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# POTENTIAL GAINS FROM PRODUCT MARKET REFORMS[1]

*While the authorities have recently legislated reforms to liberalize product and service markets and strengthen competition, the evidence suggests that regulation remains more stringent in France than in peer countries. This paper attempts to identify reforms that would lighten product and service market regulation and align France with best-performing countries and quantify the potential long-term macroeconomic gains from those reforms. The analysis based on recent OECD data suggests that efforts focused on simplifying the administrative burden on startups and reducing the state's involvement in business operations and curbing entry barriers in services—especially on retail distribution, sales of medicines, and professional services—can go a long way in bringing France closer to best practices and boosting long-term income per capita.*

1. **Strengthening competition in product and service markets can help to raise productivity.** State intervention can correct market failures in the presence of asymmetrical information (when prices fail to reflect the true quality of a good or service) or in the case of externalities (when the impact of an agent's activity on the well-being of a third party is not reflected in prices). However, excessive product and service market regulation can stifle competition in favor of incumbent firms and service providers and deter new entrants, leading to artificially high prices, hampering innovation, curbing the efficient allocation of resources, and ultimately holding back productivity growth. Several empirical studies document that competition leads firms to be innovative and efficient, which contributes to productivity and high living standards (see e.g. Bouis and Duval 2011, Bourlès et al. 2013 or Conway et al., 2006). Lower prices from stronger competition in the service sector would not only boost households' purchasing power, but also productivity growth in downstream industries that use those services as production inputs (Bourlès et al. 2013; Lanau and Topalova 2016).

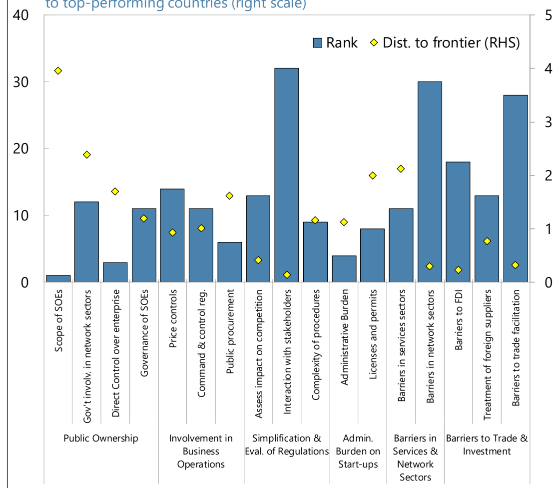
2. **France is one of the OECD countries with the most stringent regulation on product markets.** France ranks sixth out of 34 countries in the 2018 OECD economy-wide product and service market regulation (PMR) index, where a low-ranking position denotes more stringent regulation (Box 1 and Figure 1):

- *Distortions induced by the state involvement* in the economy are large in France when compared to other OECD countries (ranking in sixth position). Besides the large presence of the public sector in economic activities (especially in terms of the scope of SOEs), the state involvement in *business services* (e.g. through price controls, ownership and territorial restrictions, registration requirements) and the *administrative burden on start-ups* (e.g. the number of mandatory procedures to start a company) stand out when compared to peers, ranking in the eighth and ninth positions, respectively.

[1] Prepared by Simon Voigts (RES).

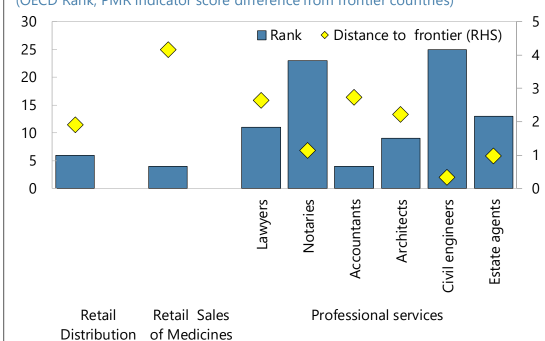
- *Entry barriers in service sectors* (which primarily affect retail distribution, sales of medicines, and professional services) are also pervasive, with France ranking eleventh among OECD countries. The bulk of France's excessive regulation in terms of state involvement in business services and barriers to entry affect retail distribution, sales of medicines, and some professional services (lawyers, accountants, and architects; Figure 2).

**Figure 1. Economy-wide PMR Indicators**
OECD Rank (left scale, small rank indicates strict regulation), and distance to to top-performing countries (right scale)




Sources: OECD and IMF staff calculations.

**Figure 2. Sectoral Indicators for Services Sectors and Retail**
(OECD Rank; PMR indicator score difference from frontier countries)




Sources: OECD and IMF staff calculations.

**3. To address this, France has enacted important reforms in recent years to lighten regulation.** Domestic rail passenger transport has been opened to competition as part of the 2017 reform of the national railway company (SNCF). The recent Business Growth and Transformation Bill (Loi PACTE) provides, among other things, for a reduction in barriers to firm entry; and planned reforms to liberalize personal transport (driving schools and auto parts) and online sales of medicines would also lighten the regulation burden. Earlier examples of regulatory reforms include the 2015 "Macron law," which eased regulation in notary services, extended business hours, and liberalized coach travel, as well as the 2013 "simplification shock" cutting red tape and simplifying firms' interaction with administrative offices.[2] However, some of these reforms aimed at boosting competition may not be reflected in France's 2018 PMR index—for instance, if they were implemented after January 1, 2018, or if they affect a sector not covered by the OECD index.

**4. But more could be done to close France's PMR gap regarding the administrative burden on start-ups, the state involvement in business services, and entry barriers in service sectors.** Given the distance to best practices, tackling these gaps could be associated with important per capita income gains in the long run. To assess the potential output gains from all these reforms, we use the IMF's Global Integrated Monetary and Fiscal model (GIMF), calibrated to France.[3] The potential economic gains are measured by the simulated impact of hypothetical reforms bringing regulation in line with best-performing countries. We simulate the impact of catching up to the

[2] For details on the reform packages see e.g. IMF country reports number 13/251 and 15/178.

[3] For details see Laxton et. al, 2010.

average of the three best-performing countries (the distance to frontier) in the selected sub-indicators of the economy-wide indicators related to the administrative burden on start-ups, state involvement, and entry barriers in service sectors and, informed by Égert and Gal (2016), assume that a one-point reduction in the aggregate indicator raises productivity by 4.7 percent.[4] The simulations assume that reforms are gradually phased in over a 7-year horizon. We also compute the portion of potential gains that can be realized by curbing regulation that affects retail trade, sales of medicines, and professional services. A few caveats are nonetheless warranted. The PMR index provides only an imperfect proxy for the actual extent of market competition and does not cover every sector in the economy. Moreover, the exercise of attaining best practices in all the selected areas is illustrative and not based on feasibility considerations. Finally, while the mapping from improvements in the PMR index to productivity shocks is based on empirical estimates in the literature, there is a large degree of uncertainty regarding these estimates. The results should thus be interpreted as an indication of the overall magnitude of possible gains and taken with caution.

**Table 1. France: Estimated Impact of Hypothetical Reforms**

| | Scope for improvement in economy-wide PMR indicator | Estimated impact of reaching frontier in service sectors (after 5 and 10 yrs.) * | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Real GDP | | Consumption | | Investment | | Real wages | | Gov. debt/GDP | |
| | | t+5 | t+10 | t+5 | t+10 | t+5 | t+10 | t+5 | t+10 | t+5 | t+10 |
| **Distortions Induced by State Involvement** | | | | | | | | | | | |
| **Involvement in Business Operations** | | | | | | | | | | | |
| **Retail price controls and regulation** | 0.9 | **0.13** | **0.19** | **0.08** | **0.12** | **0.04** | **0.05** | **0.10** | **0.20** | **-0.01** | **-0.08** |
| *Professional services, retail trade, sales of medicines* | | *0.06* | *0.09* | *0.04* | *0.06* | *0.02* | *0.02* | *0.04* | *0.09* | *-0.01* | *-0.04* |
| **Command and control regulation** | 1.2 | **0.16** | **0.23** | **0.10** | **0.15** | **0.05** | **0.06** | **0.12** | **0.25** | **-0.02** | **-0.10** |
| *Professional services, retail trade, sales of medicines* | | *0.16* | *0.23* | *0.10* | *0.15* | *0.05* | *0.06* | *0.12* | *0.25* | *-0.02* | *-0.10* |
| **Administrative Burden on Start-ups** | 1.5 | **0.42** | **0.63** | **0.27** | **0.42** | **0.12** | **0.16** | **0.33** | **0.67** | **-0.04** | **-0.28** |
| **Barriers to Domestic and Foreign Entry** | | | | | | | | | | | |
| **Barriers to Entry in Services Sectors** | 2.1 | **0.29** | **0.43** | **0.18** | **0.28** | **0.08** | **0.11** | **0.22** | **0.46** | **-0.03** | **-0.19** |
| *Professional services, retail trade, sales of medicines* | | *0.25* | *0.36* | *0.16* | *0.24* | *0.07* | *0.09* | *0.19* | *0.39* | *-0.02* | *-0.16* |
| **Treatment of Foreign Suppliers** | 0.8 | **0.11** | **0.16** | **0.07** | **0.10** | **0.03** | **0.04** | **0.08** | **0.17** | **-0.01** | **-0.07** |
| *Professional services* | | *0.06* | *0.09* | *0.04* | *0.06* | *0.02* | *0.02* | *0.04* | *0.09* | *-0.01* | *-0.04* |
| **Total impact:** | | **1.10** | **1.63** | **0.70** | **1.08** | **0.32** | **0.40** | **0.85** | **1.74** | **-0.11** | **-0.72** |

Source: Staff calculations

Note: Output, consumption and investment are in percent of no-reform output, wages in percent of no-reform wages, and the debt ratio in percentage points.

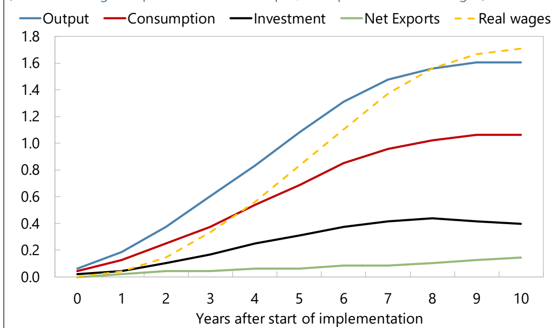
5. **The estimated potential output gain from all these reforms could be up to 1.6 percentage points in the long run (Table 1).**[5] About 60 percent of the simulated gains could be achieved by reducing the state's involvement in business operations and barriers to entry in service sectors—three-fourth of which is accounted by regulation of professional services, retail trade, and the sale of medicines—while the remaining gains could be achieved by tackling the administrative burden on start-ups. Consumption would increase due to greater current and future household wealth, despite an increase in the real interest rate (resulting from declining prices in the face of a constant union-wide nominal rate). Investment surges as productivity increases, and net

[4] This exercise is broadly in line with other studies in the literature, such as Bourlès et al. (2013), Barnes et al. (2013), and European Commission (2016).

[5] All hypothetical improvements in sub-indicators are modelled in the same way, so the impact on macroeconomic aggregates depends linearly on the distance to frontier in the respective indicator.

exports improve slightly due to a mild depreciation in the real exchange rate. While employment remains broadly stable—higher productivity reduces labor demand for given output—productivity gains translate in to higher real wages with a delay caused by rigidities. The model simulations assume that government spending remains constant as a share of GDP over the long run. However, by boosting temporarily the growth rate of output per capita, the new reforms could lower the public debt-to-GDP ratio by about 0.7 percentage points in the long run. These estimates should be interpreted with caution as maximum gains from moving to the frontier in all reform areas simultaneously, which could be difficult practically and politically.

**Figure 3: Impact of Aligning Regulation with Best Performers**
(Induced changes in percent of initial output, or in percent for real wages)




Source: IMF Staff calculation.

6. **Reform efforts could focus on simplifying regulation for start-ups, retail distribution, pharmacies and the sale of medicine, and professional services (Box 2).** We use the detailed 2018 PMR questionnaire to identify specific regulations in these areas that are particularly stringent in France. Regarding start-ups, creating a one-stop shop for issuing all authorizations and reducing the number of steps to start LLCs and personally-owned enterprises would go a long way in reducing the gap between France and peer countries. Removing restrictions in the maximum number of professionals (notaries), ownership and voting right restrictions, exclusive rights on administrative procedures (accountants, lawyers, notaries, and architects), and territorial restrictions (lawyers) can significantly improve the regulation score for professional services. A meaningful improvement in France's PMR indices can also be attained by easing authorization and registration requirements for retail outlets; allowing to sell non-prescription medicine in retail stores and loosening restrictions on their advertisement; loosening ownership restrictions for pharmacies; and easing territorial restrictions for pharmacies.

7. **In sum, further liberalizing product and service markets in France would complement recent and ongoing reform efforts by further boosting competition, productivity, and long-term growth.** The simulation results in this paper should be interpreted with care, given modeling uncertainties and the assumption that policymakers would tackle all reform areas simultaneously, which could be challenging. In practice, policymakers would need to make some reform choices, while at the same time ensuring that a sufficient critical mass of reform is achieved to generate meaningful gains. This paper points to some areas that could achieve such gains, including tackling excessive regulation in retail distribution, sale of medicines, and some professional services, and further easing regulation for start-ups.

## Box 1. The OECD's 2018 Product Market Regulation Indicators

The OECD's product market regulation (PMR) indicators measure the restrictiveness of regulation in various countries. The PMR indicators were introduced in 1998 and are updated every five years. They are based on a comprehensive set of questions on various aspects of a country's regulatory framework, which are translated into several sub-indicator scores, by type of regulation or sector of incidence, and aggregated into an economy-wide indicator (see Koske et al., 2015). In terms of type of regulation, the OECD's 2018 economy-wide PMR indicator comprises several categories that are grouped into state involvement and barriers to domestic and foreign firm entry.

**State involvement**:

- *Public ownership*—captures the pervasiveness of state ownership in network industries and in the overall economy, state control of privately-owned firms (as e.g. in the form of special voting rights), and aspects of governance of SOEs (e.g. the degree of insulation of their management from market discipline and political interference).

- *Government involvement in business operations*—encompasses indicators on price controls (e.g. regulated fees or prices that a professional charges, price controls on staple goods, gasoline, non-prescription medicines, and other goods, and restrictions on promotional sale prices), on command and control regulation (e.g. ownership restrictions and voting rights in professional service firms, ownership and territorial restrictions for pharmacies, and opening hours), and on public procurement (e.g. barriers for participating in public tenders and distortions in competition for public contracts).

- *Simplification and evaluation of regulations*—includes indicators on the complexity of regulatory procedures, on whether the impact of new regulations on competition is assessed and minimized, and on rules governing the engagement of stakeholders and the transparency of lobbying activities.

**Barriers to domestic and foreign firm entry**:

- *Administrative burden on start-ups*—captures the number of mandatory procedures and permits required to register a business, the associated costs, and requirements for minimum paid-up capital.

- *Barriers to entry in services and network sectors*—captures several types of legal and other entry barriers in retail trade, the sale of medicines, professional services, network sectors, and for-hire passenger transport services (e.g. limits in the number of professional allowed to practice, in the number of pharmacies in a given area, the number of competing firms allowed to operate a business, third-party access to networks, and the possibility of selling online).

- *Barriers to trade and investment*—captures the restrictiveness of FDI rules (e.g. foreign equity limitations), discrimination of foreign firms (e.g. regarding taxes and subsidies or in public procurement), and the extent of trade facilitation (e.g. recognition of foreign regulations and the use of international standards).

**Sectoral indicators**—The OECD also publishes sectoral indicators that quantify the stringency of all the different regulation categories mentioned above for selected sectors: retail distribution, retail sales of medicines, professional services (lawyers, notaries, accountants, architects, civil engineers, and real estate agents), and network sectors (energy, transport, and e-communications).

**Box 2. Key Regulatory Restrictions for Start-ups, Sale of Medicines, Retail Distribution, and Professional Services**

The answers in the OECD 2018 PMR questionnaire allow to identify specific regulations related to start-ups, retail distribution, the sale of medicine, and selected professional services (lawyers, accountants, notaries, and architects) that are particularly stringent in France:

**Administrative Burden on Start-Ups** (distance to frontier = 1.5; impact of each regulation in parentheses)

- Lack of one-stop shop for issuing all authorizations, permits and licenses that are required to open up a business (0.5).
- Lack of program to review and reduce the number of licenses and permits required by subnational governments (0.5).
- Excessive number of public and private bodies typically need to be contacted to start a Limited Liability Company (0.1) and a Personally-Owned Enterprise (0.075).
- Excessive number of mandatory procedures required to register a Limited Liability Company or allow it to be done via one-stop shop (0.1).

**Sales of medicines** (distance to frontier = 4.2; impact of each regulation in parentheses)

- Restrictions on the number of pharmacies that can be located in a given geographic area. (0.8)
- Restrictions on where a pharmacy can be located. (0.8)
- Restrictions for non-pharmacists to own a pharmacy (0.8)
- Restrictions to sell non-prescription medicines in non-pharmacies. (0.8)
- Restrictions on advertising of prices of non-prescription medicines. (0.8)

**Retail distribution** (distance to frontier = 1.9; impact of each regulation in parentheses)

- Requiring registration to establish a new retail outlet (in a specific register, beyond registration in a commercial or trade registry) for selling clothing and food and beverages. (0.4)
- Requiring authorization for establishing a new retail outlet for selling clothing and food and beverages. (0.3)
- Requiring a specific authorization to sell prescription and non-prescription medicines. (0.4)
- Restrictions on advertising of prices of non-prescription medicines. (0.4)

**Professional services**

**Accountants** (distance to frontier = 2.7; impact of each regulation in parentheses)

- Restrictions for non-accountants to have up to 100 percent of the voting rights in an accounting firm. (0.4)
- Exclusive rights for accountants on activities, such as drawing up financial statements, insolvency practice, tax advice, and on non-statutory audit. (0.3)
- Requiring membership in a professional organization in order to practice the profession. (0.3)
- Lack of Mutual Recognition Agreements (MRAs) of professionals with other countries. (0.3)
- Lack of clear process for recognizing education titles earned abroad. (0.2)

## Box 2. Key Regulatory Restrictions for Start-ups, Sale of Medicines, Retail Distribution, and Professional Services (concluded)

**Lawyers** (distance to frontier = 2.6; impact of each regulation in parentheses)

- Restrictions for non-lawyers to own up to 100 percent of the capital of a law firm. (0.4)
- Restrictions for non-lawyers to have up to 100 percent of the voting rights in a law firm. (0.4)
- Territorial restrictions on the ability of professionals to practice (0.3)
- Exclusive rights for lawyers on activities, such as representation before administrative agencies, drawing up legal documents, and on advice on matters predominantly regulated by domestic, foreign, or international law (0.3)
- Requiring membership in a professional organization in order to practice the profession. (0.3)
- Requiring a professional examination in order to legally practice the profession. If existing, it should be administered by an independent regulator. (0.2)
- Lack of a clear process for recognizing education titles earned abroad. (0.3)

**Architects** (distance to frontier = 2.2; impact of each regulation in parentheses)

- Restrictions for non-architects to own up to 100 percent of the capital of an architectural firm. (0.3)
- Restrictions for non-architects to have up to 100 percent of the voting rights in an architectural firm. (0.3)
- Exclusive rights for architects on activities, such as design and planning, and on representation for obtaining permits. (0.2)
- Requiring membership in a professional organization in order to practice the profession. (0.3)
- Requiring a professional examination in order to legally practice the profession. If existing, it should be administered by an independent regulator. (0.2)
- Lack of a clear process for recognizing education titles earned abroad. (0.3)

**Notaries** (distance to frontier = 1.1; impact of each regulation in parentheses)

- Restrictions for non-notaries to own up to 100 percent of the capital of a notary firm. (0.4)
- Restrictions for non-notaries to have up to 100 percent of the voting rights in a notary firm. (0.4)
- Exclusive rights for notaries on activities, such as administering oaths and certificating legal documents, and transferring of real estate titles (0.4)
- Restrictions on the number of professionals allowed to practice set by law or self-regulation by professional bodies (0.4)
- Territorial restrictions on the ability of professionals to practice (0.4)
- Minimum prices or fees regulated by the government or self-regulated (0.3)