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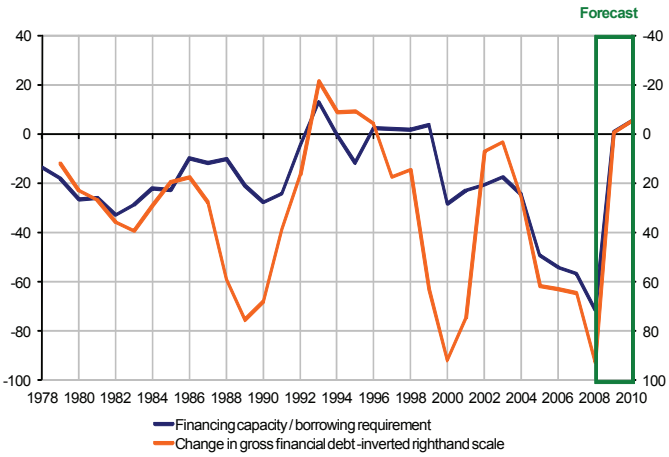
Reducing French corporate debt: why and how?

- Non-financial corporations registered a sharp increase in their debt between 2004 and 2008 (by 10 percentage points of their value added). By 2008 this had reached 121% of their value added (€1,203 billion).
- This increase in debt since 2004 appears unrelated to the acquisition of financial assets, unlike in the late-1990s. Against a background of relatively stable mark-ups and rising dividend payouts, the increase in corporate indebtedness since 2004 mainly reflects the need to finance steeply rising investment. The borrowing requirement rose from 2.9 percentage points to 7.2 percentage points of value added between 2004 and 2008.
- Low interest rates facilitated this growth in indebtedness, by limiting the corresponding financial burden (insolvency rates remain low). In addition, most of this debt is long-term, thereby limiting the risk of illiquidity. However, companies may seek to reduce their debt in the aftermath of the 2008 financial crisis.
- Two debt reduction episodes, in 1991-1998 and in 2001-2003, led to a slowdown in investment by non-financial corporations, to reduced dividend payments and, in the latter period, to asset sales. According to the forecasts appended to the 2010 Budget Bill, companies are expected to bolster their financing capacity thanks mainly to tax cuts (in particular the business tax reform), inventory rundowns, falling investment and pay restraint, all of which should help to reduce their debt.
- The reform of the business tax and measures to boost corporate liquidity and that of banks (in return for a commitment on their part to go on lending), are helping to reduce the risk of a forcible debt reduction, which would be harmful to investment.

Variations in gross financial debt and borrowing requirements of non-financial corporations (in €billion)



Sources: National Accounts, DGTPE

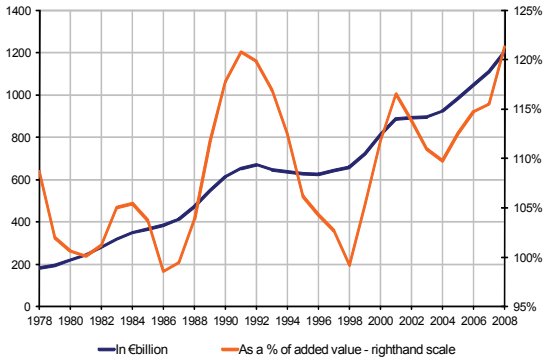
DGTPE
DIRECTION GÉNÉRALE DU TRÉSOR ET DE LA POLITIQUE ÉCONOMIQUE

1. A combination of financial conditions favouring debt-financed investment and rising dividends has led to a steep rise in debt levels since 2004

1.1 Debt levels have risen sharply since 2004

The gross financial debt of non-financial corporations represented 121% of their value added in 2008, or €1,203 billion. This figure is well in excess of the long-term average calculated for the period 1978-2008 (109% of their value added), and of the average for the past ten years (112% of their value added). Since reaching its low point in 2004, non-financial corporations' debt has resumed its upward path. This is normal in a period of expansion, but it has pushed up their indebtedness (measured in percentage points of their value added) above its 2001 peak and reaching the level of the 1991 peak. Corporate debt rose from 115% of value added in 2007 to 121% in 2008 (€92.4 billion or +5.8% in percentage points of value added). This trend is not specific to France, since it has occurred in other European Union countries also, including Spain, Italy and the United Kingdom. Non-financial corporate debt has risen more moderately in Germany in the recent period, on the other hand.

Chart 1: Gross financial debt



Source: National Accounts

Box 1: **Measuring the indebtedness of non-financial corporations**[a]

There are several ways to measure the indebtedness of non-financial corporations[b], although they do not all present the same picture of short and medium-term trends. Corporate debt is classified using the national accounts, selecting three potentially relevant fields regarding creditors:

- gross financial debt, which comprises debt securities, bonds and all financial sector lending, and excluding inter-company debts;
- consolidated gross debt, which comprises all corporate debts owed to all other institutional sectors covered in the national accounts;
- non-consolidated gross debt, which comprises all debts recognised in companies' liabilities, i.e. financial debt together with loans contracted from other agents (in particular loans from other French or foreign corporations);

Chart 2 presents the ratio of the three debt indicators to value added. The three approaches agree on the sharp growth in debt since 2004. The peak reached in 2008 is an historic high, since it exceeds the peak reached in the early-1990s. The widening gap between gross financial debt and non-consolidated gross debt illustrates in particular the growth in intra-group debt..

Table 1: The different methods of measuring indebtedness according to the national accounts nomenclature

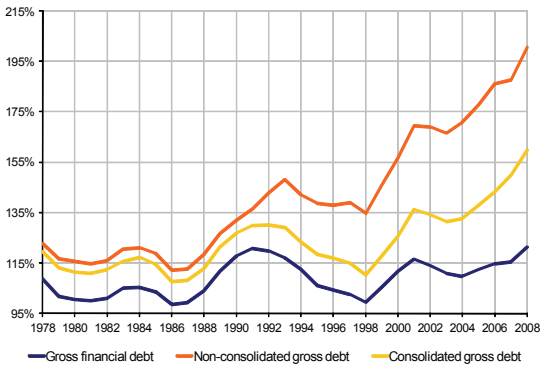
		Item*
Cash and deposits	A	PF2
Marketable debt securities and equivalent	B	PF331
Bonds and equivalent (incl. interest matured but not yet due)		PF332
Short-term lending by financial institutions	C	PF411
Long-term lending by financial institutions		PF421
Gross financial debt	**A + B+ C**	
Short-term borrowing from non-financial agents	D	PF419
Long-term borrowing from non-financial agents		PF429
Non-consolidated gross debt	**A + B + C + D**	
Short-term loans by non-financial corporations to non-financial agents	E	AF419
Long-term loans by non-financial corporations to non-financial agents		AF429
Short-term loans from the rest of the world to non-financial agents	F	PF419
Long-term loans from the rest of the world to non-financial agents		PF429
Consolidated gross debt	**A + B + C + D – E + F**	

* This is the item covered in the non-financial corporations' assets account (and the rest of the world, for the letter F).

The concept of debt considered here is that of gross financial debt. Compared with consolidated debt, this excludes loans from non-financial agents (e.g. central government, rest of the world, etc.) to non-financial corporations not in the form of securities (e.g. bonds, debt securities, etc.).

a. See Durant, D. and Girard, E., 2004, "Quels indicateurs pour la dette des entreprises françaises ?" (What indicators for French corporate debt?), *Bulletin de la Banque de France, no.122*, pp. 89-100, for additional details.
b. The non-financial corporations sector comprises resident institutional units whose prime function is to produce non-financial market goods and services. It comprises national private non-financial corporations, public non-financial corporations, and foreign-controlled non-financial corporations. It excludes foreign subsidiaries of French corporations.

Chart 2: The different concepts of debt (as % of VA)



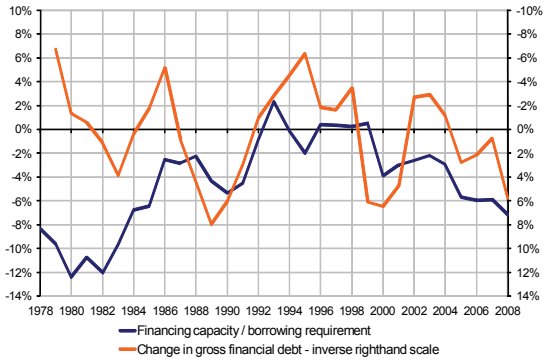
Source: National Accounts

1.2 This debt trend was driven mainly by rising borrowing requirements, contrary to 1986-1993 or 1998-2000, when financial transactions predominated

In accounting terms, an increase in debt reflects a rise in borrowing requirement or the counterpart to financial transactions such as purchases of financial securities. Financing capacity is the balance of the capital account, which is equal to gross saving[1] plus net capital transfers and less expenditures for accumulation purposes, e.g. gross fixed capital formation (GFCF), change in inventory, net purchases of valuables and of non-produced non-financial assets.

Whereas to a significant degree the previous periods of rising indebtedness reflected financial transactions (as in the period of financial liberalisation from 1986 to 1993 or the stockmarket bubble of 1998-2000), the trend in non-financial corporations' indebtedness since 2004 is strongly correlated with their financing capacity (see chart 3). The borrowing requirement went from −2.9 percentage points of value added (−€24.7 billion) to −7.2 percentage points (−€71.3 billion) between 2004 and 2008, thus mechanically increasing the debt of non-financial corporations.

Chart 3: Financing capacity / borrowing requirement and change in debt (as % of VA)



Source: National Accounts

Box 2: Keys to the transition from the capital account balance to change in debt

By definition, financing capacity (+) / borrowing requirement (–) is the balance on the capital account, this balance being the source of financial flows (from assets to liabilities) recorded in the financial statements. By definition, the relationship between financing capacity (+) / borrowing requirement (–) is:

(1) $FAF = FLF + FC/BR$

Where *FAF*, *FLF* and *FC/BR* respectively represent financial assets flows, financial liabilities flows and financing capacity / borrowing requirement.

Further, the change in financial debt corresponds to the change in its component items outstanding. Thus:

(2) $\Delta D_t = FLO_t - FLO_{t-1}$

Where ΔD and *FLO* respectively represent the change in debt and financial liabilities outstanding.

In order to harmonise equation (1) in terms of flows, and equation (2) in terms of outstandings, we have the following relation:

(3) $\Delta D_t = FLF_t + FCC_t + REM_t + ADJUS_t$

Where *FCC*, *REM* and *AJUS* respectively correspond to fixed capital consumption (here equal to zero), remeasurement, and other volume changes and adjustments.

Finally, given that financial accounts data are supplied by the Banque de France, whereas those for the national accounts are supplied by INSEE, the two financial capacities are reconciled by means of the following adjustment:

(4) $FC/BR_{BdF} = FC/BR_{Insee} + ADJUST$

This gives us the relationship between financing capacity (as calculated by INSEE) and the change in debt (defined by the change in gross financial debt):

(5) $D_t = FAF_t^{total} - FLF_t(other) - ADJUST - FC/BR_{Insee} + REM_t + ADJUS_t$

Where *FLF* (*other*) corresponds to the flow of financial liabilities other than those included within the scope of the debt.

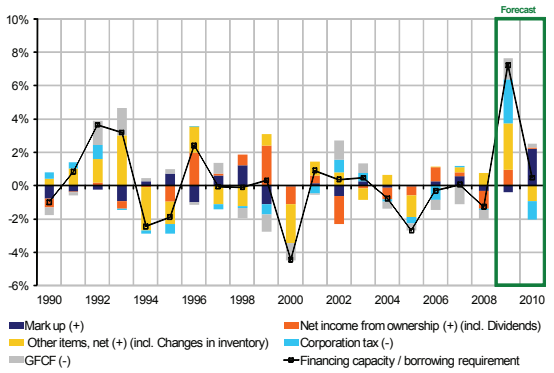
1.3 The rise in the borrowing requirement since 2004 stems from vigorous investment, fuelled by financial conditions conducive to debt financing and rising dividends.

In accounting terms, the concept of borrowing requirement can be broken down differently from the above method. In this approach, financing capacity can be analysed as the sum of (see chart 4):

- the mark up (positive effect);
- net income from ownership, consisting of dividends notably (positive effect);
- corporation tax (negative effect);
- Gross fixed capital formation (GFCF) (negative effect);
- Other items, net (including the opposite of changes in inventory) (negative effect).

(1) Gross saving may be taken to be the company's profit after tax but before investment.

Chart 4: Contribution to the change in financing capacity / borrowing requirement (in percentage points of VA)



Source: National Accounts, DGTPE

The deteriorating borrowing requirement between 2004 and 2008 stems not from falling mark ups but rather from vigorous investment against a background of rising dividend payouts. The growth in debt therefore could reflect a determination to go on investing even though cash flow was under increasing pressure from the rising dividend streams being paid in response to shareholder demands.

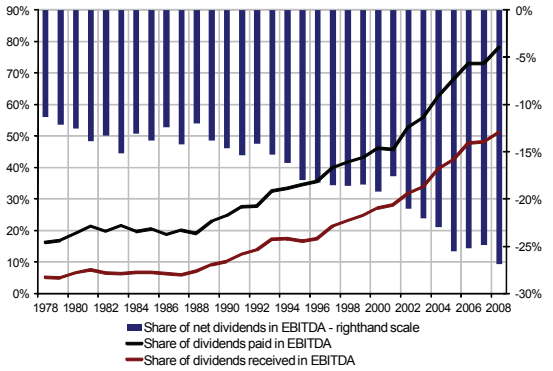
However, one could also take a different view of the combined dynamics of debt and dividends. At a time when the cost of capital was low, firms may have been encouraged to take on debt in order to invest without having to cut their dividends.

Non-financial corporations' debt has risen against a background of widespread economic expansion conducive to investment since 2004[2]. Between 2004 and 2007, investment by non-financial corporations grew at an average rate of 8.1%, hitting 11.5% in 2007. After reaching 11.5% in 2007, GFCF growth slowed to 5.9% in 2008 and fell by 7.4% in 2009.

Although investment was dynamic relative to value added, companies' financing capacity was constrained in particular by the rising dividends they were paying. This increase prompted a sharp deterioration in non-financial corporations' net dividends (i.e. the balance of dividends received less those paid), dividends received having risen less over the period. As a result, their share of VA went from –3% in the early-1980s to nearly –9% in 2008.

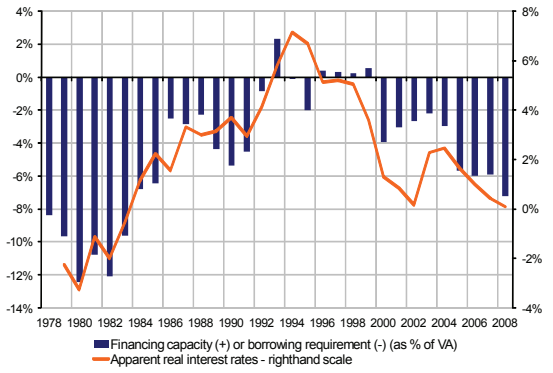
The faster growth in dividends paid than that in dividends received has been a major feature of non-financial corporations since the early-2000s (see chart 5). Their share in earnings before interest, tax, depreciation and amortisation (EBITDA) has been rising steadily since 1993 in the wake of financial markets liberalisation, going from 27.9% in 1992 to 39.9% in 1997, 46.3% in 2000 and 78.1% in 2008. Expressed in percentage points of value added, these proportions are, respectively, 8.8%, 12.5%, 14.4% and 24.4%. This growth in dividends paid by non-financial corporations may be a result of rising pressures from shareholders, due in particular to the growing importance of institutional investors (with investment funds and pension funds), which often demand high rates of return[3].

Chart 5: non-financial corporations' dividends



Source: National Accounts

Chart 6: financing capacity / borrowing requirement and real long-term rates



Source: National Accounts

The combination of dynamic investment and rising dividend payments has resulted in an internal financing rate[4] durably below 100%, with recourse to debt in the form of bank borrowing in order to finance capital expenditures. The use of debt was facilitated by low real long-term interest rates (see chart 6) and positive leverage[5] [6].

(2) Investment by non-financial corporations' investment grew at a rate of +13.8% in 1988, before slumping to –9.2% in 1993. It then rose by 9.7% in 1998 and +12.1% in 2000, then tumbled again, coinciding with a second period of debt reduction, to +5.2% in 2001, –2.7% in 2002 and +0.0% in 2003.

(3) One way of coping with this demand for high rates of return without raising dividends sharply, with the attendant reduction in internal financing capacity, is for non-financial corporations to buy back their shares, thereby mechanically pushing up their share price. But it is hard to quantify this phenomenon.

(4) The internal financing rate is equal to the ratio between gross saving by non-financial corporations (their gross disposable income) to their investment (GFCF).

(5) Leverage is the positive impact of financial debt on the firm's financial rate of return. This leverage depends in particular on the sign of the economic rate of return after interest expense on the borrowing. If the economic rate of return (i.e. the ratio of operating profit to equity and financial debt) is greater than the cost of debt, the financial rate of return rises steeply even if the firm takes on just a small amount of debt.

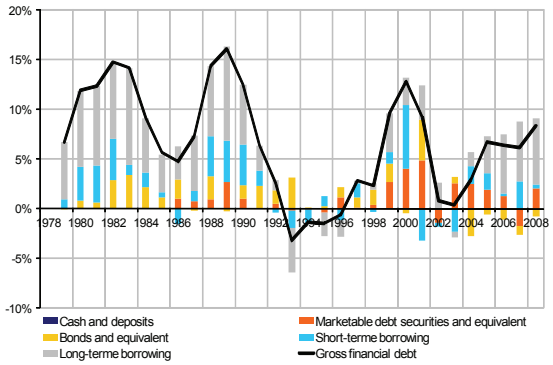
(6) For a detailed analysis of non-financial corporations' rate of return and of leverage, see Bataille, E. and Durant, D., 2005, "Mesures de la rentabilité des entreprises" (Measuring corporate profitability), Bulletin de la Banque de France, no.134, pp. 27-57; Durant, D., 2005, "La rentabilité des entreprises: une approche à partir des comptes nationaux" (Corporate profitability - A national-account based approach), Bulletin de la Banque de France no.134, pp. 53-83; Plihon, D., 2002, "Rentabilité et risque dans le nouveau régime de croissance" (Rate of return and risk under the new growth regime), Rapport du Commissariat général du Plan.

1.4 The share of short-term debt is low and the debt repayment burden is still manageable, but the financial crisis implies a likely need to rein in borrowing

While non-financial corporations' debt is at a historically high level, it does not appear to be weighing too heavily on the financial condition of firms, thanks to its profile:

- Long-term borrowing continues to account for a large proportion of debt (57% in 2008, slightly below the long-term average of 59%). The share of short-term borrowing in total borrowing has stabilised at between 10% and 15% since 2001: liquidity risk, measured by the illiquidity ratio (i.e. short-term debt as a proportion of financial debt-see chart 8), also therefore appears to be relatively limited in the aggregate. Other borrowings consist of marketable debt securities and equivalent, which have expanded considerably since the end of the 1990s (see chart 7 and table 2). A factor driving this growth has been non-financial corporations' concern to diversify their sources of short-term funding and to manage their treasury more flexibly, on more financially attractive terms.
- Interest expense remains manageable thanks to falling interest rates, and the risk of insolvency (i.e. the balance of interest received and paid relative to EBITDA) is still small: the insolvency ratio has fallen from 10% to 8% since 2005, with the exception of 2007, and is below its 1993 peak of 21.4%.

Chart 7: Contributions to growth in gross financial debt outstanding



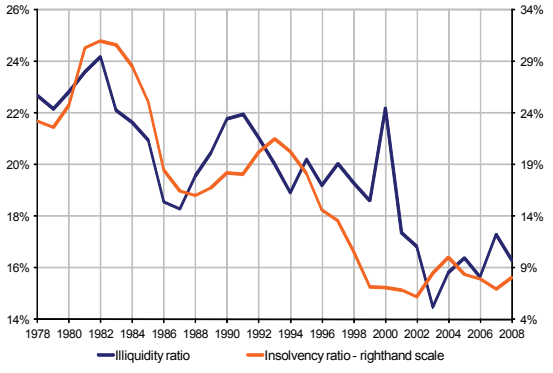
Source: National Accounts

Table 2: Non-financial corporations[a] sources and applications of funds

	1980	1985	1990	1991	1992	1993	2006	2007	2008
Applications									
Investment and change in inventory	49.0	64.8	117.1	116.6	107.4	87.8	185.6	208.4	214.5
Bonds and non-money market mutual funds	1.1	2.3	4.2	−0.9	3.4	13.2	19.5	−14.0	−8.2
Shares and other equity interests	1.8	4.6	26.2	24.3	30.9	18.3	68.1	87.2	64.6
Sources									
Saving	19.3	38.1	82.4	84.9	92.3	83.1	125.9	139.6	130.4
Debt	23.7	11.2	70.2	36.2	17.3	−34.8	72.9	96.7	90.9
Marketable debt securities and equivalent	0.0	0.5	5.5	0.4	3.4	−1.4	15.6	8.7	21.1
Bonds	2.7	2.8	9.4	11.1	8.7	8.2	−8.0	−3.9	−4.2
Borrowing from financial institutions	21.0	7.9	55.3	24.7	5.2	−421.6	65.3	92.0	74.0
Shares and other equity interests	6.2	15.1	35.6	36.8	35.4	32.7	81.7	109.5	67.5
Financial debt[b]	100.6 %	103.7 %	117.8 %	120.7 %	119.8 %	117.0 %	114.7 %	115.5 %	121.3 %

a. In € billion.
b. Banque de France concept, as % of value added.

Chart 8: non-financial corporations' ratios



Source: National Accounts

However, the financial crisis since 2008 militates against further growth in indebtedness:

- recessions classically witness a decline in corporate investment and hence debt, along with massive inventory rundowns, leading to a fall in cash facilities. The most recent Banque de France surveys report that the rate of decline in demand for credit by non-financial corporations slackened in the 3rd quarter of 2009, but this demand is still falling nonetheless;
- the financial crisis has made it harder for firms to borrow from banks as lending criteria have tightened, although these remain looser than in other euro zone countries;
- risk premiums have risen, raising the cost of borrowing and reducing leverage in a context of falling rates of return, even if falling key rates has cut the cost of borrowing by firms since 2008.

The scale of firms' bank borrowings means that it will probably take several years for them to revert to a level in terms of percentage points of value added-making possible a new cycle of debt-financed capital accumulation. For some highly indebted firms, debt reduction may be a means to ward off the risk of collapse.

2. 2. The debt reduction process: a look back at past episodes to shed light on the forecast financial condition of firms in 2009-2010

2.1 There have been debt-reduction episodes in the past, mainly as firms have rebuilt their financing capacity, with accompanying asset disposals in some cases

There are only a limited number of ways in which firms can reduce their debt, i.e. by rebuilding their financing capacity (in particular by raising their mark up either by cutting their total wage bill, trimming investment, or running down their inventory), or via asset disposals (or issuing equity).

One of the fastest means for non-financial corporations wanting to pay down their debt is to cut back on investment. Indeed, the sharp slowdown in economic activity is encouraging firms to rein-in or even cancel some investment plans as outlets dry up. Historically, both declines and subsequent resumptions of investment have always somewhat lagged behind the level of activity, as is consistent with the accelerator principle. The investment rate of non-financial corporations fell from 21.1% to 17.8% between 1991 and 1994, for instance. At the same time, however, the gross fixed capital formation (GFCF) rate fell by 11.3% from €114.1 billion to €101.2 billion, pushing up these firms' self-financing ratio from 74.4% to 87.3%. During the second episode of non-financial corporations' debt-reduction, between 2001 and 2003, the investment rate fell back from 19.8% to 18.2% (see chart 9). GFCF declined by 2.6% during the same period, boosting firms' self-financing ratio from 83.7% to 87.4%.

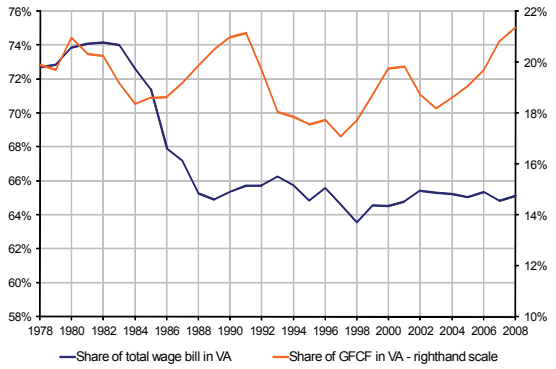
Alongside falling investment, inventory changes have also served to reduce firms' borrowing requirement and hence helped reduce their debt. The variation in inventory went from €2.5 billion to –€2.5 billion between 1991 and 1994. Inventories rose by €6 billion in 2001, and by €0.8 billion in 2002, then dropped by €1.5 billion in 2003.

Firms also use their wage bill as a means to reduce their debt, by cutting jobs or curbing wage increases in order to boost their mark up (which falls at the onset of a recession).

Whereas this had spurted from +1.8% to +4.8% between 1987 and 1990, the real total wage bill (deflated by the price of VA) then slowed, shrinking by 1.5% in 1993. The change was smaller in the early-2000s. The annual pace of growth in the real total wage bill accelerated from 2.2% to 4.3% between 1997 and 2000, then abated from 3% to 1.5% between 2001 and 2003. In terms of its amount, the total wage bill represents the largest expenditure item (65.1% of value added in 2008, see chart 9) and thus has the greatest impact on financing capacity. However, the use of the total wage bill and employment levels in general is restrained by: (i) the downward rigidity of wages and a labour market that adjusts more slowly than investment[7]; (ii) the economic cost of dismissals to firms, with the need to prepare job preservation plans[8]. Yet firms do have room to cut their wage bill at the margin, in terms of intensity, e.g. by reducing bonuses, cutting paid working time via reduced overtime, or partial layoffs.

Finally, the borrowing requirement falls automatically in times of recession, with the fall in corporation tax-which governments can accentuate in order to improve the financial position of firms.

Chart 9: Non-financial corporations' total wage bill and GFCF



Source: National Accounts

Whereas the above levers either limit or reduce debt by reducing the borrowing requirement, debt can also be cut by means of financial transactions such as asset disposals (e.g. sales of real property, financial assets, etc.) to help pay down debt. For example, some firms sold off most of their non-core assets at the end of the new technologies stockmarket bubble. But this can be a risky approach, with assets sold off cheaply, and reductions in the value of collateral put up against loans. During the two previous debt reduction episodes, there was a trend towards a reduction in non-financial corporations' financial assets. Asset flows fell from €178.6 billion to €154.8 billion between 1991 and 1993, mainly due to the decline in non-financial assets. On the other hand, asset flows fell from €397.8 billion to €295.8 billion between 2001 and 2003, but this time it was financial assets (especially shares and mutual fund units) that contributed most to the decline.

Moreover, this process can stoke fears of deflation (see box 3), as was notably the case in the United States in 2003.

(7) See, for example, Cahuc, P. and Zylberberg, A, 2001, "Le marché du travail" (The labour market), De Boeck; Blanchard, O. and Tirole J., 2003, "Protection de l'emploi et procédures de licenciement" (Job protection and dismissal procedures), Report no. 44, *Conseil d'analyse économique*.

(8) Firms employing 50 people or more and planning to dismiss at least 10 people within a given 30-day period are required to produce a job preservation plan. For further details see Bruggeman, F., Paucard, D., Lapôtre, M. and Thobois, P., 2002, "Plans sociaux et reclassements : quand l'innovation est promue par les représentants des salariés" (Redundancy and redeployment plans: when employee representatives promote innovation), DARES.

Box 3: **A theoretical model of debt-deflation**[a]

The first to study the phenomenon of deflation was Fischer[b]. Over-indebtedness and stockmarket crashes force economic agents to sell their products or assets cheaply. Reduced demand for capital brings nominal interest rates tumbling down, though usually less so than prices: real interest rates therefore rise, pushing agents even further into debt and maintaining the downward pressure on products and prices. Deflation prevents agents from finding enough money to pay down debts, while the real value of the latter goes on rising (since prices fall), prompting a wage of securities and asset disposals[c].

Take an economy where indebtedness has risen to such levels that agents no longer wish to take on additional debt. If this economy is hit by a recessive shock, this constraint will trigger a deflationary mechanism. We assume that private agents have accumulated a debt *D* on which the interest charge is *iD*, where i is the "apparent" average interest rate on all of the loans contracted. When set against private income excluding interest, *R*, this charge reaches a limit $\bar{\lambda} = iD/R$. Once this limit has been reached, income R grows at a rate i. We assume that in this stationary regime we have *PS* = *R*, where *PS* is private spending, excluding interest payments. The propensity of private agents to spend their income excluding interest, under this regime, is therefore equal to 1, the propensity to spend interest income is nil, and debt increases by the amount of the interest charge.

Now we assume the arrival of a recessive shock. Let $g = \Delta R/R$, the rate of growth in income in the period immediately following the shock. The value of g is henceforward less than the interest rate i. Spending by private agents is determined by the accounting equality $PS + \Delta PS = R + \Delta R + ND$, where *ND* is the amount of new debt (beyond that required to cover interest expense). If this amount is positive, agents will borrow and can spend above their income; if it is negative, they draw on their current income to repay part of their debt, and their propensity to spend income *R* falls below 1. The variation in their debt is thus written $\Delta D = ND + iD$. The constraint weighing on interest expense allows us to determine *ND*. That is because we should have $\Delta D = \bar{\lambda}/i\Delta R$ hence $ND = (\bar{\lambda}/i\Delta R) - iD$. We therefore have $\Delta PS/PS = g + \bar{\lambda}[g/(i-1)]$. Insofar as i can only change slowly from one period to another, this latter expression can be written: $\Delta PS/PS = g + \bar{\delta}(g-1)$, with $\bar{\delta} = \bar{\lambda}/i$ ($\bar{\delta}$ is the limited debt ratio associated with rate i). The gap between g and i plays a critical role. If a shock pulls down the growth in nominal income below the apparent interest rate on the accumulated debt, growth in private spending will fall below growth in income, still more so the higher the debt. To avoid a rise in their debt servicing burden, private agents will in effect draw on a portion of their income to reduce their debt. If there is nothing to counteract this deflationary force, the rate of growth in income will fall, period after period, even if the initial rate g was largely positive. The gap between g and i therefore provides a measure of the intensity of the pressures that will build up in an economy where private agents have saturated their debt constraint.

a. We use the model developed by Brender, A. and Pisani, F., 2003, "Risque de déflation par la dette en Europe et aux États-Unis. Quelques observations" (Debt deflation risk in Europe and the United States. Some observations), *Revue de l'OFCE*, no.86, pp. 32-41.
b. Fischer, I., 1933, "A debt-deflation theory of great depressions", *Econometrica, vol. 1* (14), pp. 337-357.
c. For further details of the study of deflationary mechanisms, see Bernanke, B., 2002, "Deflation - Making sure 'it' doesn't happen here", *Remarks before the National Economists Club*, Washington; Decressin, J. and Douglas L., 2009, "Gauging Risks of Deflation", IMF Staff Position Note, 09/01.

2.2 Corporate borrowing requirements are expected to fall sharp in 2009-2010, which should help to curb the growth in debt

According to the forecasts appended to the 2010 Budget Bill, non-financial corporations should cease to have any borrowing requirement in 2009, with a forecast financing capacity of +€0.7 billion, equal to +0.1 percentage of point value added. This would constitute an unprecedented reduction of over €70 billion in borrowing requirement in a single year. Several factors may account for this reduction:

- an historic decline in corporation tax payments (down 59% in 2009 relative to 2008, due to the sharp slowdown in economic activity since the second quarter of 2008;
- weaker investment, mainly as a result of the fall in GFCF from €212 billion to €196 billion in 2009 (–7.4%); this was the second heaviest fall since the 9.2% decline in 1993;
- an improvement in net income from ownership, from –€105 billion to –€94 billion. While income received and paid both declined, income received fell by less than income paid. This may partly be accounted for by lower interest rates (short-term rates especially) and by the expected slowdown in dividend payments as a consequence of lower profits in 2008;
- other items, net, including change in inventory, which improved from –€20 billion in 2008 to +€8 billion in 2009 as a result of massive inventory rundowns.

On the other hand, this decline in borrowing requirement in 2009 is thought to have been slowed by a cyclical deterioration in the mark up (EBITDA/VA), which is expected to come to 30.9% in 2009 (down 0.4% relative to 2008). This deterioration is expected to be relatively slight (relative to previous recessions), stemming from:

- a different employment profile and productivity cycle from those seen in 1993, with relatively weaker job destruction in 2009, thanks in particular to greater recourse to short-time working;
- the slowdown in real average per capita wages in 2009, reflecting among others smaller bonuses and reduced overtime.

With the disappearance of the borrowing requirement, and assuming a change in debt equal to the borrowing requirement (i.e. with no special financial transactions affecting the debt position), the level of financial debt is expected to remain virtually unchanged. In which case it would work out to 123% of value added in 2009, versus 121% in 2008, the slight increase being attributable to the fall in non-financial corporations' value added (–1.6%, compared with +3.1% in 2008).

Whereas in 2009 all of the factors contributing to an improvement in the borrowing requirement (and hence a slackening of momentum in the debt build-up) played a positive role (except where mark up was concerned), 2010 is more likely to see a virtual stabilisation of financing capacity:

the 2009 improvement stemming from inventory rundowns is expected to disappear (and even go into

reverse), and the massive slump in corporation tax payments in 2009 would mechanically be followed by a recovery in tax revenues[9]. These negative factors would be offset by an upturn in mark ups, as employment adjusts somewhat tardily, and due to a hefty fall in taxes on production following the business tax reform (an estimated €11.7 billion for businesses in 2010, including a permanent €4.3 billion cut according to the Budget Bill), and due to a further decline in GFCF (albeit more slowly than in 2009). However, the target mark up for non-financial corporations also depends on economic parameters that could be affected by the crisis. The change in the total wage bill will depend on the state of economic agents' bargaining power, while the scale of investment will depend on the intensity of competition in the market for goods.

Assuming a marginal change in these parameters, financing capacity would again improve in 2010, rising from +€0.7 billion to +€5.3 billion, allowing the debt reduction process to continue, albeit very sluggishly relative to earlier debt-reduction phases. This could be slower still if the yield curve were to steepen, pushing up companies' interest burden. If businesses wanted to pay down their debt at the same pace as in 1993 via their financing capacity, this would have to rise by €20 billion between 2009 and 2010[10]. If this took place via drastically reduced investment, it would represent nearly ten percentage points of investment and could accentuate (rather than attenuate) the fall in investment. If it were to take place via inventories, this would result in a further and distinctly negative contribution to growth by inventories.

Any such improvement in financing capacity could also take place partly via a cut in the dividends paid by companies. That could impact gross household disposable income, to which dividends contributed nearly 6% in 2008.

Consequently, it is very important to avoid an overreaction by firms seeking to cut their debt levels too vigorously. That is the whole point of the measures taken to bolster companies' treasury (e.g. faster payment of amounts owed by the Government, total or partial exemptions from charges on new investments and new hirings, and the business tax reform in 2010), and, in the financial sector, measures to tide the banks over the financial crisis (e.g. monetary easing via the injection of liquidity by the central bank, and the creation of the SFEF[11] in return for a commitment not to restrict access to credit for businesses.

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(9) Via the corporation tax recovery mechanism, which works through residues and down payments.

(10) With this €20 billion, the financing capacity of non-financial corporations would reach €25.3 billion (+2.5% of value added) in 2010. Financial debt would fall by €25.3 billion in 2010 to €1,177.3 billion (118.5% of value added), coming after €1,202.6 billion (123.1%) in 2009. This reduction would be in line with what happened in 1993, since financial debt fell by €21.5 billion in 1993, €8.9 billion in 1994, €9.4 billion in 1995, and €4 billion in 1996.

(11) Société de Financement de l'Économie Française- Corporation for Financing the French Economy.

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