

Can we boost growth in France?

By [Rémy Lecat](#)

In 2017, French growth is expected to accelerate to around 1.6%. In addition to support from monetary policy, ambitious structural reforms are necessary to raise the current potential growth rate, which is only just below 1.25%. These reforms need to focus on education, vocational training, and labour and competition law.

Chart 1: Lower potential growth since the Great Recession



Sources: Banque de France and Insee. Actual growth is defined as the relative change in real GDP taken from INSEE's quarterly accounts, adjusted for seasonal and working-day variations. Potential growth is defined as the rate of growth in potential output if all available production factors are used optimally: employment, productive capital, etc.

Robust, long-term GDP growth is necessary for the sustainability of public debt and welfare financing, in particular pensions and healthcare, and in fine to social cohesion. And yet, French growth has tended to slow since the 1970s. Indeed, GDP growth decelerated from 5.2% as an average annual between 1950 and 1974 to 2.3% between 1974 et 2007 and has been particularly sluggish since the financial crisis (0.6%).

What explains this slowdown and how can we return to stronger growth in the long term? Estimating potential growth provides some answers to this question.

Potential growth, the speed limit of French economic activity

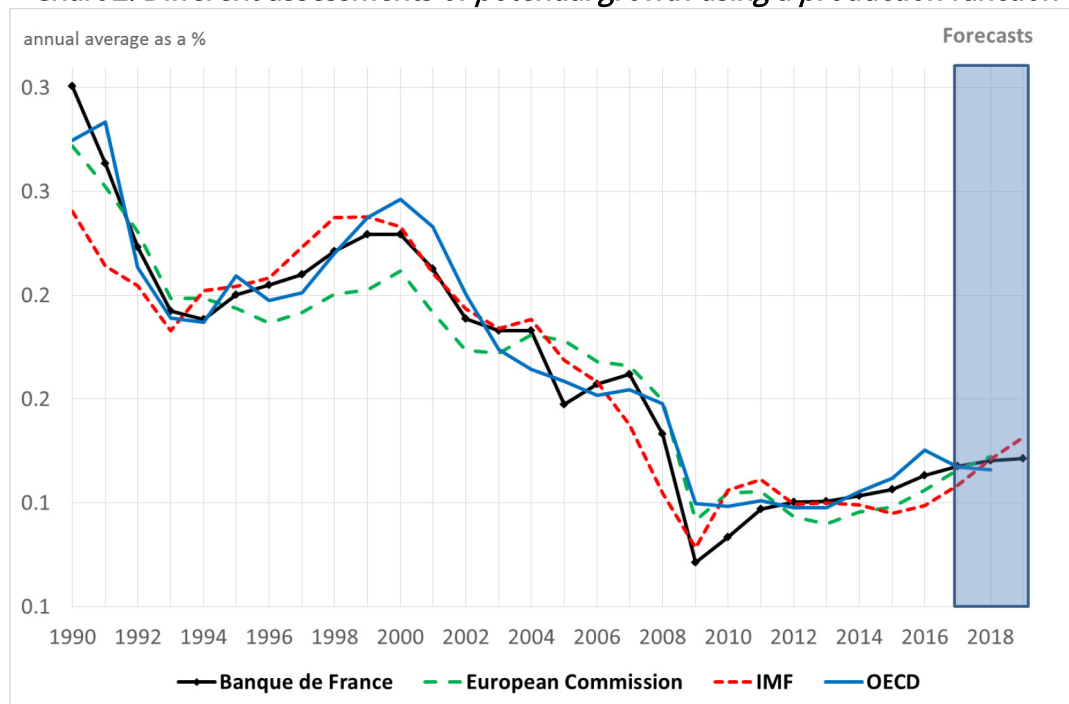
In the long term, actual growth cannot persistently exceed potential growth. If, temporarily, we can increase the production rate, do overtime, etc., the excessive use of available resources will eventually result in inflation, fatigue effects and will cause a slowdown. Potential growth can therefore be seen as a "speed limit" on economic activity.

In order to estimate potential growth, statistical methods such as smoothing or more structural techniques can be used. Structural methods are derived from economic theory. The most widely used method is the production function, which estimates potential GDP using a stock of productive capital (machinery, buildings, intangible assets), a potential employment level and the total factor productivity (TFP), which

measures the efficiency of labour and capital utilisation. Each of the methods, even the most statistical, requires numerous assumptions: for statistical methods, the degree of smoothing in particular and, for the production function, aggregating the contribution of each production factor or determining the TFP trend.

This is why assessments can diverge depending on the method and the assumptions used. Chart 2 shows the Banque de France's and international institutions' potential growth estimates, which sometimes display significant differences, while they all use production functions.

Chart 2: Different assessments of potential growth using a production function



Sources: Banque de France, European Commission, IMF and OECD.

Decline in potential growth

These assessments nevertheless lead to several converging conclusions. Potential growth has slowed since the 1990s in successive stages, and this slowdown was exacerbated by the financial crisis. Despite a slight pick-up with the current recovery, potential growth remains below its level of the start of the 2000s (see Chart 2). This slowdown can be attributed to a fall in investment, but above all to the deceleration in the efficiency of the combination of the factors of production, TFP. Between 2000-2008 and 2008-2016, potential growth appears to have declined from around 1.7% to 1.0%. According to estimates, this stems from the lower average contribution of investment (of between 0.6 and 0.8 percentage point per year) and of TFP (of between 0.1 and 0.8), whereas the contribution of the total hours worked, limited by the 35-hour working week over the 2000-2008 period, rose slightly.

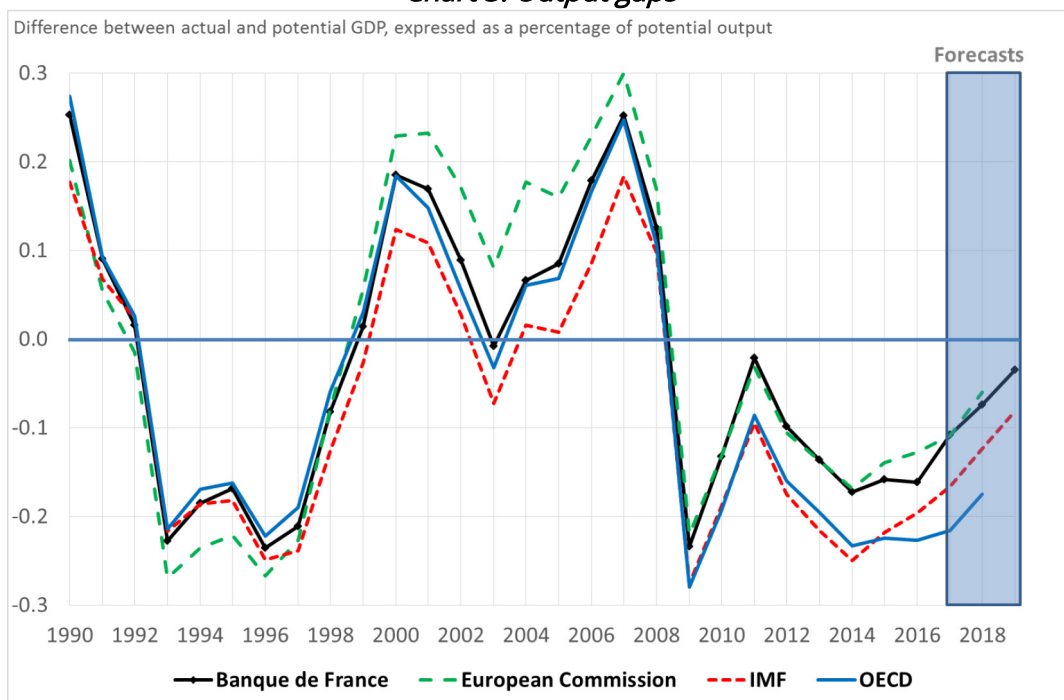
The slowdown of TFP in the direct aftermath of the crisis is partly temporary: the ageing of capital stock due to declining investment, the underutilisation of capital goods, the development of low productivity jobs for the self-employed, etc. But it is also structural. France finished catching up with the US productivity level in the 1990s but did not subsequently take full advantage of the information and communication technology revolution ([Bergeaud et al., 2016](#)); this slowdown is affecting all advanced countries, due to the possibly temporary loss of momentum of technical progress (for the United States, see [Gordon, 2015](#)).

Reduced margins for growth

The difference between actual growth and potential growth is known as the output gap, and is expressed as a percentage of potential output (see Chart 3). It gives the position in the economic cycle: if it is positive

(actual GDP is higher than potential GDP), the economy is in an upswing, and if is negative, the economy is in a downswing.

Chart 3: Output gaps



Sources: Banque de France, European Commission, IMF and OECD. The output gap, or difference between actual growth and potential growth, is expressed as a percentage of potential output.

In 2016, the French economy was still in a downswing. Compared with traditional cycles, this downswing was particularly long, lasting eight years. This reflects the normal consequences of financial crises, whose adverse effects on demand are absorbed particularly slowly (see [Reinhart and Rogoff, 2009](#)).

France's negative output gap means that it still has margins for growth, but that they are limited to around one and a half percentage points of potential GDP, and are gradually declining. Indeed, according to the Banque de France's June 2017 projections, the actual growth rate is expected to exceed the potential growth rate, thus bringing actual GDP closer to potential GDP by 2019 (output gap of ½% in 2019). This acceleration in actual growth is driven in particular by Eurosystem monetary policy stimulus ([Marx, Nguyen and Sahuc, 2016](#)).

If potential growth remains close to 1.2%, the French economy will face major challenges in terms of funding its welfare system and the sustainability of its public debt. In order to lastingly boost growth, it is necessary to raise potential growth.

In order to achieve this, structural reforms are required. A Banque de France study ([Cette et al., 2016](#)) shows that if France adopted the practices of the best three OECD countries for the regulation of product and labour markets it would lead to a 6% increase in potential GDP. Potential GDP would indeed be higher with the combination of three factors: if the employment rate notably for young people and the elderly were higher, if the labour force had skills better suited to the needs of the French economy thanks to an enhanced initial or vocational training drive; and if investment were boosted by more favourable structural conditions or if labour and capital resources were allocated to the best-performing companies.

Ambitious reforms in the areas of education, vocational training and labour or competition law would make it possible to achieve these objectives, in particularly allowing France to fully benefit from the possible acceleration in productivity thanks to advances in the digital economy.