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*Seminar on the service sector*

**Quality Regulation and  
challenges for developing the  
service sector**

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# Context

- Baumol 1967, McKinsey, M. Baily: reports on productivity
- Korea, Japan: higher productivity than the US in a few manufacturing industries, but overall lag in services accounting for large share of GDP (e.g. Retail)
- Implications for ability of Korea to reach the top OECD countries in terms of standards of living and overall development
- Key focus on productivity of the service sector: underdeveloped area of the Korean economy
- Regulatory Constraints play a key role

# The implications of the still valid Mc Kinsey Report

- An important area for innovation and productivity, particularly financial services, and retail whole sale
- A significant share of employment, and a source of new jobs
- Need for a level playing field:
  - Open up capital markets and end subsidies
  - Expand favourable business conditions
  - Remove barriers to FDI
  - Revise barriers to scale
  - Cut red tape and better enforcement

# Cross national Studies

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- Seminal studies: US / Europe comparisons, Mc Kinsey (2002):
    - *Retail*
    - *Telecommunications*
    - *Retail banking*
    - *Road freight*
  - But also missing elements:
    - *effects of spillovers (IT/Telecommunication regulation)*
    - *analysis of the regulatory aspects remained limited*
    - *no tractable strategy for addressing the issues*

# Need for sector specific economic evidence

- Focus on a few sectors building on the OECD experience
  - **Road freight** (Brazil study 2007), ECMT, regulatory reform in road freight, general regulatory reform, remaining controls for safety, cabotage, foreign firms.
    - US, Australia, UK deregulation early up: 15-25 % drop in tariffs
    - Other countries too: France deregulation similar results, Mexico.
    - Increasingly deregulated activity.
    - Implications for multimodal competition.
    - Postal services (Switzerland, 2006
  - **Postal services.** More limited deregulation. Sweden, Germany, mostly parcel services, definition of “universal services”, Sweden 6% of the market

# The case of retail

## Lessons from Europe

- Lessons from Southern European countries helpful for Korea (Italy, Spain)
- A wealth of studies:
  - **Variance across countries:** Highly regulated countries, lower productivity of retail compared to Germany and France (Italy 2009 review, Pellegrini)
  - **Variance across regions:** Italy, a natural experiment, Veneto vs. Calabria (Italy 2007 and 2009 reviews)
  - **Variance over time:** France, Galland law, and change of regulation over time (Askenazy, Weidenfeld, CEPREMAP 2007, Kramarz Bertrand 2002)

# The Italian case in an EU perspective

## Estimated cost of barriers to entry in retailing in Italy

	Retail sector considered	Benchmark	Basis of computation	Involved cost as % of GNP
<b>Nomisma (1998)</b>	Grocery retailing	Main European countries	Price differentials across store types	0.4%
<b>Pellegrini (2000)</b>	Grocery retailing	France	Retail margins in Italy and France	In a range from 1.0% to 1.5%
<b>Ravazzoni (2004)</b>	Grocery retailing	Main European countries	Price differentials across store types	0.6%

## High regulation: loss of economies of scale

Market share of the first 5 grocery retailers, selected EU countries, 2007

Rank	1	2	3	4	5	Total
<b>Germany</b>	Edeka 25.7	Rewe 18.2	Aldi 17.4	Markant 13.8	Metro 7.6	82.7
<b>France</b>	Carrefour 26.1	Leclerc 15.9	Casino 13.3	Intermarché 12.8	Auchan 12.5	80.6
<b>UK</b>	Tesco 29.2	Asda 15.6	Sainsburys 14.8	Morrison 10.5	Coop 6.2	76.3
<b>Spain</b>	Carrefour 22.5	Merdcadona 15.3	Eroski 9.6	Auchan 7.6	ECI 7.6	62.6
<b>Italy</b>	Coop 14.6	Carrefour 9.5	Conad 8.5	Auchan 8.1	Selex 7.5	48.3

# Italy, a regional perspective

- *Since 2001 constitutional reform, 23 laws on commercial distribution:*
- *Regulations of retail vary by regions:*
  - *Store size threshold*
  - *Authorisation of medium-sized and large stores*
  - *Opening hours*
  - *Promotions and sales*
- *Correlation between economic performance, inflation, occupation, investment, and degree of liberalisation (Italian competition authority ACGM 2007)*

## ***Regional regulation of commercial distribution*** ***Restrictions to competition***

Low	Medium	High
Campania	Abruzzo	Friuli Venezia Giulia
Emilia Romagna	Basilicata	Lazio
Lombardy	Calabria	Liguria
Marche	Tuscani	Apulia
Molise	Veneto	Sicily
Piedmont		Trentino Alto Adige
Aosta Valley		Umbria

# Italy, a case of two regions

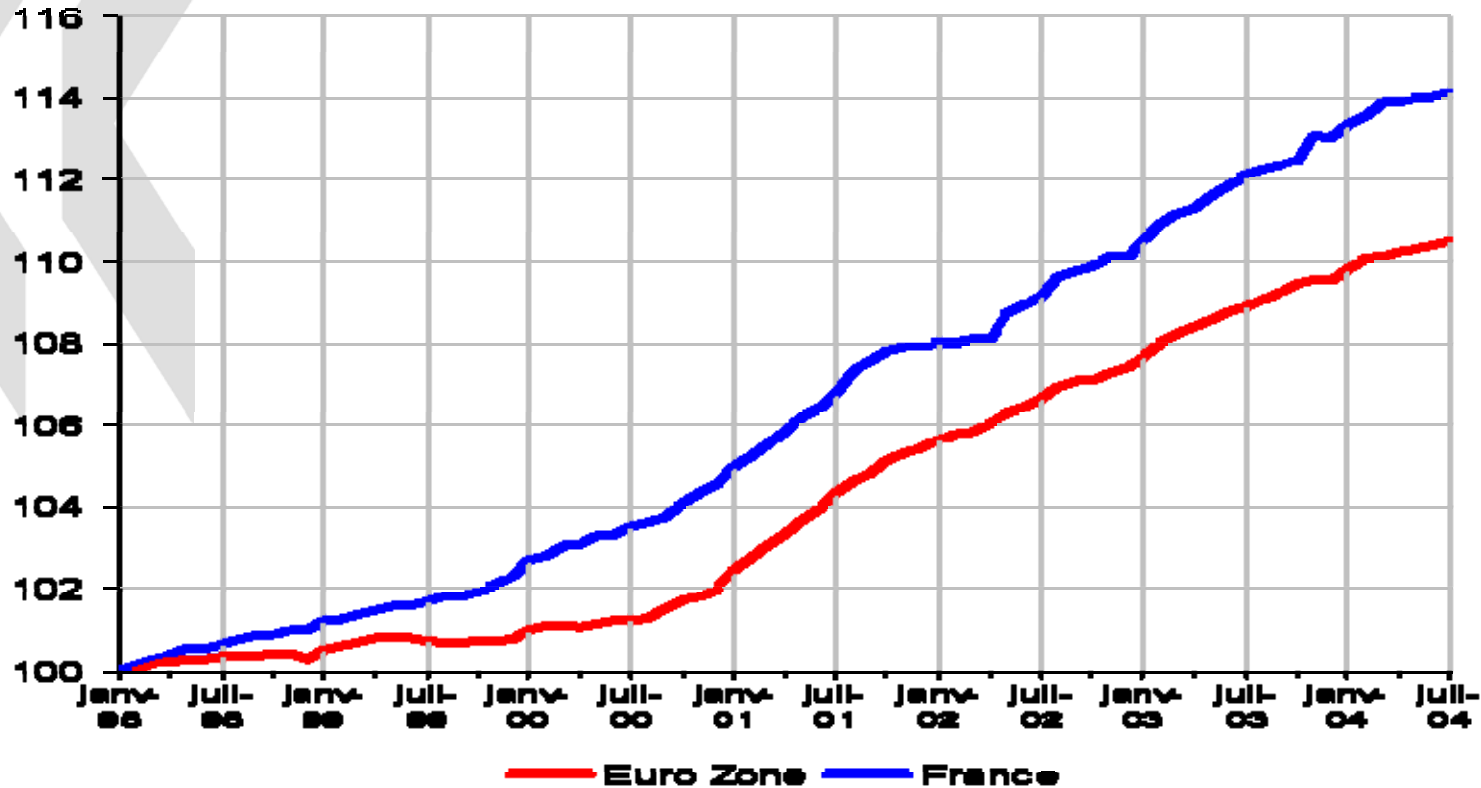
- *OECD (2006) study: Veneto vs Calabria, Interviews with stakeholders and analysis of regional strategies*
- **Veneto:**
  - *a mature region*
  - *A well developed system of large stores*
  - *Back lash and the need to preserve “urban centers”, and their specific character*
  - *Mix of urban laws and commercial distribution*
  - *A system partly frozen with local lobbies*
- **Calabria**
  - *A less developed region*
  - *A less developed commercial system at the start*
  - *An acknowledgement of the need to modernise: a fairly light regulatory framework*
  - *A rapid development of employment and retail trade activity*
- **Conclusion**
  - *Need to integrate the multi level dimension of regulation*
  - *Interplay of urban and commercial distribution rules : overlap*
  - *Competition principles need to apply nation wide*
  - *Demonstrating the benefits to regulatory reform helped to limit the losses in Veneto*

# France, policy change over time

- *Royer law 1973: Zoning regulations: local approval for the development of large stores:*
  - *Employment growth in retail stalled (Kramarz Bertrand 2002)*
  - *Negative impact on employment creation (minus 3%)*
  - *Smaller retailers' market share increased*
- *Small shops protected: strategy of above-cost predatory pricing for large stores in the 1970s and 1980s*
- *Did not hinder development of large stores: (but local oligopolies?): high productivity, at or above US levels (Askenazy)*
- *Additional laws: Galland and Raffarin laws (1996) (Askenazy Weidenfeld 2002):*
  - *regulating relationships between suppliers and retailer, (preventing predatory resale), and strengthening the regulation of authorisation for large stores*
  - *Preventing the entry of "low cost" distributors,*
  - *Entry of hard discount but of a smaller scale*
  - *Slowing the creation of new stores*
  - *Significant increase in the net economic margins for retail stores*
  - *Consumers at a loss*

# Losses for consumers

*The impact of regulation on the food component of the consumer price index in France versus euro Zone*



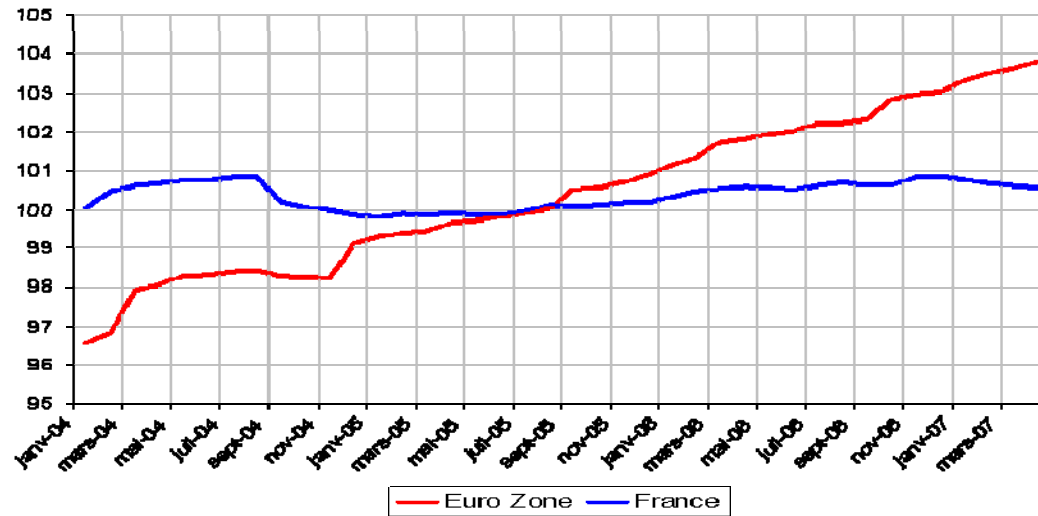
*Reforms launched by Minister of Finance Sarkozy: negotiated discount with stores,  
Dutreil Act 2005:*

*Limits on rear margins*

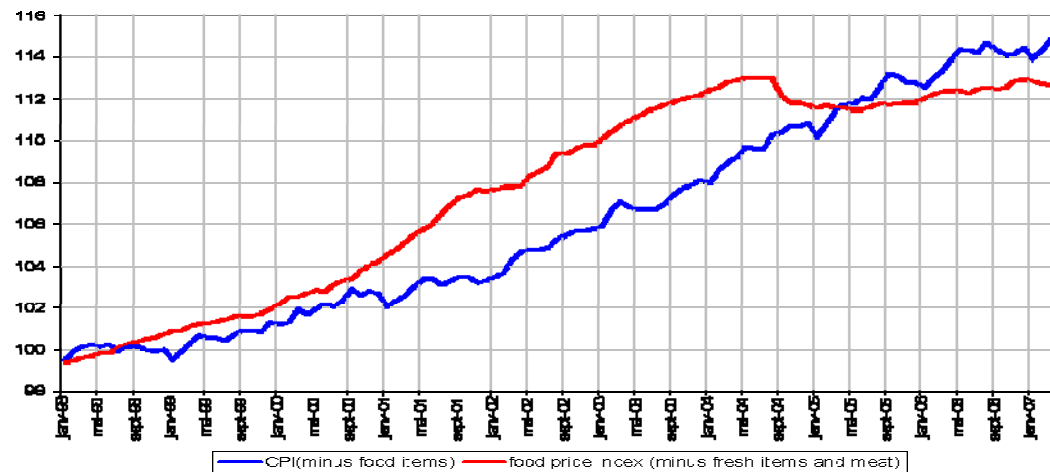
*Gradual implementation*

# A clear impact of the regulatory reform

*The impact of the reform on the food component of the consumer price index  
France versus euro Zone (Eurostat)*



*Impact on food prices versus consumer prices (INSEE)*



# Professions, Lawyers, Pharmacies

***Issues are deeply embodied in legal and institutional contexts:***

## ***Lawyers***

- In many countries with Latin/continental systems, exclusive privileges for certain acts:
  - creating a company: Mexico, Portugal, implications for cost of SME creation
  - buying and selling property: notaries in France: proposed merging with the lawyers
- Regulation restricting entry
- Regulations limiting pricing : e.g. fixed scales and lack of price competition in Italy
- Specific regulatory approaches calling for cosy arrangements: self regulation vs external regulation (e.g. professional orders created during WWII in France, still there).

## ***Pharmacies***

- Need to have a single professional owning a pharmacy in France
- Exclusive rights to distribute products:
- Italy 2008 reforms: liberalising distribution
- UK: possibility of pharmacy chains
- Asian context: different relation of prescription to physician

# Australia

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- Regulatory reform agenda already well advanced:
    - *National competition Policy*
    - *Competition Principles Agreement*
  - Achievements of the NCP
    - *Common frameworks for regulations across states, to allow economies of scale*
    - *Access regime for telecommunications, rail and other industries*
    - *But professions, pharmacies, taxis: the unfinished NCP agenda*
  - Alternative regulatory models: need to choose from a range of alternatives
  - Regulatory competition or regulatory harmonisation (PC 2000)
  - Current efforts are clearly towards regulatory harmonisation

# A perspective on Korea

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- Productivity of services around 60 % of manufacturing
  - Significant entry barriers have been reduced over time
  - **Key role of land use regulations:** zoning regulations, over 100 laws with 13 different ministries, capital region
  - **Retail**
    - Increasing foreign presence since 1996
    - Low productivity (29 % of US, 34 % of Japan and France, 2002)
    - Regulations to protect small mom-and-pop stores
    - **Stringent regulations on retail outlets**
    - **Combined effects of retail trade regulation and land use,**
  - **Professional services:**
    - **deregulation of professional associations, RRC 1998, 1999 OCRA**
    - **But slow pace of change: lack of lawyers,**

# Korean policy initiatives

- **Across the board regulatory reform: solid foundations,** RRC, RRTF: services 2/3 of reforms implemented by RRTF between 2004 and 2007, 671 regulations
- **Free economic zones and special economic zones,** but distortion of locational decisions
- **Focus on entry barriers**
- **Recent reform efforts: roadmap for the services sector,** 2008: goal :
  - to improve service account balance
  - To address implications of FTAs with the US and EU
- **PROGRESS 1:** Tourism, medical care, language training, Knowledge services
- **PROGRESS II:** Broadcasting and telecommunications, IT, legal services, employment, health care and food, business services

# Challenges for policy making

- A large and heterogeneous sector:
  - Retail
  - Taxis
  - Legal professions, consulting services
  - Medical and health care, pharmacy
  - financial services
  - Entertainment
  - Hotels, restaurants
- Large and influential constituencies: small shop keepers, taxis, barmen, bankers, physicians, etc... : example of taxi reforms
- Implications across levels of government: local authorities (retail, hotels restaurants)

# Policy options


- Need for a well targeted approach
  - Focused and efficient measures
  - Not tackling everything at once
  - Demonstrate results supported by the population
- Need for policy coherence: interplay of urban planning and commercial distribution (zoning issues are very sensitive in Korea)
- Use external tools, to force the modernisation (FTAs, EU Wide effort, service directive)
- Competitiveness agenda supported at a high level (PCNC, RRTF)



# Broader institutional and socio economic challenges

- Need for a clear strategy across levels of government
  - Benchmarking
  - Experimentation
  - Economic incentives
- Unaddressed policy challenges:
  - Share of women in the workforce
  - Labour market regulations
  - Geographical and urban vs. rural areas
- Scars from the financial crisis and mixed perspectives: blowing against the wind
- Broader regulatory aspects: business services, accounting and regulatory standards, Options for the G20

# Conclusion

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- Right focus for the long term future of Korea
  - However, no quick and magic fix:
  - A step by step approach
  - Useful work of the RRC and BAAR in Korea
  - Korea a role model for many other countries (e.g. Mexico, Brazil)
  - Achieve demonstrated results in key areas
  - Integrate the political economy of reform, in this field more than in any other