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TRÉSOR-ECONOMICS

Should structural reforms be coordinated in the euro area?

This study was prepared under the authority of the Treasury and Economic Policy General Directorate and does not necessarily reflect the position of the Ministry for the Economy, Industry and Employment.

- Within the framework of the Lisbon strategy, the European Union member states have committed to undertaking major structural reforms between 2000 and 2010. The reforms were intended to stimulate supply and demand and therefore deliver large gains in terms of activity in the reforming country.

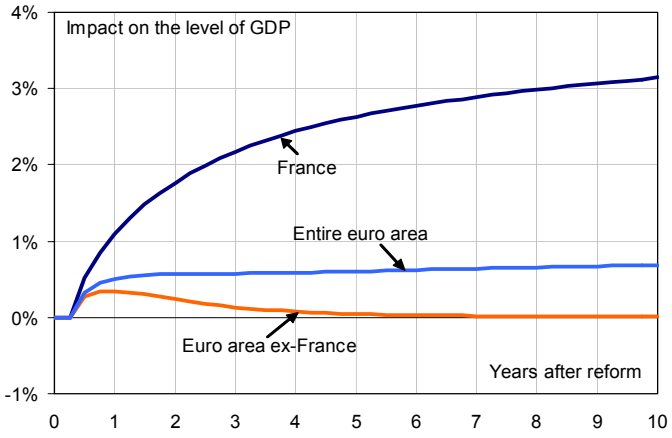
- In a monetary union like EMU, structural reforms by one member state affect the economy of other member states through changes in relative competitiveness and the reaction of the common monetary policy.

- Structural reforms to increase competition in goods and services markets have positive effects on economic activity, consumption and purchasing power in the reforming country. Reforms in the nontradable goods et services sector also have a short-term positive effect in the other countries in the monetary area. On the other hand, reforms in the sector exposed to international competition can have substantial short-term negative externalities, which are all the greater if the reforming country is a large one. Accordingly, gains would arise from coordinating the reforms of the exposed sectors within the EMU.

- Greater labor market flexibility would have positive effects on economic activity, the volume of hours worked and total earned income, despite a decline in real wages per hour worked. Simultaneous reform across the entire euro area would limit the negative impact on hourly wages, without however eliminating it completely in the short term.

- A positive solution for economic activity and purchasing power could involve synchronized implementation throughout the euro area of reforms in the labor market and in the sector sheltered from international competition.

Effect on GDP of a reform to promote competition in the sheltered sector in a single country (the case of aligning the markups in France with those observed in Denmark)



Source: DGTPE calculations.

DGTPE
DIRECTION GÉNÉRALE DU TRÉSOR
ET DE LA POLITIQUE ÉCONOMIQUE

Within the framework of the Lisbon strategy, the European Union member states committed themselves to implementing ambitious structural reforms between 2000 and 2010. The reforms aim notably to promote competition in labor, goods and services markets in order to increase economic activity and employment. Greater price and wage flexibility should help member states to better weather shocks, particularly asymmetric ones, thus partly compensating for a loss of autonomy in monetary and exchange rate policy.

When a country in the euro area implements a reform that aims to increase competition in the various markets, other countries' economies can be affected; spillover effects are transmitted essentially through two channels:

- foreign trade: the structural reforms affect relative prices of goods between the reforming country and the rest of the zone;
- common monetary policy: the European Central Bank reacts to average EMU inflation. A structural reform in one country could affect price changes in that country, and therefore in the entire euro area, leading to a in monetary policy reaction.

In light of these spillover effects, coordination of structural reforms among the various countries in the zone could be seen as advisable.

The countries in the euro area differ considerably in their degree of competition and in their level of employment protection. For instance, fixed-term contracts--which are more flexible than open-ended contracts--as a percentage of total employment in 2006 varied from 3.4% in Ireland to 34% in Spain, with 13.5% in France. These differences are tending to narrow, however, as most member states have implemented numerous reforms to increase efficiency in the functioning of the various markets.

The economic literature generally agrees on the positive long-run effects of such structural reforms, even if there are non-negligible short-term costs; see Bandt and Vigna (2007)[1] for a detailed review of the literature. Several authors have studied the best strategies for implementing reforms. Blanchard and Giavazzi (2003)[2] show that synchronization of reforms across markets, and if possible across countries, can reduce the short-term costs and strengthen the long-run gains of the reforms.

Along the same lines, Everaert and Schule (2006)[3] show that coordination of reforms across euro area countries would reduce transition costs through temporary support for monetary policy.

This study uses a dynamic stochastic general equilibrium (DSGE) model to attempt to quantify the effects of structural reforms on the economy of the reforming country, and on the rest of the euro area, as well as the gains from coordinating the reforms across euro area countries. Three types of reform are examined:

- **Increased competition in the nontradable goods sector**
- **Increased competition in the tradable goods market**
- **Labor market reforms to increase flexibility**

1. The *Omega3* model (French Treasury) is used to simulate the macroeconomic impact on the euro area of structural reforms in a single member state

In the *Omega3* model[4], the lack of flexibility in the labor, goods and services markets is modeled by markups, which increase prices and wages. Firms are assumed to be in a situation of monopolistic competition, which allows them to set prices that include a markup (price = marginal cost + markup). An increase in the degree of competition in the goods and services markets appears in the model as a reduction in this markup.

It is also assumed that workers are imperfectly substitutable, notably due to the constraints of labor market regulation. This translates into greater workers' bargaining power, which is modeled as a wage markup (effective wage = theoretical wage under perfect competition + wage markup). When the labor market becomes more flexible, if workers are partly substitutable, firms benefit from greater competition among workers, the wage markup declines and labor supply increases. This approach to the labor market, however, has numerous shortcomings, as models of this type fail to address Keynesian unemployment.

In all the simulations, it is assumed that the reform is implemented gradually over a one-year period, in a single country (France, in the case discussed here), and that it is perfectly anticipated by agents.

(1) O. de Bandt, O. Vigna (2007): "L'impact macroéconomique des réformes structurelles," *Bulletin de la Banque de France, no. 164, August*. English-language summary: "The macroeconomic impact of structural reforms," *Banque de France, Quarterly Selection of Articles.*

(2) O. Blanchard, F. Giavazzi (2003): "Macroeconomic effects of regulation and deregulation in goods and labor markets," *Quarterly Journal of Economics, 118.*

(3) L. Everaert, W. Schule (2006): "Structural Reforms in the Euro Area: Economic Impact and Role of Synchronisation across Markets and Countries," *IMF Working Paper, WP/06/137.*

(4) See B. Carton, T. Guyon (2007): "Divergences de productivité en union monétaire - Présentation du modèle Oméga3" (Productivity divergences in monetary union, Presentation of the Omega 3 model), *DGTPE Working Paper No. 2007-08, September 2007.*

Box 1: **The *Oméga 3* model**

For a detailed description of the model, see Carton and Guyon (2007), referenced in note (4). *Oméga 3* is a neo-Keynesian dynamic stochastic general equilibrium model in which agents form rational expectations about future changes in the economic variables (including economic policies) and the economy exhibits nominal rigidities.

The model comprises three countries: the first two are part of the same monetary area, while the third has a different currency and a flexible nominal exchange rate relative to the monetary area. The economies do not produce the same goods, and they have different production structures. Interdependencies between countries take the form of trade in goods and services, and short-term risk-free securities.

The model identifies two types of households. "Ricardian" households are not financially constrained, and optimize their intertemporal utility with consumption habits and labor supply. "Keynesian" households, on the other hand, are financially constrained and consume a fixed percentage of their current income and financial wealth.

Decisions regarding output, price setting, and factor demand are endogenous and firms operate under monopolistic competition. The degree of competition in the goods and services market is modeled by the markup over the cost of production. The degree of labor market rigidity is reflected in the wage markup, or the difference between the effective wage and the perfectly competitive equilibrium wage. A shortcoming of this family of models is that it does not incorporate a theory of unemployment; labor supply adjusts to fluctuations in labor demand.

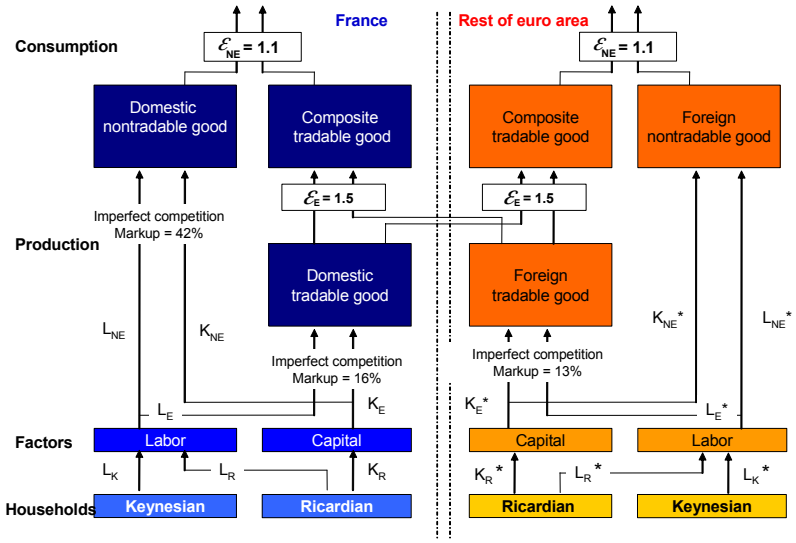
Monetary policy is endogenous. Inflation and the change in real interest rates, by construction, are nil in the long run. Thus, in the reform scenarios described here, if monetary policy plays an important role in the short term in the transmission of the effects of the reform to the rest of the euro area, its role is nil in the long term, as spillover effects are explained by the trade channel.

The model is calibrated to France, to the rest of the euro area, and to the rest of the world. The technology parameters are calibrated to ensure the steady state of the model is consistent with historical trends in national accounts and foreign trade in these areas. The dynamic parameters (e.g., adjustment costs, Taylor rule smoothing, and habit persistence) and the behavioral parameters are calibrated based on microeconomic estimation or consensus values from the literature. To calibrate markups in the exposed and sheltered sectors, we use econometric estimates of sector markups for six European countries (Table 2).[a] The estimates for the rest of the euro area are based on Germany, Italy and Belgium. Because of strong international competition, markups in the exposed sector are similar in France, the rest of the euro area, and the rest of the world. In the simulations, we consider an arbitrary 10-point reduction in the markup in the exposed sector. The differential in markups between France and the rest of the euro area in the sheltered sector arises mainly from the real estate and business services sectors. The markup in the sheltered sector is far smaller in Denmark than in the euro area, which is consistent with the results of Conway and Nicoletti (2006):[b] Denmark figures with Sweden among the European countries with the lowest level of regulation of the nontradable goods market, due to the lesser degree of occupational regulation. The wage markups are taken from Everaert and Schule (2007), who base them on microeconomic estimates of workers' bargaining power.

Table 1: calibration of markups in the Omega 3 model

	France	Rest of euro area	Rest of the world	Denmark
Tradable sector	16%	13%	15%	10%
Nontradable sector	42%	55%	25%	33%
Wage markup	35%	35%	20%	13%

Chart 1: production in the Oméga 3 model (simplified 2-area diagram)



ε_{NE} : elasticity of substitution between tradable and nontradable goods

ε_E : elasticity of substitution between domestic and foreign tradable goods

K_E : capital used in the production of tradable goods

K_{NE} : capital used in the production of nontradable goods

L_E : labor used in the production of tradable goods

L_{NE} : labor used in the production of nontradable goods

L_R : labor supply from Ricardian households

L_K : labor supply from Keynesian households

K_R : capital from Ricardian households

a. R. Bouis, 2007(2007): "Quels secteurs réformer pour favoriser l'emploi et la croissance," (in French, What sectors can be reformed to promote employment and growth), *DGTPE Working Paper No. 2007/13.*

b. P. Conway et G. Nicoletti (2006): "Product market regulation in the non-manufacturing sectors of OECD countries: measurement and highlights," *OECD Working Paper ECO/WKP(2006)58.*

2. The effect of increased sheltered-sector competition in a single country

We first consider increased competition in the nontradable goods and services sector in France, by aligning markups in the nontradable goods sector with the values observed in Denmark (Table 1). The long-run effects are very large for France, the reforming country (4.2 points of GDP). In the rest of the euro area, economic activity is stimulated during the first three years, but there is little impact in the long run.

2.1 A disinflationary effect in the reforming country

In the first year following implementation, a reform of the sheltered sector in France reduces the relative price and increases relative demand for non tradable goods. Total inflation trends downward, under a reverse Balassa-Samuelson effect.[5] The short-term effect on economic activity is subject to conflicting forces. On the one hand, the reform has a positive effect on demand for labor and capital goods in the nontradable sector, and on consumption (due to an increase in permanent income). On the other hand, real interest rates rise due to the lowering of inflation expectations, despite the reduction in central bank key rates associated with the easing of inflation pressures.

The results of the simulation suggest that aligning the degree of competition in France's sheltered sector with the value for Denmark would increase economic activity (by 1.1 points of GDP after one year), in a disinflationary context.

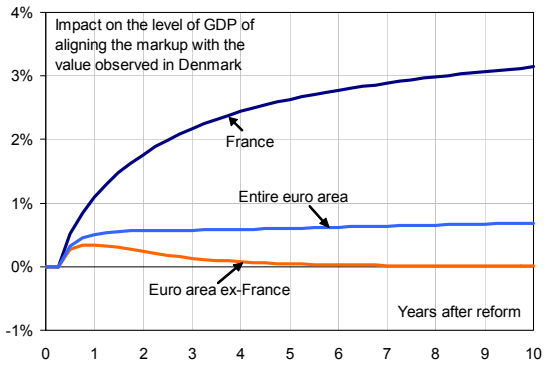
2.2 The effects on the rest of the euro area are weak, but coordination of the reforms would be beneficial in the long run

In the rest of the euro area, economic activity is stimulated during the first two years, thanks to a favorable monetary environment arising from lower inflation in France (and therefore throughout the euro area). At the same time, the relative competitiveness of the rest of the area against France declines in the medium term because lower demand for tradable goods in France causes a fall in the price of tradables produced by France; but the lower competitiveness is more than offset by the monetary environment.

Economic activity in the rest of the euro area thus rises temporarily by 0.4 points of GDP. **Real wages also rise in the rest of the euro area**, where firms substitute labor for capital, as higher demand in France increases the cost of capital goods.

In the long run, monetary policy does not come into play (see box 1) and the (very weak) spillover to the rest of the euro area is transmitted through the relative prices of imports and exports (the terms of trade). The sign of the impact depends on the elasticities of substitution between the different types of goods (Box 2). In our scenario, because of the low degree of substitutability between tradable and nontradable goods, the increase in demand for nontradable goods reduces the demand for tradable goods in France. France's terms of trade improve and the spillover effects on the rest of the zone are therefore very slightly negative.

Chart 2: Impact of the reform in the protected sector in France



Source: DGTPE calculations.

Table 2: long-run effects of aligning the level of competition with the level observed in Denmark

		Reform in France	Coordinated reform
Effects on France	GDP	**4.2**	4.1
	Consumption	**4.0**	3.9
	Investment	**7.0**	7.1
Effects on the rest of the euro area	GDP	−0.0	10.2
	Consumption	−0.0	9.7
	Investment	0.0	17.2
Effetcs on the entire euro area	GDP	0.9	8.9
	Consumption	0.9	8.5
	Investment	1.5	15.0

Interpretation: in the long run, a reform of the services sector in France increases GDP by 4.2% and consumption by 4% in France.

In the long run, the euro area member countries appear to gain from carrying out their reforms simultaneously (Table 2). In the coordinated reform scenario, markups in the sheltered sector in all countries are aligned with the value observed in Denmark.

These mechanisms may be interpreted in other ways. Some euro area countries have already increased competition in the retail sector, and have benefited particularly in terms of employment, as has the rest of the euro area to a much more limited extent. The reforms projected in France in the framework of the law on the modernization of the French economy ("loi de modernisation de l'économie") will not only have an impact in France, but will also strengthen the positive effects of the other reforms for the euro area as a whole.

(5) The Balassa-Samuelson effect describes how productivity gains in the tradable goods sector can lead to inflation.

3. Effect of increased competition in the sector exposed to international competition

3.1 A positive impact in France but a negative impact in the short term in the rest of the euro area

This section examines an increase in the degree of competition in the tradable goods and services market. The exercise aims to illustrate the mechanisms at work, which differ from those in the nontradable goods sector discussed above. Here again, we examine a France-based reform scenario.

Increased competition among French firms can arise through various channels, e.g., administrative streamlining, improved operating conditions, or better regulation of competition in certain markets to avoid concerted practices. Such measures would lead to a reduction in markups by French firms. The effects of the reforms would be equivalent to an improvement in cost competitiveness, or an increase in total factor productivity for firms in the sector. For convenience, we have chosen to model the process by a (purely arbitrary) 10-point reduction in the markup for the sector exposed to international competition. The purpose of the exercise is to illustrate the mechanisms at work, bearing in mind that the size of the shock has been chosen without reference to any specific objective.

The reform has positive effects on economic activity in France in the short term, and raises GDP by 2.3% in the long run.[6] On the other hand, the reform has negative effects for the first four years following implementation, and mildly positive effects in the long run on economic activity in the other euro area countries (Chart 1). For the entire euro area, the reform has mildly positive effects on economic activity at all time horizons.

3.2 The positive impact in France leads to overshooting

In France, the mechanisms at work are the following:

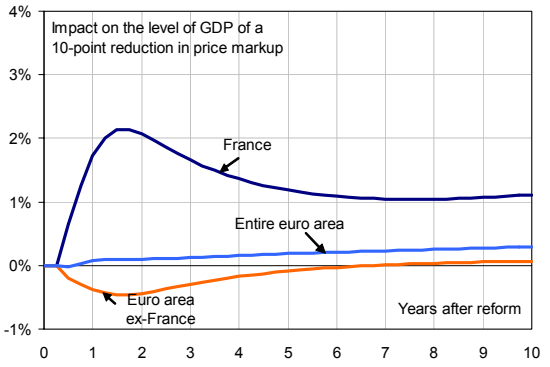
- The reduction in the markup in the sector reduces the relative price of tradable goods produced by France. Firms in the sector increase output to meet increased demand. Investment and labor demand both increase;
- The increased labor demand causes an increase in real wages;
- In the first year following the reform, decrease in the relative price of tradable goods produced in France causes a reduction in inflation. Nevertheless, the decline in prices is limited by the state of international competition in the sector (as prices are somehow "pegged" to those in the rest of the euro area); and one year after the reform, inflation increases as higher wages are passed on in the price of nontradable goods;
- The decline in the relative price of goods produced by France leads to an improvement in France's competitiveness and trade balance.

Three mechanisms thus oppose the short-term disinflationary effect: the increase in households' permanent income stimulates current consumption; the increase in factor demand by firms in the exposed sector leads to higher investment and hours worked; and the decline in real interest rates results from the increased inflation in the nontradable goods sector.

The effects on GDP and business investment continue to be substantial after five years, raising them by 2.3% and 10.4%, respectively.

3.3 A change in the distribution of economic activity within the euro area has an adverse effect on economic activity in the rest of the area in the short term

Chart 3: Impact of a reform in the exposed sector in France



Source: DGTPE calculations.

For the rest of the euro area, the effects of this reform are negative in the short term: a 10-point reduction in markups by the exposed sector in France reduces economic activity in the rest of the zone by 0.5 points after one year. These spillover effects are transmitted through two channels:

- The competitiveness of the rest of the area is degraded substantially relative to French firms, which gain market share in Europe;
- Monetary policy is tightened to counter the expected price increase in France and thus becomes too restrictive for the rest of the euro area. Higher interest rates lead to an appreciation of the common currency in the short term, which makes the rest of the euro area less competitive *vis-à-vis* the rest of the world.

In the long run, the spillover effects to the rest of the euro area become very weak but positive, raising GDP by 0.1 point. The decline in the price of tradable goods produced

(6) However, a sensitivity analysis indicates that this outcome is highly dependent on the value of the elasticity of labor supply to real wages (Box 2).

in France reduces the price of semi-finished goods exported to the rest of the euro area, and increases consumption in the rest of the euro area in the long run. Investment declines in the long run because the fall in the price of tradable goods fails to offset the market share lost to French firms by firms in the rest of the euro area.

3.4 Coordinating reforms in the euro area would reduce negative spillover

Because of negative spillover effects, notably on investment, the euro area countries as a whole would gain from synchronized implementation of product market reform (Table 3). This would reduce the short-term impact because monetary policy would be better adapted to the situation in each State, and in the long run, negative spillover effects would be offset by the positive effects of the reform in the reforming country.

Nevertheless, these results must be taken with caution. First, the model fails to account for the effects of greater competition by French firms on the rest of the world's productivity, or more diffuse channels for transmission (e.g., confidence, or lower risk premiums), and this doubtless tends to underestimate the positive effects. Second, the model ignores innovation, an important dimension of market power. It is accepted that a minimum level of economic rent, notably through the existence of patents, is needed to strengthen the incentive for firms to increase R&D and promote technological progress. This phenomenon cannot be measured by an exogenous growth model, so the effects described in the reform scenarios may be overstated in this respect as well.

Table 3: long-run effect of a 10-point decrease in price markup in the tradable sector

		Reform in France	Reform in the euro area
Effects on France	GDP	**2.3**	2.7
	Consumption	**1.3**	2.1
	Investment	**10.4**	9.5
Effects on the rest of the euro area	GDP	0.1	2.6
	Consumption	0.2	1.9
	Investment	−0.2	10.0
Effetcs on the entire euro area	GDP	0.6	2.7
	Consumption	0.4	2.0
	Investment	2.1	9.9

Interpretation: in the long run, a reform of the exposed sector in France increases GDP by 2.3% and consumption by 1.3% in France.

4. Consequences of a labor market reform intended to increase flexibility

This last section examines the effect of aligning the degree of labor market flexibility with that of Denmark. This corresponds to a 12-point reduction in the wage markup in our model, which would be a very significant shock.

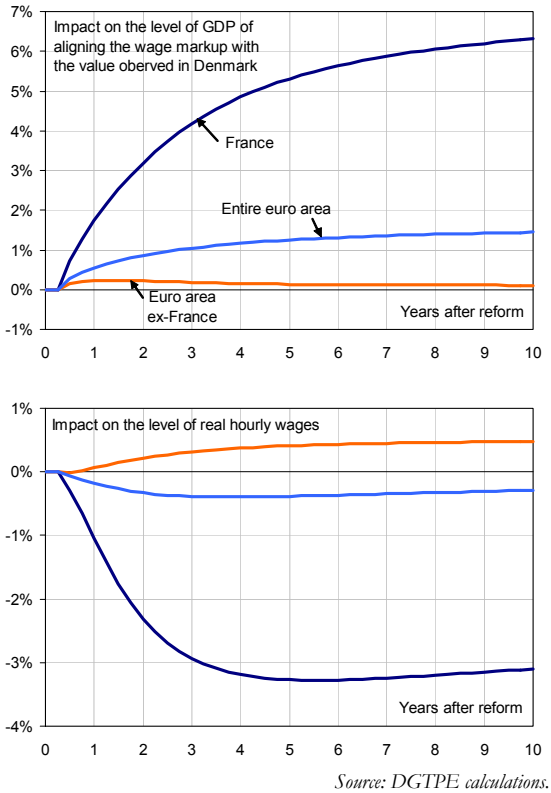
4.1 The decline in real hourly wages is offset by the beneficial effect of the increase in labor demand

This reform in France has short-term and long-term positive effects on economic activity and employment. Despite the negative impact on real hourly wages, total earned income increases owing to a greater number of hours worked.

Consumption increases as a result of the higher total purchasing power. Investment also benefits from the favorable prospects for return on capital. Nevertheless, as in the case of a sheltered-sector reform, the differential in real interest rates is unfavorable for France, in light of the decline in expected inflation.

All told, economic activity increases by 1.8 % after one year and 3.2% after two years. In the long run, labor supply increases but real hourly wages decline. The long-run effects on economic activity are positive.[7]

Chart 4: impact of labor market reform



Source: DGTPE calculations.

(7) The size however is highly dependent on the elasticity of labor supply to wages (see Box 2); this parameter is difficult to estimate and empirical values in the literature vary considerably. The estimates of the elasticity of labor supply for married men range from –0.33 to +0.03, and estimates for married women from 0.10 to 0.65 (see Cahuc, Zylberberg, 2001, "Le marché du travail," (in French, The labor market), *De Boeck Université*).

4.2 The impact in other euro area countries is limited but synchronizing reforms still offers gains

From one to three years after the reform, the rest of the euro area benefits from more accommodating monetary policy. However, inflation differentials between the reforming country and the rest of the euro area are smaller than with the other reforms in a specific sector, and the effect on economic activity in the rest of the euro area remains limited.

In the long run, spillover to the rest of the euro area is positive but weak, because France's demand for tradable goods rises.

Coordinating the reforms in all euro area countries would limit the long-term loss in the purchasing power of wages (Table 4). This would not be sufficient to eliminate the losses in real wages in the short term (–1.6% after 3 years).

The scenarios described above that use France as an example obviously apply to other large countries like Germany or Italy.

Table 4: long-run effects of aligning the degree of labor market flexibility with that of Denmark

		Reform in France	Coordinated reform
Effects on France	GDP	**7.8**	8.1
	Consumption	**9.1**	9.7
	Investment	**9.5**	8.9
	Real wages	**–2.1**	–0.0
	Total earned income	**7.2**	8.9
Effects on the rest of euro area	GDP	0.1	8.1
	Consumption	0.2	9.7
	Investment	–0.2	8.9
	Real wages	0.6	0.0
	Total earned income	0.4	8.9
Effects on the entire euro area	GDP	1.8	8.1
	Consumption	2.1	9.7
	Investment	1.9	8.9
	Real wages	0.0	0.0
	Total earned income	1.9	8.9

In the long run, increased labor market flexibility in France raises GDP by 7.8% and reduces real wages by 2.1% in France.

5. Synchronizing labor market and nontradable goods sector reforms would improve the functioning of the labor market, without a negative impact on hourly wages

In all the cases of reform considered, the scenarios examined indicate that gains arise from coordinating the reforms. For labor market reform, in particular, simultaneous action throughout the euro area would limit the negative impact on hourly wages, without however eliminating it completely in the short run.

One way to achieve labor market reform without loss of income by workers would be to combine labor market reform with increased competition in the sheltered sector, and to synchronize those reforms throughout the euro area. In such a case, the short-run and the long-run effects on economic activity, consumption, investment and real wages would all be positive.

The disinflation arising from the reform in the nontradable goods and services sector would more than offset the fall in nominal wages. Real wages would rise throughout the euro area, leading to higher consumption. Further, the central bank would respond to disinflation throughout the zone by easing monetary policy, thus favoring investment. All told, stimulus for economic activity in the entire euro area would begin in the short term.

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Box 2: analysis of the sensitivity of outcomes to model parameters

The outcomes of the simulations depend in part on the calibration of the parameters. A sensitivity analysis indicates that the wage elasticity of labor supply is the parameter with the greatest influence on the size of the economies' response to structural reform[a](Tables 5 through 7, and see note 7 on previous page). The lower the wage elasticity of labor supply, the less agents will be inclined to increase their supply of labor in order to raise their consumption. On the other hand, the levels of product markups and wage markups have only a marginal impact on outcomes, irrespective of the reform examined. In the case of a reform of the sheltered sector, the sign of the impact of a French reform on the rest of the euro area depends on the elasticities of substitution between the different types of goods.

- If the tradable and nontradable goods are complementary (elasticity less than 1), the demand in France for tradable goods rises in the long run, at the same time as demand rises for nontradable goods whose prices fall; in the absence of price adjustment, France's trade balance worsens. Because in the long run the trade balance must be in balance, the terms of trade of the rest of the euro area must improve: in this case, the spillover effects are positive.
- On the other hand, if the tradable and nontradable goods can be substituted, France's terms of trade must improve: in this case, the spillover effects are negative. The higher the elasticity of substitution between foreign and domestic goods, the milder such negative effects will be, because the long-run change in the terms of trade required to realign the trade balance is smaller.

a. Frisch elasticity, that is, the wage elasticity of labor supply holding marginal utility of consumption constant.

Table 5: sensitivity to model parameters in the case of a reform of the sheltered sector

ε_E	ε_{NE}	ε_L	France				Rest of the euro area			
			DGP	Consum.	Inv.	Wages	gdp	Consum.	Inv.	Wages
1.5	**1.1**	**1**	**4.2**	**4.0**	**7.0**	**2.6**	**–0.01**	**–0.01**	**0.01**	**1.0**
1.8	–	–	4.2	4.0	7.0	2.5	0.00	–0.01	0.01	1.0
–	1.5	–	4.3	4.3	6.8	3.0	–0.02	–0.04	0.04	0.8
–	0.5	-	3.9	3.5	7.4	1.9	0.02	0.04	–0.04	1.1
-	-	0.75	4.2	4.0	7.0	2.6	–0.01	–0.01	0.01	1.0

Interpretation: ε_E is the international elasticity of substitution between tradable goods, ε_{NE} is the elasticity of substitution between tradable and nontradable goods, and ε_{EL} is the Frisch elasticity of labor supply to wages. The first row in the table corresponds to the baseline scenario described in the article. If tradable and nontradable goods are assumed to be complementary (ε_{NE}=0.5), a reform of the sheltered sector in France would increase GDP by 3.9 points, instead of the 4.2 points in the baseline scenario.

Table 6: sensitivity to model parameters in the case of a reform of the exposed sector

ε_E	ε_{NE}	ε_L	France				Rest of the euro area			
			GDP	Consum.	Inv.	Wages	GDP	Consm.	Inv.	Wages
1.5	**1.1**	**1**	**2.3**	**1.3**	**10.4**	**7.2**	**0.1**	**0.2**	**–0.2**	**1.0**
1.8	–	–	2.5	1.7	9.9	7.9	0.1	0.2	–0.2	1.0
–	0.5	–	2.6	1.9	9.5	8.1	0.1	0.1	–0.1	0.8
–	-	0.75	1.9	0.8	9.8	7.3	0.1	0.2	–0.2	1.1

Interpretation: If tradable and nontradable goods are assumed to be complementary (ε_{NE}=0.5), a reform of the exposed sector in France would increase GDP by 2.6 points, instead of the 2.3 points in the baseline scenario.

Table 7: sensitivity to model parameters in the case of an increase in labor market flexibility

ε_E	ε_{NE}	ε_L	France				Rest of the euro area			
			GDP	Consum.	Inv.	Wages	GDP	Consum.	Inv.	Wages
1.5	**1.1**	**1**	**7.8**	**9.1**	**9.5**	**–2.1**	**0.1**	**0.2**	**–0.2**	**0.6**
1.8	–	–	8.0	9.4	9.2	–1.5	0.1	0.1	–0.1	0.4
–	0.5	–	7.8	9.1	9.5	–2.1	0.1	0.2	–0.2	0.6
–	–	0.75	6.6	7.7	8.1	–1.8	0.1	0.2	–0.1	0.5

Interpretation: If labor supply is assumed to be less elastic (ε_L =0.75), a labor market reform in France would increase GDP by 6.6 points, instead of the 7.8 points in the baseline scenario.

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