

# Product Market Reforms in EU Countries: Are the methodology and evidence sufficiently robust?

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## Abstract

In the EU of today, economic policies, competition policy and regulation are expected to be 'evidence-based'. The purpose of the present paper is to discuss critically the most prominent empirical approach to the measurement of regulation: the OECD product market regulation (PMR) indicators. The paper sets out what exactly product market reforms are and the empirical regulatory indicators that have been developed by the OECD, the World Bank and others.

The considerable merits of the PMRs are discussed first, and no less than nine advantages are identified. The remainder of the paper is devoted to a series of omissions, weaknesses and shortcomings (up to ten, in total) which, broadly spoken, have the unfortunate effect that EU countries' goods and services markets would empirically look more restrictively regulated than they really are, compared to other OECD countries.

PMRs have two vintages, one based on the period 1997 – 2005 and an improved 'integrated' PMR developed over 2006-09. The latter constitutes an improvement and does reduce or eliminate some of the shortcomings of the first PMR indicators. Nevertheless, the systemic EU-neglect bias is not addressed and remains a disturbing facet.

Before rushing to the policy inference that the neglect of EU instruments as well as fundamental rights (like free movement and the right of establishment) renders the PMRs too high (i.e. markets seem more restrictive than they are), so that *therefore* market reforms can be softened or put on the backburner, one ought to realize that the measurement of the numerous services restrictions (also in the PMR, integrated or not) is still seriously deficient. Thus, services markets might well have to be reformed more 'deeply'. Moreover, reforms are also necessary in national labour markets and in some elements of 'governance', aspects not covered in the paper.

Key words: market regulation, market integration, regulatory reform, regulatory indicators

JEL codes: L51 (Economics of regulation), R 38 (Government Policies, Regulatory Policies, under Production analysis and firm location), F 15 (Economic integration, under Trade)

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# **PRODUCT MARKET REFORMS IN EU COUNTRIES: ARE THE METHODOLOGY AND EVIDENCE SUFFICIENTLY ROBUST?**

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## **1. Introduction and purpose**

In the EU of today, economic policy-making, EU competition policy and EU regulation are expected to be ‘evidence-based’. However, in an area such as ‘regulation’, this is far from easy as ‘regulation’ would seem to be resistant to empirical measurement. The present paper aims to inspect the empirical methodology and evidence of ‘measuring’ regulation of product markets (i.e. goods and services) of the last decade or so with a view to obtaining ‘evidence’ for reform needs in the EU.

After decades of detailed, highly technical and often specific descriptive analyses of EU or OECD countries’ regulation and possible reforms, it still remained extremely difficult to transcend piecemeal approaches and shift to regulatory reform strategies with a view to higher growth, productivity and/or employment. The descriptions were difficult to use for informed political debates in parliaments or government (or at EU level, for that matter) as they were far too long and demanding in technical terms, whilst requiring prior knowledge in many domains in order to fully absorb both analysis and the policy messages.<sup>1</sup>

Endless debates would follow, frequently pushed by vested interests or those in sectors with profound information advantages, and few systematic reforms would be observed. Sectoral reforms could be witnessed but selectively and with varying degrees of ‘depth’. The prominence of lawyers, used to prepare ‘lawmaking’ but not used to link regulation to the (better) functioning of markets, maintained, perhaps unintended, a formidable barrier to systemic reforms. Politically, it was next to impossible to get a regulatory reform strategy across to voters or stakeholders (e.g. the social partners) on the basis of a mass of technical detail, except when driven by ideology rather than evidence-based economic analysis.

Since the late 1990s, however, overall regulatory reform strategies related to (better) market functioning can be ‘evidence-based’. This is due to the development of methodologies of measuring (market) regulation. The various methodologies register aspects of regulation in terms of (degrees of) restrictiveness for market players.

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<sup>1</sup> Prominent were the two volumes of OECD, 1997, The OECD report on regulatory Reform. Many detailed regulatory reform studies of OECD countries were made by the OECD such as OECD (1999a, on Japan), OECD (1999b, on the US), OECD (1999c, on the Netherlands), OECD (2000a, on Denmark) and OECD (2000b, on Spain), etc.

In so doing, one can generate a data base and exploit it for economic analysis, with a view to develop robust recommendations for the direction of regulatory reforms. For the European Union, there was widespread agreement that reforms were essential for competitive pressures in markets to increase and for productivity gains and dynamic effects to be reaped. In 2010, the EU can look back on substantial reform efforts at both levels of government. Nevertheless, many analysts are convinced that there is still a considerable reform need to be fulfilled and it is extremely important if convincing empirical economic evidence can be provided to substantiate such reform claims.

The purpose of the present paper is to discuss critically the most prominent empirical approach to the measurement of regulation: the OECD quantification of degrees of restrictiveness of product market regulation (i.e. in goods and services markets), often denoted as PMRs. Although there are other approaches (briefly touched upon the text), the reason for singling out the OECD one is simply that it is by far the most frequently utilized one in Europe and that it has had – and still has – an appreciable influence on national and EU analyses underpinning regulatory reform strategies. The criticism levelled on the OECD approach therefore has a positive aim: that regulators and analysts are conscious of the hidden and less obvious problems when employing the PMRs. Better still, the paper might prompt further improvements and corrections of the OECD approach, in particular as far as the application to the EU is concerned, so as to render it more robust and reliable for the sake of making regulatory reform recommendations. It should be emphasized that the present paper focuses on the *substance* of market regulation, *not* on the technical measurement issues (except for a brief note on the weights given to the components of the PMRs). It should be noted that the present paper solely deals with goods and services markets. Labour markets have been analysed with different methodologies; they are not part of this analysis. Moreover, governance aspects in a wide sense (including bureaucracy, the working of the legal system, the shadow economy, etc.) and restricted capabilities such as knowledge and infrastructure might also constrain the good working of markets. All these aspects matter and ought to be taken into account for broader reform strategies.<sup>2</sup> It follows that the shortcomings of PMRs identified in the present paper do not automatically lead to the inference that the need for reforms in the EU and its Member States is *therefore* less great. The interpretation of the findings will be discussed in the concluding section.

The structure of the paper is as follows.

Section 2 surveys the concept and measurement of product market reforms. It provides a taxonomy of micro-economic reforms (i.e. including labour markets, capital markets and e.g. patents, besides goods and services) and identifies what elements may constitute PMRs in a narrow and a wider sense. It briefly reviews various approaches to develop indicators measuring PMRs by respectively the OECD, the World Bank and others, before focusing on the OECD PMRs.

Section 3 sets out the OECD PMRs as first introduced and discusses their considerable merits by specifying nine advantages.

Section 4 comprises a detailed analysis of omissions, weaknesses and shortcomings. The common theme for almost all these drawbacks is what might be called an “EU-neglect bias”.

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<sup>2</sup> Neither does this paper discuss the *use* of PMRs in empirical economic analysis. Before rushing to conclusions about reforms, care ought to be taken to combine PMRs with relevant control factors. A simple but telling warning is given by Paul de Grauwe (2008, pp. 10-11) providing two graphical correlations between growth (of GDP) and PMRs: one is negative; however, it turns positive as soon as GDP per capita (i.e. the level of development) is introduced.

This analysis refers essentially to the OECD work on the 1998 and 2003 data collections, published largely in 2005 and 2006. It is this stream of data and publications which has exerted a great influence in the EU circuit and many European capitals as well as in academic and think-tank work.

Section 5 consists of an exposition of further developments and refinements of the OECD approach, first by reviewing three additional sub-indicators presented for the time in 2006 and 2007 (on services, competition policy ‘strength’ and foreign direct investment) and subsequently by an explanation and assessment of what is called the revised and “integrated” OECD PMR indicator.

Section 6 summarizes the conclusions and attempts to provide an interpretation of the significance of these findings for ‘evidence-based’ reform strategies in the EU.

## **2. Product Market Reforms: Concept and measurements**

### **2.1 Product market reforms: Concept and taxonomy**

At a general level, product market reforms (=PMRs) are changes in ‘market institutions’ with a view to have goods and services markets function better. However, once one becomes interested in measurement and/or the nuts and bolts of policies to accomplish such reforms, we need much greater detail and precision. The literature on PMRs is not very disciplined in sticking to one clear and well-accepted definition.

Four terms are often used almost interchangeably or with fuzzy boundaries: product market reforms, regulatory reforms, structural reforms and micro-economic reforms.<sup>3</sup> The latter two amount to concepts with a very wide scope, including regulatory reforms for all markets (not just goods and services), the degree and nature of state ownership as well as competition policy, but it may also include bottleneck infrastructures, education and ‘upskilling’ of workers, innovation systems, taxation and (e.g. market-friendly) public administration including e-government, pension reform and many other aspects possibly. As Figure 1 makes clear, product market reforms are only a limited subset of structural reforms or, for that matter, of micro-economic reforms. It is also not correct to regard “regulatory reform” as fully equivalent to product market reforms. Many reforms are not, strictly spoken, regulatory. More precisely, in Figure 1, under a strict definition of regulatory reforms, only the six aspects in ‘grey’ would qualify.

Figure 1 is designed to clarify for the reader what is meant by product market reforms in an EU context. The centre column in the top part of the figure and the left column in the bottom part together can be seen as ‘product market reforms’. Distinguishing the two is merely a function of how broad or narrow one defines the concept. The design of Figure 1 is inspired by the MICREF and LABREF data sets of micro-economic reforms in the EU (see Box 1 for detail). Figure 1 shows clearly that product market reforms should not be seen in isolation from other [micro-economic or ‘structural’] reforms, be they in labour markets (again, in a narrow and wider perspective), or, in capital markets (including foreign direct investment and the right of establishment) or with respect to e.g. patents (which are still national in the EU, leading to costly inefficiencies).

The narrow view of product market reforms is concerned with (internal) market integration [both effective free movement of goods and services, including mutual recognition, as well as regulatory aspects of the internal market and open and competitive public procurement], EU and

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<sup>3</sup> Some parts of section 2 draw from Pelkmans, Acedo Montoya & Maravalle, 2008.

national competition policy, national regulation in such markets [such as network industries, professional services and wholesale and retail and other services regulation ] and the openness to the world economy (which tends to improve the contestability of markets beyond what the internal market already accomplishes). The wider concept of product market reforms, designed with a view to promote (more) dynamic market conduct and rivalry, is concerned with what is usually called the business environment and (fewer barriers to) entrepreneurship as well as the longer-run impact of the knowledge-based economy, especially the use of ICT, the role of R & D and innovation. One may also include ‘state ownership’ as indeed the reform literature typically does.<sup>4</sup>

Figure 1. Product market reforms as subsets of microeconomic reforms

<p><u>Capital Markets / FDI</u></p> <ul style="list-style-type: none"> <li>○ golden shares</li> </ul> <p>[some link with state ownership more generally]*</p> <p style="text-align: center;">○ effective</p> <p><u>IPRs</u></p> <ul style="list-style-type: none"> <li>○ national (patent) regulation</li> </ul> <p>[tension with IM &amp; EU competition policy] [link with knowledge-based economy]**</p>	<p><u>Product Market Reforms</u> (narrow)</p> <ul style="list-style-type: none"> <li>○ market integration                             <ul style="list-style-type: none"> <li>▪ EU regulation                                     <ul style="list-style-type: none"> <li>• filling IM gaps</li> <li>• Better (EU) Regulation</li> </ul> </li> <li>▪ public procurement</li> <li>▪ effect. free movement + MR</li> </ul> </li> <li>○ free establishment</li> <li>○ competition policy                             <ul style="list-style-type: none"> <li>▪ anti-trust + mergers</li> <li>▪ state-aids</li> </ul> </li> <li>○ national regulation                             <ul style="list-style-type: none"> <li>▪ network industries</li> <li>▪ professional services</li> <li>▪ wholesale/retail</li> </ul> </li> <li>○ openness to world economy</li> </ul>	<p><u>Labour Market Reforms</u> (narrow)</p> <ul style="list-style-type: none"> <li>○ national labour market regulation                             <ul style="list-style-type: none"> <li>▪ job protection (EPL, etc.)</li> <li>▪ working hours</li> </ul> </li> <li>○ wage bargaining</li> <li>○ internal market                             <ul style="list-style-type: none"> <li>▪ free movement of workers</li> <li>▪ posted workers</li> <li>▪ EU minimum regulatory requirements (health/safety)</li> <li>▪ Extra-EU immigration</li> </ul> </li> <li>○ labour taxation</li> </ul>
<p style="text-align: center;"><u>PMRs (wider)</u></p> <ul style="list-style-type: none"> <li>○ business environment &amp; entrepreneurship                             <ul style="list-style-type: none"> <li>▪ start-up conditions</li> <li>▪ improving SME context                                     <ul style="list-style-type: none"> <li>• efficiency legal system</li> <li>• cut red tape (regulation)</li> <li>• better Regulatory Quality</li> <li>• G2B and G2G e-government</li> </ul> </li> </ul> </li> <li>○ state ownership* [links with knowledge-based economy, esp. R &amp; D and innovation]</li> </ul>		<p style="text-align: center;"><u>LMRs (wider)</u></p> <ul style="list-style-type: none"> <li>○ unemployment &amp; welfare-related benefits</li> <li>○ incentives-based employment policy                             <ul style="list-style-type: none"> <li>▪ active labour market policies</li> <li>▪ intra-EU, interregional, inter-sectoral mobility incentives</li> </ul> </li> <li>○ education                             <ul style="list-style-type: none"> <li>▪ systemic responses to future (skill) needs</li> <li>▪ vocational; up-skilling (on the job)</li> </ul> </li> </ul>

<sup>4</sup> Whereas the TFEU treaty (art. 345) says that the system of ‘ownership’ is a competence of the Member States, for the proper functioning of the internal market, the existence of state ownership or private ownership should not make any difference under EU law. State ownership cannot imply any privilege or advantage over privately owned companies in goods and services markets. However, one property of state owned firms remains: a Member State’s government can always prevent (hostile) takeovers – see the column on capital markets in Figure 1. For product markets in the EU, it is the competitive environment which should equally discipline privately owned and state-owned companies. One should therefore be cautious to apply the premises about state ownership (and the implications for performance) of the reform literature to the EU of today.

- \* Not in MICREF (EU law pre-empts any special privilege) but in ‘markets for corporate control’ (see capital markets, left-upper column), state ownership can render take-overs impossible.

Altogether, product market reforms in the EU context can be ‘deep’ and intrusive so as to engender permanent pro-competitive effects in all relevant goods and services markets in the Union.

*Box 1. Micro-economic reform taxonomy: the EU MICREF and LABREF approaches*

The European Commission, in close cooperation with the (Council’s) Economic Policy Committee, has developed two complementary data sets for the purpose of tracking micro-economic and labour market reforms of EU Member States since 2000. The data sets enable the tracing and the characteristics of national reforms and the deviations from agreed benchmarks or targets, see [http://ec.europa.eu/economy\\_finance/db\\_indicators/micref/index\\_en.htm](http://ec.europa.eu/economy_finance/db_indicators/micref/index_en.htm) for all the relevant links to MICREF, including one to a ‘Report to the general public’ (no date, but probably from the autumn of 2008) in which the potential uses of MICREF are explained in detail, plus [http://ec.europa.eu/economy\\_finance/db\\_indicators/labref/index\\_en.htm](http://ec.europa.eu/economy_finance/db_indicators/labref/index_en.htm) for all the relevant links to LABREF). The two data sets are qualitative and focus entirely on changes of market regulation (or related measures), not on stocks of regulation (like e.g. the OECD PMRs) and their influence on market conduct or functioning. Interesting for the purpose of the present paper, however, are the taxonomies of MICREF and LABREF. Figure 1 of our paper is consistent with these taxonomies, but it ought to be realized that the detail in the two data sets is far greater. Focusing on MICREF (is largely on product market reforms), there are four hierarchical levels to structure the areas of reform. The highest layer consists of three ‘policy domains’: open & competitive markets, business environment & entrepreneurship and knowledge-based economy. The third policy domain is obviously inspired by the Lisbon process (2000 – 2010) ; the other two domains can be regarded, wholly or largely, as product market reforms. The ‘open & competitive markets’ is divided into three ‘broad policy fields’, namely, market integration, competition policy and sector-specific regulation. In turn, these are subdivided into 15 ‘areas of policy intervention’, in turn again subdivided into a total of 68 ‘reform areas’. The domain of ‘business environment and entrepreneurship’ is divided into the broad policy fields of ‘start-up conditions’ and ‘improving the (small) business environment’, in turn divided into nine ‘areas of policy intervention’, in turn again subdivided into a total of 24 reform areas.

## 2.2 Product Market Reforms, measurement

Product market reforms in Figure 1 are complex and multi-faceted. Tracking such reforms for all Member States every year as well as over time requires considerable investment in a common methodology, taxonomy and proper reporting. In the absence of systematic reporting, it would be next to impossible to appreciate their meaning and progress in achieving better functioning markets. Following the experience in the Lisbon process and stimulated by earlier work in the OECD (see Box 2), the EU has developed the common LABREF and MICREF taxonomies (see Box 1) which will enable objective and transparent comparisons between Member States’ reform paths, also over time. For the purpose of the Lisbon process (and presumably now EU-2020), this is useful. However, a direct ‘reading’ of the functioning of markets influenced by the ‘stock’ of existing regulation and changes therein, is not possible with MICREF and LABREF. For this more economic appreciation of the nature and significance of product market reforms, many analysts, including those of the Commission, rely on the OECD PMRs.

The OECD PMRs enable analysts and policy-makers for the first time to move beyond the incredible specificity and required detail of all kinds of (EU or national) regulation. When developing an overall vision of better functioning of markets and the role of PMRs in achieving that, while attempting to avoid ideological traps of prior dispositions for political reasons, such overall empirical measurement of the status-quo and progress of reforms is eminently useful. Policy-makers in the EU are not greatly helped by lengthy descriptive surveys of regulatory reform if they wish to understand and convey to parliament and voters the key messages of PMRs and their impact. What they need is precisely a more accessible, strategic overview underpinning reform plans and showing voters the rationale in straightforward terms.

This explains the search for quantitative indicators as proxies for these reforms and their progress over time. By definition, the policy activities referred to in Figure 1 are hard to measure exactly and the more so once one enters into detail. Nevertheless, by ranking measures or interventions in terms of *degrees of restrictiveness of competition in markets*, considerable progress has been made during the last decade or so in developing indicators in the literature. Box 2 provides a summary of the more important empirical indicators with very brief comments.

There is no single classification of PMRs. Since the main preoccupation is with the supply side, there is a tendency to have special regard to the impact on business. Such impact matters surely but a singular focus on business would generate undue biases. The three often quoted data sources which produce quantitative indices are quite distinct and do not overlap more than partially in coverage. Their link with PMRs varies. First, and probably closest to our PMRs definition, is the OECD ‘product market regulation’ data base and their resulting PMR indicators [note that the R here stands for ‘regulation’ and the change between 1998 and 2003 (resp. between 1998 or 2003 and 2008), the three dates of measurement, are defined as ‘reforms’]. This work began in 1997 and has yielded so far three enormous data sets for the years 1998, 2003 and 2008 for 30 OECD countries (see Conway, Janod & Nicoletti, 2005, and Woelfl, Wanner, Kozluk & Nicoletti, 2009). It is good to realize that the OECD has employed, over the years, several sets of indicators. The virtues of adding several indicators to the original OECD PMR consist in the greater scope of market interventions covered and the attention paid to selected services known to be heavily regulated. This will be discussed in some detail later in the paper.

*Box 2. Indicators measuring ‘Product Market Reform’*

In the literature, indicators have been developed in order to dispose of empirical proxies for restrictiveness of regulation and other public and private interventions hindering or distorting competitive processes in goods and services markets. These data sets allow, in principle, comparisons between countries and between different points in time. Changes of indicators over time into the direction of less restrictiveness are usually regarded as empirical evidence of ‘product market reforms’ (note that this assumes that none of the indicators relate to market failures, so that less restrictiveness would not lead to “under-regulation”). Interested readers are referred to Dierx, Ilzkovitz & Schmidt, 2007 and European Commission, 2006 (chapter 4) for recent surveys and to the indicated literature below.

The most important indicators are:

- a. The *OECD “PMR indicators”*: they combine restrictiveness measures in 16 domains of regulation and other interventions (scaling from 0 – 6, from least to most restrictive), aggregated to three categories: state control, barriers to entrepreneurship and barriers to trade and investment; single (country) PMR indicators are found by aggregation via weights. Although the OECD indicators have advantages such as objectivity, transparency and quantifiability (see section 3), probably they are no longer “deep” and targeted enough

to identify the relevant “pockets of restrictiveness” in product markets of EU countries having already reformed at EU and national level over a period of two decades or more. (Conway, Janod & Nicoletti, 2005), hence item b.

- b. *New, targeted OECD indicators*: OECD economists have published several new, more targeted indicators since 2006 (see section 5 for detail). One set refers solely to specific subsets of services such as 6 network industries (and road transport), plus retail distribution and 4 professional services (together called the NMR indicators). The idea is that the more important “pockets of restrictiveness” are nowadays to be found in specific services markets. The data underlying NMRs are far more refined than the (services elements of) PMRs. Another indicator attempts to measure the “strength of competition policies” of OECD countries, including most eurozone countries. Of course, well designed and properly enforced competition policies greatly help markets to function better. A third indicator is the foreign direct investment restrictiveness index, measuring the deviations from “national treatment”. EU countries score well, for the simple reason that “national treatment” is a treaty obligation (art.54, TFEU). (Conway & Nicoletti, 2006; Hoj et al., 2007; Koyama & Golub, 2006)
- c. The World Bank’s annual “*Doing Business*” survey focuses on the “business environment”, with 10 indicators relating mainly to entry, transaction costs and market access.

Horizontal aspects such as “starting a business”, “enforcing contracts” and “getting credit” are combined with specific issues such as “licensing”, “trading across borders” and “employing workers”. The indicators do not target specific markets other than the labour market (World Bank, 2007). The World Bank also produces the WGI (*World Governance Indicators*) over an incredibly wide spectrum of variables (see Kauffmann, Kraay & Matruzzi, 2009; Undesa, 2007; Kauffmann et al. 2008). The six areas covered include voice and accountability; political instability and violence; government effectiveness; regulatory quality; rule of law; control of corruption. Under ‘regulatory quality’, some 63 items are or can be included dependent on source and reliability; some of these items overlap and are imperfect substitutes. Many of these items overlap with the OECD PMRs and/ or the ‘Doing Business’ indicators.

- d. The Fraser Institute’s (2007) “*index of economic freedom*” is built up – inter alia – from indices on “business regulation”, on state involvement and on freedom of trade. The data are derived from opinion surveys of business leaders in the World Competitiveness Report (of the WEF) and are therefore largely subjective; the comparability between countries and over time is to some extent intuitive and hard to verify. Conway & Nicoletti, 2006, p. 48 show that practically all OECD countries in 2003 cluster in the 5 - 7 ½ (of 10) range of Fraser (leaving out state involvement); this means that more targeted indicators are needed for identifying relevant pockets of restrictiveness hindering proper market functioning.
- e. The Copenhagen Economics *Market Opening Index*, for 7 network industries in the EU and based on 12 market opening “milestones”, ranging from ownership, third party access, the pricing of third party access, unbundling, regulation of user prices, etc. Not unlike the OECD (see b., above), a system of weights makes it possible to obtain aggregate indices per country, and for 1993 and 2003. (Copenhagen Economics, 2005) The full details of the methodology and its database are not publicly available and no follow-up of the report has been published, so that the index will be ignored in the present paper.

Readers interested in other efforts to develop indicators on micro-economic reforms (or parts of them), are referred to the MICREF Commission paper ‘Report to the General Public’ (quoted in Box 1) listing sources from the IMF and e.g. several foundations, with links (pp. 20/21).

Second, the World Bank (2007) produces an annual survey called “Doing Business”. One important similarity between the OECD and the World Bank approaches consists in the reliance on factually verified information. However, the World Bank at times has to resort to opinions, for lack of data or effective cooperation. Both institutions undertake admirable efforts to achieve the greatest possible reliability of the data, directly with many experts (up to 5000 worldwide in ‘Doing Business 2007’), including government officials, in no less than 4 rounds of completing the questionnaires, besides specific control measures. Nevertheless, for the purpose of the present paper, the World Bank data are of limited use. The reports focus on the business environment, measured by ten indicators, and, in doing so, only partially on market functioning. Insofar as specific market functioning is covered, only two indicators (licensing & ‘trading across borders’ are related to goods & services, and one to the labour market (‘employing workers’). Regulations influencing specific market functioning are therefore covered only partially at best. Where market functioning is affected ‘horizontally’ (‘starting a business’, ‘enforcing contracts’, ‘getting credit’ and ‘registering property’), the technical efficiency of local markets is at stake and this can be negatively affected by administrative inefficiencies or burdens. The OECD PMRs overlap partially with these indicators, arguably with the more relevant ones for EU countries.

From the perspective of the World Bank, such surveys can be extremely helpful for developing countries in their efforts to generate a more conducive business environment. The question is whether and to what extent such horizontal indicators about transaction costs of entry and (selected) market functioning would be significant and differentiated enough inside the EU-27. The EU, moreover, has two levels of government and this aspect is not well reflected. In empirical work, it might be problematic to employ these indicators for EU countries in attempting to find the determinants of e.g. productivity or growth, without appropriate control factors.

A third data set is the Fraser index of ‘economic freedom’ (Fraser Institute, 2007), which is built up – inter alia - from indices on ‘business regulation’, on state involvement and on freedom of trade. In the literature, it is now and then referred to, even if the drawbacks of the approach are serious. The dominant shortcoming is the lack of reliability and transparency of the underlying source (opinions of business leaders in many countries, taken from the World Competitiveness Report of the WEF). It is questionable whether business leaders or their assistants (can) answer many detailed questions on market functioning in a reasonably objective and well-informed manner [the information and knowledge required, indeed, assumed, would be far too costly to collect systematically in the firm]. Moreover, to the extent their mix of intuition and information is at least indicative, the intuition would differ amongst numerous firms and the ‘mix’ may have very different weights in each instance. Also, the precision of market functioning queries leaves something to be desired. Worse still, the comparability between countries is greatly affected by business customs and private/public relationships in each and every country, and there is no way of checking or correcting for this. Finally, there probably is an ideological bias in the Fraser index, in particular, with the index of ‘state involvement’, since there is no empirical confirmation that e.g. relatively high state budgets lead to weak market functioning or unsatisfactory economic performance – it all depends. This matters because some EU countries have relatively high shares of state budgets or social transfers.<sup>5</sup> For all these reasons, the Fraser index should be treated with utmost caution in empirical work, if at all, or selectively if one has good reasons to do so.

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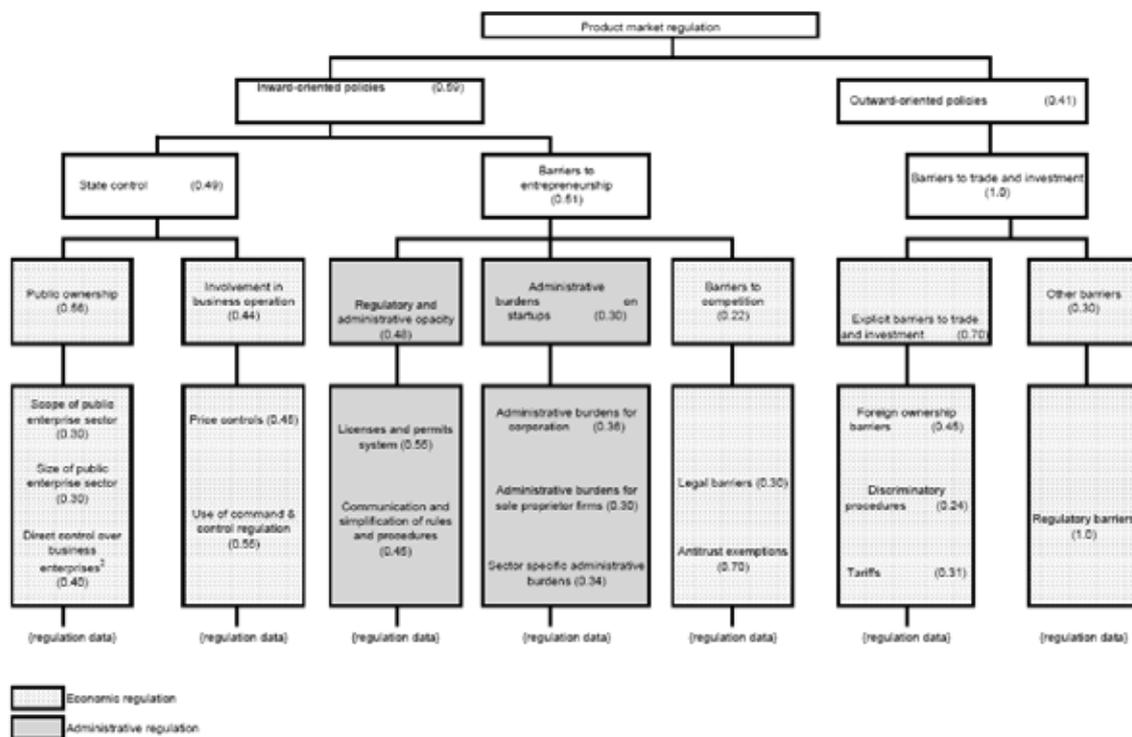
<sup>5</sup> It is interesting to note that, despite the significant differences between Fraser and OECD, Dierx, Ilzkovitz & Schmidt, 2006, p. 170, footnote 2, found that simple Spearman and Pearson tests showed a significant negative correlation between the 2003 OECD PMR indicators and the Fraser indicators of economic freedom, except in the case of state involvement.

### 3. The OECD PMRs and their advantages

There can be no doubt that the OECD economists initially led by Giuseppe Nicoletti and Stefano Scarpetta have done a wonderful service to policy-makers in an area which has always been extremely difficult to come to grips with, due to the extreme technicality, specialties and variance in regulation, not to speak of the intrinsically qualitative nature (and seeming incomparability) of regulation. Nevertheless, it is crucial to understand the pro's and con's of the OECD approach before using their empirical material and results in further empirical analysis.

It is of course important to first provide a summary of the OECD PMRs. Consider Figure 2, taken from Conway, Janod & Nicoletti 2005, and our Annex 1, an explanatory Box from the same source.

Figure 2. The PMR indicator system



1. The numbers in brackets indicate the weight given to each lower level indicator in the calculation of the higher level indicator immediately above it. The weights were derived by applying principal components analysis to the set of indicators in each of the main regulatory domains (state control, barriers to entrepreneurship, barriers to trade and investment, economic regulation and administrative regulation). The same approach was used to derive the weights used to calculate the indicators of inward and outward-oriented policies and the overall PMR indicator. The principal components analysis was based on the original 1995 data.

2. Two indicators from the 1995 version of the PMR indicators ('Special voting rights' and 'Control of public enterprise by legislative bodies') have been combined into this indicator.

Figure 2 shows that the OECD PMRs measure both ‘economic regulation’<sup>6</sup> and administrative regulation (which acts as ‘barriers to entrepreneurship’). In Conway, Janod & Nicoletti, op. cit., the authors set out the 2003 indicators, give a fairly detailed methodology (including the types of questions asked for all 16 categories – a summary is in our Annex 1 – and the scores within

<sup>6</sup> According to Conway, Janod & Nicoletti, 2005, this includes the categories ‘public ownership’, [state] ‘involvement in business operations’, ‘barriers to competition’, ‘explicit barriers to trade and FDI’, ‘other [external] barriers’.

these questions & sub-questions), discuss the vexed issue of the weights (with statistical procedures to reduce the degree of ‘subjectivity’), illustrate the pyramidal build-up of the PMRs (all the way until a *single* overall indicator is constructed - the top of the Figure 2 pyramid) and provide a considerable number of descriptive (but insightful) exercises [ per instrument type; between countries; over time; etc.] as well as correlation exercises or scatter diagrams, plus many tables giving the indicators precisely.

There seems little point in repeating all these details here as they are easily accessed from the OECD. Once the reader will have absorbed these schema’s, trend diagrams and empirical information, one may begin to appreciate the merits of this work.

The nine advantages of the OECD PMR indicators are:

- i. *objective*, as compared to interview/opinion-questionnaire-based indicators; based on factual questionnaires to (cooperative) national administrations, with multiple verification  
>>> this in turn renders them more *reliable* as such, as well as over time, and *comparable* between countries because the reporting need not be ‘context-specific’ (as the OECD calls that)
- ii. *quantifiable, by scoring (the 1 to 6 range), weighting and aggregation techniques*
- iii. *focused on market functioning*; they do that by concentrating solely on regulation which is suspected to engender anti-competitive effects or unnecessary ‘burdens’ which might smother entrepreneurialism (and as such, hinders good market functioning); the authors are careful to emphasize that they never judge or imply an assessment of the quality of regulation
- iv. *unusually deep investigation*; in the 6 sections of the 2003 questionnaire to OECD Member States, a total of 805 data points were collected
- v. practically *complete return rates* of questionnaires (after follow-ups), as a result of the agreed cooperation of all the (30) national administrations; this further raises the reliability and renders the collection *authoritative* - who would dare to challenge such a resourceful effort of so many national specialists, led by competent OECD economists !?
- vi. *sophisticated quantitative methods* have been used to objectivise the ‘weights’ employed at least to some degree, and to clarify the potential of the data set
- vii. the PMR indicators are *easy to ‘consume’ for policy makers*; the message gets across via one single indicator (per country) and, if desired, a single indicator for change between 1998 and 2003, or a single one for subsets of regulation; they can be visualized in bar diagrams, which are very reader-friendly
- viii. the *public good character* of the large data set, available at [www.oecd.org/eco/pmr](http://www.oecd.org/eco/pmr) , by now used by a good many econometricians in a range of papers
- ix. *transparency*, not just by methods and comparability but beyond: each indicator value can be traced back to its source.

#### **4. The disadvantages of the OECD PMR indicators**

The *disadvantages* of the OECD PMRs as first employed are nevertheless considerable if one wishes to employ them for a reliable economic analysis of the state of play with respect to product market reforms *in the EU*, in the pursuit of higher productivity and growth, or, for that matter, smoother adjustment and better shock absorption in the eurozone.

There are three groups of drawbacks of the initial OECD PMRs: (a) omissions which matter, (b) weaknesses in the indicators and (c) the neglect of EU fundamentals. Two of the altogether ten disadvantages largely overlap. What no less than nine of the ten disadvantages have in common is that their effect is *to portray the EU countries as more restrictive in goods and services markets*, in comparison with other OECD countries, *than they really are!* This observation is at least disturbing. It should prompt a deeper rethink of how far one wishes to go in improving such tools before relying on them in policy work.

#### 4.1 Omissions in the OECD PMRs

That omissions can be found in such exercises is of course inevitable. Regulation is so widespread and pervasive that it simply would not pay to attempt to be exhaustive, by including lots of trivial regulatory domains or tiny economic activities. However, it is possible to identify three classes of *omissions which matter*.

The *first, and probably the largest, omission* is the entire class of what I call, for convenience, SHEC regulation (SHEC = Safety, Health, Environment & Consumer protection). EU product market regulation consists overwhelmingly of SHEC regulation, usually in response to ‘market failures’. SHEC regulation is typically about SHEC objectives related to risk, i.e. risk reduction to levels that society can live with. By omitting SHEC regulation, the OECD PMRs implicitly assume that the former does not play a significant role in (hindering) market functioning. In other words, the OECD PMRs imply that economic and administrative regulation ought to be reduced for purposes of better market functioning, whereas risk regulation (sometimes called ‘social’ regulation) does not present a problem for market functioning, entrepreneurship and the like. This implicit assumption is remarkable in the light of the long-standing debate of whether the EU level regulates too much or, alternatively, EU regulation is unnecessarily costly.

This debate has eventually prompted what is nowadays called “Better EU Regulation” agenda’s and principles, culminating in the sophisticated 2009 Regulatory Impact Assessment (=RIA) Guidelines<sup>7</sup> and an ambitious programme to lower the red tape costs of EU rules.<sup>8</sup>

The omission of SHEC is *quantitatively big*. It comprises horizontal safety legislation (with the alarm procedure taking ‘unsafe’ goods off the market, voluntary or compulsory – a very costly activity in logistics and reputation), vertical health and safety regulation for many categories of goods and services, with a comet-tail of thousands of European standards (EU or purely voluntary, combined with major and accredited conformance systems, be they private or public) behind it, a large body of service regulation driven by asymmetries of information (against charlatans, moral hazard, adverse selection, other conduct rules, etc.) and (in the EU) the questions of mutual recognition of diploma’s where relevant, specific consumer protection rules (about doorstep selling, advertising, redress, etc.), and the vast and occasionally intrusive body of environmental regulation and its (costly) enforcement. Most of transport regulation (for 6 modes) and financial services and equity markets regulation (including financial institutions operating in these markets and their supervision as well as investor protection) are part and parcel of SHEC regulation.

Missing out entirely on this huge body of product market regulation (in the EU or the OECD more widely) can be justified if and only if one can at the very least offer assurances that SHEC

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<sup>7</sup> See SEC (2009) 92 of 15 January 2009, Impact Assessment Guidelines at [http://ec.europa.eu/governance/impact/docs/key\\_docs/iag\\_2009\\_en.pdf](http://ec.europa.eu/governance/impact/docs/key_docs/iag_2009_en.pdf).

<sup>8</sup> See [http://ec.europa.eu/enterprise/policies/better-regulation/administrative-burdens/index\\_en](http://ec.europa.eu/enterprise/policies/better-regulation/administrative-burdens/index_en) for all relevant links; for an overview of the targets in monetary terms for 13 priority areas, see Enterprise & Industry Magazine, 2009 / 6, December, pp. 3 – 7.

regulation is working reasonably well, the regulatory burden on market players is not affecting market functioning more than marginally, entry is not but trivially affected and entrepreneurial and e.g. investment decisions (including FDI) are not greatly influenced. One might object, for good reasons, that introducing SHEC regulation would not only vastly expand the comprehensiveness of PMRs, and perhaps become unworkable, but in addition create an extra judgmental factor: zero risks have infinite costs, so that one can only reduce risks in markets affected by SHEC issues - but how far? What would the benchmark be?

There is no position on SHEC in Conway, Janod & Nicoletti, but their silence is a de-facto acceptance of all these conditions. Curiously, this completely ignores the enormous influence the same OECD (but another division) has exercised since the early 1990s on drastically improving the regulatory system and the substance of SHEC. The Regulatory Reform reports on all OECD countries published during the late 1990s, the 10 OECD Golden Rules on the quality of (mostly SHEC) regulation (from 1995, with amazing success), the tireless and successful promotion of RIAs and the OECD-led stimulus of moving towards incentive-based regulation (again, mostly on SHEC) would all be of mere trivial importance?

Even if a hard proof is difficult to provide, such a position is probably not tenable. The EU 'Better Regulation' programme<sup>9</sup> (and its predecessors, see Pelkmans, Labory & Majone, 2000) and similar exercises in a number of EU Member States would also seem to suggest otherwise.

The neglect of SHEC regulation and its potential impact on market functioning in the EU is a serious omission in general (see before), but it also impacts on the overall picture about the EU countries' indicators. After all, the EU's (regulatory) mainstay is precisely SHEC regulation in product markets. And precisely in SHEC, the EU (despite all its slow progress and hiccups) has done an appreciable amount of 'better regulation' in the last two decades or so, and continues to improve on what is often still held (e.g. by business) to be a 'burden' for market players in the internal market. The SHEC regulatory acquis cannot be seen in isolation from free movement and the right of establishment. The incessant pressure of building a well-functioning internal market has eventually yielded quite sophisticated and often flexible regulatory solutions, frequently market-driven too, with ingenious combinations of free cross-border activities, mutual recognition, light harmonisation, more precise common regulation in yet other instances and occasionally far-reaching centralisation and EU supervision. Behind it, a highly flexible standards and conformity system has been built up, too, which is nonetheless driven by EU agreed regulatory objectives (of SHEC). The EU has, in short, managed to move far way from the rigid, intrusive, centralist and highly selective traditions of the so-called 'old' approach towards a differentiated and well-thought-out regulatory SHEC acquis. It is manifest in the New Approach since 1985 and the three stages of further improvements up to the 'goods package' of 2008.<sup>10</sup> This has been accompanied by the broadly successful development of European standards (almost invariably, performance standards, allowing innovation and design flexibility). Flexibility of national regulatory regimes have been greatly promoted by mutual recognition in goods and its counterpart coupled to home country control (e.g. in financial services and transport). Positive integration via regulation has improved since RIAs are systematically employed at EU level, in drives to further incentive-based regulation e.g. in environment and other aspects. There can be no denying that the EU has done itself a great service in improving market functioning in the internal market and, in so doing, enhancing and facilitating competitive pressures across national (intra-EU) borders. The inner dynamics of this

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<sup>9</sup> For explanation and assessment, see e.g. Renda, 2008; Allio, Rodrigo & Andres-Amo, 2009 and COM (2009) 15 of 28 January 2009, Third strategic Review of Better Regulation in the EU, plus annexes and related documents.

<sup>10</sup> See Pelkmans, 2009a; 2009b.

drive in EU product markets are strong and have not petered out at all. It has, incidentally, also disciplined the EU Member States in this vast area of regulation, either via a prohibition of domestic regulation of its own in harmonized domains, or via mutual recognition or via case law based on the treaty. If one defines SHEC as including network industries as well [in the treaty, they are “services of general economic interest”, art. 106 TFEU], progress is even more impressive (even if further progress is desirable).

Unless one assumes that all OECD countries have done equally well in the SHEC area, it is hard to accept the omission for the EU. It represents *the* success factor of the EU product markets and leaving it out when measuring regulation with a view to (better) market functioning is at least questionable, if not a serious omission. But one can go further. The EU aspect (over and above the national ones) matters for measuring the ‘restrictiveness’ of regulation in markets, even when all OECD countries would have done equally well: the SHEC acquis has enabled a steady deepening and widening of the internal market for services and goods, and in so doing, has accentuated the competitive environment for all players in these markets. Markets function much better throughout the Union and the effect is irreversible.

A *second omission* is found in financial market regulation. In terms of ‘risk regulation’, financial regulation can be classified as belonging to SHEC regulation, including the protection of savers and investors. However, that is a partial perspective on financial regulation which by definition has a micro and a macro component. The micro component is indeed a variant on what SHEC is for other goods and services markets, namely, solving market failures related to asymmetries of information (about the quality of financial institutions [assuming careful supervision] and some rules of conduct in financial services at the retail level), investor protection rules (largely, disclosure rules, including risk profiles, and proper/ sufficient supervision of market players by regulatory authorities) as well as efficiency promotion in equity markets. The current crisis in financial markets is mainly due to an irrationally relaxed attitude in supervision of mortgage markets in the US, plus a lack of independently verifiable risk-profiles in bundled financial assets (containing these high-risk or non-performing assets) traded across international financial markets, where supervision appeared to be absent and rating agencies failed. Light regulation and a lack of transparency and supervision can thus be very costly indeed! What is unique about financial regulation is that herd (risk) behaviour and contagion can turn micro failures into a major macro problem, called a financial crisis. The macro component is about ‘*systemic risk*’, where much talk is no good substitute for appropriate cooperation to pre-empt, jointly control or fend off crises prompted by contagion. The approach until today has typically been one of ‘after the fact, rescue first and repair swiftly’, and very largely on a national basis. Basel-II was apparently not good enough either. The problem here is that the OECD authors say they do not assess the quality of regulation, only its pro-competitive nature, but the (dangerous) implication of such a method is that “lighter is better”, with the US usually as the benchmark. However, in banking and financial markets more broadly, there is an old debate about the trade-off between regulation (and supervision) and financial instability: to put it simple, too little of the first will lead to too much of the second. An alternative view which overlaps largely with that on regulation is that competition in e.g. banking services markets can lead to pressures to regulate ‘lightly’ (or, to resistance against tightening it) and in this fashion ‘create’ its own financial instability sooner or later.

Thus, in short, even when SHEC legislation generally would not be included, there is still a case to insert financial markets regulation, if only for systemic risks.<sup>11</sup>

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<sup>11</sup> Note, that, in a later addition to the old PMRs, OECD economists have brought in financial regulation, in an ad-hoc fashion, even though SHEC regulation more generally has been avoided. See Figure 3.

The *third omission* which matters is that of liability. In PMRs product liability, as well as certain professional liabilities in services markets, are much more important in the comparison between e.g. the EU and the US than the silence about it in the OECD indicators seems to suggest. The Swedish Confederation of Industry (Jarnvall, Stenlund et al., 2007) speaks about a tenfold difference between typical rates in the EU and the US in product liability insurance premia for goods. Some States in the US have such aggressive medical liability rules (or courts, with juries) that specialists simply do not perform certain services in those states – a total regulatory failure, the market is no longer!<sup>12</sup> When trying to appreciate PMRs, the point is that product liability is private law (based on a public liability law, but still) and, compared to Europe, substitutes for (a) stricter public safety laws,<sup>13</sup> (b) social security, including disability protection [ which is much less prevalent in the US and hence ‘solved’ via private damages in liability cases]. The failings of the US product liability system have been analysed frequently, as to costs, incentives<sup>14</sup> and unpredictability (causing e.g. EU companies to be extra on-guard when exporting in the US). By leaving out liability precisely for product market regulation, ‘light’ regulation (being public law) is blessed more than is warranted and the EU approach might be read as relatively ‘heavy’.

## 4.2 Weaknesses of the OECD PMRs

As to the *weaknesses*, it is perhaps a little presumptuous to criticize the tremendous effort of constructing empirical PMR indicators. However, when identifying four important weaknesses, found below, one obtains a disturbing result: apart from retail, the weaknesses have the (unintended) effect of portraying EU countries as (comparatively) more restrictive in product markets than (*ceteris paribus*) they really are! Knowing the econometric exercises based on the indicators, this OECD PMRs would therefore risk to impart an unnecessarily negative bias on the results of EU countries.

In the discussion of the four weaknesses, reference is made to the basic PMR methodological document of Conway, Janod & Nicoletti, 2005, in particular, the lengthy and very detailed Annex.

First, Table 1 (in Conway, Janod & Nicoletti, 2005, Annex) is about the ‘scope’ of the public enterprise sector, by recording a “6” for a sector in which *one* firm is state-controlled (state, province, etc.) and a “0” if no firm is state-controlled. This is a measure which is liable to push up the scores of restrictiveness for all markets or instances when actual competitive pressures would militate against that.

Why? Economics of regulation say clearly that what matters is the ‘competitive environment’ of companies, not state-ownership as such. If the environment is competitive, one firm (state-owned or not) has to act like any other firm and measuring it with a “6” is without any virtue. In EU network industries, a gradually more and more competitive environment is emerging; of course, this also depends on the specific network market – still, in the PMRs any remaining state-ownership simply gets a “6”, the highest score, thereby missing out on the degree of

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<sup>12</sup> Note that in the US nuclear liability of power stations is limited ; however, for medical services, it seems not possible to introduce analogue measures, where justified

<sup>13</sup> Which may cause the OECD indicators to be more ‘restrictive’ for Europe since the EU relies less on liability and more on safety laws ; since SHEC laws are not included, thus might still come in via administrative burdens.

<sup>14</sup> See for a comparison of the EU and US approach to product liability, Silva & Cavaliere, 2000. Private litigation has huge costs and generates biased incentives: e.g. lawyers caught 52 % of all damages payments in the infamous cigarette cases!; and the smokers trying to sue the companies never got a single penny – it went to hospitals and state insurance agencies ! See Moore & Viscusi, 2000

competitive pressures in such markets.<sup>15</sup> This is not to deny that privatisation can engender positive effects on company performance but this ought to be considered together with the corporate environment (especially, competitive pressures without sheltering rules or subsidies). Moreover, if the environment is not (sufficiently) competitive, a private firm will also reduce the proper functioning of that market, so state-ownership is not unique either (yet, if private, the indicators do not pick that up). Worse, the data points include transmission & distribution in gas and in electricity as well as the operation of rail infrastructure and e.g. water transport, which are all natural monopolies. There is no obvious reason why such heavily regulated natural monopolies are ‘better’ when privately owned [again, it depends on the quality of regulation, not state-ownership].<sup>16</sup> Ergo, the scores here are almost by definition too high for EU countries in general and greatly biased towards low scores for countries which tend to regulate *private* firms in network activities. The latter effect will reduce over time now that most network industries in the Union have been or are being privatized. The authors could have mitigated this scoring problem by recognizing (i) that market functioning is not captured well this way and hence lower the ‘yes’ score from 6 to a ‘2’ or a ‘3’, thereby avoiding the forceful upward push of the scores; (ii) and leaving out all the natural monopolies in any case.

Second, Table 4 (in idem) is about ‘command & control’ (=C & C) regulation. Now, C & C regulation can be a serious issue in SHEC (esp. environment but not only), but this (SHEC) domain is ignored, as noted. One half of the weights in this table are about three transport sectors and retail. Whereas the road transport questions seem reasonable, the queries in the other three are not. In retail, it is all about shop opening hours – whether markets function better when opening hours are free is debatable but surely the consumers are better off (however, the small shop owners worse).

But far more important retail restrictions are ignored, such as land-zoning restrictions (often unavoidable in Europe given density; some such restrictions may actually be welfare increasing compared to free availability), shopping mall restrictions (e.g. one bakery only; no free entry) and size-of-shops restrictions. We do know from economic analyses that such restrictions cause significant differences in competitive aspects of retail markets between EU countries. In air travel, the OECD query is whether USO/PSO requirements exist for domestic routes – however, that is not necessarily restrictive of competition – indeed, in the EU open tendering via the EU Official Journal is compulsory (under strict EU conditions) so the operational measures are pro-competitive. By measuring merely the USO/PSO requirement, one misses the point (and, again, EU countries look more restrictive than they are). In rail, the same USO/PSO requirement pops up and the same objection applies (here, PSOs are typically subsidized according to EU-based criteria, in order to prevent distortions). Altogether, therefore, the C & C queries are inappropriate in general and notably for EU countries.

Third, Table 11 (in op. cit.) is about legal barriers to entry. This is a must, of course, in a list of regulatory indicators. There are three problems here. First, there is again a binary choice: yes (6) or no (0), whereas the formulation of Conway, Janod & Nicoletti (p. 47) is “...restrict the

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<sup>15</sup> Illustrating this with an example, in the first half decade after EU telecoms liberalisation (in 1998), when fixed (landlines) telephony was still very important, Norwegian Telenor (fully state-owned at the time) was consistently the lowest cost provider in the EEA.

<sup>16</sup> The Table also includes sectors where one has serious doubts whether a non-subsidized state-owned firm (EU rules do not tolerate subsidies for economic operations) could survive if underperforming, such as restaurants and hotels, manufacturing of basic metals and e.g. motion picture distribution. Scores of 6 just because one (!) firm in the market might happen to be state-owned would be unjustified. The film distribution in the EU is actually dominated by an American joint venture of three film producers, with recurrent problems of anti-competitive behaviour despite a special EU exemption.

number of competitors in at least some markets in” 2-, 3- or 4-digits ISIC sectors specified. The authors could have opted for a lower score, dependent on whether there is a standard justification possible (e.g. mobile telecoms is always restricted to 4 or 5 players max. due to spectrum scarcity). Indeed, sometimes such restrictions are or can be justified. Second, it is artificial, if not wrong, to give a 6 score to cases of natural monopoly (again, the authors have gas, electricity, rail as well as road infrastructure; in telecoms it is justified in fixed lines and internet, but in mobile the dividing line between a legal barrier and an auction limiting the number of competitors, given frequencies, is very thin). One also wonders what the point is of more competitors in “collection, purification and distribution of water” and why a single supplier needs to be scored a 6, although – when properly regulated – performance might well be superior to multi-provider supply. Third, two broad sectors typically plagued by legal barriers to entry are absent: one is retail which is dealt with elsewhere,<sup>17</sup> the other one left out here is ‘professional services’, notorious for such barriers, more often than not amplified by anti-competitive self-regulation. All in all, this category is too simplistic and hence misleading. There is no obvious EU neglect in this instance.

Fourth, Table 16 (in op. cit.) is about tariff barriers. The authors admit that ‘simple average of MFN tariffs’ does not convey more than the broad idea that (OECD) countries are now quite open, except (usually) for agriculture (however, agrofood is not looked at specifically). Preferential tariffs are not studied which once again leads to a bias against the EU since EU MFN tariffs are only paid by a handful (not all) OECD countries’ exporters, plus Russia and the Ukraine. Most EU imports from nearly 130 countries are subject to lower tariffs than MFN, or zero tariffs, due to FTAs, GSP or EBA.<sup>18</sup>

Because non-agricultural tariffs are low anyway in OECD countries, the measure chosen adds rather little, certainly for the EU, US and Japan (Mexico or S. Korea might be different). The big problem here is that ‘market access’ – indeed, *regulatory barriers* to access – are *not* included except in a very weak sense (in their Table 15) via queries based on elementary WTO obligations (on e.g. MRAs, equivalence and standards). This is a strange omission in a questionnaire about *regulatory* indicators.<sup>19</sup> And it matters. Admittedly, it is not so easy to do, but that is just as true for all the rest in the questionnaire. And the notifications under TBT/SPS in the WTO or the annual US reports on the market access problems the EU causes, and the EU annual report about the US barriers to market access the US causes, and similar reporting done in Japan about the EU and US would all have been partial remedies to obtain some measures. The upshot is that either the indicators here are all low, hence, not adding more insight, or systematically far too benign, because regulatory measures are omitted. For EU countries, the point is not a trivial one given the sophisticated EU regime pre-empting regulatory barriers inside the EU (or EEA) and the fairly high rate of overlap for European standards with world standards (compared to the US or Japan, for instance).<sup>20</sup> Also, mutual recognition in the EU goods market extends to third country imports, once legally allowed on the market in any one EU country. In other words, the EU market access regime is rather favourable to third countries.

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<sup>17</sup> However, in Table 10, p. 46, retail licenses or permits are regarded as ‘sector-specific administrative burdens’, although they may well serve as legal barriers to entry.

<sup>18</sup> The Everything-but-arms (EBA) regulation of the EU applies to the 48 poorest countries in the world. All goods come in tariff-free, with almost no exceptions.

<sup>19</sup> One reason might well be the neglect of the large domain of SHEC regulation for goods and services. Regulatory barriers to trade are overwhelmingly in this category.

<sup>20</sup> In a briefing paper for the EP, Renda & Schrefler (2008) report that 27 % of CEN standards reflect ISO standards, whereas no less than 57 % of CENELEC standards are identical to IEC standards and another 8 % is only slightly amended. For the US or Japan these overlaps are far smaller.

All else equal, world trade in goods and services is therefore exercising considerable competitive pressures (both actual and potential) in the EU internal market, once the EU regulatory system and its close alignment with WTO and world standards would be taken into account.

### 4.3 Ignoring EU fundamentals

The OECD PMR indicators suffer from an *EU-neglect bias*. EU fundamentals are simply ignored and they matter for market functioning. The bias leads unambiguously to the conclusion that the OECD PMRs are too restrictive for EU countries as compared to other OECD countries. The details of this bias require careful exposition and follow below. The origin of the problem is easily identified, however. The OECD PMRs are entirely focussed on *countries* (i.e. OECD Member States). In so doing, the profound influence of *the EU, as a whole*, on the regulatory environment in goods and services markets and, of course, in exposing companies to the far-reaching competitive pressures in the EU internal market without ‘barriers to trade and investment’ and with a powerful EU competition policy, is largely missed out. It is difficult, if not impossible, to ‘read’ the EU regime of the competitive internal market from the *national* regulatory ‘books’ of the EU Member States. The treaties cannot be found there, nor can EU case law. Where the EU employs an ‘EU regulation’ as a legal tool (and not a directive), nothing shows up in national rule books. EU directives, on the other hand, have to be transposed and in those cases the national regulatory regime and that of the Union would largely be identical, except for ‘gold plating’.

In general, for the EU-27, the methodology of scoring regulatory indicators solely on a national basis cannot possibly be correct. Indeed, for some aspects found in the lower levels of the PMR indicators, a number of regulatory provisions are included for EU countries which either cannot be enforced (given the supremacy of EU law) or must have a mere residual character.

The EU-neglect bias manifests itself in four ways.

First, there seems to be *no recognition*, let alone explicit recording, of the ‘*negative integration*’ of the EU, in particular, of course in the internal market. This is not a single issue with respect to the indicators but a *systemic* issue of intra-EU law and case-law based directly on the treaties (i.e. the economic freedoms; for the present PMR purposes, especially the free movements of goods and of service as well as the right of establishment and the free movement of capital since it is related to financial services). To some extent, this must show up in the abolition of national laws (when they become useless, that is, unenforceable, or, infringing EU law) and insofar as this is the case, the indicators will pick it up (if the measures capture it in the questionnaire). But often it is not taken into consideration; probably, the national civil servants filling in the forms are not aware of each and every aspect; it is also possible that national provisions remain, even if their application is severely restricted by EU law, as a kind of residual, fall-back option for the national administration. But in all such cases, where EU law prevails, whatever restrictions are still on the books of Member States would generate a more restrictive picture than is actually correct.

*Box 3. OECD PMRs neglect EU negative market integration*

**Examples where the EU neglect bias is likely to play a role include**

- i. Table 3 (in Conway, Janod & Nicoletti, 2005, annex ) on direct government control over enterprises, ‘golden shares’ are mentioned, yet, these have been explicitly forbidden by the ECJ as incompatible with the free movement of capital.<sup>1</sup>
- ii. Table 5 (idem); price controls in transport are forbidden in the internal market, given liberalization.
- iii. Table 11 (idem); legal barriers to entry have to be justified in the EU (and there are compulsory principles for that); the problem is that, in the rare cases that they are justified, it becomes very difficult to argue that they are ‘restrictive’ for the functioning of markets as there is likely to be a market failure which is overcome; this puts the entire table into potential jeopardy. The question to ask in such a questionnaire ought to be: ‘does this restriction escape the prohibition by EU law, or, has it been explicitly been justified in the EU context’? If the former, it can be kept as restrictive (will be very rare indeed); if the latter, the authors have to make the case that it is nevertheless bad for market functioning.
- iv. A similar problem crops up with respect to Table 13, op. cit. (on discriminatory procedures, because they are, as a rule, forbidden by virtue of the non-discrimination (of nationals, incl. firms) provision in the TFEU treaty and the tough ECJ rulings on it. The EU practices ‘national treatment’ (art. 48, EC; art. 54, TFEU) for all and any companies formally established on EU soil. The queries on appeal procedures in ‘domestic regulatory systems’ and on prior communication miss the point because that falls under EU based judicial review, with access to national courts in all Member States. However, this is nowhere written in national regulation (as it is EU law), yet, a ‘no’ score would be given a ‘6’.
- v. As to Table 16 (idem; on tariffs), EU Member States are implicitly considered to have a *national* trade policy (no longer since decades), whilst the (huge) internal market seems by implication irrelevant. Economically, and for the understanding of cross-border competitive pressures, it matters a lot for EU countries to give special attention to the fact that some 55 % to 80 % (dependent on the EU country) of trade in goods is totally tariff free and to a very large extent barrier-free as well, as it applies to *intra-EU* (intra-EEA) exchange; for services, tariffs never exist, of course, but barriers are usually lower than in international economic intercourse. Comparing other OECD countries with an EU country is thus comparing *like* with *unlike*. Even inside NAFTA, where tariff-free trade in goods applies (though with very restrictive origin rules in cars and clothing), a lot of regulatory barriers have remained and services trade is far more restricted than in the EU. Trade inside NAFTA simply cannot be compared with an EU having no customs borders anymore and accomplished far-reaching harmonisation (which is shunned by NAFTA, for example). Truly barrier-free trade in goods and services<sup>1</sup> matters a great deal because it disciplines markets inside the internal market quite a lot and in any case much more than the indicator of “foreign” (sic !) trade can possibly reflect.

Second, there is also *no explicit recognition* of the *positive integration* of the EU for EU countries. This comprises EU regulation and competition policy and several other common policies. Apart from SHEC regulation, this is relevant for network industries (in idem, Tables 1, 4, 11, and 12) and some other instances (e.g. Table 15 on regulatory trade barriers). To some extent, this also applies to professional services.<sup>21</sup>

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<sup>21</sup> Taking negative and positive economic integration together, one observes the crucial difference between MICREF (see Box 1) and the OECD PMRs in the attention paid to market integration in the former.

Third, there is an ‘EU neglect bias’ due to the complete by-passing of the EU level of government. One may object that this point is more or less the same as that about positive integration, above. However, it goes beyond that. The OECD focuses on what EU *countries* do and don’t.

But in the area of regulation, broader strategies are assumed at the EU level and one must take these into account, if one is to appreciate the impact on regulation and market functioning.

First, the EU Better Regulation strategy entails several aspects where good practices introduced at EU level (which directly support market functioning) also influence ‘better’ practices at the Member States’ level. This is the case for e.g. simplification, administrative burdens and alternatives to command & control regulation.<sup>22</sup> Second, a credible form of EU level influence is of course the verification of enforcement and action on infringements of EU law, frequently with respect to regulatory issues which create complications for cross-border business activities. And the subsequent recourse to the ECJ. On these aspects, EU Member States are incomparable to other OECD countries (including NAFTA countries). Third, there is a tough and pervasive competition policy at EU level and the combination of EU competition policy and EU regulation for network industries. The intrusiveness of EU competition policy (including strict state aids control, unique amongst OECD countries) for cross-border economic intercourse inside the Union is again incomparable with anything other OECD countries will experience (beyond their borders). Therefore, the picture about EU countries remains incomplete if the EU / Member States interface is not addressed at both levels of government. Generally, this interface has led to more rather than less competitive pressures to be unleashed, so it matters for the purpose of designing and measuring PMRs.

## 5. Deepening and widening the OECD PMR indicators

### 5.1 New regulatory indicators

Recently, OECD economists have published a series of new indicators, some of which are deepening areas which were covered in a shallow fashion (e.g. retail), other ones significantly widening the scope of regulation covered.

The new contributions are three:

- a. zooming in on *services* (non-manufacturing) regulation (=NMR) – see Conway & Nicoletti, 2006 - in greater depth;

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<sup>22</sup> Take Table 7 (in Conway, Janod & Nicoletti, op. cit.) where a simplification issue is addressed, all about licenses and permits (a good point in itself). But the simplification programmes of the EU (about simpler laws, not licenses) going on since 1996 but more effectively since 2005 are nowhere addressed. In contrast, EU Member States did not (until very recently) have such programmes (with one or two exceptions). The pressure is from the EU level to the national level! Consider Table 8 (idem) on administrative burdens - focusing on business start-up costs (typically, a national issue) – ignores the ACM (= administrative cost model) of the EU leading to a cut of 25 % of ‘red tape’ in EU rules. In fairness, it should be emphasized that the EU only began to work with ACM in 2007. But (other than the UK, NL and DK) EU Member States have only recently begun to address ACM, again due to EU pressures (in the Lisbon framework and via Better Regulation, the two overlap). Consider Table 4 (idem) on command & control regulation: the first two queries are about the obligation of regulators to assess alternative policy instruments and ‘guidance’ about them, which may or may not be the case in EU countries, but is *always* the case in the RIAs *at EU level*. However, the RIAs have only been formally introduced at EU level in 2003 (too late for the OECD indicators in 2003). Once again, the EU level of government has been in the lead, not Member States, followed later by the Member States as a group via soft declarations (given subsidiarity).

- b. attempting to measure the ‘*strength of competition policies*’ by means of a ‘competition law and policy indicator’, which should of course impact on the proper functioning of goods and services markets (see Hoj et al., 2007)
- c. zooming in on *foreign direct investment* with the help of a ‘FDI restrictiveness index’ (see Koyama & Golub, 2006)

Given the lack of competitive pressures in many services sectors as well as the observed price stickiness in services overall, the NMRs are probably the more important ones. Figure 3 depicts the system clearly: they are broken up in ETCR (network industries + road transport) and RBSR (retail & business services regulation).<sup>23</sup> Conway & Nicoletti, 2006, subsequently calculate what they call ‘RI indicators’: these ‘regulation impact’ indicators show a measure of the ‘*knock-on*’ effect to other sectors, be they manufacturing or services, of the degree of restrictiveness of the services indicators (the NMRs) based on input-output matrices at the 2-digit ISIC level. One can best ‘read’ the RI indicators as a comparative figure – all is measured (from 0 to 1, the latter being most restrictive) against extreme degrees of restrictiveness of services regulation, causing knock-on effects for sectors consuming these services. Note that NMRs only indicate regulatory restrictiveness, hence, the RI indicators, too, in a way; they do not show price or quality effects as such. Figure 3 also shows that, in a somewhat ad-hoc fashion, regulation of financial markets has been brought in (for one year only). As discussed above, the inclusion of financial market regulation is justified (even when SHEC regulation is left out), if only for systemic reasons of financial stability.

Figures 4 and 5 show the degree of detail in resp. the network industries, and retail + professional services. The de-facto overlap of Figure 4 with the 2003 PMRs is great.<sup>24</sup> However, vertical integration or separation and market structure are added and a finer disaggregation into submarkets is pursued (e.g. basic letters, parcel and courier services in postal). So, they are better and more refined.<sup>25</sup> As to Figure 5, the professional services are completely new (and go deep); for retail, 2 ‘entry’ queries (large-outlet restrictions, typical for Europe, and protection of incumbents, now finally forbidden in the new services directive 2006/123) are new and price controls are new for ‘conduct’ rules (although some specific retail price control questions are in the PMRs).

Once this is all done, the ‘knock-on effects’ (RI indicators) are derived. First, the authors note (rightly) that there are propagation mechanisms, *other than* the RIs: the effect on the price of investment goods and the ‘Baumol disease’ effect acting through wages.<sup>26</sup>

The RI indicators are nothing else than a multiplication of NMR indicators (the extent of anti-competitive regulation in services) with the total input coefficients. Thus, more precisely, an indicator of anti-competitive regulation in services sector  $j$  at time  $t$ , multiplied with the total input requirement (termed  $w$ ) of sector  $k$  for intermediate inputs from services sector  $j$ . Thus:

$$RI_{kt} = \sum_j NMR_{jt} \cdot w_{jk} \quad 0 < w_{jk} < 1$$

<sup>23</sup> Business services comprise here the professional services (and, in fact, only four of them). Note that Eurostat employs a much wider definition of ‘business services’.

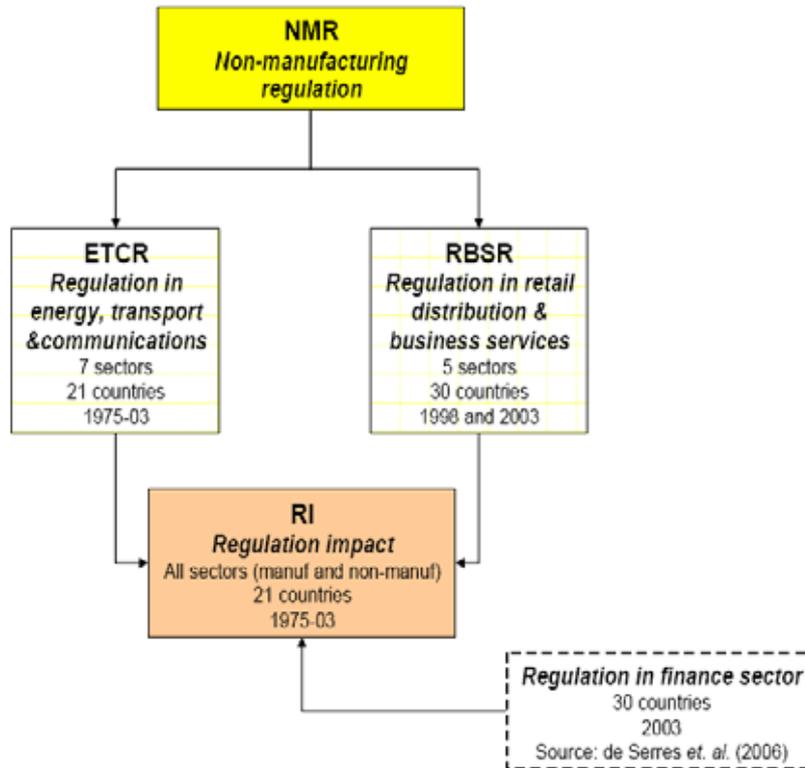
<sup>24</sup> See the Figures 12 and 13 (Conway & Nicoletti, op. cit., p. 47) with a correlation coefficient of 0.69 between 2003 PMRs and the ECTRs (and 0.81 in 1998)

<sup>25</sup> Thus, their Figures 6 (p. 41), 7 and 8 are far more informative for network industries than would ever be possible in the PMRs.

<sup>26</sup> Wages rise in services, not reflecting the low productivity increases so typical for services, but because manufacturing allows wages to rise in line with their productivity growth, and workers are intersectorally mobile and will induce wage convergence to some extent.

This calculation is possible at 2 digits ISIC level, in total 39 such sectors over 1975 – 2003. Note that the ECTR indicators exist for all years and the RBSR indicators only for 2 years, so RIs are heavily biased towards network industries.

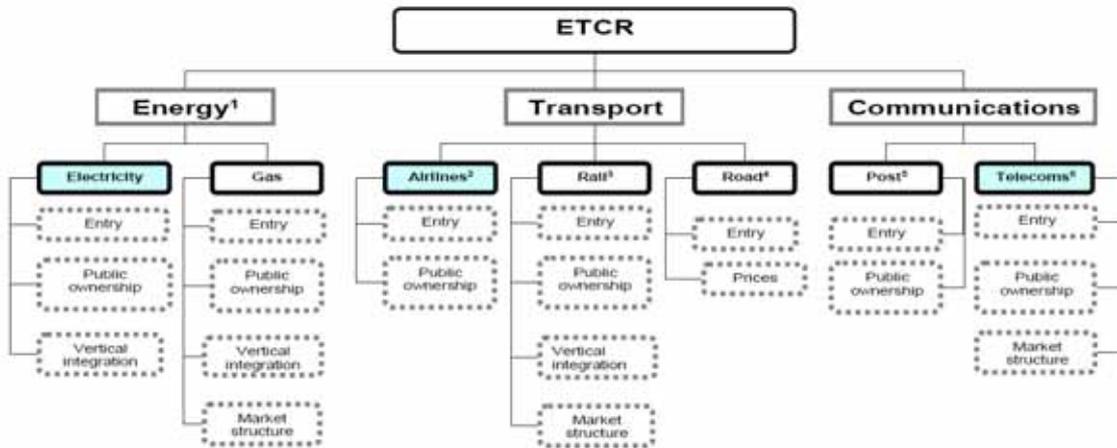
Figure 3. Structure of the NMR indicator system



As illustration of the knock-on effects of restrictive regulatory regimes for services, consider first Figure 6. It shows that, on a scale from 0 to 1, the restrictiveness of services regimes is transmitted to manufacturing, ranging from around 0.1 for Sweden and the Netherlands all the way to 0.35 for Austria.

It might also be of interest to study the knock-on effect of restrictive services regimes on ICT-using sectors, identified as the principal engine of extra productivity growth in the US between 1995 and 2005. Consider Figure 7. One can observe, first, that ICT-using sectors undergo a larger knock-on effect than in Figure 6, and, second, that in many countries the knock-on effect for ICT-using sectors is bigger than of ICT-producing sectors or of other sectors (this is also true for the US with RI = 0.2). Would the RIs of around 0.4 for France and Germany and more than 0.5 for Italy help to explain the infamous productivity growth gap of this episode?

Figure 4. Structure of the ETCR indicator system



1. The indicators cover production, transmission and supply; 2. The indicator covers passenger service.
3. The indicator covers both passenger and freight services; 4. The indicator covers freight services; 5. The indicator covers basic letter, parcel and courier services; 6. The indicator covers trunk and long distance fixed telephony as well as mobile telephony.

Figure 5. Structure of the RBSR indicator system

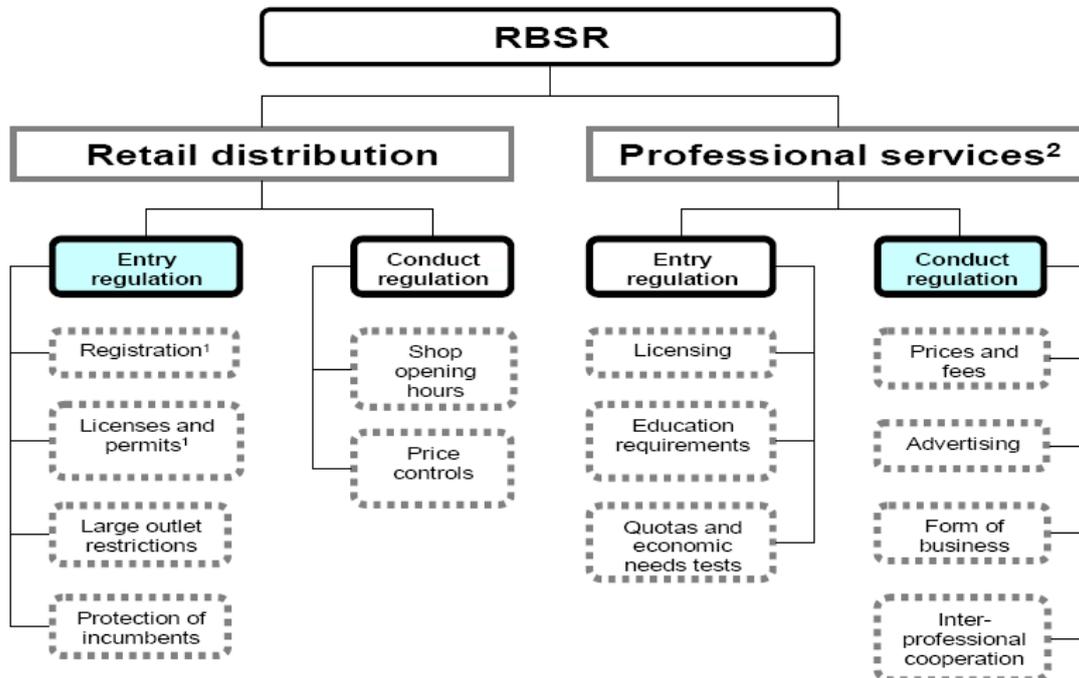
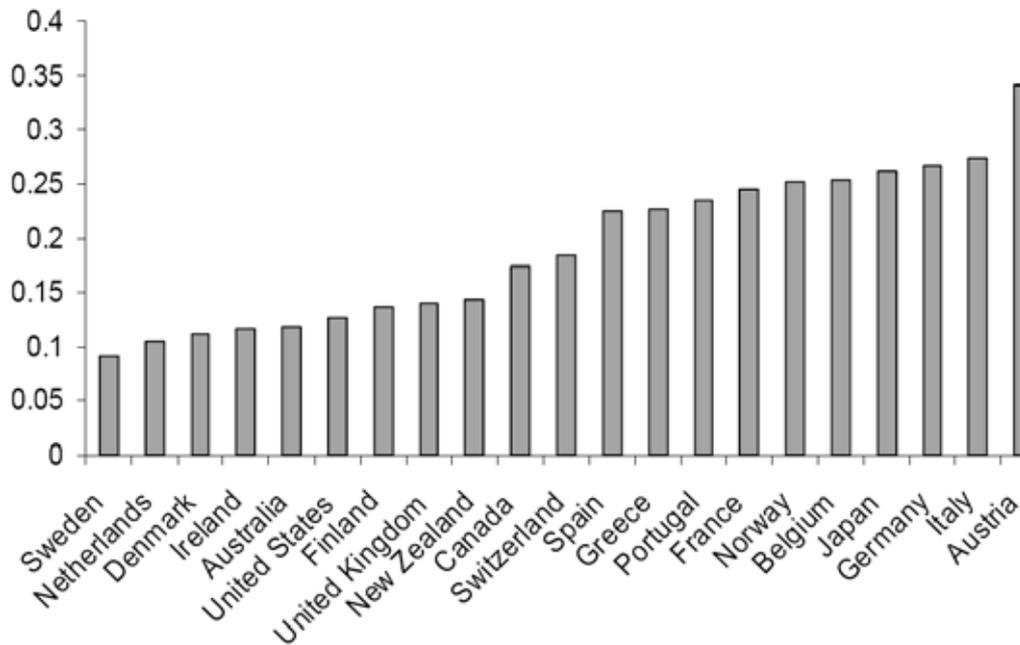


Figure 6. The impact of non-manufacturing regulation on the manufacturing sector, 2003 (scale normalised to 0-1 from least to most restrictive of competition)

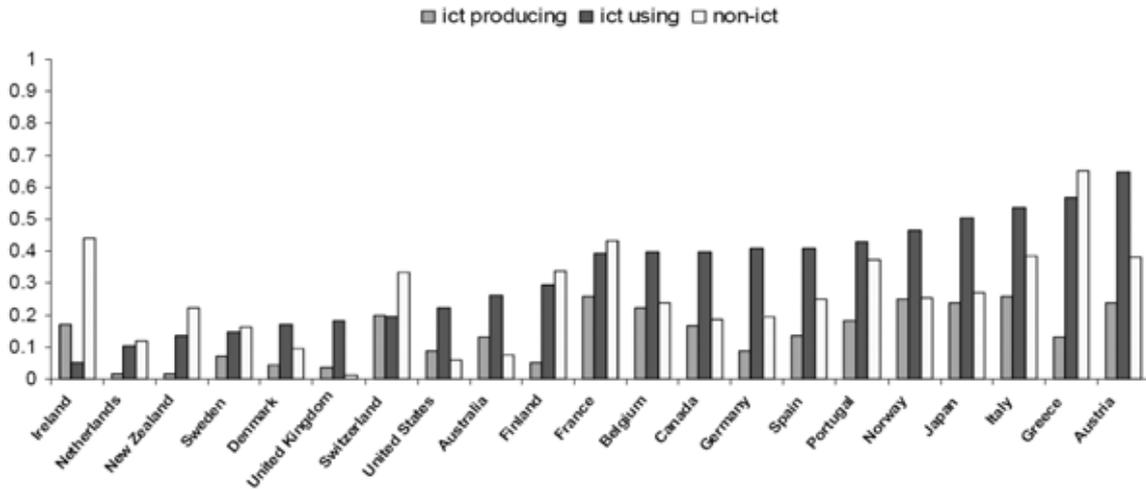


source: OECD International Regulation Database

The OECD Competition law & policy (CLP) indicator is defined and explained in detail in Hoj, 2007 and applied in Hoj et al., 2007. In a complementary approach to measuring the restrictions of competition (as in the PMRs), the OECD here attempts to “synthesize policies aimed at promoting competition”. The CLP indicator synthesizes about 100 data points per country. Curiously, though in line with drawbacks of the PMRs, no CLP indicator for *the EU* as a whole is included, despite the well-known preponderance of this common policy for the competition in the single market. It consists of two components, one measuring the general anti-trust framework<sup>27</sup> and the other measuring the promotion of competition in network industries, the former with a weight of 75 % and the latter 25 %. The former in turn consists of (i) the scope and exemptions of anti-trust covered and the ‘effectiveness’ of merger regimes; (ii) the effectiveness of enforcement (based on the scope of private legal action and the risk in assuming anti-competitive behaviour, indicated by e.g. leniency programmes and resources); (iii) the degree of independence of the competition authorities as well as their accountability.

<sup>27</sup> Note that anti-trust is narrower than (EU) competition policy, since it does not include state-aids.

Figure 7. The impact of non-manufacturing regulation on ICT-producing, ICT-using, and non-ICT intensive sectors, 2003  
(scale normalised to 0-1 from least to most restrictive of competition)



Note: These data are the simple averages of the regulation impact indicators for the individual industries included in ICT-producing, ICT- using, and non-ICT intensive sectors in 2003. The data are ordered according to the indicator values for ICT-using sectors.

The latter consists of the independence of (network) sector regulators as well as entry barriers and the degree of vertical integration. The CLP indicator is only available for 2003. It is exceedingly difficult to assess the utility of this indicator for the measurement of regulation of markets.

In the literature, very few attempts have been made to analyze the numerous subtle differences in national competition policies<sup>28</sup>, let alone, to firmly link that to performance indicators or, still more courageously, to the (better ?) functioning of product markets.<sup>29</sup> It is well-known that, when having regard to the last two decades or so, all EU countries have introduced and/or tightened their national competition policies, usually based on the EU rules and practices. Nevertheless, some EU countries have a weak CLP indicator (Austria, Greece, Portugal) and the query is how reliable CLP is in this respect for assessing the capability of obtaining a better functioning of product markets in these countries. Apart from the obvious and non-trivial influence of EU competition policy throughout the internal market for goods and services (ignored in CLP), one can question whether the composition of the indicator (and the fact that it is a mere snapshot) can serve as a guarantee for proper measurement. Thus, Italy comes out with a low CLP (i.e. a strong pro-competitive set of institutions) even though in OECD PMRs and NMRs markets in Italy seem to be relatively restricted on the basis of regulation.<sup>30</sup>

<sup>28</sup> See Van Cayseele, Sabbatini & Van Meerbeek, 2000, for a careful comparison of the policy in four EU countries.

<sup>29</sup> Some notion of the qualitative and analytical difficulties to assess the effectiveness of competition policy, and even more so, when relating it to how markets function, can be had from a special issue of *De Economist*, Vol. 156, 4 of 2008, in particular, Niels & van Dijk (pp. 349 ff), van Sinderen & Kemp (pp. 365 ff), Bucirossi et al., (pp. 453 ff) and Neven & Zenger (pp. 477 ff).

<sup>30</sup> See also the position of Italy in Figures 6, 7, 8, 9 and 10 in Hoj et al., 2007 ; similarly, in Conway & Nicoletti, 2006, op. cit., Figure 12 shows correlations between PMRs and ETCRs in 1998 and in 2003, and whilst Italy improved strongly on its ETCR in that period, it is still among the higher ones whereas it

The OECD ‘FDI restrictiveness index’ primarily aims at measuring deviations from ‘national treatment’, rather than the institutional environment more generally. It is mainly about (five distinct) degrees of state ownership, and more broadly about entry restrictions and post-entry operational restrictions. The index covers 9 sectors and 11 subsectors (Koyama & Golub, 2006). It cannot be surprising that EU countries come out on top. EU countries are subject to a treaty obligation of national treatment ever since the Rome treaty, with few and carefully conditioned exceptions. Interestingly, Koyama & Golub, *op. cit.*, also show that EU countries largely extend this open attitude to third countries. EU countries typically have scores below 0.2 and e.g. Italy, France and Germany all below 0.1; the only odd exception is Austria.<sup>31</sup> Thus, EU countries are anything but restrictive in this respect. Numerous studies show that FDI (other than tariff – hopping, but the EU has very low tariffs for products other than agro) tends to increase competitive pressures in goods and services markets. The EU has long remained and still is the largest receiver of FDI in the world economy, which – other things equal – should be expected to have pro-competitive effects in markets.<sup>32</sup>

## 5.2 The new, integrated PMR indicator

The OECD has used the occasion of a new round of registering data for its five-yearly PMR survey in 2008 to attempt to ‘integrate’ the additional, selected indicators, discussed in 5.1 above, into a new broader PMR indicator.<sup>33</sup> The old PMR is regarded as an ‘economy-wide’ indicator whereas the NMR approach is typically sector-based (see Figures 3, 4 and 5). Integrating the two (plus the FDI and CPI indicators) can be applauded for two important reasons: (a) with the NMR, (often restrictive and pervasive) services regulation assumes a much greater prominence – which is justified as well by the enormous weight of services in GNP (some 70 % in the EU) – and (b) several shortcomings or weaknesses of the former PMR are thereby addressed. The former tree-structure based on 16 low-level sub-indicators (see Figure 2, above) is now replaced by a tree-structure based on 18 low-level sub-indicators as shown in Figure 8.

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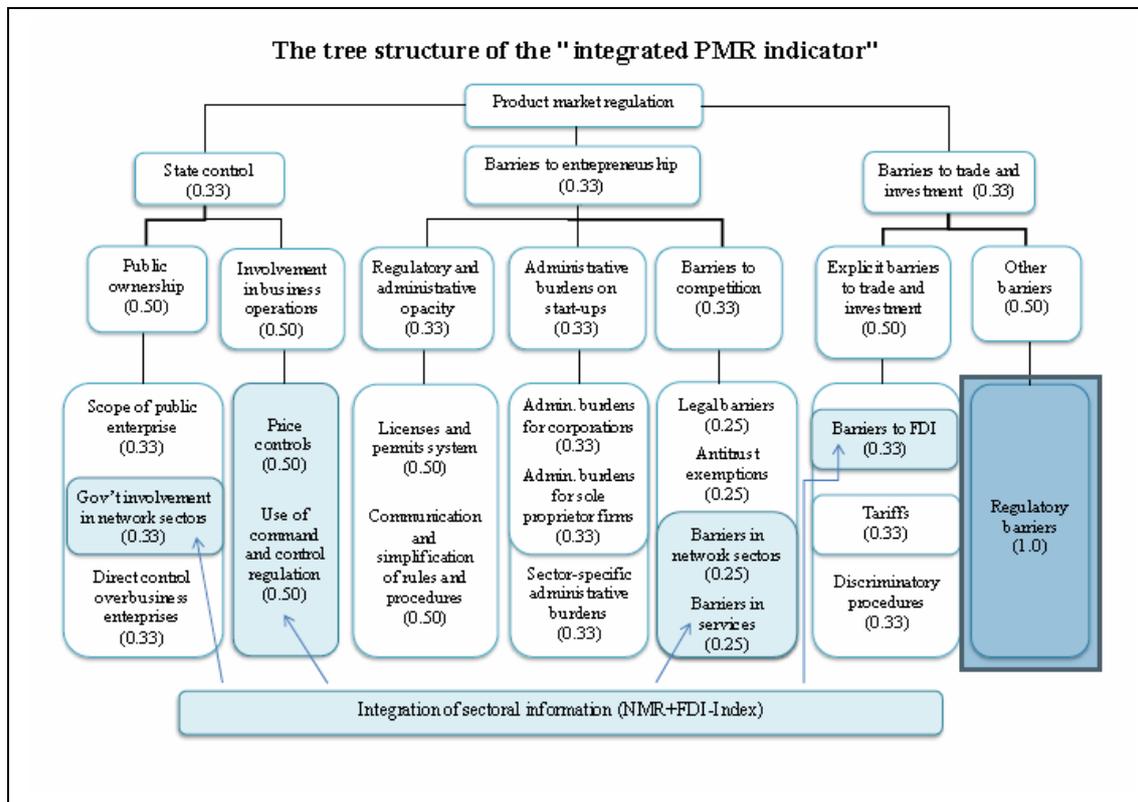
is second-best in network policies of the CLP indicator ( Figure 4B in Hoj et al., *op. cit.* ) ; interestingly, Italy in 2003 has the highest (i.e. restrictive) PMR of all OECD.

<sup>31</sup> Note that this is partly due to restrictions in professional services and partly to maritime (!) services, for a landlocked country (!), which shows how problematic a mechanical application of such an index can be.

<sup>32</sup> FDI inflows are currently affected by the crisis, with a shift towards developing countries. Nevertheless, after having received some 60 % - 80 % of all FDI inflows to developed countries for over a decade, the EU share of inflows hovered around 55 % - 60 % in 2006 – 2008, with a peak of \$670 bn in 2007 and a decline to around \$ 500 bn in 2008. Compare with US + Canada in 2008 (around \$ 380 bn) and China (\$ 108 bn) or China plus Hong Kong (\$ 191 bn). See UNCTAD, *World Investment Report 2009*, Figure II.7 and Figure II.25, respectively.

<sup>33</sup> See Woelfl, Wanner, Kozluk & Nicoletti, 2009, providing detailed explanation and annexes.

Figure 8. Revised and integrated OECD PMR



The other significant change is the revision of the weights applied. When comparing Figures 2 and 8, the weights inside the seven boxes at the bottom of the tree differ considerably. That is also the case for higher layers of the tree, both horizontally and vertically. This tree-like aggregation technique can therefore influence the final overall PMR as well as its sub-aggregates via the chosen weights. In turn, this might possibly bias results of econometric analysis when using the PMRs. We have not included this problem in section 2 because it is a technical question, not one of regulatory substance – the main focus of the present paper. Nevertheless, and rightly so, empiricists have repeatedly pointed to the dangers of getting the weights wrong (that is, arbitrary or biased). In an attempt to avoid arbitrary and subjective weights, those in Figure 2 were determined by principal components analysis (taken the 1998 structures for granted). In Figure 8, the methodology has shifted to an equal weights system, both in the low-level boxes and horizontally at each layer.<sup>34</sup> As Woelfl et al. show (op. cit., pp. 30 – 36), the impact of these changes is rarely important and some of the shifts have the effect of compensating one another. While one cannot dismiss the possibility of some impact of whatever (not too unreasonable) weight system one adopts, there seems to be no reason to criticize the OECD approach on this account.

The revised PMR can be considered an improvement. It is better capable to highlight the pockets of restrictiveness in economic and administrative regulation. The two further additions (CPI and the FDI index) might be helpful in some cases but, for the EU-27, they are of trivial importance at best because FDI cannot be restrictive in the EU and the differences between

<sup>34</sup> Note that the EU Joint Research Centre has conducted a comprehensive sensitivity analysis before equal weights were introduced. See Woelfl et al, op. cit., note 4, p. 6.

national competition policies – given the EU standards used by all – can only be detected in more subtle applications not caught by the CPI. The conclusion of surveying regulatory reforms in product markets over the period 1998 – 2008, in Woelfl et al, 2009, p. 21, is therefore critically dependent on the revision of the PMR: “The ‘integrated PMR’, which embodies more sectoral information than in past versions of the PMR, highlights that differences in PMR across countries and over time hinge to a large extent on differences in sectoral regulatory policies.” Some disadvantages, specified in section 4 above, are reduced or eliminated by these modifications. Nonetheless, several omissions and weaknesses as well as the EU neglect bias are not overcome with the revised, integrated PMR.

## 6. Conclusions

Overall regulatory reform strategies in OECD countries can be ‘evidence-based’ since the late 1990s. Although there is, by 2010, ample supply of distinct data sets and regulatory indicators which can be utilized to generate empirical economic analysis (‘evidence’), the OECD PMR indicators have been and still are prominent. This prominence also applies to the analytical economic underpinning of regulatory reform strategies of and in the EU.

The present paper takes a critical look at the OECD PMRs, whilst explicitly recognizing no less than 9 merits and advantages of that approach. There are two stages of development of the PMRs: the period 1998-2005, with the relatively well-known and widely used classical PMRs (see Figure 2), and its revision and extension into an ‘integrated’ PMR (Figure 8). The classical PMRs suffer from a range of drawbacks, which can be divided in three groups: important omissions, weaknesses and the neglect of EU fundamentals. Amongst the omissions, the most important one is the neglect of the very large domain of ‘risk regulation’ based on objectives of safety, health, environment and consumers (and investors) protection (SHEC, for short). The implicit assumption behind the PMRs is that SHEC regulation, in overcoming these ‘social’ (non-economic) market failures, is not an important reason for goods and services markets in the EU to function suboptimally or show rigidities. This is a remarkable position, not only because precisely the OECD has been the champion of ‘better’ regulation and systematic RIAs (which are applied to SHEC regulation), but also because EU regulation is overwhelmingly about SHEC. Conceptually, also regulation of financial markets (not in the classical PMR) is part and parcel of SHEC regulation, but, in addition, there is a macro component in such regulation, attempting to pre-empt or contain ‘systemic risk’ of financial instability. Amongst the weaknesses one should mention, the undue weight (and unjustified wide coverage of state ownership (certainly in the light of EU treaty rules and case law and the trend to more competitive pressures in markets where state-owned firms still operate), the inappropriate queries and data under ‘command and controls’ (again, also in the light of EU law), the shortcomings of the ‘legal barriers to entry’ and the absence of ‘regulatory’ barriers in the trade barriers. In most of these instances, (and some minor ones like product liability), the unfortunate effect is that EU countries’ goods and services markets would ‘empirically’ look more ‘restrictively’ regulated than they really are (compared to other OECD countries).

This systematic disadvantage over a range of obligations is amplified when zooming in on the neglect of EU fundamentals. This EU-neglect bias is systemic in the PMRs in that the OECD is solely interested in (OECD) *countries* and not in the EU as an ‘internal market’ and related common policies. This shows up, in many instances, in the lack of recognition of both negative and positive market integration. In other words, the EU treaty, case law, the Commission as the ‘guardian of the treaty’ and the European Court of Justice have long proved capable of maintaining a strict regime of free movement of goods, services and capital (when linked to financial services) as well as the right of establishment, which is intrusive for 27 Member States and disciplines their possible interventionism while pre-empting protectionist regulation.

Moreover, common EU regulation and policies are, more often than not, related to the proper functioning of the internal market, in e.g. overcoming numerous market failures and via EU competition policy. This neglect-bias extends to the neglect of EU SHEC-regulation in a number of ways. Finally, it fails to detect the considerable EU-level influence on national regulatory reform.

Since 2006, the revised PMR has been developed, by incorporating building blocks like network industries, retail and some professional services; a ‘competition law and policy’ (CLP) indicator; and an FDI restrictiveness index. Moreover, the weights in the classical PMR were altered to an ‘equal-weights’ system.

In the case of the EU, the CLP and FDI indicators would seem to add little: the CLP ignores (once again) EU competition policy itself and the influence of its standards on national CLP; the FDI index invariably scores well for EU countries (the reason is simply that in the EU, national treatment has always been obligatory).

The detailed addition of three components of services (networks, professional services and retail) constitutes a major improvement. When in 2009 the 2008 survey was reported on the basis of the revised PMR (see Woefl et al., 2009), precisely the services indicators were highlighted as the marked distinctions between (EU) countries. Also, the ‘knock-on’ effects of restrictive service regulation on goods markets and even more on ICT-using sectors, as presented, show the relevance for deep reforms in services markets. However, also the revised PMR suffers from the same drawbacks as the classical PMRs, be it that some measure of financial market regulation (for one year) has been taken into account.<sup>35</sup>

Therefore, we conclude that the OECD PMRs confer a significant and systematic bias onto the empirical results for EU countries. More precisely, and all else equal, EU countries’ markets come out more restrictively than they really are (compared to other OECD countries).

What are the implications of these somewhat disturbing findings for the underpinning of EU and Member States’ reform strategies? To answer this question, one first has to go back to the introduction of the present paper. The underpinning of market regulation reforms in EU countries depends on the quality and comprehensiveness of the PMRs or other indicators about goods and services regulation, as well as on indicators about labour market functioning, plus administrative and/or ‘governance’ aspects. The criticism on the OECD PMRs concerns only goods and services market regulation, not other reforms. There is, however, one important connection between labour market reform and product market reform and this can play a role. In the analytical literature, it is by now well established that rigidities of labour markets tend to go together with relatively restrictive services market regulation.<sup>36</sup> This can hardly be surprising given the high labour content of services. However, even when focussing solely on product markets, in particular services markets, there are good reasons to regard the strongly sectoral slant in the ‘integrated PMR’ (Figure 8) as necessary but insufficient, even when all the criticism levelled on PMRs would somehow be addressed. The intrusive screening process of national (and regional and local) services regulation (including permits, etc.) which has taken place in the EU during 2007 / 2009 under the horizontal services directive 2006/123 as well as

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<sup>35</sup> Insofar as the micro component of financial market regulation is concerned, this is SHEC regulation. It is unclear why one instance of SHEC is included and a wide range of other SHEC regulatory domains is not. Also, in professional services, regulation often blends ‘economic’ and ‘social’ (SHEC e.g. asymmetries of information) regulation.

<sup>36</sup> See e.g. Boeri, Nicoletti & Scarpetta, 2000 and Fiori et al. 2008. Whereas Bassanini & Duval, 2006, find complementarity between labour and services markets, Griffith et al, 2007 and Fiori op. cit. find substitutability.

other exercises the European Commission has undertaken in certain services markets which were ‘malfunctioning’<sup>37</sup> have made clear that services restrictions are ‘deep’ and widespread; they may also show up at more than one level of government. It will not be easy to develop new PMRs which will be capable of ‘catching’ most of these numerous petty or less petty restrictions throttling initiatives or rivalry in services markets. Of course, we do not know whether and to what extent services markets in other OECD countries might be equally restricted in countless ways. If not or less, the correction of the overall EU neglect biases of the PMRs may well be offset again by the incidence of so many services restrictions. Moreover, it should be noted that the services directive has a long list of derogations and a number of those would seem to be the mere result of lobbying rather than of a sound justification.

The conclusion is that the underpinning reform strategies should best be based on PMRs which are further extended so as to cover ‘deeper’ restrictions as well as corrected for the EU neglect biases, identified in the present paper, besides other ways of measuring or investigating the ‘malfunctioning’ of markets.

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<sup>37</sup> One can mention the DG Competition inquiry in EU retail financial markets and the ongoing DG EcFin work on market monitoring e.g. in food value chains and distribution.

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## Annex 1. Key questions for OECD PMR indicators

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### Box 2. The low-level PMR indicators

There are 16 low-level indicators in the PMR system. These indicators cover a wide range of product market policies. This box gives a brief description of each low-level indicator. Comprehensive details on the data and methodology used to construct the low-level indicators are provided in the annex.

**Scope of public enterprises:** this indicator measures the pervasiveness of state ownership across business sectors as the proportion of sectors in which the state has an equity stake in at least one firm.

**Size of public enterprise:** reflects the overall size of state-owned enterprises relative to the size of the economy.

**Direct control over business enterprises:** measures the existence of government special voting rights in privately-owned firms, constraints on the sale of state-owned equity stakes, and the extent to which legislative bodies control the strategic choices of public enterprises.

**Price controls:** reflects the extent of price controls in specific sectors.

**Use of command and control regulation:** indicates the extent to which government uses coercive (as opposed to incentive-based) regulation in general and in specific service sectors.

**Licenses and permits systems:** reflects the use of 'one-stop shops' and 'silence is consent' rules for getting information on and issuing licenses and permits.

**Communication and simplification of rules and procedures:** reflects aspects of government's communication strategy and efforts to reduce and simplify the administrative burden of interacting with government.

**Administrative burdens for corporations:** measures the administrative burdens on the creation of corporations.

**Administrative burdens for sole proprietors:** measures the administrative burdens on the creation of sole proprietor firms.

**Sector-specific administrative burdens:** reflects administrative burdens in the road transport and retail distribution sectors.

**Legal barriers:** measures the scope of explicit legal limitations on the number of competitors allowed in a wide range of business sectors.

**Antitrust exemptions:** measures the scope of exemptions to competition law for public enterprises.

**Ownership barriers:** reflects legal restrictions on foreign acquisition of equity in public and private firms and in the telecommunications and airlines sectors.

**Tariffs:** reflects the (simple) average of most-favoured-nation tariffs.

**Discriminatory procedures:** reflects the extent of discrimination against foreign firms at the procedural level.

**Regulatory barriers:** reflects other barriers to international trade (e.g. international harmonisation, mutual recognition agreements).

Source: Conway, Janod & Nicoletti, 2005.

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