



PUBLIC DEBT ADMINISTRATION AND THE EFFICIENCY OF CENTRAL GOVERNMENT FINANCING BY AGENCE FRANCE TRÉSOR

Communication to the National Assembly's Committee
on Finance, the General Economy and Budget Oversight

February 2022

Executive summary

At the request of the Finance Committee of the National Assembly, the Court carried out an investigation into the administration of the public debt and the efficiency of the financing of Central Government by Agence France Trésor (AFT - French Treasury Agency). This survey follows previous publications, in particular the report on the situation and outlook for public finances of June 2021, that on the public finance strategy for the exit from the crisis, produced at the request of the Prime Minister, and the 2022 annual public report.

This report does not return to the theme of debt sustainability but analyses the administration of the public debt by each of the general government bodies and more particularly the administration of Central Government debt by Agence France Trésor.

A continuous increase in general government debt, a growing financing challenge in financial markets

General government debt has increased continuously over the last decades to stand at €2,834 billion at 30 September 2021, or 116.3 points of GDP. Central Government bears the largest share of the public debt, nearly 80%, to the tune of €2,230 billion, due to its recurring deficits for 40 years but also to its role as reinsurer which leads it, in times of crisis, to take on the financing of a large part of the measures to support or revive the economy.

Central Government, the other central government bodies and the social security funds now cover most of their net borrowing by calling on the financial markets, the consequence of an old process of disintermediation. Bank loans nevertheless remain the preferred mode of financing for local authorities and hospitals. Although Central Government dominates the sphere of public issuers by its issue volumes, the other entities are financed by a different range of securities.

In a context of a marked increase in their indebtedness, public issuers have been able to benefit from favourable market conditions due to accommodating monetary policies (lowering of base interest rates, asset purchase programmes), which have led to a reduction and maintenance of interest rates at historic lows.

Agence France Trésor's organisation favours flexibility

Agence France Trésor (AFT - French Treasury Agency) was created by decree on 8 February 2001. It is a department with national competence under the authority of the Minister of the Economy, Finance and Recovery and reports to the Director General of the Treasury. It is primarily responsible for managing Central Government's debt and meeting its cash needs. It can also be responsible for managing the financing of entities other than Central Government by agreement, as is the case with the Caisse d'amortissement de la dette sociale (Cades - Social Debt Redemption Fund) since 2017.

The reference documents, such as the general operational framework, mention that the management of Central Government debt is carried out "*in the best interests of the taxpayer and under the best conditions of security*". AFT's mission is thus broken down into three objectives: the issue itself of the volumes, governed each year by the Budget Act, the minimisation of the cost of these issues and the management of the related risks.

AFT is a compact structure whose size has changed little despite the sharp increase in public debt. It employs 48 people, including 7 under the management agreement with Cades. It is organised along conventional lines for a issuer of this nature.

AFT's positioning is geared towards market operators and it relies heavily on a group of banks who are primary dealers (SVTs - Spécialistes en Valeurs du Trésor), which play a key role as buyers of bonds issued by AFT before reselling them on the market, as facilitators of the secondary market in Central Government securities and, more generally, as advisors to the agency. The status of Primary Dealer is granted every three years after a selection which led in December 2021 to the renewal of the 15 institutions previously selected. This SVT system has been operating satisfactorily in France since 1987 and is found in most major countries.

A robust strategy that has made it possible to meet the increase in financing needs with the health crisis

AFT's issuance strategy is guided by the principles of regularity, transparency and flexibility. The main element of AFT's strategy for its regular issues, but also when it wants to develop innovative products (such as indexed Treasury Bonds or green Treasury Bonds), is to ensure that there is sustainable market demand. For these products, as all sovereign debt issuers do.

AFT believes that the surest way for SVTs to buy French debt and at the best price for the tax payer is for the securities issued to correspond to investor demand. Thus, one week before each medium and long-term auction, the agency has a discussion with the SVTs to understand market expectations for the upcoming issue and to calibrate the latter as best as possible, in terms of type of securities (nominal or indexed bond, benchmark bond or older), maturity or volume. This principle, applied consistently, has established the agency's credibility among market operators.

These guidelines have continued to prevail in the face of increases in net borrowing related to the health crisis. In 2020 and 2021, net issues of medium and long-term French debt thus increased very significantly to reach €260 billion, compared to €200 billion in 2019. Facilitated by the major presence of the Eurosystem as a buyer on the secondary market, the excess debt was correctly absorbed by the market. It also benefited, in terms of its financing resources, from the significant increase in deposits from Treasury correspondents.

This market demand monitoring strategy has contributed to the increase in average debt maturity over the past fifteen years. It stands at 8.4 years in 2021 after 8.2 years in 2020 and is above the main comparable countries, with the exception of the United Kingdom, but where pension funds have a unique position in Europe.

This strategy has also contributed to resorting to issues from old bonds, carrying a higher interest rate, and led to the generation of issue premiums in a context of very low rates and massive purchases of securities by the Eurosystem. According to estimates made by AFT at the request of the Court, all the premiums received by Central Government up to 2020, net of their amortisation, have led, all other things being equal, to a reduction in outstanding public debt of around 4.3 points of GDP by the end of 2020. This effect does not result, according to the Court's analysis, from AFT's desire to apparently reduce the level of debt.

Finally, the desire to offer innovative financial instruments that meet investors' expectations has enabled AFT to be a key player in the market for inflation-indexed Treasury Bonds, which represent nearly 10% of issues. annuals, and green Treasury Bonds. With nearly €42 billion in outstanding green Treasury Bonds at the start of 2022, France is thus the leading European issuer of this type of instrument.

If the operational principles work well, including in times of tension, AFT's strategic dimension and communication could be strengthened. Indeed, once the principles have been set out, interesting analyses are produced by the agency, particularly with a view to the meetings of the strategic committee, which brings together qualified individuals to advise the agency. These quality analyses could be expanded and systematised. Beyond its central principle of monitoring demand, AFT uses its freedom of action to make management choices that deserve greater clarification. AFT would also benefit from communicating more regularly on the key elements of its strategy, particularly to the economic and academic world, when they appear in public debate.

A changing market environment with the Eurosystem's purchasing programmes and the emergence of potential competition from the European Commission

Since 2014, the Eurosystem has implemented various purchase programmes to support monetary policy transmission mechanisms in the euro area as well as price stability. In the context of the health crisis, these programmes have been significantly strengthened by the introduction of the *Pandemic Emergency Purchase Programme* (PEPP) in March 2020, for a maximum amount of €1,850 billion. For France, this programme alone represented €271 billion of purchases between March 2020 and November 2021. The gradual withdrawal of these programmes, which is beginning to take shape, is a major challenge for an issuer like AFT.

In addition, the European Union has significantly strengthened its presence as an issuer on the financial markets with the health crisis. The volumes issued to finance crisis support measures via the *Sure* (*Support to mitigate unemployment risks in an Emergency*, set up in 2020) and *Next Generation EU* programmes are expected to reach €100 billion and €800 billion respectively over the next few years, i.e. around €150 billion per year for the *Next Generation EU* programme alone. However, the European debt is perceived in several respects, particularly in terms of interest rates, as being similar to the French debt. Although in the current situation, where demand is supported by the Eurosystem, the effect of competition induced by the European issuer does not lead to a decline in demand for French securities, this emergence must nevertheless remain a point of attention for AFT.

As with the main principles of its strategy mentioned above, the international developments which the agency will have to face in the coming years deserve greater analytical insight, which could for example take the form of prospective scenarios. It reinforces the need to maintain and deepen a diverse investor base whose structure has been changed by the Eurosystem's purchases.

Gradual strengthening of AFT's role within public issuers to be better structured

Although public issuers each have their own financial cultures and practices, they nevertheless share with AFT the problem of fluid access to the market. Against the backdrop of a sharp increase in financing needs, communication between issuers organised under the aegis of AFT was strengthened to avoid certain operational difficulties such as overlapping issuance calendars.

AFT has also intervened for other issuers in the form of technical assistance, particularly in times of crisis such as for Acoiss (Central Agency for Social Security Funds) in the spring of 2020. AFT facilitated the intervention of SVT banks to provide it with additional financing.

The agency functionally incorporated the Cades teams in 2017 within the framework of a management agreement, at a time when it was anticipated that the latter would cease its activity in 2024. This operation is almost completed today, although some projects still remain to be finalised, such as the reconciliation of certain information systems. This successful integration, which met the objectives of maintaining specific skills in the public sphere, will have been positive for AFT and for Cades.

Three possible scenarios for changing AFT's role within public issuers

The central role played by AFT within public issuers raises the question of how the relationship between AFT and these bodies should develop. In view of recent developments in AFT's role, three scenarios can be put forward.

The first scenario is the *status quo* with cooperation based on an informal framework, temporary actions at constant staffing levels, and a case-by-case examination of the appropriateness of other possible mandate agreements. This type of relationship may be widely shared by entities that are sensitive about their management autonomy while maintaining a periodic link with AFT. However, it does not guarantee either the durability or the homogeneity of practices and does not sufficiently take into account the change in dimension of the issues associated with public debt administration in a context that is currently exceptional, with low interest rates and massive intervention by the European Central Bank, but which is likely to change over the next decade.

The second scenario is to strengthen the cooperation framework between issuers in the context of a sharp increase in debt issues. This may involve setting up indicators measuring the quality of each issuer's cooperation (information on upcoming transactions, fluidity of bilateral exchanges, etc.), or even establishing a formal framework, taking into account the specific characteristics of each entity. This scenario would have the advantage of sustaining the coordination efforts made so far and avoiding a return to previous situations of lesser cooperation.

Finally, the last scenario would involve broadening AFT's scope of action by establishing new mandate agreements for debt issuance and administration, based on the model of what was done with Cades. In this scenario, the organisations would retain their financial independence. It is therefore not a question of AFT taking over the debt of the bodies covered by a mandate agreement. It would nevertheless be a more engaging process from a functional point of view, which would ensure a high level of consistency within public issuers. It remains that among the existing issuing entities, an agreement could be complex to put in place with Unédic and could come too late with Société du Grand Paris, which has carried out most of its issuance programme.

However, the possibility of functionally integrating new public issuers emerging in the coming years could be the subject of an *ex ante* analysis, specifying the criteria to be used and matching the agency's resources with these additional missions.

Beyond sound public debt administration, a public finance strategy is necessary to ensure the sustainability of public debt

Good public debt administration makes it possible to obtain financing at a lower cost and to make the best use of the various configurations of the financial markets to raise the funds necessary to finance deficits. But these deficits are imposed on the debt manager and it is their current and future levels that are crucial to ensure debt sustainability.

At a time when the level of public debt has continued to rise since the financial crisis and has now reached a very high level of more than 110 points of GDP and the structural deficit is expected to be close to 5 points of GDP in 2022, it is crucial to build a public finance path that will allow the debt to start falling and to rebuild room for manoeuvre in order to cope with the next economic slowdown.

Recommendation

1. Continue to centralise the cash of public bodies on the Treasury account (*AFT*);
2. In order to shed light on the trade-offs that AFT is faced with, deepen the strategic analysis and carry out an overall review of the strategy each year, to be presented to the Strategy Committee prior to the preparation of the financing framework for the Budget Bill (*AFT*, *DGT*);
3. Communicate more regularly on the structural elements of the strategy, especially when they are in public debate (*AFT*);
4. Set up monitoring of cooperation and methods for exchanging information between large public issuers and study the need to formalise cooperation by specifying AFT's coordinating role (*AFT*, *DGT*);
5. Study the feasibility and appropriateness of scenarios for extending AFT's role in public issuers (*AFT*, *DGT*).