Policy priorities for the digital economy

It is already clear that this century will be dominated by economies of scale – the US, China, India etc. A re-invigorated internal market is therefore essential if Europe is to avoid marginalisation – economic fragmentation to member state level economies will deprive Europe of the opportunity to be among the leaders of the 21st century economy. The internal market has a major role to play in achieving a competitive, sustainable and cohesive society for European citizens. An advanced digital infrastructure is a necessary enabler for such an internal market.

Europe can be proud of what it has achieved in telecommunications over the past two decades. The European mobile standard – GSM – has achieved de facto global adoption. Network competition has made the European mobile industry a global leader, in handset and network equipment manufacture, and operations. Europe today is one of the most connected regions of the world. Three things have enabled this to happen: the adoption of a common standard across a sufficiently large market to allow scale advantages; a series of liberalising measures in the 1980s and 1990s; and major investment which has driven innovation through competition and allowed a respectable return for investors.

*Telecoms can and should underpin a competitive, sustainable and cohesive economy*

For the next phase of Europe’s economic development, it is necessary to build on the success of the past two decades in telecoms. A major upgrade and investment in communications infrastructure is necessary over the next decade. Without such investment, it will be impossible to achieve the ambition of universal access to high speed broadband connections for Europe’s households and small businesses.

Universal access to digital services will make Europe more competitive by helping Europe’s SMEs to grow with a lower cost-base, creating knowledge-based jobs in manufacturing and services. The digital infrastructure will also make Europe more sustainable through smart systems (grids, logistics, cities etc) which reduce carbon emissions while improving lifestyles: we can already see how certain mobile technologies could save €43bn a year in energy costs by 2020, as well as reducing CO2 emissions by 110m tonnes a year – equivalent to the annual carbon emissions of Belgium: we expect to identify further savings as our experience of smart systems develops. The combination of universal broadband and smart systems will make European society more cohesive by enabling the key public services necessary for ageing communities (health, transport, energy etc) to be more responsive and efficient.
Telecoms needs a vision, and Europe needs a digital strategy

The investments in telecoms infrastructure need to be made at a time when access to capital will be more constrained than at any time in the past two decades. Because telecoms services are increasingly converging, less dependent on a particular network technology to carry them, investment in fixed and mobile telecoms infrastructure needs to be seen as part of a whole. Granting access to radio spectrum is a major strategic policy direction for the coming decade, and must be consistent across the EU, promoting liberal, competitive investment. The telecoms industry’s capacity to invest needs to be coherent and competitive between different types of network technology, and between service providers and those who build and operate the infrastructure across which the services are provided. This convergence of technical platforms will bring important advantages for people and businesses, with services available through fixed and mobile connections, irrespective of location.

Competition will drive innovation and investment, but is lacking in the fixed-line sector

While mobile has seen the greatest investment and innovation, there have been important advances in fixed-line communications as well. But despite the efforts of regulators, in most European countries competition in the fixed telecoms market has failed to establish itself. The former state owned incumbents continue to dominate most national markets, capture almost all the available cash flows in fixed-line communications, and continue effectively to control the investment cycle. Indeed, measured across total telecoms (fixed, cable and mobile) in most markets the incumbent retains between 60% and 80% of the total cash flows, with most of the rest going to the other mobile operators. In a number of national markets, the incumbent captures between 90% and 100% of fixed line cash flows.

The current structure of the telecoms sector means that Europe is not well placed to make the necessary investments:

- in mobile communications, the industry is fragmented, and many operators lack the scale necessary to sustain major investment programmes. Europe has around 40 mobile operator groups operating with over 90 licenses, compared with 3 in China, and 4 in each of Japan and the US. For Europe to benefit from mobile operators with the scale and funding capacity to build the next generation of mobile infrastructure, significant market consolidation, both in national markets and across borders, is necessary.

- the fixed-line sector is too concentrated, and remains dominated by fixed incumbents who capture almost all the cashflows. Existing regulatory models have not created sustainable competitors. A properly competitive economic structure will only be achieved by a significant transfer of strategic control over

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1 internet protocol – IP – will provide that basis for most digital services in future
2 the UK and Ireland are significant exceptions
the core access infrastructure away from the incumbent operators to non-incumbent entities. This could be achieved through various models of shared or co-investment which would provide equal cost access and thus sustain competition in the broadband market. With a more balanced industry structure, and a more sustainable distribution of cashflows and funding capacity, competition would stimulate investment and innovation.

The increasing convergence of fixed and mobile infrastructures\(^3\) and services means that these changes are effectively inter-dependent. Europe can no longer afford a 'two speed' competitive model, in which an over-fragmented mobile sector co-exists with an over-concentrated fixed sector.

**Value should move freely along the internet value chain, to the benefit of consumers**

Finally, even if these structural changes to the fixed-line and mobile sectors succeed in establishing a soundly competitive industrial structure within the European telecom sector, this will not provide the basis for the major investments necessary over the coming decade if there is a loss of funding capacity to other parts of the industry value chain, or to other regions.

This would arise, for example, if 'net neutrality' regulation were applied to infrastructure owners in such a way as to deprive them of the value creation opportunities on which new infrastructure investments and services must be based – there should be no artificial barriers to the flow of value along the internet value chain. Equally, if the market for applications ("apps") on smartphones develops in a fragmented way without adequate interoperability, there could be an effective barrier to choice as customers are "locked in" to a particular make or operating system by the apps they already possess.

The existence of such barriers would be as destructive of investment stimulus if they were to arise in internet search, the apps market, or service provision, as in fixed-line telecoms. The current debate on net neutrality in the US is of critical strategic importance to Europe for this reason.

**Conclusion**

The next phase of development of the internal market relies on a major investment in new digital infrastructure. The potential benefit to the European economy and society is huge. But this benefit requires some key strategic policy choices, underpinned by a determined shift in regulation, to break open monopoly elements of the value chain, to break down barriers within the value chain, and to provide the basis for investment stimulated by competition, driving innovation into the European internal market.

\(^3\) one over simplified vision of the future is that access and backhaul networks will be fibre, and "last mile/last metre" connections to the customer will be wireless (whether cordless handsets and wifi in the home, or mobile connections to a base-station)