Open Up
How to fix the flaws in the EU’s Digital Single Market

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January 2017
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The authors acknowledge the assistance of Edward Percarpio (background research) and Eoghan Gannon (copy editing).

Report design by Data Design, a product of AudienceNet.
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Europe is a laggard in both the development and the deployment of digital technologies. It urgently needs to do more to foster digital enterprise. Even more importantly, it needs to speed up and deepen the adoption of digital technologies across the economy, and thus reap their many benefits (section 1).

Yet policymakers in Brussels – pressured by those in Berlin and Paris who have been captured by corporate dinosaurs from the analogue age – wrongly tend to view digitalisation as an American threat, against which Europe cannot compete in the marketplace (section 2). So while EU policymakers claim to want to encourage digitalisation, in practice they are often seeking to limit digital competition.

The European Commission has produced a blizzard of digital initiatives in recent years, the latest of which is due on 11 January 2017. Many are part of the wide-ranging Digital Single Market (DSM) strategy. Others are closely associated, notably the General Data Protection Regulation (GDPR), the EU’s new data-privacy rules. The Commission has also launched a bevy of antitrust cases against US technology firms.

This report’s assessment of the DSM strategy and associated initiatives is that they are not fit for purpose. They amount to a jumble of outdated, corporatist, counterproductive industrial policies that favour producers over consumers, big companies over small, traditional incumbents over digital start-ups and EU firms over foreign ones.

Contrary to the Commission’s sales pitch – and unlike the original drive to create a Single Market in goods – the DSM strategy does not seek to tear down regulatory walls and mesh national markets into a single EU one. In fact, it contains hardly any liberalisation and seeks to impose new regulatory burdens on the digital economy – and thus on the economy as a whole. Worse, if intra-EU commerce continues to move online, ill-founded DSM rules will become the new Single Market rules, in effect supplanting the old liberal ones.

The Commission’s claim that the DSM strategy could boost the EU economy by €415 billion a year does not stand up (section 3). Its only liberalising measures so far are minor. The Commission wants to ban companies from refusing online sales (except for copyright reasons) or setting different prices on the basis of a customer’s home country. And it wants to enable Europeans to watch the TV shows available to them at home on streaming services such as Netflix when roaming in another EU country.

Fortunately, there already is a digital single market in many areas. With the exception of national copyright rules and media laws, there are few barriers to cross-border data flows within the EU (section 4). Online retailers are also able to export freely to other EU countries.

The real barriers to trade lie offline. The EU lacks a comprehensive single market in services and has yet to liberalise sectors that are crucial for digitalisation – such as retail, telecoms, payments and transport services – because of protectionist interests in some major EU countries. While the internet has fostered innovative new services that bypass national regulations – including online payments systems (such as PayPal and Stripe), e-books (such as Amazon’s Kindle), car-sharing platforms (such as France’s BlaBlaCar) and online call services (such as Skype, a European start-up now owned by Microsoft)
– this has prompted a corporate backlash against “unfair” online competition.

Regrettably, EU policymakers are mostly siding with the offline dinosaurs. Instead of viewing digitalisation as an opportunity to integrate EU services markets, the DSM strategy does nothing to tackle offline barriers to competition while seeking to impose new ones online.

In some cases, the Commission wants to impose new EU regulations in areas that were mostly unregulated at a national level, notably on online call and chat services such as WhatsApp (section 5). In others, it is introducing excessively bureaucratic harmonised EU rules, notably on data privacy. In effect, these inflict the red tape that prevails in France and Germany on more liberal EU economies too. The Commission has already inflicted more burdensome value-added tax (VAT) rules on online services. These measures will harm the digital economy and favour big established companies.

The EU’s digital initiatives aren’t just corporatist; they are protectionist (section 7). The GDPR explicitly discriminates against foreign firms. The Commission is also embarking on a digital industrial policy that seeks to hamper big European companies’ foreign competitors.

Yet far from nurturing European champions, regulatory hurdles and protectionist measures will stifle Europe’s digital economy. In an era of global supply chains, where data is an increasingly important input for all firms, EU businesses – not least in manufacturing – need access to the best and latest digital services from around the world at the lowest cost.

To salvage the DSM strategy, it needs rethinking.

To unleash economic growth, stimulate digital enterprise and enhance consumer welfare, the EU needs to turn the DSM project into a true Single Market project – an Open DSM (section 8). This would keep digital markets open to the rest of the world and reframe the “threat” of online competition as an opportunity to open up offline markets – and thus create a genuine single market in services. An Open DSM would be based on four key principles: non-discrimination, appropriate deregulation, data openness and dynamic competition.

At the very least, the EU should not impose discriminatory regulatory burdens on online businesses. Nor should the EU seek to “level the playing field” by trapping internet start-ups in the excessive regulation that bedevils offline sectors such as retail, taxis, hotels, telecoms and broadcasting in many EU countries. Unlike most of the proposals in the DSM strategy, prospective digital regulations ought to be both necessary and proportionate.

Rather than trying to overregulate the internet as much as offline services markets often are, the EU ought to subject all existing market rules, both EU and national, to a searching examination of whether they are fit for purpose in a globalised digital age – in particular, whether they encourage innovation, enterprise and market integration. Such a colossal undertaking has been successfully achieved before: the 1986 Single European Act streamlined EU and national regulations on a wholesale basis.

On the basis of such a review, the EU and national governments should then deregulate markets to spur digitalisation and eliminate regulatory requirements that unduly hamper traditional industry. The top priority should be addressing the lack of dynamism in services sectors key to the internet, such as retail, consumer financial services, telecoms, transport and distribution.

Increased competition is particularly vital to ensure greater investment in Europe’s antiquated telecoms infrastructure. Far from sheltering telecoms companies from competition, they should be encouraged to take the competition to online firms. Ensuring that data flows freely within the EU is a pre-requisite for opening up EU services markets. An EU-wide ban on local storage and processing requirements would improve efficiency, bolster integration and act as a ratchet against future protectionism as services move online.

The EU ought to protect data privacy in a way that keeps markets open and Europe’s services exporters competitive. GDPR determinations of whether third countries’ privacy rules are “adequate” – and thus whether data is allowed to flow freely to them – ought to be expedited and based on objective criteria of the actual protection achieved, not on the legal approach that the country has chosen. The Privacy Shield that enables US-based companies to self-certify their compliance with EU rules also ought to be extended to other reliable jurisdictions.

EU competition policy also needs rethinking in the digital age. In the fluid and fast-changing digital world, its narrow, static analysis of competition issues based on rigid definitions of market structure is particularly inappropriate. It ought to embrace a broader, dynamic analysis of competition that gives more weight to the benefits of innovation.

As it stands, the DSM strategy is not fit for purpose. It is corporatist, protectionist and anti-innovation. What the EU needs instead is a seamless, non-discriminatory and dynamic digital single market that enables companies and consumers to operate smoothly across the EU and globally; does not discriminate against online suppliers, challenger companies and non-EU firms; and encourages innovation that boosts productivity and benefits consumers. Europe needs to open up markets to digital technologies, not do digital down.
Introduction

“The internet and digital technologies are transforming our world. But existing barriers online mean citizens miss out on goods and services, internet companies and start-ups have their horizons limited, and businesses and governments cannot fully benefit from digital tools. It’s time to make the EU’s single market fit for the digital age – tearing down regulatory walls and moving from 28 national markets to a single one. This could contribute €415 billion per year to our economy and create hundreds of thousands of new jobs.”

EUROPEAN COMMISSION

The European Commission’s sales pitch for its flagship Digital Single Market (DSM) strategy seems compelling. But it is utterly misleading. In many areas – from search engines to social networks – there already is a digital single market: a global one. Where national barriers do exist, they are mostly in ossified offline services sectors, such as taxis and telecoms, rather than online. And the DSM strategy does not generally seek to tear down those regulatory barriers and mesh national markets together; it seeks to impose harmful new regulations on the digital world and close Europe off from global competition. This corporatist, Fortress Europe approach advocated by Germany and France will not boost the EU economy by €415 billion as the DSM strategy envisages, let alone help it catch up with the United States: it will trap Europe’s economy in the slow lane.

The DSM strategy is the centrepiece of a broader EU response to digitalisation. Since its launch in May 2015, the Commission has made a flurry of announcements that flesh out its headline proposals (see Table 1 for a summary). While some of the most protectionist ideas – such as the proposal to create a “European cloud” that would expel foreign internet companies – have been dropped, many of the proposals are deeply troubling. More are in the pipeline. A new communication on the free flow of data is expected on 11 January 2017. Building on the General Data Protection Regulation (GDPR), the EU’s new data-privacy rules, the rules on privacy in internet communications are set to be revised in a new e-Privacy Directive. A further overhaul of the complex framework of EU telecom rules is also forthcoming.

In parallel, the EU’s Competition Commissioner, Margrethe Vestager, has taken aim at many digital companies. She has instigated a selective probe of the e-commerce sector, with the predetermined conclusion that internet firms are dominant and dividing up the single market; launched case investigations into Apple’s tax dealings with Ireland, Google’s shopping-comparison service and its Android smartphone-operating system; and announced that further cases against American internet companies – notably Amazon – are in the pipeline.

In the battery of complex legislative initiatives and antitrust investigations, whose collective impact this paper will consider, is bewildering. Yet governments, businesspeople, entrepreneurs and citizens need to pay attention. Undeniably, EU governments and businesses need to do more to seize the opportunities of digitalisation and respond to its challenges. It is reshaping almost every business in every sector of the economy – and Europe is a digital laggard, both in the development of new technologies and in their deployment across the economy. But what if the EU’s many digital initiatives don’t add up – or would actually make matters worse?

The stakes are huge, the risks imminent and the costs of failure daunting – for the dynamism of all Europe’s economies and the competitiveness of its businesses, new and old; for their ability to provide good jobs and rising living standards; and for the welfare of consumers, the rights of citizens and societies’ opportunities for progress. That’s why this report’s damning assessment of the EU’s DSM strategy at

its half-way point – that it is not fit for purpose – urgently needs to be heeded.

Instead of boosting consumers, competition and digital start-ups, the DSM strategy seeks to protect analogue-age corporate dinosaurs, notably in Germany and France, and Europe’s digital flops. It amounts to a jumble of outdated, corporatist, counterproductive industrial policies that favour producers over consumers, big companies over small, traditional incumbents over digital start-ups and EU firms over foreign ones.

The 1986 Single European Act created a genuine EU single market in goods by tearing down national barriers and thus opening up markets both within the EU and globally. In contrast, the “digital single market” strategy leaves national barriers intact, while imposing new EU regulations and seeking to close the EU off from the world. That is not just misguided; it threatens the Single Market itself. If intra-EU commerce continues to move online, ill-founded DSM rules will become the new single-market rules, in effect supplanting the old liberal ones.

The DSM strategy can still be salvaged, but it needs rethinking. To deliver a genuine, open digital single market, policymakers need to reconsider how the founding principles of the original Single Market translate to new rules in the global digital age.
TABLE 1
Key points of the DSM strategy and associated digital initiatives

**E-COMMERCE**
Proposed regulation to ban “unjustified” geo-blocking and price discrimination online. Companies would be prohibited from refusing online sales (except for copyright reasons) or setting different prices on the basis of a customer’s home country.

Proposed amendment to Consumer Protection Cooperation Regulation that would delegate power to investigate blocking to national authorities.

“Guidance” issued on Unfair Commercial Practices Directive that obliges search engines to distinguish ads from search results and requires shopping platforms to clarify when a seller is a private person.

**DATA PRIVACY**
General Data Protection Regulation (GDPR) that harmonises data-protection rules across the EU. Requires the appointment of data protection officers, the reporting of privacy breaches and the obtaining of explicit consent to collect information, and bans data transfers to third countries unless their data-protection laws are deemed “adequate” – under the threat of sanctions of up to 4% of a company’s global turnover. Comes into force in 2018.

Guidelines on how adequacy decisions for third countries should be undertaken.

Forthcoming plans to update the E-Privacy Directive likely to seek to apply stricter consensual rules for online marketing than for telephone marketing. Also likely to seek to restrict the use of cookies and any information stored for personalisation and analytical purposes by websites.

**COPYRIGHT**
Proposed regulation on cross-border portability of online content services that would allow EU residents to roam “temporarily” with content that they have subscribed to or paid for in their home country.

Proposed directive on copyright that would recognise “publisher’s right” (enabling press publications to collect fees from search engines that display snippets of news from their sites), oblige social media to undertake measures to protect rights-holders (transparency on usage, technical implementation of protective solutions) and allow museums to digitise their collections (but not to put them online).

**TAXATION**
New tax rules for online (but not offline) services in force since January 2015. Suppliers of online video, apps and content services must pay value-added tax (VAT) in the countries in which their customers are located, rather than in the country in which the supplier is based.

Proposed simplification of VAT rules for businesses that sell goods and have a turnover of less than €10,000 a year.

Proposed abolition of duty exemption on imports of less than 22 euros.

**INDUSTRIAL POLICY**
Communication on standardisation and interoperability.

Package of measures to help digitise European industry.

Proposed fiscal and political “action plan” on 5G mobile broadband and public wi-fi, and “softened” rules for state intervention.

**CYBERSECURITY**
Directive on the Security of Network and Information Systems. This cybersecurity directive imposes detailed obligations on security and reporting measures – but only for critical infrastructure and online platforms. Came into force in August 2016; must be transposed into national law by May 2018.

**COMPETITION INVESTIGATIONS AND INQUIRIES**
Selective sector inquiry into e-commerce focusing on consumer items (clothes, electronics, digital content) usually sold by foreign platforms.

Investigation of Google search results and shopping features, followed by a statement of objections on Android operating system.

Widely expected antitrust investigation into Amazon.
1 A digital laggard

Europe seems like a digital also-ran.

The giants of the global internet economy – Google, Apple, Facebook, Amazon (the GAFAs) – are all American. Apple’s biggest rivals in smartphones and other connected devices are Asian, not European.

The most promising tech start-ups are elsewhere too: the US has Uber (valued at $68 billion in December 2016), Airbnb ($30 billion) and six other privately held tech companies valued at $10 billion or more, China has six and Europe none. Only Sweden’s Spotify (valued at $8.5 billion) comes close – and it is considering moving its headquarters to the US. While venture-capital investment in European digital tech firms reached $12.6 billion in 2015, that is dwarfed by the $42.1 billion invested in the US.

Europe has many amazing internet start-ups, but they are almost all small. It urgently needs to do more to foster digital enterprise – in ways that, unlike the proposals in the DSM strategy, are actually likely to succeed. Even more importantly, it needs to speed up and deepen the adoption of digital technologies across the economy, and thus reap their many benefits.

The digital economy is much broader than the GAFAs. It is more than networks, smart devices, online services and apps. It also encompasses the use of computers, the internet and data by almost everyone: farmers and financiers, manufacturers and music makers, multinationals and start-ups, providers of public services and many others.

Digitalisation can enable businesses and organisations across the economy to provide consumers with new and better products and services; vastly increase their efficiency; create better-paid jobs; and connect businesses, assets and people together in more productive ways. Since digital technologies are advancing so rapidly, policies and regulations that may enhance (or hamper) their development and use are vital for economic growth and Europeans’ welfare – whether they are provided by American, Asian or European firms.

Yet European consumers and companies are often digital laggards. While around four in five Spaniards and Britons own a smartphone, as do a similar proportion of Americans, Germans and Italians are a bit behind and the French more so. In e-commerce, Britons are world leaders in online shopping, but most of Europe lags behind the US, and even China.

Overall, European businesses tend to invest less in digital technologies than American ones do, and to make less good use of their investments. As a result, digital technologies contributed over twice as much to the productivity growth of workers in the US between 2001 and 2011 as they did in the EU.

Since official statistics designed in the industrial age tend to underestimate productivity gains in the internet age, the true gap between the US and EU is likely even greater. Admittedly, productivity growth has been disappointing since the financial crisis on both sides of the Atlantic, partly because investment has been depressed. There are also transitional issues, as businesses and the economy as a whole grapple with how best to make use of new digital technologies. Moreover, costs are often duplicated initially as businesses invest in digital processes alongside traditional ones: think of a newspaper that now has a digital edition, but that has not yet phased out its print version.

Even so, digitalisation is crucial for longer-term productivity growth – and hence higher living standards.

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8 While digital technologies contributed 0.9 percentage points to average annual labour-productivity growth of 1.5% in the US between 2001 and 2011, they contributed only 0.4 percentage points in Europe, where labour-productivity growth averaged 1.2%. See Désirée van Welsum, Willem Overmeer and Bart van Arnhem, “Unlocking the ICT growth potential in Europe: Enabling people and businesses”, The Conference Board report for the European Commission, 2013

2 An American threat?

Europe’s digital backwardness ought to spur EU policymakers and businesses to do better. Yet policymakers in Brussels – pressured by those in Berlin and Paris who have been captured by analogue-age corporate dinosaurs – wrongly tend to view digitalisation as an American threat, against which Europe cannot compete in the marketplace. So while EU policymakers claim to want to encourage digitalisation, EU policies have been hijacked by the agendas of powerful national governments with technophobic and protectionist leanings.

The conception of the DSM strategy followed an intensive lobbying campaign by German and French businesses and their respective governments. This includes a leaked Franco-German letter to EU commissioners demanding a “level playing field” – notably by targeting online “platforms”, a disparate group of mostly American digital firms that happen to threaten established companies in France and Germany.10 Yet as the UK’s Competition and Markets Authority and other antitrust authorities have observed, there is not much evidence of a market failure that needs correcting.11

EU policymakers have expressed a desire to regulate, limit or even replace the motley crew of businesses that they have designated as “platforms”. These include, among others, online retailers, operating systems, streaming services, search engines, hardware manufacturers and social networks. With a few exceptions such as Dailymotion (France), Spotify (Sweden) and WeChat (China), the platforms are all American.12 As the EU’s then Digital Commissioner, Germany’s Günther Oettinger, put it, “it must not happen that Google makes future products such as cars or televisions and European companies remain the role of the supplier [sic].”13 Rather, as he said at the launch of the DSM strategy, the EU needs to regain its “digital independence”.

With all due respect, no, it doesn’t.

It is true that US firms dominate whole swathes of the new internet economy, from online search to social networks. The internet is also exposing inefficient European companies in traditional services sectors such as taxis, retail and media to digital competition, often by US firms, highlighting the EU’s failure to open up many services markets. And American tech firms are increasingly disrupting manufacturing too. Alarmed by how Apple’s iPhones and Google’s Android have outcompeted European mobile-phone makers, German car manufacturers are terrified that Silicon Valley will eat their lunch too.

Yet the framing of digitalisation as an overwhelming American threat best tackled by limiting competition is wrong-headed. It ignores the huge benefits that Europeans gain from being able to freely ‘google’ or ‘bing’ a whole world of valuable information, share their experiences with friends on Facebook and hail an Uber on their smartphone. It omits the new opportunities for smaller companies – start-ups, family businesses, sole traders – such as the young entrepreneurs in Berlin, Paris and Tallinn who can now reach a global audience online with relatively little capital, even when their bank managers don’t believe in their ideas. It embodies a defensive, negative, corporatist outlook that emphasises the threat to established companies, rather than the opportunities for them to reinvent themselves and continue to grow in the digital age. And it leads readily to a protectionist response that would stifle innovation, curb economic growth and cost jobs.

Given the anti-American fervour in some quarters, the biggest concern is that EU policymakers are willing to turn a blind eye to the collateral damage that their actions could impose on European digital entrepreneurs and the economy as a whole. While some of the expected measures targeting US internet companies have since been dropped or watered down for now, the DSM strategy remains deeply flawed. It contains hardly any liberalisation (section 3). It leaves offline barriers to competition and innovation in sectors crucial to digitalisation untouched (section 4). It imposes many new discriminatory, anti-innovation and consumer-unfriendly regulatory burdens on firms that trade and operate online (section 5). It unfairly targets online “platforms” (section 6). And it explicitly involves a misguided digital industrial policy (section 7).

12 Erik Chidambaram, “American cultural imperialism has a new name: GAFA”, Quartz, 1 December 2014
13 Alex Barker and Jeevan Vasagar, “Incoming EU digital chief lashes out at Google”, Financial Times, 29 October 2014
3 Where’s the liberalisation?

The DSM strategy is not what it claims to be. Unlike the original Single Market project that simplified and harmonised over a thousand national laws and opened up domestic markets to local and international competition, none of the legislative proposals published since the launch of the DSM strategy contain any significant liberalisation.

The European Commission claims that its DSM strategy could boost the EU economy by €415 billion a year (some 3% of GDP), but its figures don’t add up. Nearly half (€204 billion, or 1.6% of GDP) of that putative gain is assumed to come from making the e-commerce sector more competitive. Yet that is absurd: total e-commerce spending (for all business-to-business, business-to-consumer and peer-to-peer sales, including delivery costs, VAT, financial services and online gambling) is €477 billion — and the DSM strategy has yet to produce any initiatives that lift barriers to e-commerce.\(^\text{14}\)

The Commission also assumes that streamlining business rules could deliver gains of 0.3–0.5% of GDP. Yet the increased regulatory burden of new taxation requirements, liability rules and other administrative barriers will actually lead to productivity losses, not gains. The Commission also assumes benefits from successfully challenging the many national competences and quasi-monopolies on postal and delivery services. These are highly regulated in countries such as France, which has banned Amazon from offering free delivery to its customers.\(^\text{15}\) But so far, the DSM strategy has failed to do this.

For now, the Commission has focused its efforts on banning “unjustified” online geo-blocking and price discrimination. In effect, it wants to prohibit companies from refusing online sales (except for copyright reasons) or setting different prices on the basis of a customer’s home country. This is a good thing: Germans ought to be able to benefit from the same low prices as Spaniards when renting a car in Spain, an issue that the Commission has already addressed by other means.\(^\text{16}\) But it is a relatively minor issue, since most online retailers — including Amazon — want to maximise their international sales and do not block or automatically redirect their customers to local sites based on their residence. So it is fanciful to believe that it will deliver huge economic benefits (see Figure 2).

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\(^\text{14}\) E-Marketer Europe, “European Ecommerce Turnover Hit 477 Billion This Year”, accessed at http://www.emarketer.com/Article/European-Ecommerce-Turnover-Hit-477-Billion-This-Year/1012975


The only other liberalising measure in the DSM strategy is in the broadcasting sector and is bite-sized. Thanks to the internet, Europeans have gained access to a much wider range of information and culture – whether produced locally or elsewhere. But the EU does not have a single market for streamed video, music and other digital content; national copyright and media laws stand in the way. To serve the US market, streaming services such as Netflix and Spotify need a single copyright licence for each movie or music track they offer; in the EU, they have to secure rights separately in each EU member state. That is costly and time-consuming, so they have an incentive to skip smaller EU markets that are not lucrative enough. And if, for instance, Netflix lacks the right to stream a Danish TV show in Belgium, it prevents customers from countries where it does own the rights from viewing the show when in Belgium through a technique known as geo-blocking. When Hollywood studios and major sporting franchises, such as the English Premier League, license their content to TV networks in each local European market, they insist on geo-blocking – a practice that has been challenged under EU antitrust rules. In its rationale for the DSM strategy, the Commission argues that it is discriminatory to block access to content on the basis of customers’ residence or citizenship – and rightly so. But according to the Commission’s own survey, which probably overestimates the saliency of the issue, only 8% of Europeans had tried to access cross-border content online – and around half of those had actually succeeded. So, yes, Europeans should be allowed to watch their favourite TV shows while travelling in the EU, but it won’t make a big difference to the economy as a whole. After all, it will have only a marginal impact on the EU broadcasting industry, which has a total annual turnover of only €509 billion. With the best will in the world, the Commission’s figures simply don’t add up.

4 The real barriers left untouched

Only 4% of internet traffic from EU countries goes to online services in another European country. This widely quoted statistic seems like compelling evidence for the premise behind the DSM strategy that digital markets in the EU remain a mosaic of 28 segmented national markets. But think again. While 42% of online services in the EU are conducted within an EU country, 54% are provided by US companies. Are digital markets where foreign firms provide a majority of the services closed? Of course not. The real problems mostly lie in the over-regulated offline economy, where domestic barriers impede services trade, but which digital technologies are opening up to competition.

While national copyright and media laws continue to segment EU audiovisual markets, few other barriers impede cross-border data flows within the EU. Data-localisation requirements (bans on moving certain types of information overseas) are relatively rare within the EU and mostly concern archaic issues (such as an obligation to keep physical copies of company records in the home country) or non-commercial matters, such as national security. Contrary to common misperceptions, personal information could be moved freely within the EU even before the GDPR replaced the 1995 Data Privacy Directive.

Similarly, “over-the-top” (OTT) services such as search engines, travel websites and social media cannot be blocked by EU or national regulators, provided they comply with local copyright laws. Business and consumer software can also be downloaded freely from a vendor in another EU country. Developers and online services are free to use whatever protocols or standards they find suitable. With very few exceptions (for hazardous items) online retailers are able to export freely to other EU countries, because the principles of non-discrimination and mutual recognition have been enshrined in EU law since the late 1970s. So, contrary to what the European Commission seems to think, internet regulations cannot be the main reason why only 7% of smaller European businesses export, just 15% of Europeans buy online from another EU country and there isn’t a European equivalent of Amazon.

The real barriers to trade lie offline. While the EU has a fully liberalised internal market in goods, both the 1986 Single European Act and the 2006 Services Directive failed to provide a functioning framework for an equivalent market in services. And the EU has yet to liberalise sectors that are crucial for digitalisation – such as retail, telecoms, payments and transport services – because of protectionist interests in some major EU countries.

Surveys by the Organisation for Economic Co-operation Development (OECD) highlight that product-market regulation in EU countries is often more restrictive than in other developed countries – notably in sectors that are critical to e-commerce (see Figures 3A-C). For example, in the telecoms and broadband market, old monopolists have often been allowed to hold on to their access networks (and thus their access to customers), while incumbents have also been discouraged from challenging each other. In the retail sector, many countries have restrictions on where shops can be located, what they can sell, when they can open and even on which periods of the year discount sales are allowed. In the transport sector, prices are kept artificially high through medallion systems, strangling at birth any potential European Uber. In the retail sector, major European markets such as France, Germany and Italy score worse than most OECD countries, including the US.

**FIGURE 3A. REGULATORY RESTRICTIVENESS IN NETWORK SECTORS (TELECOMS, POST, UTILITIES), 2013**

<table>
<thead>
<tr>
<th>Country</th>
<th>Score</th>
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<tr>
<td>UNITED STATES (2008)</td>
<td>2.0</td>
</tr>
<tr>
<td>EU AVERAGE</td>
<td>1.5</td>
</tr>
<tr>
<td>FRANCE</td>
<td>1.0</td>
</tr>
<tr>
<td>GERMANY</td>
<td>0.5</td>
</tr>
<tr>
<td>UNITED KINGDOM</td>
<td>0.0</td>
</tr>
<tr>
<td>SWEDEN</td>
<td>0.0</td>
</tr>
<tr>
<td>ESTONIA</td>
<td>0.0</td>
</tr>
</tbody>
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Source: OECD Indicators of Product Market Regulation

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21 This was established through the Cassis de Dijon ruling in 1979, whereby EU member states must mutually recognise each other’s regulations, unless limiting EU regulations exist. Any derogations from this non-discrimination principle tend to be narrowly interpreted by the CJEU (see, among others, Judgment of the Court (Sixth Chamber), Manfred Saeger v Dennemeyer & Co. Ltd, C-76/90, 25 July 1991)
This failure to deregulate offline markets harms online trade. EU countries that have more open domestic markets tend to generate more innovative and successful businesses that have adapted well to the digital age. Witness how many online wine retailers in the EU are based in the UK rather than in Italy or France, two of the world’s largest wine producers.

In their evidence to the Commission’s e-commerce sector inquiry, respondents from countries with liberal offline retail markets – such as Sweden, Denmark and Portugal – reported a high share of cross-border e-commerce sales, despite their geographical remoteness, small domestic markets and linguistic challenges (see Figure 4).24 In contrast, countries with the worst business environments for retailers, such as Belgium and Italy, have very low international sales online.

The good news is that the internet has fostered innovative new services that bypass national regulations. These include online payments systems (such as PayPal and Stripe), e-books (such as Amazon’s Kindle), car-sharing platforms (such as France’s BlaBlaCar) and voice-over-IP (VoIP) call services (such as Skype, a European start-up now owned by Microsoft).

These digital upstarts highlight the EU’s failure to create a genuine single market in services. Excessive regulations in many EU countries have until now stunted intra-EU trade in services. Services account for 74% of the EU economy, yet intra-EU trade in services was only €841 billion in 2014, a mere 8% of household consumption and 6% of GDP.25

The bad news is that this has prompted a corporate backlash against “unfair” online competition – especially in countries that have failed to encourage competition in their offline markets – and the Commission is mostly siding with the offline dinosaurs. Instead of viewing digitalisation as an opportunity to integrate EU services markets, the DSM strategy does nothing to tackle offline barriers to competition while it imposes new ones online.

The EU has yet to liberalise sectors that are crucial for digitalisation – such as retail, telecoms, payments and transport services.
5 New roadblocks to digitalisation

The EU ostensibly seeks to encourage digitalisation, yet it is actually increasing regulatory burdens on digital firms. In some cases, it is seeking to impose new EU regulations in areas that were mostly unregulated at a national level. In others, it is introducing excessively bureaucratic harmonised EU rules. In effect, these inflict the red tape that prevails in France and Germany on more liberal EU economies too. Worse, these new regulatory burdens on online firms are often greater than those on offline firms.

That isn’t just bad for the digital economy; it favours big established companies over digital start-ups. While EU telecoms giants, national broadcasters and Silicon Valley multinationals can afford huge compliance departments and an army of lawyers, excessive administration costs, legal liabilities and red tape are crushing for smaller European businesses. These new EU regulatory burdens cover data privacy, video streaming, messaging services, taxation and consumer contracts, in addition to targeting online intermediaries through various means. The EU’s main objective is to “level the playing field” – in the wrong direction, by neutralising the advantages that the internet provides to start-ups and new market entrants and thus entrenching the position of traditional companies. In some cases, the DSM strategy would harm online innovators by treating them as exactly equivalent to roughly similar old offline businesses and imposing inappropriately burdensome regulations on them. In other cases, it actually seeks to impose greater, discriminatory requirements on digital-native firms and services than on their offline equivalents.

PRIVACY RULES WILL HAMPER START-UPS

The GDPR, the EU’s new data-privacy legislation, imposes burdensome new requirements on any entity that stores personal information. While it also removes regulatory discrepancies among EU countries, these were not barriers to trade. Thanks to the 1995 Data Privacy Directive, data controllers and processors were already able to handle and move data within the EU by complying with the privacy laws of their home country. Thus the GDPR does not make intra-EU data flows any easier; it introduces harmonised standards that impose higher compliance costs on all EU companies.

Sound, simple and effective privacy standards are like consumer standards – a public good that benefits all of society, especially vulnerable groups. But overly complicated, disproportionate and discriminatory standards can become a net cost. Striking the right balance is tricky. To what extent should businesses be required to file paperwork before they even get started? To what extent should users be expected to be vigilant? To what extent should law-enforcement agencies be relied on to find violations as they occur?

Whatever the “right” balance is, compliance requirements are particularly burdensome for smaller businesses. Start-ups lack the resources to hire data-privacy officers, conduct data-privacy impact assessments and investigate whether their information-technology (IT) suppliers are within an EU jurisdiction, all of which is mandated by the GDPR. To abide by the new data-privacy laws, which come into force in 2018, the first employee that a European entrepreneur would need to hire would not be a developer, sales manager or user-interface designer – but rather a privacy lawyer. One study suggests that that complying with the GDPR will cost smaller businesses up to €7,200 annually – consuming 16–40% of their annual IT budget. The high standards offered by EU privacy rules may be legitimate and enjoy broad political support, but they privilege multinationals and offline dinosaurs, while discriminating against dynamic start-ups.

FIGURE 5. ESTIMATED ANNUAL GDPR COMPLIANCE COSTS FOR SMALLER EUROPEAN BUSINESSES IN VARIOUS SECTORS

<table>
<thead>
<tr>
<th>Sector</th>
<th>Estimated Cost (€)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retailers and Wholesalers</td>
<td>4,258</td>
</tr>
<tr>
<td>Hotels and Restaurants</td>
<td>3,820</td>
</tr>
<tr>
<td>Transport, Storage, and Communications</td>
<td>2,952</td>
</tr>
<tr>
<td>Professional and Business Services; Real Estate</td>
<td>7,265</td>
</tr>
</tbody>
</table>

Source: Christensen, Calciago, Etro, Rafert (2013)26

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27 Ibid.
Nor are the administrative requirements likely to be lighter once the GDPR is supplemented by the e-Privacy Directive, the updated privacy directive for electronic communications that is currently being drafted. Given the GDPR’s extremely broad definition of personal information, it is reasonable to assume that practically all use of data will fall within the scope of either the GDPR or the upcoming e-Privacy Directive, including the use of data in industry and by automated software. Around three-quarters of all data transmissions involve user-generated information, while even enterprise data may contain information on customers and employees. Even purely machine-generated data (such as machine-to-machine communications or stock inventories) is often collected or transferred on devices where employees are logged in. It is reasonable to assume that practically all data flowing within the single market falls under EU privacy laws and thus any commercial use of data could be blocked on the grounds of containing personal information.

FAVOURING TRADITIONAL TV NETWORKS OVER ONLINE VIDEO STREAMING

The proposed Audiovisual Media Services Directive (AVMSD) favours traditional TV broadcasters by seeking to impose unduly burdensome new regulations on video streaming services (such as Netflix and Amazon Prime Video). It proposes that streaming services should be subject to fees and levies in both the country from which they operate and those to which they stream – a double jeopardy to which traditional TV broadcasters are not subjected. It also seeks to loosen the rules for traditional TV broadcasters – for example, on how often they may show ads – while allowing EU governments to force online streaming services to pay financial contributions to the local film industry. The Commission’s premise is that video streaming is harming traditional TV because of differences in regulation. Yet even in their most successful markets, video-on-demand services represent only 8% of viewing and scarcely compete with traditional TV for advertising.29 In any case, the Commission should not be seeking to impede digitalisation by favouring established TV networks over online video streaming services.

REGULATING ONLINE SERVICES AS IF THEY WERE TRADITIONAL TELECOMS PROVIDERS

The DSM strategy also seeks to shore up traditional telecoms companies. Chat and call functionality in over-the-top services (OTTs) such as WhatsApp, Facebook Messenger, Skype and WeChat have become massively popular. Traffic on WhatsApp alone exceeds global text-messaging (SMS) by 50% and seems to be rapidly replacing traditional SMS services, which once provided telecommunications networks with big profits.30 So it seems reasonable to demand that the consumer-rights regulations that apply to EU telecoms providers, as well as the privacy rules (the e-Privacy Directive), ought to apply to such services too.31 But treating apps as telecoms networks is disproportionate, if not absurd. They are not network services, but downloaded apps that allow users to send messages, files, videos and make purchases.32

Treating chat and call apps as equivalent to traditional telecoms companies and subjecting them to the cumbersome EU telecoms rules that govern fixed-line networks leads to absurdly burdensome requirements. For instance, it entails that emergency numbers and social-services numbers must be reachable through the app itself – even though the apps are installed on smartphones that are perfectly capable of making emergency calls securely, for free. This may not seem like a big deal, but it is. Relaying an internet chat from an app on to a physical phone line requires either considerable technical work that places an unreasonable burden on small app developers, or costly interconnection charges that place them at the mercy of traditional telecoms companies, who will thus have a monopoly on using phone numbers. It is just as outrageous as if telecoms companies had to pay a fee to communicate with their clients via their Facebook, Hotmail or Gmail accounts.

CONSUMER CONTRACTS

The EU is also seeking to impose additional burdens on companies that enter into contracts with consumers online. The Commission is proposing to revise consumer-contract laws so that consumers’ “home” law would apply when they purchase downloads such as apps, music and films – from another EU country.33 As a result, a small digital business, such as an app developer, would have to become knowledgeable about the laws that apply in each of the 28 member states – a huge burden. The Commission also wants to make suppliers of apps and digital content liable for any defects in their products for an unlimited period of time. And it would reverse the usual burden of proof: instead of the buyer having to prove that the defect existed at the time of supply, the supplier would need to prove that it didn’t. For instance, an app vendor would have to be able to prove that any issue was due not to its software, but to the user’s device or users themselves. The app vendor would also be liable if, say, an app stops working on an antiquated iPhone 3 twenty years from now! The only way in which an app vendor could protect itself against such claims would be by collecting enormous amounts of data on users’ behaviour, as evidence for a future court case. That would be very costly, not to mention an infringement of users’ privacy.

Strengthening consumer rights is generally a good thing – but not if taken to extremes. Imposing disproportionate liabilities on smaller businesses would discourage entrepreneurs from starting businesses and deprive Europeans of new digital services.

REVERSING TAXATION RULES FOR ONLINE SERVICES

The Commission had already imposed discriminatory new tax burdens on the digital economy prior to the announcement of the DSM strategy. Whereas firms that sell services offline to customers in another EU country pay value-added tax (VAT) at the rate prevailing in their home market, those that sell services online must now pay VAT at the location of the consumer. That is a big additional burden for online service providers, which must now administer VAT for every EU country to which they sell. Likewise, taxes on online advertising, a primary source of revenue for many digital firms, must now be paid in the countries where users view them. While the

31 Ibid.
Commission is trying to mitigate the burden that it has created, notably by establishing a Mini One-Stop Shop (MOSS) to report and pay VAT, the new VAT rules still hamper and unduly burden online trade. To make matters worse, for digital services the EU is also trying to reverse the general international principles of corporation tax that apply to offline companies. In the OECD Action Plan against Base Erosion and Profit Shifting (BEPS), an intergovernmental attempt to reform corporation tax, the EU has suggested that the cross-border supply of services via the internet should be equivalent to “local presence”, and therefore subject to double-taxation. Perversely, this could justify double taxation or even bans on European firms trading with the many countries that allow goods to enter but impose restrictions on local presence. It is not always lawful for an EU exporter that trades with, say, China to actually invest there, or to be present there of its own accord. So the EU proposal would set an extremely dangerous precedent. If a mere website were to constitute “local presence”, many European firms would find themselves unwittingly subject to foreign tax, privacy and security laws. The Commission also wants to remove de minimis rules that waive tariffs on imports valued at less than 22 euros, contrary to common international practice.

EXTENDING COPYRIGHT TO NEWS LINKS

Recent laws and court rulings in Germany and Spain have extended copyright – and thereby the right to collect levies – to internet links that point to news content. For example, if a search result displays a short text fragment from a publicly available news source, the search engine or news aggregator must pay a levy. This has led to the closure of Google News in Spain, with declining visitor traffic and ad revenues for news sites as an unintended consequence. The Commission now proposes that this “ancillary copyright” for news content should apply across the EU. Yet this would contradict traditional copyright law and international agreements that establish the right to quotation. Indeed, the fact that this copyright extension would apply only to news content highlights that it is the result of lobbying by traditional news media publishers, at the expense of ordinary Europeans. The measures outlined in this section are powerful evidence that the DSM strategy favours big traditional companies at the expense of digital upstarts and Europeans as a whole.

36 Proyecto de Ley por la que se modifica el Texto Refundido de la Ley de Propiedad Intelectual, aprobado por Real Decreto Legislativo 1/1996, de 12 de abril, y la Ley 1/2000, de 7 de enero, de Enjuiciamiento Civil, No. 81-3, 22 July 2014; amendment of German Copyright Act of 2013, art 87f.
6 Targeting online platforms

A key issue is not just whether and how the EU regulates the digital sector, but when. EU authorities are already able to intervene if digital firms breach privacy, copyright or consumer-protection laws. But as the previous section shows, the EU is now seeking to regulate digital-native firms (in particular online platforms) ex-ante rather than ex-post – in effect, presuming harm before it occurs (or doesn’t). Indeed, as EU Digital Commissioner, Oettinger pushed for a powerful new EU regulator to rein in online platforms, stressing the need to “replace today’s web search engines, operating systems, and social networks.”

The new regulation on data privacy and proposed ones on digital copyright, video streaming and messaging services would give the EU discretionary and discriminatory powers to target online “platforms”. Businesses will understandably fear that any digital innovation may be singled out in future if powerful EU companies and governments feel threatened. This has worrying implications for the investment climate in the EU, with the resulting regulatory uncertainty likely to deter innovators and investors.

In an open letter to the Commission on 4 April 2016, ministers from 11 EU countries – Britain, Bulgaria, the Czech Republic, Denmark, Estonia, Finland, Latvia, Lithuania, Luxembourg, Poland and Sweden – urged that platforms not be hampered by ex-ante regulations. “Platforms should be seen as an opportunity, not a threat,” they correctly conclude, arguing that only a favourable business climate – in other words, digital-friendly deregulation – will spur the development of indigenous European platforms. Nine of those countries have since formed a like-minded group called Digital-9 (or D9), which may yet pursue a different approach unless EU policies turn more digitalisation-friendly.

**ANTITRUST ABUSE**

The EU is also pursuing many – largely unfounded – ex-post antitrust and privacy enforcement actions against online platforms. According to the analytical documents that support the DSM strategy, the primary justification for the Commission’s unprecedented and unorthodox onslaught on online intermediaries is that they are natural monopolies. It is argued, for example, that Google could abuse its near-monopoly of internet search in the EU to exclude competitors from its search listings. Germany’s Federal Cartel Office is also investigating Facebook over how it obtains and makes use of user data. But this reasoning is unsound. Online intermediaries have disrupted business models and transformed many sectors, including retail, travel, advertising, telecoms and payment services, by challenging the offline giants that once dominated those markets. Sales platforms such as Amazon, Google and Apple’s iTunes Store have thereby enabled many other businesses, notably smaller ones, to reach many new consumers worldwide. Where the old industrialists scaled production, platforms aggregate demand.

Online intermediaries have greatly reduced barriers to entry for start-ups and smaller businesses. They have massively diminished search costs and provided price transparency for consumers. In this way, they have hugely increased competition, not decreased it. The upshot is that, thanks to online intermediaries, market power has often shifted from incumbent companies to consumers. Hurrah!

While online intermediaries have vastly improved competition in the sectors that they have disrupted, “network effects” entail that consumers tend to congregate on the most popular platforms. Thus the bigger a social network is, the more beneficial it becomes. Intermediaries, meanwhile, have near-zero marginal costs, so adding users barely increases their costs.

If the internet was a static system with high entry costs, the end result would be markets with only a few providers that new entrants would struggle to penetrate. But in the ever-changing digital world, online market concentrations are rarely static. Facebook outcompeted several larger, more established and better-financed social networks (including MySpace, Friendster and Google+) as well as specialised and local networks, such as StudiVZ in Germany.

In 2004 the European Court of Justice (ECJ) ruled that bundling Windows Media Player with its Windows operating system constituted an abuse of Microsoft’s dominant position. Yet a previously near-bankrupt hardware firm – Apple – was already disrupting the market with its iTunes media player: A small Swedish company, Spotify, then stole a march on Apple with its music-streaming service. Thus, as well as shrinking marginal production costs, digitalisation lowers the cost of market entry. A new platform or social network can be launched with relatively little capital and technical knowledge that start-ups can readily acquire. Even extremely high levels of market concentration can be challenged in dynamic markets where innovation is rapid, challengers are creative and risk capital is widely available.

Yet the EU’s highly static view of antitrust policy struggles to take account of this. In recent years, the European Commission has launched investigations against Apple’s iTunes, Google’s comparison-shopping service and its Android mobile operating system on the assumption that their current market share meant their dominance was entrenched and open to abuse. But that is not the case.

Back in the digital dark ages before smartphones, EU antitrust authorities forced Microsoft to unbundle its Internet Explorer browser and Media Player from its Windows operating system, viewing their bundling as an abuse of the monopoly that Windows enjoyed on desktop PCs. Yet even though Windows’
dominance was far more entrenched than Apple’s or Google’s is now, it eventually ended. This happened not because of EU authorities’ intervention, but because its rivals, notably Apple and Google’s Android, innovated and outcompeted it.

Now the Commission is targeting Android – and potentially Amazon soon also. Undeniably, both are very popular at the moment. But the smartphone and e-commerce markets are fiercely competitive. In the smartphone market, Apple is hugely profitable, while Microsoft’s deep pockets ensure that Windows Phone will continue to challenge. The e-commerce market is fragmented, with many niche and local online and offline players. In both markets, there is nothing stopping others — a competing platform, a Chinese upstart or even a European one — from establishing a rival. Indeed, messaging apps such as China’s WeChat are already evolving into platforms that enable consumers to do all sorts of tasks without leaving the app, thereby undermining Android’s importance. At the same time, Alibaba is becoming the dominant e-commerce platform in Asia and emerging economies in general.

Since today’s market leaders could – and one day will – be disrupted by rivals, the Commission is wrong to get so worked up about protecting competitors. The most important aspect of antitrust is to mitigate harm. If tech giants really did harm consumers by providing an inferior or biased product, that day would surely come sooner.
7 A protectionist industrial policy

The DSM strategy imposes new regulatory burdens that favour global giants over start-ups and smaller companies, as well as offline dinosaurs over digital innovators.

Since many digital firms happen to be foreign – and the DSM strategy specifically targets American online platforms – this corporatist charter is also protectionist. As this section shows, the GDPR also explicitly discriminates against foreign firms. Worse, the Commission is embarking on a digital industrial policy that seeks to hamper big European companies’ foreign competitors. That is misguided – and bound to fail.

“FOREIGNERS CAN’T BE TRUSTED”

It is perfectly legitimate for EU authorities to seek to protect the personal information of Europeans. But this ought to be done in a way that restricts digital trade as little as possible and isn’t intentionally protectionist – which is not the case with EU privacy laws. The GDPR extends the scope of EU data-protection rules to foreign companies outside the EU’s jurisdiction and forces them to assume extensive legal liabilities that may conflict with obligations under laws in their home country. As a general principle, firms are forced to relocate into EU jurisdictions and build administrative functions inside the EU.

These legal risks and compliance costs may deter foreign service providers from supplying EU customers altogether. By default, non-EU entities are not entitled to handle the data of EU citizens unless they operate in a jurisdiction deemed by the EU to offer “adequate” data protection. In practice, the EU requires that they offer protection that is “essentially equivalent” to EU law. As a result, EU privacy rules stipulate that personal data can flow to only a few jurisdictions in the European Economic Area (EEA), Argentina, Canada, Israel, New Zealand and Uruguay, which together with the EU account for less than a fifth of international services trade.47 Indeed, in the Schrems case the Court of Justice of the European Union (CJEU) ruled that data cannot flow to countries where the government engages in the type of electronic surveillance that most EU governments themselves engage in.48

The GDPR prevents European users and firms from taking advantage of the full global offering of big-data applications, hosting and experts. For example, a small business cannot use any cloud or other IT services from a non-approved country to run its customer and marketing database, while foreign social networks and e-commerce sites may block EU customers to avoid falling foul of the conflicting requirements of EU and local laws. While US tech giants enjoy preferential treatment under the EU-US Privacy Shield, which allows them to self-certify their compliance with EU rules, suppliers from the rest of the world (including technology hubs such as India, Korea and Japan) must use cumbersome routes that are only feasible for multinationals.

DIGITAL INDUSTRIAL POLICY

While the protectionist intent of the GDPR is hidden, the European Commission is quite explicit about pursuing a digital industrial policy. “Building on and complementing the various national initiatives for digitising industry, such as Industrie 4.0, Smart Industry and Industrie du Futur, the Commission will use its policy instruments, financial support, coordination and legislative powers to trigger further public and private investments in all industrial sectors and create the framework conditions for the digital industrial revolution,” it states.49 Since industrial policy is a national competence, the EU intervenes by deploying funds for programmes that national governments want to see executed, notably through funding for research (Horizon 2020) and through the European Fund for Strategic Investments (EFSI) which seeks to mobilise private funds with EU guarantees. The DSM strategy also seeks to foster the development of EU-led standards in five priority areas: 5G communications, cloud computing, the internet of things, big data and cybersecurity.50 Such standards would give technical advantages to the EU firms collaborating to create them – especially if they go on to become global ones.

While the EU was previously successful at leading the process of setting international industrial standards for mobile networks in the late 1980s and 1990s, the situation is different now. The national telecoms monopolies that played a pivotal role in launching and setting the standards for early mobile phones do not dominate the world of apps, streaming and the cloud. And while government-mandated standards were previously crucial to ensure interoperability (the ability to use any phone with any operator), most of today’s standards are market-based and emerge as the result of competition – and cooperation – between private companies, not public fiat. Thus the EU does not need to (and probably could not) create a standard protocol for the cloud, 3D printing and the internet of things to function and evolve.

More broadly, as this report highlights, many DSM proposals seek to benefit incumbent companies through regulations that hamper competitors, be they local start-ups or US tech giants – a classic European industrial policy of trying to pick winners and losers.

INDUSTRIAL POLICIES DON’T WORK

Yet even in the analogue age, industrial policies had a terrible track record.51 Policies that favour specific industries, technologies or firms tend to fail, because policymakers lack the information to make judgements about the best way forward, especially in areas of rapid and unexpected technological change. Worse, policymakers are often captured by powerful lobby groups: they listen to industry insiders with a vested interest, rather than to the small voice of the upstart, the challenger or the company that has yet to be born. Those two huge flaws are glaring in the DSM strategy.

In a globalised digital economy, old-fashioned industrial policy is even more self-defeating. In an era of global supply chains, where data is an increasingly important input for all firms, EU firms need access to the best, latest and lowest-cost digital services from around the world. Indeed, sectors in which Europe is a world leader, such as finance, engineering and consulting, are increasingly technology businesses.52 Digital services also

account for an ever larger share of the value added of European manufacturing; even steel mills are turning into customer-centric services firms that manage customer relations online and provide various services with their products.\footnote{See case study by Magnus Rentzhog, “At Your Service”, Kommerskollegium, 2010, accessed at http://www.kommers.se/Documents/dokumentar/x/ publikationer/2010/utifrånarsReport-2010-2-at-your-service.pdf} In the German and French machinery sectors, internet-related activities are as important production inputs as raw materials and electricity.\footnote{Erik van der Marel, Hosuk Lee-Makiyama and Matthias Bauer, “A Friendly Fire on Economic Recovery: A Methodology to Estimate the Costs of Data Regulations”, ECipe working paper 02/2014, accessed at http://www.ecipe.org/app/uploads/2014/12/WP22014.pdf} Such figures understate the importance of data as an input, since many vital services are provided free by internet intermediaries and thus not captured in official statistics.

**FIGURE 6. USE OF INTERNET RELATED ACTIVITIES IN VARIOUS INDUSTRIES**

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>TELECOMS</td>
<td>32%</td>
</tr>
<tr>
<td>BUSINESS SERVICES</td>
<td>7%</td>
</tr>
<tr>
<td>FINANCIAL SERVICES</td>
<td>5%</td>
</tr>
<tr>
<td>MACHINERY, ELECTRONICS</td>
<td>5%</td>
</tr>
<tr>
<td>CONSUMER SERVICES</td>
<td>5%</td>
</tr>
<tr>
<td>TRADE, DISTRIBUTION</td>
<td>4%</td>
</tr>
<tr>
<td>UTILITIES</td>
<td>3%</td>
</tr>
<tr>
<td>UTILITIES</td>
<td>3%</td>
</tr>
<tr>
<td>CONSTRUCTION</td>
<td>2%</td>
</tr>
<tr>
<td>OTHER MANUFACTURING</td>
<td>2%</td>
</tr>
<tr>
<td>MINERALS, PETROLEUM, GAS</td>
<td>1%</td>
</tr>
<tr>
<td>MOTOR VEHICLES</td>
<td>1%</td>
</tr>
<tr>
<td>FOOD</td>
<td>1%</td>
</tr>
<tr>
<td>CLOTHING &amp; TEXTILES</td>
<td>1%</td>
</tr>
</tbody>
</table>

Source: van der Marel, Lee-Makiyama and Bauer (2014)\footnote{Ibid.}

Inputs of foreign digital services make EU businesses more competitive, preserving well-paid jobs in Europe and creating new ones. Europe’s world-leading suppliers of (increasingly digital) services – such as providers of professional services, network equipment and advanced technologies – also increasingly export to Asian and American supply chains. Since global markets are much larger and faster growing than EU ones, European firms and workers benefit handsomely from this.

In short, trying to foster European champions through regulations that limit foreign competition would hamper European businesses’ ability to make use of the best digital technologies and suppliers and thus hobble their ability to compete internationally. Studies on the GDPR show that if the EU restricted data flows to the US, EU exports would fall and US ones rise thanks to weaker competition from Europe.\footnote{US Chamber of Commerce, “The Economic Importance of Getting Data Protection Right: Protecting Privacy, Transmitting Data, Moving Commerce”, 2013, accessed at https://www.uschamber.com/sites/default/files/documents/files/3205gb_EconomicImportance_Final_Revised_it.pdf} Far from nurturing European champions, regulatory hurdles and protectionist measures will stifle Europe’s digital economy.

Far from nurturing European champions, regulatory hurdles and protectionist measures will stifle Europe’s digital economy.
8 The way forward: An Open DSM

At half-time, it is obvious that the DSM strategy is not fit for purpose. It is corporatist, protectionist and anti-innovation.

To unleash economic growth, stimulate digital enterprise and enhance consumer welfare, the EU desperately needs to turn the DSM project into a true Single Market project – an Open DSM. This would keep digital markets in the EU open to the rest of the world and reframe the “threat” of online competition as an opportunity to open up hidebound offline services markets, and thus create a genuine single market in services.

An Open DSM would be based on four key principles: non-discrimination, appropriate deregulation, data openness and dynamic competition. It would not discriminate against online firms, regulate the digital economy only where necessary and in a proportionate way, and examine whether existing offline regulations are fit for purpose. It would tackle the barriers that limit competition and innovation in offline services sectors that are key to digitalisation. It would find ways to reconcile European data-privacy regulation with global openness. And it would involve rethinking EU competition policy in the digital age. The aim would be seamless markets for both consumers and businesses, regulation that does not discriminate against new, foreign or online companies, and dynamic competition that encourages innovation.

As the former Italian prime minister and EU commissioner Mario Monti has observed, existing Single Market rules were not flexible enough to cope with changes brought on by new products and technologies in general, not least from the internet and globalisation.57 The founders of the Single Market never intended its original directives and regulations to be a European constitution; markets change. Market rules must too, if the single market is to function properly as one.

NON-DISCRIMINATORY, APPROPRIATE AND PROPORIONATE DIGITAL REGULATION

At the very least, the EU should not impose discriminatory regulatory burdens on online businesses. An item ordered online ought to be taxed similarly to one ordered from a traditional mail-order company. Indeed, as businesses increasingly use the internet for sales, customer interaction and support, the distinction between “traditional” and “online” makes ever less sense.

Nor should the EU “level the playing field” by trapping internet start-ups in the excessive regulations that bedevil offline sectors such as retail, taxis, hotels, telecoms and broadcasting in many EU countries.58 The internet has revealed how incomplete the EU single market in services is. That Uber is lawful in the UK and Sweden but not in Belgium and Germany makes a mockery of the “single market”. Instead of trying to shoot the messenger, EU policymakers ought to heed it: New technologies that challenge old business models are not a problem; they’re progress.

Unlike most of the proposals in the DSM strategy, prospective digital regulations ought to be necessary and proportionate. EU law is based on the principle of proportionality enshrined in the EU Treaties.59 This proportionality test has been developed into a general requirement that any directive must be “appropriate” and “necessary” to achieve its objectives.

In addition, the World Trade Organisation’s two-tier necessity test demands that member states first prove that their actions are “necessary” to achieve the desired policy objective and then always pursue the “least trade-restrictive measure” reasonably available. The EU should likewise pursue the least-trade restrictive policies for new digital legislation – not least because EU rules that discriminate against foreign competition could otherwise be challenged at the WTO.

OPEN UP SERVICES MARKETS THAT ARE CRUCIAL FOR DIGITALISATION

Rather than trying to overregulate the internet as much as offline services markets often are, the EU ought to subject all existing market rules, both EU and national, to a searching examination of whether they are fit for purpose in a globalised digital age. In particular, the Commission should probe whether they encourage innovation, enterprise and market integration.60

Clearly, this is a colossal undertaking: such a review would likely have to scrutinise tens of thousands of legal acts. But such a task has been successfully achieved before: the 1986 Single European Act streamlined EU and national regulations on a wholesale basis.

On the basis of such a review, the EU and its member states should then deregulate markets to spur digitalisation and eliminate regulatory requirements that unduly hamper traditional industry.

The priority should be addressing the lack of dynamism in overregulated services sectors that are key to digitalisation, such as retail, consumer financial services, telecoms, transport and distribution.

Increased competition is particularly vital to ensure greater investment in Europe’s antiquated telecoms infrastructure. Only 79% of Europeans have access to 4G mobile networks61 and the development of faster fibre-based broadband (fibre to the home, FTTH) is more ambitious in China than in Europe.62 Yet far from “too much competition” holding back investment in the telecoms sector, as industry insiders plead and EU officials believe, it is a lack of competition that allows entrenched incumbents to rest on their laurels and milk European consumers.63 After all, incumbents tend to focus their investments on metropolitan areas where they face competition from cable companies and market challengers. So the EU ought to do more to open up telecoms infrastructure to competition from challengers and alternative technologies.

Just as OTTs are allowed to provide voice and messaging services that compete with telecoms providers’ services, telecoms providers should be allowed to expand into streaming, VoIP and messaging services, with the same light-touch regulation. Since internet technology is here to stay and market convergence between telecoms, data and audiovisual services provided online (so-called “triple play” and IP technology) is inevitable, this would benefit both telecoms giants and consumers.

59 Treaty on the Functioning of the European Union (TFEU), Article 5, supplemented under the Lisbon Treaty by the Protocol on the application of the principles of subsidiarity and proportionality.
60 The need to review existing regulations has been highlighted by, among others, Strategic Policy Forum on Digital Entrepreneurship, “Accelerating the digital transformation of European industry and enterprises,” March 2016.
63 See also European Commission, “A Digital Agenda for Europe”, 2010
DATA OPENNESS

Ensuring that data flows freely within the EU is a pre-requisite for opening up EU services markets. Yet there are already some twenty national data-localisation measures within the EU, whereby governments restrict data transfers to other EU countries. An EU-wide ban on local storage and processing requirements would be relatively easy to implement – especially now that the GDPR has harmonised data privacy rules within the EU. This would improve efficiency, bolster integration and above all act as a ratchet against future protectionism as services move online.64 A majority of EU governments support such a ban, but Germany and France are vehemently opposed.

The EU ought to protect data privacy in a way that keeps global markets open and Europe’s services exporters competitive. The GDPR entails that EU authorities could block almost all data flows between the EU and its major trading partners, since almost all contain some form of identifiable personal information. Most countries, including eight of the EU’s top ten trading partners, are unwilling to introduce legislation modelled on EU privacy rules; in some cases, their constitutional structure precludes it.

For data and services trade to flow to a country outside the EU, the GDPR requires that the third country’s privacy regulation be “essentially equivalent” to the EU’s. In effect, this means “near identical” in approach, rather than providing essentially the same level of protection.65 Perversely, countries such as Uruguay and Argentina that have equivalent laws but little means to enforce them are deemed adequate; while others (such as Australia, Japan, Korea and some heavily regulated sectors and states in the US) that offer functionally adequate levels of protection are deemed inadequate. To support trade and genuine de facto protection of EU citizen’s rights, adequacy decisions ought to be expedited and based on objective criteria of the actual protection achieved, not on the legal approach that the third country has chosen.

The Privacy Shield that enables US-based companies to self-certify their compliance with EU rules also ought to be extended to other reliable jurisdictions. A global self-certification mechanism under EU management would be hard to enforce, since the EU lacks jurisdiction over overseas data handlers and relies on governments for enforcement. But self-certification programmes could be set up with most countries where the rule of law is enforced and bilateral cooperation with the EU is effective. In other cases, a self-certification programme would need to be accompanied by a mechanism to strengthen judicial cooperation through legal instruments, such as mutual legal assistance treaties (MLATs) or other means of bilateral judicial and law-enforcement cooperation.

At the same time, the EU needs to address market failures overseas. In every trade agreement that it negotiates, it should demand non-discrimination (known as “national treatment”) commitments and tackle digital trade barriers. For instance, many telecoms markets are still riddled with entry restrictions that bar EU telecoms operators and OTTs from investing there. In some countries, even patching through calls or network connections to people located there entails paying extremely high discriminatory interconnection fees to local monopolists.

The EU should also use the WTO’s General Agreement on Trade in Services (GATS) and its annexes on telecoms to address anticompetitive behaviour and discriminatory terms that harm smaller EU businesses and telecoms incumbents. Europe ought to make enforcing these rules a priority, if necessary by launching WTO cases.

DIGITAL ANTITRUST

Last but not least, the philosophy and practice of EU competition policy needs rethinking in the digital age. In the fluid and fast-changing digital world, the EU’s narrow, static analysis of competition issues based on rigid definitions of market structure is particularly inappropriate. It ought to embrace a broader, dynamic analysis of competition that gives more weight to the benefits of innovation.66

As it stands, any firm can be deemed dominant and potentially abusing its dominant position if the relevant market is defined narrowly enough. For instance, there may be only one small bookstore in a particularly city district and if the local book market is defined as an area readily reachable on foot, it could be construed as enjoying a local monopoly. But if one broadens the market to an area readily reachable by car – or includes online booksellers – that perceived monopoly disappears.

Market boundaries are particularly fluid online. Take Google, the target of several EU antitrust inquiries. It is clearly dominant in the EU search-engine market: more than 90% of such internet searches are routed through Google, the target of several EU antitrust inquiries. It is particularly inappropriate. It ought to embrace a broader, dynamic analysis of competition – and thus make antitrust authorities need to intervene in cases where dominance becomes entrenched and abused, new entry is blocked or impeded and consumers are harmed. But where that is not the case, heavy-handed intervention that tries to set in stone online market structures blocks innovation, depriving consumers of its benefits. Aggrieved competitors should not be the judges of whether consumers are harmed.

An Open DSM, as outlined in this section, would upgrade and complete the existing Single Market for a global digital age. Unlike the misguided DSM strategy, it would foster greater integration, competition and innovation – and thus make Europeans better off.

Conclusion

The European Commission’s DSM strategy is based on two premises: that digital markets are segmented along national lines and that American companies often monoplisate them. As this report has shown, those premises are both false and incoherent.

After all, if digital markets are national, how can they be monopolised by foreign firms? In fact, digital markets are mostly global and they tend to be dynamically competitive, because technology is changing fast and barriers to entry are generally low. Europe’s digital backwardness will not be solved by trying to limit foreign competition. On the contrary, European businesses and consumers need access to the best, latest and lowest-cost digital services in the world in order to be competitive and productive. Protecting the privacy of Europeans’ personal data can be achieved in ways that keep markets open.

Nor will Europe’s economy prosper if the digital sector is tied up in red tape in order to protect big fat companies that have been sheltered from competition offline for too long. European consumers and the companies of tomorrow should not be sacrificed for the interests of privileged insiders. Digitalisation is an opportunity, not a threat.

The stakes could scarcely be higher. The digital economy is becoming the economy, so bad DSM rules threaten to supplant good Single Market ones. To make the most of the huge opportunities that digitalisation offers for boosting productivity and living standards, Europe needs to seize the future through an Open DSM.

Europe needs a seamless, non-discriminatory and dynamic digital single market. One which enables companies and consumers to operate smoothly across the EU and globally. One which does not discriminate against online suppliers, challenger companies and non-EU firms. One which encourages innovation that boosts productivity and benefits consumers. Europe needs to open up markets to digital technologies, not do digital down.

Europe needs to open up markets to digital technologies, not do digital down.