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FIRST FRENCH LINKER TREASURY DSK BOND

FINANCIAL INSTRUMENTS DEBT MANAGEMENT DSK CENTRAL BANK

Benjamin Lemoine discusses the intimate relationship between state financial instruments and the politics of public debt.

DSK STANDS FOR SELF-DISCIPLINE

Before "DSK" was shorthand for scandal, it was the name of a French sovereign bond. The acronym was first used by the French newspaper *Le Monde* in December 1997 to report on a debt instrument named after Dominique Strauss-Kahn, then France's Minister of Economy and Finance. In the presence of an assembly of Paris Stock Market agents, Strauss-Kahn proudly announced the launch of this eponymous asset, the very first to be indexed to France's rate of inflation. In the UK, this category of bond is called a *linker* because the interest rate paid by the borrowing country is linked to inflation.

The DSK bond was tailored to meet the appetite of creditors – especially big institutional investors like life insurance companies, pension funds, savings and investment banks – for secure investments protected against inflation-risk, the possibility that cheaper money could be used in the future to repay debts taken out when a currency had a higher value. The bonds' promoters argued this category of government security offered a win-win arrangement for all parties. The borrowing government would pay a reduced inflation-risk premium which lowered its interest rate and generated savings in its debt repayment budget, while banks and creditors would see their investment protected from price increases.

According to conventional financial historians and public finance textbooks sophisticated government securities like the DSK bond are a "logical" and "necessary" step in a country's evolution because they permit governments to respond to natural competitive pressures in the capital markets. The authors of this financial innovation assumed that governments struggle to maintain price stability against inflation, so they invented a contract that concretely connects political interests to the interest rate. The political will to meet specific economic objectives which are attractive to capital investors is written into the bond itself. When a government issues an inflation-indexed bond it commits to keeping inflation low and to restricting money creation. The job of defending these goals is delegated to the national and later European central bank.

It is worth nothing that under the terms introduced by this new category of government security, elected officials have an incentive to not interfere in monetary policy, which effectively frees the central bank from the influence of the state treasury and neutralizes the role of democratic government in monetary affairs. Inflation-indexed bonds not only reward specific economic condition, they materialise the institutional conditions under which policy measure to achieve low inflationary conditions can be made. Linkers or inflation-indexed bonds are deliberately shaped by treasury officials as a signal that discipline will be exerted on public finance. They further signal that arrangements institutionalizing the economic policies that suit the preferences of market actors will be put in place.

Debt management practices can certainly neutralize governments, but my research suggests these practices are neither the result of a naturally evolving history nor of politically neutral options. The DSK is part of a long-term process in which governments are wilfully self-disciplining with regards to public spending, money creation and inflation-control in order to make their debt more attractive to global investors.

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This process of self-disciplining began in France in the late 1960s when some agents of state financial administration broke with the practices inherited from the second world war reconstruction with its administered economy. In this period, France's treasury organisation functioned as a bank for the national economy. It gathered savings which made it possible to manage the treasury without selling debt to the markets. Politicians and civil servants called this system the *circuit du Trésor* (Treasury circuit). The circuit provided resources to the state for public spending, investing in the economy, and managing the treasury department.

When debt and treasuries were issued, mainly within the short term banking system, the prices were administratively determined through the legal provision of the so called *treasury bills threshold.* Starting in 1948, the Ministry of Finance required banks that were holding a current bond account exclusively composed of treasury bills at the Bank of France to retain 95 per cent of the bonds in their portfolio. Banks were further required to not fall below the amounts of treasury bills they were already holding. This threshold setting mechanism ensured that banks maintained their subscription and did not abandon government bills.

If the treasury bills threshold seems authoritarian, this is only because we are looking at it retrospectively. At that time, it was considered a legitimate instrument. In his lectures to the students of Sciences Po in 1948, François Bloch-Lainé, then French Treasury manager described the state treasury departments with specific characteristics that differentiated it from banks, in particular its direct contribution to the regulation of the money supply and credit allocation. "State and Public Treasury do not have the same concerns as the private or semi-public treasuries," he wrote. "Formerly, Treasury was operating more like a bank or a corporate business, ie, it was forecasting on a short term basis and was appealing to the market to the extent it needed […]. Today [in 1948], with its bond issuing constantly open, it picks up in a permanent way all availabilities that fuel its funds."

The threshold was an administrative device that performed multiple roles: it secured resources where the value was assigned by the state, and gave the central public administration the opportunity to directly control monetary supply and credit distribution. Reforms that occurred during 1960s were deliberately designed to neutralize the Treasury's role in monetary affairs, because its tools were accused of feeding inflation. According to Jean-Yves Haberer, a young technical advisor to the French minister of finance who directed the operationalization of these reforms, the main object was to "gradually force [the treasury department] to live as a borrower, that is to say, to ask itself questions of a borrower such as the cost of borrowing and the debt burden services".

To "put the debt in the market" was to force the state to live in a real market for funding.

Making the state manage debt like any other actor or organisation meant deconstructing and dismantling all powers, privileges and idiosyncratic devices the treasury department enjoyed in finance and in the economy of the time. This is why, since the end of 1960s, state engineers in France have increasingly focused on state financing activities instead of on the problems of credit allocation in the general economy. These engineers have built the system that opens the country to the international capital markets. As a result, France's creditworthiness has become contingent and dependent upon the politics and social or public policies that accommodate reimbursements for creditors. Such a process is self-reinforcing because competition between governments for financing creates an incentive for countries to promote more sophisticated and attractive innovations for creditors such as the DSK bonds of the late 1990s.

Strauss-Kahn's bonds were an important addition to the French strategy of managing debt through the market. Unlike an older generations of treasury and central bank officials who negotiated with unions in the middle of the 1980s to de-index wages from inflationary pressures, today's civil servants enthusiastically promote "modern" capital market sovereign bonds which deliberately connect remuneration to the rate of inflation as a means of improving France's creditworthiness in the eyes of creditors. In so doing, they reinforce the process of putting debt to the markets and the pressures that fall on other kinds of state payments. While financial products are nowadays linked to inflation and creditors are protected through their hold of solid bond contracts and products, social benefits, public spending and pensions are threatened by "default" or partial payment.

Indeed, one can observe during the European debt crisis, that states have to make a trade-off between all the public constituencies who depend upon their debt. This pits social beneficiaries that receive public spending and specific treatments against private creditors who hold the debt as an asset. For example, in 2000, the manager of the sovereign department at Moody's was already expecting almost "every industrialized nation to "default" on its pension promises". The agency concluded that "with few exceptions, it is nearly impossible for almost every major developed nation to meet the public sector pensions currently promised, including health care for seniors, without significant adjustments to future benefits". "Fortunately for governments," the rating agency seems to rejoice, "the public does not generally view pension "defaults" as seriously as a breach of promise by a government on its bond obligations. Why this is so appears to be simply societal conventions" (Truglia 2000).

Since societal conventions appear to be more easily manipulated than contractual debt obligations, states are concretely disciplined on their social policies, public spending and monetary control by market techniques. It is somewhat ironic that high civil servants in the treasury who are supposed to fund state activities promote innovations like DSK bonds. Yet the budgetary cost-cutting measures endlessly discussed in the US debt-ceiling debate and the European and Greek debt crisis, barely scratch the surface of how deeply debt instruments reshape the agency of the state, impose constraints, reformat the state's goals, and reconfigure relationships between creditors, citizens and economic policies.

In sovereign debt markets, the letters DSK still stand for self-discipline.

Reference

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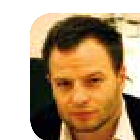

Benjamin Lemoine is a CNRS researcher scholar at the Institut de Recherche Interdisciplinaire en Sciences Sociales (IRISSO), Université Paris-Dauphine.

Adapted by **Martha Poon.**