

## Does Europe need subsidized competition for achieving the goal of rapid deployment of broadband networks?

Comments by Hans W. Friederiszick,<sup>1</sup> Rainer Nitsche (both ESMT Competition Analysis) and Lars-Hendrik Röller (European School of Management and Technology, ESMT) on the draft Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks (in the following “Draft Broadband Guidelines”).<sup>2</sup>

### Introduction

We appreciate the opportunity to comment on the Draft Broadband Guidelines. It is our understanding that the Draft Broadband Guidelines build on the refined economic approach and the balancing test as proposed in the State Aid Action Plan and further outlined in a recent horizontal paper on common principles for an economic assessment of the compatibility of state aid (in the following “Common Principles”).<sup>3</sup>

The Draft Broadband Guidelines constitutes a major potential deviation from those Common Principles (or at least allows such an interpretation) with respect to one issue though: competition is not used as an instrument to reach specific policy objectives; rather it is a policy objective in itself.

The Draft Broadband Guidelines constitute a convincing approach for areas where at least two broadband operators are present (black areas: presumption of illegality) and areas where no private investment in NGA is expected in the future (white areas: presumption of legality). However, in the grey areas, where an incumbent already exists, the issues are more novel. In these areas, criteria are suggested to assess state aid that is granted in support of building a second NGA infrastructure, i.e. aid is granted to subsidize competition itself.

This raises the fundamental questions of whether tax payers’ money should be used to subsidize competition per se, or only when the goal of rapid deployment of broadband networks is likely to be

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<sup>2</sup> Disclaimer - this comment reflects our independent views; we have carried out academic as well as consulting work for Deutsche Telekom in the past.

<sup>3</sup> COMMON PRINCIPLES FOR AN ECONOMIC ASSESSMENT OF THE COMPATIBILITY OF STATE AID UNDER ARTICLE 87.3

achieved. In our view it is the latter that justifies the usage of public resources. Along the same lines, the Draft Broadband Guidelines seem to propose that State aid could be granted to remedy access conditions that are not adequate.

*“Where the market does not provide sufficient broadband coverage **or the access conditions are not adequate**, state aid may play a useful role” (Draft Broadband Guidelines, para 33; emphasis added).*

Justifying state aid by regulatory failure broadens the scope of state aid considerably. Although this is in principle possible, more effects based evidence and clearer criteria that, if met, are likely to lead to rapid deployment of broadband networks is needed, before embarking on using public resources to subsidize entry.

We suggest that the revised Guidelines should clarify the Commission’s position on these matters.

## The problem at hand

The Draft Broadband Guidelines emphasise the objective of rapid and widespread deployment of NGA infrastructure across Europe. However, the Draft Guidelines do not restrict the role of State aid to achieve this objective. Rather it proposes to use state aid to mitigate market power and lower prices:

*“Although a network operator may be present in the zone targeted by the State intervention, certain categories of users may still not be adequately served in the sense that either some broadband services requested by the users were not available to them or their **prices were not affordable** compared to the same services offered in other more competitive areas or regions of the country. If in addition, there are only little prospects that third parties would build an alternative infrastructure, the funding of an alternative infrastructure could be an appropriate measure” (Draft Broadband Guidelines, para 39, emphasis added).*

Moreover, the Commission in its assessment would consider whether

*“effective network access is not offered to third parties or access conditions (regulated and unregulated access) are not conducive to effective competition” (Draft Broadband Guidelines, para 40).*

## The danger of making grey areas white

Subsidising entry in order to lower prices in grey areas reduces the profits of the monopolist and therefore reduces the incentive to invest. In grey areas, which do not commercially sustain two operators, the prospect of competition through subsidised entry may deter the investment that leads to the initial deployment of the NGA infrastructure.

Subsidised entry devalues the investments of the incumbent operator. While this may have no immediate effect on past (sunk) investment of the incumbent it changes the incentives for future investments not only of the incumbent but of all market participants in neighbouring markets that

anticipate subsidised entry. Crowding-out effects are in our experience significant in this policy area. A policy of subsidised entry into markets with pre-existing infrastructure may therefore easily jeopardize significant investments and not be helpful in achieving the stated goal of rapid deployment of broadband networks.

## Using State aid to remedy regulatory failures

The Draft Broadband Communication offers State aid as a policy tool in cases where there is no effective competition either due to no regulation or due to regulatory failure. This raises the concern that taxpayers' money is used to remedy regulatory failures. Why should tax payers pay for regulatory failures? Is State aid the right approach to foster entry?

There is a rather sophisticated debate on the appropriate regulatory environment for NGA that focuses on the need for sufficient investment incentives. Risk sharing and other approaches have been proposed in the draft NGA Guidelines and various risk sharing schemes are being developed and implemented by investors. There is a danger that the prospect of State aid financed entry will undermine the investment incentives that the NGA Guidelines attempt to create.

## Conclusion

While we appreciate the general approach taken in the Draft Broadband Guidelines we propose to clarify in the final version the position of the Commission regarding the use of State aid to subsidise entry in grey areas with regulated monopolies. Competition is a means to an end and not an end in its own right.