

# Agenda

Advancing economics in business

## Watch out for the super-regulators! Centralising oversight of EU telecoms

The proposed creation of the European Electronic Communications Market Authority, as part of the latest review of the EU telecoms regulatory regime, is currently high on the European regulatory agenda. The net benefits from its introduction have been estimated at between €250m and €800m. Are these benefits overstated? Have the risks and costs of centralisation been fully taken into account?

In its latest review of the regulation of the electronic communications sector, the European Commission has proposed the creation of a centralised regulatory body, the European Electronic Communications Market Authority (EECMA)—also (somewhat confusingly) referred to as ETMA, the European Telecom Market Authority.<sup>1</sup> EECMA would replace the European Network and Information Security Agency (ENISA) and the European Regulators Group (ERG). It would have the potential to change the way regulatory obligations are imposed by the national regulators. In conjunction with the Commission's new veto powers on remedies, EECMA is expected to take on a greater role in improving oversight and implementation of regulatory remedies across the EU. Indeed, the Commission's stated rationale is to:

- strengthen the regulatory framework in light of technological convergence and the prospects of transnational markets;

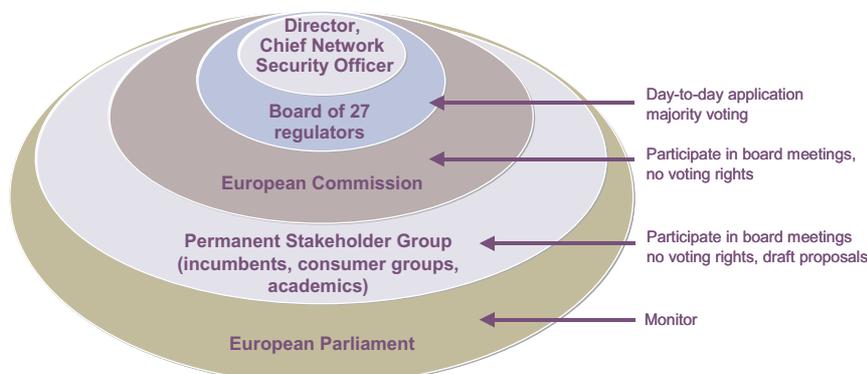
- streamline authorisation procedures for a number of European services;
- establish an EU-wide institutional mechanism for the allocation of spectrum.<sup>2</sup>

EECMA would act as an independent advisory body to the Commission on a range of issues. Its duties would be limited to the provision of opinions to the Commission and the publication of non-binding guidelines and studies—it would have no discretionary decision-making powers. The structure of the new regulatory body is illustrated in Figure 1.

To analyse the strength of the arguments in favour of EECMA's creation, it is necessary to understand the rationale behind the Commission's proposals, and to consider whether this additional layer of centralism is justified in light of the underlying economics of the communications sector.

Many industry stakeholders have expressed doubts about the need to extend the Commission's regulatory powers, arguing that the ERG itself, a body that comprises representatives of each of the Member States' national regulatory authorities (NRAs), is capable of providing recommendations concerning the Commission's regulatory decisions. According to the ERG, the Commission's proposals could add red tape, contrary to the Commission's plans to reduce the bureaucratic burden on market players and NRAs.<sup>3</sup> This would therefore not be in line with the Commission's better regulation

Figure 1 Structure of EECMA



Source: Oxera, based on European Commission (2007), 'Proposal for a Regulation of the European Parliament and of the Council Establishing the European Electronic Communications Market Authority', November 13th.

principles, as argued by the European Economic Area Standing Committee of the EFTA States.<sup>4</sup> Consistent application of EU-wide spectrum policy is, on the other hand, subject to less controversy.

Considerations of establishing a European ‘super-regulator’ are not unique to the telecoms sector. For example, the Commission’s proposal to reform European electricity and gas markets includes establishing a pan-EU regulatory agency.<sup>5</sup> The proposed agency would provide regulatory oversight of transmission system operators for gas and electricity, particularly in matters relating to cross-border infrastructure and related network investments.

So what insights can economics provide to this debate?

## A fragmented market, but a common regulator

The transition of national markets to an integrated market is one of the key policy challenges against which the proposal for a super-regulator should be judged, as highlighted in the Commission’s explanatory memorandum for the establishment of EECMA:

In the age of technological progress, cross-border business activities and growing consumer demand for electronic communications services regardless of geographic location, achieving a true internal market in telecoms becomes essential for Europe’s competitiveness.<sup>6</sup>

A harmonised regulatory approach is considered by the Commission as crucial for the achievement of an integrated European market for electronic communications.<sup>7</sup> It is clear from the proposed change to the regulatory structure that the Commission considers that such harmonisation is more likely to be achieved via the creation of a pan-European authority than by the current regulatory structure. This corresponds to the underlying rationale for EECMA—namely to strengthen the regulatory framework in the context of the development of transnational markets and technological convergence.

The European market for electronic communications services remains fragmented and national in nature, with few operators offering pan-European services. It could therefore be argued that the list of pan-European markets subject to ex ante regulation requiring supervision by the proposed authority is considerably shorter than suggested by the Commission.

- **International mobile roaming.** International roaming is one of the few examples where no unilateral agreement on how to regulate these markets could be reached among NRAs, even though there was a general consensus that wholesale prices were too

high.<sup>8</sup> To overcome the incentive problem of reaching a unilateral agreement to lower wholesale charges, the market has been regulated via an EC Regulation.<sup>9</sup>

- **Voice over Internet protocol (VoIP).** This is another service with pan-European potential. As highlighted by the ERG, the possible benefits of cross-border services are currently not being exploited due to differences in the general authorisation conditions across Europe, such as geographic numbering policy and emergency calls. The provision of common VoIP services across the EU may be viewed as uneconomic as a result of these differences.

A broader question is whether the geographic scope of a wider set of telecoms services has in any way been constrained by the absence of a single European regulator, and whether the existence of such a regulator would promote transnational telecoms services.

In relation to the first of these questions, it is far from clear whether the geographic scope of most telecoms services would justify such a change in the institutional set-up, or whether the ability to provide EU-wide services has been constrained more by differences in regulatory measures adopted at the national level than by the separate ownership of the network assets in different countries.

Barriers to a transnational market also relate to the nature of many communications markets that are subject to ex ante regulation, including the following.<sup>10</sup>

- **Economies of density.** Geographic factors such as economies of density often support no more than one or two operators in national markets. Bitstream access is an example where local parameters, such as economies of density and network topology, play a prominent role when considering the best regulatory approach.
- **Infrastructure substitutability.** Most European wholesale markets for telecoms services are considered to have insufficient supply substitutability of access infrastructure. Communication services that are heavily regulated, particularly the access element, can be sold only in a single location, which eliminates the possibility of cross-border activities. Local-loop unbundling services, for example, are feasible in only one location.
- **Legacy of incumbents.** Traditional market segments, such as access to fixed telephony and broadband, are typically characterised by large market shares from former incumbents. This is in part due to the fact that such infrastructure investment has traditionally accrued at a national level within the EU.

On this basis, it is not clear whether the Commission's rationale for streamlining procedures is supported by the geographic scope of those markets that it intends to regulate. In some Member States, there is also a growing body of support for sub-national regulatory measures to be developed to reflect divergent conditions of competition within Member States. For example, the Commission recently approved the proposed de-regulation of the wholesale broadband market in some parts of the UK since those geographic areas were considered as being characterised by effective competition.<sup>11</sup> Such developments might be less likely in a centralised regulatory arena.

## What are the potential benefits of a pan-European regulator?

Although the list of pan-European markets subject to ex ante regulation by EECMA is currently short, there may be other justifications for a supra-national regulator, including better coordination and lower transaction costs. The Commission's cost-benefit study of EECMA identifies potential economic benefits in the areas of consumer welfare, availability of new services, investment incentives and incentives to innovate.<sup>12</sup> It is, however, intrinsically difficult to ascertain the magnitude of those benefits beyond a certain level of approximation. In particular, improvements in dynamic efficiency with a future effect on the innovation and technological improvements are often not commensurable.

Any assessment of potential benefits must be made against the status quo, which includes the current structure and effectiveness of the ERG and the Commission's current activities.

The Commission's cost-benefit analysis identifies four potential sources of benefits that could eventually lead to greater market harmonisation. These benefits are also reflected in the Commission's rationale for establishing EECMA.

- **Transnational markets.** The Commission believes that centralised supervision of transnational markets would benefit from EECMA. As discussed above, international roaming and VoIP have been identified as markets that may warrant further regulatory intervention at the European level. Improved supervision of regulated services with a pan-European dimension may solve incentive problems of local authorities in intervening. A reduction in prices and improved transparency are a potential source of consumer welfare gains in this regard.
- **New authorisation procedures for transnational services.** The lack of pan-European authorisation procedures is thought to be a cause of delay to the

introduction of pan-European services such as satellite services. Delayed introduction of those services is particularly harmful to electronic communication markets characterised by technological change and lock-in effects. A more harmonised approach could therefore be expected to become a potential source of dynamic efficiency improvements.

- **National market analysis.** Since the implementation in 2002 of the current regulatory framework, the Commission has begun several infringement procedures against NRAs for failure to notify market reviews. However, non-compliance with the so-called Article 7 procedures was triggered largely by problems in the process of transposing the regulatory framework into national law. Market reviews were not significantly delayed once the transposition was successfully completed. The economic benefits of EECMA are also viewed by the Commission to be of limited value in this context since compliance with Article 7 procedures is still highly dependent on NRAs and national appeal courts.
- **Oversight and veto of NRA remedies.** Central to an assessment of potential regulatory benefits is improved cooperation between the NRAs. A peer review mechanism of the information gathered in local markets is assumed to increase the overall level of analysis. This, in turn, is expected to reduce the likelihood of systematic regulatory errors. A more consistent application of best-practice regulation within Europe may be of particular benefit to less experienced NRAs with access to fewer resources. This could improve overall consumer welfare and investment incentives.

In addition to those benefits outlined by the Commission's cost-benefit analysis, it is possible to identify a number of additional economic welfare gains that may arise on the basis of this pan-European authority.

- **Regulatory risk.** Changes in laws or regulations may increase the costs of operating a business, which may negatively affect investment incentives. Enforcement of regulatory remedies on prices and quality of service may, for example, change future returns on investments. Harmonised regulatory intervention by EECMA—particularly with regard to regulatory remedies—is assumed by the Commission to reduce overall regulatory costs for companies by making expectations about regulatory remedies more certain. This applies to both pan-European and national investments. The enforcement of regulatory measures currently depends on national European institutions. A

more harmonised regulatory approach could give further clarity to investment decisions that encompass more than one country. For national investments, unexpected changes in a country's regulatory approaches might be less probable under the supervision of a pan-European authority, as NRAs and the Commission may be more likely to adopt a common approach.

- **Economies of scale.** The full exploitation of scale economies may be put at risk due to the current regulatory system.<sup>13</sup> The authorisation and right-of-use for frequencies and numbers are a key source of improvements in this regard. This argument does not necessarily hold, however, for access markets subject to ex ante regulation where EU-wide markets and intra-EU trade is often not a viable economic solution due to the nature of telecoms markets and associated infrastructure investments.

## Do these benefits outweigh the costs?

The cost–benefit analysis of the Commission's proposals suggest that the economic benefits of €250m–€800m exceed the budgetary costs of EECMA by a factor of 10 to 30 times. The costs taken into consideration relate only to the direct budgetary costs such as staff wages.

However, When modelling the behaviour of regulatory agencies, few theories make use of budget-maximising hypotheses.<sup>14</sup> Not only direct costs, but also indirect costs and benefits, such as investment incentives for businesses, are taken into consideration. Judgements on the desirability of the proposed authority thus also involve a more thorough understanding of potential indirect costs of this pan-European authority than set out by the Commission.

- **Country-specific knowledge.** Expertise about local circumstances and a detailed knowledge of local markets are usually greater at the national level. The right balance between access infrastructure and unbundling, and between wholesale unbundling and

wholesale managed services is highly dependent on the particular empirical factors in a particular Member State. The remoteness of EECMA from the markets that it would regulate could be therefore be disadvantageous, raising costs for operators and the NRAs due to the need to educate EECMA personnel about the local conditions in each Member State. Diversity in regulatory approaches may benefit innovative industries, as NRAs can experiment and learn from their experiences. A one-size-fits-all approach may therefore not always be an appropriate solution to the European market.<sup>15</sup>

- **Coordination.** There are concerns that enhanced cooperation could be achieved through the existing ERG, without adding an extra layer of centralism. This is in line with views of, for example, the French regulatory authority, which suggests that EECMA may even impede the dynamics of positive cooperation within the ERG.<sup>16</sup>

## Concluding remarks

Although the legal mandate of EECMA is relatively limited, since it is envisaged to have no discretionary decision-making powers, the introduction of a pan-European super-regulator has led to significant controversy among stakeholders, not only on political grounds but also economic. Focusing on the latter, as this article has done, it is clear that there are a number of additional considerations.

In particular, little analysis appears to have been undertaken of the extent to which the development of pan-European services are impeded by the separate ownership of assets on a national level. Instead, it is effectively assumed that the existence of different regulatory measures on a national level impede such development. This assumption may not be consistent with developments in a number of Member States. Harmonisation of regulatory measures may lead to regulation across Europe that is either too weak or disproportionately strong relative to national market conditions.

- <sup>1</sup> European Commission (2007), 'Proposal for a Regulation of the European Parliament and of the Council Establishing the European Electronic Communications Market Authority', November 13th.
- <sup>2</sup> European Commission (2007), 'A Study on the Cost–Benefit Analysis of Options for Better Functioning of the Internal Market in Electronic Communications (with special focus on the establishment of European Electronic Communications Market Authority–EECMA)', October 22nd.
- <sup>3</sup> ERG (2007), 'Letter to Commissioner Viviane Reding', November 6th.
- <sup>4</sup> European Economic Area Standing Committee of the EFTA States (2008), 'Subcommittee II on the Free Movement of Capital and Services, EEA EFTA Comments on the Proposal for a Regulation of the European Parliament and the Council Establishing the European Electronic Communications Market Authority', March 18th.
- <sup>5</sup> European Commission (2007), 'Proposal for a Regulation of the European Parliament and of the Council Establishing an Agency for the Cooperation of Energy Regulators', COM/2007/0530 final–COD 2007/0197.
- <sup>6</sup> European Commission (2007), 'Proposal for a Regulation of the European Parliament and of the Council Establishing an Agency for the Cooperation of Energy Regulators: Explanatory Memorandum'.
- <sup>7</sup> ERG (2006), 'Effective Harmonisation within the European Electronic Communications Sector: A Consultation by ERB, ERG (06) 68.'
- <sup>8</sup> Ibid.
- <sup>9</sup> European Commission (2007), 'Accompanying Document to the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on market reviews under the EU Regulatory Framework (2nd report), Commission Staff working document, COM(2007) 401 final, Brussels, SEC(2007) 962, July 11th, p. 12.
- <sup>10</sup> ERG (2006), op. cit.
- <sup>11</sup> European Commission (2008), 'Telecoms: Commission Approves OFCOM Proposal to De-regulate Part of UK Broadband Market', press release, February 14th.
- <sup>12</sup> European Commission (2007), 'A Study on the Cost–Benefit Analysis of Options for Better Functioning of the Internal Market in Electronic Communications (with special focus on the establishment of European Electronic Communications Market Authority–EECMA)', October 22nd.
- <sup>13</sup> European Commission (2007), 'The European Telecom Market Authority: Factsheet—2007 EU Telecoms Reform no. 3', November.
- <sup>14</sup> Majone, G. (1996), 'The European Commission as Regulator', in G. Majone, *Regulating Europe*, Routledge: London.
- <sup>15</sup> See, for example, del Castillo, P. (MEP) (2008), 'A Guide from EECMA to BERT', March 25th.
- <sup>16</sup> *Les Echos* (2008), 'Non à un super régulateur européen des telecoms', February 20th. Interview with Paul Champsaur, Chairman of the Autorité de Régulation des Communications Electroniques et des Postes.

If you have any questions regarding the issues raised in this article, please contact the editor, Derek Holt: tel +44 (0) 1865 253 000 or email [d\\_holt@oxera.com](mailto:d_holt@oxera.com)

Other articles in the April issue of *Agenda* include:

- competition in energy markets: a consumer perspective *Allan Asher, energywatch*
- myopia or yours? how pension reform can encourage saving for retirement
- taking stock: competition and investment in gas storage services

For details of how to subscribe to *Agenda*, please email [agenda@oxera.com](mailto:agenda@oxera.com), or visit our website

**[www.oxera.com](http://www.oxera.com)**