

AAA, AA+: much Ado About nothing?

by [Jérôme Creel](#)

The loss of France's AAA rating on Friday the 13th of January 2012 was a historic event. It poses three questions: should the austerity measures announced in autumn 2011 be strengthened? Why has Germany been singled out? And what is to be done now?

The loss of the AAA rating on French government bonds is not surprising – far from it. The sovereign debt crisis that has shaken the euro zone for over two years, starting in the autumn of 2009, was not managed properly because it occurred during a recession, at a time when all the EU Member States had their eyes glued to their own economic difficulties. In the absence of a concerted response that included immediate solidarity and mutual guarantees by the euro zone Member States of the zone's entire public debt, with the support of the European Central Bank (cf. Catherine Mathieu and Henri Sterdyniak, [here](#)), the foreseeable contagion occurred. The objective public finance mistakes committed by successive Greek governments followed by the vagaries of the Irish banks have now led to a systemic crisis in Europe.

By implementing austerity measures simultaneously, Europe's governments have magnified the economic difficulties: economic stagnation and even recession are now on the agenda for the euro zone (cf. Xavier Timbeau *et al.*, [here](#)). A downgrade of debt ratings in the euro zone was thus to be expected. It does, however, raise three questions.

1. Should the austerity measures be strengthened? In a commentary on the supplementary 7 billion euro French austerity plan announced in November 2011, Mathieu Plane

(see in French [here](#)) pointed out that the race for the AAA rating had already been lost. The impact of this austerity plan on economic growth was objectively inconsistent with the fiscal consolidation target – and Standard & Poor's was surely not unaware of this argument.

2. Why did S&P single out Germany and Slovakia, the only economies in the euro zone not downgraded on Friday 13 January? While their commercial links are undeniable (cf. Sandrine Levasseur, 2010, [here](#)), which could justify their comparable treatment, the main markets for both of these economies, and particularly Germany, lie in the euro zone. Slowing growth in the euro zone outside Germany will not leave the other side of the Rhine unaffected (cf. Sabine Le Bayon, in French [here](#)). It is difficult to see how the contagion of the crisis could stop at the borders of Germany and Slovakia. The recent take-up of German government 6-month bonds at a negative interest rate could even be interpreted to reflect extreme distrust of Germany's commercial banks. In any case, its economy, situated in the euro zone, is no less fragile than that of France.
3. What should be done now in France? The loss of the AAA rating reflects a negative outlook both for the state of public finances and for economic growth. While Germany has not been downgraded, it is possible that this is because S&P takes a positive view of its non-cooperative strategy in the past. From this perspective, the principle of a social VAT measure can be considered a way to help France catch up with Germany in terms of competitiveness, as Jacques Le Cacheux points out ([here](#)): if the Germans did it, why can't we? This would help boost tax revenue by increasing the competitive advantage of businesses established in France. If such a measure were to be adopted, Germany and France would be on equal footing. The two countries could then sensibly consider a cooperative policy for a recovery in Europe.

Some possible focuses include: industrial policy (cf. Sarah Guillou and Lionel Nesta, in French [here](#)); social policy; an ambitious climate and energy policy (cf. Eloi Laurent, [here](#)); and a financial policy that includes a common tax on financial transactions, with the revenue raised being used to ensure that the taxpayer would never again need to bail out the private banks, which would free up additional maneuvering room for the first three policies. The policy outlines would of course need to be defined, but it is crucial to recognize that policy action is urgently needed.