
Istituto Bruno Leoni

# Index of Liberalizations 2015

## THE 2015 INDEX OF LIBERALIZATION

Competition and market opening are essential pre-conditions for economic growth and human prosperity. However, over-regulation and the existence of legal obstacles to competition are significantly hampering the ability of the European Union 28 member states to develop and modernize themselves.

The Istituto Bruno Leoni's Index of Liberalizations aims at identifying both the barriers to competition and the best practices across the EU, by surveying 10 sectors of the economy: motor fuel retail markets, electricity and natural gas market, labor market, postal services, telecommunications, TV broadcasting, rail transport, air transport, and insurance market. For each sector a synthetic Index is built, that allows to measure the degree of market openness in each member states. The most liberalized member state is conventionally awarded a score equal to 100%, while other countries are ranked accordingly. Sectoral results are then averaged in order to reflect an overall degree of liberalization, that expresses to what extent market entry, entrepreneurial organization, and market exit are effectively left free from distortionary regulations.

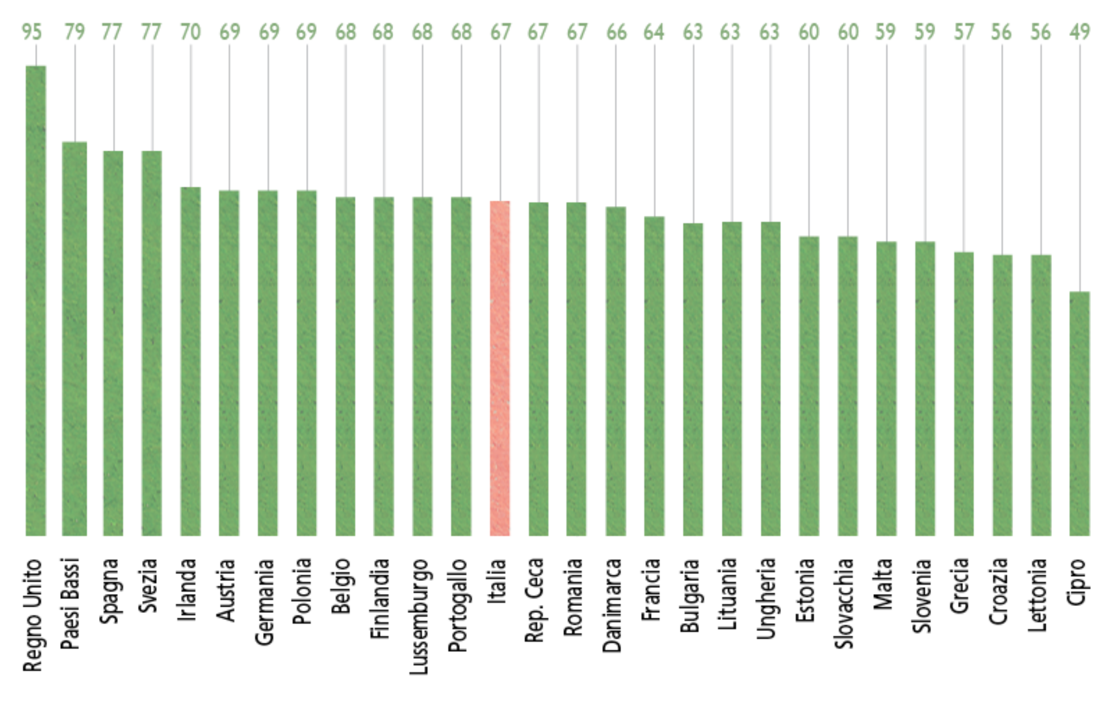
The Index thus measures what can be thought of as the "distance from the frontier" of market openness within the EU. It also allows to identify the biggest obstacles to a truly competitive environment in every sector, thereby providing guidance for a pro-market policy making in each member state as well as at the EU level.

The Index of Liberalizations was created in 2007 as an Italy-focused benchmarking effort. In 2013 the coverage of the Index was extended to the EU15. Since 2015 it covers the whole EU28.

In 2015, the most liberalized countries in the European Union are the UK (with an average score of 95%), the Netherlands (79%) and Spain (77%). The least liberalized countries were Cyprus (49%) and Latvia and Croatia (both at 56%). A significant variation across sectors was also observed: some countries, that may be on average relatively closed to competition, may be good or even top performers in specific sectors.

The following figure summarizes the results of the 2015 Index of Liberalization.

**Figura 1.** Indice delle liberalizzazioni 2015




The Index of Liberalizations aims to be a tool to promote competition as well as to increase the awareness, in Europe and in EU member states, of the need to fully open markets in order to catch growth opportunities that would otherwise go wasted. The process of European integration can be seen as either a risk or an opportunity. While a temptation to over-regulate the economy is constantly looming, the EU has played a substantial role in promoting market opening throughout the member states. The 2015 Index of Liberalization suggests that a meaningful integration of the European economies can only be achieved through a major swift towards deregulation of the markets, both at the EU and national level. The Index shows where deregulation should happen and helps identify what models are working best. In this respect, liberalization – as captured by the IBL Index – may be a crucial component of a bottom-up process of building Europe through a well-functioning, open, competitive single market for goods and services. (carlo stagnaro)

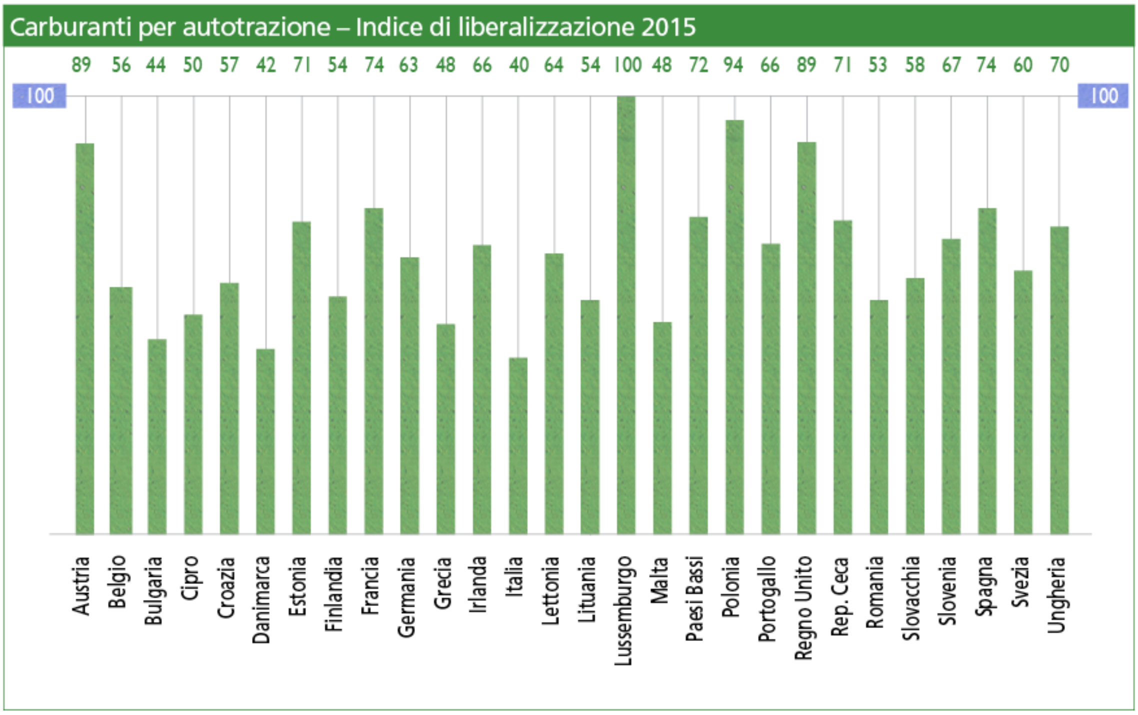
## INTRODUCTORY ESSAY: AUSTERITY IS NOT ENOUGH

In the aftermath of the Great Recession, several European countries resorted to deficit containment policies, and were forced to reduce public spending. In order to mitigate the harsh, short-run impact of these necessary policies on economic life, structural reforms are needed. Such reforms would reduce the negative impact of the economic downturn and facilitate growth by reducing obsolete, inefficient or redundant regulations in labour and product markets. Economic literature is almost unanimous in forecasting significant gains in terms of growth, employment and reduced inequality stemming from reforms aimed at reducing impediments to economic activity. While structural reforms are strongly encouraged by international organizations and often debated in political platforms, they are seldom carried on systematically, since they are often opposed by interest groups which benefit from the very same, inefficient regulation.

The 2015 Index of Liberalization's introductory essay surveys the economic literature on potential economic gains in the euro zone, and analyzes four case studies from countries with acute fiscal sustainability issues, namely Greece, Italy, Portugal, and Spain. The scope and pattern of reforms are variable: Spain and Portugal had a faster paced and broader platform of reforms. Labour and product market reforms were carried out simultaneously, allowing complementarity effects, and this resulted in a larger improvement of macroeconomic indicators. Italy and Greece were less resolute, with the latter focusing more on fiscal austerity than growth, and their reformative programs lacked of prompt and effective enforcement, resulting in a lower impact on GDP and unemployment.

From these experiences some lessons can be drawn: labour and product market reforms need to be pursued at the same time, since the increased buying power which consumers have in a more competitive market can ease the impact of a lower labour protection. Structural reforms need to be carried out bravely: the more extensive and fastpaced the program, the easier it will be to reap the political fruits of the reforms and buy consensus for further ones. Reforms cannot be an occasional and unconvinced episode: it needs to be part of a systematic effort to constantly constrain and improve regulation. (rosamaria bitetti)

## GASOLINE RETAIL MARKET



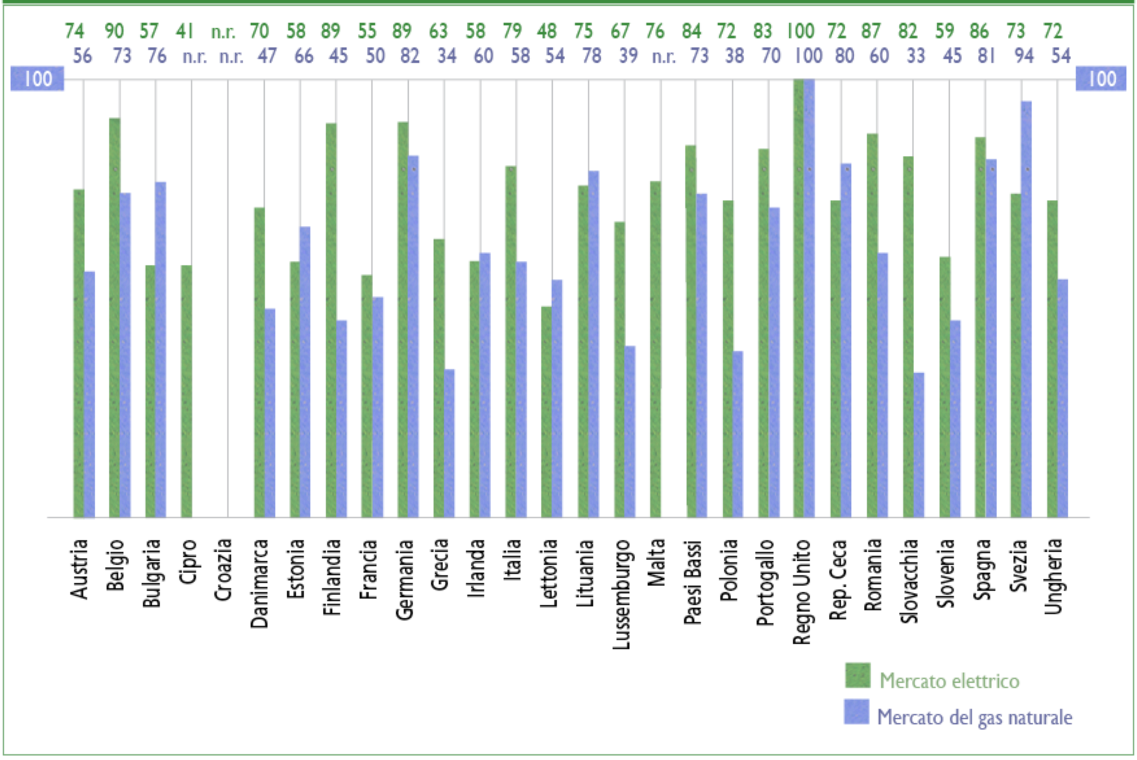

Gasoline retail markets are undergoing a structural change, due to the long-term declining trend of the diesel and gas demand, especially in Western Europe. Measuring the degree of market openness, in such a context, implies to look at the ability of the market to adapt to new business models and organizational settings.

According to the IBL Index of Liberalization, in 2015 the most liberalized EU member state was Luxembourg (which scores 100%), followed by Poland (94%), and Austria and the UK with an equal score of 89%. The least liberalized countries were Italy (40%), Denmark (42%), and Bulgaria (44%).

The Index of Liberalization takes into account three indicators: "Tax", "Price", and "Organization". Tax measured the incidence of excise taxes and VAT on the final price of gasoline: the underlying concept is that a higher tax incidence reduces the incentive of the consumer to look for a better price, because the variation among different suppliers is limited. Price focuses on the so-called industrial price, i.e. the price of gasoline before taxes. Since gasoline and diesel are uniform products with a (at least) regional wholesale market, it can be safely assumed that differences in retail prices reflect the extent of competitive pressures. Finally, Organization looks at the modernization process of distribution networks, with particular regard to the penetration of self-service facilities and the availability of non-oil products at the gas pump. (carlo stagnaro)

## ELECTRICITY AND NATURAL GAS

Mercato elettrico e del gas naturale – Indice di liberalizzazione 2015




The IBL Liberalization Index for the electricity and gas sector investigates the competitive environment in the following subsectors: generation and import of electricity (production and import for gas), transmission, distribution, and supply.

As far as electricity is concerned, the most liberalized EU member state in 2015 was the UK, that was selected as a benchmark for the other member states. Hence the UK was awarded a score of 100%. Following the UK, were Belgium (90%) and Germany (89%). The least liberalized countries were Cyprus (41%), Latvia (48%), and France (55%).

As far as natural gas is concerned, the most liberalized countries in the EU28 in 2015 were the UK (100%, being the top performer), Sweden (94%), and Germany (82%). The least open countries were the Slovak Republic (33%), Greece (34%), and Poland (38%).

In order to build the Liberalization Index, the following measures have been considered with respect to the largest operator in the upstream and retail segments of both sectors: the extent of Government ownership, the size of its market share and the degree of vertical separation with respect to network operators. For electricity generation, two additional measures have been considered. Namely, the pervasiveness of the regulation supporting: (i) renewable generation, i.e. whether feed-in tariff, green certificates, quota obligations or a combination of the three is in place; and (ii) generation adequacy, i.e. whether an "energy only" market desig, a strategic reserve, a capacity market, or a capacity payment is adopted. For both gas and electricity retail segments the existence of retail price regulation and households' switching rates have been also assessed.

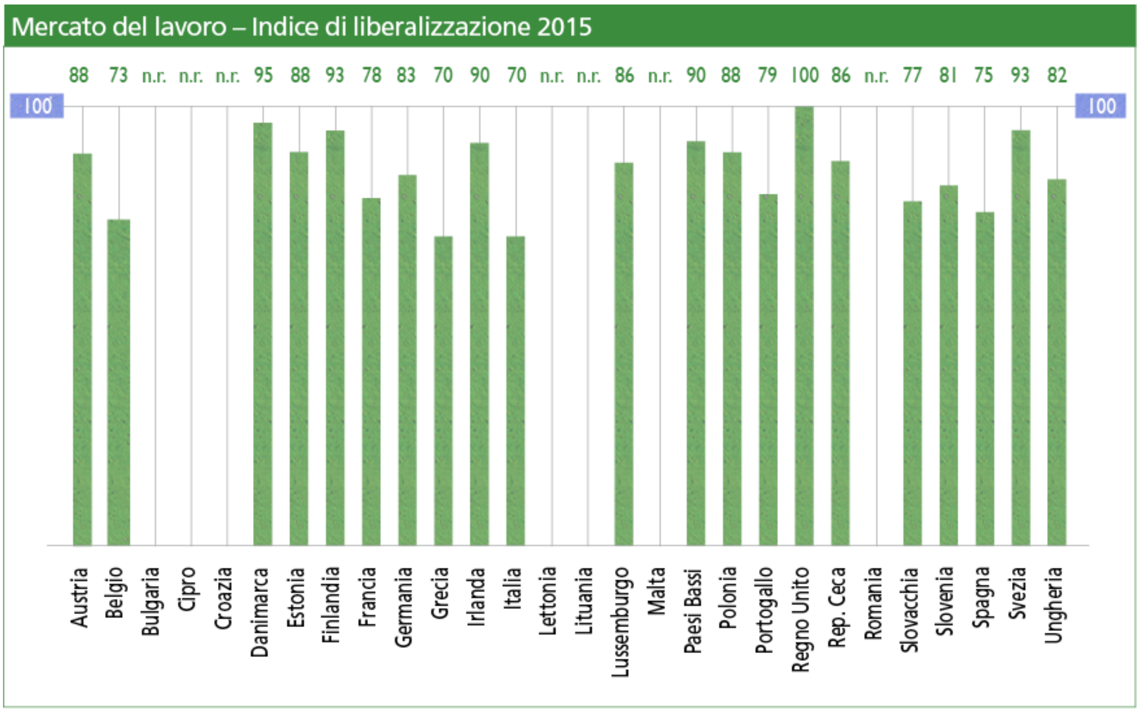
For each segment, and for both the gas and electricity sector, countries have been ordered from the least to the most liberalized: e.g. countries where the largest operator in the market still retains a significant market share and/or adopt a retail price regulation rank behind those countries showing a higher degree of market entry and/or the abolition of retail price regulation. The average of these subsectoral rankings determines a country's ranking with reference to the generation/production or import, distribution, transmission, and supply segments. For each country, the average of these subsectoral rankings identify the IBL Liberalization Index for the electricity and gas market.

With respect to both the electricity and gas sector, the Index shows that the main obstacle to effective competition and European countries' convergence is represented by the adoption of retail price regulation. As argued by the European Commission in several occasions, retail price regulation may prevent consumer engagement, tariff and commercial innovation and encourage the suppliers' coordination. All these factors may jeopardize competition and translate into higher energy prices and limitations of consumers' right to choose.

For the electricity sector, an additional source of concern emerges. Specifically, the presence of subsidies to renewable as well as conventional generation may further discourage European countries' integration and hinder competition in the internal market. The achievement of a low carbon generating fleet should carefully balance the trade-offs entailed by the so-called energy trilemma (i.e. the complex interaction between energy security, energy equity, and environmental sustainability). In particular, funding to renewable as well as conventional generation should aim at supporting the trilemma's objectives rather than meet vested interests and regulatory capture. Unnecessary (and administrated) costs for consumers are not only unfair but also represent an opportunity cost, with respect to more valuable alternative uses, and a constraint to the ability of suppliers to reduce costs and innovate.

With respect to the gas sector, the IBL Index also suggests that the extent of public participation in the upstream segment is a relevant factor discouraging competition. In particular, public ownership is usually associated with a higher degree of market concentration, also at the retail level, and with a lack of effective vertical separation along the value chain. All these factors may affect entry at the wholesale and retail level and influence the diversification of supply sources by means of policy-making capture due to the public shareholder's conflict of interests. In turn, this negatively affects consumers' choice and costs and the aspired goal of the European energy integration. (simona benedettini)

## LABOR MARKET




The Index of Liberalization measures the flexibility and adaptability of labor markets. Under the Index methodology, the most liberalized labor market in the EU28 in 2015 was the British one (which was assigned a score of 100%), followed by Denmark (95%) and Finland and Sweden (both with 93% score). The least liberalized economies were Greece and Italy (both at 70%), Belgium (73%), and Spain (75%).

The deterioration of the labor market as well as the growth in unemployment (particularly long-term and youth unemployment) in the EU is undoubtedly a consequence of the international economic crisis, which has led to a drop in labor demand, as well as, in some countries, to a structural change in their economy. Economic sectors which previously absorbed a considerable share of total employment were downsized during the recession. An overall look at the European landscape suggests that the employment levels achieved during the pre-crisis years have been affected across the board. However, not all EU member states reacted likewise: differences can be observed both in terms of economic recovery and in terms of a labor market reaction to the economic trend.

In the best-performing countries, the economic recovery took place earlier, leading to a positive effect on the labor market. In other European countries, on the contrary, the crisis has highlighted those serious labor market dysfunctions which had previously been partially offset by economic growth. These problems are a function of several factors whose interplay may affect the creation of demand for labor, thus reducing the incentive for employers to hire, as well as the supply of adequate labor skills.

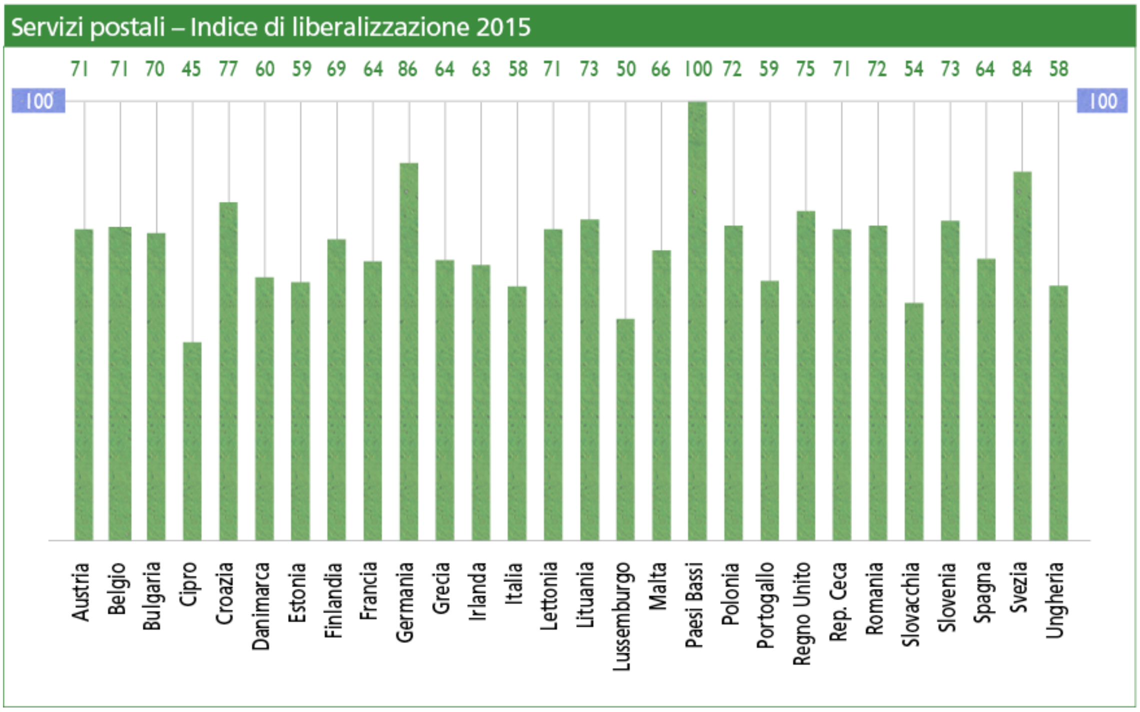
These factors include an excessively rigid employment regulation, a fairly high tax wedge, which drains companies' resources which might be usefully allocated to make investments, innovate and create new jobs or guarantee higher salaries to the existing ones.

In the recent years the most troubled countries, which also feature a segmented labor market - such as Portugal, Spain, Greece, and Italy - have enacted reforms aimed at introducing an higher degree of flexibility in the labor market, in order to make it more dynamic and reduce the dualism which characterizes it.

The degree of liberalization of the labor market is measured through two indicators: "Regulation" and "Performance", which are weighed, respectively, 2/3 and 1/3 in determining the overall sectoral Index of Liberalization. "Regulation" takes into account the labor legislation's protection level as well as the weight of the tax burden: hence it focuses on the legal framework. The "Performance" indicator looks instead at the actual results of the labor market. In particular, it considers long-term unemployment (ie the share of the labor force which is unemployed for more than 12 consecutive months) and youth unemployment.

In comparison with the general framework set out in the 2014 Liberalization Index, however, there are not significant changes, as the United Kingdom confirmed its status of most liberalized country among EU's member states, especially thanks to the mark scored in the "Regulation" indicator. With regard to the "Performance" indicator, Denmark managed to improve its position, recording the best score on a par with Austria. (fabiana alias)

## POSTAL SERVICES MARKET



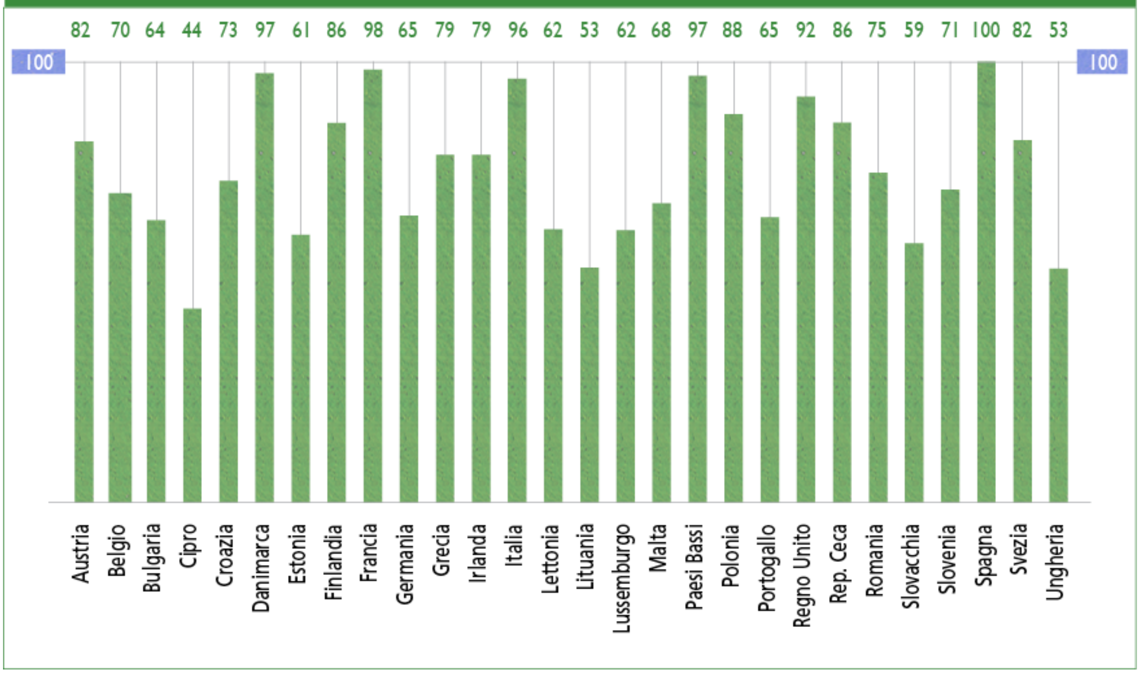
According to the 2015 Index of Liberalizations, the Netherlands is the EU member state with the most liberalized postal market, followed by Germany (86%) and Sweden (84%). The least liberalized countries are Cyprus (45%), Luxembourg (50%) and Slovakia (54%).

The Index comprises three macro-indicators, which have been built by aggregating both qualitative and quantitative indicators reflecting the degree of market openness and competition in the delivery industry. The first indicator looks at the legal framework, tracking the extent and scope of postal liberalizations and the level of independence which regulators enjoy. The second indicator deals with the regulatory framework and any remaining barriers to entry: the range of services covered by universal service obligations, the funding mechanism for universal service, the licensing regime, the prevision and scope of tax exemptions for postal services, are all taken into account. The third indicator addresses the actual degree of competition within the market, in light of the newcomers' market shares, state ownership of the incumbent and the amount of mail revenues as a percentage of its total revenues, which may suggest that cross-subsidization is occurring.

All countries considered, with a few minor exceptions, have liberalized postal markets from a legal perspective, as required by EU law. However, the market shares of newcomers show that much work remains to be done to ensure actual competition can emerge. In this regard, one major issue is the treatment of universal service obligations, which in some instances appear to be granting unfair advantages to government-owned incumbents, even in the absence of monopoly rights. (massimiliano trovato)

## TELECOMMUNICATIONS

Telecomunicazioni – Indice di liberalizzazione 2015

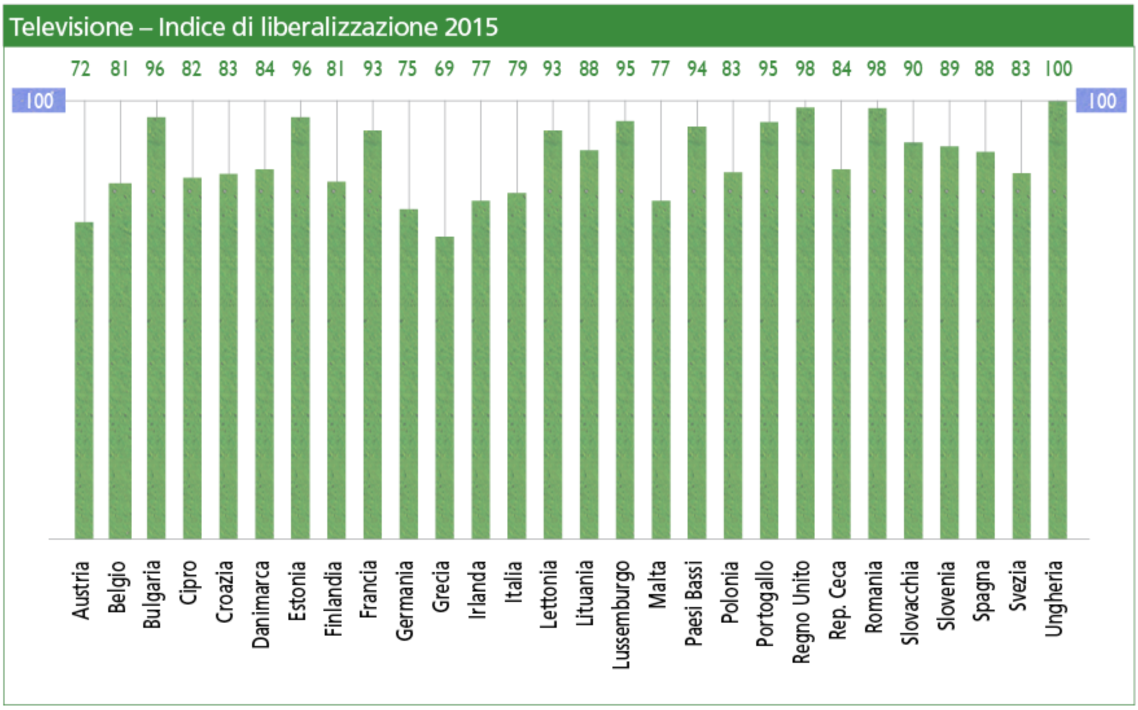


According to the 2015 Index of Liberalizations, Spain is the EU member state with the most liberalized telecom market, followed by France (98%), Denmark and the Netherlands (tied at 97%). The least liberalized national markets are found in Cyprus (44%), Lithuania and Hungary (both ranked at 53%).

The Index comprises three macro-indicators, which have been built by aggregating both qualitative and quantitative indicators related to the degree of market openness and competition in the telecom industry. The first indicator deals with the competitive landscape, by tracking the market shares of incumbents in fixed voice, fixed broadband and mobile. The second indicator looks at two factors: platform competition and the development of competing technologies; and the market players' position relative to the so-called ladder of investments: deeper infrastructural choices (such as LLU in fixed markets or own networks in mobile markets) are favored over lighter forms of access (such as bitstream or mobile virtual networks). The third indicator reflects customers switching, by taking into account the churn rate, the share of customers who switched providers in the last year.

While the telecom industry is, all in all, one of the most competitive ones, due to a fairly extensive and successful liberalizing trend that started in the mid 1990s, remonopolization is still a possibility, especially given the Commission's push for the deployment of higher capacity networks. EU and national policymakers need to strike an optimal balance, maintaining a strong incentive to invest without reducing the room for competition. (massimiliano trovato)

## TV BROADCASTING

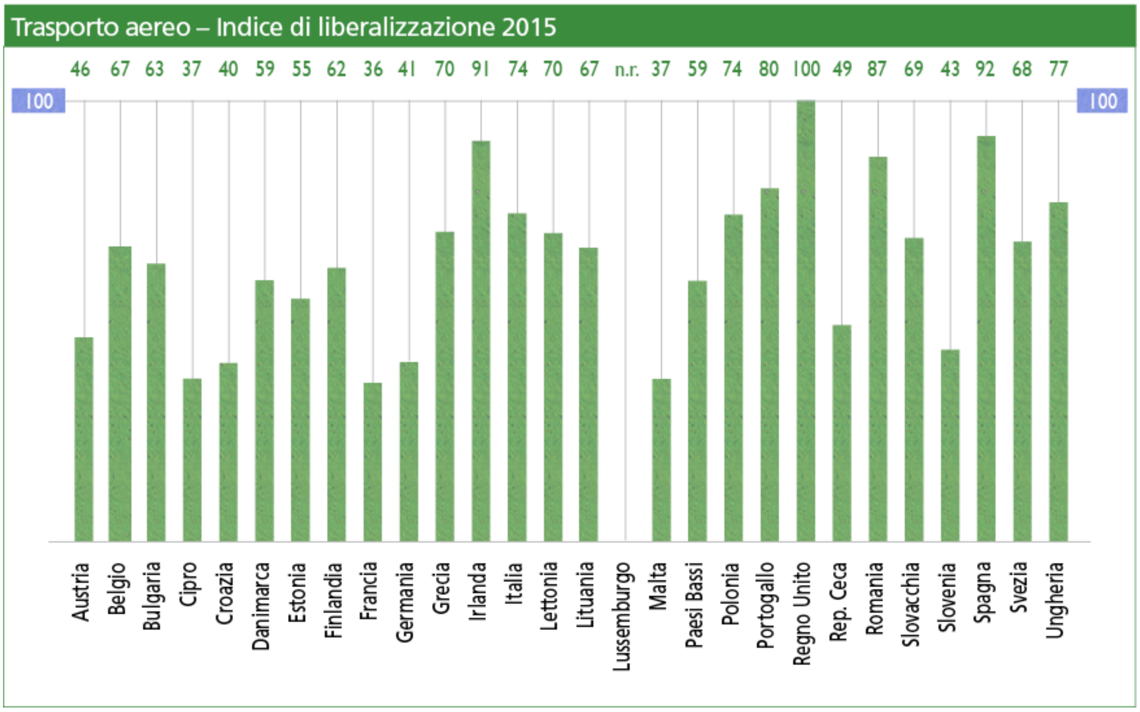



According to the 2015 Index of Liberalizations, Hungary is the EU member state with the most liberalized television market, followed by the UK and Romania (tied at 98%). The least liberalized national markets are found in Greece (69%), Austria (72%) and Germany (75%).

The Index comprises three macro-indicators, which have been built by aggregating mostly quantitative indicators pertaining to the degree of market openness and competition in the television sector. The first indicator considers the role of public broadcasting services, based on the levy and respective amounts of license fees, as well as their share of commercial revenues and audience. The second indicator looks at platform competition, as shown by the availability of competing technologies and the penetration of pay-TV services, under the assumption that network competition eventually fosters service competition. The third indicator deals with the competitive environment, by taking into account market shares in audience as well as in advertising and the number of market players (weighted by each country's population).

EU audiovisual regulation tends to focus on content requirements rather than market structure—leaving room, at least in principle, for a wide array of different models. As a matter of fact, however, in all European countries (the only exception being Luxembourg) government-owned entities are entrusted with the provision of public broadcasting services. While the development of new technologies and business models has had a strong and positive influence on the competitive landscape, direct government intervention in the television market still proves to be a major obstacle to its full liberalization. (massimiliano trovato)

## AIR TRANSPORT



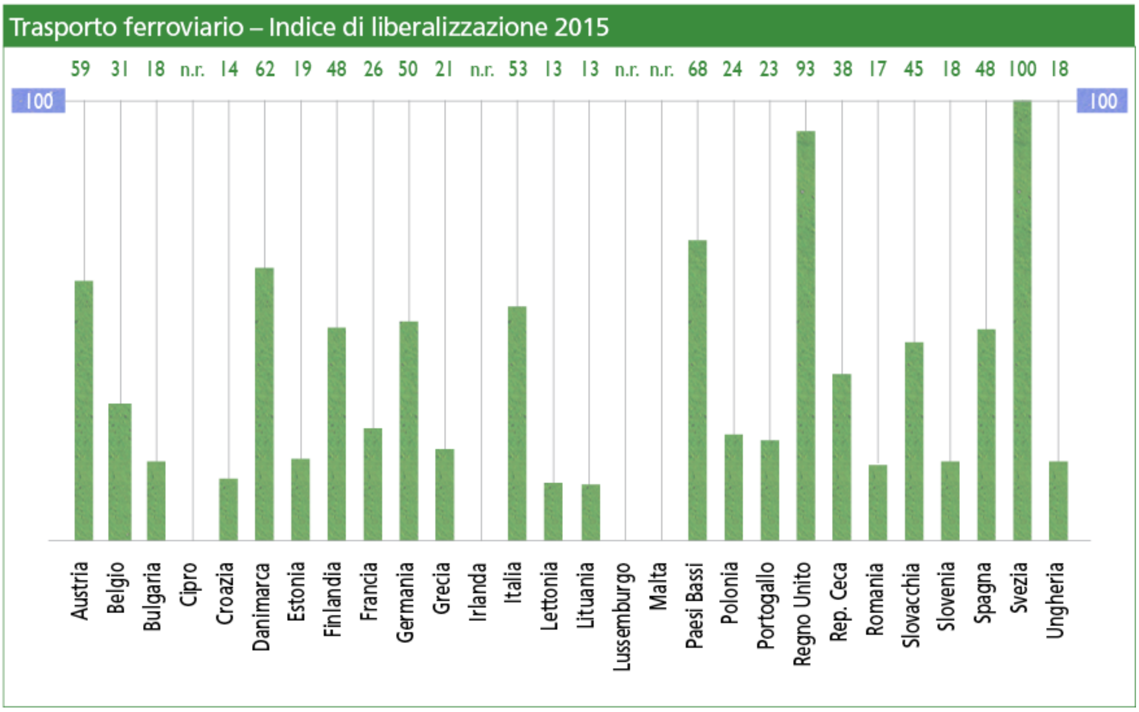

In 2015 the EU28 country with the most liberalized air transportation sector was the UK (which, under the 2015 Index of liberalization methodology, was assigned as score of 100%), followed by Spain (92%) and Ireland (91%). The least liberalized countries were France (36%), Malta and Cyprus (both at 37%). The regulation of air transport is strongly harmonized at the EU level: hence the gap between the top-performers and the least open economies is mainly due to either the lack of transparency of national regulations, or to measures that are aimed at protecting the interests of the "national champions".

The 2015 Index of liberalizations for air transport takes into account two macro-indicators: the former relates to Regulation, Legal and Airport Barriers, and Public Interventionism (RBI); the latter is concerned with the actual market results. The indicators are weighed respectively at 3/5 and 2/5 in the determination of the overall sectoral index.

The RBI Indicator is built by considering: the regulator's degree of independence; the existence of legal barriers to entry in the market; the existence of barriers for a newcomer to start flying from any given airport; the number of public interventions in the market in the past five years. Legal or airport barriers have been introduced in many EU15 member states with particular regard to low-cost airlines. By the same token, several European countries intervened repeatedly in the market either to prevent low-cost carriers to compete on a level playing field with traditional carriers, or to bail out or help the "national champion."

The Market Indicator looks at the growth rate of the market; the market share of the newcomers; and the degree of market concentration as measured by means of the HHI Index. (andrea giuricin)

## RAIL TRANSPORT




In 2015 the EU28 member state with the most open railway market was Sweden (which is assigned a score of 100%), followed by the UK (93%) and the Netherlands (68%). The least liberalized countries were Lithuania (13%), Latvia (13%), and Croatia (14%).

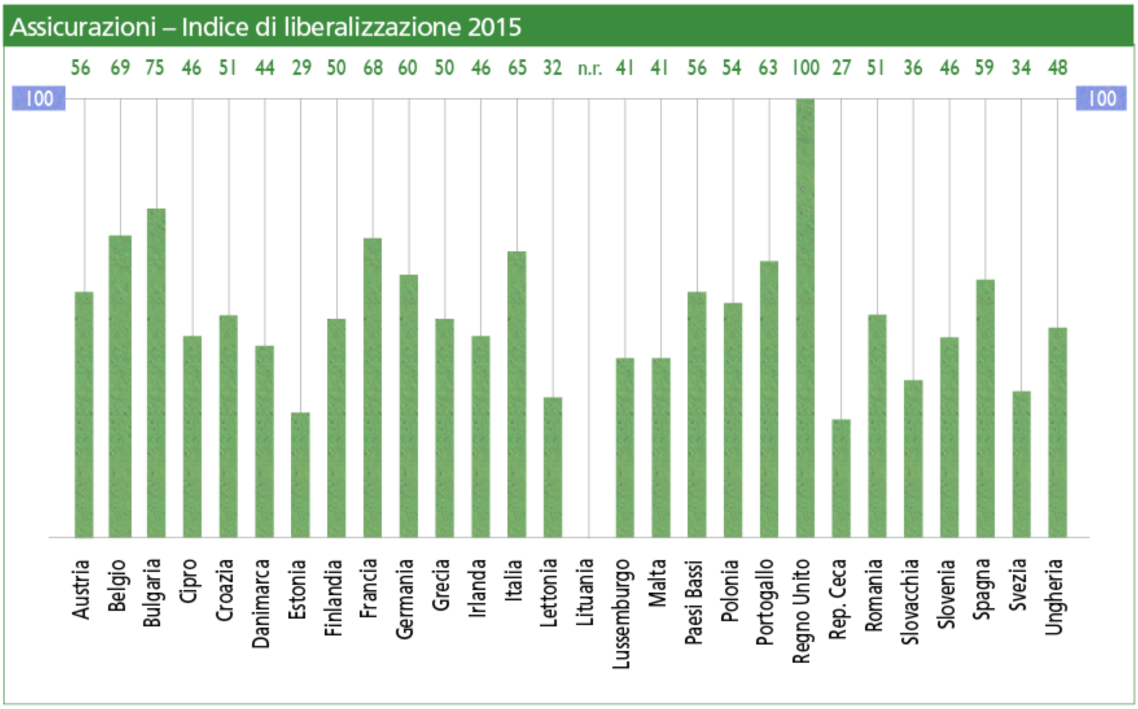
As the distance between the first two countries and the third one suggests, this is a sector where EU directives were not strong enough to promote a fair degree of market openness all across Europe. In fact only two countries went as far as to fully open their markets—in particular by implementing network ownership unbundling—while most member states chose to formally comply with the EU regulations without compromising the incumbent's dominant position. Moreover, incumbents are frequently state-owned.

The Index of Liberalizations comprises two macro-indicators: the former looks at the regulatory setting, the latter at actual market results.

As far as the regulatory setting is concerned, the following information is considered: the regulator's level of independence; the regulator's ability to actually exercise its monitoring and sanctioning functions; and the degree of separation of the railway network, ranging from weak forms of accounting separation (as in most of the surveyed countries) to ownership unbundling (as in the UK and Sweden).

The market macro-indicator, instead, takes into consideration: the formal liberalization of regional railway transport (i.e. whether competition in the market is allowed and whether public service contracts are awarded under an open, competitive tender scheme); the actual competition in the high-speed segment, where applicable; and the growth in railway transport demand since 1995, i.e. since the EU directive on market opening in the railways sector, under the assumption that, all else being equal, liberalizations result in better service quality and increasing demand, hence the latter may be also seen as a proxy for the former. (paolo belardinelli and carlo stagnaro)

## INSURANCE




In 2015, the EU member state with the most liberalized insurance market was the UK (with a 100% score under the Index of Liberalization methodology), followed by Bulgaria (75%) and Belgium (69%). The least liberalized countries in the EU28 were the Czech Republic (27%), Estonia (29%), and Latvia (32%).

The degree of liberalization of the insurance market is established on the basis of two indicators: Design and Structure. The "Design" indicator consists three sub-indicators, accounting for the existence of mandatory insurance schemes against accidents at work; the weight of alternatives distribution channels of insurance products (ie, broker, direct sales and bankassurance); and the extent and distortive potential of taxation on insurance products. The "Structure" indicator comprises the following variables: aggregators, concentration, and foreign operators, that are useful in evaluating the competition in the market. "Aggregators" measures the maturity of the aggregators' market looking at the penetration on population. "Concentration" indicates the market share of the largest five insurance groups. "Foreign operators" is a proxy for the openness degree of the market, as expressed by the number of foreign operators on the total.

In 2015, as well as in 2014, the most liberalized market is the United Kingdom's (that scores 100%), characterized by a great performance on both the number of foreign operators and the development of aggregators market, that make offers more transparent and consumers more willing to switch policies. It is interesting to notice that there is a huge difference between United Kingdom and all the other countries. Bulgaria (75%), Belgium (69%), France (68%), Italy (65%), Portugal (63%), and Germany (60%) are the only countries reaching a score of at least 60%. This suggests that most EU28 member states still regulate heavily their insurance markets, preventing customers from enjoying lower prices and more diversified and effective insurance products. (paolo belardinelli)