

2. Digital Single Market Strategy

Purpose:

The Digital Single Market Strategy (henceforth – the Strategy) is a set of policies presented by the European Commission to create growth and jobs with the help of the development of innovations, digital technologies and cyberspace. Such a development of the Digital Single Market is expected to generate up to €250 billion worth of growth in the European economy in the course of the mandate of the current Commission through the creation of thousands of jobs and a vibrant and knowledge-based society. Various regulatory measures are stipulated to achieve these goals. They include a revised telecom regulation, copyright and data protection legislation, management of radio waves, and changes in competition regulation.

Summary of the response:

While the strategy is generally a step forward in advancing the single market, there are concerns regarding potential restrictions of competition in some of the aforesaid areas. Analysis of the Lithuanian Free Market Institute (henceforth LFMI) shows that there are three main areas where competition might be distorted, preventing the attainment of the strategic goals.

The regulatory environment for platforms and intermediaries

Competition policy in the digital market raises some serious concerns. The Strategy pays close attention to the biggest entities in the digital market. It should be noted though that the market situation has developed organically and may change at any moment. No particular entities should be targeted for the following reasons:

- Market concentration does not necessarily indicate market power;
- The digital market can be quickly transformed by innovations that come from other sectors;
- Legal certainty is crucial for business.

Market concentration does not necessarily indicate market power

The fact that some entities hold a significant market share does not necessarily indicate that market power can be abused. Previous research in the digital sector carried out by DG COMP gives a very different image from what we are used to and it is perfectly illustrated by the Microsoft case.

The software developer has long been in the crosshairs of antitrust institutions. In 2004 the Commission was concerned with Microsoft's actions in bundling its products with the Windows operating system. However, competition is what drives changes in the market, and other software developers such as Apple and Google have pushed Microsoft's market share down to 20 per cent. Therefore, changes were caused by other market players rather than the Commission's policies.

Innovation can quickly change the market

Innovation is a key element of the digital market. Even though the Commission acknowledges this, it fails to fully appreciate the impact that innovation has on the market.

First of all, the goal to apply strict competition rules and focus on entities with higher market concentration disregards potential competition, especially that from other sectors. Since the digital market is open and the entrance costs are low, a new market player may enter the market at any time. What is more, innovations may emerge from another digital sector, therefore market players operate in a competitive environment regardless of the size of their market share.

New digital market players such as Amazon, Facebook and Twitter show just that. Even though they are new in the digital sector, they have aggressively moved into the market of online advertising. Their expansion has led to a decrease in Google's share of online advertising revenues.

The above-mentioned case of Microsoft is another example. The loss of such a tremendous part of Microsoft's market share was a result of innovations from other digital sectors. The development of smart phones and tablet computers led to a sizeable extension of the software market where Microsoft failed to react as fast as other companies did.

Situations like that happen in all sorts of digital sectors and VoIP is one of them. This innovation has become a significant competitor to telecom providers even though it is built on a completely different technology. The Strategy also addresses this issue briefly stating that telecom operators are competing with services that are chosen by end-users as substitutes but are not subject to the same regulatory regime. While the precise formulation on this is ambiguous, we should bear in mind that if the same economic regulations that are currently applicable to the telecom industry were imposed on VoIP industries, they could restrict competition in the VoIP sector and therefore stifle innovation. If the VoIP technology is working well enough to compete with the incumbent telecom industry even in its early stages of maturity, there is no point in regulating it, especially from the point of view of competition policy. The goal of the Strategy is to increase competition and innovation and to implement rules that foster them. Equal rules are usually regarded as instrumental in this respect, but this case shows otherwise and suggests that equal rules may bring equal restrictions that would stifle the performance of a particular sector.

These cases show that technological innovation and open market entry are the most effective safeguards. Regulation that stifles innovation or attempts to shape the market may do more harm than good.

Legal certainty and clarity is crucial for business

The Strategy states that the Commission has to evaluate the situation in order to create new legislation for different digital sectors. While the goal of ushering in new laws is not detrimental per se, the scope of this future legislation is of vital importance.

It is understandable that there is a need to create a regulatory environment suitable for all purposes, but regulation should not be targeted at particular entities. The Strategy states that the way in which some online platforms use their market power raises concerns and should be analyzed beyond the application of the law on competition. Such a fragmented application of the law, possibly aimed at particular market players, is far from certain and clear. Any differentiated regulation for specific market players must have a strong justification. To add, claims that the current regulation is not sufficient or does not exist cannot justify differentiated regulation. Such a precedent for applying harsher rules for specific legal entities in the European Union is against the principles of legal certainty and clarity. What is more, similar regulations would send a wrong message to other potential investors.

The one-size-fits-all regulation can only work on a very broad level, e.g. regulation of basic and most fundamental features of the market. Regulation can only remain fair and technology-neutral when it is concentrated on this level. By venturing into very specific regulation of particular sectors the Commission risks starting to pick winners and losers among technologies or companies or even fundamentally changing the market and depriving consumers of products that could be developed by market forces rather than regulatory regimes.

Public broadband networks

The Commission aims to improve infrastructural competition in fixed line and broadband networks and there is an additional plan to invest public funds into broadband networks. The following three aspects should be considered prior to carrying out such a plan:

- The “market failure” argument is not true;
- Public investments might not be economically justified and could stifle innovations and investment;
- Public investment must ensure competition.

Different levels of infrastructure development across countries or regions do not mean a market failure

The main argument for the necessity of public investment into network infrastructure is that supposedly a market failure can be observed in some territories in the European Union. The Commission claims that given the large investments needed to roll out and upgrade the current connections to the next generation of digital networks – often based on fiber technology – there is a serious risk that market failure will rapidly increase the so-called “digital divide” across Europe.

Such arguments are not correct. Private sector investment into internet connection technologies is very significant. The global proportion of people using the Internet has risen at a compound annual growth rate (CAGR) of 12% in the period from 2008 through 2012. Due to the introduction of the 4G technology in 2010, there was a significant increase in the Internet speed too. [1] And it was not public investment but the private sector that gave a boost for such a rapid growth. When it comes to internet coverage, growth rates in mobile broadband population penetration appear to be significantly higher than the already high corresponding historical growth in mobile cellular penetration. Mobile broadband penetration exceeds cellular penetration by 5 to 19 per cent. Given the increasing reach of mobile broadband networks and upgrades to newer technologies, fast uptake of mobile broadband access is very encouraging for increasing overall Internet penetration.

Therefore, the argument that the market has failed and the public sector must step in with public investment is not true. The Commission has formulated standards that may appear a bit unrealistic to reason its intervention into the market. The market has not failed but has performed precisely as it should. The regions with the most users and demand have seen the largest development of infrastructure. On the contrary, rural regions are not developing as fast as heavily urbanized ones and have less users and less demand. It would be strange and unnatural to expect the same or comparable level of IT infrastructure in cities and rural areas. However, the data suggest that the internet penetration is increasing. This situation can be defined as a market action rather than failure. Market mechanisms define where the infrastructure development is necessary. It is important to acknowledge that investing in unlimited access to high speed internet is irrational as it competes with alternatives uses of resources.

Government broadband networks - economically unjustified and costly

Active public investment into broadband networks might bring unexpected consequences. In 2011 President of the United States Barack Obama stated that one of the goals of his term was to ensure that 98% of Americans have access to the Internet. Governmental public networks sprung up throughout the country, but the results were not as positive as expected. These government-owned networks did not meet the objectives in terms of coverage. To add, the private sector could have reached the same coverage without government intervention. What is more, these networks imposed a heavy financial burden on taxpayers.

Government-owned networks used taxpayer funds to build networks in areas where high-speed Internet was already provided by the private sector. This network overbuild is counter-intuitive since it requires that taxpayers fund and subsidize a network that duplicates an existing one. This is one of the most important lessons from the United States' case. Even if a government decides to develop broadband infrastructure, it has to carefully assess where such projects are necessary in order to avoid duplication and maintain competition. Otherwise government-owned networks would unfairly compete with the existing providers. What is more, as a government entity, a government-owned network can practice various anticompetitive activities that may put private firms at a competitive disadvantage. Thus, municipalities that use taxpayers' money to build a broadband network actually act to forestall market entry and decrease competition. Government-owned networks deprive consumers of the benefits of competition and choice, governments lose tax revenue from private networks that might have otherwise entered that market, and taxpayers pay more in taxes as they subsidize the operation and maintenance of those networks.[2]

Government-owned networks tend to fail because they lack a sustainable business plan and long-term resources to invest in maintenance and necessary upgrades as technology evolves. When this happens, taxpayers have to fund the failures.

What is more, investment into infrastructure may slow down innovations. With public infrastructure in place, the private sector might lose incentives to innovate and devise cost-effective ways to reach far-away end-users.

Outcomes that have been registered in the United States should be examined carefully in order to avoid the same mistakes and related economic losses and other damages such as distortions of free competition and slower investments.

Public investment must ensure competition

Even if the Commission decides to proceed with a public investment plan, it has to follow two fundamental principles: it must cooperate with the private sector and ensure competitive procedures.

Cooperation with the private sector will not only provide private entities with an opportunity to participate in infrastructure development. It will also ensure that the best practices of the private sector are used in the process. Private companies could bring advanced business management techniques, innovations and private investment into infrastructure development projects. This will not be possible without ensuring competition, because the public sector will deliver the most by competing for the participation in infrastructure development.

There is a danger that the government would see a public investment plan as a carte-blanche to favor public companies in tenders, create government-owned IT entities and engage in business. If the Commission goes ahead with this plan, it must provide very stringent safeguards to prevent governments from engaging in such practices.

Telecom single market

One of the goals of the Strategy is to review the Telecom Single Market package. It is expected that revisions will help to provide harmonized rules for net neutrality and rules that would eliminate roaming surcharges (for data in particular). But the Net Neutrality policy and prohibitions on roaming charges are not as positive as they seem to be.

- Net neutrality slows down competition, helps bigger companies to consolidate their market position and increases barriers for upstart companies.
- Prohibition on roaming charges could lead to lower supply and higher consumer prices.

Net neutrality slows down competition

Current internet regulation allows companies to focus on the most profitable sectors. Basically, Internet Service Providers (ISPs) charge more those who are willing to pay more. Net Neutrality policy would force ISPs to charge the same for different types of data transferred. Also, this policy does not allow data transfer prioritization. Prioritization allows ISPs to charge people more if they want a faster or more stable connection. A tangible empirical analogy would be a furniture delivery company charging the same regardless of the amount of furniture delivered or a restaurant charging the same as a fast food outlet.

Such limitations on data transfer prioritization would diminish competition. Firstly, such limits may increase data transfer prices. Net Neutrality may result in higher prices for those users that need lower quality data transfer services. What is more, this does not simply mean an increase in prices, but a better competitive position for the established market players as opposed to their upstart competitors. In order to progress, large companies have to maintain existing consumers and protect them against emerging upstarts. To add, Net Neutrality could raise the costs of doing business. This means that the established market players will adapt to higher costs more easily than their new competitors. It may also slow down the development and decrease investments in fiber optics as there will be less incentives to strengthen your competitiveness. Therefore, less competition will result in higher prices and slower innovation will bring lower quality.

It should be noted that other sectors to which a parallel is being drawn (e.g. utilities or electricity grids) do not operate completely neutrally with regard to what is being transferred. Electricity grids have congestion charges, some types of energy (e.g. green energy) is sometimes given priority in congested situations, users have different contracts depending on how much reliability they need, etc. Regulation of the Internet just like other utilities is incorrect in both cases: in the direction intended as well as the analogy used.

Prohibition on roaming charges may lead to lower service supply and higher end-user prices

Instead of bringing benefits, the Commission's goal to completely ban roaming charges may actually harm consumers. Roaming charges exist because it is more expensive to provide cross-border calls, messaging or data transfer services. Prohibitions on roaming charges might lead to two outcomes. Firstly, such a policy might reduce supply. Economic logic says that price-ceiling policies tend to do that. This means that if telecom companies cannot cover their cross-border call costs, they will refrain from providing these services. Another option is that service providers will cross-subsidize roaming calls in order to cover the costs. This means that they will have to charge more for local services in order to cover the costs of cross-border services and this will in turn affect all users regardless of whether they need roaming services or not. Therefore, the abolition of roaming charges will not help solve problems. It would only lead to lower supply and higher prices.

Conclusion

In considering what regulation is necessary for the implementation of the Strategy, it should be remembered that market concentration does not necessarily indicate market power and market changes are frequently the result of innovation. Also, legal certainty is crucial for business. Therefore, the broadband network development has to be competitive and very limited, because such an investment could inflict a heavy financial burden and stifle innovation. The Telecom Single Market plan raises concerns since both the Net Neutrality policy and the prohibition on roaming charges might slow down competition.

[1] http://www.internetsociety.org/sites/default/files/Global_Internet_Report_2014_0.pdf

[2] <http://www.coalitionfortheneweconomy.org/wp-content/uploads/2012/01/1-6-12-Coalition-for-a-New-Economy-White-Paper.pdf>