Center for
Technology Innovation
at BROOKINGS

May 2016

The European Union's Digital Single Market Strategy: A conflict between government's desire for certainty and rapid marketplace innovation?

By Stuart N. Brotman

Stuart N. Brotman is a nonresident senior fellow in the Center for Technology Innovation within Governance Studies at Brookings.

INTRODUCTION

Last May, the European Commission (EC) released its Digital Single Market Strategy (DSMS). As EC President Jean-Claude Juncker has noted, "The development of a single market for digital activities in the EU is hampered by cross-border barriers and differences in national telecoms, spectrum, copyright, e-commerce, data protection and consumer law regimes. The commission's Digital Single Market Strategy is intended to overcome these barriers but, in many areas, will require the resolution of difficult regulatory and policy issues."

According to the DSMS, a single digital market is "one in which the free movement of goods, persons, services and capital is ensured and where citizens, individuals and businesses can seamlessly access and exercise online activities under conditions of fair competition, and a high level of consumer and personal data protection, irrespective of their nationality or native residence."

> The digital single market strategy is based on the premise that public authorities should play an instrumental role in promoting markets for online purchases.

The DSMS reflects a number of major policy pillars for deliberation and subsequent implementation by the European Union's 28 member states. These include:

- **Geoblocking:** reducing barriers to consumers who wish to purchase digital content from any member state, and to access digital content purchased in their home country when they travel to other EU countries. According to the EC, “unjustified” geoblocking is a form of territorial segmentation that represents an obstacle to a single digital market.

- **Copyright:** with a range of copyright regimes in the member states, a new balance may be necessary to improve cross-border access of digital content while preserving the rights of content creators. The legal responsibility responsibility of Internet service providers (ISPs) in removing infringing content once notified may need to be re-evaluated. The EC has noted that any new measures regarding ISP liability must be made “with due regards for their impact on the fundamental right to freedom of expression and information.”

- **E-commerce:** harmonized rules throughout the EU for online purchases (potentially encompassing both physical goods and digital content), along with a set of core EU contractual rights for online sales of tangible goods domestically and internationally (i.e., guaranteed periods and consumer remedies for non-performance by online merchants.

CHALLENGES OF THE DIGITAL SINGLE MARKET STRATEGY

The ambitious nature of the DSMS reflects a number of realities that the EU is confronting. The European Union still is a patchwork of national online markets. This limits both the supply and demand of new digital services throughout Europe. According to the EC, “persistent fragmentation is stifling Europe’s competitiveness in the digital economy.”

Most of the major online success stories have originated outside Europe—Google, eBay, Amazon and Facebook, for example, all were developed in the United States.

European consumers are hesitant early digital adopters due to their uncertainty about rights and legal protections when doing business online. Consumers also can purchase physical digital products such as CDs and DVDs throughout Europe, but often cannot buy comparable online content since digital distribution rights have been licensed on a national rather than pan-European basis. This is in contrast to the United States, where a simpler business environment with more open distribution channels enables American consumers to buy digital content in all states and territories without restrictions.

The DSMS is based on the premise that public authorities should play an instrumental role in promoting markets for online purchases. This includes enhancing trust in the development of Europe’s online economy. With a growing scourge of identity theft and online fraud, coupled by cyber attacks in countries such as Estonia and Lithuania, Europeans remain ambivalent about how extensively they want to engage in the online world. Some 60 million Europeans have never used the Internet, indicating that they have no need for it or that it is too expensive. Socio-economic factors also contribute to this lack of interest, too, since these non-users include those aged 65-74, those with low incomes, and those who are unemployed or have lower levels of education. This take-up gap also is rooted in lack of user skills and overall digital literacy, which is estimated to be as high as 45 percent throughout Europe.

Additionally, member states are at different stages of digital development. Nordic countries such as Denmark, Finland and Sweden are undisputable leaders, while countries such as Romania, Bulgaria and Greece are digital laggards.

Consequently, the DSMS is being developed against a backdrop of nascent rather than fully evolved digital engagement. Only 49 percent of EU Internet users listen to music, watch videos and play games online. About half of

European Internet users have purchased online, but less than 20 percent of this group has purchased online from another country. According to the EC, one reason for this is that people feel they are better protected when buying online in their own country.

There also is a palpable sense that Europe is slipping behind economically because of its digital reticence. The eurozone's GDP is set to shrink 0.4 percent this year, which is a sign that some significant EU intervention may be necessary if Europe is to become internationally competitive in the digital domain. According to the EC, the DSMS is aimed at making Europe "a powerhouse of smart, sustainable and inclusive growth on the global stage."

On the bright side, Europe's digital future seems to be based largely on a mobile environment, since the majority of Europeans already access the Internet through mobile devices. Almost 90 percent of Europeans have 4G mobile coverage, which enables digital video delivery and streaming video, while about 70 percent have high-speed fixed broadband capability. Mobile also is available in more rural areas than fixed broadband. In short, the context for the DSMS is based on mobility rather than a more static digital environment rooted in larger devices that are tethered to fixed locations.

The eurozone's GDP is set to shrink 0.4 percent this year, which is a sign that some significant EU intervention may be necessary if Europe is to become internationally competitive in the digital domain.

The EC's public consultation has received strong support for the general principle that consumers and businesses alike should be allowed to purchase and access services online from anywhere. But beneath this veneer of consensus, there are sharp differences. Consumer groups and individual participants who filed comments indicated that blocking access to websites across borders—with or without re-routing to national websites offering the same goods and services—is a significant barrier. This includes access to digital content, including through apps that enable access if that content has been paid for (e.g., with a subscription) in the home country.

The perspective of companies and business associations is sharply different. This group acknowledges that blocking web access across geographic borders is a barrier. They also have voiced concerns regarding disproportionate shipping costs between countries for physical goods.

For digital goods, they indicated the implications for copyright and content licensing raise another set of issues that need to be resolved if geoblocking restrictions for these goods are to be lowered by legal mandate.

It remains uncertain whether the EC will deal with geoblocking as two different phenomenon due to the copyright and licensing implications for digital content; if so, the restrictions on unjustified geoblocking may be limited initially or exclusively to physical goods such as clothing, footwear and accessories, computer hardware and electronics, and media (books, CDs, DVDs, videogames).

The other threshold that the EC must grapple with is the scope of "justified" vs. "nonjustified" geoblocking. Consumers and consumer groups want justified geoblocking to be a narrow set of exceptions, with most practices falling under a legally-prohibited "not justified" category. They argue that in most cases, geoblocking should be prohibited when sellers incur no additional cost or administrative burden; when the means of payment are internationally valid and accepted (e.g., through a Euro-wide credit card); or when consumers are willing to pay any additional costs for cross-border processing, delivery and returns.

Here too, however, those on the business side have a significantly different perspective. As a general principle, company respondents to the public consultation argue that providers of goods or services should be free to decide the geographic scope of their operations. No government requirement should force them to extend their offer to markets where they previously have not been active. Companies also have enumerated several other categories that should be recognized in any EU geoblocking policy. These include differences in manufacturing warranties, health and product safety rules, consumer rights protections and languages. Some of these compliance costs could be passed on to consumers, but some would also need to be absorbed by transacting businesses, affecting overall profitability. Additionally, as consumer costs for cross-border transactions arise, the demand for them may decrease, thus creating an unintended consequence that further fragments markets throughout Europe.

Member states will need to implement geoblocking restrictions that are consistent with what the EU recommends. The EC could favor the consumer sentiment that supports a hard line on geoblocking practices. Refusals to download digital products across borders also may be limited by law. Under this scenario, companies would be required to accept cross-border transactions throughout the EU when they could pass on the delivery costs to consumers, or where consumers themselves made arrangements for third-party delivery. Businesses would be required to explain, either before the completed transaction or upon request, any differences in treatment of customers based on residence and/or nationality. They also would need to obtain consumer consent prior to automatic rerouting of a transaction to a buyer's place of residence or nationality.

The aspects of the DSMS that touch upon copyright also raise complex issues regarding whether—and if so, how—copyright protection should be changed in the EU to reflect a different balancing of legal rights for content creators and users. Those who argue for no changes to be made believe that key data metrics support their view. For example, EC-funded research indicates that 90 percent of online users find what they want through a search, and only 4 percent access digital content from another member state. Perhaps most importantly, about 7 million people in Europe earn their livelihoods from core creative industries such as film, music, and television. There has been little empirical analysis to date to forecast how large an economic impact (e.g., lost jobs and wages) copyright changes may have on this group.

The aspects of the DSMS that touch upon copyright also raise complex issues regarding whether—and if so, how—copyright protection should be changed in the EU to reflect a different balancing of legal rights for content creators and users.

Those arguing for less copyright protection indicate that a substantial number of users are deprived of a vast wonderland of digital content, and that they will increasingly demand cross-border availability. Their alternative would be to seek out the same content through illegitimate websites; EU survey data indicates that 22 percent of Europeans might do so. Such websites do not pass on any royalties to copyright holders, making content piracy such a potent threat to the economic incentives to create content.

Given this context, it will be important for the EU to assess whether to limit liability of Internet service providers (ISPs) for contributory copyright liability. Currently, absent knowledge of a specific online posting of copyrighted content without permission, an ISP will face no penalty provided it has taken down the infringing content once notification has been received by the copyright owner.

Currently, the biggest obstacle to increasing European e-commerce is the reality that the vast majority of Europeans (84 percent) prefer to shop locally.

Remedies aimed at punishing consumers for online copyright infringement have proven to be ineffective in Europe, similar to their ineffectiveness in the United States. A graduated response approach, which entails continuous monitoring of users by ISPs, backed by an ultimate threat of having broadband network service cancelled, has been tried without success in France. It is difficult to oversee administratively and is perceived by many to be too draconian an approach against individual consumers.

The optimal solution would entail converting the current “notice and takedown” system into a “notice and stay down” regime. But so far, it is unclear how that conceptual transition can be implemented in practice, since re-uploading by others creates infinite opportunities to undermine legal prohibitions. Other approaches in this area, such as expanded legal duties for ISPs to cooperate and better educate users about copyright infringement may be more practical solutions for the EC to pursue in order to achieve comparable outcomes.

The realm of e-commerce is closely linked to geoblocking, much as geoblocking is closely linked to copyright protection. Here again, current data may not suggest obvious policy improvements that can be crafted by the EC. Currently, the biggest obstacle to increasing European e-commerce is the reality that the vast majority of Europeans (84 percent) prefer to shop locally. Their trade preferences are due to home market familiarity, language fluency and geographic proximity. These factors seem well out of the reach of any government policy that might change them.

High delivery costs, the cost of returning goods and long delivery times also are formidable obstacles that may be beyond any governmental mandate. These economic and scheduling issues are decided by individual businesses. Forcing companies to rectify them may involve financial losses. In turn, fewer companies then might be engaged in e-commerce, which would undermine the DSMS goal of expanded cross-border buying opportunities.

THE EU’S ABILITY TO SHAPE A DIGITAL SINGLE MARKET

The DSMS raises fundamental issues regarding to what extent both the EC and its member states will be able to influence how the digital marketplace continues to develop in Europe. In the United States, federal pre-emption has enabled e-commerce to flourish, in large part due to an outright legal ban on online sales tax for purchases transacted solely online across state borders (some retailers, such as Amazon, have agreed to collect and remit sales tax to specific states, however).

It is unlikely, and probably impossible from a legal standpoint, that the EU will seek to emulate this digital free zone approach by requiring the equalization or outright elimination of value-added taxes for online purchases across borders.

Geoblocking in the U.S. largely has been managed through private contracts rather than government mandates. Those who wish to access content they paid for outside their home locality, including across state lines, typically are allowed to do so through widespread TV anywhere functionality that enables mobile multi-platform viewing. This is a value-added service that broadband network providers such as Comcast and Verizon offer as an inducement to attract and maintain subscriber loyalty in an era where "cord cutting" (accessing programs directly online through over-the-top providers such as Netflix and Hulu Plus) is a viable alternative. No government intervention has been necessary here. It is unclear whether there are different structural barriers in Europe that would prevent comparable TV anywhere services from functioning with minimal government oversight (e.g., antitrust reviews to prevent anticompetitive practices).

The copyright issues Europe is facing may not be more pronounced than those of the United States. The challenge of strengthening protection for content creators while enabling greater access by users remains a serious one, with digital distribution exacerbating the ability to protect the creative efforts of content creators. Copyright piracy remains a continuing global problem with multi-billion dollar consequences, rather than being solely confined to Europe. This larger scope suggests that EU DSMS policies in this area may be incomplete and ineffective because the geographic reach of the Internet, along with its users, poses a much larger threat to worldwide copyright infringement. China, for example, will not be able to be controlled by EU policies, so massive piracy is likely to continue there, with a population several times larger than all of Europe.

CONCLUSION

The EU believes that it can be both comprehensive and incremental in its DSMS. This approach may be too ambitious and too minimal in its impact. Given the rapid development of continuing the digital marketplace, the EU's commitment to "future proofing" seems likely to continue as an illusive goal.

> On balance, the better approach of a DSMS may be a recognition that digital policymaking needs to operate in a more digital context—always evolving, never certain, and ready to change direction whenever significant shifts in marketplace supply and demand forces occur.

Perhaps a better approach would be for the EC to develop aspirational goals and metrics that can help the EU and its member states assess the effectiveness of policies based on the DSMS. Such a route has been followed in crafting the digital agenda for Europe, which established benchmarks for broadband speeds by the year 2020. So far, the EU only has achieved about one-third of its goal to reach 100 percent coverage at 30 Mbps. However, setting an objective with an end date is useful for evaluating how well policies are working, and determining how much fine-tuning may be necessary.

Unlike the slow pace of policymaking in the EU and the member state implementation that is required by the EU treaty to follow, technology business model development operates with an entirely different formula for success. Beta testing, trial and error, and fast failing are approaches that sharply contrast with the mechanisms of government policymaking in general and the EU in particular. By aiming for a single permanent pathway, with many years ahead until success or failure will become apparent, the current paradigm for digital policymaking that the DSMS embodies does not seem to be in synch with the speed and agility that are core characteristics of the digital marketplace. As in business, perhaps the better course would be more in line with the dynamic, disruptive philosophy that permeates the digital marketplace.

The DSMS illustrates that the EU is not yet ready to move in this direction. It seems committed to emphasizing top-down government control in shaping the future of the digital marketplace in Europe. On balance, the better approach of a DSMS may be a recognition that digital policymaking needs to operate in a more digital context—always evolving, never certain, and ready to change direction whenever significant shifts in marketplace supply and demand forces occur.

The author thanks Jamie Alexander Greig, a doctoral candidate in the College of Communication and Information at the University of Tennessee, Knoxville, for his research assistance. The views expressed herein are solely those of the author.

GOVERNANCE STUDIES

The Brookings Institution
1775 Massachusetts Ave., NW
Washington, DC 20036
Tel: 202.797.6090
Fax: 202.797.6144
brookings.edu/governance

EDITING
Nick McClellan

PRODUCTION & LAYOUT
Nick McClellan

EMAIL YOUR COMMENTS TO GSCOMMENTS@BROOKINGS.EDU