



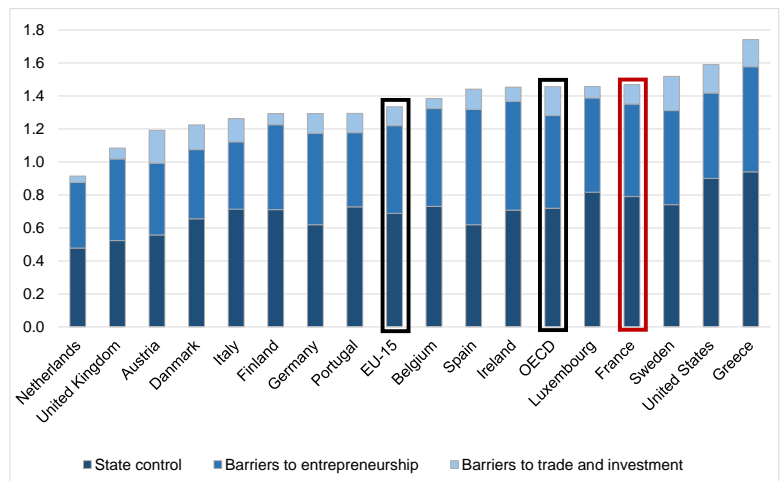
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# TRÉSOR-ECONOMICS

## Sectoral regulations in France

- Many business sectors are subject to government intervention in various forms, such as pricing regulations, professional qualification requirements, and State ownership or State control of companies.
- These regulations are necessary when free competition does not allow for efficient resource allocation. In these cases, government intervention aims to protect consumers and to ensure the circulation of quality goods and services. Nevertheless, such regulations can be excessive and may favour incumbent firms to the detriment of new entrants. Such regulations result in less competition, higher prices, lower downward pricing pressure on firms, dampened competitiveness, and ultimately lower growth potential for the overall economy.
- This raises the question of what constitutes the right level of regulation. Every five years, the OECD publishes its PMR (Product Market Regulation) indicators on an economy-wide basis, as well as sectoral indicators. International comparisons of the markets for goods and services are usually based on these indicators. Such indicators facilitate the identification of the French regulation's specific characteristics and the progress achieved, in terms of deregulation, thanks to reforms. The higher the indicator, the higher the degree of regulation. However, an absence of regulation should not be considered as a baseline.
- The OECD's indicators suggest that the French economy is, on average, more regulated than other European countries, while also highlighting the efforts made to reduce regulatory burdens. Thus, the PMR for France stood at 1.47 in 2013, versus an average of 1.34 in the EU-15 (see chart below). This represents a 0.91-point reduction over 15 years. The level of the PMR in France reflects the sizeable stakes owned by the French State in network industries (transport, communications and energy).
- Several recent measures, implemented since the PMR was most recently published in 2013, have been designed to significantly enhance France's position. These measures include the “simplification shock” (a radical administrative streamlining and regulatory reform) started in March 2013, along with the Growth, Economic Activity and Equal Economic Opportunity Act of August 2015 (also known as the Macron Law). Consequently, at the time of its next publication, the PMR indicator should decline from 1.47 to 1.34 for France, thus reaching the average for the EU-15 at the time of the last publication.
- However, these indicators present certain limitations. They focus on the existence of regulations, without always taking into account the legitimacy or proportionality of such regulations. In addition, these indicators are not always suitable for each country. Although they provide a snapshot of the regulations and sectors that offer the potential for reform, only a detailed analysis of the competitive structure of each sector can identify the actual need for reform.

PMR indicator (2013)



Source: Directorate General of the Treasury (based on OECD data).

## 1. Regulations to tackle market failures: justifications and limitations

### 1.1 Market failures justify regulation of economic activities...

Regulations are often designed to tackle market failures, i.e. situations in which free competition among private-sector players does not allow for efficient resources allocation.

When one firm holds a monopoly or when a market is highly concentrated, such as in network industries (transport, communications and energy), government intervention is necessary to ensure access to products at reasonable prices in all parts of the country. This intervention can come in many forms:

- The State, as a shareholder, can control prices.
- The State can entrust an independent administrative authority with regulating prices and markets (in France, for example, ARAFER, the Rail and Road Regulatory Authority, regulates railways and interurban road transport via coaches or on motorways).
- The State can also require companies to fulfil public service obligations or to apply uniform tariffs (for example, the Energy Regulation Commission (CRE) sets rates for accessing the power grid so that the same tariff is applied across all of France, regardless of local supply costs).

In cases of externalities (i.e. when an economic agent's activity affects the well-being of a third party without giving rise to a market transaction), the State intervenes to ensure optimal social well-being. This was the justification for the Act of 13 March 1937, which responded to an increase in the number of taxis by requiring taxi drivers to have parking authorisation (more commonly called a “taxi licence”) and capping the number of licences to prevent congestion on the roadway.

Lastly, State intervention ensures that in cases of asymmetrical information, the price accurately reflects the quality of a good or service. To do so, the State can set professional qualification or consumer information requirements, regulate prices or implement authorisations or labels. Thus, for example, healthcare professionals must show certain qualifications in order to provide reliable services to patients.

### 1.2 ...but regulations can be excessive and costly

While State intervention is justified in cases of market failure, there is no guarantee that the proposed regulations are the most appropriate, that they are set at the right level or that they have not become less relevant over time. In particular, there is a risk that regulations can be excessive and can reduce competitive intensity, therefore harming consumers. For example, the quota system for allotting taxi licences – initially aimed at fluidifying traffic – actually resulted in an insufficient supply of taxis in large cities.

More generally, by limiting competition, regulations can lead to low productivity. On the one hand, the reduced competitive pressure allows firms to benefit from an economic rent and high prices on regulated markets; this curbs their incentives to invest and innovate (direct effect). On the other hand, firms on downstream markets also have reduced incentives to innovate inasmuch as a portion of their innovation rent could be captured by firms upstream in the production process (indirect effect).

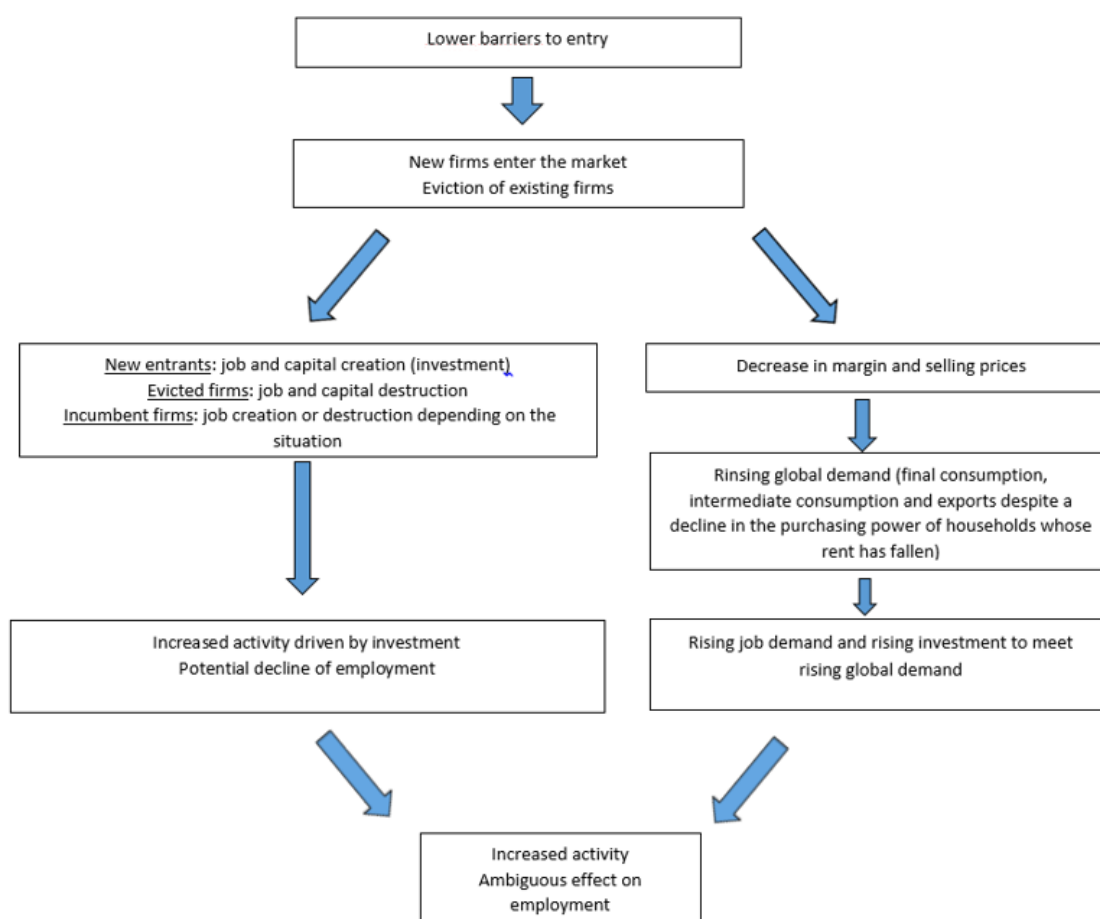
There is also a risk of “regulatory capture” when regulated firms use their superior knowledge of how the market functions to encourage the regulator to implement measures that are favourable to them.

## Box 1: Macroeconomic effects of pro-competition structural reforms on the market for goods and services

The pro-competition product market reforms frequently recommended by the European Commission, the OECD and the IMF are aimed at enhancing the economy's growth potential and competitiveness. A study of 25 OECD countries over the period 1985-2013<sup>1</sup> shows that an “average” decline in the ETCR (Energy, Transport and Communication Regulation), i.e. of  $-0.31$  of a point, would result in a long-term increase of more than 2% in GDP per capita, mainly due to gains in total factor productivity.

From a static standpoint, pro-competitive reforms favour the entry of new firms and thus drive the supply up, leading to lower prices<sup>2</sup> both for consumers and for firms that use these products as intermediate goods. This increases GDP in the long term. In the short term, deregulation's effect on the jobs market are ambiguous, as the poorest-performing firms are forced out of the market and incumbents may see a decline in activity. In a given sector, increased competition can have a negative impact on jobs when the productivity gains caused by the reform outstrip the increase in demand due to lower prices. However, recent empirical studies have struggled to clearly establish negative short-term effects of structural reforms on employment<sup>3</sup>, with some research even highlighting positive effects.<sup>4</sup>

**Diagram 1: Overview of short- and medium-term effects of pro-competition reforms**



<sup>1</sup> Egert, B. and P. Gal (2017), “The Quantification of Structural Reforms in OECD Countries: A New Framework”, *OECD Economics Department Working Papers*, No. 1354, OECD Publishing, Paris.

<sup>2</sup> If the market price is higher than the regulated price, deregulation will not lead to a decrease in the price.

<sup>3</sup> See, for example: Bouis, R., R. Duval and J. Eugster (2016), “Product Market Deregulation and Growth: New Industry-Level Evidence”, *IMF Working Paper*, No. WP/16/114.

<sup>4</sup> Gal, P. and A. Hijzen (2016), “The Short-Term Impact of Product Market Reforms: A Cross-Country Firm-Level Analysis”, *OECD Economics Department Working Papers*, No. 1311, OECD Publishing, Paris.

From a dynamic standpoint, the fiercer competition resulting from deregulation can have two opposite effects. Stronger rivalry on markets encourages firms to innovate in order to differentiate themselves and improve their productivity. This innovation incentive concerns not only firms in the newly-deregulated sector, but also downstream firms because upstream firms are no longer able to capture their rent. Deregulation should also drive up demand for labour factor, as well as investment in R&D and ICT (information and communications technology)<sup>5</sup>, which in turn should accelerate new technologies' spread. Conversely, fiercer competition reduces firms' margins, which curbs their capacity to finance innovation. Competition's overall effect on innovation will depend on how dynamic the sector is, how far it is from the technology frontier, the size of sector firms and the regulatory environment (industrial protection, financial support for R&D, etc.). On average, however, fiercer competition results in productivity gains.

## 2. OECD indicators show a relatively high level of regulation in France

The OECD produces two families of indicators (see Box 2 below). These indicators point out a high level of regulation in France.

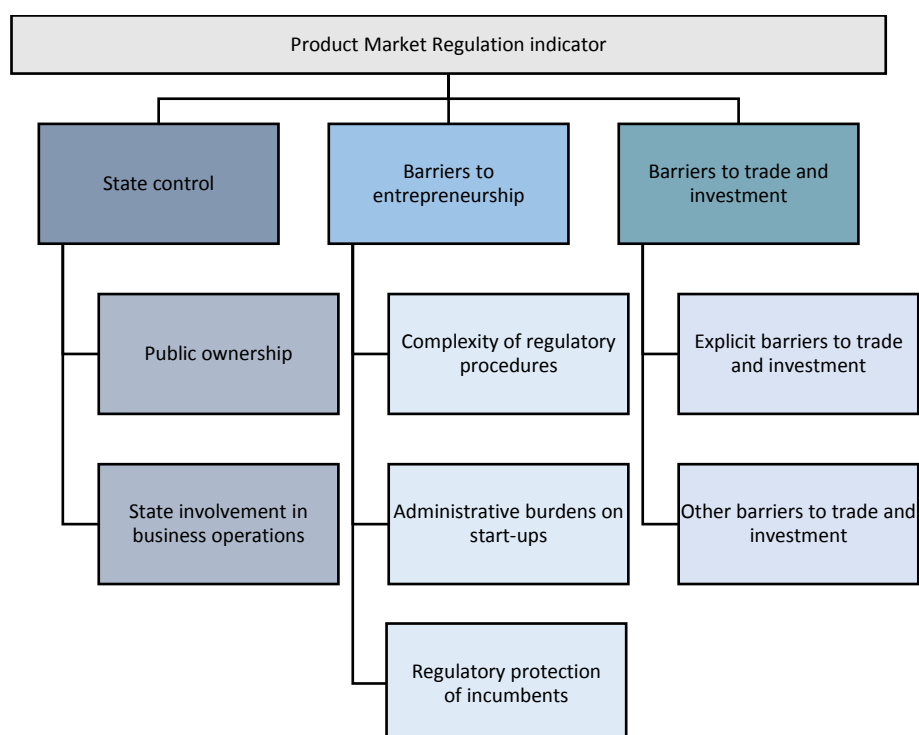
### Box 2: Structure of regulation indicators

Every five years, the OECD publishes indicators on an economy-wide and sectoral basis; the most recent publication was in 2013. These indicators are constructed from a broad series of questions (200 in all) regarding the existence and intensity of certain regulations and the market structure characteristics.

#### The economy-wide PMR (Product Market Regulation) indicator

The integrated PMR indicator gives a transversal (multi-sectorial) approach of the level of regulation in an economy through three sub-indicators: State control, barriers to entrepreneurship, and barriers to trade and investment.

Figure 1: Structure of the economy-wide Product Market Regulation (PMR) indicator



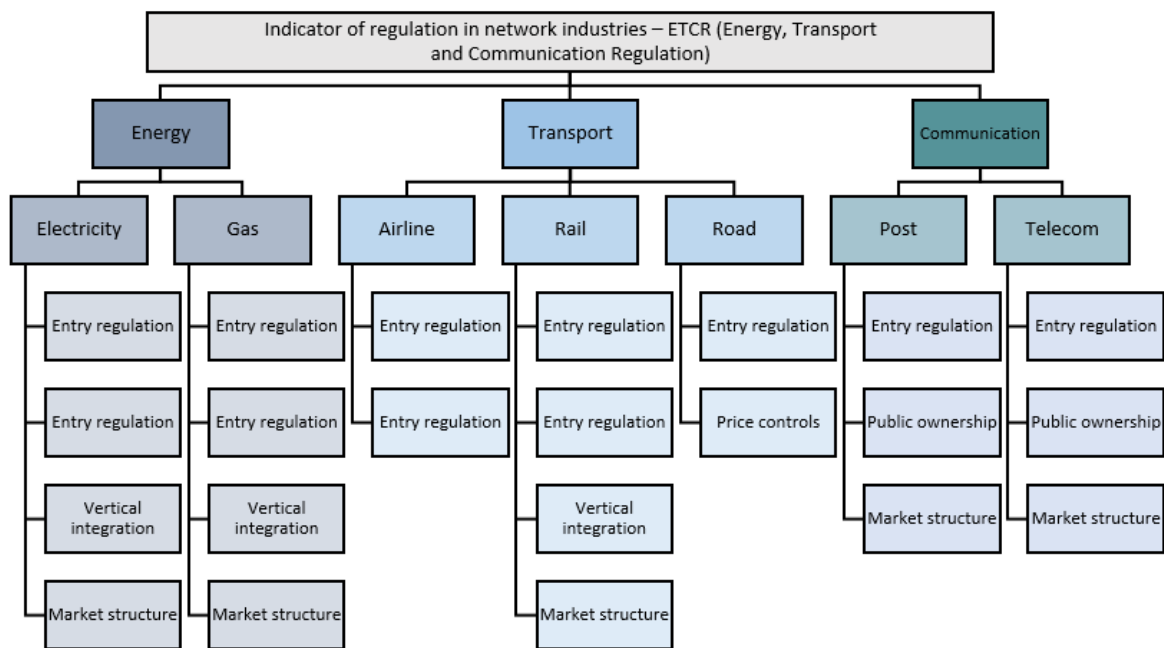
<sup>5</sup> Cette, G., J. Lopez and J. Mairesse (2017), "Upstream Product Market Regulations, ICT, R&D and Productivity", *The Review of Income and Wealth*, vol. 63(1), pp. S68-S89.

### *NMR (Non-Manufacturing Regulation) indicators*

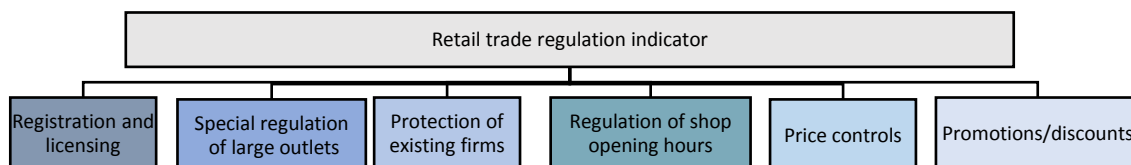
The OECD publishes three indicators on the level of regulation in non-manufacturing sectors. These are commonly referred to as NMR (Non-Manufacturing Regulation) indicators. These comprise one indicator for network industries (known as ETCR: Energy, Transport and Communications Regulation), one for retail distribution and one for professional services.

The ETCR indicator covers regulation in network industries, i.e. energy, transport and communications. Depending on the market, this indicator can take account of: entry regulation, public ownership, vertical integration, market structure and price control.

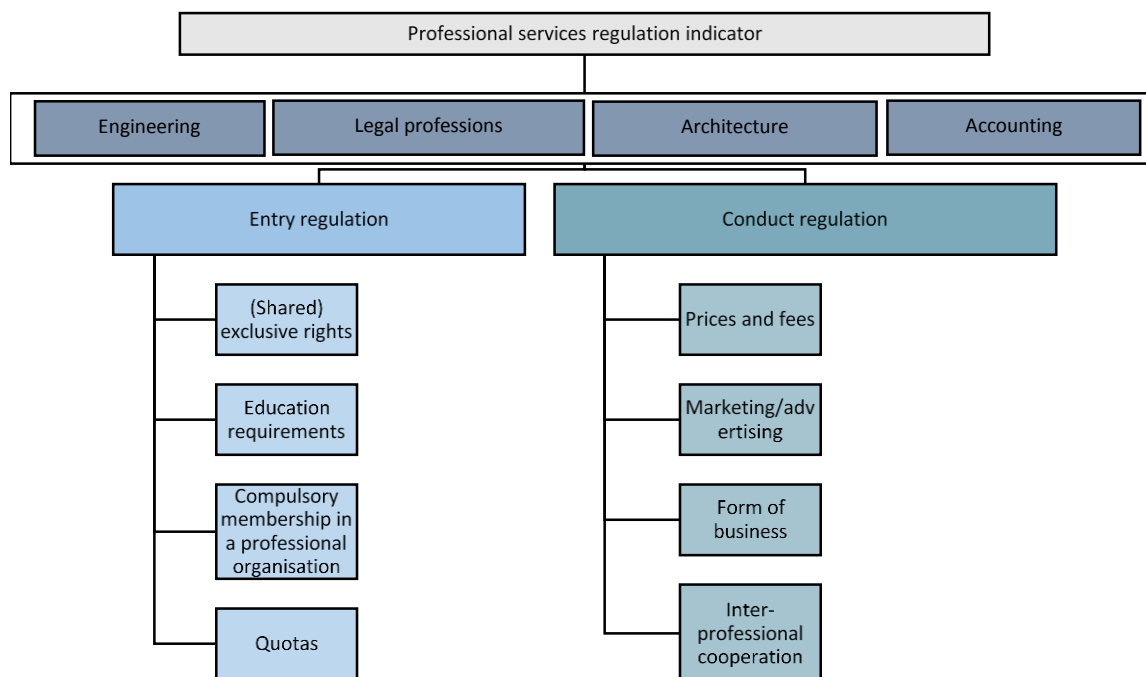
**Figure 2: Structure of the indicators of sectoral regulation (Non-Manufacturing Regulation, NMR)**



The retail distribution indicator takes into account specific regulations such as regulations on the implementation of large outlet.



The professional services indicator deals with these professions in a specific way, while applying a uniform approach to the various professions covered (architects, engineers, legal professionals and accounting professionals).



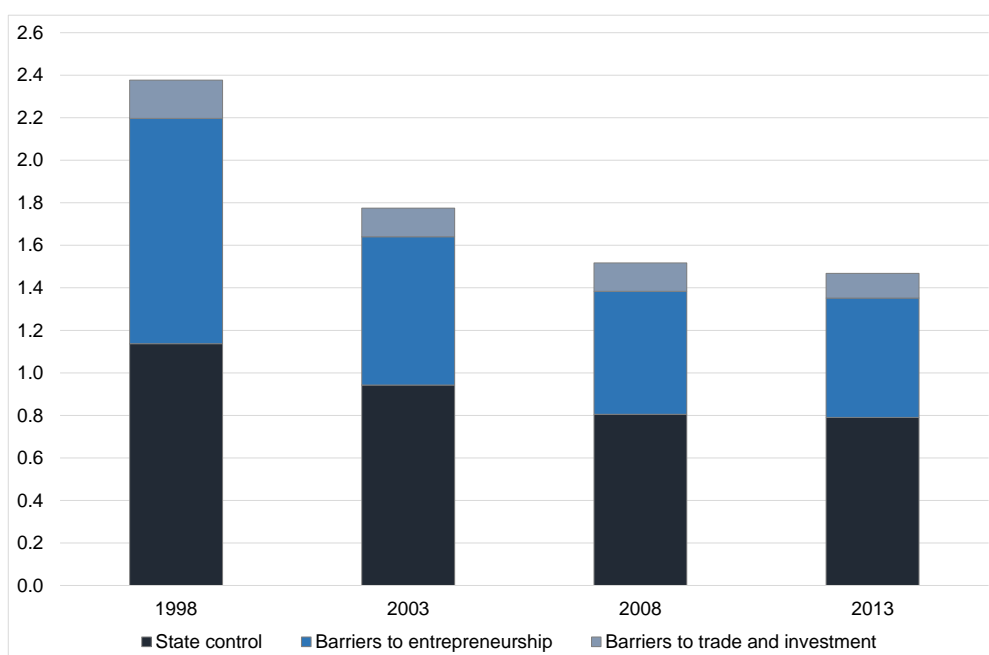
Source: Directorate General of the Treasury (chart), based on OECD methodology.

## 2.1 Albeit higher than the European average, the overall level of regulation in France has declined since 1998

In 2013, the overall PMR indicator for France stood at 1.47, in line with the OECD average but higher than the EU-15 average of 1.34. This gap is mainly due to the “State control” sub-indicator (0.79 for France vs. 0.69 for the EU-15); the other two sub-indicators were in line with the EU-15 average.

Nevertheless, the overall PMR indicator for France has declined by 0.91 of a point in the span of 15 years – a reduction largely attributable to the lowering of barriers to entrepreneurship.

Chart 1: Trend in the overall PMR indicator for France



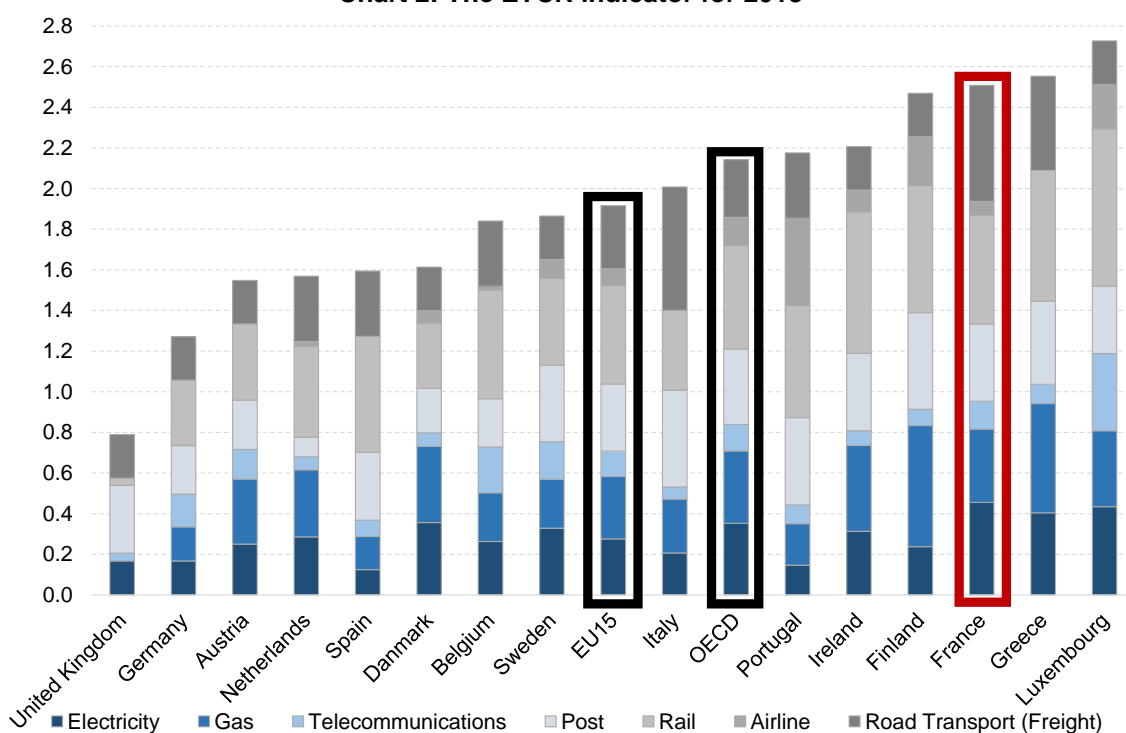
Source: Directorate General of the Treasury (chart), based on OECD data (Product Market Regulation Database).

## 2.2 The ETCR indicator also reflects a high level of public ownership in France

The regulation level for network activities, the ETCR indicator, stood at 2.51 for France in 2013, higher than both the EU-15 average of 1.92 and the OECD average of 2.12. The largest contributors to the ETCR indicator for France came from road transport (23%), rail (21%), energy (18% and 14% for electricity and gas, respectively), and the post (15%). Apart from the airline sector, all network industries in France are more regulated than the EU-15 average. The 0.59-point gap between the French and EU-15 indicators primarily reflects the contributions of road transport (0.26 of a point) and electricity (0.18 of a point).

One-third of the indicator is related to the French State's financial interests in EDF, La Poste and the SNCF. Entry barriers represent one-fifth of the ETCR indicator. Entry barriers are found mainly in the road transport sector, where they particularly correspond to the administrative authorisation required to operate as a haulier. The presence of industry heavyweights (outside the airline and road transport sectors), such as the SNCF in the rail transport sector, represents more than one-fifth of the amount of the ETCR indicator.

**Chart 2: The ETCR indicator for 2013**

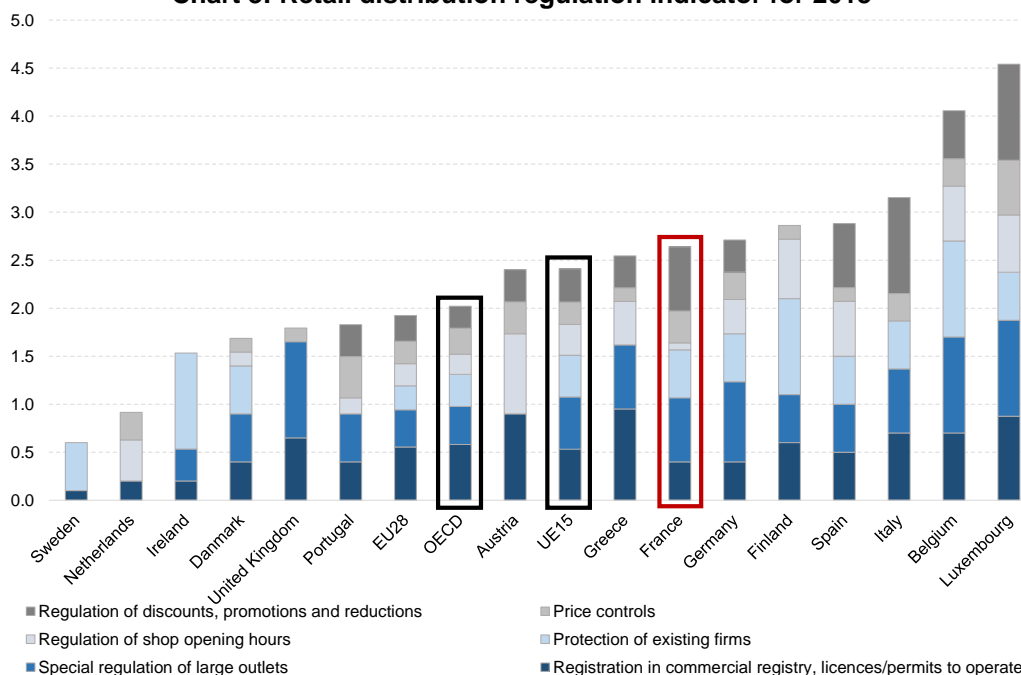


Source: Directorate General of the Treasury (chart), based on OECD data (Product Market Regulation Database).

## 2.3 The retail regulation indicator shows a wide variety in regulation levels, with France showing significantly higher regulation than the average

With an indicator of 2.64 in 2013, the retail distribution sector is more highly regulated in France than for the EU-15 average (2.41) or for the OECD (2.02). The two categories of regulations with the greatest impact are the regulation of large outlets implementation and the regulation of promotions/discounts. Each of these categories represents one-quarter the amount of the indicator, contributing significantly to the regulatory gap between France and the EU-15. Indeed, French regulations require firms to obtain a special commercial exploitation licence for any outlet of more than 1,000 square metres, and French law prohibits resale below costs, which results in framework for sales periods. Conversely, regulation of shop opening hours is more flexible in France than in the EU-15 on average; this helps reduce the overall gap to 0.25 of a point.

**Chart 3: Retail distribution regulation indicator for 2013**



Source: Directorate General of the Treasury (chart), based on OECD data (Product Market Regulation Database).

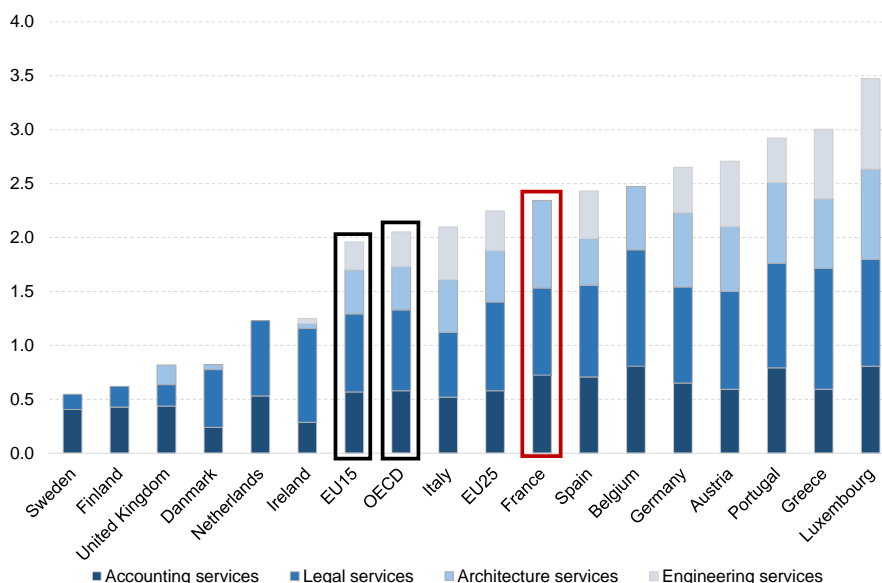
This indicator and its sub-indicators vary widely from one country to another. The indicator for Luxembourg is seven times higher than for Sweden. The UK and Portugal have similar levels of retail distribution regulation, but the UK regulates mainly large retail outlets, whereas Portugal implements a wide array of regulations.

#### 2.4 Despite the non-regulation of engineering services, the professional services indicator is high in France

For professional services, France shows a higher level of regulation (at 2.34 for 2013) than the average for the EU-15 (1.93) or the OECD (2.05).

The fact that France does not regulate engineering services is offset in the overall indicator by a high level of regulation for legal and architecture services. The regulation sub-indicator for architectural services in France (0.81 in 2013) is practically twice the EU-15 average of 0.41 (see below).

**Chart 4: Professional services regulation indicator for the four regulated professions for 2013**



Source: Directorate General of the Treasury (chart), based on OECD data (Product Market Regulation Database).



### 3. Recent reforms and programmes are likely to improve the functioning of markets and lower OECD indicators

The most recent indicators published by the OECD pointed to a high level of regulation in France, but these figures date back to 2013. Reforms implemented since then on certain markets are likely to drive a reduction in these indicators during their next update in 2018. However, the impact of these reforms on the PMR indicator does not always fully reflect their real impact on the competitive functioning of markets. As the PMR indicator does not provide a perfect measurement of regulation and its effects, it only gives an incomplete view of the consequences of these reforms for competition.

#### 3.1 The PMR indicator is set to decline from 1.47 to 1.34 thanks to the “simplification shock” and the Growth, Economic Activity and Equal Economic Opportunity Act (known as the “Macron Law”)<sup>6</sup>

##### a) The “simplification shock” considerably lowered barriers to entrepreneurship

In March 2013, the French government launched a radical administrative streamlining programme called the “simplification shock” to cut red tape and boost new businesses creation and growth. The development of a single window for companies and the creation of the Business Simplification Council (whose assignment is to propose strategic priorities to the government in terms of simplification policy, notably for professional licences and permits) are expected to reduce France's PMR indicator by 0.12 of a point – i.e. the approximate gap between the PMR for France and the EU in 2013.

In March 2017, 65% of the 460 measures<sup>7</sup> adopted by the Business Simplification Council were in place. These measures make it easier to create and run a business. Moreover, 22 new simplification measures, aimed at innovation and job creation, were put forth on 23 March 2017. These measures are set to take effect gradually by the end of 2018. The implementation of all these measures will reduce administrative burdens and the costs of creating a business, and should ultimately drive a further reduction in the PMR indicator level. Other measures are also likely to be implemented, as the Business Simplification Council frequently makes further recommendations.

##### b) The Macron Law eased regulations in legal and accounting services

With regard to regulated professional services, the Macron Law notably allowed for the following developments:

- interprofessionality: accounting and legal professionals can now create firms to exercise several legal professions<sup>8</sup> or accounting services professions jointly;
- access to certain company legal forms: legal or judicial services firms can now operate as ordinary law companies (Simplified joint-stock company, limited liability company, public limited company<sup>9</sup>).

Although these are important reforms that remove restrictions on the exercise of professions, they are unlikely to have more than a slight impact on the PMR. However, the OECD has calculated that the Macron Law's measures regarding regulated legal services could boost GDP by around 0.1 of a point within five years and 0.2 of a point within ten years, provided they are firmly and effectively implemented<sup>10</sup>.

<sup>6</sup> As the indicator does not include the coach transport sector, this estimate does not include the effect of the opening up of the coach market to competition on routes more than 100 km long, even though this reform created a massive supply-side boost.

<sup>7</sup> Source: website for the Directorate General for Government Modernisation, “Public services becoming simpler and more innovative” (in French).

<sup>8</sup> Lawyers, barristers before the Conseil d'Etat or Cour de Cassation, legal auctioneers and valuers, bailiffs, notaries, court-appointed administrators and receivers, patent lawyers.

<sup>9</sup> Apart from limited partnerships and general partnerships.

<sup>10</sup> OECD (2015), “France: Evaluation de certaines mesures de la Loi pour la croissance, l'activité et l'égalité des chances économiques et perspectives de futures réformes” (untranslated), September.

### **3.2 Measures that improve the competitive functioning of the transport market will only have a slight impact on the economy-wide regulation indicator**

In accordance with the EU's Fourth Railway Package adopted in December 2016, the passenger rail market is slated to open up for competition in December 2020 at the latest for commercial services (i.e. the TGV) and in December 2023 for subsidised services (in France, the TER, Transilien and TET). New urban public transport lines in the Paris region will be opened up to competition from the outset. In the longer term, this market is set to be fully opened up to competition.

These reforms will substantially change the market structure but are expected to reduce the PMR indicator by around 0.01 of a point only. Indeed, this indicator will still be affected by the French State's sizeable financial interests in the SNCF and by the imposition of public service requirements.

## **4. The OECD indicators are useful but imperfect for formulating structural reform recommendations**

### **4.1 The indicators provide only an imperfect view of the regulatory level and trend...**

The PMR and NMR indicators are produced by aggregating answers to all questions on a scale of 0 to 6. The choice of questions, the scoring scales and the number of questions for each sub-indicator can bias the assessment of the level of regulation in one sector or one economy.

Thus, sectoral or professional regulation is only addressed in terms of measures taken by the State; this can lead to an erroneous view of the level of regulation. Such is the case, for example, in the architecture services sector, which shows an indicator equal to zero or nearly in the Netherlands, Sweden, Denmark and Finland – despite the existence of strong incentives for architects to join professional organisations that have oversight over their members' level of qualifications.<sup>11</sup> Generally speaking, membership in these professional organisations acts as a form of credentialing or opens access to certain training courses. In turn, members must respect professional standards (e.g. in Finland) or comply with a code of conduct (e.g. in Denmark). In practical terms, the levels of regulation for architects – based on the web of laws/regulations in France or enforced by professional organisations in these other countries – appear similar. However, in the OECD's indicators, only France is recorded as regulating the architectural services sector.

In addition, the level of an indicator can be highly sensitive to the choices made regarding the characteristics included in the indicator. For example, to measure the burdens of creating a company, the indicator is based on the time and money required to found a public limited company (*société anonyme*, SA), but this is not a very relevant indicator for France, where almost all newly-founded firms choose a legal form other than SA: in 2015, for example, private limited companies (*sociétés à responsabilité limitée*, SARL) and simplified joint stock companies (*sociétés par actions simplifiées*, SAS) represented 96% of all companies created in France.<sup>12</sup> If this indicator were calculated on the basis of an SARL instead of an SA, it would be reduced by half, because there is no minimal capital required to found an SARL (vs. €37,000 for an SA) and no requirement to appoint a statutory auditor when the company is created.

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<sup>11</sup> Each of these countries has a professional organisation including a large number of architects (the Finnish Association of Architects (SAFA) counts around 80% of Finnish architects with university degrees among its members). Such membership rates reflect strong incentives to join these organisations (as a sign of quality) and a very broad dissemination of their regulations. Moreover, in the Netherlands, the term “architect” is a legally-protected title whose usage is controlled by an authority.

<sup>12</sup> INSEE, Sirene database.

Lastly, the questions chosen do not always capture gradual changes in competitive intensity or market access. Thus, the setting up of free establishment zones<sup>13</sup> for notaries results in more competition on the French notary market, as it facilitates market access. Nevertheless, this reform will not lead to a decline in the PMR indicator, inasmuch as the establishment of notarial offices is still controlled. Likewise, although the Macron Law opened the long-distance coach sector up to competition for routes more than 100 km long, leading to a massive supply-side boost, this substantial reform will have no impact on the PMR indicator.

#### **4.2 The indicators do not allow to appreciate the economic rationale or proportionality of regulations...**

The PMR and NMR indicators reflect the existing regulations but do not signal whether those regulations are proportional and economically justified. For instance, the qualifications required of legal services professions, as well as information obligations, address the fact that consumers lack the expertise to determine whether the services offered will meet their needs. These requirements are therefore justified so long as they are proportional to these objectives. Moreover, the retail distribution NMR and PMR indicators include, on an equally-weighted basis, regulations for very different products that follow various economic rationales (such as fuel, tobacco, alcohol, pharmaceuticals, Internet services and certain commodities). For example, tobacco prices are regulated to prevent discounts that would go against public health objectives, whereas drug prices are regulated in France via a price cap negotiated with healthcare professionals, at a level that allows price competition<sup>14</sup> while also curbing social security spending. In both cases, regulations appear proportional to their objectives, but this is not reflected in the OECD indicators.

Therefore, structural reforms cannot be implemented with the sole aim of reducing the PMR indicator, given the risk of deteriorating the functioning of markets and harming consumers. More generally, the OECD indicators are not connected with issues involving health, safety, the environment or consumer protection.

#### **4.3 ...or the competitive functioning of markets**

The PMR indicator in France is largely determined by the fact that the French State has financial interests in firms (in 30 of the sectors in question) and owns a large percentage of the incumbent operators in six network industries (electricity, gas, rail, air, post and telecoms).

However, the example of the telecoms sector suggests that the level of public ownership does not have to decline in order to simulate the competitive landscape. Thus, the fact that the French State owns a stake in the incumbent firm did not prevent a fourth telecoms operator to enter the market in 2012, and does not hamper competition, which is particularly dynamic on the mobile segment, with prices down 12% p.a. on average between 2011 and 2016.<sup>15</sup> This competition reflects the definite success of EU regulation (notably the Telecoms Package) in opening up markets to competition, and the enforcement of EU regulation by ARCEP (the French Telecommunications and Posts Regulator).

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<sup>13</sup>The Order of 16 September 2016, in application of Article 52 of the “Macron Law”, defined 247 “free establishment” zones and set a schedule for new openings in order to gradually increase the number of notaries in these zones (1,650 new notaries by 2018). This Order also defined 60 “controlled establishment zones” where applications for new notarial offices must be reviewed by the Ministry of Justice beforehand, following an opinion issued by the Competition Authority. Outside these zones, in order to be appointed as a public officer and law official, a notary must either be sponsored by a notary leaving the profession or an associate, or be selected through a competitive examination organised by the professional body for notaries.

<sup>14</sup> In its Decision No. 01-D-07 of 11 April 2001, the Competition Council noted with regard to practices on the wholesale pharmaceutical market, that “[...] although the practice is not widespread, the hearings revealed that retail pharmacists could legally sell pharmaceuticals for lower than the regulated price, which is only a price cap; this would allow them to pass the incentives they received from wholesalers onto end consumers [...]”.

<sup>15</sup> ARCEP data.

In all, the PMR and NMR indicators are useful tools for an international comparison of regulation levels, but are no substitute for an in-depth analysis of markets in order to formulate structural reform recommendations. The OECD therefore recommends that its indicators be used as a supplement to other indicators that evaluate the degree of competition on each market or its performance in terms of competitiveness.

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