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**PRODUCT MARKET COMPETITION AND ECONOMIC PERFORMANCE IN FRANCE**

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**By Jens Høj and Michael Wise**

*An earlier version of this Working Paper contained a Figure (3) with an incorrect labelling.*

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## ABSTRACT

### PRODUCT MARKET COMPETITION AND ECONOMIC PERFORMANCE IN FRANCE

Over the past decade, French economic growth has been insufficient to bring down high and persistent unemployment. Available cross-country evidence suggests that enhancing competition is an important means to improve economic performance. France is catching up with best practice in competition policy reform. However, other policy considerations often hamper the emergence of effective competition. Relatively weak competitive pressures remain in a number of sectors, particularly in sheltered service industries. Restrictions on competition reduce productivity growth and hinder job creation in regulated sectors. Policy must focus on giving more weight to overall consumer welfare in the face of opposition from relatively small but vocal special interest groups. This paper discusses reforms that would increase competition by: i) strengthening institutions and better clarifying their responsibilities with respect to competition enforcement; ii) reinforcing the ability of sector regulators to improve non-discriminatory third-party access and other aspects of competition in the network industries; iii) abolishing overly prescriptive regulation in the retail sector; and iv) removing unnecessary protection in some professional services.

JEL classification: K21, L11, L16, L33, L43, L81, L9

Keywords: France, productivity and growth, product market competition, competition law, regulatory reform, retail sector, network industries.

This Working Paper relates to the 2005 OECD *Economic Survey of France* ([www.oecd.org/eco/surveys/france](http://www.oecd.org/eco/surveys/france)).

*Also available in French under the title  
“La gestion des dépenses publiques en France”*

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## PRODUCT MARKET COMPETITION AND ECONOMIC PERFORMANCE

**Jens Høj and Michael Wise<sup>1</sup>**

1. French labour productivity levels are among the highest in the OECD. However, the high productivity partly reflects a much lower rate of labour utilisation - especially of low-skilled workers - whereas a number of other OECD countries achieve high aggregate productivity while employing a much larger share of the working age population. Unemployment remains uncomfortably high and much of it is structural. Raising labour utilisation while maintaining high productivity calls for reforms in both the labour and the product markets. The OECD Growth Study and other empirical work have shown that competitive pressures are likely to stimulate productivity growth, particularly through innovative activity. Moreover, product market reform can also directly contribute to employment growth.<sup>2</sup> Thus, more intense product market competition could help in maintaining productivity performance even as higher growth increases the employment rate of low-skilled workers. The same process also helps to sustain the internationally exposed sector. Naturally, sustained growth results from the interaction of a large range of policies. This chapter examines the scope for competition-increasing product market reforms in France, while other policies, notably labour market policies, are analysed in other chapters.<sup>3</sup>

2. In France, policies to promote competition have started to have an important impact on business conditions, but they have often been implemented later than in other European countries and they have on a number of occasions been subordinated to other policy concerns. Over the past decade product market reform has been extensive but, as broad reforms were also implemented in other countries, French product markets remain relatively regulated, even if the level of regulation has moved closer to the OECD average. In particular, state control over business sector activities is still relatively heavy and barriers to entry are still higher than in best-performing countries (Figure 1).

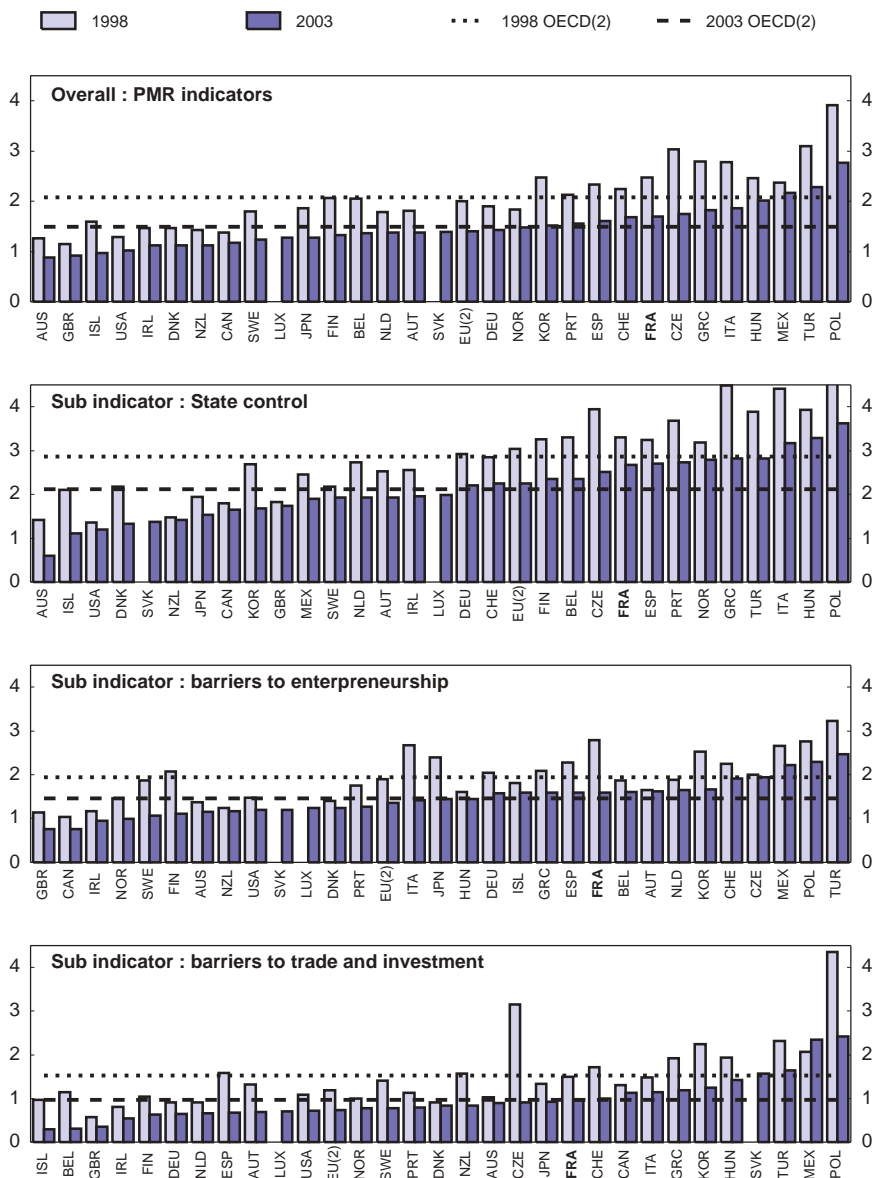
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1. This paper was originally prepared for the OECD *Economic Survey of France* published in September 2005 under the authority of the OECD's Economic and Development Review Committee. Jens Høj is an economist in the Economics Department and Michael Wise is a lawyer in the Competition Division in the Directorate for Financial and Enterprise Affairs. They are indebted to Jørgen Elmeskov, Mike Feiner, Val Koromzay, Andrew Dean, Maria Maher, Giuseppe Nicoletti, Wilhelm Leibfritz, Paul O'Brien, and Stephanie Jamet, and other colleagues in the Economics Department for useful comments. Special thanks to Nadine Dufour and Roselyne Jamin for excellent secretarial and technical assistance.

2. Bayoumi *et al.* (2004) estimate that the differences in competition can account for over half of the current gap in GDP per capita between the euro area and the United States.

3. However, there is an important interaction between policies. For example, product market reforms are likely to increase returns to skills as profits become more sensitive to cost considerations (Guadalupe, 2004). However, the French system of automatic extension of wage agreements may inhibit the materialisation of such outcomes. Ebel and Haefke (2004) find that combining liberalisation with a move towards a more decentralised system of wage determination could lower unemployment in the European Union by a third.

Figure 1. Changes in product market regulation<sup>1</sup>



1. Sorted by 2003 values. The scale of indicators is 0-6 from least to most restrictive.
  2. Simple average.
- Source: OECD, PMR indicators.

3. The chapter begins with a short review of the growth performance over the past decade and its possible links to the state of competition. Next, indicators of product market competition are examined to gauge the strength of competitive pressures. This is followed by an assessment of the general framework for applying competition law and its role in promoting competition. Attention is then turned to a number of sectors where regulatory policies inhibiting competition can be expected to have particularly large overall impacts. The chapter concludes with recommendations for further regulatory reforms aimed at increasing competition and estimates of their possible effects on macroeconomic outcomes.

## Macroeconomic performance and indicators of competition

### *Economic performance has been dragged down by protected domestic sectors*

4. The French economy has expanded at around two per cent per annum over the past decade, which is somewhat below the best performers in the EU, who have all implemented wide-ranging reforms to boost product market competition (Table 1). During this period, there was strong productivity growth in manufacturing, but nevertheless overall productivity developments were subdued, reflecting particularly weak productivity growth in the service sector. This partly reflects the increased participation of low-skilled employees. Nevertheless, GDP per hour worked remains high in an international context, although this in part reflects relatively low labour utilisation, which drags down GDP per capita to the EU average.

5. Exposure to international competition through trade and foreign direct investment has contributed to the good productivity performance in the manufacturing sector. For example, the increasing integration of European markets has contributed to the openness of the economy being roughly in line with the predictions from analyses which takes into account the size of the economy and transportation costs (Engel and Rogers, 2004).<sup>4</sup> Similarly the presence of foreign affiliates in manufacturing tends to be higher than in other countries of comparable size (Figure 2). Indeed, import barriers are lower than in most other EU countries and there are relatively few direct restrictions on inward FDI. (Figure 3). But it is possible that inward FDI may be somewhat hampered by the perception of political influence weighing on certain investment decisions - a perception which is perhaps fuelled by merger control not being the responsibility of the competition authority.<sup>5</sup> The relatively weak performance observed in some domestically oriented industries, like food processing, perhaps reflects weaker competitive pressures in downstream sectors, such as retail distribution (see below). The productivity performance in the service sector does not benefit from international competition to the same degree as in the goods sector because international trade in services is much lower than in manufactured goods and because the presence of foreign affiliates in services tends to be lower than in other countries.

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4. Perhaps surprisingly, the authors do not find much effect of the introduction of the euro, which could be expected to increase price transparency.

5. Empirical work suggests that European regulatory intervention is more likely to take place when European firms are harmed by increased foreign competition, indicating that European regulatory stance is protectionist and only to a little extent focused on combating monopoly power and protecting consumers (Aktas *et al*, 2004). Moreover, other empirical work shows that lenient merger policy to create “national” champions may damage a country’s international competitiveness, possible because the basis for strong international competitiveness is fiercely competitive domestic markets (Clougherty and Zhang (2004) and Høj and Wise (2004a))



Table 1. Output, employment and productivity

	France	Germany	Italy	United Kingdom	Netherlands	Sweden	United States	Japan	OECD	EU 15
<b>A. Growth decomposition, 1992-2002</b>										
Average GDP growth	2.0	1.3	1.6	2.9	2.7	2.5	3.2	1.0	2.6	2.1
<i>of which:</i>										
Productivity	1.1	1.1	1.3	2.0	0.7	2.5	1.8	1.2	1.1	1.3
Employment	0.9	0.2	0.3	0.9	2.0	0.1	1.4	-0.2	1.5	0.8
<i>of which:</i>										
Unemployment <sup>1</sup>	0.1	-0.2	-0.0	0.6	0.3	0.1	0.2	-0.3	0.0	-1.3
Labour force	0.8	0.4	0.3	0.3	1.6	-0.1	1.2	0.2	1.5	0.7
<b>B. Labour productivity growth, 1992-2002<sup>2</sup></b>										
Agriculture <sup>3</sup>	3.0	4.8	4.0	1.7	2.0	3.5	1.5	0.4		
Total manufacturing	3.6	2.1	1.6	2.6	2.5	7.0	3.9	3.2		
Food products, beverages <sup>4,5</sup>	-0.9	1.3	0.8	0.9	3.0	2.6	-1.7	-0.1		
Printing and publishing <sup>5</sup>	1.1	1.4	0.4		3.0	3.3	-1.8	0.1		
Machinery and equipment <sup>5</sup>	7.3	2.1	1.7	4.4	1.9	13.2	11.2	5.6		
Electricity, gas and water	2.1	5.4	5.5	7.6	3.7	1.8	1.2	2.5		
Construction	-1.1	-0.2	-0.1	1.9	-0.9	0.6	-0.2	-2.6		
Total services	0.2	1.0	0.9	2.1	0.5	1.7	1.6	0.9		
Wholesale and retail trade <sup>5</sup>	0.6	-0.8	0.9	2.4	0.8	3.4	3.8	0.7		
Communication <sup>5</sup>	2.7	7.6	3.4	5.1	3.5	3.9	2.3	1.3		
Financial services <sup>6</sup>	-1.0	3.3	2.8	1.3	0.5	4.9	4.1	4.6		
Other services	-0.2	0.2	0.2		-0.2	-2.4	0.0	0.4		
<i>Memorandum items:</i>										
GDP per capita <sup>7</sup>	75.8	71.8	71.1	77.5	80.5	75.7	100.0	74.2	74.6	72.9
GDP per hour worked <sup>7</sup>	103.5	100.9	105.0	79.2	105.8	85.0	100.0	72.4	80.6	91.5
VA per hour in manufacturing <sup>7</sup>	97.3				96.3	86.1	100.0	80.3		

1. A positive sign indicates that unemployment has declined and contributed to boost output growth.

2. Or latest available year.

3. Including hunting and fishing.

4. Including tobacco.

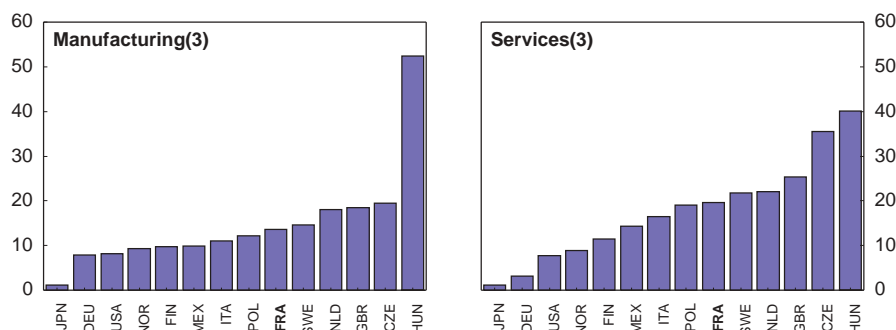
5. 1993-2002 for Sweden.

6. Including non-financial services for the United Kingdom.

7. 2002 levels, PPP-based. United States = 100.

Source: OECD.

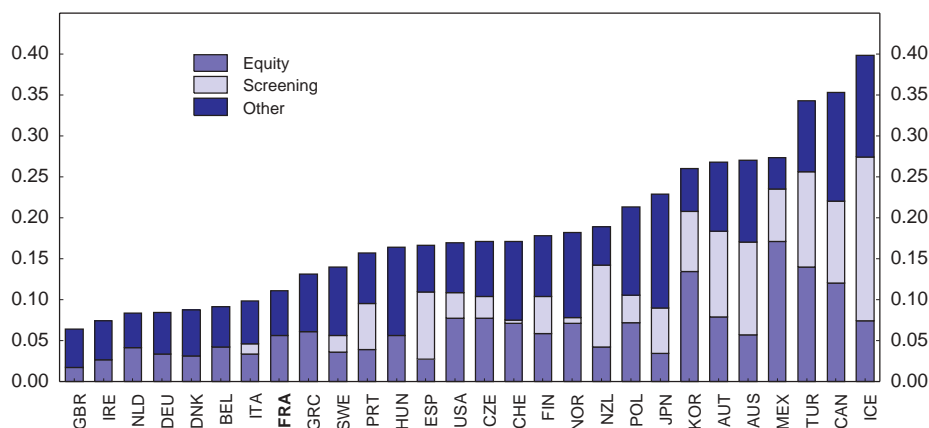
**Figure 2. Turnover of foreign affiliates in manufacturing and services<sup>1</sup>, 1990's**  
As a per cent of business sector value added<sup>2</sup>



1. Activities of foreign affiliates are classified into industries according to the principal activity of the affiliate. Data are means over available years.
2. Value added is total value added (gross domestic product) in the reporting country.
3. Turnover of foreign affiliates in manufacturing is an aggregate corresponding to Total Manufacturing (ISIC rev.3), in services is an aggregate corresponding to Total Services (ISIC rev.3).

Source: OECD, WP No 359, Policies and international integration: Influences on trade and foreign direct investment.

**Figure 3. Breakdown of FDI restriction by type, 1998-2000<sup>1</sup>**

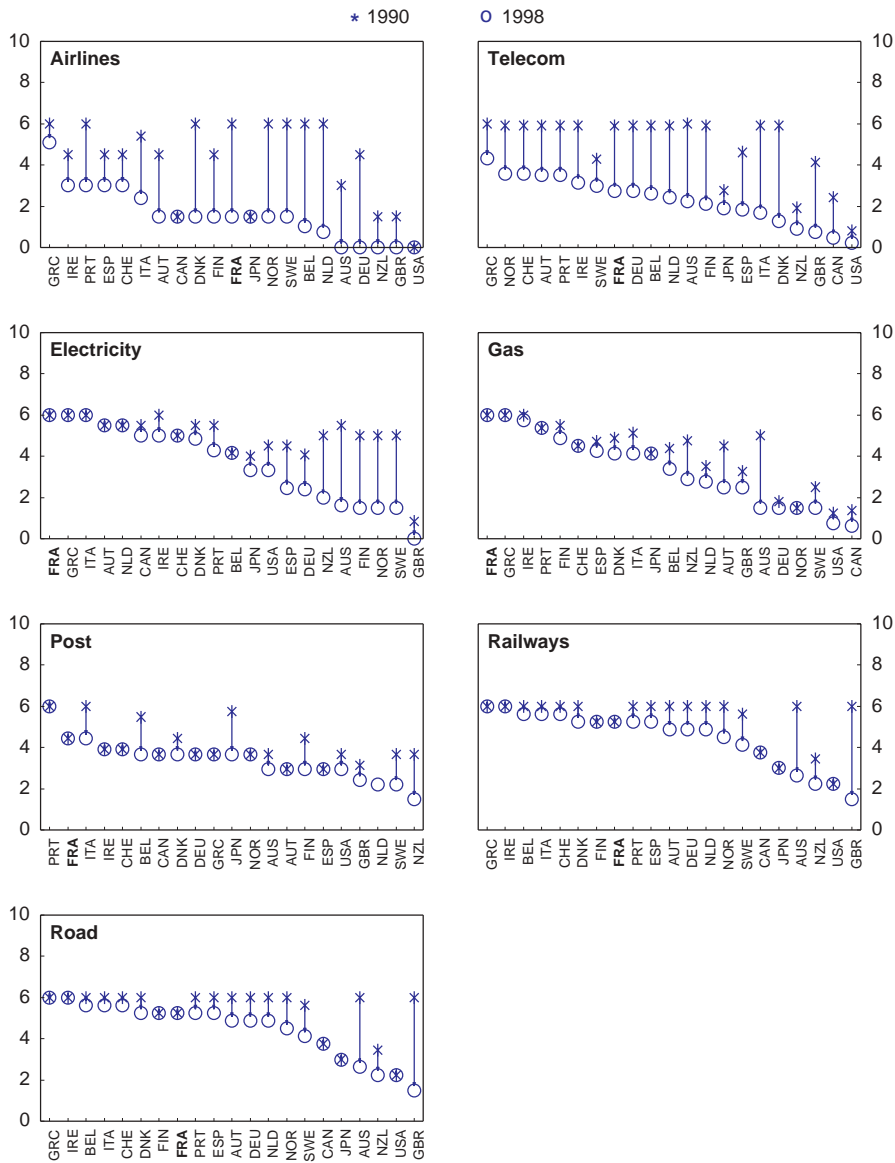


1. The indicator ranges from 0 (least restrictive) to 1 (most restrictive). The most recent year for which data are available varies across countries between 1998 and 2000.

Source: UNCTAD and OECD.

6. The most significant drag on French productivity growth has come from the non-manufacturing sector (Table 1). Services productivity has hardly expanded as the weak performance in retail and, especially, banking and business services has weighed on overall performance. Even in better performing sectors, such as in the electricity and communication sectors, productivity growth has been more subdued than in most other OECD countries. For example, the poor performance in the electricity sector has led to a

**Figure 4. Regulatory reform in non-manufacturing industries, 1990-1998**  
(from most to least restrictive)



Source: OECD regulatory database.

negative productivity gap *vis-à-vis* the United States of 20 and 13% in generation and distribution, possibly reflecting substantial overcapacity in France (McKinsey & Company, 2002). A common and important element behind the relatively poor performance in the service sectors is the relatively slow implementation of regulatory reform. OECD data suggests that liberalisation of network industries has lagged behind, even with respect to other large continental countries (Figure 4). Indeed, in 2004 France had the highest transposition deficit of EU directives, including the postal services and the telecommunications directives (which have just recently been transposed), among the old (15) members of the European Union (European Commission, 2004a).<sup>6</sup> Moreover, competition in retail and business services is impaired by restrictions on entry and business operation and the self-regulation of professional service associations.

7. Economy-wide productivity growth has also been held back by the disappointingly low rate of diffusion of ICT. While manufacturing productivity may have been sustained by a relatively high share of R&D spending in GDP, overall ICT investment has been below average and the growth contribution of ICT has been relatively weak (Figure 5). International evidence shows that ICT investment has generally been higher in countries where the regulatory environment promotes competition.<sup>7</sup> Moreover, an important factor in the diffusion of new technologies is the formation of new SMEs, which is hindered by start-up costs and red-tape (Bassanini *et al.*, 2002). The administrative burden of starting a new company has been reduced since the late 1990s, in particular since the adoption of the measures contained in the 2003 *loi pour l'initiative économique* (loi Dutreil)<sup>8</sup>, and remains at the OECD average.

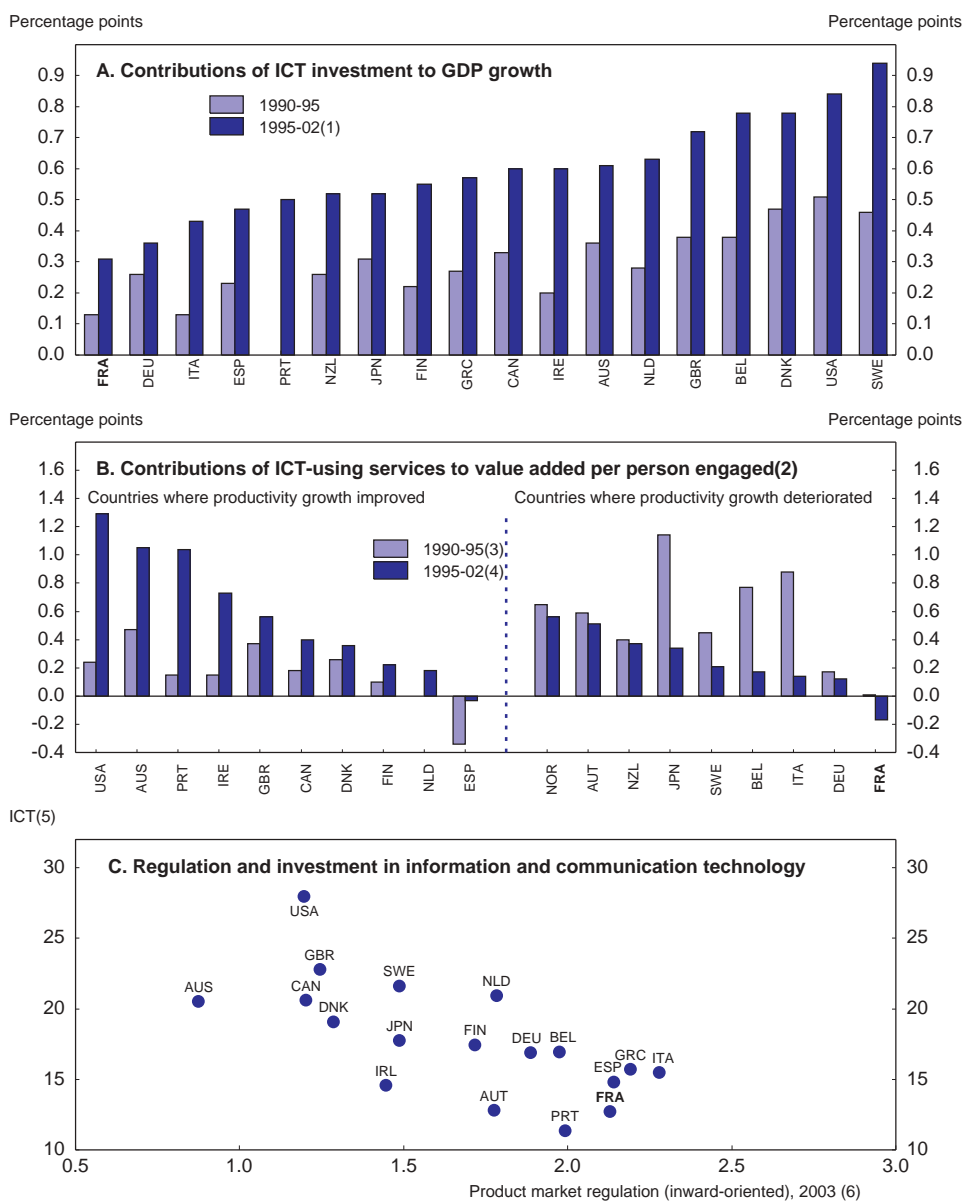
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6. In addition, France has the second highest number of open infringement cases.

7. Government regulation requires France Telecom to spend 4% of unconsolidated revenues on R&D, which in 2003 was equal to about 1% of turnover. However, this is still less than what the privately owned British Telecom spends on R&D. (OECD, 2005)

8. Between 2002 and 2004, the number of new business start-ups increased by some 25%.

Figure 5. ICT investment, diffusion and contribution to growth



1. 1995- 02 for Australia, Canada, France, Germany, Japan, New Zealand and the Unites States; 1995-01 for other countries.
  2. ICT-using services are defined as the combination of wholesale and retail trade (ISIC 50-52), financial intermediation (ISIC 65-67) and business services (ISIC 71-74).
  3. 1991-95 for Germany; 1992-95 for France and Italy; 1993-95 for Korea.
  4. 1995-99 for Korea and Portugal; 1995-00 for Ireland, Spain and Switzerland, 1995-01 for Australia, France, Germany, Hungary, Japan, Mexico, Netherlands, New Zealand and Norway.
  5. 2001 or the latest available year, as a per cent of total non-residential gross fixed capital formation.
  6. Indicator of economy-wide regulation excluding barriers to international trade and investment. The indicator ranges from 0 to 6, from least to most restrictive.
- Source: OECD Productivity database, December 2004.

8. Firm creation may also be discouraged by inappropriate bankruptcy policies. Complicated and drawn out procedures (completion of bankruptcies typically take about 7 years as compared with less than 3 years in most Anglo-Saxon countries) increases the cost (actual and psychological) of bankruptcy, which tend to increase the risk-averseness of entrepreneurs, hampering new entry as well as preventing entrepreneurs' entry into other entrepreneurial activities. This has been linked to the lower turnover of business relative to the population in France as compared with many other countries (Boston Consulting Group, 2002). Recognising the above issues, the government has proposed to ease bankruptcy procedures and reduce the financial risks associated with providing additional credit.<sup>9</sup>

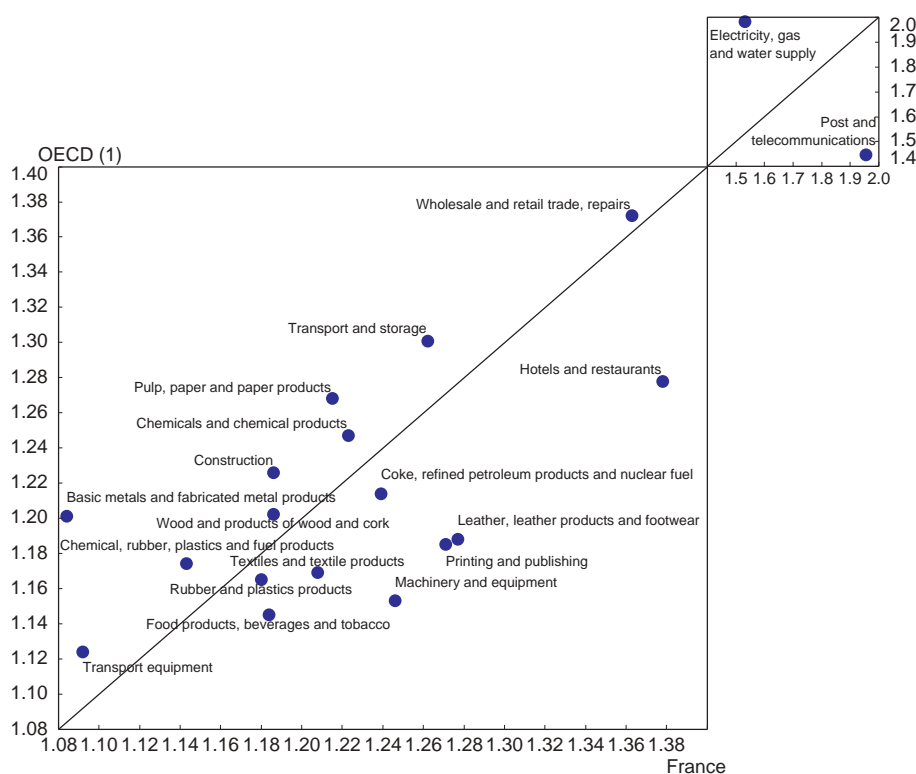
9. Measuring the strength of competition is not straightforward. Nevertheless, a survey of available indicators may, individually or in combination, convey useful information on the strength of competitive forces in the economy. The evidence emerging from such an exercise confirms that competitive pressures are relatively weak in domestically-oriented and sheltered sectors. *Concentration* is fairly high in a number of service sectors. This is particularly the case in the newly liberalised network industries, such as the energy and communications markets, which continue to be dominated by (state-controlled) incumbents. Concentration is also high in inherently competitive industries such as retail distribution, where entry regulation has been a factor in increased concentration over the past decade. In the domestic passenger transport market, concentration in air transport has increased as the government-controlled incumbent has purchased competing domestic rivals. The restrictions on long-distance bus transport have meant that concentration in land passenger transport has not been diluted, as in other countries, through intermodal competition. *Mark-ups* are not particularly high in general (Figure 6), although in relatively domestically-oriented sectors such as the food and beverages producing sector they are estimated to be higher than in other countries, possibly helped by regulation that increases the sector's negotiating power *vis-à-vis* the retail sector. Mark-ups are also relatively high in the newly deregulated post and telecommunications sectors, possibly reflecting the market power of the incumbents. The surprisingly low mark-up in utilities may be related to over-investment in electricity generation. Similarly, the *price level* in France corresponds to expectations, although the relative price of services tend to be higher than in other countries when taking into account the income level (OECD, 2005).<sup>10</sup> For instance, in terms of purchasing power parity, prices for communication services are considerably higher than the EU average.

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9. Previously, creditors extending or providing new financial resources to a bankrupt company could become liable to other creditors for all financial losses associated with the bankruptcy.

10. Another explanatory factor may be the relatively high minimum wage level in France, which would tend to push up prices in labour intensive sectors. However, if such sectors were exposed to foreign competition both the wage and input structures would adjust to lower prices.

Figure 6. Industry-level mark-ups in France and other OECD countries



1. Average of Austria, Belgium, Canada, Finland, Germany, Italy, Japan, Netherlands, Norway, United Kingdom and United States.

Source: OECD, STAN database.

## Competition law

10. France has had a modern competition law for nearly 20 years, but enforcement has become a priority only recently. (Box 1). Concerns about buyer power and unfair competition are prominent, focused on prescriptive regulation, particularly in the retail sector (see below). There are two competition law institutions, the independent *Conseil de la concurrence* and the *Direction générale de la concurrence, de la consommation et de la répression des fraudes* (DGCCRF), which is located in the Ministry of Economy, Finance and Industry.<sup>11</sup> The DGCCRF also has principal responsibility for administering rules concerning buyer power and unfair competition. There are shared responsibilities in network industries between the *Conseil* and sector regulators. Merger control rests with the Ministry of Economy, Finance and Industry, possibly encouraging the perception that merger decisions involve considerations other than competition policy.

11. In merger control and in the operation of competition enforcement policy, there is room for greater transparency. *For merger control, France would do well to follow the example of most other OECD countries, which have given responsibility for control of implementation of merger policy to the competition authorities rather than to the government.* If policy factors other than effects on competition

11. The title is sometimes translated as the General Directorate for Competition, Consumer Affairs, and Trading Standards.

are to be considered, those should be defined separately and subject to a different process (if those issues are not also included in the competition body's jurisdiction). This approach is increasingly being adopted in countries whose merger control system had resembled that of France. France splits competition enforcement activity between two institutions, the *Conseil de la Concurrence* and the DGCCRF (a directorate of the French Ministry for the Economy, Finance and Industry); unusually, the latter combines competition enforcement with other kinds of market regulation and surveillance. *The framework of competition law needs to be reinforced, either by fully transferring competition enforcement, and the necessary resources, to the Conseil de la Concurrence, or by more clearly separating the responsibilities and resources attaching to the other market surveillance activities within the Finance Ministry.*

### Box 1. French competition policy and enforcement

The competition law was comprehensively codified in the 2001 *nouvelles régulations économiques* (NRE – new economic regulation), which added a pre-merger notification requirement, stronger sanctions and a provision for leniency. Many of these latest measures follow procedural developments and requirements from EU law and enforcement practice. With its 1986 *Ordonnance*, France was one of the first in Europe to adapt its national competition law to the EU rules (in contrast to the late implementation of EU directives for opening network sectors to competition). Unlike most other Members, though, France has detailed rules about buyer power and unfair competition in its competition statute. Since the 1996 *loi Galland*, the *Conseil de la concurrence* has expanded powers to address abusively low prices, and the 2001 NRE strengthened the sanctions against abuse of economic dependence.

France's two competition law institutions occupy different positions and to some extent represent different approaches to organising the implementation of competition policy. The *Conseil de la concurrence* is a collegial decision-maker with the status of an independent administrative authority and processes that resemble those of a court. Private parties can complain against other firms directly to the *Conseil de la concurrence*, and appeals from its decisions are taken to the Court of Appeal of Paris. The *Conseil de la concurrence* is relatively large, with 17 (mostly part-time) members and a staff of about 120, of whom about 40 are permanent *rapporteurs*. DGCCRF, which is part of the system of public administration subject to the administrative law jurisdiction of the *Conseil d'état*, has a staff of several thousand stationed across the country, most of whom are occupied with other tasks of market oversight and consumer protection. Thus, resources allocated to competition issues are probably adequate, but too much emphasis is placed on issues that do not obviously contribute to general consumer welfare. DGCCRF devotes less than 10% of its resources to competition issues and "restrictive practices" and brings each year thousands of small-scale proceedings to enforce the rules about restrictive practices, compared to at most a few hundred matters about anti-competitive practices. The antitrust cases usually demand more resources and strenuous investigation methods. Still, DGCCRF is also pro-active in tracking down alleged violations whose effects on market competition are more ambiguous, initiating many cases about below-cost pricing because firms are reluctant to complain to the *Conseil de la concurrence* for fear of retaliation – and, perhaps, for fear of futility, as the *Conseil de la concurrence* has been sceptical of such competitor complaints. DGCCRF is paying increasing attention to horizontal cartels, most of the successful cases concerning public procurement contracts. DGCCRF can initiate enforcement proceedings in the courts or at the *Conseil*. Most of the decisions and sanctions handed down by the *Conseil de la Concurrence* come in the wake of proceedings initiated by the Ministry following a DGCCRF inquiry.

The Ministry of Economy, Finance and Industry is responsible for decisions about merger control. In addition, any order prohibiting a merger or imposing conditions on it must be issued in conjunction with the minister responsible for the sector concerned after the *Conseil de la Concurrence* has given its opinion. The latter has to be consulted in connection with injunctions and bans. The decisions taken are published and the reasons given whenever a breach of competition has been detected. Decisions can be referred to the *Conseil d'État*. The role of the *Conseil de la concurrence* is merely advisory and for most transactions, the opinion of the *Conseil* is not sought. Such systems are often criticised for non-transparency. By not referring a potentially anti-competitive transaction to the *Conseil* for study, a Minister could shield it from scrutiny in order to promote other policy goals.

Provisions for sanctions are adequate and flexible. A multifactor balance means sanctions may not be strictly proportional to gain or harm. Sanctions are generally well below the cap, which for firms is 10% of total turnover. But they are often a substantial fraction, or even a multiple, of the firms' turnover in the market actually affected. Criminal penalties are also possible, even involving some prison sentences. Judged by recent developments, there may be increased willingness to apply criminal penalties as exemplary punishment for particularly egregious violations. The *Conseil* has asked prosecutors to consider criminal charges against the ring-leader of a cartel that tried to fix the price of bread; such measures are also taken by the DGCCRF. Processes for applying the law are improving, but more



could be done. Enforcement against clandestine cartels should be helped by the recent authorisation of a leniency programme. Delays in the process of reaching a full decision at the *Conseil* have improved as the number of pending cases has declined. Nevertheless, cases filed at the end of 2003 could expect to reach final decision in about 26 months, down from a previous average time of three years or more. Advisory opinions and decisions about interim relief are much quicker, averaging about 3 months. An accelerated process for *de minimis* cases was put in place in March 2004, so it is too early to evaluate how well it is actually working. Private lawsuits are a potentially important supplement to public enforcement, as public action against construction bid rigging has been followed by private damages claims for hundreds of millions of euros.

There are no significant sectoral exemptions from the general competition law. In principle, competition law applies to public-service and government-related entities, but applying competition policy in the context of infrastructure public services can involve subtle distinctions concerning the jurisdictions of the private law institutions and the administrative law that governs public entities. The public service functions themselves are also subject to a form of competition policy oversight, but this is applied by the *Conseil d'état*.<sup>1</sup> These jurisdictional distinctions complicate processes, but they have not yet produced substantive conflicts, which potentially could adversely affect competition. The *Conseil de la concurrence* consults regularly with the sectoral regulators for energy and telecoms, whose jurisdictional and administrative positions are similar, and the *Conseil d'état* has consulted with the *Conseil de la concurrence* on occasions when its administrative law cases required application of concepts that have developed under the general competition law.

1. The *Conseil d'état*, the supreme administrative court, has a two-fold role, of advising the government and of acting as the ultimate judicial authority in the administrative jurisdiction responsible for the performance of public service functions and those implying a public power prerogative. In these functions, it is increasingly involved in competition issues as network sectors are being liberalised. Its primary judicial roles involving competition policy issues are deciding appeals of ministerial decisions about mergers and of some decisions of sector regulators, such as those imposing fines.

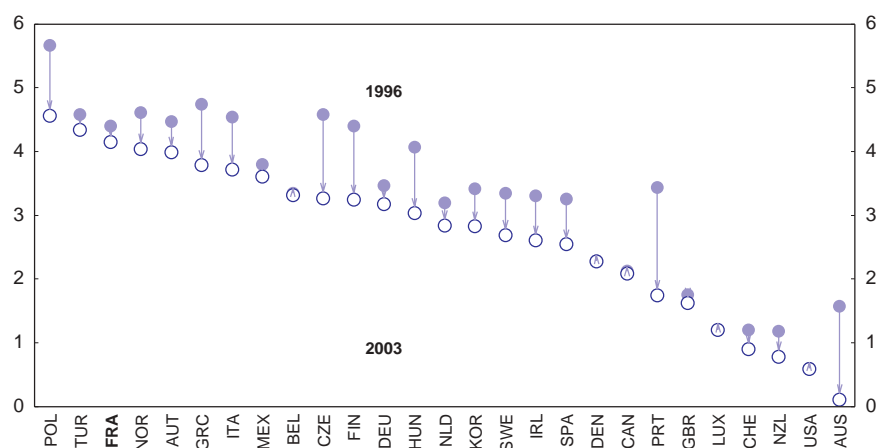
## Public ownership

12. The government has divested shareholdings equivalent to some 2% of GDP since 1998, of which more than 1% since 2002, through its ongoing privatisation programme. Nevertheless, public ownership remains relatively high (see Figure 7).<sup>12</sup> Publicly-controlled firms are particularly active in network industries - such as energy, post and telecommunications, and transport. In these industries, incumbents are vertically-integrated companies that hold dominant positions and operate in both natural monopoly and (downstream or upstream) competitive markets. The well-known regulatory issue of securing non-discriminatory third party access for new competitors to the networks is complicated by public ownership, because ensuring a level playing field is made more difficult by the possibility of “softening” the budget constraints of public enterprises. This may involve special fiscal arrangements (as was unveiled by the proceedings initiated by the EC in connection with tax relief which, in its opinion, had been granted to EDF in 1997) and/or explicit and implicit financial guarantees on the companies’ liabilities (including those related to special retirement schemes for their employees). Related to this issue is the granting of state aid, which distorts competition *vis-à-vis* private companies, by for example, allowing financially distressed publicly-controlled firms to retain all their assets (as recently in telecommunications). In this context, there is a heightened risk of cross-subsidisation of competitive activities from monopolistic market segments aimed at putting competitors at a disadvantage. Recent examples of such strategic behaviour

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12. Many OECD countries have pursued fairly extensive privatisation programmes since the beginning of the 1990s. However, a common feature has been that governments have not relinquished final control as privatisation has not been completed or corporate governance control has been maintained through cross-holding or special veto rights (Bortolotti and Faccio, 2004). For example, during the second half of 2004 the French government will sell an additional tranche of France Telecom shares, bringing the government’s ownership share below 50%, but nevertheless the government remains the largest shareholder. For the time being, however, the government remains responsible for some 72000 staff, i.e. approximately 57% of the total workforce in France which retain civil servant status.

include for example France Telecom's repeated setting of abusively high ADSL wholesale fees. Moreover, while the competition law applies to publicly-owned companies, the deterrence effect of sanctions may be less effective for public companies since the fines are, ultimately, paid by the public purse.

**Figure 7. Relative size of the public enterprise sector<sup>1</sup>**



1. Index 0-6 scale from lowest to highest share of public enterprises, index based on the extent of state ownership and (gross) proceeds from privatisations.

Source: OECD, Products Markets Regulation indicators.

13. As pointed out by international experience in the area of structural separation of network industries, it is unlikely that the mere accounting separation, which currently prevails in many French incumbent public enterprises, can provide an effective safeguard against anti-competitive practices. This is mainly because the incumbent has an information advantage *vis-à-vis* the regulator and because of the judgemental nature of accounting for common costs. More formal – legal or ownership – separation would reduce incentives to use soft budget constraints to drive competitors out of business while at the same time facilitating the tasks of regulators and competition law enforcement agencies.

14. Further privatisation of companies operating in competitive markets would, therefore, provide the best way to level the playing field in network industries, eventually leading to an increase in consumer welfare through lower prices and greater choice. Recognising this, the government has recently taken steps to change the status of public enterprises to limited companies (as for example with EDF and GDF in mid-2004), subjecting them to private company law and accounting rules (so called corporatisation) as well as opening up for injection of new capital.<sup>13</sup> While this move is in the right direction, it could have undesirable effects if it is not followed by rapid privatisation, because the new status now allows public enterprises to enter markets that are outside their major line of business. Such entry typically takes place through mergers and acquisitions, which are not always subject to an evaluation of competition effects, raising concerns such as harmful cross-subsidisation between competitive and non-competitive markets and consolidation of dominant positions. Indeed, as recognised in a recent parliamentary report on the management of state-owned companies, in the past public enterprises have shown a tendency to expand through mergers and acquisitions, somewhat independent of considerations related to efficiency and profit

13. The corporation also removes the state's de facto guarantee of the corporatised companies' debt. For example in the case of EDF this guarantee was considered as illegal state aid by the European Commission (OECD, 2003).

maximisation.<sup>14</sup> These investments have sometimes led to substantial losses, such as the write-off of France Telecom's German UMTS license and EDF's investments in the Argentine energy sectors. Such market expansion strategies have sometimes been linked to the corporate governance problems of publicly-controlled companies. As a rule, when public enterprises with a public service obligation embark on a strategy of expansion, they may also engage in anti-competitive behaviour (Sappington and Sidak, 2003). Thus, unless associated synergy effects can be demonstrated to be large and positive, such expansion should only be allowed once the involved markets have been opened successfully to competition.

15. To address some of these problems, a State Ownership Agency (*Agence des participations de l'État*, APE) was established in 2003, which exercises voting rights in general meetings. However, the government's shareholder rights are still mostly exercised by the relevant line ministries. Securing uniform corporate governance standards across state-owned companies requires that all such responsibilities are transferred to APE (OECD, 2003). However, only further privatisation (where the state at least gives up its controlling interest) accompanied by regulatory reforms might provide a definitive solution to the competition problems associated with publicly-controlled companies.<sup>15</sup>

16. One of the goals of maintaining public control in network industries has been to secure the universal provision of high quality public services at reasonable and geographically uniform prices. With the liberalisation of network industries and the application of EC law, the French notion of "mission de service public" will have to be adapted to an environment in which many companies could in principle provide such services. With the increase in the number of providers, the dispersion of prices may increase.<sup>16</sup> This is already the case in water services, where the outsourcing of provision by local authorities to private companies has led to geographically dispersed prices.<sup>17</sup> Moreover, new ways of financing the cost of universal service obligations (USO) must be found to ensure that the provision of these is competitively neutral. This process has started. For example, in the electricity (and telecommunications) sector(s), a public service charge is added to prices. The associated revenue is paid into a central fund to finance the cost of universal services. The provider of the latter continues to be the incumbent, but could in principle be any operator (for example, in telecommunications a bidding process will be established to the providers of various USO). Although similar compensation systems have been established in other countries<sup>18</sup> a less distorting form of financing would be a fiscal transfer from the government, as the universal service charge reduces relative price differentials. In any case, the key to secure a level playing field in USO provision among several competitors is that the associated payment for providing universal services equals the difference between the cost of the USO and its associated benefits, such as brand recognition or the sale of other services over the same network (for example taking into

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14. In this connection, the Conseil de la Concurrence fined France Telecom for violating orders in both 2003 (€ 40 million) and 2004 (€ 20 million).

15. In addition to the positive effects on product market competition, privatisation also enhances stock market liquidity, improving capital allocation and thus growth prospects (Bortolotti and de Jong, 2004).

16. Currently, the dominant incumbents usually suggest a set of prices (in the monopoly segment), which is then accepted or moderated by the government.

17. Water charges are determined on various principles of cost-recovery (Bongaerts, 2002). Provision is either organised by the municipalities or by outsourcing to private operators (Garcia and Thomas, 2003). Costs are at times increased by a lack of economies of scale (Garcia and Thomas, 2001 and Ménard and Saussier, 2000). Competition issues in the sector include the repeated renewal of long-term contracts because of the costs associated with building municipal water management units and the simultaneous loss of business tax revenues (Clark and Mondello, 2000) and that the private water companies are often engaged in delivering other services to the municipalities, creating potential lock-in effects (Elnaboulsi, 2001).

18. Specific requirements for universal service differ across countries. For example, in the case of Spain, accessibility to the postal service is ensured, but higher charges are required in remote areas.

account that French postal offices provide postal services as well as a number of banking services). Competitive tendering for the provision of USOs (as is suggested by new EU directives), would make the assessment of cost and benefits easier and more market based.

### Sector analysis

17. Regulatory policies for private service sectors vary in scope. Some sectors, such as retail distribution and professional services are inherently competitive. However, the intensity of competition is affected by regulations - such as those concerning the relationship between producers and large retailers – or entry requirements in the self-regulation by professional associations. Network industries, on the other hand, are characterised by “natural monopoly” segments, where competition is difficult (or even impossible) to introduce. In such cases, the regulatory framework should be directed to securing non-discriminatory third party access to the networks and opening potentially competitive segments to competition. The gains from successful regulation in these areas have been shown in other countries to be potentially very large. In cases where concerns about supply reliability and insufficient network capacity have been raised, closer inspection has related such problems to the design of the implemented reforms and not to deregulation *per se*.

### Professional services

18. Self-regulation (or similar rules embodied in legal statutes) in professional services is relatively common in OECD countries. Proponents contend that by alleviating information asymmetries, this self-regulation protects consumers and secures high quality services. But this self-regulation may also restrict competition unnecessarily. In France, there are access restrictions, with training requirements which are comparatively strict for certain professions such as certified accountants, lawyers, notaries and architects, and especially demanding for the first three (Paterson *et al*, 2003). In addition, lawyers and notaries are also subject to strict regulation of conduct. (Figure 8). These restrictions have led to a fairly low supply of such services relative to the population. The fact that the restraints limit supply is revealed by the sharp increase in the number of lawyers in the 1990s after the mutual recognition of qualifications in the EU (Gromek-Broc, 2002).

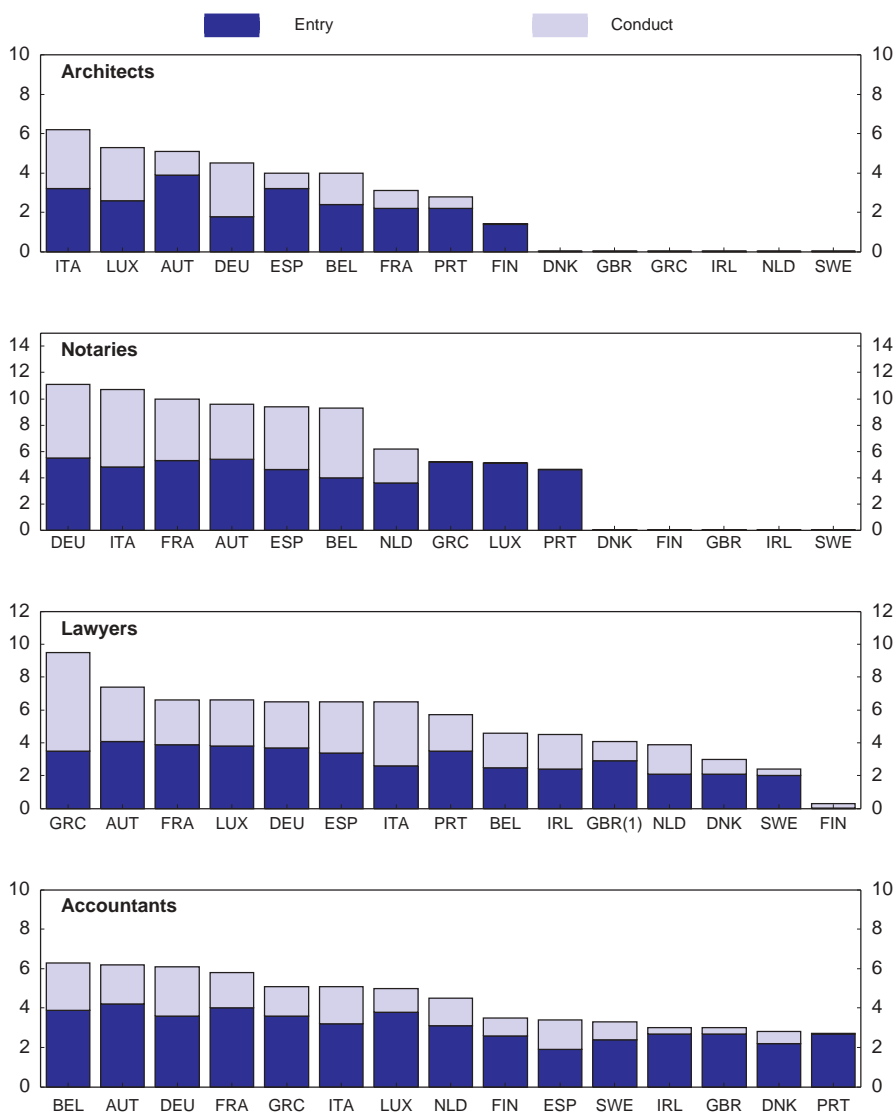
19. Part of the strict access regulation is related to some of these professions having a semi-public status as they perform official services for the state, such as notaries’ conveyance and tax collection activities - services that in other countries are provided by lawyers or by the parties in the transaction. Indeed, some professions have legal limits, such as the number of lawyers authorised to appear at the Supreme Court and at some of the lower courts. Some of the professions that undertake official services are also engaged in supplementary activities, with for example notaries having the right to perform as real estate agents. However, notaries are only allowed to be remunerated for such additional services if the transaction is registered in their office, and advertising for such services is not allowed. The participation of notaries in the real estate market has seemingly not prevented competition problems from arising in a market that is characterised by relatively low barriers of entry, but which nevertheless has uniform charges that are higher than in other countries (Catte *et al*, 2004).<sup>19</sup> The *Conseil de la Concurrence* has addressed some of the competition problems in these sectors with, for example, the prohibition of fee scales by the French Architects’ Association (European Commission, 2004b). To sum up, there appears to be considerable scope for reducing the restrictiveness of regulation within professional services. Indeed, an expert report proposed recently to facilitate access in professional services (Cahuc and Kramarz, 2004).

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19. Real estate agents need a professional licence, which is given on the basis of three criteria: a professional aptitude test based on a diploma or experience, a clean criminal record and professional insurance. The DGCCRF instigated an investigation of the sector in spring 2004.

Competition can be further enhanced by allowing other bodies to execute official services that are currently reserved to particular professions as well as removing restrictions on the performance of market activities.

**Figure 8. Regulation of professional services in the EU**  
Indices



1. Referring to legal system in England and Wales.

Source: Institute for Advanced Studies, Economic impact of regulation in the field of liberal professions in different Member States.

**Retail distribution**

20. Since the 1960s, the French retail sector has, as in other countries, been transformed with the growing market shares of larger out-of-town retailers (Cliquet, 2000). However, this development was seen as a threat to small retailers, leading to the introduction of commercial zoning regulations aimed at large retail outlets in 1973, which was further strengthened in 1996. This led to a merger-induced increase in concentration in both the food and the non-food segments that is higher than in most other larger European

countries (Corstjens *et al.*, 1995). (Box 2). Thus, entry restrictions have tended to reduce competitive pressures between large retailers and protect them from entry of innovative retailers. While concentration in retailing can benefit consumers through increased economies of scale and scope, some authors have pointed to possible adverse effects on product variety and differentiation of retail outlets, especially in the presence of barriers to new entrants (Inderst and Schaffer, 2004; Corstjens *et al.*, 1995). However, over the past decade there has been another structural change of the retail market as “hard discounters” (vertically integrated chains of relatively small outlets specialised in offering a limited number of mostly own-label goods) in food retailing gained a market share of about 13½ per cent in early 2005, and as specialised stores (often referred to as category killers) in mostly suburban shopping centres gained market shares from department and other larger stores in city centres as well as from hypermarkets (Allain and Chambolle (2003), Cliquet (2000), Castets (2004)).<sup>20</sup>

### Box 2. Regulation affecting the distribution sector in France

Commercial zoning regulation was introduced in 1973 (*Loi Royer*). The creation or extension of any new large retail establishment requires the approval of a regional zoning board, composed of nine store owners (of which seven must be self-employed), two consumer representatives, and nine regionally elected politicians. The regulation used to apply to all stores larger than 1 500 m<sup>2</sup>, except in cities with less than 40 000 inhabitants where the limit was 1 000 m<sup>2</sup> (Bertrand and Kramarz, 2002). However, these limits were restricted to an internationally low threshold of 300 m<sup>2</sup> in general in the 1996 *loi Raffarin*, though very large outlets (+6 000 m<sup>2</sup>) became subject to special investigations. The same law also changed the composition of the boards which are now made up of 3 elected representatives, the presidents of the chambers of commerce and trades and a representative of the consumer associations. The boards have been rather restrictive, only approving about 40% of the applications submitted between 1974 and 1998. Following the setting of the 300m<sup>2</sup> threshold and the change in the boards' composition, the approval rate increased to 80% over the period 1997-2005. Even so, during the second half of the 1990s, only 13 new hypermarkets were opened and the number of approved supermarkets declined substantially, effectively protecting this segment against entry of innovative competitors (McKinsey Global Institute, 2002). The board decisions can be appealed to the Minister in charge of retail and crafts, who will be advised by a national zoning commission. Contrary to many other European countries, there are generally no restrictions on shop opening hours, except on Sundays, which require special permits (Allain and Chambolle, 2003). However, the effective barrier on maintaining services around the clock comes from labour market regulation.

The *loi Galland* of 1996 introduced a strict rule against pricing “below cost”, which is narrowly defined as the invoice price, and is enforced by criminal penalties. The rule is moderated by regulations that permit such sales when they are confined to particular dates. Thus all outlets schedule their promotions for the same time, which tends to prevent one from gaining a competitive advantage over others. The rule and its prescription of the key reference level of “cost” have led to controversies, particularly concerning price setting. Distributors' imposition of so-called *marges arrières*, or off-invoice charges ostensibly to cover marketing services, shifts costs back to suppliers. Suppliers complain that major distributors use such opaque and questionable devices to force wholesale prices down, while some distributors complain that the rule's rigidity prevents them from passing on savings by reducing retail prices. There is an exemption from the rule as food retail shops smaller than 300 m<sup>2</sup> and non-food shops smaller than 1000 m<sup>2</sup> may sell at below costs if this is to align prices with neighbouring competitors. Such regulation confuses purchasing power with the size of stores as for example “hard discounters” may combine purchasing power and relatively small outlets. Moreover, regulation to secure “fair” competition includes provisions that producers are required to present price lists for their products in a non-discriminatory manner, meaning that all clients must be offered identical terms for similar services, including unit price and any volume discounts. Other regulations to secure “fair” competition include a prohibition of “abusively” low prices (which includes the sale of own-label goods at below cost). To further the negotiation process, a commission for commercial practices has been created to supervise the commercial relations between producers and retailers. In 2003, a Ministry circular specified that price reductions accorded to a retailer and equivalent to a similar reduction in the “*marge arrière*” should not be considered as a discriminatory practice.

For cultural reasons, a number of restrictions are placed on advertising. These are now being relaxed. The ban

20. In addition, there was a restructuring among (and a one-fifth reduction in the number of) the small retailers away from traditional family owned enterprises towards franchising, thereby benefiting from the efficiency gains arising out of vertical integration (Seguin, 2001). Contributing to this shift was a regrouping of small shops in shopping centres and around large outlets.

on using television commercials for newspapers/magazines was removed in early 2004. At the same time, large retailers were allowed to utilise local, cable and satellite TV for televised commercials and this permission will be extended to national TV chains by 2007, making nation-wide image advertising part of the retailers' competitive strategies. However, even by then retailers will be prevented from using televised commercials for promotional campaign for special offers except if they include similar campaigns in other EU members. The remaining restrictions (besides those imposed for health and public order reasons) are bans on television advertising for movies and books -- though in the latter case commercials over cable and satellite TV (comprising about 10% of the market) are allowed -- leading the European Commission to ask for a formal repeal of such restrictions (European Commission, 2004e).

1.1 The combination of increasing concentration and increasing market shares raised fears of large retailers exploiting their market power. This led to very prescriptive regulations concerning the producer-retailer negotiation process and the strict enforcement of the ban against pricing below cost (*loi Galland* of 1996).<sup>21</sup> The combined effect of entry restrictions and the *loi Galland* has been to increase the relative bargaining power of large-scale producers and retailers to the detriment of small producers and consumers. The regulations also have a number of negative consequences on industry outcomes and on consumer welfare.

1.2 The first consequence is to further weaken incentives for price competition among retailers. According to the new rules, the starting point for the commercial negotiations with retailers is the price list of the producers, which the law prescribes to be "non-discriminatory" *vis-à-vis* retailers: producers have to offer similar wholesale prices to all the retailers they deal with. The invoice price paid by retailers to producers also constitutes the lower bound for retail prices, as the *loi Galland* defines cost as the per unit invoice price. Given the high degree of transparency of the price lists, the strict enforcement of the ban against below-cost pricing enables retailers to gauge the invoice price paid by competitors, leading to a reduction in the scope for price competition as any additional price reduction obtained by one retailer will be passed on to competing retailers.<sup>22</sup> The second consequence is to weaken incentives for retailers to negotiate lower wholesale prices with producers and bolster their profits through higher listing fees (Box 3).<sup>23,24</sup> A further problem is that tacit collusion among producers has been facilitated as diverging

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21. The law against selling below cost was introduced in its current form in 1963. Such practices are criticised as predatory, although they may also form part of strategies that actually enhance consumer welfare. Moreover, prohibition of below-cost-pricing can only be a partial protection of small shops against large retailers as competition between the two types of shops are taking place in a number of dimensions, including location, quality and convenience. In addition, small shops often benefit from a cluster effect as a means to attract costumers, leading to a clustering of small specialized shops around large retailers (Allain, M.-L. and C. Chambolle, 2003).

22. As a further measure to regulate the negotiations between retailers and producers the *loi Galland* contains a regulation that restricts the involved parties' ability to unilaterally terminate long standing contracts. In addition, producers are allowed to refuse to supply new entrants, like hard discounters, if the producers do not have a dominant position on the market and do not impose discriminatory conditions on some of their clients.

23. The prohibition of below-cost pricing has increased the benefits associated with marketing strategies based on promising lowest possible prices in the market. If customers find lower prices elsewhere, this information can be used to either obtain lower prices from the producer or to bring pricing-below-cost complaints to the DGCCRF.

24. The Delors directive of 1984 states that annual conditional volume discounts should be part of the general sales conditions, although the *loi Galland* clarifies that such discounts cannot be part of the below cost sales calculations.

prices became easier to observe (Allain and Chambolle, 2004).<sup>25</sup> The effect of invoice prices setting the lower bounds for retail prices is that producers get a large degree of control over the retail price of their product in the same manner as if they were pursuing (the strictly illegal) retail price maintenance. This power is reinforced by their ability to take under-pricing retailers to the competition authority.<sup>26</sup> By the same token, producers that tacitly collude over prices are able to detect possible deviations of other producers from the tacit agreement. As a result, efficiency gains and economies of scale effects are not passed on to consumers in the form of lower consumer prices, but tend to be shared between producers and retailers through the listing fees.

### Box 3. Negotiations in the retail sector and the role of listing fees

Negotiations between producers and retailers include elements such as size and quality of shelf space and other services delivered. These elements are typically purchased through an annual listing fee (“*marge arrière*”) from producers to retailers and as such are not included in the invoice price. Thus, the prohibition against pricing below costs creates incentives to accept similar wholesale prices as the competitors and to bolster profits through higher listing fees. The size of the latter will tend to reflect the relative bargaining positions of competing retailers *vis-à-vis* producers. Indeed, over time, the margin between retail and invoice prices has decreased as retailers’ profits have been moved to listing fees, with their share of (increasing) total margins having increased to nearly 90% on average.

Retailers may bolster their profits two ways. The listing fee (“*marge arrière*”) is made up of the sums that suppliers pay retailers for services linked to the resale of goods (e.g., promotional schemes) and by conditional discounts. It has two components, namely discounts for commercial services (such as quality of shelf space) and conditional volume discounts, both typically paid annually. Negotiations over these elements are typically concluded at the same time as the contract, but they do not appear on the invoice. The difference between the invoice price and the final retail price (“*marge avant*”) consists of unconditional volume discounts and the retailer’s margin.

21. Large retailers have had relatively limited success in countering the increasing power of producers to maintain retail prices by developing their own brands (so-called own-label products produced either in-house or sub-contracted), which account for only about one fifth of sales (in 2000) as compared with twice that share in the United Kingdom (Allain and Chambolle, 2003). Contributing to the more limited success of own-label brands in France are the continuing restrictions on large retailers’ use of televised advertising, despite recent measures to ease such restrictions (see Box 2), as own-brand labels rely on such advertising to bring across the complicated high-quality-low-price message of own-labels when they are competing with established brands within the same shop. Only hard discounters in the food segment and category killers in the non-food segment have had some success in using own-label products (Séguin, 2001). By concentrating on relatively limited product ranges to penetrate the French market and compete on prices, their market share in food retailing reached 13%.<sup>27</sup>

22. Against this background, it is perhaps not surprising that regulation in retail has led to cost-push type inflation in the order of an additional 0.1–0.2 percentage points to consumer price inflation per year (Canivet *et al.*, 2004), with for example the prices of branded goods increasing by some 3% in 2003 as compared with ½ per cent for own-label products (Allain and Chambolle, 2004). Moreover, since the end

25. An example of such collusion was found between breweries for supplies to hotels, restaurants, and cafes, leading the European Commission to impose fines of a combined € 2½ million in the autumn 2004. (European Commission, 2004c)

26. During the summer 2004, producers were complaining that some retailers had chosen to lower prices of some products below the invoice price as a way to meet the objectives of lower prices by 2% as stipulated in the agreement with the Ministry of Finance (Le Figaro, 2004)

27. For example, in the year to November 2003, “hard discounters” lowered their prices for food products by an average of 1%, while larger retailers increased their prices by an average of 2% in the same period.



of the 1990s the increase in French food prices (excluding perishables and meat) has been almost twice the pace observed in the EU area. In addition, pre-VAT price for branded goods from supermarkets have increased faster than in other EU countries over the past three years, leaving them comparatively high (European Commission, 2004d). (Figure 9). In this context, the Minister of the Economy sponsored in mid-2004 an agreement between retailers and suppliers to lower prices by showing a larger share of the listing fees on the invoice, thus passing on price cuts to consumers.<sup>28</sup> It is true that an incitement for both retailers and producers to enter an agreement was the loss of market shares to “hard discounters”. However, while this agreement did result in a price fall in the short run<sup>29</sup>, a durable solution should rely on more structural measures to level the playing field to broaden the scope for competition. For instance, according to some estimates abolishing the *loi Galland* could reduce prices of consumer goods by as much as 5%, boosting consumers’ purchasing power by around 3% (Camdessus, 2004). A further negative welfare effect is below average employment, where the entry restrictions on large outlets are estimated to have reduced employment by some 1 300 jobs per year (Bertrand and Kramarz, 2002). Even though employment growth in the sector has been average over the past decade, the employment share remained relatively low.<sup>30</sup> (Figure 10). The latter may also be explained by a rigid labour market entailing lower service levels (shorter opening hours and less assistance at the counter) and fewer part-time employees than, for instance, in the United States (Jany-Catrice and Baret, 2001).<sup>31</sup>

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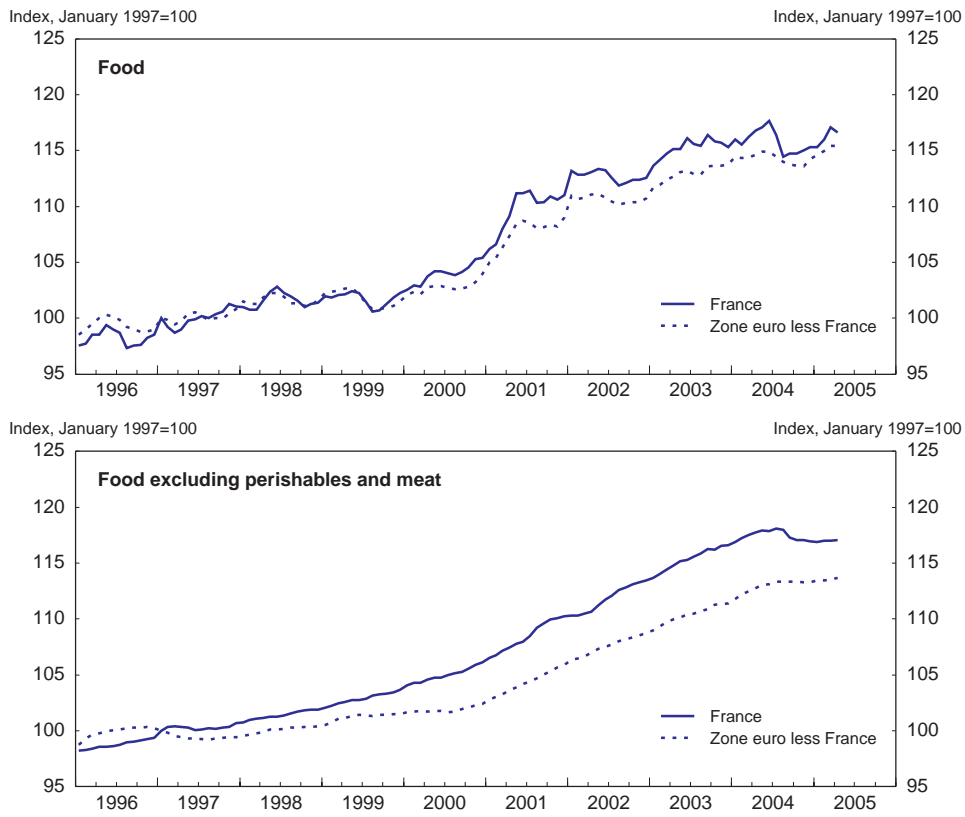
28. On 17 June 2004 an agreement was entered between retailers and suppliers to lower prices by 2% in September the same year and a further 1% in 2005 by integrating a part of the “marges arrières” into the invoice through negotiations between retailers and producers. The agreement is estimated to have lowered inflation by 0.2 percentage point (INSEE, 2004). Considerable controversy has followed about the implementation of the agreement and no agreements have been established for about half of the about 5000 products concerned (Castets, 2004).

29. The INSEE index of convenience goods prices fell by 0.9% over the period March 2004 – March 2005.

30. The introduction of commercial zoning regulation was followed by a substantial slowdown of employment growth in the retail sector that was not experienced in other parts of the economy (thus ruling out effects of changes in economy-wide regulation). The commercial zoning regulation acts as an entry barrier and has a negative impact on employment in the sector. The regulation also prevents positive spill-over effects arising from when a large scale store’s higher customer traffic into an area increases sales in surrounding shops. Moreover, such types of regulation reduce consumer welfare by limiting the number and size of shops, as well as increasing travelling and in-store queuing time for consumers.

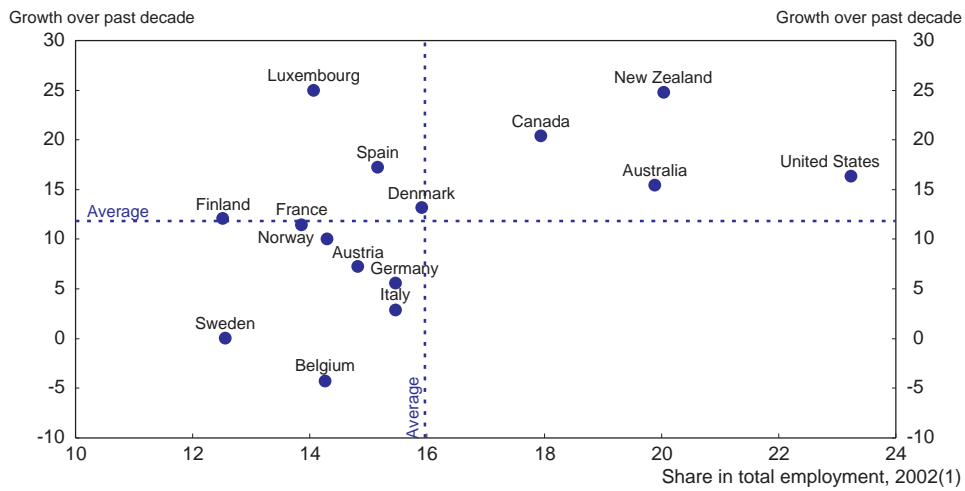
31. Interestingly, the sale concentration is higher in France, where half of the turnover is achieved on Fridays and Saturdays, while in the United States 45% of the turnover is achieved on Fridays, Saturdays and Sundays.

**Figure 9. French and EU food prices**



Source: Eurostat.

**Figure 10. Employment share and employment growth in retail sector**



1. 2001 for Australia and the United States.  
Source: OCDE STAN database.

23. Recognising the shortcomings of the current system and in order to find a more lasting solution, a government-sponsored commission (the “Canivet” Commission) proposed in October 2004 to reform the existing regulation more structurally by integrating the listing fees in the invoice while retaining the ban against selling below cost. In April 2005, the government put before Parliament a bill which would appreciably alter the definition of selling below cost, but would continue to ban it. The likely effect of this legislation will be to reduce prices but not to eliminate the problems arising from the ban, even if the possibility of bigger price differences, which is incorporated in the bill, is a step in the right direction. The commercial code already contains a prohibition against abuse of market dominance, so that insofar as the regulation is aimed at repressing such behaviour, the general competition law should suffice. Predatory pricing is generally prohibited in OECD countries, but few countries try to enforce a strict ban on below-cost pricing as such, because in a number of circumstances such strategies are neither predatory nor do they reduce consumer welfare.<sup>32</sup> In addition, it is difficult to correctly assert what constitutes pricing below cost. Thus, consumer welfare could be expanded by relying on a general prohibition of predatory pricing and use this general principle when investigating individual cases of below-cost and abusive pricing. Additional steps to increase competitive pressures in the distribution market would involve relaxing restrictions on large outlets to allow entry of new and innovative competitors, aligning televised advertising rules on those of other countries, easing the regulation on sales and abolishing remaining regulated monopolies in the distribution of tobacco and newspapers and magazines.

### *Network industries*

24. French network industries have typically been organised as publicly owned monopolies with a strong emphasis on public service aspects. This approach has been successful in providing France with modern high technology networks that deliver high quality services at prices to the consumer that are generally on a par with the European average. However, the associated historical costs have been considerable and have at times led to a degree of excess investment in capacity and infrastructure. Furthermore, it is not certain that quality and the general provision are superior to what can be observed in other countries with competitive markets. International experience shows that successful liberalisation of network industries improves efficiency and often lowers prices. In France, the opening up of network industries has tended to be in response to EU directives and has been more gradual than in most other countries. Presently, France is implementing remaining EC directives, pushing ahead with liberalisation of network industries, creating an opportunity to make this part of a coherent structural reform strategy to bolster growth.<sup>33</sup> The main challenge in this area is that following the formal opening of the network industries, few sectors put in place market structures that sufficiently support competition. Thus, the promotion of effective competition in the network industries requires effective *ex ante* regulation and policies aimed at increasing competitive pressures through the creation of more pro-competitive market structures

### *Electricity*

25. After having trailed the liberalisation process in other European electricity markets, France is now moving forward according to the EC timetable (Desama, 2004). Since mid-2004 there has been a free choice of suppliers for all business customers and full market opening will be implemented by 2007, when households will become eligible for free supplier choice. However, formal opening will not suffice to achieve competitive markets for all customer classes due to the lack of market structures to support

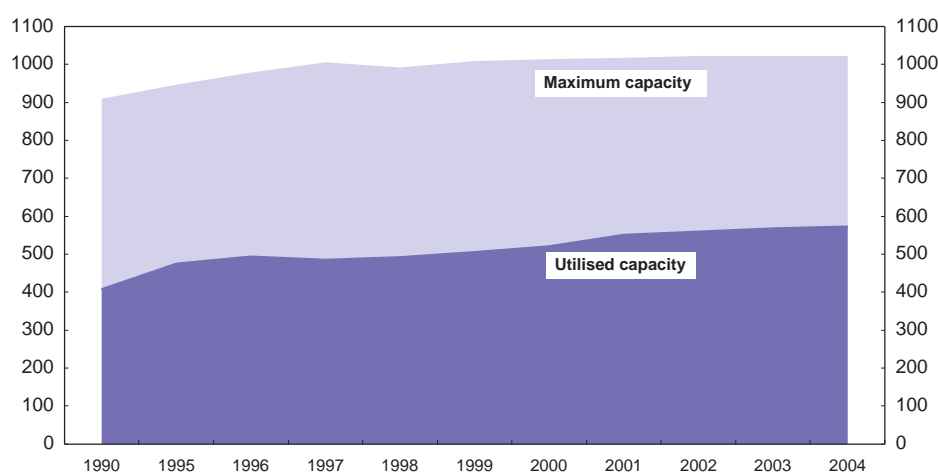
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32. Examples include when retailers have failed to correctly predict market demand for individual items and need to clear stocks or when below cost pricing is used as a “loss leader” strategy, where individual items are sold at very low prices to attract customers, which are expected to purchase other goods.

33. For a review of the economic and political issues involved in the liberalisation of network industries in France, see, for example, Varone and Genoud (2001).

competition. The government-owned incumbent is effectively a vertically-integrated company with a dominant market position and a substantial degree of over-capacity in generation (Box 4). Over the past decade, average reserve capacity in French generation has been slightly less than 50% and during the highest peak load demand registered (during the winter of 2003) reserve capacity remained at around 30%. (Figure 11). This level of excess capacity seems excessive as international standards would point to a requirement of an average of 15-20% when taking into account the reliability of French generation.

**Figure 11. Average capacity utilisation in electricity generation**  
In Terawatt hour



Source: INSEE, Annuaire statistique de la France, 2004, 2002 and ministère de l'Économie et des Finances.

#### Box 4. The French electricity market

The French electricity market is dominated by EDF (*Électricité de France*). The top three generators account for more than 90% of all electricity generation - a concentration that is higher than in most other European countries. In France only EDF has a market share of more than 5%, whereas in other large European countries there are at least 4 firms (and 8 firms in the United Kingdom) with higher market shares. Three-quarters of supplied electricity comes from nuclear power. The second largest energy source is hydropower with the remainder mostly coming from various fossil fuels and renewable energy. The strategy to rely primarily on nuclear power for electricity generation was developed in the 1960s, but was mainly implemented following the first oil crisis in 1973 (Hadjilambrinos, 2000). As a result French electricity generation is characterised by low variable costs and low emissions.

By some estimates EDF already had sufficient nuclear power generation capacity by 1982, but additional capacity was built in the following decade. By the mid-1990s, the overcapacity in generation translated into a substantial export of electricity and according to some observers at times below-cost prices (Hadjilambrinos, 2000). By 2002, France was - with nearly 15% of generated electricity - the largest exporter of electricity in the EU (accounting for almost half of all electricity exports in 2000, and 22% in 2004), probably held back by insufficient cross-border interconnection capacity (European Commission, 2004).

Despite the recent improvements in market opening, France has not moved as far as other European countries, either in legal terms or *de facto*. In 2002, the extent of the market that was declared open was the lowest in Europe (when five countries already had fully liberalised markets) and the expansion of eligibility to 37% in 2003 did not significantly change that ranking (OECD, 2004b). As from 1 July 2004, this proportion rose to 70%. The liberalized part of the market has seen relatively high activity with about 20% of all eligible customers having changed provider as of April 2004. Nevertheless, structural measures to support competition are less comprehensive than in other countries. The network management of the transmission grid is the responsibility of RTE (*Réseau de transmission d'électricité*), which is owned by EDF but with accounting and management separation. The head of the RTE is nominated by EDF but appointed by the government. The Act of 9 August 2004 imposes a legal separation in line with European

directives by making RTE a subsidiary, but this measure does not go as far as in certain other European countries. The management separation of distribution has also been implemented, although this is less strict than the legal separation that is implemented in other EU countries; a legal separation is expected by 2007 at the latest.

The energy regulating authority (*Commission de régulation de l'énergie* -- CRE) is responsible for securing non-discriminatory third-party access to the transmission system with powers to order interim protective measures and sanctions. However the authority has no powers concerning operating licenses. CRE proposes tariffs for transmission and distribution network access, which are then forwarded to the Minister of the Economy, Finance and Industry. The Minister may approve or reject them but has no power to change them. Other rates and price ceilings are submitted to CRE.

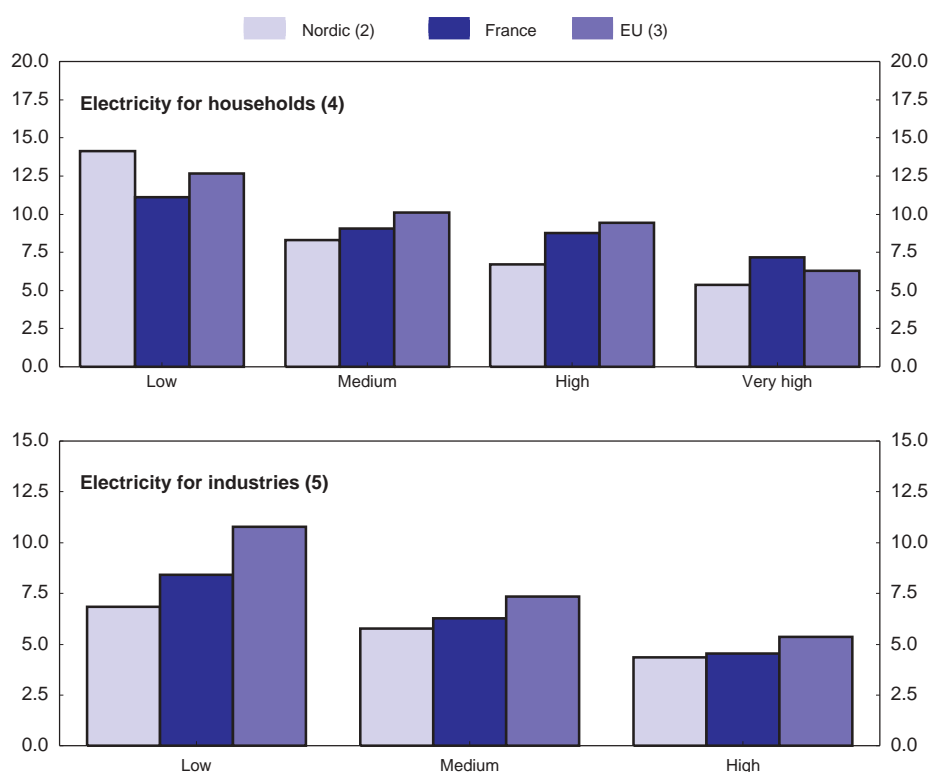
26. Electricity prices in France are below the European average (Figure 12). There is free price determination in the liberalised industry segment, while prices in the regulated household segment are subject to political control.<sup>34</sup> Electricity prices benefit from generation technology with low variable costs, reflecting past investments that benefited from subsidies, such as state guarantees. However, the over-capacity in generation indicates that there is probably scope for even lower electricity prices. Moreover, the low prices for low consumption households in France, as in other countries with little or no competition in this market segment, is the result of public service obligations, rather than a reflection of the associated costs.<sup>35</sup> Thus, cross-subsidisation is taking place at several dimensions and the introduction of effective competition will make prices more cost-reflective. For example, the integrated Nordic electricity market is (together with the United Kingdom) the most competitive electricity market in Europe and, as France, relies to a large degree on nuclear and hydropower technologies. A comparison with this market gives an indication of the possible price effects of successful liberalisation, pointing to benefits for industrial users and households with high consumption.

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34. Prices for household customers are administratively determined. EDF proposes an increase that is subsequently negotiated with the minister in charge. The role of the regulator is to evaluate whether the proposals are reasonable. Following the changed status of EDF in mid-2004 the company proposed an increase of about 2½ per cent to cover the cost increase of the provision of public services that was increased by one third (Les échos, Mardi 27 juillet 2004). The Prime Minister decided in the autumn that electricity prices should remain unchanged over the next year.

35. Included in the electricity prices are a number of charges. There is a charge for financing public service obligations, which include uniform prices for high quality electricity across all of the country (including areas not connected to the national grid), subsidised prices for poor citizens, and the purchase of electricity generated using environmentally friendly technologies. Quality of electricity is difficult to measure on an internationally comparable basis. However, measured in terms of time lost to unplanned interruptions the quality in France is higher than in southern European countries and Finland (European Commission, 2004).

**Figure 12. Pre-tax electricity prices<sup>1</sup> in Europe**  
Euros per 100kWh, 1st July 2004



1. Data are taxes excluded and for some countries it is an average of various local prices.
  2. Excluding Denmark.
  3. EU 15, excluding Finland and Sweden.
  4. The selected standard households are classified 'Low' with an annual consumption of 1.2 mWh, 'Medium' with 3.5 mWh and 'High' with 7.5 mWh and 'Very high' with 20 mWh.
  5. The selected standard industries are classified 'Low' with an annual consumption of 30 mWh, 'Medium' with 1.25 gWh and 'High' with 24 gWh.
- Source: Eurostat, Statistics in focus, Environment and energy.

27. The introduction of effective competition requires measures that counter act the dominant position of EDF - measures that are likely to meet fierce opposition from the unions (Box 5). International experience shows that the accounting separation in place is unlikely to secure non-discriminatory third-party access charges as the network owner has an incentive to provide access to its own generation plants first. In addition, with accounting separation alone, non-discriminatory access charges may be difficult to verify (even if access contracts are approved by CRE) because of asymmetric information and the arbitrary allocation of common costs. The form of legal separation chosen by France may not significantly improve the situation. Thus, there is a need for formal separation of the vertically-integrated incumbent, preferably involving a transfer of ownership. The process towards a competitive electricity market could be accelerated by horizontally unbundling generation plants.<sup>36</sup> Such a measure would introduce incentives to better exploit the existing capital stock as exemplified by experiences in Norway, where a similar build-up of excess generation capacity was removed by the introduction of competition

36. It is difficult to assess how many competing generators are necessary for securing a fully competitive market. Green and Newbery (1992) argued that the initial creation of three competing generation companies in the UK did not suffice and at least five companies should have been created.

between publicly-owned hydro-power plants, which markedly lowered prices and boosted demand (Høj and Wise, 2004b). Moreover, the present limited international interconnection capacity should be expanded to weaken the incumbent's market power (as happened in the Nordic countries), which would also increase supply security during peak load periods (OECD (2004c) and Merlin (2004)). An additional measure to further the latter would be to allow the market to determine which generation technologies to implement and pursue environmental goals through market-based mechanisms. In addition, privatisation should be pursued and CRE should resume full responsibility for regulated tariff setting in the relevant parts of the wholesale market.

#### Box 5. Resistance to liberalisation of the energy markets

Employees of the EDF and GDF have long been opposed to a change in the status of their enterprises, fearing that any privatisation would lead to dismissals and/or to a deterioration of their working conditions. In many ways the employees, who have civil servant-like status, enjoy special benefits. These include a favourable price for electricity, which is equal to about 5% of the standard retail price (the associated tax liability is covered by EDF), housing benefits in kind, frequently a short working week, wages that are about a quarter higher than average wages. In addition, the "comité d'entreprise" – which organises social activities for the employees and their families – is run by the unions and has about 3 700 employees (large enough to have its own "comite d'entreprise") with a budget of € 400 million, which is financed by a transfer from EDF equivalent to 1% of turnover (Le Monde, 2004). Following considerable labour market unrest prior to the changing status of the energy companies, the employees received a wage increase of 6½ per cent on top of the 2½ per cent increase received a couple of months before. In addition, most of EDF's 112 000 employees are members of a generous pay-as-you-go pension scheme for utility employees. In total, EDF's pension liabilities have been estimated to be in the order of € 50 billion. From the beginning of 2005, basic pensions will be paid by the general public social security scheme in exchange for a transfer of € 7.7 billion and EDF will remain responsible for additional benefits.

#### Gas

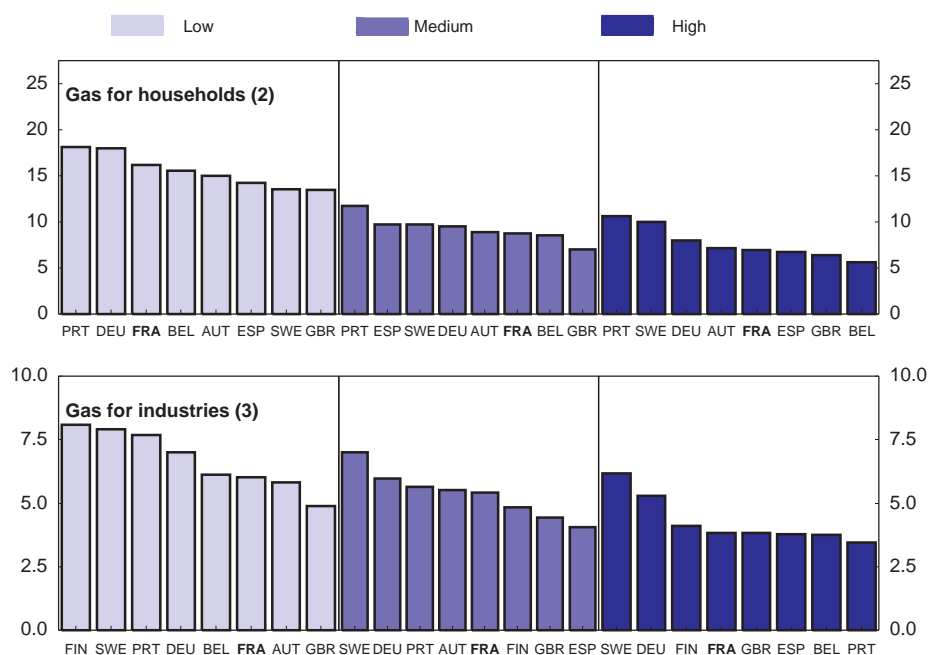
28. The gas market shares many of the characteristics of the electricity market. The liberalisation process is following the same pattern and the sector is dominated by the vertically-integrated government-owned incumbent (GDF – *Gaz de France*), which controls 96% of distribution lines, 100% of entry points into the country, 75% of the high-pressure transmission system and 83% of storage. The status of GDF (like EDF) changed from a public enterprise to a limited company in 2004, just as the European gas directive was totally transposed, thus giving firms the freedom to choose their suppliers. In addition, there is a private vertically-integrated local monopoly (owned by Total) in the southwest of France. Pursuant to the Act of 9 August 2004, Gaz de France and Total transformed their transport networks into subsidiaries, creating Gaz de France Réseau Transport and Total Infrastructures Gaz de France. Recently-introduced measures to secure non-discriminatory third party access include obligations on the grid operators to grant access and to implement accounting separation for vertically integrated companies, along with a "gas release" programme for EDF and Total. The associated tariffs are determined by the Ministry of Economy, Finance and Industry following an opinion issued by the regulator (CRE). Nevertheless, problems persist. The liberalisation process in the gas sectors in Europe is far from being completed as partly revealed by higher European prices as compared with North America (IEA, 2004).<sup>37</sup> Within Europe, French pre-tax prices compare favourably on average. However, closer inspection indicates that prices for households tend to be higher than in a number of other countries, while prices for small to medium industrial customers are well above those in the relatively more competitive British market.<sup>38</sup> (Figure 13). *A priori*, the relatively

37. The difference in natural gas prices reflects both the degree of competition and proximity to cheap natural gas resources.

38. Natural gas pricing in the non-regulated part of the market is subject to ministerial approval. In the autumn 2004, GDF asked for price increases of 8%, but was only allowed 3%.

large number of supplier countries to France should enhance the conditions for creating a fully competitive market (Cussagnet, 2004).

**Figure 13. Pre-tax gas prices<sup>1</sup> in Europe**  
Euros per Gigajoule, 1st July 2004



1. Data are taxes excluded and for some countries it is an average of various local prices.
  2. The selected standard households are classified 'Low' with an annual consumption of 8.37 Gj, 'Medium' with 83.70 Gj and 'High' with 1047 Gj. 2. The selected standard industries are classified 'Low' with an annual consumption of 4186 Gj, 'Medium' with 41860 Gj and 'High' with 418600 Gj.
- Source: Eurostat, Statistics in focus, Environment and energy.

29. Farther-reaching liberalisation of the gas market would benefit gas consumers through lower prices, which for exporters will boost their competitiveness. In addition, the role of gas as intermediate input in the electricity sector is likely to increase as that sector widens its technology choice, including gas fired turbines. However, for these benefits to materialise further measures must be implemented. As in the electricity sector, there should be a total unbundling of vertically integrated companies. Without such unbundling, third party non-discriminatory access to the network cannot be totally secured. Other suppliers wanting to connect to the networks are subject to rather detailed requirements and failure to comply may lead to heavy financial penalties (IEA, 2004). Both the regulator and competitors have complained about a lack of sufficient information to evaluate pipeline availability and new entrants have complained about access problems, particularly in the south-west of the country.<sup>39</sup> These problems point to the need for more effective *ex ante* regulation, which, among other things, should include giving powers to CRE to determine regulated prices and tariffs. Moreover, non-discriminatory third-party access to storage facilities (currently negotiated on a case-by-case basis) should be improved. Such facilities are primarily used for public service obligations and balancing, where the latter is offered at a uniform charge despite cost differences between reservoirs and the charge is difficult to evaluate because of information asymmetries (Esnault,

39. Partly in response to these concerns, rate of return regulation of 12% in real terms for new infrastructure investments connecting France and Spain and a gas release programme have been proposed.



2003).<sup>40</sup> Non-discriminatory access to storage is an important measure to stimulate new entry in the early phases of market liberalisation, as also competitors have to equilibrate supplies against the seasonal variation in demand, pointing to the need for imposing access obligation on the incumbents. Such a measure should be transitory to facilitate new entry until additional storage capacity is developed by independent operators. The principle of third-party access to storage was written into the Act of 9 August 2004.

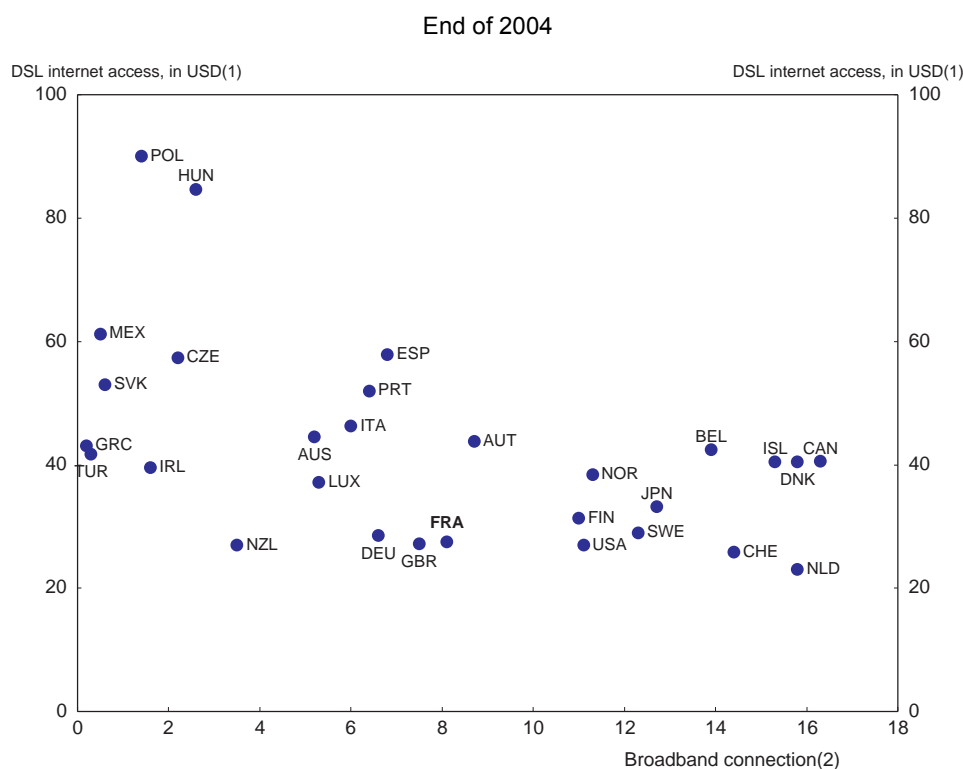
### *Telecommunications*

30. The telecommunications market was deregulated at a slower pace than in many other European countries, although by 2004 the complete set of EU directives was implemented. As a result the degree of effective competition is still lagging behind what can be observed in countries that liberalised earlier, notably the Nordic countries that opened up their telecommunication markets a decade ago. The sector regulator ART (*Autorité de régulation des Télécommunications*) is an independent regulator, with fixed-term contracts for its commissioners and the usual powers to secure non-discriminatory third party access.<sup>41</sup> In 2004, the new telecommunications law implementing the EC directives enhanced the powers of ART to make it responsible for regulating tariffs and for authorisation of new market entry as individual licenses will no longer be generally necessary. The Ministry of the Economy, as provided for under the European directives, has held on to certain tasks that in some other countries are allocated to the sector regulator, such as decisions concerning issues like interconnection and interoperability. ART has been active in promoting competition, particularly in lowering termination charges on mobile networks and in lowering costs of co-location and of partial unbundling of local loops.<sup>42 43</sup> The latter has been instrumental in reducing retail prices considerably, leading to fast growth (albeit from a low base) in high-speed ADSL connections (Figure 14) (Bezzina, 2001 and Bourreau, 2003).<sup>44 45</sup> In the longer term, however, competition

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40. In a gas importing country like France there is typically a time gap between the arrival of natural gas and its consumption, necessitating a non-discriminatory third party access to storage facilities (of which 13 out of 15 facilities are owned by GDF with the two others owned by Total Fina Elf) for competition to become effective.
41. The chairman and two members are appointed by the President of France and the other two members are appointed by the Chairs of the National Assembly and the Senate. ART can impose penalties through licence suspension or through fines of a maximum of 3% of net turnover (5% for repeated offences). However, these powers have not been used so far and are not extended to imposing fines for delays, such as in making lines available for leasing.
42. The two mobile operators with SMP (Substantial Market Power) first had to reduce their charges by 40% over a three year period. However, the retail prices for fixed to mobile phone networks remained nearly twice as high as the associated costs in other countries (Konkurrencestyrelsen, 2004). Consequently, ART imposed another reduction in termination charges by 36% over two years, starting from 1 January 2005. Mobile network operators have put in place a “bill and keep” system for termination of mobile calls on another operator’s network, whereby the originating network charges the caller and there is no termination charge between the two operators. In general the charge for calling within a network is similar to those for calling other networks, although often operators will offer a special low charge for within network calls during off-hours.
43. Another factor behind the lack of competition has been timid regulatory actions in some areas. For example, operators used to charge a minimum of a full minute of connection even if actual call time was only a few seconds. Despite complaints the regulator did not act and eventually a consumer organisation took the operators to court, which led to charging by the second.
44. In addition the ADSL speeds on offer are often sufficient to support Internet as well as other services, such as IP (Internet Protocol) telephony and cable TV. One reason for the previously slow roll-out of broadband is probably the continued high utilisation of Minitel, which in early 2002 had as many users as the Internet (about 15 million) (Susbielle, 2003).

in this area should be based on the appropriate market structures, pointing to the need for developing alternation platforms for high speed connections, like cable-TV (See Annex 4A.1, The cable-TV market in France).

**Figure 14. Broadband penetration and user charges in the OECD**



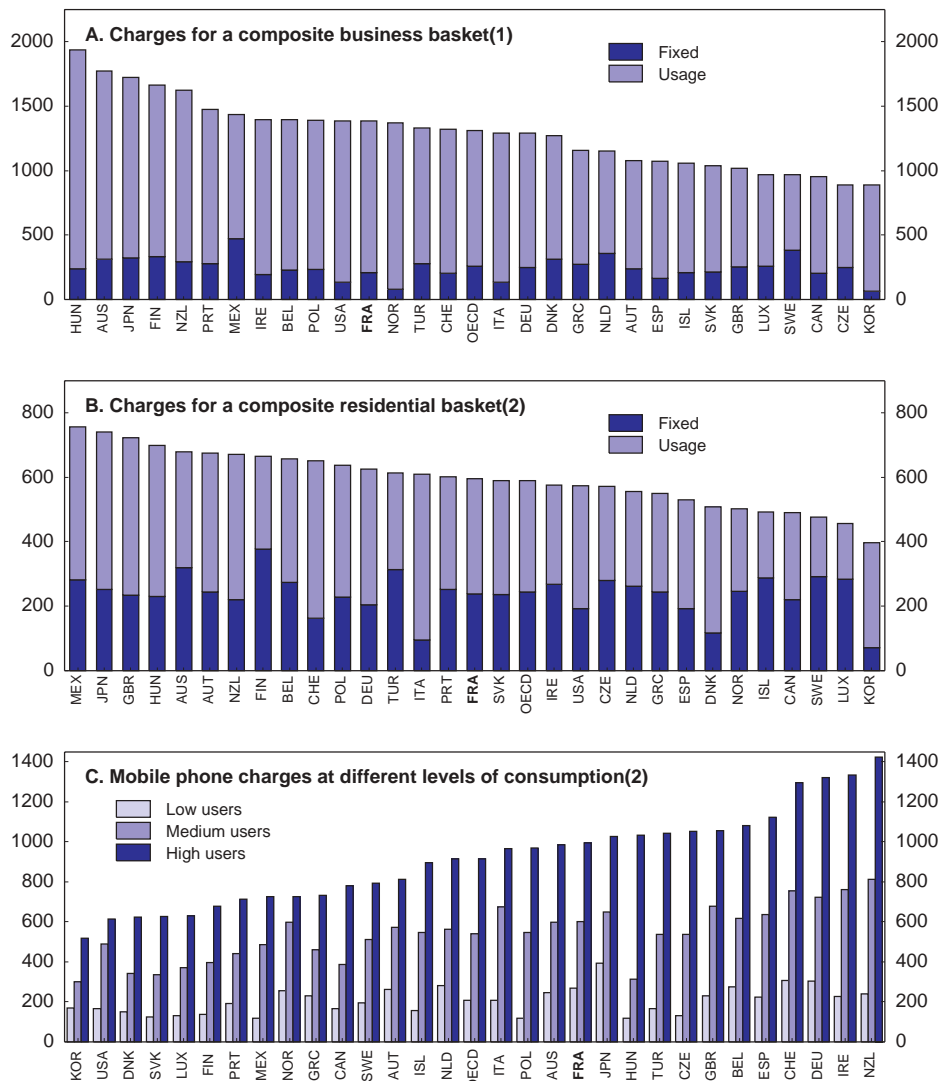
1. Monthly charges, including VAT. Modem rentals are excluded as in most countries they can be purchased by users.
2. Per 100 inhabitants.

Source: OECD, Communications Outlook Database.

31. Prices for telecommunications services are above the OECD average, which to a large degree can be explained by high prices for mobile phone services (Figure 15). The high prices are likely to be related to the highly concentrated market structure, which is dominated by the partly government owned incumbent France Telecom, which has benefited from certain support from the government (OECD, 2004b) (Box 6). In addition, there are fewer fixed and mobile network operators than in similarly sized other European countries (European Commission, 2003). Moreover, there has been almost no development of alternative fixed line networks in voice telephony with competition in this segment primarily targeting the general public and mostly involving pre-selection, and more recently unbundling.

45. The lack of competition in the broad-band segment has spilled over the narrow band segment as France Telecom did not have any incentives for deviating from its standard time-base interconnection rate, inducing ART to introduce flat-rate Internet call origination (FRIACO) in 2002, allowing for important price declines for narrowband Internet access.

**Figure 15. Telecommunication charges in the OECD**  
In USD, August 2004



1. Excluding VAT.

2. Including VAT.

Source: OECD, Communications Outlook database.

### Box 6. Financial aid to France Telecom

France Telecom's indebtedness increased by a factor of nearly five between 1998 and 2000, largely as the result of an aggressive programme of foreign acquisitions, which carried heavy losses - for example the complete write-off of the investment in a German UMTS license. Another example is France Telecom's investment in the Danish mobile phone market, which led to an estimated accumulated loss of about € ½ billion as expected integration effects failed to materialise. At the end of 2002, total debt stood at around € 68 billion, for turnover of just above € 47 billion. The indebtedness prompted the majority shareholder to announce that it would be ready to open a credit line of € 9 billion as an advance on its participation in the company's capital increase. The firm never used this advance; in addition, the government requested that the incumbent management be replaced, and that France Telecom implement a plan to cut costs and divest its least profitable subsidiaries in order to reduce its debt. Vivendi, the owner of one of France Telecom's domestic competitors, Cegetel, was forced to sell assets to improve its debt situation and British Telecom, the UK incumbent, had to sell its mobile phone activities several years ago in the face of large debts. This triggered complaints to the European Commission about unfair state aid. The Commission ruled that the proposed advance did constitute an incompatible aid with the treaty but did not demand its reimbursement. The French authorities and France Telecom have filed an appeal. In an attempt to lower its debt servicing burden, France Telecom has entered negotiations about selling its cable TV subsidiary.

France Telecom has received various types of support from the government. The selection process for the allocation of the UMTS licences through a "beauty contest" was arguably biased towards French operators (Penard, 2002), as the selection criteria gave a relatively high weight to difficult-to-define elements. But the Commission found that this process had favoured neither Orange nor SFR, contrary to the assertions of Bouygues Télécom (all three being French firms). Indeed, no foreign candidates submitted a request for a licence, although this could easily be the result of the global downturn in the telecommunications market. The European Commission has estimated that the special corporate tax regime for France Telecom between 1994 and 2002 constituted state aid as the company was paying tax directly to the state whereas its competitors paid it to each municipality where they operated. The French authorities and France Telecom contested this decision by the TPI. Other support may potentially include payments for universal service obligations, where the preliminary estimate of net costs showed a doubling in 2002 although final estimate was lower. Other EU countries have legislation in place for similar funding schemes, although only one other country has activated its scheme (EU, 2003).

32. Competition in the mobile phone market took off with the entry of a third operator in the mid-1990s with a focus on handset and add-ons, but a decade later almost no other entry has materialised, which is likely to explain the relatively low mobile phone penetration (Hamdouch and Samuelides, 2001, Gruber and Verboven, 2001).<sup>46</sup> Contrary to more competitive European markets, the French operators with substantial market power are not subject to a resell obligation. Indeed, the new entry of a re-seller in mid-2004 (a so-called Mobile Virtual Network Operator) MVNO benefited from the inclusion of a resell condition in the license for the next generation of mobile networks (the so-called UMTS or Universal Mobile Telecommunications System licence) for one of the existing mobile phone operators.<sup>47</sup> Following the new entry, the increase in competitive pressures manifested itself in a sharp lowering of prices for mobile phone text messages (SMS - Short Message Service).<sup>48</sup> In addition, the lack of competition can be

46. Mobile phone penetration in terms of subscribers per 100 inhabitants is at 65 in metropolitan France still below the EU average of 75.

47. The lack of network sharing in France has forced each of the three operators to create denser and larger networks than in other countries, arguably creating more unused capacity than in countries with network sharing. Part of the good coverage was reached through a government subsidy of € 44 million to the operators in the end of 2002 to reduce lack of coverage in certain areas. When the UMTS networks are being brought into operation, the capacity is set to increase further.

48. Immediately following the entry of the new MVNO, competitive pressures increased in the area of SMS with the new entrant offering SMS for 9 cents each as compared with 15 cents for the existing operators. The scope for further reduction of SMS prices is clear considering that the MVNO offer is still three times higher than comparable Danish prices (Nordic Competition Authorities, 2004) and that SMS revenues represent 12% of the mobile phone operators' turnover, but more than 30% of their overall profits

explained by operators pursuing lock-in strategies - that increases customers switching costs - by offering long-term contracts of up to two years that are difficult to terminate, leading to a low rate of customers changing provider (Penard, 2002, ART, 2001).<sup>49</sup> (Box 7). Thus, additional measures should be implemented to increase rivalry in the mobile phone market, including imposing resell obligations on network operators, shortening effective contract periods and requiring the sector regulator to publish relevant consumer information.

#### Box 7. Mobile phone contracts

The length and conditions of mobile phone contracts tend to bind customers to the provider with a consequent reduction in rivalry between operators. Contract length is a minimum of 12 months and is in most cases between 12 and 24 months. It is difficult to terminate a contract prior to its end-date. For example, theft of the mobile phone is not a sufficient reason, although more abusive clauses (such as those preventing customers in areas without coverage from terminating their contracts) have been removed after pressure from consumer groups and the regulator. The latter has no powers to impose modifications of contracts. Moreover, contracts are automatically renewed unless a prior notice of the contrary is forwarded to the operator. A new law in early 2005 requires service suppliers to give a month notice about contract terminations and inform that unless customers disagree the contracts will be renewed. In contrast, similar Danish contracts are limited to a maximum of six months and in Finland no contract binding is allowed. An additional issue is that the operators have varying practices with respect to terminating contracts ranging from allowing termination over the phone to requiring the use of recommended letters with notice periods from one to three months. Even finding the relevant addresses can be complicated. Unlike telecommunications authorities in other countries, ART does not provide consumer-relevant information on its homepage, such as contact points and price comparisons, measures that typically increase transparency of the market and thereby enhance competition.

#### Railways

33. There is practically no competition in the provision of passenger railway services, unlike in other European countries, such as Germany, the United Kingdom, Sweden and Denmark, despite the institutional separation of network and service provisions and the third party access measures implemented in 1997. Moreover, intermodal competition from long-distance bus transport is very limited. The Ministry of Transport has refused, as a matter of principle, to authorise long-distance bus services on routes already served by trains, so as to maintain the integrity of the railways (OECD, 2001). There are a number of negative externalities (such as pollution and accidents) associated with long-distance bus transport, but a better allocation of resources would be obtained if these concerns are addressed through the tax system or through market based instruments. On the other hand, intermodal competition between the well-developed system of modern long-distance fast trains (TGV – *Trains des Grande Vitesse*) and domestic air transport is stronger than in other countries (Seabright, 2003).<sup>50</sup> Nevertheless, the efficiency of the railway system has been declining in the latter part of the 1990s (Friebel *et al*, 2004)<sup>51</sup>.

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(Susbielle, 2003). ART is investigating SMS prices, which could lead to regulation of wholesale prices for SMS from the beginning of 2005.

49. The mid-2003 introduction of mobile phone number portability should lower switching cost, although a year later rather few consumers had switched and the porting process of an average 2 ½ months is rather long.
50. SNCF is somewhat handicapped in its price setting, which is subject to approval by the Minister, as opposed to the free and independent price determination of airlines.
51. According to the government, the contract scheme introduced in 2000 between the SNCF and the regions was nevertheless able to revitalise regional rail transport, with the supply of rail transport expanding by nearly 3.3% in 2003 and by 4% in 2004.

34. The government has taken steps to open railway freight to competition by March 2006, thus beating the final deadline set by EU directives (January 2007)<sup>52</sup>. However, to level the playing field in the railway sector a number of measures should be implemented. To facilitate new entry by lowering associated fixed costs, the incumbent (SNCF) should be under obligation to rent out its rolling stock, preferably through the establishment of an independent rolling stock company. Moreover, presently only SNCF has the necessary technical expertise to evaluate whether new rolling stock fulfils security standards. In a competitive environment this would provide the incumbent with a regulatory role that should be the responsibility of an independent body. The government has planned to institute such a body by the end of March 2006. Furthermore, the incumbent is highly favoured insofar as the usage fees it pays the owner of the infrastructure (RFF – *Réseau Ferré de France*) are much smaller than the management fees it charges RFF – with the resulting deficit covered by transfers from the central government (OECD, 2003).<sup>53</sup> In a competition-neutral environment RFF should be made responsible for network management. This would reveal the associated true cost that should form the basis of the network setting non-discriminatory third party access fees.

#### *Domestic air transport.*

35. Since the full opening of domestic air transport in spring 1997, achieved with the liberalisation of cabotage, the market share of the dominant incumbent (Air France) has increased from 68% to nearly three quarters as the number of domestic competitors declined, despite Air France being a relatively high cost carrier (particularly in terms of wage expenses) as compared with low-cost companies.<sup>54</sup> Stronger competitive pressures come from increased inter-modal competition from high speed trains and from the entry of (foreign) low-cost carriers. Prior to the liberalisation of cabotage the incumbent was recapitalised with € 3 billion (OECD, 2004b). Since then, the emergence of effective competition seems to have been slowed by the dominant position of the partly government-owned incumbent and non-competitive practices in airports, including the non-competitive provision of ground handling services and the granting of slots on the basis of the grandfather principle. The regulating authority is the Directorate-General for Civil Aviation (DGAC) under the Minister of Transport, whereas the government's ownership interests in Air France and *Aéroports de Paris* (ADP), the company managing the two main Paris airports, are administered by the Ministry of Economy and Finance. The government has gradually lowered its stake in Air France, a limited company since 1998, from 44 to 18.7%. France has therefore joined the general trend in Europe of privatising national carriers. The government has announced its intention, in the near future, to open up the capital of ADP, which became a limited company at the beginning of 2005.<sup>55</sup> In principle, the market is subject to the authority of the *Conseil de la Concurrence*, but in reality a number of cases are outside the scope of the *Conseil* as they involve administrative decisions made in the course of exercising public service missions, which entails the use of public power prerogatives. Moreover, part of the increasing market share of Air France arose from the company investing in regional carriers, but the

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52. SNCF is also involved in road freight transport through a subsidiary.

53. Other subsidies include state aid to a number of SNCF subsidiaries (in the non-passenger transport segment) which is currently being investigated by the European Commission. Empirical investigations show that high aid intensity has a negative effect on technical efficiency at the European level, raising questions concerning the long-term effects of maintaining aid (Freideriszick et al., 2003).

54. For example, in 2004 the number of competitors was around 10 - about a third of the level four years earlier - operating on about 5% of all routes, down from around 10% in 2000.

55. ADP would also be subject to general specifications stipulating the conditions under which the company would provide public services in connection with the operation of the airports it owned. The law also provides the framework for an economic regulation, the main instrument of which is the possibility for the government and ADP to conclude a five-year contract governing adjustments in airport fees.

*Conseil* was not involved in the Minister of the Economy's decision to allow such mergers, preventing scrutiny on the grounds of competition criteria.

36. Reforms to further competition in this sector should aim at facilitating access for new service providers and at clarifying the role of the State by separating the functions of the regulator from those of shareholder and service provider. Landing slots are the essential pillar of access, and while the current system favours the incumbent, a pool of slots is nonetheless reserved for new entrants. Thus introducing a market-based allocation of slots would improve access conditions and provide for a more efficient infrastructure utilisation. Reduction of the government's stake in Air France to less than 20% ought to remove the conflict between the state as an owner and as a regulator together with any perceptions of an uneven playing field. Further measures would include separating out the regulatory role of the DGAC (and increase its independence) and the role of provider of air control services, as in other European countries. The reform of the DGAC at the beginning of 2005 does in fact create a clearly identified cluster of air traffic control services. This will also facilitate benchmarking of such services, which is already carried out by Eurocontrol's Performance Review Commission, with a view to their full privatisation. Separating ADP's activities in the same way would remove some of the conflict of interest issues and increase the regulatory scope of the *Conseil de la Concurrence*. This measure should be combined with the introduction of competitive tendering for ground handling services and airport concessions - if not full privatisation - which would increase their ability to develop their comparative advantages and associated airport charges, leading to an improvement in resource allocation.

#### *Postal services*

37. The opening of the postal service market lags behind developments in other countries. The EU postal directive from 2003 has not yet been implemented by France, resulting in a referral to the European Court of Justice. However, a law regulating postal activities, transposing that directive, has just been adopted. Once the directive is implemented, the incumbent (La Poste) will lose its monopoly on domestic mail, where the reserved area will be for letters of less than 100 grams, and there will be full market opening of cross-border mail. The market should be fully liberalised by 2009 (European Commission, 2004).<sup>56</sup> This new law will make ART the regulator for postal services with powers with respect to tariffs, dispute settlement and licenses for new operators. While this is a welcome measure, there remains an issue of cross-subsidies between competitive and non-competitive market segments and between La Poste's postal and financial services. The implemented accounting separation will be insufficient to resolve these problems, basically because many of the common costs come from mail sorting functions and can be allocated in a number of different ways. The accounting issue is also present in the provision of universal service obligation (USO), particularly in sparsely populated areas. The cost of the latter is compensated through a fund, which is financed through a surcharge on competitors. However, imposing a USO fee on competitors may create a cost disadvantage if the associated benefits are larger than the costs and if the USO includes other than essential postal services. This points to the need for determining the compensation for the USO through an analysis of the involved costs and benefits - the latter arising from such factors as having a nation-wide brand and a network that can cross-sell financial services, for example. Sweden and New Zealand have undertaken such cost-benefit analysis, which in both cases led to the assessment that the net costs were negligible and no compensation is paid. Moreover, if the net cost of USO is found to be positive then the compensation should be financed through a fiscal transfer, since universal services benefit the entire economy and would make the cost of USO explicit to the taxpayers.

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56. Quality of postal services is difficult to measure, but there are indications that the quality of domestic mail services is among the lowest among the EU countries (European Commission, 2004g). Moreover, the regulated stamp prices are fairly low in a European context, but considerably higher than in the United Kingdom, which has one of the less regulated postal markets in Europe.

## Macroeconomic effects of regulatory reform

38. The macroeconomic benefits of reforms to increase competitive pressures can be substantial. The propagation and channels through which product market reforms affect the economy depend on a number of factors including changes in relative prices and profit margins, and possible dynamic effects on innovation. Assessing the impact of such reforms is a complex undertaking, but at least two simple approaches are useful to provide some rough indications. First, including synthetic indicators of regulatory stance in regressions of aggregate performance variables is a relatively straightforward method that does not require assumptions about the character of reforms. Following this method, Nicoletti *et al.* (2001), Nicoletti *et al.* (2003) and Nicoletti and Scarpetta (2003) estimated that if France aligns its microeconomic regulation to that of the least restrictive OECD country, then the long-run employment rate would increase by more than 1 percentage point and that over ten years multi-factor productivity (MFP) growth would increase annually by about 0.2% (Table 2). In addition, the measure will, together with a reduction of remaining restrictions on FDI, expand the stock of inwards FDI by about two-thirds. Aligning state control to the average level in the OECD and industry specific regulations to that of the best performing OECD country would further increase annual MFP growth by 0.4 and 0.8 percentage points, respectively. This implies an increase in annual MFP growth of nearly 1¼ per cent, equivalent to a 15 percentage points increase in the level of MFP after 10 years.

**Table 2. Potential effects of further regulatory reforms in France<sup>1</sup>**

	Long-run employment rate (% increase)	Multifactor productivity growth over 10 years (% increase in annual rate)	Inward FDI (% increase in level)
Effect of easing economy-wide regulation	1.16	0.19	57
Effect of easing industry-specific regulation	--	0.43	--
Effect of reducing state ownership	--	0.79	--
Effect of reducing FDI restrictions	--	--	10

1. Alignment of regulation on least restrictive OECD country [2003]. Effects estimated from the results of panel regressions relating to the employment rate, multifactor productivity and inward FDI to regulation and other variables.

Source: Nicoletti *et al.* (2001), Nicoletti and Scarpetta (2003), Nicoletti *et al.* (2003).

39. The second approach makes explicit assumptions about the potential for product market reforms to reduce price-cost margins and to enhance productive efficiency and performance. Following this approach Table 3 presents estimates of the possible economic effects on sectoral and aggregate economic performance of reforms in network industries, distribution and professional and community services. The estimates suggest that regulatory reform in these sectors may increase aggregate labour productivity by some 2½ per cent and could lead to a decline in producer prices of a somewhat larger magnitude. The estimates rely on judgemental assumptions about the scope for reducing price-cost margins and increasing labour and capital productivity within each sector based on realignment with international practices. The economy-wide effects are obtained by using the 1995 input-output tables. No aggregate employment gains were factored in, even though dynamic effects of regulatory reform are likely to lower structural unemployment and increase labour supply. The estimates do not include effects of increased dynamic efficiency and improved resource allocation, which means that they are on the conservative side.



**Table 3. Assumptions and effects of pro-competitive regulatory reform in selected industries**

	Energy	Post and telecommunications	Road transport and railways	Retail distribution	Professional services <sup>1</sup>	Community social and personal services <sup>2</sup>	Total economy
<b>Assumptions (% change)</b>							
Costs of intermediate inputs	0	0	-5	-5	0	-5	
Labour costs							
labour productivity	-15	-10	-10	-5	-7.5	-5	
wages	-10	-5	-5	0	-10	-5	
Capital costs	-20	-5	-10	-5	0	-10	
Profits	-5	-10	-10	-10	-10	0	
Price elasticity of demand	-0.5	-0.5	-0.2	-0.5	-0.5	-0.2	
<b>Sectoral effects (%)</b>							
Direct price effect	-10.4	-7.6	-9.3	-4.9	-6.4	-8.1	
Price-induced output effect	5.2	3.8	1.9	2.5	3.2	1.6	
Employment, price-induced effect <sup>3</sup>	-9.8	-6.2	-8.1	-2.5	-4.3	-3.4	
<b>Economy-wide effect on (%)</b>							
Producer prices, direct effect	-0.2	-0.1	-0.4	-0.4	-0.4	-0.9	-2.5
Producer prices, total effect <sup>4</sup>	-0.4	-0.2	-0.5	-0.5	-0.8	-0.9	-3.2
Employment (after full labour market adjustment)							
Labour productivity (weighted by share in aggregate output)	0.4	0.2	0.4	0.4	0.5	0.6	2.4
Output							2.4
<i>Memorandum items</i>							
Share in aggregate employment	0.8	4.3	2.1	6.3	1.9	11.2	
Share in aggregate value added	2.3	4.0	1.7	5.0	3.6	22.7	
Share in aggregate output	2.4	1.6	4.0	8.2	6.7	11.0	

1. ISIC74, Other business services.

2. Effects from improving public procurement policies and greater use of competitive tendering.

3. Resulting from the direct effect via productivity and the induced (offsetting effect via higher output).

4. Combines the direct effect of the fall in prices of the sector being deregulated with that resulting from the fall in prices in other sectors due to lower input costs

Source: Nicoletti, G. and S. Scarpetta (2003), OECD

## Overall assessment and scope for further action

40. France is catching up to best practices in regulatory reforms for introducing and promoting competition. However, other policy considerations may hamper the emergence of effective competition. Available indicators point to relatively weak competitive pressures in a number of sectors, particularly in sheltered service industries. Thus, further reforms are proving necessary to promote competition, which should boost growth as well as increase the economy's resilience to shocks. The next phase of reforms should do a better job of balancing consumer welfare against the opposition of relatively small but highly vocal special interest groups. This requires both institutional changes and further incremental measures to expand the scope for competition, by exposing larger segments of the economy to increased competition. The basic framework for general *ex post* regulation should be rebalanced. To focus their activities and priorities the competition policy enforcement units of DGCCRF should be more clearly separated from the units that apply other regulations, if not moved to the *Conseil de la Concurrence*, which would also eliminate the perceived risk of political influence.

41. Within network industries reforms should work on two fronts: strengthening the powers and independence of sector regulators, and promoting market structures that can underpin competition. The reforms should go beyond mere accounting and legal separation in order to secure non-discriminatory third party access as well as horizontal separation in competitive segments. Additional measures in this direction would be the continuation of an ambitious privatisation programme that at least removes the government's controlling stakes, preferably after formal separation. Efforts to promote competition in network industries would benefit from a more rigorous and transparent evaluation, and competition-neutral financing, of universal service obligations. In inherently competitive sectors, such as distribution, even if the proposed reform of the *loi Galland* is a step in the right direction, the overly prescriptive regulation of price setting and entry controls should be replaced by a more general approach of countering market dominance through the economy-wide competition framework. Besides these general recommendations, a summary of the more detailed recommendations is presented in Box 8.

### Box 8. Summary of recommendations

#### The competition framework needs strengthening

- The profile and priority of investigation and enforcement against anti-competitive practices should be raised. The framework of competition law should be bolstered either by transferring full powers of enforcement to the *Conseil de la concurrence*, with the resources that implies, or by more clearly separating the functions and resources from other market-surveillance functions within the Ministry of Finance.
- In merger control, France would do well to follow the example of most other OECD countries, which have placed policy implementation responsibility in this area with the competition authorities rather than with the government.
- In publicly-owned companies a clearer formal separation between competitive and non-competitive activities should be introduced. To remove the potential conflict between the state's regulatory role and its ownership interests, the ownership function of publicly-owned companies should be concentrated in APE (*Agence des participations de l'État*). The government should, however, pursue an ambitious privatisation programme.

#### Excessively prescriptive regulations in retail distribution should be abolished

- Competition problems in the retail sector should be addressed under the general competition law framework and the prescriptive regulation that dampens price competition should be abolished.
- Zoning laws aimed at large retailers should be reviewed to facilitate new entry.

- Television advertising rules should be relaxed to allow a broadening of marketing strategies.
- Remaining state monopolies, as in tobacco distribution, should be removed.

**Sector regulation needs comprehensive reforms**

- The restrictiveness of regulation governing professional services should be reduced and measures to increase rivalry should be introduced.
- Sector regulators should have full responsibility for the determination of regulated prices and charges.
- A common approach to universal service obligations needs to be introduced, entailing cost-benefit analysis to determine the net cost of such obligations, which should be financed through a fiscal transfer.
- The introduction of effective competition in the *electricity* market will be accelerated by eroding the incumbent's dominance. This can be achieved by expanding the international interconnection capacity and through horizontal separation of generation.
- More effective *ex ante* regulation is needed in the *natural gas* sector.
- In the *telecommunication sector*, conditions for competing platforms in the high speed fixed line segment should be improved; greater resell obligations should be imposed on mobile phone network operator to allow new entry, and the effective length of mobile phone contracts should be reduced. Termination charges should become subject to *ex ante* regulation. The regulator should engage in providing relevant consumer information to increase transparency.
- In *land passenger transport*, possibilities for intermodal competition should be enhanced. Moreover, effective vertical separation should be introduced in railways -- the latter would include making the network owner responsible for management -- as well as securing non-discriminatory third party access to rolling stock.
- In the domestic *air transport sector*, the provider and regulator roles of the sector authority should be separated. The airport administrator for the largest airports should also be separated into management and service provider functions. The scope of the *Conseil de la concurrence* in this area should be expanded. The incumbent air transport company should be fully privatised to remove the conflict of interest between the state as an owner and as a regulator, enticing new entry. The latter could be furthered by introducing market based slot allocation as well as introducing competitive tendering for ground handling services and airport concessions, if not full privatisation.
- In the *postal sector*, the liberalisation process should be accelerated to catch up with developments elsewhere in Europe. In the liberalisation process, attention should be paid to preventing the incumbent from cross-subsidising between competitive and non-competitive market segments. Similarly, the compensation for providing universal service obligations should be based on the net cost, *i.e.*, balancing the costs against benefits, and should preferably be paid as a fiscal transfer.

## ANNEX: THE CABLE TV MARKET IN FRANCE

Cable television networks are less developed than in other countries with only one-third of homes being passed by cable networks as compared with an OECD average of nearly 60%, mostly as a legacy of archaic regulation that has not been conducive to developing alternative fixed line networks (OECD, 2004b), although recent regulatory changes should allow a consolidation of the sector. Moreover, only a small share of cable TV subscribers also receives telecommunications services over the same network. There are more than 800 licensed cable operators (often commanding a local monopoly) but five of them account for nearly 90% of the market. The market is dominated by France Telecom, which is the largest service provider (as well as having a minority holding in another large provider) and proprietor, owning both its own cable-TV network and that used by one of the other large providers. However, France Telecom is trying to divest its cable-TV assets, which, together with the permission for cable-TV networks to merge into larger units, should spur developments in the market. Cable companies have operating agreements with municipalities of between 20 and 30 years and upon their termination the municipalities have the right to reclaim the cable network. Such agreements put cable-TV companies at a disadvantage *vis-à-vis* alternative platforms for providing telecommunications services, hampering investment in the segment.

The government has an objective of enabling high speed Internet access in all French municipalities by 2007, which has led the government to provide financial aid to secure coverage for the large number of municipalities without high speed Internet access. However, in addition to cable TV networks other platforms can also provide (very) high speed broad band, which include electricity utilities that uses their right of way to connect households with fibre optics, forcing incumbents to upgrade their ADSL connections. While in principle there is nothing to hinder a similar development in France, it would nevertheless imply that government-owned companies compete with each other.

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