

DSM STRATEGY AND DIGITAL REGULATION IN THE EU

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EU MAINTAINS A TOUGH STANCE TOWARD IT GIANTS

In the course of economic digitalization, US IT major companies, such as Google, Apple, Facebook, and Amazon (collectively known as GAFAs), are further increasing their advantages, while the EU continues to take a tough stance toward these companies.

In recent months alone, a number of specific actions have been taken. For example, in March 2018, the European Commission made a proposal to introduce a digital tax¹, and in May 2018, it enforced the General Data Protection Regulation (GDPR), which requires companies to manage personal data rigorously. The European Commission also imposed a €4.34 billion fine on Google for competition law violations in July 2018, and launched a preliminary investigation into possible infringement of competition law by Amazon in September 2018. The European Parliament passed an EU draft directive designed to strengthen copyright protection on the Internet in September 2018.

There is a growing international criticism of US IT giants, due in part to the revelation in March 2018 that Facebook had shared the personal data of tens of millions of users with data analysis firm Cambridge Analytica, and that the data may have been used to influence the outcomes of elections, including the American presidential election. That said, the EU's hardline stance towards IT giants stands out even more.

EU DIGITAL STRATEGY—AIMING TO CREATE DSM

The EU is not opposing economic digitalization, but working positively to drive the change.

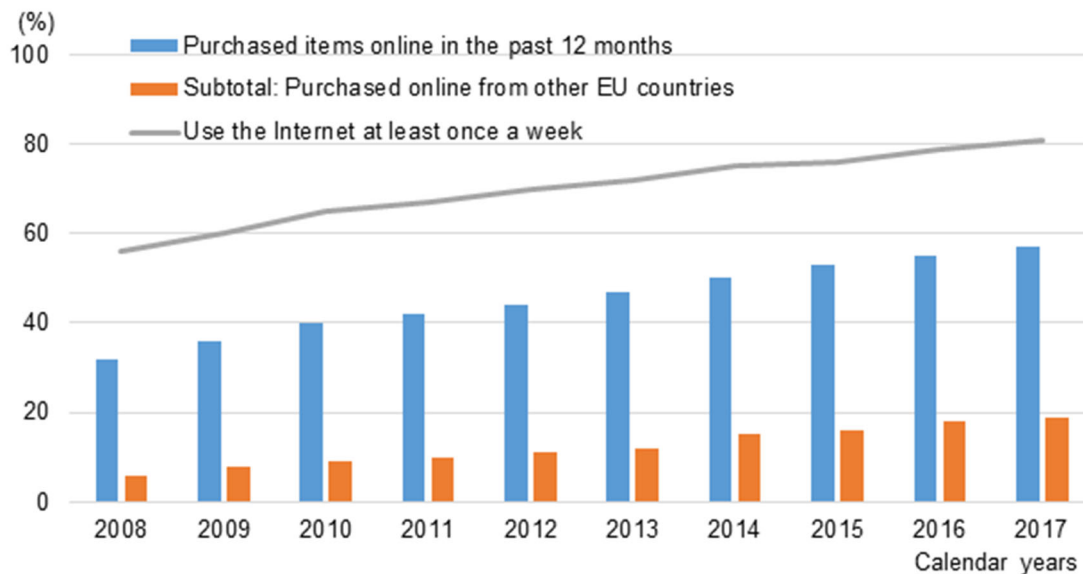
In its promotion of economic digitalization, the EU is tackling some challenges related to cross-border online transactions. Such issues include geo-blocking, which restricts access to Internet content based upon the user's geographical location, as well as different value-added tax (VAT) systems by country and the complexity of administrative processes when shipping goods overseas.

Statistics for 2017 show that 19% of EU citizens had purchased goods and services online from other countries within the EU in the past 12 months (Figure 1). Around 80% had used the Internet at least once a week, and almost 60% of EU citizens had purchased goods or services online in the past 12 months. Given that "the free

¹ Efforts to build a consensus in the EU appear to have bogged down because of opposition from countries that have actively used low taxes to attract the US IT companies, such as Ireland. Under such a situation, in October 2018, the UK announced that it would introduce its own digital tax, imposing a 2% levy on income earned by IT companies from UK users.

movement of people, goods, services and capital” is a basic principle of the EU, the figure of 19% has substantial scope for further growth.

Figure 1: Online Purchasing in the EU



Note: Including purchases of services
Source: Compiled by MGSSI using Eurostat data

To address these issues, the EU has adopted the Digital Single Market (DSM) strategy, the aim of which is to allow consumers and businesses to receive as much benefit as possible by integrating digital markets within the EU. The DSM strategy is built on three pillars :1) better access for consumers and businesses to digital goods and services across Europe, 2) creating the right conditions and a level playing field for digital networks and innovative services to flourish, and 3) maximising the growth potential of the Digital Economy. It consists of 16 specific key initiatives under the three pillars (Figure 2).

Figure 2: Three Pillars and 16 Specific Key Initiatives for the DSM

Pillar 1: Better access for consumers and businesses to digital goods and services across Europe	
1	Legislative proposals for simple and effective cross-border contract rules for consumers and businesses
2	Review the Regulation on Consumer Protection Cooperation
3	Measures in the area of parcel delivery
4	A wide ranging review to prepare legislative proposals to tackle unjustified Geo-blocking
5	Competition sector inquiry into e-commerce, relating to the online trade of consumer goods and the online provision of digital content
6	Legislative proposals for a reform of the copyright regime
7	Review of the Satellite and Cable Directive
8	Legislative proposals to reduce the administrative burden on businesses arising from different VAT regimes
Pillar 2: Creating the right conditions for digital networks and services to flourish	
9	Legislative proposals to reform the current telecoms rules
10	Review the Audiovisual Media Services Directive
11	Comprehensive analysis of the role of platforms in the market including illegal content on the Internet
12	Review the e-Privacy Directive
13	Establishment of a Cybersecurity contractual Public-Private Partnership
Pillar 3: Maximising the growth potential of the Digital Economy	
14	Initiatives on data ownership, free flow of data (e.g. between cloud providers) and on a European Cloud
15	Priority ICT Standards Plan and extending the European Interoperability Framework for public services
16	New e-Government Action Plan including an initiative on the 'Once-Only' principle and an initiative on building up the interconnection of business registers

Source: Compiled by MGSSI based on European Commission documentation

Expectations toward the DSM are high, and the European Commission estimates that the economic effects could amount to €415 billion. More specifically, price reductions in the e-commerce field, enhanced welfare of people as a result of the expansion of choices, as well as cost reductions, productivity improvements, and new business opportunities resulting from the spread of cloud computing and other information technologies, are anticipated.

In May 2017, the European Commission released a mid-term review of the DSM strategy, in which it identified three areas where further action is needed: (1) maximising the development of the data economy (using the full potential of digital data to provide economic and social benefits), (2) protection of European assets through solving cyber-security challenges, and (3) promoting the online platforms as responsible players of a fair internet ecosystem. In relation to (1), the European Commission has pointed out that when the development of the data economy contributes in a number of areas, including the growth of European companies and the modernization of public services, and if appropriate policies are implemented, the value of the data economy will double from the 2016 level to 4% of GDP by 2020. A particular priority at present is the facilitation of flows of non-personal data within the EU. In October 2018, the European Parliament passed draft rules on the free flow of non-personal data in the EU. Ms. Anna Maria Corazza Bildt, who reported on the rules, stated that the rules would “pave the way for artificial intelligence, cloud computing and big data analysis”. Her comments are indicative of EU’s high expectations toward the future growth of these industries.

USING COMPETITION LAW TO ENSURE A LEVEL PLAYING FIELD

Of the abovementioned three priority areas identified by the EU under the DSM strategy, the most significant from the perspective of regulating US IT giants is the third one: promoting the online platforms as responsible players of a fair internet ecosystem.

Major US IT firms attract large numbers of businesses and consumers by offering platforms for online sales and advertising, in the form of software and applications. Data obtained from users is utilized to customize their services, and these companies gain an overwhelming competitive advantage, especially over new market participants. As a result, the market shares of US IT giants rise even further, allowing them to establish a monopoly or oligopoly situation in some markets.

According to an EU survey on relationships between small and medium enterprises and platform providers, “Flash Eurobarometer 439 ‘The use of online marketplaces and search engines by SMEs’” (released in June 2016), 82% of EU SMEs that sell online rely on search engines to sell their products or services online, and 66% believe that their position in search results has a significant impact on their sales. Further evidence of the significantly heavy reliance of European businesses on platform providers can be found in a May 2017 report published by the European Commission under the title “Business-to-Business relations in the online platform environment”. According to this report, 90% of survey participants have used social media and SNS for marketing purposes.

This type of relationship can easily lead to unfair business practices. In the abovementioned European Commission survey, 46% of respondents answered that they had experienced problems with platform providers. The percentage rises to 75% among companies that make more than half of their sales via platforms. Specific examples of problematic business practices include a lack of transparency in search results and rankings, the removal of products or services from lists without prior notice, preferential treatment for the platform provider’s own products or services, and the restriction of access to personal and non-personal data.

The fine for violations of competition law, noted at the beginning of this report, was used against a platform provider that abuses its dominant position to the detriment of EU companies, especially as a case that the EU considers the effect of the abuse to be particularly serious. (Platform providers’ holding a monopoly/oligopoly status itself is not an issue per se.) In April 2018, the European Commission proposed new rules stipulating standards for fair trading practices, measures to ensure transparency, and the creation of dispute settlement mechanisms. These rules will prevent EU SMEs that are in the weaker positions against platform providers from

being forced to sign disadvantageous contracts. It will also create a legal mechanism, in the form of an arbitration system, for fighting unfair practices. Together with fines for competition law violations, the new rules are expected to be used as a way of countering unfair practices by major US IT firms.

EU'S INTRODUCTION OF THE GDPR WITH THE AIM OF PROTECTING PERSONAL DATA AND ENCOURAGING COMPETITION

Next, we will look at the EU General Data Protection Regulation (GDPR), which establishes common rules across the entire EU² for the processing and movement of data. Ideas provided in the GDPR, namely gaining the confidence of EU citizens concerning the protection of personal data, formulating common rules for the protection of personal data within the EU, and allowing personal data to be stored and processed freely (under the rules), are all necessary conditions for ensuring the development of the digital economy and creating the DSM. In this sense, the GDPR can be seen as an essential component to promote the DSM.

In the EU, personal data protection is positioned as part of fundamental human rights. Because of the GDPR's role in protecting this important value, violations will incur extremely heavy penalties, a fine of up to €20 million or 4% of the global sales in the previous financial year, whichever is greater.

One particularly notable feature of the GDPR is the establishment of the right of data portability. Data portability is the right of data subjects (EU citizens) to obtain the personal data they have provided to data controllers (platform providers, etc.) in a structured³, commonly used, and machine-readable format, and to transmit those data to another data controller without hindrance. According to guidelines published by the European Data Protection Board (EDPB), examples of data subjects' own information that they may be interested in obtaining include playlists and access records for music streaming services, and contact lists of web mail applications. The ability to transfer these types of data to competing services can be expected to result in a major alleviation of the difficulties experienced by users when they change services. The extent to which users will actually switch services is uncertain at present, but by reducing the current concentration of user data in the hands of a limited number of platform providers, this measure can be expected to stimulate the creation and growth of new services. In this sense, the GDPR has an aspect of an EU means of countering the influence of US IT giants.

However, we also need to be aware of the risk that the GDPR could have an unforeseen negative impact on EU start-ups. The stringent protection of personal data required under the GDPR could be a factor leading to higher costs and thus discourage start-ups from innovating. Furthermore, if the enforcement of the GDPR results in heightened awareness of personal data, it is possible that EU citizens will select familiar services, such as those provided by the GAFAs companies, and shy away from unknown start-ups.

Many companies, including the GAFAs, have changed their privacy policies or taken other steps in response to the enforcement of the GDPR. While on the day that GDPR came into force, a non-profit privacy protection group sued Google and Facebook on the grounds that they were in violation of the regulation, there have been no such cases that fines have been actually imposed for GDPR violations. But a survey by US firm Talend showed that 70% of companies were unable to meet the one-month deadline for compliance with data portability

² The GDPR covers a total of 31 countries, including EU members, together with Norway, Ireland, and Liechtenstein.

³ "Structured" means in a format that can readily be organized into tables, etc. The GDPR does not provide any recommendations, etc., concerning what constitutes a structured, commonly used, and machine-readable format, but a format that entails restrictions, such as fee-based licensing contract, would be deemed to be inappropriate.

requirements, indicating that the development of structures to cope with the GDPR by businesses still has a long way to go.

Since the GDPR applies to any situation in which data relating to EU citizens is processed or transferred, such as during Internet transactions, even if the company concerned does not have an office in the EU, Japanese companies could also be affected by the regulation. In July 2018, personal data was leaked as a result of unauthorized access to a French hotel reservation site that was handling bookings for hotels in Japan. This raised the possibility that the Japanese hotel that had made a contract with the site could be guilty of GDPR violations as a data controller. The GDPR has only been in force for a short time, and we will need to await judgments by the EU authorities as to what actually constitutes a violation of the regulation. That said, Japanese companies need to take necessary precautions, assuming various potentially damaging situations.

DIFFICULT TO CREATE INTERNATIONAL DATA TRANSFER RULES, AND RISK PREDICTABILITY IS LOW

As discussed in this report, the EU has taken actions against US IT giants to create a regional DSM by ensuring a fair competitive environment and establishing the personal data protection as a common rule within the EU.

Looking at the trends around the world, at a time when the importance of data to economic activity is increasing, a growing number of countries are placing restrictions on cross-border transfers of personal data. Also, the introduction of the GDPR has triggered some countries to look at issues relating to the handling of personal data. Restrictions on transfers of personal data are already in place in several countries, including Canada, Australia, Singapore, and Malaysia. Like the EU, some countries require that the recipient countries for data transfers also have adequate levels of data protection.

Meanwhile, there have also been moves to impose even stricter requirements, such as the local installation of servers and other related equipment. China typifies this trend. Under its cyber security law, operators of vital information infrastructure are required to store important or personal data within China. Similar moves have been seen in other countries, such as Russia, Indonesia, and Vietnam. In addition to the protection of citizens' privacy, these measures are apparently designed to maintain political stability by keeping sensitive data monitorable, and to foster domestic companies by preventing market entry by foreign companies, such as the GAFA.

Data regulations reflect each country's ideology. Since the nature of regulations can vary according to each country's priorities, such as freedom of economic activity, personal privacy, or security, it is likely to be difficult to introduce uniform data regulations across the world, despite the need for internationally common rules as the basis for the development of the data economy.

As economic digitalization continues, there are likely to be more and more situations in which Japanese companies will acquire and utilize data. We need to be aware of the risk of major impact on the business environment, such as that sudden changes in policies on the management of personal data and other information in countries where companies do business may prevent them from utilizing data.

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