Right Direction, Wrong Territory

WHY THE EU’S DIGITAL SINGLE MARKET RAISES WRONG EXPECTATIONS

MATTHIAS BAUER
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Executive Summary

In the United States, tech startups have immediate access to hundreds of millions of potential customers—not so in Europe, where regulation of digital and nondigital industries differs substantially across individual countries.

The most prominent attempt to harmonize national laws that regulate digital businesses and markets for digital products and services across Europe is the Digital Single Market (DSM), an initiative of the current European Commission. While not misguided in spirit, the DSM is unlikely to solve the systemic problems with the European Single Market unless it is combined with reforms that address regulatory heterogeneity in the EU’s nondigital goods and services sectors. Advertising the DSM as the EU’s flagship initiative creates the risk that EU citizens and political leaders will lose sight of the fragmentary nature of the EU’s nondigital markets.

To become a tech powerhouse, the EU has a long way to go in deepening the European Single Market, especially across conventional, nondigital sectors. European institutions must make the case to European citizens and policymakers for regulatory cooperation and setting evidence-based standards, including regulatory cooperation arrangements under the umbrellas of the Transatlantic Trade and Investment Partnership Agreement and other EU trade agreements.
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Policymakers in Europe tend to be confused about policies that would allow European economies to grow at pre-crisis rates. Some call for an end of fiscal austerity. Others call for deregulation. A small number advocate deeper economic integration under the auspices of the EU’s Single Market. Since the current European Commission led by Jean-Claude Juncker took office in November 2014, it has made creation of a genuine Digital Single Market (DSM) in the EU a priority. The Commission and the European Parliament identified digital technologies and digital business models as crucial to Europe’s internal and international competitiveness. Accordingly, the EU’s DSM strategy, adopted in May 2015, sets out 16 initiatives to address three overarching objectives:

• To create better access for consumers and businesses to digital goods and services across Europe,

• To put in place the right conditions and a level playing field for digital networks and innovative services to flourish, and

• To maximize the growth potential of the digital economy.

To strengthen Europe’s digital economy, EU lawmakers currently focus almost exclusively on barriers explicitly enumerated by the DSM strategy, including policies to stimulate investment in high-speed internet infrastructure, measures against “unjustified” cross-border geo-blocking, and policies to harmonize national data privacy and consumer protection legislation.

Each of these legislative initiatives should be judged on its own merits. Although the EU is generally moving in the right direction in seeking a greater harmony of national laws that regulate digital businesses, its policy priorities are on the wrong territory. The remedies proposed by EU’s Digital Agenda will not cure the EU’s structural Single Market disease.

This is because the EU’s most pressing structural impediment to digital businesses developing and scaling up is the regulatory heterogeneity in nondigital industries. Due to fragmented regulatory frameworks for many goods and most services sectors, it will remain difficult for any digital business to contest traditional industries by digitalizing old-economy business models and to grow by expanding across national EU borders.

The EU’s exclusive focus on digital barriers has created another problem. The promotion of politically easy-to-sell digital policies distracts public attention away from the fragmentary nature of the EU’s Single Market. It also creates the risk that European citizens and, thus, political leaders will lose sight of the merits of harmonized, nondiscriminatory rules that foster competition, contestable markets, and economic development across and beyond the EU.

The backlash against the Transatlantic Trade and Investment Partnership (TTIP) agreement between the EU and the United States, which is meant to include a modern and comprehensive chapter on
good (evidence-based) practices of regulatory cooperation, can be attributed to EU institutions’ and most member state governments’ failure (or lack of willingness) to convincingly communicate the consequences of legal fragmentation and discriminatory national laws existing in the EU. Far too often, the EU’s free trade agreements as well as the EU Single Market integration were sold exclusively on the back of simplistic narratives about economic growth and job creation, which ignored the underlying mechanisms at work.

The DSM in the Context of the EU’s Internal Market Policies

To strengthen Europe’s digital economy, EU lawmakers—guided by the insight that digital technologies “know no borders”—focus almost exclusively on the barriers enumerated in the DSM strategy. The adoption and diffusion of digital technologies within traditional European goods and services sectors could become the main drivers of new business models, product innovation, and employment. But here lies the problem: the traditional, nondigital markets still “know” national borders.

The European Commission and the European Parliament identified digital technologies and digital business models as the key components of Europe’s internal and international competitiveness. Following the Lisbon Strategy’s objective to turn the EU into the “most dynamic and competitive knowledge-based economy in the world by 2010,” the Digital Agenda for Europe was conceived as one of the seven top initiatives of the Europe 2020 strategy. Released in 2010, the Europe 2020 strategy set out the importance of information and communication technologies (ICT) for the achievement of a DSM. Accordingly, the Commission highlighted the need for a reliable European legal framework to stimulate investments in a competitive high-speed internet infrastructure and in related services. In addition, the Commission stated the aim to create a true Single Market for online content and services governed by clear European rights regimes.1 Shaped by the objectives of the Europe 2020 strategy, the DSM strategy adopted in May 2015 sets out 16 initiatives that aim to address the three overarching objectives2 summarized in Table 1.

Achievements in DSM Legislation as of November 2016

The recently issued Commission’s working plan for 2017 reiterates its focus on the DSM:

Releasing the full additional growth potential of connected Digital Single Market by completing the implementation of the Strategy will remain high on the agenda in 2017. As announced in last year’s Work Programme, we will deliver the remaining proposals in the next few months, such as the Value-Added Tax (VAT) REFIT [Regulatory Fitness and Performance] package covering proposals on e-commerce, e-publications and e-books and initiatives on advancing the data economy including addressing unjustified barriers to the free flow of data within Europe.3

The program listed the connected Digital Single Market as the fourth of the new initiatives undertaken by the Commission. The Commission’s working program further states:

Connectivity is key, and the Commission will deliver on its promise to bring about the abolition of mobile roaming charges by mid-2017. We will review the progress made towards completing the Digital Single Market and will identify where further efforts are needed by the co-legislators and any necessary further proposals.4

For the time being, however, most digital agenda policies are at the proposal stage or pending legislative approval by the European Parliament and the Council of European Union and further implementation by the member states. In 2016, European Commission made 14 legislative proposals (see Table 2 and Appendix A).5

These initiatives have their own merits and will also create their own distortions. While a full
To an American reader used to the idea of largely unfettered interstate commerce within the United States, the Single Market narrative may give the impression of streamlined national regulations in Europe. In reality, the EU’s regulatory landscape is still characterized by various degrees of harmonization and mutual recognition in the goods and services sectors. It is a patchwork of legislative and regulatory models. The current “nondesign” of Europe’s market policies reflects the fact that from the very beginning the Single Market was built on a vague political vision rather than a smart political agenda. This causes a great deal of confusion and uncertainty about what entrepreneurs (and consumers) legally can or cannot do across borders, and what permits are required to engage in the markets in other EU countries. This fragmentation and regulatory heterogeneity will not go away even if the DSM strategy delivers on its promises.

Table 1. The EU’s 2015 DSM Strategy

<table>
<thead>
<tr>
<th>Pillar</th>
<th>Policy Initiative</th>
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| **Objective 1.** Better access for consumers and businesses to digital goods and services across Europe | • Rules to make cross-border e-commerce easier, including consumer protection rights  
• Better enforcement of consumer rights  
• More efficient cross-border parcel delivery  
• An end to discriminatory practices in geo-blocking  
• A renewed approach to apply antitrust law in the e-commerce sector  
• A reform of European copyright legislation  
• An increase in access of broadcasting services across Europe  
• A reduction of the administrative burden of complex value-added tax (VAT) procedures in cross-border sales |
| **Objective 2.** Creating the right conditions and a level playing field for digital networks and innovative services to flourish | • An ambitious modernization of EU telecoms legislation  
• A review of the audiovisual media framework  
• An inquiry of online platforms as a dominant player in digital markets from the perspective of competition law  
• A modernization of the EU data privacy legislation (e-privacy directive)  
• Measures on cyber and network security |
| **Objective 3.** Maximizing the growth potential of the digital economy | • The promotion of the free flow of data by a European “Free Flow of Data Initiative” and a “European Cloud Initiative”  
• The definition of interoperability standards in various areas of the DSM (e.g., e-health, transport planning, and energy)  
• An inclusive digital society |

Table 2. Overview of Proposed DSM Policies

<table>
<thead>
<tr>
<th>DSM Policy</th>
<th>Stated Objective of Policy Proposal</th>
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<tbody>
<tr>
<td>Digital contracts for Europe</td>
<td>• Alignment of contract rules for digital content and physical goods</td>
</tr>
</tbody>
</table>
| EU copyright rules               | • Better choice and access to content online and across borders  
• Improved copyright rules on education, research, cultural heritage, and inclusion of disabled people  
• A fairer and sustainable marketplace for creators, the creative industries, and the press                                                                                                                                      |
| Geo-blocking                     | • Addressing geo-blocking and other forms of discrimination based on customers’ nationality, place of residence, or place of establishment within the internal market                                                                          |
| Portability of digital content   | • Ensuring the cross-border portability of online content services in the internal market                                                                                                                                            |
| Parcel delivery                  | • Improvement of delivery services for consumers and small- and medium-sized enterprises (SMEs)  
• Ensuring cost-effective solutions and promote interoperability of delivery services between operators and e-retailers                                                                                                           |
| Audiovisual media services       | • Providing rules to shape technological developments  
• Creating a level playing field for emerging audiovisual media  
• Preserving cultural diversity  
• Protecting children and consumers  
• Safeguarding media pluralism  
• Combating racial and religious hatred  
• Guaranteeing the independence of national media regulators                                                                                                                                                                      |
| Telecoms                         | • A sound regulatory framework for electronic communications, promoting competition and consumer rights  
• Promoting investment in broadband networks supporting high-speed internet  
• Supporting wireless technologies, such as 3G and LTE, through the radio spectrum policy program  
• Protecting mobile users from high roaming charges when traveling in the EU or internationally  
• Taking a leading role in international discussions on internet development and governance                                                                                                                                          |
| Radio spectrum policy            | • Harmonizing spectrum-access conditions to enable interoperability and economies of scale for wireless equipment  
• Working toward a more efficient use of spectrum  
• Improving the availability of information about the current use, plans for use, and availability of spectrum                                                                                                                                 |
| Free Wi-Fi for Europeans         | • Promotion of free Wi-Fi connectivity for citizens and visitors in public spaces such as parks, squares, public building, libraries, health centers, and museums everywhere in Europe                                                                                   |

Note: For an overview of the status of the legislative proceedings, see Appendix A, http://www.aei.org/publication/appendix-a-right-direction-wrong-territory/ (online only).

Source: European Commission.
Regulatory Heterogeneity and the Impact on Digital Business Models

Differences in country-specific regulations and regulatory diversity hamper trade in traditional nondigital sectors. As is discussed below, regulatory heterogeneity is a key factor determining the decisions of European online businesses to engage in cross-border commerce in the EU. Since it is hard for digital business models to gain ground and expand in a fragmented nondigital world, EU lawmakers need to address “national regulatory silos” beyond what the EU has identified as its priorities in its DSM agenda. Since most digital business models aim to “digitalize” old sectors, fragmented nondigital markets pose a challenge for any startup or incumbent firm aiming to roll out a digital business to another European country, let alone to the EU market as a whole. Different national regulations of traditional nondigital sectors still effectively prevent businesses from experimenting with ideas and business models that could add value to product and service offerings in nondigital sectors, such as through a more efficient exploitation of ICT capital and large volumes of industry data.

Although the pace of structural economic change that arises from technological innovation is difficult to project ex ante, the economic literature is fairly clear about the factors encouraging or discouraging structural economic renewal. While changes in consumer tastes, demographics, and work habits drive structural change, the institutional and regulatory environment is also crucial. On the other hand, tight regulatory measures effectively hinder economic adjustment and productivity-enhancing structural economic change. At the same time, business regulations have a cultural effect because they affect existing production patterns, business models, and work habits.

The variation in country-specific productivity (growth) rates and in levels of regulatory heterogeneity reflects the lack of economic convergence in European Single Market and the incompleteness of the European Single Market. The Single Market is still characterized by restrictive regulatory standards and their heterogeneity. Although progress has been made over the past 20 years, the lack of harmonization of national laws and the deficiencies in the EU’s mutual recognition framework remain the rule rather than the exception. The impact of anticompetitive product market regulations goes beyond the markets that are explicitly targeted by these regulations. Tight regulations have knock-on effects on downstream sectors and their competitiveness, such as when firms use the output of highly regulated sectors as intermediate inputs in the production process.

Subsidies, establishment barriers, and differences in tax systems hinder economic adjustment processes by effectively protecting low-productivity incumbents from competition. In other words, these policy instruments can protect incumbents that would not survive in a less distortionary and more harmonized regulatory environment. Removing regulatory obstacles to entrepreneurship and investment, and eventually to competition, would therefore encourage firms to experiment and invest resources in new ideas, products, and business models.

Openness to trade is another driver of a productivity-enhancing reallocation of an economy’s domestic resources. The ease of doing business across borders is crucial for foreign companies to operate, invest, and innovate in other jurisdictions and to stimulate local business cycles. In practice, however, regulatory obstacles often prevent companies from investing in foreign markets or servicing foreign customers. Heterogeneity in regulations is found to significantly impact a company’s choice in how to service foreign markets for most product and services sectors.

As a result, the main barrier for the expansion of businesses is regulatory heterogeneity, not the level of regulation. Many regulatory measures increase a company’s fixed cost of market entry because they need to set up resources and processes to comply with diverse country-specific provisions. Without a functioning system of mutual recognition or harmonization, the cost of market entry adversely affects firms’ total average cost per unit of output, increasing it with every new nondomestic export market. One consequence of regulatory heterogeneity is to prevent firms from engaging in international trade. That adversely affects
intra-industry competition, cross-country innovation spillovers, and economic convergence. For services sectors, Kox and Lejour show that regulatory heterogeneity creates a market entry barrier for SMEs and negatively affects services exports. Therefore, as argued by Pelkmans and De Brito, regulatory heterogeneity is not only costly to businesses, but also detrimental to consumers who are confronted with higher prices and less product variety.

“Nondigital” Regulatory Heterogeneity in the EU

As for market regulations in EU member states, survey data reveal substantial differences in both the scope and the restrictiveness of sectoral regulations. These reflect the enduring resistance of EU member states to giving up various legislative and regulatory powers (see Figures 1–4). Regulatory heterogeneity in traditional nondigital markets therefore remains an important source of variation in EU member state’s productivity levels. The intra-EU total factor productivity levels, for example, are not converging. Between 2000 and 2009 the aggregate total factor productivity of Northern European countries increased, while it decreased for several Southern European countries, which show higher average levels of regulatory restrictiveness. Diverse laws regulating investment, market entry, entrepreneurship, state-owned enterprises, and network industries remain a core feature of the Single Market, as are diverse sets of rules for a wide range of services sectors including telecoms, transport, retail, and professional services. Figure 1 provides the aggregate OECD indices of product market regulation.

In commerce, national legislation remains the dominant source of law. Technical and administrative barriers to trade, widely known as nontariff barriers to trade (NTBs)—such as horizontal regulations, national product standards, market entry regulations, and red tape—began to be dismantled only with the launch of the Single Market Program in 1985. More than 24 years after the original 1992 deadline, European firms still confront myriad national and even regional laws. They also face innumerable regulatory provisions driven by inconsistent national and sometimes regional public policy objectives. Examples include national copyrights regimes and education systems as well as local and regional rules, such as regulations on taxi transport and waste management. True, waste management and taxi services can be regarded as nontradable sectors with a degree of heterogeneity of preferences that ought to be reflected in different regulatory practices. However, the regulatory status quo systematically discourages cross-country investment and the dissemination of new, much more efficient technologies and business models (taxi services) and prevents efficient and innovative foreign suppliers from engaging in regional tender procedures (waste management services).

According to the OECD’s 2013 product market regulation (PMR) index, the Netherlands shows the lowest aggregate value for regulatory restrictiveness, suggesting that Dutch regulations are on average the least restrictive in terms of the burden they create for established businesses and for investors and startups. Market-specific regulations in Greece, on the other hand, were most restrictive, indicating that businesses already operating or willing to operate in Greece face serious obstacles due to national laws (see Figure 1).

For member states that are covered by the OECD’s survey, the restrictiveness of both horizontal and industry-specific regulation varies widely. That impairs the functioning of the Single Market (see Figure 2). Although the barriers to trade and investment, for example, are generally modest in most member states, policy heterogeneity is most significant in this policy field. It implies that it is comparatively easy to invest across borders for those businesses that have sufficient financial and human administrative resources to deal with diverse country-specific obligations, compared with investing or simply trading across EU borders. Accordingly, diversity in national regulations can be regarded as a subsidy to larger businesses, effectively discriminating against SMEs.

In licensing and permitting laws, regulatory provisions and procedures tend to be highly complex. At the same time, the heterogeneity of national legislation is considerable. The same is true for government
involvement in network service sectors. Accordingly, a comprehensive reform package addressing regulatory heterogeneity would significantly affect intra-EU trade. As outlined by Fournier et al., aligning PMR indicators to the average of the top half of the best performers would bring down regulatory heterogeneity by one-fifth and could increase intra-EU trade intensity by more than 10 percent.15

Heterogeneity in market regulations is also a typical feature of network services industries such as airline services and telecommunication as well as postal and transport services. Retail markets across the EU are characterized by significant differences in national regulations, and that holds true for a large number of professional services.

As shown in Figure 3, over the period between 2008 and 2013, the progress in regulatory convergence was slow. Most sectors do not exhibit any advances in regulatory convergence. For engineering and architectural services as well as telecommunications, regulatory diversity within the Single Market even increased as expressed by the absolute distance between minimum and maximum restrictiveness levels.

The OECD’s services trade restrictiveness indices exhibit a similar picture (see Figure 4). In this core category, regulatory heterogeneity is a salient characteristic of all services sectors covered by the OECD’s surveys. Differences in restrictiveness reflect general regulations that apply across all sectors of the economy, such as barriers to the movement of employees, barriers to competition, restriction on foreign entry, and transparency in the rule-making process.

Figure 5 shows a negative relationship between the level of regulatory restrictiveness and the size of ICT capital investment across certain regulatory categories. Total ICT capital investment tends to be lower the higher market entry barriers; the stronger regulatory protection of network, retail, and
For digital companies, entering a foreign market governed by regulations that are different from domestic laws increases compliance costs, often to punitive levels. Regulatory compliance can take various forms: the choice over the legal form of market entry, the adoption of products and services, and the way products and services are allowed to enter the market.
Figure 3. Diversity in Regulatory Restrictiveness in Services Sectors

Note: The box plot shows the minimum, first quartile, median, third quartile, and maximum regulatory restrictiveness levels. Dots represent mean values.

Figure 4. Heterogeneity in Services Trade Restrictiveness

Note: The box plot shows the minimum, first quartile, median, third quartile, and maximum regulatory restrictiveness levels. Dots represent mean values.
Figure 5. Regulatory Restrictiveness and Investment in ICT Capital: Average Share of ICT Investment for 2001–09
Lessons from the EU’s Legislative Initiative on “Unjustified Geo-Blocking”

In the DSM strategy, the European Commission wants to create a seamless European digital marketplace, in which all industries can take full advantage of what digitalization offers. The Commission committed itself to “make legislative proposals in the first half of 2016 to end unjustified geo-blocking.” With its legislative proposals, the Commission aims to address a key priority of the European Council, which concluded in May 2015 that “action must be taken . . . to remove the remaining barriers to the free circulation of goods and services sold online and tackle unjustified discrimination on the grounds of geographic location.”

Geo-blocking, which encompasses the blocking or modification of digital content (including offers of physical goods and services) based on customers’ place of residence within the EU, is a textbook example of how disproportionate, unjustified, and unnecessary national laws restrict businesses from serving customers across European borders. While copyright issues are explicitly excluded from this legislative initiative, the EU’s main objective is to address “unjustified market fragmentation strategies” that are based on customers’ nationality or place of residence. For most businesses, however, geo-blocking of digital content and the modification of digital offers are indispensable to comply with different national laws. Geo-blocking is a direct consequence of regulatory market fragmentation within the EU. Accordingly, it is not geo-blocking that hits consumers and prevents European businesses from expanding. Rather, it is legislative fragmentation of traditional sectors at the level of the national member state that imposes significant costs on businesses and consumers alike (see Table 3).

A substantial number of sector-specific and horizontal regulations are still fragmented along national lines. Differences in horizontal legal provisions, for
### Table 3. Taxonomy of Stated Concerns Justifying Blocking and Modification of Digital Offers

<table>
<thead>
<tr>
<th>Physical goods</th>
<th>Nondigital services</th>
<th>Digital services</th>
</tr>
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<tbody>
<tr>
<td>3. National regulations of “terms and conditions”</td>
<td>8. National regulations for the provision of public services</td>
<td>11. National regulations on the provision of digital content</td>
</tr>
</tbody>
</table>

Table: A. Legal Compliance with National Law of EU Member States | B. Efficient Business Administration, Profitability, and Freedom of Contract

<table>
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<tbody>
<tr>
<td>1. National consumer protection regulations</td>
<td>1. Lack of financial resources</td>
<td>1. Unviable markets, risk of sunk costs, and mitigation of general business risk</td>
</tr>
<tr>
<td>2. National data protection regulations</td>
<td>2. Lack of internal administrative capacities</td>
<td>2. Market entry and access and contracts providing for “exclusive territory” distribution</td>
</tr>
<tr>
<td>3. National regulations of “terms and conditions”</td>
<td>3. Lack of external administrative capacities</td>
<td>3. Differences in willingness to pay and price differentiation according to national demand characteristics</td>
</tr>
<tr>
<td>5. National VAT regimes</td>
<td>5. Language barriers</td>
<td>5. Mitigation of fraud and counterparty risk</td>
</tr>
<tr>
<td>6. Diverging fiscal requirements beyond national VAT requirements</td>
<td>6. Lack of adequate logistical and delivery solutions</td>
<td></td>
</tr>
<tr>
<td>7. National protection of brands and trademarks</td>
<td>7. Lack of adequate payment methods</td>
<td></td>
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</tbody>
</table>

Table: B.2. Profitability and Freedom of Contract

<table>
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<tr>
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<tr>
<td>3. Differences in willingness to pay and price differentiation according to national demand characteristics</td>
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<tr>
<td>4. Brand reputation considerations</td>
</tr>
<tr>
<td>5. Mitigation of fraud and counterparty risk</td>
</tr>
</tbody>
</table>

example, require cross-EU-border online traders to adapt to national VAT, consumer protection, and data protection laws. In sector-specific regulations, businesses must customize products and services according to national product safety regulations, national technical regulations, national labeling requirements, national waste management regulations, and national construction material regulations (see columns 1 and 2 in Table 3). For example, an architectural service provider in Athens cannot simply offer its services via an online platform to Berlin customers without aligning their product offers and services packages with country-specific requirements. Similarly, a construction materials provider in Warsaw must adapt its product portfolio to Swedish product and building standards to qualify for Stockholm demand.

The variation in national regulation and the surrounding legal uncertainty affect digital businesses’ market entry and market expansion decisions. Administrative barriers and compliance risks affect the firms’ assessment of legal and financial investment risks, let alone the need to set up additional resources to administer country-law specific contract requirements or to fulfil local commercial presence requirements (see columns 3 and 4 in Table 3). Additional and unnecessary regulation works like a tax or a tariff. It drives a wedge between the price of production and consumer’s nominal willingness to pay. That is, it effectively destroys a certain number of mutually beneficial exchanges that would have occurred otherwise, with adverse effects on competition and employment, let alone on the development of professional qualification and vocational training.

Taxi markets are a compelling example of unjustified, discriminatory regulation of nondigital services at national and local levels, which prevents digital business models from gaining ground anywhere in Europe. A regulation of entry persists in many—importantly, not all—member states despite overwhelming evidence of lack of competition, high consumer prices, poor quality, and monopolistic rents of taxi license holders in traditional taxi services markets. License systems are still a major feature of many (not all) local taxi markets in the EU, which is why innovative taxi app providers are prohibited from operating. Licenses are granted by local governments and usually capped to control market supply, while at the same time prices are set by law rather than supply and demand.

**Conclusions**

Irrespective of the nature of business models in question, regulation sets the institutional context for economic activity and entrepreneurial discovery. The digital economy is not unique in the sense that regulatory heterogeneity would be higher in “native-born” digital sectors than elsewhere. In the EU, most traditional nondigital, or less digitalized, goods and services sectors are still regulated in a highly fragmented fashion, leading to high costs of entry and of doing business across borders and, consequently, to a lower contestability of traditional markets.

Legal barriers in the offline world create costly barriers for both goods and services trade. Regulatory heterogeneity makes it difficult for companies to establish operations in other countries without costly adaptions of business models to foreign laws and regulations. For European digital and nondigital industries to become more innovative and internationally competitive, policymakers must effectively address regulatory fragmentation in the EU’s internal goods and services markets where heterogeneous national regulations still dominate.

The Digital Single Market is a worthy ambition, but it will not unleash the potential of Europe’s digital economy unless combined with deep reforms addressing regulatory heterogeneity in nondigital sectors. That is where the main obstacles to Europe’s digital future lie. It is not important whether new digital innovations carry a European or foreign passport. The merit of any innovation primarily comes with its adoption. Accordingly, the important reform strategy for lifting Europe’s economic growth is rather the capacity of economies to quickly transact and adapt to new technologies and innovative business models.

Recognizing the lack of harmonization in traditional sectors and its adverse impact on digital businesses not only requires new thinking about specific policies for digital sectors. It also requires
considerable reforms of general market policies, aimed at creating a genuine nondigital European Single Market, which is arguably the most fundamental precondition to ease structural economic change and to create a true cross-national DSM.

“Nobody can fall in love with the single market,” Jacques Delors used to say. The current degree of harmonization and mutual recognition under Single Market regulation suggests that this realization has remained a guiding principle and hidden working title for many EU policy proposals. So far the EU’s DSM agenda has followed the path of least resistance, as European institutions have tried to raise as little political friction as possible. The EU’s declared priority focus on “pure” digital barriers bears another rather systemic problem. The promotion of politically easy-to-sell digital policies distracts public attention from the protracted fragmentariness of the EU’s Single Market. It also compounds the risk that European citizens and political leaders alike will lose sight of the merits of harmonized and nondiscriminatory rules that foster competition, economic development, and convergence and increase the contestability of markets across and beyond the EU.

The ongoing backlash against TTIP and further liberalization of international trade at large, which is meant to include a modern and comprehensive chapter on fact- and evidence-based regulatory cooperation, can be attributed to the failure of EU institutions and most member state governments to convincingly communicate the everyday shortcomings of legal fragmentation and discriminatory national laws in the EU. These range from national technical regulations in goods sectors to diverse national regulations of private and public services markets.

DSM policies’ overall economic impact on digital and nondigital businesses will likely be trivial, as will be the overall economic impact on jobs and new economic opportunities in the EU. Past failures to emphatically communicate the economic and social merits of a truly level regulatory playing field within the EU as well as regulatory cooperation in EU trade agreements with the United States and other countries are at the heart of European citizens’ distrust of the EU and national political antagonism. EU policymakers and national governments must reinvigorate the narrative that the European Single Market is at the heart of the project of European integration. They must also point out unequivocally that international regulatory cooperation in general is key for well-regulated, contestable, competitive, and nondiscriminatory national markets.

About the Author

Matthias Bauer is a senior economist at European Centre for International Political Economy.
Appendix A

Appendix A is available at http://www.aei.org/publication/appendix-a-right-direction-wrong-territory/.

Appendix B

EU Competence in the (Digital) Single Market

The issue of EU competence is crucial for understanding EU lawmaking because any EU legal acts will bind the member states and constrain their competence to the extent of the legally binding act. In principle, the EU has only competence conferred on it by the EU Treaties, so-called attributed competence, which has been developed gradually through the various subsequent stages of the development of the treaties.

Prior to 2009, drawing a clear line on the scope of the EU competence was a challenging exercise, creating tensions and resulting in turf wars among the EU institutions and member states on whether the matter at issue fell within the scope of EU exclusive or shared competences. To ensure the development of the EU law, the development of Court of Justice of the European Union case law interpreting treaty provisions would have to be taken into account as well as development of the EU secondary legislation (directives and regulations specifying the legal norms enshrined in the broad treaty provisions).

In sum, the EU can only act within the limits of powers assigned to it, consequently where the EU competence, at least to some extent, does exist. As clearly explained by Craig and De Burca:

EU competence resulted from a symbiotic interaction of four variables: Member State choice as to the scope of the EU competence, as expressed in the Treaty revisions; Member State and since the SEA [Single European Act], European Parliament acceptance of legislation that fleshed out the Treaty Articles; the jurisprudence of the EU Courts; and decisions taken by the institutions as how to interpret, deploy, and prioritize the power accorded to the EU.\textsuperscript{19}

The Lisbon Treaty provided for a tripartite division in EU competences to achieve greater clarity. Consequently, pursuant to Articles 2–6 of the Treaty on the Functioning of the European Union (TFEU), one can distinguish between the nature and the scope of EU competence, dividing it into exclusive (Article 3), shared (Articles 2(2) and 4), and supplementary, complementary, and supportive competences (Article 6).

Shared competence is a default position in the Lisbon Treaty.\textsuperscript{20} The adoption of harmonized legislation in internal market primarily includes Article 114 of the TFEU as a legal basis for the EU acts. The well-established principle of EU law primacy, acknowledged for the first time in \textit{Costa v Enel},\textsuperscript{21} ensures that in the event of a conflict between the EU and domestic law, the latter should be set aside to the extent of incompatibility,\textsuperscript{22} and the national law must be interpreted and applied, insofar as possible, so as to avoid a conflict with a Community rule.\textsuperscript{23}

Within the group of competences, the EU cannot supersede the member states. The competences not conferred with the EU, remain with the member states. Moreover, since Maastricht Treaty, the principle of subsidiarity ensured that EU should exercise the competence, currently enshrined in Article 5(2) TFEU. The EU has a number of legally binding and nonbinding instruments serving the purpose of achieving the EU objectives. Article 288 TFEU provides the spectrum of the EU legislative acts, including a regulation, a directive, a decision, and a recommendation.
EU Regulations

EU regulations are binding in their entirety and directly applicable in all member states, being the most efficient instrument in achieving the harmonization in the internal market because they become automatically a part of the internal domestic systems. Taking the example from the Digital Single Market agenda, the regulation on cross-border parcel delivery services will effectively ensure that the same rules apply across the EU, ensuring affordable, high-quality cross-border delivery services can build trust in cross-border online sales. EU regulations are also the most rigid of its legal instruments.

EU Directives

In order to ensure some flexibility in the adoption of the EU law, directives are adopted to harmonize certain areas or to introduce complex regulatory change. Whenever the EU adopts the directive, it effectively bounds the member states as to the end result that has to be achieved, leaving some flexibility on the form and method applied in its implementation. Moreover, the directives do not necessarily have to be addressed to all the member states. The court held that EU directives have direct effect, permitting individuals to rely on them in any action against the state,\(^4\) including the damages stemming from the non-implementation of the contested directive.\(^5\)

In the Digital Single Market agenda, an example of a directive can be illustrated on the one addressing geo-blocking and other forms of discrimination based on customers’ nationality, place of residence, or place of establishment within the internal market.

Decisions and Recommendations

According to Article 288, the decisions are binding in their entirety, and a decision with specified addressees is binding only on them. In contrary, the recommendations and opinions adopted by the EU institutions have no binding force, as the soft law instruments. Lastly, by virtue of Articles 290–291, the Commission can further precise the EU legislation in the form of a delegated or an implementing act.
Appendix C

The Development of the EU Law in the Nondigital Single Market

The Single European Act, signed on February 17, 1986, constituted a fundamental step toward achieving the EU internal market. It focused on promoting better legislative rules allowing for the facilitation in harmonizing the legislation as well as introduced a new approach to the EU market.

First, the act contained new procedures aiming at facilitating the legislative process in order to achieve the complete internal market, which are currently found under Articles 26 and 114 of the TFEU. Notably, Article 26(2) defines an internal market as an area without internal frontiers, in which there could be free movement of goods, services, persons, and so forth, amounting to an ongoing, dynamic policy objective.

As of today, the emphasis of this provision shifted toward regulatory obstacles in ensuring the effectiveness of the four freedoms. The Single European Act also provided for a dichotomy of the EU legislative powers over the internal market, currently covered by Articles 114 and 115. The general legislative power provided in Article 114 authorizes the EU institutions to adopt any measures under ordinary legislative procedure, on condition that such measures must be intended to improve the conditions for the establishment and functioning of the internal market.

In contrast, Article 115 provides for a rigid unanimity rule, authorizing only adoption of directives. This article can be used as a legal basis for the EU legislative process only if the measure directly concerns one of the EU freedoms. Article 114 never did provide, nor does it provide, for any general power in adoption of the EU market regulations. The measures must genuinely have as their object the improvement of the establishment and functioning of the internal market.

To the extent of the most developed freedom in movement of goods, the principle of mutual recognition in the EU internal market provides for a notification requirement of any laws that could hinder or even prevent free movement of lawfully produced goods marketed within the EU market. Any such restriction should be justified under Article 36.
Notes


4. Ibid., 7.

5. Appendix A (available only online) summarizes the state of play in the EU’s legislative processes. Appendix B gives a brief overview of EU competence in (digital) law-making. Appendix C gives a general overview of the development of the EU law in the non-digital Single Market.


11. Some opponents of greater degrees of regulatory harmonization in the EU argue that regulatory competition is needed to ensure sound regulatory practices that are fit for purpose. Such arguments miss the point given that the world of today counts more than 170 non-EU countries to look at for regulatory comparison.


14. For a comprehensive analysis of regulations of taxi market, which are among the most regulated sectors in OECD countries, see an OECD report summarising the OECD Competition Committee debate on improving competition in taxi services. Organisation for


16. As for the complexity of regulatory procedures, the positive slope of the line is driven by two distinct outliers: Italy, which shows a low share of ICT capital investment with a low level of regulatory complexity, and the UK, which shows a high share of ICT capital investment (for the reasons discussed above) and a high degree of regulatory complexity. Eliminating the UK and Italy from the dataset would result in a negative sample correlation between the size of ICT capital investment and the complexity of regulatory barriers.


21. Case-6/64, Falminio Costa v. ENEL, ECR 585, 593.


