Written by **Bob Adelmann** on November 9, 2013

S&P Downgrades France's Debt Again, to Third Tier, Halfway to Junk

In its announcement Friday that credit rating agency Standard and Poor's (S&P) was cutting its rating on France's debt for the second time in less than two years, the agency minced no words:

> The downgrade reflects our view that the French government's current approach to budgetary and structural reforms to taxation, as well as to product, services, and labor markets, is unlikely to substantially raise France's medium-term growth prospects.
>
> Moreover, we see France's fiscal flexibility as constrained by successive governments' moves to increase already high tax levels, and what we see as the government's inability to significantly reduce total government spending….
>
> In our view, the current unemployment levels are … depressing longer term growth prospects.

S&P saw this coming back in January 2012, four months before Francois Hollande, the presidential candidate for the both the Socialist and Far Left Parties, took over as president of France. During the election campaign Hollande promised to revive the moribund French economy by doing even more of what had stalled the economy in the first placed. The steps he advocated included canceling previously enacted tax cuts and exemptions for the wealthy; raising the top tax bracket to 75 percent; reducing the retirement age for receiving full pensions from age 62 to 60; hiring 60,000 new teachers; funding 150,000 "mentors" to teach the unemployed new skills; imposing rent controls; and building 500,000 new homes annually for the poor and needy.

It didn't take long for the other two credit rating agencies, Fitch Ratings and Moody's Investors Service, to see what these would do to France's already staggering economy, and thus they reduced their ratings as well, in July and November, respectively.

Incumbent president Nicolas Sarkozy, whom Hollande ousted in May 2012, saw what was coming as well, criticizing Hollande's proposed agenda, and claiming that it would bring about "economic disaster within two days of taking office." It started two days after Hollande took office but it took a year and a half for the effects from that disaster to kick in.

Instead of meeting the European Union's "guidelines" of the public debt being limited to no more than 60 percent of the country's economic output, French officials have allowed it to soar to 90 percent. France also failed to meet another EU parameter: keeping annual deficits at three percent or less. France's is now four and one-half percent. Its unemployment rate is over 11 percent with little expectation that it will decline substantially anytime soon.

Why should it? When capital that could otherwise be employed profitably is extracted from the economy to support an enormous welfare state, the economy's engine stalls. That's the message S&P was delivering to Hollande and the world on Friday.

Barely a month ago riots in the rural area of Brittany signaled that there was no more blood to be squeezed out of the turnip. A "green" tax on produce trucks was met with such violent resistance from farmers that the French Prime Minister Jean-Marc Ayrault suspended the tax "indefinitely." That tax was supposed to raise another $1 billion in revenue to help fund the government's long and growing list of welfare state programs. Hollande's new taxes on corporations and high-income earners have already raised an estimated $100 billion, but S&P thinks that's about it.

The French citizenry think so too. Public opinion polls on Hollande's performance have been dropping ever since he took office and have now fallen to the lowest level in 50 years.

What is assuring further downgrades By S&P, Fitch, and Moody's is Hollande's obstinacy in maintaining his destructive program. In reacting to the downgrade on Friday, he told a World Bank conference in Paris, "I will confirm this strategy which is ours, the course of which is mine…. This policy is the only one that will ensure our credibility."

Bond "vigilantes" noted that the downgrade still keeps French debt rated as "investment grade," thus avoiding triggers in pension plans that would otherwise require them to disgorge the lower rated debt. And Hollande almost gleefully pointed out that the interest rate investors are demanding in order to hold French government securities has barely budged, and is still much less than holders of American debt are demanding. As the *New York Times* pointed out,

> Mr. Hollande argued that the proof of confidence in his reforms was in the low interest rates investors were demanding to hold French debt. The benchmark French 10-year bond's [interest rate] … is among the lowest of major economies, and lower than that of the United States.

On the other hand, senior executives in France confirmed that they have already cut their investments in the country by seven percent this year and expect to cut another two percent in 2014.

The term "investment grade" is finally being seen for what it is. Labelling as investment grade the debt of countries so desperately mired in socialistic interventions as are France and the United States is like giving a top credit rating to a household that spends only 110 percent of their income instead of their neighbor who is spending 120 percent.

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