"Structural reform is difficult, but unavoidable", published in *Le Monde* on 20 March 2014

Too low! In France, annual growth potential hovers between 0.8% and 1%. Yet growth is critical to improve living standards, reduce the national debt and rebalance welfare systems without dramatic consequences – and therefore to keep public debt under control without harsh austerity measures. Structural reform is the only option for increasing growth potential.

The Nordic countries and Canada introduced such reforms in the 1990s with great success, as did Germany in the early 2000s with equal success. Spain and Portugal are actively going down the same road, although in mid-crisis, and their social costs are consequently high, at least in the short term. In France, irrespective of the government's hue, such structural reform is very difficult to implement. However, there does exist a fairly strong convergence of ideas. Here are some of the more noteworthy ones:

1 – The cost of labour is crucial to an economy's competitiveness, but only in relation to productivity. On average, Germany's cost of labour is only slightly lower than in France, but the country has the advantage of a competitive economy and a largely surplus balance of trade, reasonably high levels of growth and low unemployment. In France, with only slightly higher labour costs, the situation is the reverse. This is due to a cost of labour, after corrections for productivity gains, which greatly increased in France during the 2000s compared with Germany. The country also produces mid-range and medium quality goods, while in Germany specialisation tends to focus at the top of the range. France must achieve a cost of labour, after corrections for productivity, that correlates with its range of manufactured goods.

Higher labour productivity underpins economic growth and is necessary if salaries are to be raised without losing competitiveness. Just as with the search for top-of-the-range goods, productivity gains also require both research & development and investment. Companies must maintain adequate profit levels to achieve this. Yet over the past ten years, France is one of the few OECD countries to have seen a fall in its companies' profit levels. So how do we finance investment, modernisation, innovation and a move to high-end goods and services? To encourage innovation, competition must be increased in certain overprotected sectors.

And, lower labour costs are vital for the employment prospects of underqualified workers in non high-end sectors. Empirical studies demonstrate this very clearly. This could be achieved via lower social charges or lower salaries, with additional welfare payments supplementing salary to ensure a decent standard of living.

2 – An increase in the working population – which, just as with productivity gains, is a determining factor in economic growth potential – must lead to labour market reforms by limiting inflexibilities such as threshold effects, complexity of employment law, etc. There must also be greater incentives to return to the labour market. There is a clear empirical relationship between the rate of unemployment and the length, level and especially the degressivity of unemployment protection. Such reforms must necessarily go hand-in-hand with better training and improved support to get back to work. It is a question of developing "flexible security". At the same time, it is vital to reform pensions by raising the number of contribution years so as to increase the working-age population. As the example of many other European countries shows, this is the only way to stimulate growth while resolving the pension system's financing conundrums. Like any additional taxes on assets, any lowering of pensions depresses the economy.

3 –Potential growth and competitiveness can also be increased by seeking out more efficient public services, by establishing a better relationship between the usefulness and quality of public service and the level of public expenditure. Yet France has one of Europe's highest rates of public expenditure and taxation as a proportion of GDP, yet its level of public services (social security, local authorities, state) lies only within the European average. In other words, efficiency is not up to scratch while public debt is increasing to dangerous levels. So reform is the only option.

I believe there is cause for optimism: given all the examples in other countries, the French seem to be gradually coming to terms with the fact that the level of social protection and public services has been artificially kept up for many years via increasing levels of public debt, which have now become unsustainable. The effort to be made is therefore better understood, as is the necessity of seeking out a better balance between individual rights and obligations in order to protect what really matters, namely an equitable society with high living standards and strong welfare protection, which at the same time promotes social cohesion and enterprise.

As reform in the short term may have social costs and only bear fruit in two or three years' time, implementation must go hand-in-hand with measures whose effects will be visible in the short term, supporting both the economy and employment. A significant lowering of social security contributions for low-paid workers together with an increase in VAT could bring about such an effect. It is therefore up to the governments, of whichever hue, to explain the direction and necessity of reform and to ensure that measures are introduced at the right time, backed with adequate support, accompanied by just and equitable implementation.

Olivier Klein, Economics and Finance Professor, HEC.