform of the international monetary system and of the price volatility of raw materials. Hence the following four clauses:
– G20 should have a permanent secretariat;
– G20 should ask the IMF to reopen negotiations on a mechanism restructuring sovereign debt;
– with a view to restructuring the International Monetary System on a long-term basis, we should start by allowing the IMF to issue its own debt and to engage in currency swaps with national central banks;

– it is urgent to negotiate a frame for the mobility of people at international level and create an international migration organisation.

2. The goals of poverty reduction are now global

Poverty affects all countries. Hence the following three clauses:
– In developed countries, the reduction of public deficits in the coming years will mechanically lead to a drop in household average available income. It is an extremely dangerous time for fragile populations. In the debate on the evolution of social protection, we must stress again the urgency in protecting the 20% lowest incomes. In France, this leads to rethinking the articulation between "Employment Bonus", "Active Solidarity Income" and housing benefits.
– In order to fight poverty in the world, it is important that the volatility of raw material and farming prices be controlled. This implies a massive reinvestment in agriculture and offer possibilities, particularly in Southern countries, and a redevelopment of support policies for farmers.
– As part of the co-responsibility between States, we must promote a new partnership, not a humanitarian one but an economic one. It must involve an important, rapid and unconditional economic help to Tunisia and Egypt: this is the 40 billion promised by G8 as "sustainable partnership".

3. Supervision and financial regulation must be put to the service of the real economy

Two years after the financial crisis, legislative efforts such as the Dodd-Frank Act in the United States, and the establishing of supervision committees such as the Systemic Risk Committee for the macro prudential risk at European level, show a will to consolidate financial regulation. In order not penalise growth, we should not multiply regulations, but make the existing regulations more efficient. Lack of coordination between new norms/standards (Bale III and Solvency II) may have perverse effects on the long-term financing of the economy.
– We must therefore change Bale III and Solvency II in order to make financial regulation less pro-cyclical and to avoid having banks' and insurance companies' discouraged from investing in long-term projects, which are economically promising but risky and lack return.
– The shadow-banking sector, which developed through securitisation activities outside of any banking supervision, turned out to be excessively vulnerable to neglected risk. We must ensure, thanks to supervision, the follow-up of financial innovation and check that regulation evolves along with innovation.
– Finally, all over-the-counter activities should be funded with enough capital and, when they are sufficiently standardised, they should be transferred on to clearing houses.

B. At the European level

4. We need a European Minister of Finance

The current sovereign debt crisis in Europe requires the kind of reactivity, which we have not achieved. Of course, Europe has shown a deep commitment, yet its reaction capacity is neither quick nor efficient enough. Hence the demand to have someone in charge and, for this reason, we support the call for a European Minister of Finance from the president of the ECB.
In the medium run, it is clear that the governance of Europe will have to be improved.

– We must extend transfers of skills and of sovereignty to areas where needs for investments in physical capital are important and make sense at European level, in particular in the energy and in the transportation sectors.
– We must allow the issuance of a common bond within the Eurozone (Eurobond). This debt will probably be more liquid and will increase the financing facilities of the Eurozone. The lack of fiscal discipline as well as moral hazard can be tackled with other instruments (for instance on the criteria of the liquidity facility provided by the ECB: the admissible haircut on government bonds used as collateral should be directly indexed on the fiscal indicators of the given country).

5. Europe must set clear and firm rules regarding the intervention of rating agencies on sovereign debts

More than any other, the market of sovereign debt and its derivatives (sovereign CDS) have revealed their imperfections due to asymmetric information and, as a result, their vulnerability to panic runs, speculative attacks and liquidity problems. In such a context, it is no longer desirable to have all the information available transit exclusively through a price-mechanism. Financial contracts which are less reactive to new information are optimal: this represents a change of paradigm with respect to the hypothesis of efficiency of financial markets. To reveal too much information can paradoxically turn out to be harmful: if obligations are too sensitive to information, their owners will react excessively to any new piece of information and markets will then be submitted to adverse selection and panics.
– The rating of sovereign countries is a public good. For sovereign countries, the only impartial and competent authority is the IMF. Rating agencies can very well express their opinion, except when a country benefits from IMF support.
– Sovereign CDS have not proven their efficiency on fiscal discipline. We need to draw a clear line between CDS which play a coverage role and those which serve a speculation motive. CDS must be limited to their coverage purpose.

6. There will not be sustainable growth in Europe without long-term savings

– Developed countries have experienced a shift: the scarce resource is no longer investment opportunities but long-term savings. We must make sure that savings are properly allocated, and especially that ill-calibrated prudential rules or accounting standards do not prevent long-term investment.
– We must implement a public insurance against systemic risks. Long-term investment must involve both the private and the public sector, through a mechanism by which the State is in charge of big « disasters » risks while other risks are financed and managed through the regular functioning of the market.

C. At national level

7. A fiscal system must foster growth and employment as well as ensure social cohesion

All developed countries will need a daring fiscal system able to meet the following double challenge: on the one hand, the needed reduction of public debt will lead to a deterioration of the purchasing power, which will have to be offset by transfers towards the lowest income; on the other hand, to restore growth, we have to direct savings towards long-term investment.
– We need a complete overhaul of our fiscal system: ruling out tax exemptions on the basis of a rigorous cost/benefit analysis and systematically keeping in mind both objectives of competitiveness and social cohesion.
– We have to grant a beneficial tax status to long-term investors.

8. France needs a strategy for the competitivity of its firms

Inertia effects (firms produce, invest and innovate in areas where they have acquired some experience, which can turn out to be sub-optimal when it leads companies to persist in « dirty » or out-of-date activities) and externalities justify State intervention to direct investment.
The two guidelines for public intervention in industrial matters should be the following: to have a voluntarist attitude, rather than a defensive one, towards globalisation and industry; to reconcile industrial and competition policies.

– We must first reshape the governance of industrial policy to avoid risk of captures and promotion of « national champions ». This can transit through three channels: decentralize subsidies at regional or local level; condition all instruments, including the French « Grand Emprunt », towards cooperation with other European or foreign countries; explicit all industrial decisions and resolve trade-offs in transparency taking all stakeholders into account.
– Public subsidies must be targeted towards sectors, rather than firms, generating growth and in which competition already operates.

– Public intervention in industrial matters must be systematically evaluated, according to its socio-economic and environmental return, in order to be able to stop subsidies, which are no longer justified. To avoid creating dependence on public help, the sectors must only be accompanied temporarily.

9. A diversified energetic mix is essential for strong growth

Maintaining the competiveness of firms, in particular in Europe, requires an innovating and bold energy policy. In particular we must make sure that we do not discourage the search for new energies through a fallacious implementation of the precautionary principle.
– About the nuclear, we must strengthen the resources of supervisory authorities in order to guarantee the transparency of information and the safety of the activity.
– We must ensure long-term and reliable funding for renewable energies.
– We must reopen the debate on shale gas.

10. The young generations must be at the heart of public strategies to exit the crisis

Citizens actually have a strong demand for State intervention and protection but it takes on different shapes depending on age: the over-60 want to preserve their pensions and are asking for a protective State; the 30 to 60 years old want to maintain their purchasing power and expect the public sphere to protect markets and employment; the under 30 want to access jobs and housing and call for a change of the playing rules and financial transfers in their favour.

– We recommend to redirect intergenerational transfers in favour of the young, for instance by favouring donations over inheritance.
– To relieve young people from the job insecurity they are facing while taking into account the need for flexibility on the firms' side, we advocate for a unique labour contract.
– Of course we must also invest in the human capital of young people: invest in primary and secondary education, as well as universities but also promote designs such as the « time savings account » (*Compte épargne temps*) which gives individuals time and resources to educate themselves all along their lives.

These ten projects and twenty-six proposals summarize the Cercle des économistes wishes to see the emergence of a new equilibrium between States, international organizations, markets and civil societies, a more balanced equilibrium capable of generating a more sustainable growth.