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# Identifying Priority Service Sectors for Reforms in France

By Magdalena Kizior, Dominique Simonis, Edouard Turkisch and Irene Vlachaki

## Summary

Given their high economic importance, their high labour intensity and their increasing contribution to manufacturing exports, services in France have a strong potential to create jobs and enhance productivity and contribute to overall competitiveness. Despite recent reform efforts in some service sectors, a number of issues continue to hamper activity in those sectors that need to be addressed. In order to help prioritise reforms in services in France, this paper identifies sectors that are both economically important and score relatively poorly with respect to three dimensions of market performance (competition, openness, innovation). This screening exercise points to a set of sectors with a relatively weak performance when compared to other service sectors in France. A cross-country comparison with the performance of the identified sectors in the other large euro area economies (Germany, Spain, Italy) and the UK is then provided. The results show that, despite a relatively good market performance overall, several service sectors of major economic importance in France are characterised by low competition. This is notably the case for a number of business services (architectural and engineering activities, administrative and support services), as well as for the sectors of retail trade, accommodation and food services, and health. This analysis provides useful insight about the challenges in some sectors, which would be candidates for reforms in priority, and invites further analysis on the causes of their weak performance.

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## 1. Introduction

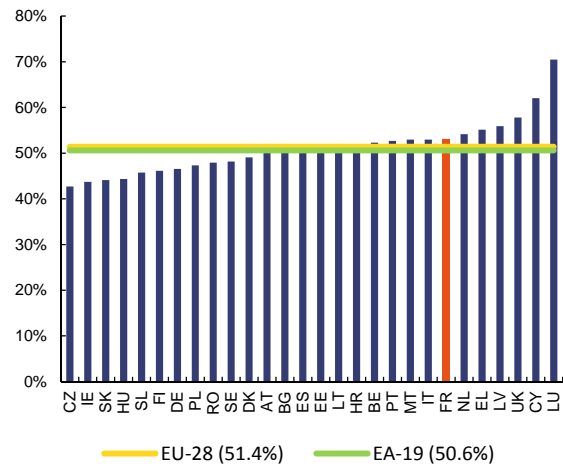
The economic importance of services is high, both directly –in terms of share of the economy– and indirectly –in terms of their increasing role as an input to other sectors. Therefore, well-functioning services play an essential role for the economy and reforms in this area can entail a potential significant positive economic impact if sufficiently ambitious and fully implemented. This paper applies an indicator-based screening methodology<sup>1</sup> to identify service sectors that are both economically important and which show a low performance in France. This exercise provides useful insights about the challenges in some sectors to be analysed further in view of the prioritisation of reforms in France.

To do so, it considers both the economic importance and the market performance of French service sectors to define their relative position vis-à-vis other sectors in France and then compares the market performance of services in France with that in other large economies in the EU for the same sectors. The exercise shows that, despite a relatively good market performance overall, several service sectors of high economic importance in France are characterised by low competition compared to the same sectors in the other large economies in the EU.

## 2. Economic importance of services

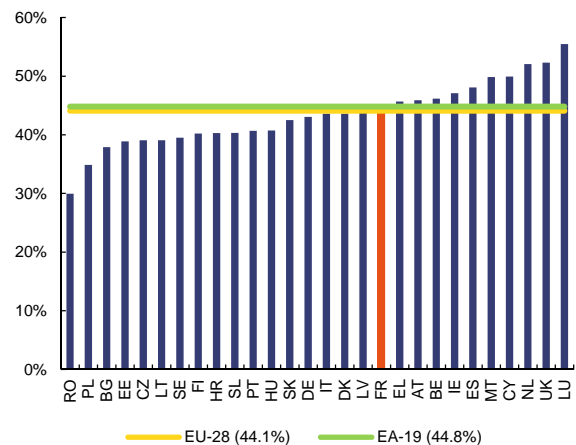
Services are a driving force of the French economy. Market services generate more than 50% of value added in France and employ more than 40% of the active labour force (Figures 1 and 2). In terms of value added, this share is close to the euro area average and comparable to that of Italy and Spain, while it is higher than in Germany.<sup>2</sup> Over the last decade, services have contributed significantly to job creation, in particular in SMEs.<sup>3</sup>

Figure 1: Gross value added share of market services (2016)



Note: Market services correspond to Nace Rev 2 classification G-N.  
Source: Eurostat.

Figure 2: Employment share of market services (2016)



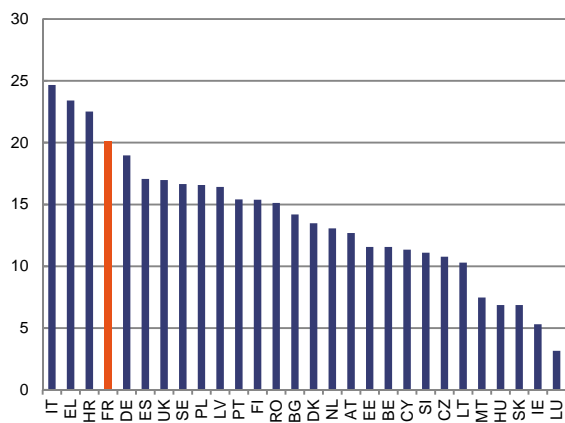
Note: Market services correspond to Nace Rev 2 classification G-N.  
Source: Eurostat.

At the same time, the importance of services for the French economy at large is particularly high due to their strong interlinkages with other economic sectors. Indeed, services represent an important production input for other industries (forward linkages, see also Timmer et al., 2015) or a user of other sectors' inputs (backward linkages). These interactions have been strengthened by the increasing role of Information and Communication Technologies (ICTs) in the last decade, which has helped to make many services more tradeable. Indeed, forward linkages are particularly strong for

business services, given their knowledge-intensive character and dispersion across the upper and lower parts of the value chains of manufacturing firms.

In addition, the share of domestic services in the value added of French manufacturing exports (almost 20%) is among the highest in the EU according to the latest available data (Figure 3). This means that further improving productivity in services in France could potentially benefit exporting sectors and stimulate output and employment at economy-wide level.

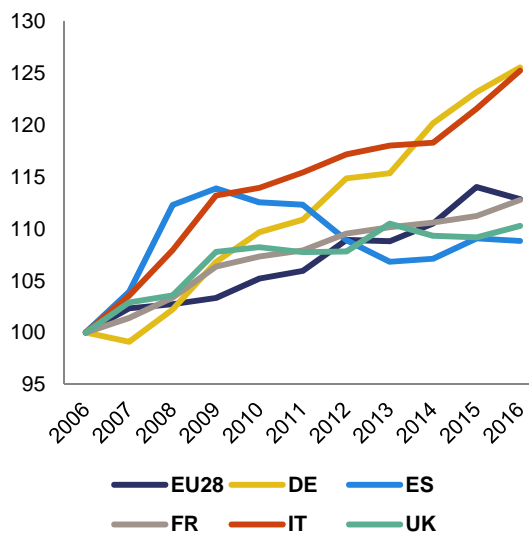
Figure 3: Share of market services in the value added of manufacturing exports (2014)



Source: Timmer et al. (2015).

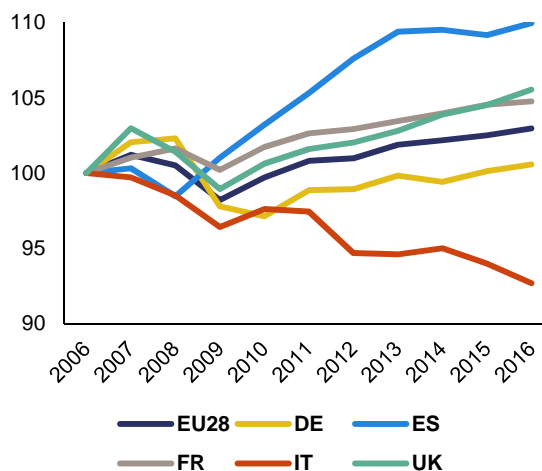
Between 2006 and 2016, nominal unit labour costs in market services in France increased as a whole at the same pace as in the EU 28 (see Figure 4). Nevertheless, this was the result of different wage and productivity patterns: wages increased more in France than in the EU during this period, but so did productivity. Nominal unit labour costs increased more slowly in France than in Germany and Italy, thanks notably to higher productivity gains. Conversely, higher labour productivity gains in Spain after 2008 allowed unit labour costs to grow at a slower pace than in France during the period 2012-2016 (see Figure 5).

Figure 4: Nominal Unit Labour Cost index in market services



Source: Eurostat National Accounts.

Figure 5: Labour Productivity index in market services



Note: Labour productivity per person employed, based on value added at constant prices.

Source: Eurostat National Accounts.

In this context, well-functioning services can support competitiveness and contribute to job creation and inclusive growth. Competitiveness gains can be realised directly through a reduction in the prices and tariffs of services that should, ceteris paribus, increase their demand, but also indirectly by boosting competitiveness of industries that use these services as input for their production (through lower costs and better quality services). In addition, reducing mark-ups in services through increased

competition may, in turn, contribute to offsetting the shift of resources (labour and capital) that has occurred since the 2000s from tradable sectors to competition-sheltered services, and its subsequent adverse effects on export performance. Indeed, this shift of resources has been partly driven by developments of relative prices between the manufacturing sectors, in particular, and the services (Galois, 2012; Enderlein and Pisani-Ferri, 2014). Finally, a reduction in mark-ups in services can support economic growth by increasing consumer purchasing power which can, subsequently, help boost the demand of other products, and foster investment.

### 3. The screening exercise

This paper uses cross-section data to identify service sectors that are both economically important and showing low performance in France. This exercise provides useful insights about the challenges in some sectors to be analysed further in view of the prioritisation of reforms in France.

The analysis covers most of the French service sectors for the period 2010-2014, given data availability constraints and combines different databases: Eurostat, EU KLEMS, Orbis, World Input-Output database (see Table 1 in annex for the list of sectors included). A two-step screening approach is employed. First, it assesses the market performance of service sectors within France taking into account their economic importance; second, it compares the performance of the identified sectors with that of the same sectors in other large economies in the EU, namely Germany, Italy, Spain, and the UK.

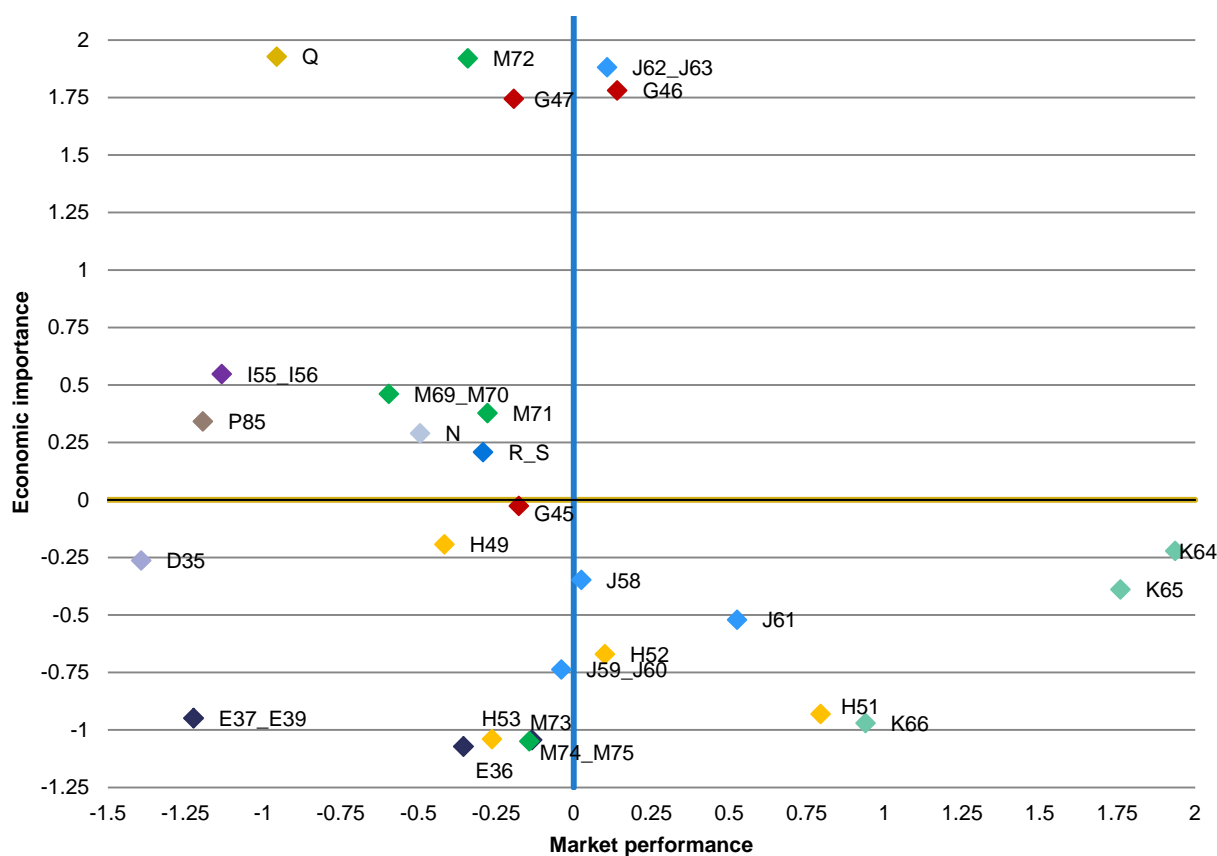
In the first step, market performance is captured by indicators covering three dimensions: (i) competition (measured in terms of the market share of the four

largest firms, the turnover of firms among the four largest firms over 4 years, and mark-ups); (ii) integration (measured in terms of trade openness and the number of intra-EU foreign affiliates over total number of firms<sup>4</sup>), and (iii) innovation (measured in terms of labour quality, ICT contribution to value added growth and labour productivity growth). Economic importance is proxied by indicators of value added, household final consumption and investment shares (see Table 2 in annex for further details).

Figure 6 presents the results of the first step of the screening exercise, which consists of a horizontal assessment of economic importance and market performance of the majority of service sectors in France. The position of each sector is set by a composite indicator for each dimension – economic importance and market performance. The two-dimensional representation of Figure 6 makes the sector selection explicit by showing sectors in four quadrants, according to their position on the vertical axis for economic importance and their position on the horizontal axis for market performance. This enables to select the potential candidates for reform, i.e. sectors which matter for the rest of the economy and display poor performances (upper left quadrant). Other sectors, such as those that are less economically important but still relatively underperformant (bottom left quadrant), could also be considered as other potential candidates for priority reforms, in particular if they play an important role as an input for other sectors. But the current analysis focuses on those more economically important sectors identified in the upper left quadrant. Similarly, sectors located in the upper right and bottom right quadrants would be sectors performing relatively well and are therefore not the focus of the second step of the screening.



Figure 6: Relative performance of service sectors in France



Note: Service sectors included: D35 - Electricity, gas, steam; E36 - Water collection and supply; E37\_E39 - Sewerage and waste; G45 - Trade of motor vehicles; G46 - Other wholesale trade; G47 - Other retail trade; H49 - Land transport; H50 - Water transport; H51 - Air transport; H52 - Transport support ; H53 - Post ; I55\_I56 - Accommodation and food; J58 - Publishing; J59\_J60 - Motion; J61 - Telecom; J62\_J63 - Programming and information; K64 - Financial services; K65 - Insurance; K66 - Auxiliary to finance ; M69\_M70 - Legal, accounting and consultancy; M71 - Architects and engineers; M72 - Research; M73 - Advertising; M74\_M75 - Other technical; N - Administrative and support; P85 - Education; Q - Human health and social work; R\_S - Arts, recreation and other services.

Note: The point corresponding to the sector H50 - Water transport (3.3,-1.6) does not appear on the graph.

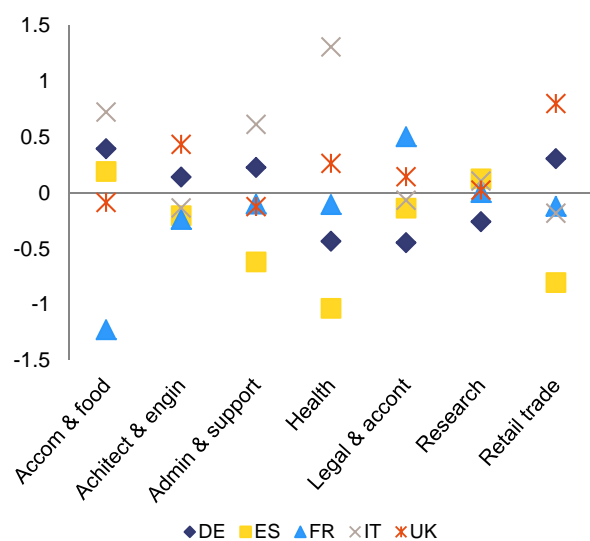
Source: European Commission, Eurostat, EU KLEMS, Orbis, World Input-Output databases.

Our analysis shows that several sectors of high economic importance are characterised by low market performance compared to other service sectors in France. This is notably the case for a number of *business services (architectural and engineering activities, legal and accounting activities, administrative and support services), retail trade, accommodation and food services, research and health.*<sup>5</sup>

In the second step, comparing the identified sectors for France to the same sectors in other large economies in the EU (Germany, Italy, Spain and the

UK), it can be observed that, with the exception of food and accommodation services, and health, these sectors, identified in the first step, tend to show a relatively good overall market performance notably thanks to their higher capacity to innovate and to penetrate in foreign markets. However, when considering the competition dimension separately, it appears that some of those services have a relatively lower performance in France than in other large EU economies (with the noticeable exception of legal and accounting activities and scientific research activities), leaving an important scope for improvement (Figure 7).

Figure 7: Cross-country comparison of competition in services



Source: European Commission, Eurostat, EU KLEMS, Orbis, World Input-Output databases.

The relatively low degree of competition in French services can be attributed to different sector-specific factors. In **accommodation and food services**, barriers to entry appear to play a role, given the relatively low birth and churn rates<sup>6</sup> and the high survival rates of French firms.<sup>7</sup> As regards the **health sector**, in particular, some reforms have been introduced notably through the Healthcare law of 2016 (*loi Santé*). Among other things, the law relaxed shareholding requirements for pharmacies and medical test laboratories and allowed for an extension of the remit of certain professions, such as midwives, and medical and dental assistants.

In the sector of **retail trade** and, to a lesser extent, in **business services**<sup>8</sup>, newly-established companies and SMEs appear to have difficulty growing. In the retail sector especially, this is evidenced by the coexistence of relatively high birth rates and low survival rates of French firms. Moreover, both in the retail sector and in business services, the gap between SMEs and larger firms in terms of labour productivity growth is larger in France than in other large economies in the EU.<sup>9</sup> France has taken some reforms to reduce the regulatory burden affecting the functioning of the retail sector in line with the European Council recommendations addressed to France in the period 2011-2014. Policy measures included, in particular, the 2014 Consumer law<sup>10</sup> that simplified authorisation requirements for the opening of trade outlets, and the 2015 Macron law<sup>11</sup>, that increased the possibilities for retailers to open on Sundays. More recent legislation, however, points to new authorisation requirements for retailers

in the region of Paris. Indeed, in 2017, retail authorisation was extended to shops of a minimum surface of 400 m<sup>2</sup> (compared to 1,000m<sup>2</sup> before).<sup>12</sup> These results suggest that further reforms could facilitate firms' growth in the retail sector.

Concerning **legal and accounting services**, the analysis shows that, although these business services appear to perform better overall in France compared to Italy, Germany, Spain and the UK, mark-ups in France tend to be higher than in these countries, while labour productivity growth for smaller firms is relatively lower. In terms of reforms, the '*Macron law*' of 6 August 2015 included measures to improve competition in accounting and legal professions, notably by easing some barriers to activity, but it did not significantly affect tariffs. Tariffs fell by 5% on average for commercial court clerks, but by only 2.5% in the case of notaries and court bailiffs. The law lifted, in particular, restrictions on legal corporate forms for a substantial number of legal professions<sup>13</sup> and loosened ownership rules and joint practices for certain legal professions but also for accountants, architects and surveyors. For notaries, the law reviewed tariffs and established 247 free set-up zones allowing the setting up of offices for 1 650 additional notaries within a period of two years, although job opportunities for new entrants were constrained in November 2016 by a decree allowing established notaries of professional civil partnerships to open several offices.

These findings suggest that further reforms would be needed to improve the market performance of business services more generally, given notably their strong interlinkages with other economic sectors in France.



## 4. Looking at the impact of reforms in services

There is some empirical evidence showing how pro-competition reforms in services may affect key macroeconomic outcomes, therefore underlining the relevance of such reforms.

Using panel data on 15 OECD countries and 20 manufacturing industries over the period 1985-2007, Bourlès et al. (2010) suggest that, in France, reducing the regulatory burden in services in 2010 to the best practice level observed in 2007<sup>14</sup> would boost total factor productivity (TFP) in the French manufacturing sector and in the whole economy by 1.58% and 0.58%, respectively, over the period 2010-2015. Based on a panel of OECD countries, Bouis and Duval (2011) similarly argue that, provided that they are swiftly implemented, pro-competitive product market reforms could boost overall productivity by 2.5% within 5 years in France.

Analyses relying on more disaggregated and country specific data have also suggested that reforms in services in France can generate significant gains that disseminate to the rest of the economy. Forlani (2010) employing firm-level data for 13 service sectors and 18 manufacturing sectors of France during the period 1996-2004, shows that a higher degree of competition in services and network industries, in particular, can have a positive impact on TFP of the manufacturing sector.<sup>15</sup>

Using input-output analysis, Fernández Corugedo and Pérez Ruiz (2014) show that a 1 percent increase in TFP across all services sector in France (induced by a 6 percent cut in regulatory barriers to entry across all sub-sectors) could increase economy-wide GDP in France by almost 2%, 2 years after the increase in TFP, thanks to the amplification effects that arise from between sector production linkages.

A 2013 report by the *Inspection Générale des Finances* of the French Treasury identified –on the basis of simple correlations between excessive profitability and applicable regulation– 37 regulated professions which showed signs of weak competition and proposed regulatory changes which could increase GDP by 0.5 pp and create more than 120,000 jobs over 5 years.<sup>16</sup> The OECD (2015) estimated that five sets of measures included in the law on economic growth, activity and equal opportunities (Macron Law) – the reform of regulated professions, the extension of Sunday and

evening trading, the opening-up of passenger coach transport, the simplification of redundancy rules and easier procedures for obtaining a driving license – could potentially increase France's GDP by 0.4% over 10 years. More recent simulations of the impact of reforms by the European Commission, using the QUEST model, suggest that a selection of product market reforms (some reforms cannot be quantified) aimed at reducing regulatory barriers in professional services, the retail sector, network industry and electricity could boost French GDP by 0.10% and employment by 0.06% after 5 years, compared to the baseline (European Commission, 2016).<sup>17</sup>

## 5. Conclusions

Despite a relatively good market performance overall, several service sectors of high economic importance in France are characterised by a lower degree of competition than in other large EU economies. This is notably the case for *architectural and engineering activities* and for *administrative and support services*, as well as for the sectors of *retail trade, accommodation and food services, and health*. The relatively low degree of competition in these service sectors in France can be tentatively explained by different factors specific to each sector, notably barriers to entry or obstacles for newly-established companies and SMEs to grow.

Regulatory restrictions may contribute to explain weak performance in some service sectors, such as business services and regulated professions. The Macron law of 2015 introduced reform measures in a number of regulated professions, notably legal and accounting professions. This positive development represents a first step and further reforms are warranted to remove remaining unnecessary regulatory restrictions in other professions and in the broader services sector.

Policy measures to tackle sector-specific barriers to competition in the aforementioned identified service sectors would also benefit from other structural reforms (both on product and labour markets) with a view to maximising their impact.

Finally, given the strong interlinkages between services and manufacturing, reforms aiming to improve the economic performance in services may also contribute to a more efficient and productive manufacturing sector and thereby to more competitive exports. If appropriately designed and implemented, these reforms in services could also ultimately support job creation.

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## Annex – Sensitivity check of the market monitoring methodology (Product Market Review 2009) for France

According to the methodology of the Product Market Review 2009, market performance is captured by the level of competition (market share of the four largest firms (C4), turnover of firms among the four largest firms over 4 years, mark-ups), integration (trade openness and number of intra-EU foreign affiliates over total number of firms<sup>1</sup>), and innovation (labour quality, ICT contribution to value added growth and labour productivity growth). Economic importance is proxied by indicators of value added, household final consumption and investment shares.

Given the data availability constraint and discussion over the robustness of indicators, several types of sensitivity checks were tested, notably:<sup>2</sup>

1. **Alternative indicators of market structure** (see Sensitivity check 1). In particular, we tried a number of alternative simple indicators being part of the composite ones (e.g. unit labour cost growth instead of productivity growth in the innovation component, or TFP growth instead of productivity growth). We also examined the sensitivity of the C4 indicator database in comparison with the **Herfindahl-Hirschman Index, as well as** turnover of firms among the four largest firms over 8 years instead of 4<sup>3</sup>.
2. **Excluding single indicators in turn** (see Sensitivity check 2). We also excluded single indicators (e.g. the mark-ups) entering the composite ones to see if their exclusion modifies considerably the selection of sectors.<sup>4</sup>
3. **Excluding/including single sectors in turn** (see Sensitivity check 3). Finally, as the score per sector is normalised with respect to other sectors, we tested the exclusion of singular sectors (e.g. H50-Water transport), or their inclusion (e.g. real estate activities).

The results show that in most of the cases the sectors selected in the baseline analysis also appear to display poor performance in alternative specifications. Moreover, the use of different indicators for competition suggests that ranking of the sectors and firms' selection is relatively stable across the indicators. Other results are available on demand.

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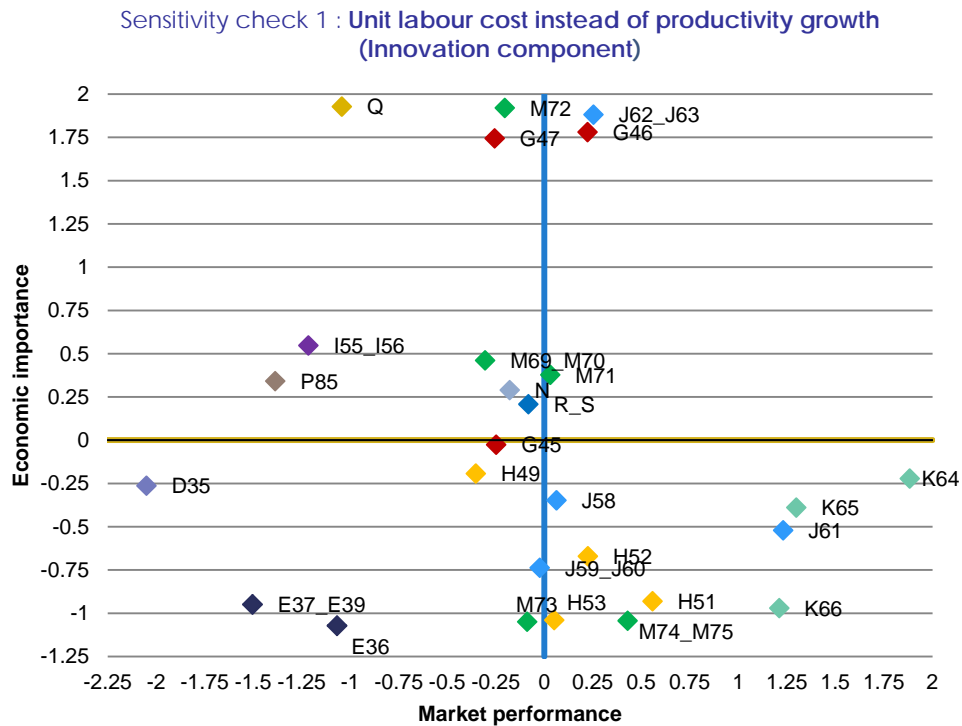
P<sup>1</sup> PA third variable, namely consumer prices index, was initially used to construct the integration index, but was eventually omitted due to data availability constraints. We included the variable, classified according to COICOP classification and translated to NACE rev.2 in one of our sensitivity checks. The number of sector is however very limited. Producer prices have been tested as well, but the sector coverage remains very restricted.

P<sup>2</sup>P The sensitivity checks not presented in this annex are available upon request.

P<sup>3</sup>P All the mentioned competition indicators are issued from the Orbis database and also may be influenced, to a certain degree, by problems of representativity and company composition of the sample.

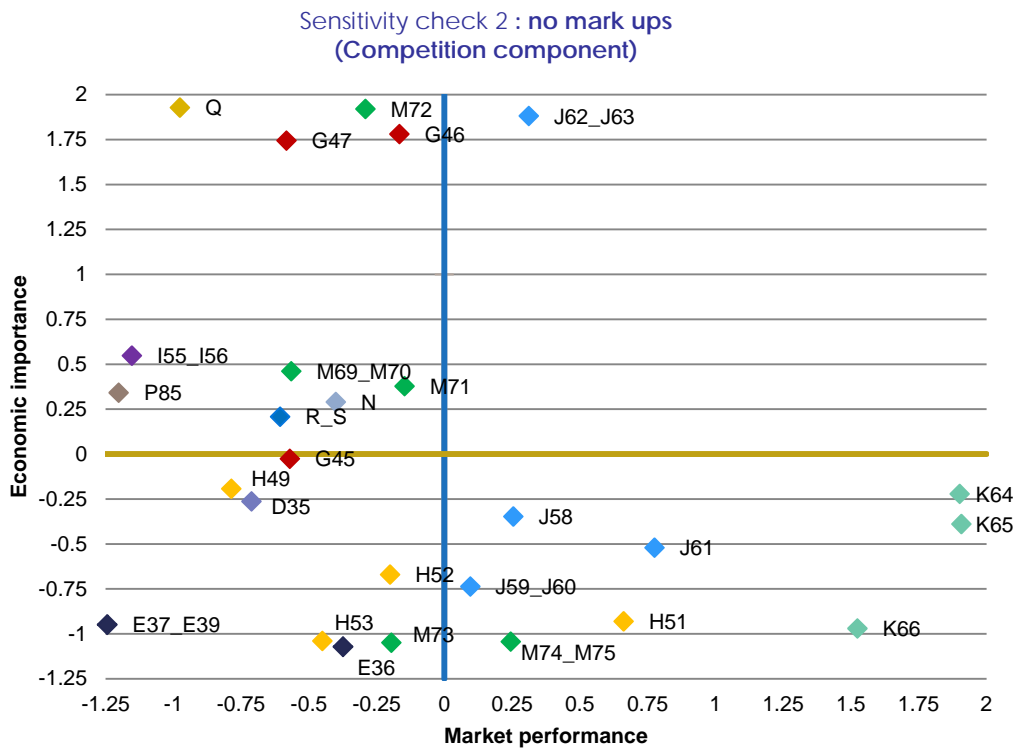
P<sup>4</sup>P The current indicator for margin, originally coming from Thum&Canton (2015), could be criticised because mark-up estimates are not directly available for each sector and because questions may also be raised about being possibly out of date

I) Alternative indicators of market structure



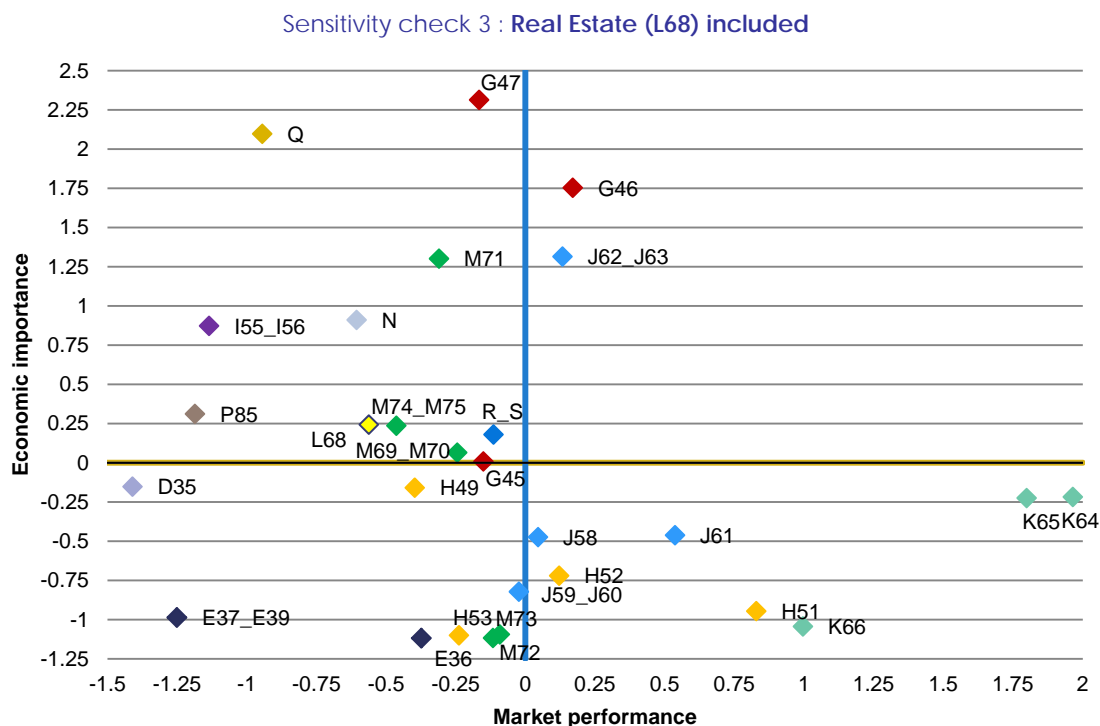
Note: The point corresponding to the sector H50 - Water transport (2.6, -1.1) does not appear on the graph.

II) Excluding single indicators in turn



Note: The point corresponding to the sector H50 - Water transport (2.9, -1.1) does not appear on the graph.

III) Excluding/including single sectors in turn



Note: The point corresponding to the sector H50 - Water transport (3.3, -1.1) does not appear on the graph.

**Sectors in Nace rev. 2 classification:** D35 - Electricity, gas, steam; E36 - Water collection and supply; E37\_E39 - Sewerage and waste; G45 - Trade of motor vehicles; G46 - Other wholesale trade; G47 - Other retail trade; H49 - Land transport; H50 - Water transport; H51 - Air transport; H52 - Transport support ; H53 - Post ; I55\_I56 – Accommodation and food; J58 - Publishing; J59\_J60 - Motion; J61 - Telecom; J62\_J63 - Programming and information; K64 - Financial services; K65 - Insurance; K66 - Auxiliary to finance ; M69\_M70 - Legal, accounting and consultancy; M71 - Architects and engineers; M72 - Research; M73 - Advertising; M74\_M75 - Other technical; N - Administrative and support; P85 - Education; Q - Human health and social work; R\_S - Arts, recreation and other services.

Table 1: **Service sectors included in the analysis**

D35	Electricity, gas, steam and air conditioning supply
E36	Water collection, treatment and supply
E37-E39	Sewerage; waste collection
G45	Wholesale and retail trade and repair of motor vehicles and motorcycles
G46	Wholesale trade, except of motor vehicles and motorcycles
G47	Retail trade, except of motor vehicles and motorcycles
H49	Land transport and transport via pipelines
H50	Water transport
H51	Air transport
H52	Warehousing and support activities for transportation
H53	Postal and courier activities
I	Accommodation and food service activities
J58	Publishing activities
J59_J60	Motion picture, video and television programme production, sound recording and music publishing activities; programming and broadcasting activities
J61	Telecommunications
J62_J63	Computer programming, consultancy and related activities; information service activities
K64	Financial service activities, except insurance and pension funding
K65	Insurance, reinsurance and pension funding, except compulsory social security
K66	Activities auxiliary to financial services and insurance activities
L68	Real estate activities
M69_M70	Legal and accounting activities; activities of head offices; management consultancy activities
M71	Architectural and engineering activities; technical testing and analysis
M72	Scientific research and development
M73	Advertising and market research
M74_M75	Other professional, scientific and technical activities; veterinary activities
N	Administrative and support service activities
P85	Education
Q	Human health and social work activities
R_S	Arts, entertainment and recreation; Other service activities



Table 2: **Data sources**

	Indicator	Source	Time coverage
<b>ECONOMIC IMPORTANCE</b>	Value added share	WIOD	2014
	Consumption share	WIOD	2014
	Investment share	WIOD	2014
<b>INTEGRATION</b>	Intra-EU foreign affiliates	SBS / Eurostat	2013
	Exports+ imports/ VA (intra & extra)	WIOD	2014
<b>INNOVATION</b>	ICT	EU Klems	average over 2010-2014
	Labour quality	EU Klems	average over 2010-2014
	Labour productivity growth	Eurostat	average over 2010-2014
<b>COMPETITION</b>	Mark-ups	Thum&Canton (2015)	2013
	C4	Orbis/WIOD	average over 2010-2014
	TNF	Orbis	average over 2010-2014

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P<sup>1</sup>P The exercise presented in this Economic Brief differs from the EU-level market monitoring exercise conducted previously See Chapter 2 (and annex 2.2.) in European Commission (2009), Product Market Review 2009, European Economy 11. The current exercise is carried out at the country level, which allows cross-country comparisons.

The current exercise also varies from other product market analyses carried out at national level with more disaggregated data as those analyses generally use as references either the other sectors of the economy or the time evolution of the services at hand. See for instance, the analysis on Belgium; AGORA-MMS project - FPS-Economy, SMEs, Self-employed and Energy (2011) Monitoring of Markets and Sectors.

P<sup>2</sup>P Using a broader definition of services that includes non-market service sectors as well, it becomes evident that services are rapidly gaining ground in France compared to the other large economies in the EU.

P<sup>3</sup>P Data come from the World Bank and the OECD.

P<sup>4</sup>P This concerns the affiliates that domestic firms have in other EU countries.

P<sup>5</sup>P Also education and arts, recreation and other services are selected. However, due to their particular non-market nature, we would not focus on them in the analysis.

P<sup>6</sup>P The churn rate is the ratio of the sum of newly established and exiting enterprises to the total number of enterprises in an industry. There are no data available for patent agent related activities.

P<sup>7</sup>P Source: Eurostat Structural Business Statistics databases.

P<sup>8</sup>P Business services include professional, scientific, and technical activities, and administrative and support services, including legal and accounting activities as well as architectural and engineering activities and travel agency activities.

P<sup>9</sup>P Source: Eurostat Structural Business Statistics databases.

P<sup>10</sup>P Loi relative à l'artisanat, au commerce et aux très petites entreprises.

P<sup>11</sup>P Loi pour la croissance, l'activité et l'égalité des chances économiques.

P<sup>12</sup>P This measure should apply for three years as of 1st January 2018. The government will have to present an evaluation report to the Parliament at the latest 8 months before the end of this period and propose follow-up measures.

P<sup>13</sup>P Lawyers, lawyers before the supreme courts, notaries, court bailiffs, legal auctioneers, insolvency practitioners, and court appointed receivers.

P<sup>14</sup>P The best practice is defined as the average of the three lowest values of the anti-competitive regulation indicators in the upstream sectors across countries.

P<sup>15</sup>P Competition in network industries is also essential for manufacturing firms' propensity to export, as opposed to aggregate competition in services that exerts a negligible and non-statistically significant effect.

P<sup>16</sup>P These professions corresponded to a total annual turnover of about EUR 235 billion and 6.4% of GDP in 2010.

P<sup>17</sup>P The quantification of product market reforms includes the partial privatisation in network sectors (gas and telecom), the reform of the Sunday and evening openings in the retail sector, reforms of the regulated professions included in the Macron Law, and the reform of the electricity regulated tariffs. The sum of these product market reforms was translated into a reduction in the final goods price mark-up of 0.21 pp and a 0.03% increase in labour productivity.

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