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Mélenchon is right about France's debt

More austerity could deepen France's social tensions and strengthen the far right. But there is another way to tackle its debt

The sorry state of France's public schools, which sparked angry demonstrations across the country, was a symptom of chronic austerity. But that did not stop the sirens of deeper austerity from rehearsing their song. Emmanuel Moulin, the governor of France's central bank, is calling for large budget cuts to avert the 'risk of being gradually strangled by rising interest rates'. If that happens, social tensions will be further inflamed and desperately needed investment will vanish. With Germany already confronting deindustrialisation and surging support for far-right forces, France's public debt is shaping up as Europe's next fault line.

Against this backdrop, Jean-Luc Mélenchon, leader of La France Insoumise and a presidential contender, has put forward a proposal involving around €600 billion ($673 billion), or 18 per cent of France's aggregate public debt. These are French government bonds that France's central bank owns and will hold to maturity, at which point taxpayers will have to pay more taxes, or borrow more, to repay their own central bank.

Mélenchon's point is that it is absurd for one arm of the French state to borrow €600 billion to pay another arm of the state. His alternative is a debt swap between the Treasury and the central bank that, in practice, retires that debt to create fiscal space for desperately needed investment.

In the interest of full disclosure, I am not a mere commentator in this debate. Mélenchon's debt plan is based on my debt-swap proposals in 2015, when I was briefly Greece's finance minister. The idea was to short-circuit the madness that the European Commission, the European Central Bank and the International Monetary Fund were trying to impose.

What Mélenchon is proposing: convert the

Soon after moving into the finance ministry, I had to repay the ECB around €6 billion for maturing Greek bonds it had bought in 2011 to

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bail out the mainly French and German banks that had held them. As the Greek government was bankrupt, no sane investor would lend my ministry the money to repay the ECB. So, to maintain the pretence that I was repaying the ECB, the ECB and the IMF wanted the bankrupt Greek banks to issue €8 billion of worthless IOUs that my bankrupt ministry would guarantee. The ECB would accept them as collateral and lend the banks €6 billion. I would then sell the banks new bonds that no investor would touch, take 'their' €6 billion, and hand it back to the ECB. It sounds like a Ponzi scheme, because that is what it was.

My counterproposal was simple. Swap the entire collection of Greek bonds owned by the ECB at that time for a single perpetual bond with an identical face value paying the ECB one per cent of that value in perpetuity. Nothing novel there: at around the same time, George Osborne, the UK's Chancellor of the Exchequer, was retiring a perpetual bond issued by the British state in 1752. Not a euro would be written off. The ECB would save face. The Greek people would get some breathing space. And Europe would be spared a scheme that disgraced it in the eyes of anyone with a sense of decency.

That is what Mélenchon is proposing today: convert the French government bonds already held at the French central bank into perpetual bonds. Then use the fiscal space this creates exclusively for investment in quality jobs, education and social housing. The only difference between his proposal and mine is that Mélenchon suggests a zero per cent coupon, whereas I proposed a one per cent interest rate that would have pre-empted any legalistic accusation that we were writing off the debt.

Would that be inflationary? No. The perpetual bonds would not be new debt and would not add a single euro to the money supply.

Would it amount to, as France's Economy Minister Roland Lescure claimed, '…saying we won't repay the people we owe money to… savers, life insurance policies, and banks.' No. The €600 billion has already been taken out of the bond market; it is not owed to savers, policyholders or banks; the bonds sit in the vaults of the state's own central bank.

Olivier Blanchard, the IMF's chief economist when I was crossing swords with it, commented that '[t]he net effect would be zero' as the state would save on interest but lose the same amount in central bank profits.

But this is simply untrue. Blanchard neglects to mention that refinancing the 18 per cent of debt sitting at the central bank would unnecessarily raise the cost of servicing the remaining 82 per cent of France's public debt, thus increasing the pressure for more austerity, which would deepen discontent and depress investment.

A question of political will

Is there any valid reason for rejecting Mélenchon's proposal, other than it was proposed by Mélenchon, or by me back in 2015? Former EU Internal Market Commissioner Thierry Breton came close to an answer: the *Banque de France* is part of the Eurosystem governed by the ECB and cannot independently cancel or erase bonds. That is true, but the ECB's Governing Council could make this decision as long as it applied to every eurozone member state.

Just as the Eurosystem purchased bonds of every eurozone member state in proportion to each country's GDP during the euro crisis, the Eurosystem can retire the debt of every eurozone member state that it holds, giving precious fiscal space to all. If it made this conditional on using the extra fiscal space to invest in the clean energy, education and social housing that Europe needs, so much the better.

But the European Commission and the ECB will kill any such proposal, as they killed mine in 2015. They know that more austerity now will reinforce Europe's already mind-numbing levels of inequality and stagnation. They understand that it will put more wind in the sails of the surging far right. But such is their reflexive determination to press for maximal austerity that they do not flinch.

When, in the name of moderation, the centrists brand every sensible alternative to severe austerity as 'nonsense', they leave voters only one electable rebellion on offer, and the far right is happy to supply it. Zealotry in a grey suit, repeating that there is no alternative, does not look like zealotry until it fails. But then it is too late.

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