## ***Strand Consult Research Note:***

# Europe's Disconnected Continent: The next crisis hitting the EU will likely be digital—and long and expensive for society

There is much discussion about the EU telecoms package "Connected Continent: a single telecom market for growth and jobs", and EU leaders are proud to have introduced rules on roaming and net neutrality. These so-called consumerist policies have largely been the focus of the media while the proposal's 7 pillars and over 100 sub-items have been overlooked. The EU telecoms package can have a profound impact on the telecommunications infrastructure that is the foundation of modern European information society.

Listening to EU grandstanding and the uncritical media coverage, one can get the impression that lower roaming rates are all that is needed to create jobs and growth in the EU. The fact of the matter is that lower roaming rates are not in themselves a threat to telecommunications companies. But the EU has not admitted the consequences of its policy: Mandating lower roaming prices is a way to harmonize telecom prices in Europe. This inevitably means that firms must reduce output, lower costs, lay off workers, and reduce investments in infrastructure on which the information society depends.

The EU's roaming proposal is nothing more than feel good and look good politics, timed to appear to voters just before May elections. Only the naïve believe that ensuring consumers a low mobile bill during summer vacation can revolutionize the ailing telecommunications market. In practice the EU's "roam like home" policy means that consumer pay the same rate whether they use the network in their own country or in any other EU network. The price control has no regard to the underlying costs, such spectrum, taxes, infrastructure, contract conditions and so on. If operators have to lower prices, cuts have to come somewhere else. The inevitable is that operators will decrease investments in infrastructure—even further.

The revenue loss from the average roaming customer will likely be marginal. The bigger impact comes from the policy's unintended consequences, that of the creation of a new market for "mobile arbitrage", the sale and speculation of SIM cards and mobile services from low cost EU countries to high ones. It's no secret that the EU is hardly a physical single market, let alone a digital one. Just looking at price differentials between cars gives an insight to the challenge of creating a single market. Car producing countries such as Germany, Sweden, Spain, and France encourage their sale with little tax on cars while Denmark marks up the price by 180%. The EU demanding a single price for cars would be welcomed by consumers but met with outrage by governments. Yet the cost of a car is a larger expense both in upfront and maintenance costs than telecommunications is for consumers.

If EU leaders cared so much about consumers, why don't they address the expenditures that drive the greater part of consumer income, such as housing, fuel, transportation, food, and clothing? Consumers even spend more on discretionary vacations than they do on telecommunications. EU prices, even with roaming fees, fall well below the 5% of gross domestic income per income threshold suggested by the ITU. The only explanation is that the telecom industry has not done a good enough job to explain to politicians and the public they tremendous value of telecommunications. As a result, the EU has used the telecom industry as its whipping boy and created a flawed telecoms package is that it is based on eight false assumptions. The proposals and actions of the EU leaders demonstrate that they do have the courage nor the intellect to resolve the fundamental problems that make Europe uncompetitive in the digital domain. This report describes why the EU continues to fall behind the US and many Asian countries in network investment and digital innovation.

A decade ago, many considered the EU an economic threat to U.S. economic and technological dominance. At that time there were six European handset makers, and Europe's Global System for Mobile Communications was the global mobile standard.

The reality is different today. There are no significant European phone makers. EU network investment has plummeted from one-third to less than one-fifth of the world's total. The U.S., which invests in broadband at twice the per capita level of the EU, has fostered 15 of the world's top 25 Internet companies; the EU has only created one.

American operators invest almost twice per capita compared to operators in the EU ( Denmark and Norway are two of the very few exceptions). All told, 74 percent of the EU fixed broadband subscriptions are delivered by DSL (versus 34 percent in the U.S.), and just 26 percent of people in the EU can get 4G/LTE (versus 97 percent in the US)..

What's going on is that the total pie of investment in communication networks is increasing. The US has upped his commitment, so that it continues to account for a quarter of the world's total. While EU operators make some investment, they just can't keep up with other regions, especially when it comes to next generation networks. Strand Consult predicts that network investment will be free fall for the next three to four years for the following reasons.

**Uncertainty**
The current EU proposal will probably not be adopted before EU elections in late May. The new commissioner that replaces Neelie Kroes will likely not support the proposal either, or at least not in the current form. While Europe's operators might not necessarily be impacted if the proposed rules are not enacted, there is no indication that a new governmental regime will create an environment that encourages investment. Europe's operators will hold back on their investments in the uncertain political climate.

**Inevitable consolidation driven by low profitability in the industry**
Europe's telecommunications industry needs to consolidate. It is happening in Ireland, Germany, Spain, and especially France. Operators hold back investments during a shake-out. It is only once the dust settles and the remaining operators in a re-capitalized position, do they begin investing again. To be sure, national and EU competition authorities assess the impact of the consolidation, if not try to thwart it some cases. That doesn't incentivize investment either.

Europe still has not emerged from the financial crisis created by irresponsible policies and unscrupulous banks. Its lingering effects are probably the reason why many Europeans reject the EU. Politicians are desperate to do anything that makes them look friendly to voters, even to sacrifice the very logic and principles of their platforms. Free roaming is a free gift. But even free roaming doesn't help the unemployed Greeks, Portuguese, Spaniards, and Italians. They cannot afford to travel anyway.

Traffic on telecommunication networks continues to grow in the EU. Over the top players such as Netflix, Google, Facebook, Whatsapp, and Skype cannibalize telecommunications industry revenue. Should the current version of the net neutrality rule be approved by the Council of Ministers, this trend will only increase. The combination of increased traffic, an unbalanced regulatory playing field for network and OTT communication providers, declining revenue of operators, political uncertainty, and price controls makes for a toxic cocktail.

At the time when the EU desperately needs infrastructure investment to deliver the information society, the EU policy response is to promote a policy that decreases investment. Thus, the EU sets the stage for the next crisis, that of a digital crisis in which businesses and households can't get the connectivity they need; operators are not allowed to increase prices to deliver it. The inevitable shortage means that a few will be basic connectivity for a low price, and many not at all.

There is nothing in the EU's proposal to create jobs, increase competitiveness, or exit the financial crisis. The vision of the EU of a powerful connected continent will likely remain a dream and the short the time that the EU was a competitive force in its telecommunications sector is just a memory. After the current crop of politicians fade away and the new digital crisis sets in, we will feel the impact of such irresponsible policies. It is a shame for everyone as telecommunications is the foundation for our modern information society. All be can be assured with the policy that does not support network investment is a Disconnected Continent. Many politicians played a role in the financial crisis; with the coming digital crisis, the blame will be on EU politicians.