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The Fiscal Policy of Germany and France. From the Creation of the Euro up to the Pandemic

Piotr Ptak
Helena Chodkowska University of Technology and Economics
e-mail: piotr.ptak@uth.edu.pl
ORCID: 0000-0002-0784-595X

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Abstract: The aim of this article is to demonstrate the development of general government debt and general government balance in two Eurozone countries, Germany and France, in order to investigate the extent of the fulfilment of the convergence criteria. The article is divided into two periods: from the creation of the Euro currency to the period before the global financial crisis, and after it to the time of the pandemic. France and Germany notoriously violated the rules of the Stability and Growth Pact. The beginning of the financial crisis saw a sharp rise in the deficit and debt-to-GDP ratio to over 80% in both countries followed by a fiscal consolidation period. As a result, Germany managed to reduce its debt to 60% of GDP, while in France this indicator achieved a level close to 100% in 2019. The methodology is based on an analytical approach and a literature review of the subject (see Escolano, 2010). Following this methodology, the debt sustainability analysis of the public debt was carried out. According to the author, France should have carried out the necessary structural reforms. Otherwise, if interest rates of ECB continue to rise, France may face a critical situation.

Keywords: fiscal balance, primary balance, fiscal sustainability, the Stability and Growth Pact.

1. Introduction

Budget deficits are a common phenomenon in modern economies. They appear and deepen not only in special situations such as wars or crises, but also in normal times, most often as a result of state intervention and the implementation of state functions in the area of the economy. In addition to the economic and social prerequisites of a deficit such as a decrease in tax revenues during periods of slowdown or an increase in spending on social benefits, in modern democratic countries there are also specific political mechanisms that make governments tend to generate significant budget

deficits (a phenomenon called deficit bias). It often happens that this leads to mounting indebtedness and can endanger the long-term sustainability of public finance (see Reinhart, Reinhart, & Rogoff, 2012; Reinhart & Rogoff, 2009, 2010). The inclination to the deficit and, consequently, the tendency to indebtedness itself, is caused both by reasons related to the functioning of the representative democracy system as well as by reasons specific to the monetary union in the case of the euro area. It is precisely the awareness of the threats related to the deficit propensity that has contributed to monetary integration in Europe. Budgetary equilibrium was considered a prerequisite for maintaining the high credibility of the single currency. Therefore, before the entry into force of the monetary union, the mechanisms of coordination and fiscal control were introduced into the EU legal order. The main mechanism was the Stability and Growth Pact, containing a set of fiscal rules and preventive and corrective procedures to ensure fiscal discipline. The Stability and Growth Pact, in its assumption, was to be the most far-reaching instrument of community intervention in fiscal policy. Although it has been in force since 1999, the pact failed to ensure fiscal discipline in the euro area.

Among the countries which notoriously were breaking the rules of the Pact there were primarily France and Germany – the leading architects of European integration and later the creators of the common currency. Two things united these countries: on the one hand, they have provided constant political support for the Euro project both before and after the outbreak of the global financial crisis, and on the other, those countries failed to comply with the Pact's rules on fiscal policy and were even trying to soften its provisions in the period before the outbreak of the global crisis. Definitely one thing significantly set apart the two countries in the period after the outbreak of the crisis, namely establishing and maintaining fiscal discipline. While Germany in 2019 met all the provisions of the modified Stability and Growth Pact as well as the provisions of the Fiscal Compact[1] (maintaining even a general government surplus for several years and reaching the debt criterion of 60% of GDP), France's fiscal position deteriorated further and the debt-to-GDP ratio was close to 100%. Above all, Germany and France are two striking examples of countries that – despite expressing ongoing political support for the European currency – conduct two different fiscal policies: one that is exemplary and should be still followed by many other Member States and the second one that should be avoided as otherwise it might even endanger the euro project itself[2]. The main aim of this article is to present the development of general government debt and general government balance in two Eurozone countries, Germany and France, in order to investigate the extent of fulfilment of the convergence criteria. Secondly, the article points out the relevant factors that were responsible for the given course and pace of fiscal consolidation aimed at growing out of debt by both countries. Finally, an analysis of sustainability of general government debt in Germany and

[1] The Treaty on Stability, Coordination and Governance (TSCG).

[2] In terms of the size of GDP, France is the second largest euro area economy whereas the Italian economy, which faces significant problems connected with the poor condition of its banking system and high debt-to-GDP ratio, third.

France is presented that includes three sensitivity scenarios. The article refers to two periods: since the creation of the single currency until the period of the global crisis and up to the pandemic. The methodology adopted by the author is based on an analytical approach and a literature review of the subject (see Escolano, 2010). Based on this methodology, the debt sustainability analysis of the general government sector was carried out. The analysis demonstrates the changes to be implemented to the primary balance to allow countries to grow out of debt. The conclusions constitute the final part of the article.

2. Deficit bias phenomenon – why does it happen?

Empirical research shows unambiguously that in modern democratic countries there are specific political mechanisms that make governments tend to generate significant budget deficits (a phenomenon called deficit bias). It often happens that this leads to mounting indebtedness, and can endanger the long-term sustainability of the public finance. In the subject literature there are several hypotheses that try to provide an explanation of deficit bias. According to the first one, the propensity of politicians to increase debt is determined by the political cycle (Nordhaus, 1975). In order for politicians to maximise their chances to be reelected, they simply ‘buy’ voters by raising spending or lowering taxation. Moreover, a hypothesis of fiscal illusion can take place that explains with clarity why voters favour wasteful governments (Wagner, 1977). There is a tendency for society to re-evaluate the current expenditure, and in parallel underestimate the future taxation burden resulting from the earlier growth in public spending. Furthermore, the fiscal deficit constitutes a result of the strategic use of indebtedness (Rubini & Sachs, 1988) – a government still in power but uncertain about its reelection, starts to conduct an expansive fiscal policy to decrease the room for manoeuvre for their successors. According to the next hypothesis, a permanent fiscal deficit occurs as a result of passing the costs on to the next generations (Tabellini, 1991). Finally, mounting public debt can be reflected by the problem of common resources (von Hagen, 1998). The government tends to prefer public expenditures concentrated on specific electorate groups or regions, whilst the advantages of such expenditure are internalized by certain groups, then costs of the spending are redistributed to all taxpayers (Ptak, 2016, pp. 608-609).

Furthermore, in the framework of the Monetary Union, the tendency for budget deficit intensifies due to the occurrence of two peculiar phenomena, namely free riding and moral hazard. The first problem refers to a situation when any EMU country breaks the established and reference value of fiscal deficit through an increase in public spending, while being aware that any additional costs related to that (an increase in interest rates as a result of an increase in aggregate demand with a constant supply of money) will be incurred by all EMU countries. In turn, the second phenomenon, namely moral hazard, appears when an EMU country increases its indebtedness over an acceptable threshold while being aware that in the case of

potential insolvency, other countries will be compelled to assist it with financial aid because the losses connected with bankruptcy (impairment of banking sector assets) could outweigh the cost of the aid itself (Greece as an example) (Rosati, 2013, p. 15).

3. Fiscal rules and fiscal performance in the European Monetary Union

The main mechanism of coordination and fiscal control introduced into the EU legal order prior to the entry into force of the Monetary Union was the Stability and Growth Pact, containing a set of fiscal rules both preventive and corrective procedures to ensure fiscal discipline. The creators of the EMU were aware that fiscal discipline will constitute a prerequisite for maintaining the high credibility of the single currency. Under the Treaty on the Functioning of the European Union (TFUE) and the Stability and Growth Pact, three fiscal rules were introduced into the EU economic governance system: the 3% deficit rule, the 60%[3] debt rule and the rule of maintaining budget balance in the medium term after taking into account the impact of the business cycle (MTO rule i.e. Medium Term Objective). Overall, the Stability and Growth Pact of 1997 provided the fiscal criteria to which all Member States are supposed to conform.

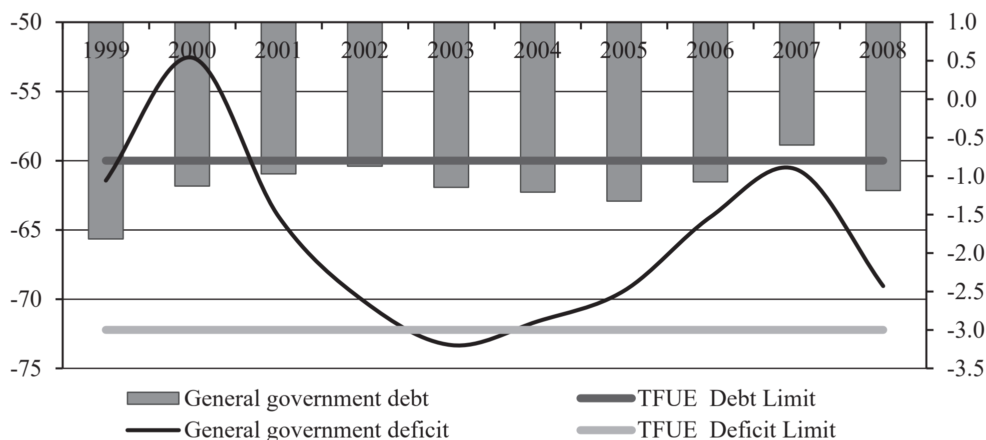

Fig. 1. General Government Debt and General Government Balance (right axis) in the euro area in % of GDP in 1999-2008

Source: AMECO database, European Commission.

[3] Based on empirical studies, a certain level of indebtedness beyond a given threshold starts to have negative repercussions on the economy and policy making. The relationship between public debt and economic growth is insignificant for debt-to-GDP ratios below a given threshold, but above it the average economic growth rate starts to decrease rapidly (Reinhart & Rogoff, 2010). For instance, Reinhart and Rogoff (2009) put the threshold at which public debt is associated with lower contemporaneous growth at about 90% of GDP for both advanced and emerging economies. Other studies (Reinhart et al., 2012) with alternative methodologies and samples demonstrate similar estimates.

Although these rules had been in force since 1999, they failed to ensure fiscal discipline in the EU. Figure 1 demonstrates the evolution of the budgetary situation in EMU states since the creation of the Monetary Union. In the period 1999-2008, EMU countries as a whole did not manage to generate a budget surplus even once, but instead showed a persistent deficit .

As a result, public debt remained above 60% of GDP all the time within the period. In total, in 1999-2008, EMU countries violated the deficit rule 42 times and the debt rule 61 times [calculation based on statistical data from AMECO database, European Commission]. Overall, one can conclude that the system of maintaining fiscal discipline in the EU failed to work properly.

4. Fiscal policy of Germany and France before the outbreak of the financial crisis

Meeting the deficit criterion was not a great challenge when adopting the single currency. In practice, often one-off budget operations (including raising taxes or sale of state assets) and changes on the expenditure side allowed candidate countries (except Greece) to reduce the budget deficit below 3% of GDP, and even to achieve a budget surplus in the designated time. During the implementation of budgetary reforms, the main problem turned out to achieve the level of general government debt (60% of GDP)[4]. In the year of entry into the EMU (1999), both Germany and France managed practically to meet the criteria from the Maastricht Treaty (60% and 60.5% of GDP in terms of general government debt, and –1.7% and –1.6% of GDP in terms of general government balance, respectively). However, the original principles set out in the Stability and Growth Pact seemed sufficient until the first economic recession in 2002, as a result of which, among others, Germany and France showed an excessive deficit of the general government sector (over 3% of GDP), persisting over the following years. Budget difficulties in this period also affected other EMU countries (Marchewka-Bartkowiak, 2011, p. 2).

In the period 1999-2008 there were frequent cases of the violation of fiscal rules adopted in the Stability and Growth Pact (specifying the acceptable limits of debt and budget deficit), which led to a systematic increase in public indebtedness. In this period, both Germany and France broke the deficit rule five times and as a result the general government deficit was significantly higher than in the euro area as a whole (see Figure 2).

In turn, public debt in 2003-2008 in those countries was persistently above the threshold of 60% of GDP (see Figure 3). Furthermore, both Germany and France were trying to soften the provisions of the Stability and Growth Pact and thus avoid

[4] In 1999 half of the countries that adopted the single currency did not meet the required level of debt.

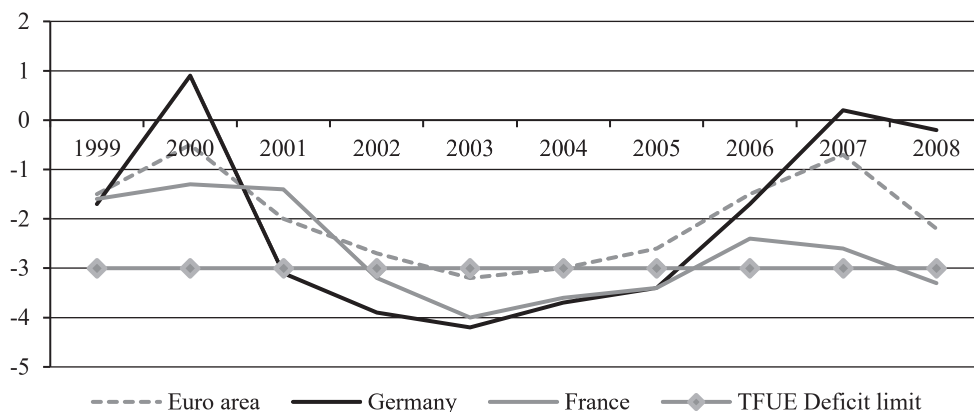

Fig. 2. General Government Balance in Germany and France against the euro area in % of GDP in 1999-2008

Source: AMECO database, European Commission.

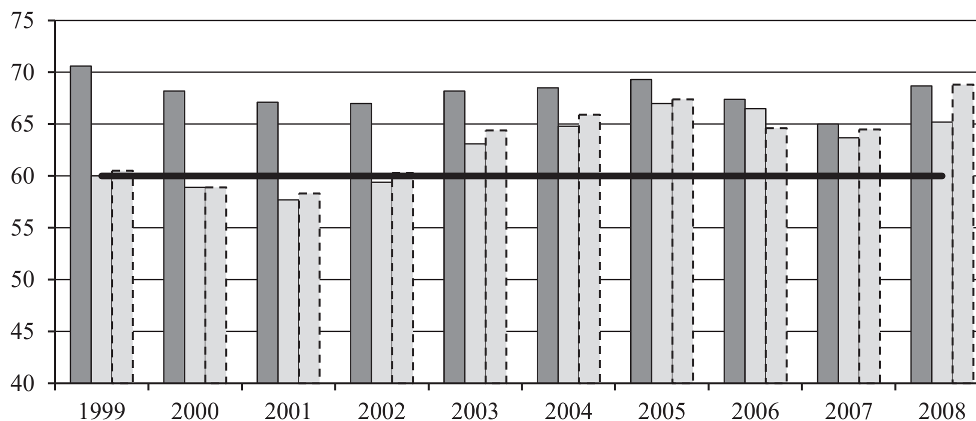

Fig. 3. General Government Debt in Germany and France against the euro area in % of GDP in 1999--2008

Source: AMECO database, European Commission.

penalties[5]. In 2005, under pressure from Germany and France, the European Commission agreed that countries would not automatically be subject to the excessive deficit procedure – which could theoretically lead to financial penalties for wasteful governments – if the infringement has economic justification or contributes to

[5] Even if it was found that the budget deficit of a given country is excessive, when determining the appropriate time to correct it, the circumstances surrounding the occurrence of an excessive deficit were taken into account, consciously increasing the time needed to offset this indicator. Sanctions as the last resort were never used (Nowak-Far, 2007, pp. 45-52).

improving the efficiency of the economy. Since they are the largest eurozone countries, France and Germany thus avoided any consequences of violating the Maastricht criteria; this practice has become widespread (Forbes, 2011).

Summing up, one can say that in the case of Germany and France their fiscal policies were neither sustainable nor counter-cyclical[6]. The fiscal policies conducted by those countries led to a steady increase in public debt and even in the periods of high economic growth (e.g. years 2006-2007) they failed to balance their budgets. Simply put, the Stability and Growth Pact did not work.

5. The outbreak of financial crisis and institutional reforms

The global financial and economic crisis revealed numerous weaknesses and gaps in the fiscal governance system based on the Stability and Growth Pact, such as the actual lack of incentives to maintain fiscal discipline, excessive and politicized nature of preventive and corrective procedures, lack of sanctioning mechanism for the debt rule and the MTO rules, lack of appropriate EU fiscal rules in domestic law and the possibility of statistical manipulation to lower the actual amounts of debt and deficit. As a result, the indebtedness of many EMU countries increased instead of falling, and when the crisis came those countries were on the brink of insolvency (Greece, Ireland, Spain, Portugal).

The primary fiscal balance is the best available variable for presenting the overall fiscal picture within governmental control. The primary balance is the overall fiscal balance excluding net interest payments on public debt. This is of a particular importance in terms of short-run sustainability, as it demonstrates to what extent a government can honour its obligations without incurring additional indebtedness. Along with net interest payments for debt servicing, which constitute an inflexible part of public budgeting, the primary balance provides the most accurate reflection of the state of fiscal management in a country (OECD, 2017). According to the International Monetary Fund, the global financial crisis resulted in the greatest ever worsening of the primary fiscal balance, with the average primary fiscal deficits in 2008-2009 larger than at any other period in history aside from the two World Wars (see IMF, 2013). In the euro area, the fiscal position was similar. Figure 4 presents the government debt and primary fiscal balance in the EMU, both prior to the crisis and during the crisis years (the right axis corresponds to the fiscal primary balance).

[6] Economic theory recommends that the optimal fiscal policy must fulfil two basic conditions: it must be sustainable and it must be counter-cyclical. Fiscal policy is sustainable if the public debt-to--GDP ratio converges toward a constant value in the long run. In turn, a counter-cyclical policy is a policy that reduces the amplitude of the business cycle fluctuations, meaning is expansionary during economic slowdowns and contractionary during economic expansions (Janikowski, 2018, p. 8).

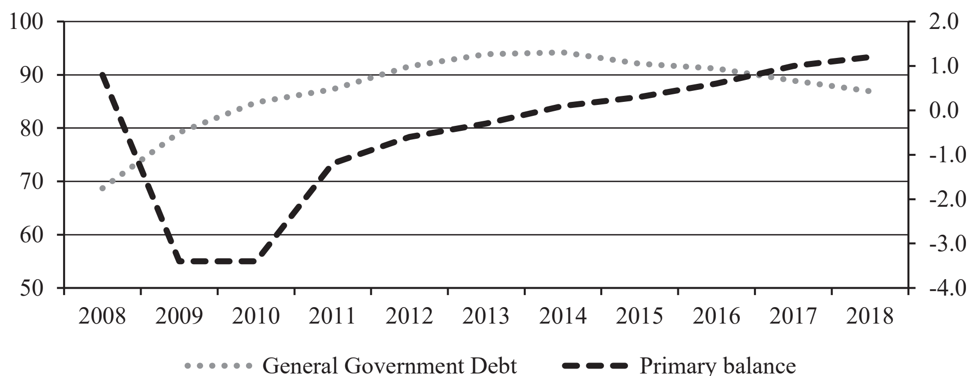

Fig. 4. General Government Debt and Primary balance (right axis) in the euro area in % of GDP in years 2008-2018

Source: AMECO database, European Commission.

A considerable worsening in the primary balance was accompanied by a rapid rise in the debt-to-GDP ratio, and as a result of fiscal consolidation carried out by countries, the ratio was put to a gradual halt in the years to come. In 2015 the debt--to-GDP ratio started to decline, whereas the primary balance started to record positive values which meant that the start of the process of moving out of debt in the euro area came into effect.

The experience of financial and economic crisis led European leaders to address measures aimed at restoring fiscal discipline in the Member States[7]. One of the solutions signed by Member States was the Treaty on Stability, Coordination and Governance (TSCG), the so-called Fiscal Compact which specifies requirements for fiscal rules in the countries that are subject to the provisions of the Treaty. It strengthens the reformed Stability and Growth Pact, under which:

– national deficits must not exceed 3% of gross domestic product (GDP),
– national public debt must remain below 60% of GDP.

The signatory countries are to commit themselves to implementing in their legislation fiscal rules which require that the general government budget be balanced or show a surplus. The two major components of the Fiscal Compact are the mandatory balanced budget rule and the benchmark for government debt reduction. The fiscal rule is considered to be met if the annual structural balance achieves the country-specific medium-term budgetary objective and does not violate a deficit (in structural terms) of 0.5% of GDP. In cases when the government debt-to-GDP ratio is considerably below 60% of GDP and risks to long-term fiscal sustainability in general are low, the target can be placed higher to the level of 1% of GDP. If the structural balance of a country deviates significantly from the medium-term budgetary objective, corrective measures are taken automatically.

[7] A complex description of the relevant reforms can be found e.g. in (Rosati, 2013).

The requirements of the Treaty also include a numerical benchmark for debt reduction for Member States with government indebtedness exceeding 60% of the GDP reference value. Countries with a general government debt above 60% of GDP are supposed to reduce the ‘surplus of debt’ (i.e. the percentage above 60% of GDP) by one-twentieth annually. Countries that do not conform to those rules may be subject to financial fines of up to 0.1% of GDP.

The Treaty entered into force on 1 January 2013 and its solutions adopted strengthened supervision and imposed on politicians restoration and maintenance of fiscal discipline in public finance of Member States.

6. Arithmetic of deficit-debt dynamic

The following formula allows to make a decomposition of changes in the debt ratio into the most underlying factors, such as interest rates, inflation, fiscal adjustment, etc. (see e.g. Escolano, 2010):

$$d_t - d_{t-1} = \frac{i_t}{1+y_t} d_{t-1} - \frac{y_t}{1+y_t} d_{t-1} + p_t , \tag{1}$$

d_t – debt at the end of period t, as a ratio to GDP at t,
d_{t-1} – debt at the end of period $t-1$, as a ratio to GDP at $t-1$,
i_t – nominal interest rate in period t; paid in period t on the debt stock outstanding at the end of $t-1$,
c_t – nominal GDP growth rate between $t-1$and t,
p_t – primary fiscal deficit in t, as a ratio to GDP at t.

This equation demonstrates that the change in the debt-to-GDP ratio equals the impact of interest (positive) and nominal GDP growth (negative), along with the contribution of the primary deficit:

$$d_t - d_{t-1} = p_t + d_{t-1}\left(\frac{i_t - y_t}{1+y_t}\right). \tag{2}$$

Equation (2) shows that the change in debt-to-GDP ratio constitutes the sum of primary fiscal deficit and the snowball effect which is the combined effect of the interest rate of government bonds and the growth rate of nominal GDP on the debt--to-GDP ratio. A constant debt-to-GDP ratio will be maintained if the left side of equation (2) equals zero. In order to stabilise the debt-to-GDP ratio at a specified debt level, one has to meet the following condition:

$$-p_t = d_{t-1}\left(\frac{i_t - y_t}{1+y_t}\right). \tag{3}$$

Equation (3) shows that the condition for stability of the debt-to-GDP ratio requires that the primary deficit equals the snowball effect. The public debt will not

grow if the primary deficit is compensated by the surplus of growth of nominal GDP above the level of nominal interest of government bonds. One can conclude that the debt-to-GDP ratio will grow indefinitely if the nominal interest rates of government bonds exceed the growth rate of nominal GDP, unless the primary budget is in a sufficient surplus in order to compensate for that. Based on the experiences of many countries, to stop the process of growing debt, not only a primary balance but also a primary surplus is required to be achieved. Therefore, the sign of formula $i_t - y_t$ is essential for the debt-to-GDP dynamic. In the case of high and positive value of formula $i_t - y_t$, stabilising the debt-to-GDP ratio requires maintaining a sufficient primary surplus (Ptak, 2017, pp. 45-46).

7. Fiscal policy during and after the financial crisis

At the beginning of the crisis the fiscal situation in Germany and France did not differ greatly from most of the euro-zone countries. The lack of balanced budgets and, consequently, maintaining budget deficits over the years even in times of fast economic growth had to lead to their deepening and rapid increase in the debt-to--GDP ratio. Fiscal Consolidation packages were launched, however, with very different results. The fiscal picture after the crisis indicated a significant gap between Germany and France in terms of achieving primary balance as clearly illustrated in Figure 5.

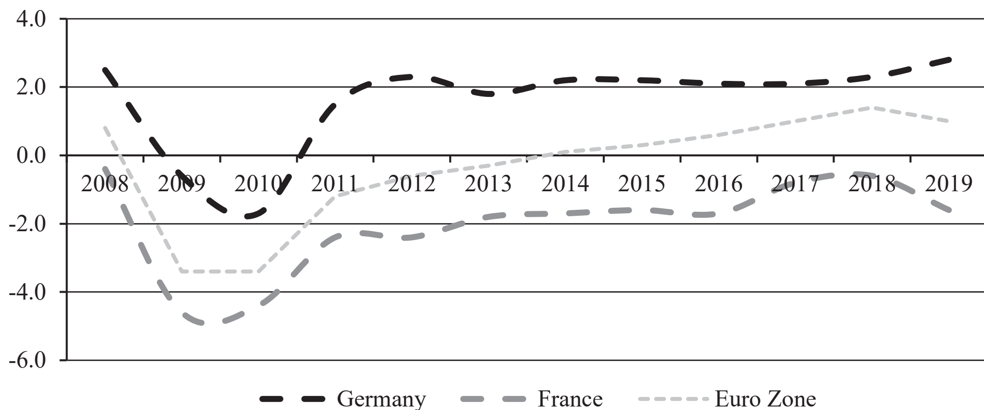

Fig. 5. Primary balance in Germany, France and in the Euro area in % of GDP in 2009-2019

Source: AMECO database, European Commission.

In this respect, while Germany achieved a significant primary surplus – much greater than the average value of the euro area as a whole – France still did not manage to achieve even a primary balance, which clearly illustrates the strikingly differentiated fiscal effort both countries undertook. As a result, in 2019 the debt-to-GDP ratio in

Germany fell even below the value of 60% of GDP as required by the Stability and Growth Pact of 1997, while in France the ratio shaped close to 100% (97.5%). Note that after the outbreak of the global financial crisis, the debt-to-GDP ratio in 2010 in both countries was running at a relatively similar level (80%-85% of GDP). However, the gap between Germany and France rose to almost 40% in 2019 (Figure 6).

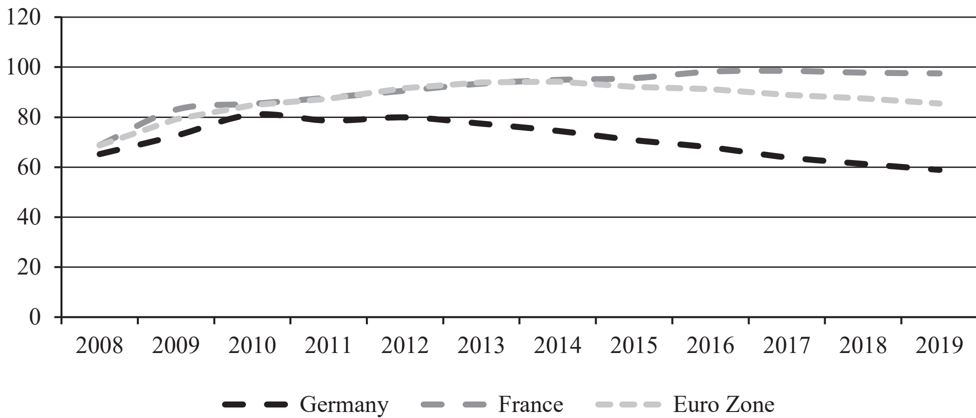

Fig. 6. General Government Debt in Germany, France and in the Euro area in % of GDP in 2009--2019

Source: AMECO database, European Commission.

Furthermore, Table 1 demonstrates the sustainability of general government debt in Germany and France, including three sensitivity scenarios, to better illustrate the changes in relation to the required level of primary balance to be in accordance with equation (3).

Table 1. Sustainability of General Government Debt in Germany and France

	Primary balance as % of GDP			Threshold of primary balance beyond which the government debt starts to fall		
	2020	2021*	Forecast 2021*	Scenario 1**	Scenario 2***	Scenario 3***
France	–7.8	–6.9	–6.7	–4.6	–8.8	–5.6
Germany	–3.7	–5.9	–3.7	–2.5	–5.0	–3.1

* Based on European Economic Forecast, Winter Autumn, Institutional Paper 160, European Commission 2021.

** Scenario 1 assumes lower inflation and real GDP rates by 1.0 pp. compared to Forecast 2021.

*** Scenario 2 assumes higher inflation and real GDP rates by 1.0 pp. compared to Forecast 2021.

**** Scenario 3 assumes higher government long term interest rates by 1.0 pp. compared to data (Reuters).

Source: own calculations based on AMECO database, European Commission.

Up to the pandemic, Germany managed to build and maintain a large primary surplus which facilitates the fast reduction of debt-to-GDP ratio. In turn, France not only did achieve primary balance but also recorded primary deficit all the time. The outbreak of the pandemic, along with the support provided by governments, led to a significant worsening of the primary balance, however in the case of France this was twice as much as for Germany.

Scenario 1 reflects lower inflation and real GDP rates by 1.0% compared to the 2021 forecast. In this particular case, the value of the primary balance beyond which the debt starts to fall increases for France and more so for Germany, however both countries can maintain a primary deficit which will be sufficient to start to reduce its indebtedness. Due to the high dynamic of nominal GDP and interest rates close to zero for France and negative for Germany, both countries have to moderately tighten their fiscal policies.

Scenario 2 considers higher inflation and higher real GDP rates by 1.0% compared to the 2021 forecast. The value of the primary balance beyond which the debt starts to fall decreases significantly for France and increases slightly for Germany. In turn, in scenario 3 which assumes higher government long-term interest rates by 1.0 pp. compared to the data for 2021, the value of primary balance beyond which the debt-to-GDP ratio starts to fall will require higher fiscal adjustment for Germany and almost an for France.

The analysis carried out only confirms that the sign and value of primary balance in accordance with equation (3) is highly sensitive about the sign and value of formula $i_t - y_t$. At present, the high nominal GDP growth (y_t) supports the debt reduction, notably for France. Furthermore, the highly expansionary monetary policy of the European Central Bank enables to keep very low interest rates (i_t) (close to 0%), hence keeping low the cost of servicing debt as well. Overall, France is the country that primarily benefits from the favourable development of the sign of formula $i_t - y_t$. In the opposite case, given France's highly insufficient efforts to improve the primary balance, the debt-to-GDP ratio would deteriorate further and faster. In both countries, the public debt increased significantly during the pandemic. Nevertheless, toward the end of the forecast's horizon (2023), Germany is much closer than France to form a primary surplus and start to lower its debt-to-GDP ratio, which is projected to be lower by 45 pp. than in France. Under such circumstances, France will be required to implement appropriate measures and tackle the fiscal deficit.

Comparing the outcome of the analysis with the progress toward the second main component of the Treaty on Stability, Coordination and Governance in the EMU, in the case of France, the benchmark for government debt reduction could have also not been in line with the Treaty's provision. The difference between the government debt-to-GDP ratio and the TFUE threshold of 60% of GDP has had to be decreased at an average rate of one-twentieth annually. Table 2 presents two paths of the debt-to-GDP ratio: the actual one and the one required by the Fiscal Compact.

Table 2. Changes of Debt-to-GDP ratio in Germany and France in the years 2014-2019

In % of GDP		Path of debt-to-GDP ratio required by Fiscal Compact						Actual path of debt-to-GDP ratio					
	2013	2014	2015	2016	2017	2018	**2019**	2014	2015	2016	2017	2018	**2019**
Germany	77.4	76.5	75.7	74.9	74.2	73.5	**72.8**	74.5	70.8	67.9	63.9	61.3	**58.9**
France	93.4	91.7	90.1	88.6	87.2	85.8	**84.6**	94.9	95.6	98.2	98.5	97.8	**97.5**

Source: the author's own calculation based on AMECO database.

Since the adoption of the Fiscal Compact, Germany managed to reduce its debt--to-GDP ratio considerably more than required by the provisions of the Fiscal Compact, while France let it continue to rise. If France had respected the provisions of the Treaty, the debt ratio would have been, on average, 13 percentage points lower than before the pandemic.

Note again that for the development of formula $i_t - y_t$, was strongly impacted by the highly expansive monetary policy of the European Central Bank. Up to the pandemic, the average interest of long-term government bonds (i_t) was much lower than prior to the crisis. It was surprising to see that in both countries but especially in France, despite the large growth of debt-to-GDP ratio, the cost of debt servicing in relation to GDP fell (Figure 7).

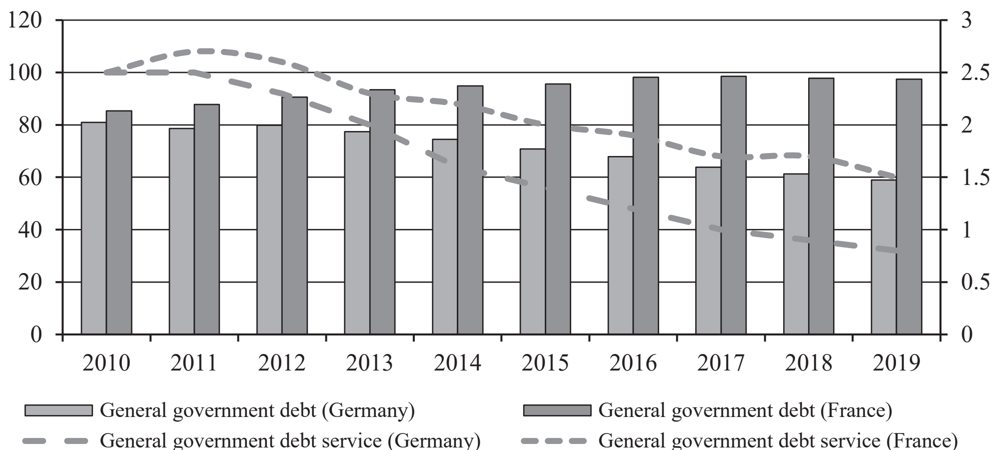

Fig. 7. General Government Debt and its service (right axis) in Germany and France as % of GDP in 2010-2019

Source: AMECO database, European Commission.

In the case of Germany this situation is not surprising. Germany undertook a significant fiscal effort to tackle the growing debt and managed to reduce it to even a lower level than prior to the crisis, whereas France was not able to stop the growing

debt-to-GDP ratio, which before the pandemic ran close to 100% of GDP, and afterwards to 118%. The low interest of government debt means that France could afford to service its debt. However, the monetary policy conducted by the European Central Bank weakens the need to carry out the necessary structural reforms that would improve the competitiveness of the French economy and this argument cannot be ignored (The Economist, 2012). International organizations like the Organization for Economic Co-operation and Development (OECD) has recommended to France a long-term strategy to reduce public expenditure without endangering social protection so as to allow lower taxes with sustainable public finances. Such a combination would generate faster growth and lower unemployment (see e.g. OECD, 2017, p. 10).

At present, the ratio of both public expenditure and revenues to GDP in France has been the highest in the whole EU. It is not surprising, therefore, that with such high taxes the French economy is uncompetitive, and the high share of expenditures to GDP makes it impossible to reduce the deficit faster and thus to slow down the growth of debt (OECD, 2018, p. 114). In 2019, the general government deficit in France was the highest in the Euro Area (Figure 8) and it is worth adding that France has failed to balance its budget since 1974, so it is not surprising that the indebtedness has been on the upward trend. In contrast, Germany built the third highest general government surplus and hence the debt-to-GDP ratio was on the downward path. In fact, this chart shows almost a mirror reflection between Germany and France in terms of fiscal performance.

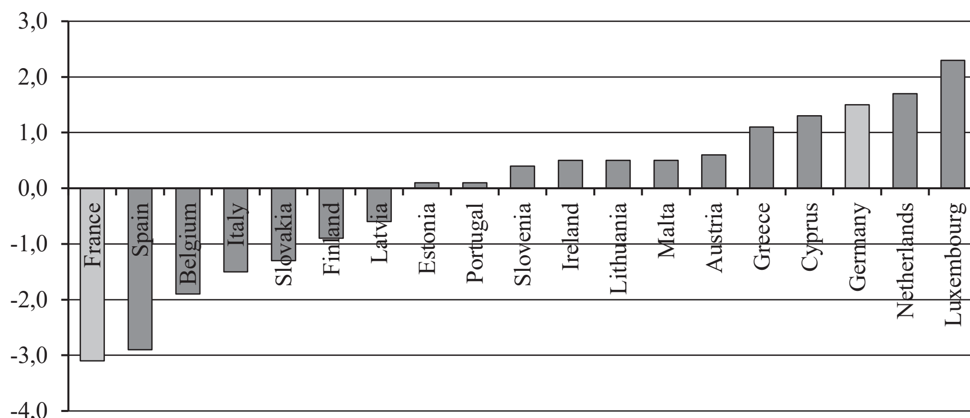

Fig. 8. General Government Balance in the euro area as % of GDP in 2019

Source: AMECO database, European Commission.

Therefore, France should have used the conditions of faster economic growth recorded for the last few years to carry out the necessary reforms. Due to the outbreak of the pandemic and the response of the government to it, general government debt

in France grew in years 2019-2021 by 20% reaching the level of 118%, whereas in Germany substantially less – by 10%, and reached 68%. This only proves the need to focus on developing and maintaining a primary surplus to reduce the debt-to-GDP ratio to be in line with the provisions of the Fiscal Compact and in accordance with equitation (3).

8. Conclusion

Fiscal discipline was to form the basis and prerequisite for building credibility of the single currency. The main mechanism to ensure that was the Stability and Growth Pact of 1997 which included admissible limits on general government deficit and debt. Although it was in force since 1999, the Pact failed to ensure fiscal discipline in the Euro Area. Among the countries which were notoriously breaking the rules of the Pact were primarily France and Germany, the leading architects of European integration and later the creators of the common currency. Even though they provided constant political support for the euro project both Germany and France were trying to soften the provisions of the Stability and Growth Pact and thus avoid penalties.

The fiscal policies conducted by those countries led to a steady increase in public debt and even in the periods of high economic growth (e.g. 2006-2007), they failed to balance their budgets. Simply put, the Stability and Growth Pact did not work. The recent crisis clearly exposed any dysfunctionalities in the construction of the Euro area. The experience of the financial and economic crisis led European leaders to address measures aimed at restoring fiscal discipline in the Member States. The reformed Stability and Growth Pact and the Fiscal Compact constitute the foundations of a new European economic governance system.

During the outbreak of the financial crisis the fiscal situation in Germany and France did not differ much from most of the euro rea countries. The lack of balanced budgets and, consequently, maintaining budget deficits over the years even in times of fast economic growth had to lead to their deepening and rapid increase in the debt-to--GDP ratio. Fiscal consolidation packages were launched, however, with very different results. In this respect, while Germany achieved a significant primary surplus much greater than the average value of the euro area as a whole, France did not manage to achieve even a primary balance – which clearly illustrates the strikingly differentiated fiscal effort both countries undertook. This is confirmed by the sustainability analysis conducted in the article.

In 2019 the debt-to-GDP ratio in Germany achieved lower value than 60% of GDP as required by the Stability and Growth Pact of 1997, while in France the ratio ran close to 100%. Note that after the outbreak of the global financial crisis the debt-to--GDP ratio in 2010 in both countries was running at a relatively similar level (80-85% of GDP). However, the gap between Germany and France rose to almost 40% in 2019, hence before the pandemic and after it in 2023, according to the latest forecast of the European Commission. That is why it is not surprising that the general government deficit in France was one of the highest in the Euro Area.

It is necessary to mention the expansive monetary policy of the European Central Bank. Up to and during the pandemic, the average interest of long-term government bonds (i_t) was much lower than prior to the crisis, therefore France could afford to service its debt effortlessly, and should have taken advantage of this time and carried out the necessary reforms in order to improve the competitiveness of its economy and increase production capacity, and above all, to reduce the ratio of both public expenditure and revenue to GDP which are the highest in the whole EU. Otherwise, if current ECB interest rates continue to rise, France might finally find itself facing a critical situation.

Nevertheless, due to extraordinary circumstances, the fiscal policy stance can deviate from the domestic fiscal rules, as the European Commission allowed their members to activate the escape clauses. However, in the foreseeable future actions taken by France will be closely monitored. France as the main architect of the single currency should set an example to mobilize other countries to conduct reforms, like Germany does, otherwise in the event of another economic slowdown domestic fiscal problems will only gain in importance. Political support for the single currency is not enough, the real strength of the European currency should be the good condition of its economies and to ensure this, fiscal discipline is fundamental. Therefore, France should finally prove its capacity to maintain a continued fiscal discipline.

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Polityka fiskalna Niemiec i Francji. Od utworzenia strefy euro do pandemii

Streszczenie: Celem artykułu jest prezentacja rozwoju długu sektora instytucji rządowych i samorządowych oraz salda sektora instytucji rządowych i samorządowych w dwóch krajach strefy euro: w Niemczech i we Francji w celu sprawdzenia stopnia wypełnienia kryteriów konwergencji. W artykule omówiono dwa okresy: od czasu utworzenia wspólnej waluty do okresu przed globalnym kryzysem i po globalnym kryzysie do czasu pandemii. Francja i Niemcy notorycznie łamały zasady Paktu Stabilności i Wzrostu. Początek kryzysu to skokowy wzrost deficytu oraz relacji długu do PKB do poziomu ponad 80% w obu krajach, a następnie okres konsolidacji fiskalnej, w efekcie której Niemcy zdołały obniżyć swój dług poniżej 60% PKB, podczas gdy we Francji wskaźnik ten zbliżył się do 100% w 2019 roku. Metodologia przyjęta w artykule opiera się na podejściu analitycznym oraz przeglądzie literatury przedmiotu. W oparciu o tę metodologię przeprowadzono analizę stabilności długu publicznego. Zdaniem autora, Francja mogła wykorzystać okres wzrostu gospodarczego i przeprowadzić niezbędne reformy strukturalne. W sytuacji, kiedy podwyżki stóp procentowych ECB będą kontynuowane, kraj ten może znaleźć się w obliczu sytuacji krytycznej.

Słowa kluczowe: saldo fiskalne, saldo pierwotne, stabilność fiskalna, Pakt Stabilności i Wzrostu.