

The debates on public debt, from Necker to the present day

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Necker's financial policy provoked a debate that continues to this day on the proper way to finance the exceptional expenditure of the state. Should one resort to borrowing, which spreads the burden over time, or to taxation, which imposes it immediately? Necker favoured borrowing to finance the war, relying on administrative reform and on confidence to limit its cost. His successors inherited a heavier debt. One of them, Calonne, would reveal the scale of the deficit a few years later and attempt, without success, to have a tax reform adopted by an assembly of notables.¹ The failure of that attempt opened the way to the convening of the Estates General.

The debate sets two lines of reasoning against each other. The first holds that borrowing is justified for exceptional expenditure, provided that the state enjoys solid credit and that the future burden remains sustainable. The second emphasises the danger of indebtedness that escapes control, especially where the institutions do not allow revenue to be raised when the need arises. The French experience at the end of the eighteenth century illustrates the second line of reasoning: for want of a tax reform, the monarchy found itself trapped by its debt.

Contemporary Switzerland has settled this debate through institutional rules. The debt brake enshrined in the Federal Constitution requires that the ceiling on total expenditure be set by reference to estimated revenue, taking account of the economic situation (Art. 126 para. 2 Cst.), so that expenditure and revenue balance over an economic cycle (Art. 126 para. 1 Cst.). Comparable mechanisms exist in several cantons.² The stability of Swiss public finances is an asset for the financial centre, since it strengthens confidence in the franc and in the institutions.

Worked example. A state borrows 100 million at 6 per cent to finance a war. If it repays nothing and generates no surplus, the interest burden

amounts to 6 million a year. If its revenue stands at 50 million, the interest on this single loan absorbs 12 per cent of revenue. If the next war requires a further loan of the same amount, the burden doubles and reaches 24 per cent of revenue. Without tax reform or spending cuts, the state enters a spiral in which it borrows to pay the interest. The figures are fictitious; they describe the mechanism that led the French monarchy to the crisis of 1788.

1 Notes

1. Wikipedia (fr), “Assemblée des notables de 1787-1788”: plan presented to the king on 20 August 1786 to close a deficit (86 million livres in 1785, 91 million in 1786, 125 million in 1787) by means of a territorial subsidy and a stamp duty; first meeting of the Assembly on 22 February 1787 at the hôtel des Menus-Plaisirs in Versailles; dismissal of Calonne in April 1787, followed by Loménie de Brienne. ↩
2. Constitution de la République et canton de Genève of 14 October 2012 (Cst-GE; rs/GE A 2 00; lexfind.ch), Art. 152 (“As a general rule, the State balances its operating budget”) and Art. 156 (“The State keeps indebtedness under control and maintains it at a level that does not threaten the interests of future generations. A deficit operating budget may be accepted only by a majority of the members of the Grand Council”). ↩

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