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WHAT IS THE DIGITAL INTERNAL MARKET
AND WHERE THE EUROPEAN UNION SHOULD INTERVENE?

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Abstract

This paper analyses the digital internal market and when EU intervention is needed to achieve this internal market. It sets legal and economic criteria to determine the appropriate scope of the EU intervention. It applies these criteria to several case studies and concludes that sometimes the EU intervention is not justified (choice of regulatory remedies in many national markets, regulation of mobile termination rate, price control of Next Generation Access networks), whereas in other cases EU intervention is justified (entry regulation, international roaming, spectrum).

The paper calls for a more open debate of the concept and the means to achieve the digital internal market. It also submits that EU intervention should focus on the areas where its benefits are the highest (in particular given the possibilities of economies of scale provided by the technology or the cross-country externalities), and where its costs are the lowest (in particular given the heterogeneity of national preferences or the need for regulatory experimentation and competition). Therefore, EU intervention is more relevant for the content part of digital regulation (such as copyright, privacy, electronic commerce, dispute resolution) than for the infrastructure part (i.e. the electronic communications networks and services). In particular, this paper calls the Commission to use with extreme caution its new power on regulatory remedies, especially in the context of the deployment of NGA, given the uncertainty on the best form of regulation.

Keywords

Digital internal market; level of intervention; regulatory remedies

1. Introduction*

Many Commission policy initiatives and independent studies, of which this special issue of Communications & Strategies is an example, show a renewed interest in the progress towards the achievement of the internal market for digital services, whether on the content part (e.g. electronic commerce or e-government services) or on the infrastructure part (i.e. electronic communications networks and services). The Digital agenda for Europe, one of the seven flagship initiatives of the Europe 2020 Strategy for jobs and growth, places the internal market at its core.¹ Some of the 12 key actions of the recently adopted Single Market Act of the Commission should contribute to the digital single market.² Among the independent studies, the Monti Report on the internal market recommends several actions to shape Europe's digital single market.³ According to Copenhagen Economics (2010), the EU could gain 4 % of GDP by stimulating the digital internal market by 2020. This corresponds to a gain of almost €500 bn and means that the digital single market alone could have a similar impact to the famous Delors 1992 internal market programme.

To achieve such internal, several policies will be needed at the national and the EU levels. It is important that the EU intervention takes place where it is the most useful; otherwise it may be counter-productive and wastes the EU's "political capital", which has decreased over the years. In the past, the Commission sometimes intervened where, we would submit, it was not appropriate, whereas the Council opposed intervention in other areas where it was justified.

Accordingly, this paper proposes areas where EU intervention is justified and areas where national freedom of action is more appropriate. After this introduction, Section 2 explains our conception of the internal market with its implication for public policies, and then sets legal and economic criteria to base EU intervention. On that basis, Section 3 gives some cases where EU intervention may be, according to us, over intrusive or other cases where EU intervention may be justified. Finally, Section 4 concludes.

This paper does not deal with the different types of institutional coordination for the EU intervention ranging from weak to strong coordination: Ad-hoc discussion of issues of common interest and/or mere exchange of information between national regulators; Euro-regulator with soft power (voluntary guidelines) and consensus decision making; Euro-regulator with hard power (binding rules) and qualified majority voting, Commission with soft power; Commission with hard power, possibly after the opinion of the BEREC.⁴

* An earlier version of this paper was presented at the 30th Anniversary Conference of the CRID held in Namur (Belgium) on 21 January 2010 and has benefited from the comments of the participants. The authors would also like to thank Robert Queck for his very useful comments.

¹ Communication from the Commission of 26 August 2010, A Digital Agenda for Europe, COM(2010) 245/2.

² Communication from the Commission of 13 April 2011, The Single Market Act, COM(2011) 206.

³ Monti (2010: 44-46). With regard to telecommunications services and infrastructures, the Report recommends a review of the sector to prepare proposals for creating a seamless regulatory space for electronic communications, including proposals to reinforce EU level regulatory oversight, to introduce pan-European licensing and EU level frequency allocation and administration.

⁴ On such issue, see Commission Services Impact Assessment of 28 June 2006 on the Review of EU regulatory framework for electronic communications networks and services, SEC(2006)817, p. 19-21, and Nicolaidis (2006, p. 5).

2. The internal market in electronic communications and the optimal level of regulation

When dealing with the internal market, two related issues should be distinguished. First, what is the internal market and what does it imply for public policy at national and EU level? Secondly, what is the optimal level of regulation (between the national and the EU levels) to achieve the internal market?

2.1. The concept of the internal market in electronic communications and the required public policies for its establishment

Article 26(2) of the Treaty on the Functioning of the European Union (TFEU) states that

The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties.

The achievement of such internal market requires some public policies at the national as well as at the EU levels. We can find some indications in Article 8(3) of the amended Framework Directive⁵, which provides that

The national regulatory authorities shall contribute to the development of the internal market by *inter alia*:

- removing remaining obstacles to the provision of electronic communications networks, associated facilities and services and electronic communications services at European level;
- encouraging the establishment and development of trans-European networks and the interoperability of pan-European services, and end-to-end connectivity;
- cooperating with each other, with the Commission and BEREC so as to ensure the development of consistent regulatory practice and the consistent application of this Directive and the Specific Directives.

More generally, the national and EU policies necessary to achieve the internal market for public policy need to be debated further between stakeholders but, at this stage, we submit that the conditions and policies for the achievement of the internal market in the electronic communications networks and services are:

- The removal of all barriers to entry between the Member States and the establishment of conditions which are sufficiently harmonised such that operators and consumers may benefit from the economies of scale made possible by technology;
- A level playing field and a strict non-discrimination and high transparency between all players, being national or foreign, incumbent or new entrant, implying the possibility of competition;
- The presence of independent regulators, not captured by national operators, to ensure the application of the non discrimination and transparency rules;

However, the achievement of the internal market should not lead to the negation of national preferences which are not contrary to the conditions defined as necessary for the achievement of the internal market.

- Such national preferences may relate to economic regulatory issues when theoretical and policy debates exist, such as facilities versus service-based competition, the need and the speed for achieving the symmetry of termination charges, or entry assistance measures (such as national roaming). An old example where the impact of the differences of national preferences on the internal market has been exaggerated is the 1998 Numbering Directive.⁶ This Directive imposed on

⁵ Directive 2002/21 of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services, OJ [2002] L 108/33, as amended by Directive 2009/140.

⁶ Directive 98/61 of the European Parliament and of the Council of 24 September 1998 amending Directive 97/33 with regard to operator number portability and carrier pre-selection, OJ [1998] L 268/37.

the Member States an obligation to implement Carrier Pre-Selection (CPS) by 2000. The United-Kingdom, with a tradition of facilities-based competition, strongly opposed CPS as it was removing an incentive for operators to invest in local loops. The UK was outvoted in the Council and was forced to implement CPS. Whether the UK was right to oppose CPS is a matter of opinion. What is difficult to understand is why the British preference for a stronger incentive to investment in the local loop was an obstacle to the achievement of the internal market and why the country had to be brought in line.

- National preferences may also relate to social policies. It is appropriate to let the Member States decide on the scope of the digital services of general economic interest they want to make affordable to their citizens.

Moreover, the achievement of the internal market should not be expected to lead to the harmonisation of prices.⁷ Indeed, national differences in population density, GDP per capita, industry history and structure, consumer preferences and the fact that most electronic communications services are not tradable between Member States (thereby impeding any possibility of arbitrage) will inevitably result in differences in prices. To be sure, the prices of electronic communications services are geographically averaged across the national territory in most Member States although there are regional cost differences between, say, urban and countryside areas. However, this similarity in price is due to a political decision to impose geographic tariff averaging for social and territorial cohesion reasons among each Member State. The level of solidarity at EU level can not justify a similar EU averaging.

2.2. The justification of an intervention at the EU level

The second issue is to determine when an intervention at the EU level is justified to achieve the internal market.

2.2.1. The legal criteria

In EU law, an intervention at the European level is justified when it passes two successive tests, the legal basis test (in particular the legal basis related to the internal market) and the subsidiarity test.⁸ The legal basis test determines whether the EU has a competence to act, whereas the subsidiarity test determines whether the existing competence may be exercised, hence the former should be run before the latter.

The internal market legal basis, Article 114(1) TFEU, provides that

The European Parliament and the Council shall (...) adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.

In the *International roaming Regulation* case,⁹ the Court of Justice interpreted this provision with a reasonably restrained economic interpretation:

32. According to consistent case-law the object of measures adopted on the basis of Article [114(1) TFEU] must genuinely be to improve the conditions for the establishment and functioning of the internal market (...). While a mere finding of disparities between national rules and the

⁷ In this sense also, see the Opinion of Advocate General Poaires Maduro in Case C-58/08, *The Queen (on the application of Vodafone and others) v. Secretary of State for Business, Enterprise and Regulatory Reform (International roaming regulation)*, ECR [2010] I-0000, para.32.

⁸ We do not deal here with the principle of proportionality of Article 5(4) TEU because it is not related to the existence or the possibility to exercise EU competence, but to the manner this competence should be exercised.

⁹ Case C-58/08, *International roaming regulation*

abstract risk of infringements of fundamental freedoms or distortion of competition is not sufficient to justify the choice of Article [114 TFEU] as a legal basis, the Community legislature may have recourse to it in particular where there are differences between national rules which are such as to obstruct the fundamental freedoms and thus have a direct effect on the functioning of the internal market (...) or to cause significant distortions of competition (...).

33. Recourse to that provision is also possible if the aim is to prevent the emergence of such obstacles to trade resulting from the divergent development of national laws. However, the emergence of such obstacles must be likely and the measure in question must be designed to prevent them (...).

The Court of Justice follows the same line of reasoning in the *ENISA* case, the other case where the limits of Article 114 TFEU were tested in the electronic communications sector, by judging that¹⁰ :

(...) that provision is used as a legal basis only where it is actually and objectively apparent from the legal act that its purpose is to improve the conditions for the establishment and functioning of the internal market.

If the legal basis test is met, then the subsidiarity test should be examined. Article 5(3) of the Treaty on the European Union (TEU) provides that:

the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.

On that basis, two observations may be done:

- First, the relationship between the legal basis test and the subsidiarity test is complex because both tests have a different objects (determine whether there is an EU competence, and then whether this competence may be exercised), but same elements may be used to prove both tests. This was clear in the *International roaming regulation* case where the trans-national aspect of international roaming was used both in the legal basis and in the subsidiarity tests.
- Second, both legal tests give some flexibility to the EU institutions to determine their competences. To use this flexibility in the most efficient way, some economic criteria may be useful, on which we now turn.

2.2.2. The economic criteria

To determine the economic criteria justifying an efficient EU intervention, we rely upon the theory of fiscal federalism which aims to find the optimal level of governance and public intervention.¹¹ According to such theory, there are several benefits to centralisation (read EU intervention) which are of substantive and institutional nature.

The substantive benefits are:¹²

1. The internalization of the cross-country externalities; there is such externality when the regulation (or the absence of regulation) in country A has significant effect on the welfare of the consumers and/or firms in country B and that effect will not be taken into account by the regulator of country A. One example is the regulation of international roaming.

¹⁰ Case C-217/04, *United Kingdom v. European Commission and Council*, ECR [2006] I-3771, para.42.

¹¹ Alesina, A., Angeloni, I, Schuknecht L. (2005), Oates (1999) and (2005), Pelkmans (2005), Tabellini (2003). For an application in telecommunications, see Barros (2004), Cave and Crowther (1996), Haucap (2009a: 466-472), Nicolaidis (2006).

¹² We do deal with the issue of regulatory race to the bottom, rarely applicable in electronic communications as the electronic communications networks and services are not tradable across countries.

2. The cost saved by regulated operators with the elimination of regulatory duplication (one-stop-shopping or home-country control). An illustration of this would be a single EU authorisation procedure.
3. The economies of scale and transaction cost saved by NRAs in the design of regulation and the implementation of such regulation. An example might be a common approach to cost auditing.

The institutional benefits are:

1. The additional commitment value as a centralised authority may be more independent and less prone to capture by local operators.
2. The institutional support for small or weak local regulators which may lack empowerment, skills, independence or accountability.

Besides reasons of economic efficiency, centralization may also be justified for social motives. For instance, the averaging of telecom tariffs is justified for territorial cohesion.

However, centralisation also has some substantive or institutional costs.

The substantive costs are due to:

1. The heterogeneity of preferences for economic or for social policies; a case in point is the different scope of the services of general economic interest among Member States.
2. The heterogeneity of natural and historical endowments, such as speed and history of infrastructure deployment, spectrum allocation, market structures.
3. The removal of the possibility for regulatory competition, experimentation and innovation to detect and then possibly converge towards the most efficient form of regulation.¹³ Allowing such experimentation is particularly useful when there is uncertainty on the appropriate regulation. This is the case in sectors with technological evolution. For instance, the following concepts have been developed in one Member State and then copied in several others: carrier pre-selection, interconnection charges based on Long Run Incremental Cost (LRIC), local loop unbundling, wholesale line rental, third-party billing, interconnection capacity based charging (FRIACO), national roaming, or geographical market segmentation. This cost is sometimes regrettably forgotten in studies.¹⁴

Institutional costs arise because:

1. The institutional capabilities are often heterogeneous among Member States, which may imply the need for simpler regulation for micro States.¹⁵
2. The information asymmetry is usually higher at the central level than at the local level, for instance for cost information.
3. Accountability is, in some cases, lower at the central level than at local level.
4. Central procedures have a lower responsiveness and flexibility than local procedures.
5. Centralisation risks of creating an additional (central) layer of regulation without removing the local level of regulation, leading to more regulation and additional complexity.¹⁶

Thus, for each policy, or part of an overall policy, the benefits and the costs of centralisation should be balanced to determine the optimal level of regulation.¹⁷ Often that choice is not always clear cut and

¹³ ERG (2006, p. 11).

¹⁴ For instance European Evaluation Consortium (2007, p. 21-24) which does a cost-benefit analysis of the harmonisation of remedies without taking into account the benefit of regulatory experimentation.

¹⁵ Ovum and Indepen (2005: Section 6).

¹⁶ See Eurostrategies and Cullen International (1999).

may entail trade-offs among efficiency arguments or between efficiency and social arguments. Moreover, this choice is complicated by an endogeneity issue as the level of governance impacts on the costs and benefits of centralisation. Thus, centralisation may stimulate more central economic activities which, in turn, will justify more centralisation. Those dynamic and endogenous effects are particularly relevant in the European Union where some harmonisation measures were imposed for, and led to, more Europeanization of business or citizen relationships (think of the effects of the Erasmus student exchange programmes).

3. The practice of EU intervention in the regulation of electronic communications

After having dealt with the legal and economic criteria justifying EU intervention, we review now whether those criteria have been applied in practice by the EU institutions. In the first sub-section, we deal with cases where EU intervention would be over-intrusive, whereas in the second sub-section we deal with cases where EU intervention would be justified.

3.1. Some cases where EU intervention is not justified

3.1.1. The choice of remedies in the national market analysis

According to the Framework Directive, the Commission may review NRA market analysis that could affect trade between Member States.¹⁸ Those are

Measures that may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States in a manner which might create a barrier to the internal market. They comprise measures that have a significant impact on operators or users in other Member States, which include, inter alia: (i) measures which affect prices for users in other Member States;(ii) measures which affect the ability of an undertaking established in another Member State to provide an electronic communications service, and in particular measures which affect the ability to offer services on a transnational basis; (iii) and measures which affect market structure or access, leading to repercussions for undertakings in other Member States.¹⁹

During this review, the Commission may comment and possibly, in a second stage, veto the market definition and the market power assessment in the NRA draft measure which would create a barrier to the single market or not be compatible with EU law.²⁰ Moreover, where the Commission finds that divergences in the implementation by the NRAs of the regulatory tasks create a barrier to the internal market, the Commission may issue a recommendation or, regarding numbering and the SMP procedure, a decision on the harmonized application of the EU provisions in order to further the achievement of the main objectives of the EU regulation (effective competition, internal market, citizens' interests).²¹

In practice, the Commission adopts a very broad interpretation of the concept of "measures that could affect trade between Member States". It grants itself the competence to review all NRAs' draft

(Contd.) _____

¹⁷ Note that in general, stakeholders are less keen of centralization than the Commission Eurostrategies/Cullen International (1999), Hogan & Hartson and Analysys (2006, p. 91). Alesina, Angeloni and Etro (2001) discuss the possibility of a centralization bias in the Union.

¹⁸ Art. 7(3) of the amended Framework Directive 2002/21.

¹⁹ Recital 38 of the original Framework Directive 2002/21.

²⁰ Art. 7(4) and (5) of the amended Framework Directive 2002/21.

²¹ Art. 19(1) of the amended Framework Directive 2002/21.

market analyses²² without really investigating the effects on trade between Member States on a case by case basis.

Moreover during its review, the Commission in practice conducts a consistency check between the different approaches of the NRAs rather than investigating whether the differences between NRAs' measures are such as to obstruct the fundamental freedoms, and thus have a direct effect on the functioning of the internal market or to cause significant distortions of competition (to paraphrase the Court of Justice). In its last Report on the market review process,²³ the Commission notes that

Regulatory remedies still vary across Europe, even where the underlying market problems are very similar. This is a serious impediment to achieving a true single market.

However, the Commission does not articulate a precise rationale why a divergence in remedies or regulatory approaches on markets defined as being national would necessarily affect trade between member States and impede the single market.²⁴ According to us, the Commission view is too broad. It does not correspond to the legal reasonably restrained economic interpretation of the Court of Justice nor to the balancing test of the theory of fiscal federalism, especially as such broad interpretation does not allow regulatory experimentation.²⁵

Obviously, the situation is different in the case of transnational markets²⁶ where EU intervention is more easily justified. This is, for instance, the case for satellite communications which have a *de facto* pan-European footprint and the costs of serving one national zone or several ones are largely fixed. The 2008 Parliament and Council decision setting out a single selection procedure at EU level for Mobile satellite services (MSS) operators was a faltering step in the right direction. Following the EU selection procedure,²⁷ operators should apply, at national level, for the right to use specific radio frequencies and the right to operate mobile satellite systems. The rights of spectrum use and authorisations should be granted to operators by Member States' authorities for a period of eighteen years. In addition to frequency rights and authorisations, Member States should also grant to operators the authorisations to operate complementary ground components of mobile satellite systems on their territories. Trans-national market may also apply to the provision of services to 'high-end' business users (typically multinational companies) which would perhaps benefit from a stronger EU intervention, as argued by some.²⁸ However, it should be recalled that the majority of electronic communications markets remain national or regional, and that is not necessarily due to differences in national regulation but to product characteristics (local infrastructures).

²² See Commission Guidelines of 9 July 2002 on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, OJ [2002] C 165/6, para.147 stating that "*the notion of an effect on trade between Member States is likely to cover a broad range of measures*". So far, all NRAs draft decisions have been notified to the Commission for comments.

²³ Communication from the Commission of 1 June 2010 on market reviews under the EU Regulatory Framework (3rd Report), COM(2010) 271, p. 4.

²⁴ See also the Opinion of Advocate General Poaires Maduro in Case C-58/08, *Roaming Regulation*, para.18.

²⁵ In this sense also, Larouche and de Visser (2006) stating that, "*the Commission should intervene only when the draft measure proposed by an NRA is such that it will hamper the internal market (on the basis of concrete evidence) or that it will significantly conflict with Community law. A mere divergence of opinion between the Commission and the NRA (or between NRAs) is not sufficient to justify a Commission veto*".

²⁶ Article 2(b) of the amended Framework Directive defines that 'transnational markets' as covering the Community or a substantial part thereof located in more than one Member State. For an assessment of the cost and benefits of an EU intervention on trans-national services, see European Evaluation Consortium (2007, p. 25-27 and 31-33).

²⁷ Decision 626/2008 of the European Parliament and of the Council of 30 June 2008 on the selection and authorisation of systems providing mobile satellite services (MSS), OJ [2008] L 172/19, and Commission Decision 2009/449 of 13 May 2009 on the selection of operators of pan-European systems providing mobile satellite services (MSS), OJ [2009] L149/65. The two operators selected are Solaris and Europasat. Solaris Mobile is experiencing some technical problems which limit the bit rate on the uplink. Europasat satellite is still being built.

²⁸ On that issue, see BEREC Report of February 2011 on relevant market definition for business services, BoR (10)Rev1.

3.1.2. A first specific application on regulatory remedies: the regulation of the Mobile Termination Rate

The relationship between the mobile industry and the internal market started as a happy story. In 1987, the Council adopted a Directive reserving 50 MHz of spectrum in the 900 MHz band for pan-European mobile network, which became known as the GSM standard, along with a recommendation.²⁹ This common frequency band, allied with a common technical standard, ended the fragmentation of the European mobile market³⁰ and generated large economies of scale that, in turn, led to a rapid fall in the prices of network equipment and handsets. In the US, operators were free to select a technical standard of their choice and this led to a fragmentation of the market, seen by many as the reason why the US market was slower to take off.

Throughout the 90s, the mobile industry was the technological pride of Europe. The industry was virtually unregulated. The 1996 Mobile Directive³¹ was adopted by the European Commission to liberalise mobile telephony. The Commission was right to impose competition in the sector but the effect of the Directive was limited since the vast majority of Member States had already licensed two, three or even four operators. Competition in the mobile sector has led to the development of several mobile groups active in several markets (Vodafone, Orange, O2, T-Mobile...).

The 2000 3G Auctions

The year 2000 was a turning point for the mobile industry. While the dot-com bubble burst in March 2000, the 3G auction in the UK brought £22.5bn to the Treasury in April and the proceeds of the German auctions in August 2000 reached €50bn. The European Commission tried to influence the design of the subsequent auctions for fear that large amounts would continue to be siphoned off from the telecom sector. However, the Commission faced the national interests of finance ministers and no EU policy ever emerged on auction design beyond basic principles such as non discrimination and transparency.³²

Mobile Termination Rates (MTRs): 1987-2003

By August 2000, mobile penetration had reached 55% of the EU-15 population.³³ Mobile phones had become part of everyday life and the taboo surrounding a possible regulation of mobile communications fell apart. Actually, the 1997 Interconnection Directive included provisions on MTRs.³⁴ Under this regime, mobile termination rates had to be cost-oriented if the mobile operator was designated as having Significant Market Power (defined at that time as a rebuttable presumption of 25% market share or more in value) on the national market for interconnection. The latter included the termination traffic of both fixed and mobile operators. In 1998, only fixed incumbent operators were designated as having SMP. However by 2000, the combined effect of growing mobile traffic and high mobile termination rates (15-20 eurocents higher than fixed termination rates) meant that the

²⁹ Council Directive 87/372 of 25 June 1987 on the frequency bands to be reserved for the coordinated introduction of public pan-European cellular digital land-based mobile communications in the Community, OJ [1987] L 196/85, and Council Recommendation 87/371 of 25 June 1987 on the coordinated introduction of public pan-European cellular digital land-based mobile communications in the Community, OJ [1987] L 196/81.

³⁰ Until the early 90s, several standards of analogue mobile telephony co-existed NMT in the Nordics and Benelux, C-450 in Germany and Portugal, TACS in the UK, RC 2000 in France, RTMI in Italy...

³¹ Commission Directive 96/2 of 16 January 1996 amending Directive 90/388 with regard to mobile and personal communications, OJ [1996], L 66/36.

³² Art. 9(1) of the amended Framework Directive 2002/21.

³³ Communication from the Commission of 7 December 2000, Sixth Report on the Implementation of the Telecommunications Regulatory Package, COM(2000) 814.

³⁴ Art. 7(2) of Directive 97/33.

fixed incumbent operator was no longer the only SMP operator on that market. By the middle of 2003, all EU-15 Member States but four³⁵ had intervened by reducing MTRs, either by designating one or several mobile operators as having SMP, or by making a determination in an interconnection dispute or by referring the matter to the Competition Authority (UK).

MTRs: 2003-now

The 2003 Commission recommendation on relevant markets³⁶ brought a narrower definition of the relevant market for mobile termination: Voice call termination on individual mobile networks (market 16). The logical implication of such a definition is that all mobile operators have 100% market share on the market for voice termination on their own network. Consequently, they are designated as having SMP and have cost-orientation imposed on them.

In the course of 2004 and 2005, NRAs carried out the analysis of market 16 and imposed glide paths. By selecting specific cost bases and cost accounting standards (contribution to common costs, contribution to marketing expenses...), NRAs opted for a relatively soft landing of MTRs rather than for an abrupt application of a strict definition of current costs. As a rule of thumb, MTRs dropped by one to two eurocents a year.

The argument is often heard that MTRs vary from country to country by several hundred percent and that this is evidence of widely diverging national policies.³⁷ While this observation is arithmetically correct, all Member States have followed the same policies of imposing glide paths for MTRs. In 2000, MTRs spread between 15 and 25 eurocents; as of July 2010, the weighted average was 5.65 eurocents and existing glide paths suggest most countries will be below 3 eurocents by 2014. So it is very much the same policy that is applied over the European Union, with only the speed of the adjustment varying from country to country.

Symmetry of MTRs

A number of NRAs have and are still setting higher MTRs in favour of late entrants on the markets. The Commission has for a long time opposed asymmetric MTRs, describing it as entry assistance interfering unduly with market forces.

Yet in a number of markets, such as France and the UK, in spite of the asymmetry in MTRs, late entrants on the markets have been net out payers of MTRs to early entrants. This is due to the existence of On-Net retail prices. Consumers prefer larger operators so that a higher proportion of their calls is covered by On Net retail prices. This so-called 'club effect' is magnified by the gap between costs and the MTRs. This creates an artificial handicap for the smaller operators and creates a vicious circle: the smaller their market share, the less attractive their offerings. This forces late entrants to offer All-Net prices to increase the attractiveness of their offerings. This means that a late entrant's clients are ambivalent between On Net and Off Net calling, while an early entrant's clients tend to avoid Off Net calls. This results in a traffic imbalance and a net out payment from the late to the early entrants.

The Commission is unconvinced and argues that the market share of a given mobile operator is a variable under its control. To consolidate its position, the Commission has adopted a recommendation on the regulation of fixed and mobile termination,³⁸ against the majority of the Member States voting

³⁵ Denmark, Germany, Luxembourg and Ireland.

³⁶ Commission Recommendation 2003/311 of 11 February 2003 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation, OJ [2003] L 114/45.

³⁷ See, among others, Pelkmans and Renda (2011).

³⁸ Commission Recommendation 2009/396 of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, OJ [2009] L 124/67.

at the Communications Committee.³⁹ The Commission states that, to determine the minimum efficient scale for the purposes of the cost model, and taking account of market share developments in a number of EU Member States, the recommended approach is to set that scale at 20 % market share. Furthermore, even the Commission acknowledges that asymmetry can be justified for a period of up to four years after market entry.

Other parties point out that there are very few, if any, examples of a number 3 or 4 entrant in an EU market ever gaining the second largest market share in revenues. Therefore, a longer transition period is needed in the interest of long term competition.

The Commission justified its intervention to ensure legal certainty and the right incentives for potential investors.⁴⁰ However, the discussion above shows that there are two respectable schools of thought,⁴¹ with valid arguments on both sides, hence regulatory experimentation by Member States is justified. Moreover, there are no counterbalancing arguments justifying EU regulation as it is hard to see why a difference of say 25% in the MTRs of two mobile operators in the same country aimed at balancing interconnecting payments could have a material effect on the internal market. Similarly, Haucap (2009b:30) states that:

It is simply unrealistic to assume that the regulation of MTRs would be used as a tool of strategic regulatory policy by NRAs. Hence, cross-border externalities provide no economic justification for harmonising MTR regulation at a European level.

Thus, we submit that that Recommendation was not justified because its benefits are very small (in terms of cross-country externalities, or economies of scale/savings of transaction costs), but its costs may be high (complicated system, no possibility of regulatory experimentation by Member States).⁴²

3.1.3. A second specific application of regulatory remedies: Next-Generation Access Networks and the migration between copper and fibre - pricing

The current debate on the relative prices of copper and fibre loops provides another good illustration of a field where several schools of thoughts exist and where there can be room for national preferences and experimentation. There will be a form of platform competition between current generation access (CGA) and fibre-based next generation access (NGA). Regulated wholesale prices will be one important factor influencing the pace of the migration from CGA to NGA.

At this stage, the European Commission and many national regulators are unclear as to whether lower CGA prices (resulting from a different regime of cost accounting) would speed up fibre roll-out as argued by alternative operators (ECTA)⁴³ or whether, on the contrary, stable or even higher copper prices (resulting from fewer customers sharing the fixed costs of CGA) would drive customers to NGA, as argued by ETNO.⁴⁴

The implementation of cost orientation implies decisions at four different levels. Furthermore, at each level, several options exist:

- cost source, e.g. top down (based on the actual accounting of the operator) or bottom up (engineering model);

³⁹ 12 against, 10 abstentions, and 5 in favour: Result of the vote at the Communications Committee of 18 February 2009.

⁴⁰ Recital 4 of the Recommendation 2009/396 on the Regulatory Treatment of Termination Rates.

⁴¹ For a summary of the debate in the economic literature on the regulation of MTR, see Haucap (2009b:31).

⁴² IRG/ERG Response of September 2008 to Public Consultation on Termination Rates, ERG(08) 31 rev1 stating that: “*the development of the internal market (...) is best achieved by ensuring that national decisions are taken on the basis of shared principles, rather than requiring uniformity in the fine detail of the regulatory approach*”.

⁴³ See Hoernig et al. (2011).

⁴⁴ See Williamson, Black and Wilby (2011).

- cost base, e.g. Fully Distributed Costs (FDC), Stand Alone Costs (SACs) Long Run Incremental Costing (LRIC);
- depreciation method, e.g. historical costs (HCA), current costs (CCA); and
- price control type, e.g. cost orientation, retail minus.

For CGA, in its 2009 recommendation on termination rates, the Commission has advocated a precise combination of bottom up, LRIC, current costs with a price control based on cost orientation.⁴⁵ In its 2010 recommendation on NGA, the Commission wisely refrains from being too specific and simply refers to cost orientation.⁴⁶ This should not be seen as a sign of weakness or a lack of political clout. In the absence of a reasonable consensus, the Commission should leave each NRA free to pursue the policy which, they believe, will foster investment in NGA in their own country. In view of the relative uncertainty of the optimal combination of cost accounting concepts, it is hoped that the Commission will not issue similar strict guidance on fibre.

3.2. Cases where EU intervention is justified

3.2.1. The regulation of market entry and the principle of home-country control

Home-country control procedures are an extension of the *Cassis de Dijon* doctrine⁴⁷ to services. Throughout the 90s and 00s, the extension of the doctrine to services was seen in many sectors ranging from audiovisual to electronic commerce services.⁴⁸ In the field of electronic communications services, Member States have strongly opposed this approach. In 1992, when the Commission tabled a proposal for a Mutual Recognition of Licences whereby a telecommunications operator duly authorised in its home country would be authorised to provide services in other Member States, the initiative was strongly opposed by Member States.

In 1994, the Commission issued a second unsuccessful proposal. The idea was then to harmonize national licensing conditions; since licensing conditions would be the same in every Member State, operators would be able to operate across borders without obstacles. After an unsuccessful attempt by the European Telecommunications Office – a CEPT body based in Copenhagen – to harmonise licences, the idea was abandoned.

In November 1995, the Commission tabled a third proposal which led to the adoption of Directive 97/13.⁴⁹ The approach was to try to limit the range of conditions that Member States could impose on operators to what is strictly needed to ensure consumer protection, network integrity, security of staff, prevention of anti-competitive behaviours, measures for disabled people.... That same approach still prevails in the current Authorisation Directive.⁵⁰

In practice, the cost for industry of having that third option is probably not much higher than having a regime of mutual recognition or a fully harmonised regime. This is because the procedure for

⁴⁵ Commission Recommendation 2009/396 on the Regulatory Treatment of Termination Rates.

⁴⁶ Commission Recommendation 2010/572 of 20 September 2010 on regulated access to Next Generation Access Networks (NGA), OJ [2010] L 251/3. On the additional national flexibility given by each iteration of the Recommendation, see Cave and Shortall (2010).

⁴⁷ Named after the Case 120/78 Rewe Zentral c. Bundesmonopolverwaltung für Branntwein, ECR [1979] 649.

⁴⁸ Directive 2000/31 of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market, OJ [2000] L 178/1, Art. 3.

⁴⁹ Directive 97/13 of the European Parliament and of Council of 10 April 1997 on a common framework for general authorisations and individual licences in the field of telecommunications services, OJ [1997] L 117/15

⁵⁰ Directive 2002/20 of the European Parliament and of the Council of 7 March 2002 on the authorisation of electronic communications networks and services OJ [2002] L 108/21, as amended by Directive 2009/140.

obtaining an authorisation has become much lighter than in the early 00s. Furthermore, compliance costs would be relatively equal under the three regimes since it is anyway the responsibility of each national regulator to undertake the surveillance of its own market.

3.2.2. International roaming

In December 2000, the European Commission's Competition Directorate-General adopted a working document on the initial findings of its Sector Inquiry into mobile roaming charges.⁵¹ The Commission's view was that the international roaming market was not competitive as Inter-Operator Tariffs (IOTs) were set by the operators and are not subject to competition. IOTs had risen and have become much more closely aligned. The Commission's view was that this was not coincidental, but the result of collusion. Seven months later in July 2001, the same DG conducted dawn raids on nine mobile operators in Germany, the UK and the Netherlands. This did not lead to any Commission decision.

The 2003 Commission recommendation on relevant markets identified a wholesale national market for international roaming on public mobile networks (market 17).⁵² Finland in 2005, followed by Austria, Denmark, Italy, Spain and Slovenia in 2006, all notified analyses pointing to an absence of any Significant Market Power position, whether single or joint. The Commission did not veto any decisions. However, in June 2006, in the comments on AGCOM's, the Italian regulator, notification, the Commission noted that⁵³

(...) it has not so far been possible, for a national regulator alone, also because of the cross-border nature of international roaming services, to act effectively to address the high level of wholesale international roaming charges. The Commission is therefore considering the adoption of EU measures to address the high international roaming prices.

Beyond individual initiatives such as *Vodafone Passport*, it is regrettable that in the years 2005-2006, the industry failed to propose a market-based solution to meet the concerns of consumers and politicians about high retail roaming prices.

In June 2007, a regulation setting ceiling prices at both retail and wholesale level was adopted by the European Parliament and the Council.⁵⁴ The validity of such a regulation, and the validity of intervention at the EU level, was confirmed by the Court of Justice in June 2010. The Court⁵⁵ judged that the international roaming regulation was justified because:

As regards the functioning of the roaming market (...) and taking into consideration the considerable interdependence of retail and wholesale charges for roaming services, it is clear that a divergent development of national laws seeking to lower retail charges only, without affecting the level of costs for the wholesale provision of Community-wide roaming services, would have been liable to cause significant distortions of competition and to disrupt the orderly functioning of the Community-wide roaming market (...)

EU intervention is also justified on the basis of the economic criteria of the fiscal federalism as the regulation of international roaming is a typical case of direct externalities between countries. If Member State A caps prices for international roaming in its own territory, the beneficiaries are foreign

⁵¹ Working Document of DG Competition of 13 December 2000 on the Initial Findings of the Sector Inquiry into Mobile Roaming Charges.

⁵² Commission Recommendation 2003/11 on relevant markets susceptible to ex-ante regulation.

⁵³ Commission Decision of 7 June 2006, Case IT/2006/0393.

⁵⁴ Regulation 717/2007 of the European Parliament and of the Council of 27 June 2007 on roaming on public mobile telephone networks within the Community and amending Directive 2002/21/EC, OJ [2007] L 171/32, as amended by Regulation 544/2009

⁵⁵ Case C-58/08, *International roaming regulation*, para.47.

consumers, while domestic mobile operators suffer as do domestic consumers since – in response to a decrease in roaming revenues – other mobile telecommunications prices may increase or handset subsidies decrease due to the waterbed effect.⁵⁶

Thus, we concur with the Court of Justice⁵⁷ and note that paradoxically, one of the few cases where the competence of the EU to intervene in electronic communications regulation was contested before the Court was a case where, at least according to the principles of fiscal federalism, the optimal level of regulation was without doubt the EU level. We also observe that, while acknowledging the ‘dirigiste’ approach of the roaming regulation and its departures from the market-based approach promoted by the EU for other electronic communications services, it is fair to recognise that competition in this sector has so far failed.

3.2.3. Spectrum

Another example of a positive EU intervention is the recently proposed decision on the Radio Spectrum Policy Program.⁵⁸ One of the RSPP’s most important objectives is to complete the analogue terrestrial television switch-off by January 2012.

In May 2010, the Commission adopted a Decision⁵⁹ setting harmonised technical conditions for the use of the 800 MHz band for non-broadcasting services, in particular for mobile broadband services using 4G technologies such as LTE.⁶⁰ The decision does not require Member States to open the 800 MHz band for non-broadcasting services but if/when a Member State does decide to, it must follow the technical conditions set by the Decision.

The RSPP, however, would mandate the implementation of the decision to clear the 800 MHz band by January 2013. One of its main goals is to make spectrum available for wireless broadband services. This would support the ambitious goals set by the Digital Agenda for Europe whereby all Europeans have access to basic broadband by 2013 and at speeds of 30 Mbps or above by 2020. Also by 2020, half of all European households should be subscribers to broadband connections of 100 Mbps.

Here we welcome the Commission’s policy because it clearly aims at achieving economies of scale for network equipment and handsets, at minimising the problems of spectrum interference across borders and therefore at lowering costs that will benefit consumers.

4. Conclusion

To conclude, we think that the digital internal market should be fostered as it may benefit the EU economy and its citizens. However, we call for a solid and open debate on the definition of the digital single market and the appropriate policies at the national and EU level. Today, there are divergent views but no real debate on the conditions required to achieve the internal market.

⁵⁶ Haucap (2009a, p. 471). Such cross-countries externalities have been explicitly recognised by the the Opinion of Advocate General Poiras Maduro in Case 58/08 *International roaming regulation*, para. 27. The Advocate-General insists several time of the cross-border nature of roaming for the regulation to pass the legal basis and the subsidiarity test.

⁵⁷ For the opposite view, see Brenncke (2008).

⁵⁸ Commission proposal of 20 September 2010 for a decision establishing the first radio spectrum policy programme COM (2010) 471.

⁵⁹ Commission Decision 2010/267 of 6 May 2010 on harmonised technical conditions of use in the 790-862 MHz frequency band for terrestrial systems capable of providing electronic communications services in the European Union, OJ [2010] L 117/95.

⁶⁰ The 800 MHz (790-862 MHz) band is the upper part of the spectrum that will be freed up with the switchover from analogue to digital terrestrial television broadcasting – the digital dividend.

Then, Europe needs to define more precisely when EU intervention is justified and when it is not. It needs to define more clearly which national policies constitute an unacceptable fragmentation of the internal market and what is merely the expression of national preferences without any material impact on European welfare. It should do that on the basis of the legal criteria (the legal basis test –Article 114 TFEU- and the subsidiarity test), but also, and more importantly given the relative flexibility of the law, on the basis of the economic criteria provided by the theory of fiscal federalism.

We submit that fostering the digital internal market does not mean that the EU should intervene in all parts of the regulation of the digital society. Any EU intervention should focus on the areas where its benefits are the highest, in particular given the possibilities of economies of scale provided by the technology or cross-country externalities, and where its costs are the lowest, in particular given the heterogeneity of national preferences or the need to allow for regulatory experimentation and competition.

On that basis, we submit that EU intervention is more relevant for the content part of digital regulation (such as copyright, privacy, electronic commerce, dispute resolution) than for the infrastructure part (i.e. the electronic communications networks and services), as the former is based on tradable goods whereas the latter is mainly based on local non-tradable goods.

At the infrastructure level, we submit that EU intervention should be concentrated on pan-European services (e.g. satellite communications) and international mobile roaming, spectrum, security and standardisation. Conversely, we think that EU intervention is not justified for national market analysis, especially for the choice of remedies when there is little impact on the single market and where there is uncertainty on the most appropriate regulatory approach. In particular, we submit that the Commission should use its new power on the choice of regulatory remedies with great care, showing each time why the choice of a particular remedy would affect trade between Member States and the single market. Such care is particularly relevant regarding the regulation of Next Generation Networks where uncertainty remains on the appropriate regulatory approach to stimulate investment, hence regulatory experimentation and competition would be useful.

The development of electronic communications regulation in Europe has been fuelled so far by healthy competition between the Commission and national regulators. Over the years, depending on the issues, the EU or specific Member States have been in the driving seat in terms of generating new regulatory ideas. The battleground has been the legislative process, with the Council and the European Parliament striking the balance. But the battle has also been intellectual, with winning ideas trialled by the most innovative regulators being subsequently implemented in other countries.

In addition, the EU should provide support for small regulators which so request.⁶¹ The regulatory framework is complex and regulators in small countries do not necessarily have the resources to meet their duty. That problem will become even more acute with the next wave of accession countries (Balkans).

⁶¹ This is in line with Article 16(7) of the amended Framework Directive 2002/21, and Article 3(1c) of the Regulation 1211/2009 of the European Parliament and of the Council of 25 November 2009 establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office, OJ [2009] L 337/1. More generally see the new Art. 197 TFUE on administrative cooperation.

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