EDITORIAL

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The Financial Sustainability Conundrum in Central Government

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In recent decades, policy-makers, policy-advisors and the media have been paying considerable attention to the level and growth of governmental debt. Both US and EU jurisdictions have introduced specific regulations to supervise and limit the issuance of governmental debt and related deficit-spending policies. Social welfare has been supposed to be improved by the limitation and eventual reduction of governmental debt, in absolute terms or relative to the size of the national economy.

This bogeyman view on governmental debt assumes its analogy with debt owned by an individual to another individual. The government economy comes to be understood as a family economy where responsible parents assure the payment of all incurred debts through their present and future salaries, refraining from passing-over incurred debt burden to their children. Public debt is then expected to be repaid by current and future tax revenues as a matter of fiscal responsibility.

This bad analogy neglects the role that the government function plays in the overall economy through space and time. In this context, public debt management relates to the use of borrowing to fulfil general interest missions with an overall redistributive purpose, including assurance for welfare obligations and guarantees, as well as to the monetary base management.

General financial statistic conventions acknowledge that governments perform transfers and non-market provision of goods and services, with an overall purpose to redistribute incomes and fortunes across citizens. In this way, governments may compensate inequality in allocation of income and wealth achieved in other spheres of economy and society (Dabla-Norris et al., 2015).

To achieve this redistribution purpose, governments consume resources acquired through taxation and borrowing, so as to redistribute them at the macroeconomic level. Citizens contribute with resources to be redistributed by paying taxation and subscribing governmental debt issuance and refinancing. This functioning does not require generation of commercial revenue or maintenance of financial capital through time.

In this context, central government is deemed to be financially sustainable when it can pursue its ongoing general interest missions while fulfilling its financial obligations when they are due in time and amount. This fulfilment does not depend only on (present and future) tax revenues, but also on placements of public debt with: (i) governmental entities, (ii) resident and foreign debt-holding investors, (iii) monetary financial institutions and central banking. Financial markets may facilitate some of these transactions on sovereign debt. Each country has its own ongoing policy mix among these placements, contextualising and conditioning its debt capacity over time and circumstances (Lemoine, 2016). Placements may receive different accounting treatments, making international comparison difficult if not hazardous.

The first kind of placement points to efficient management of financial resources through the whole governmental entity. This debt issuance remains within related governmental entities and may be offset through consolidation of financial statements.

The second kind of placement recycles cash hoardings held by households and other financial investors. From the viewpoint of individual holders, governmental debt is to be remunerated by interest charges and repaid by capital instalments at its nominal value. At the aggregate level, this governmental borrowing enables transferring borrowed funds in view to redistribute them across citizens and through generations. This mechanism is made possible by continued refinancing of governmental debt at every capital instalments: When one cohort of debt securities becomes due, a new debt issuance is performed to replace the expiring one. In this way, the governmental entity can sustain a virtually permanent negative balance (deficit spending), as long as lenders go on subscribing its refinancing issuances over time and circumstances.

The third kind of placement shows the connection between governmental debt and the monetary base. When central banks acquire governmental debt, including against currency issuance, they monetize it at least

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temporarily. Through this mechanism, the government issues debt to finance its spending and the central bank acquires the debt, leaving the system with an increased capacitance of base money. This monetary base provision is required to maintain sufficient cash and cash-equivalent assets to be used for payments and settlements in the monetary system. The quite infamous bank-sovereign nexus (Leonello, 2017) is less a vicious circle than a consequence of this institutional organisation of governmental debt refinancing and its quasi-monetary nature. Recent macroeconomic contributions point to this link between treasures and central banks in case of money-financed fiscal stimulus (Turner, 2015).

Another public sector specificity concerns governmental assurance of collective obligations and guarantees. The refinancing mechanism explained above enables issuing fresh debt to roll over debt obligations that become due, instead of repaying them from tax revenues. The assurance mechanism consists in promising to cover for possible future payments - such as 'pay-as-you-go' pension obligations – when they become due, but governments are not yet liable for them today. Generally speaking, these commitments remain then unfunded and do not involve refinancing needs on their financial position until and unless they become due. All these collective guarantees and contingencies do presently exist as potential (but not yet actual) governmental liabilities (Coeuré, 2007).

In sum, public debt management relates to the refinancing process and the assurance of collective obligations such as pensions, showing the link between the fiscal system (taxing power), the monetary base (involving the quasi-money nature of sovereign debt), and the welfare policies. In this context, financial sustainability does not involve only the capacity to sustain the burden of interest charges and capital instalments through tax revenues, but also the ongoing capacity to both monetize this burden for sake of monetary base management, and place it with resident and foreign debt-holders, as well as with related governmental entities. Japan's sovereign debt management policy mix constitutes one relevant illustrative example of high and sustainable public debt outstanding that is mostly denominated in national currency, largely managed by the central Bank of Japan (and resident monetary financial institutions) and mainly held by resident investors. Vice-versa, some international sovereign debt restructuration shows the additional difficulties that arise when public debt management involves issuances in foreign currencies and through foreign networks (CONVIVIUM, 2016).

Our analysis raises new questions for the public debate on public debt management. If governmental debt has to be repaid as it is the case for business entities: how to achieve welfare policies (involving redistribution)? How to constitute and manage the monetary base? If future commitments - such as 'pay-as-you-go' pension obligations - have to be funded when they accrue: Why start paying interest charges today to fund future commitments that may never materialise? Why take and hold funding risk and leveraged investment risk since today for those faraway future commitments?

The functioning of government differs from that of a business entity, requiring a specific institutional framework (GASB – Governmental Accounting Standards Board 2013). However, this functioning process has never prevented modern states to be funded and refinanced for centuries by final investors active on Securities Exchanges. Those investors have been accepting for long that structural debt is issued and refinanced over time to cover governmental expenditure, including for investment purpose (Ragot, 2017; Ragot & Saraceno, 2016). Not to mention the overarching constitutional project involved in designing and managing the monetary base of a polity (Desan, 2014).

All together, these specificities of financial sustainability in central government require specific accounting treatments to be consistently represented and governed. Notwithstanding the favour by international accounting standards for both the private (IFRS) and the public sector (IPSAS), a balance sheet accounting basis appears to be inconsistent with these specificities. Financial reporting on this basis generally shows material negative net assets that prove public debt use to cover for investment and operating expenses over time. However, its representation through negative net assets may be misleading for managers, citizens and policy-makers. On the one hand, this representation does not address the redistributive purpose that overarches the functioning of government. On the other hand, it does not inform on the specific use of public debt issuance and refinancing that generates negative net assets.

In its recommended practice guideline, the IPSAS Board - International Public Sector Accounting Standards Board (2013) acknowledges the debt dimension of long-term sustainability of a public sector entity's finances. Accordingly, information on net debt assists users in assessing the entity's ability to meet its financial commitments as they become due or to maintain, refinance or increase its levels of debt and thereby evaluate the sustainability of the entity's debt.

It is time to reconsider public sector balance sheet and cash flow statements to better represent and control for this specific working of public finances. Accrual-based accounting statements may then be combined with cash-based accounting statements prepared for budgetary purposes. Public debate on public debt management may be better served and informed by an accounting representation that consistently considers the specificities of public finances concerning public debt issuance, public debt refinancing, and non-debt commitments.

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