

Beyond the Digital Tax: The Challenges of the EU's Scramble for Technological Sovereignty

by Nicola Bilotta

ABSTRACT

The COVID-19 pandemic has laid bare how critical digital platforms are to the functioning of our economy. Big Tech companies are likely going to emerge stronger from the COVID-19 emergency, due to the massive surge in demand for public, retail and corporate digital services. This megatrend has consolidated the dominant market position of digital multinationals – almost all of them from the US – in the EU markets, raising critical questions ranging from the EU's ambition for technological sovereignty to the much more urgent issue of how Big Tech's profits should be taxed. The "digital tax" issue – already the source of a lively international debate before COVID-19 – has gained in prominence as it would be an important instrument for governments in dire need of raising money to finance the post-pandemic economic recovery. With the digital tax included the Next Generation EU recovery fund presented by the European Commission, the EU is expected to further consolidate its global leadership in tech regulations. However, European regulatory activism could also raise barriers to transatlantic trade and investments, thus producing new tensions with the US.

Digital governance | Taxation | European Union | USA | Transatlantic relations | Coronavirus

keywords

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by Nicola Bilotta*

Introduction

The COVID-19 pandemic has disrupted the world economy, causing a deeper crisis than the 2008–09 Great Recession. The crisis has produced (many) losers and (very few) winners in global markets. Among the latter, Big Tech firms have performed particularly well. Thanks to the massive surge in public and private (both retail and corporate) demand for digital services as well as expectations of further investments in supply chain digitalisation, digital multinationals such as Amazon and others will likely emerge from the pandemic stronger than before.

In the EU, the prospect of massive Big Tech profits has rekindled the heated debate on the so-called “digital tax”, a levy specifically designed to make Big Tech companies pay a greater share of taxes in countries where they make profits rather than where they legally reside. As EU governments are set to deploy extraordinary expansionary fiscal measures to stimulate an economy placed in an artificial coma by extended national lockdowns, the appeal of the digital tax has increased massively.¹ Attesting to this, the digital tax features amongst the sources of funding in the Next Generation EU recovery plan recently unveiled by the European Commission, although details on how it would work have yet to materialise.

In laying bare how critical digital services are to European economies, COVID-19 has also made EU governments acutely aware of their dependence on foreign companies, specifically US multinationals, for the provision of those services. Market dominance by US digital giants is giving new prominence to the debate on the EU's ambition for “technological sovereignty”. While the Next Generation EU plan seems to have come up with an ambitious regime of digital investments to

¹ Sébastien Laffitte et al., “International Corporate Taxation after Covid-19: Minimum Taxation as the New Normal”, in *CEPII Policy Briefs*, No. 30 (April 2020), <http://www.cepii.fr/CEPII/en/publications/pb/abstract.asp?NoDoc=12596>.

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mitigate its structural digital underdevelopment, the EU should further strengthen its role as the world leader in technology regulation. Digital regulation may increase the EU's international influence, as it is increasingly relevant to geopolitical balances. However, precisely for this reason, it may generate significant tensions with the US.

1. US Big Tech: the winners of the COVID-19 emergency

The COVID-19 emergency has deeply impacted Internet multinationals, disrupting their business models or damaging some of their most profitable activities. Airbnb, the online platform for renting out properties and spare rooms, has been hit severely by the travel restrictions and the consequent decline of the tourism industry. Airbnb is reported to have lost around 90 per cent of bookings, seeing its market value plunge from 31 billion to 26 billion US dollars, a 16 per cent decrease in two months.² Uber, the world's leading ride-hailing platform, has experienced an 80 per cent drop in global ride demands compared to last year.³ According to Cowne & Co., Alphabet and Facebook are estimated to lose about 28.6 billion and 15.7 billion US dollars, respectively, in digital advertisement revenue in 2020.⁴ The slowdown of the global economy and the fall in demand are pressing enterprises to rationalise their budget allocation and marketing strategy. Thus, it does not come as a surprise that the market capitalisation of the five largest tech giants (Alphabet, Amazon, Apple, Facebook and Microsoft) decreased by more than 1 trillion US dollars between February and March.

Yet, this is only one side of the story.

After a short while, capitalisation of these companies started to grow again, accounting for a fifth of the entire Nasdaq 100 technology sector index's market capitalisation in April.⁵ The worldwide lockdown is driving up demand for digital products and services of which these players are the main providers, as their latest quarterly results highlight. Big Techs could thus emerge from the crisis with stronger market positioning.

Microsoft recorded a positive quarter with revenues of 35 billion US dollars (a 15 per cent increase compared to a year ago) and net income for 10.8 billion US dollars (+22 per cent). The revenues generated by the intelligent cloud segment grew by

² David Lee, "Airbnb Lowers Internal Valuation by 16% to \$26bn", in *Financial Times*, 3 April 2020, <https://on.ft.com/3bO840c>.

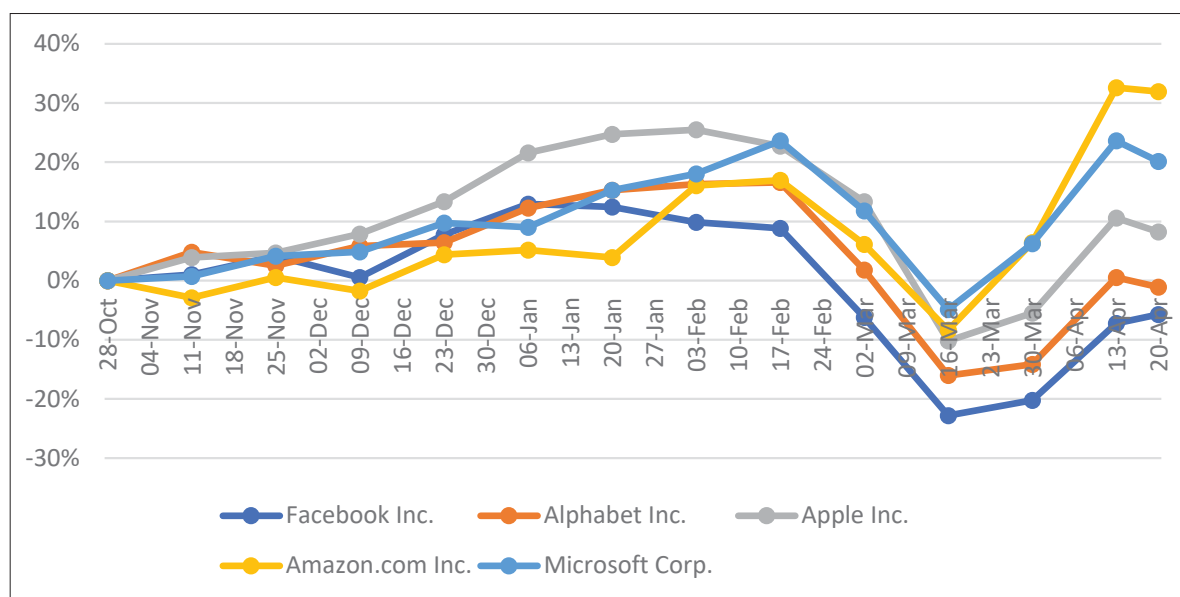
³ Amir Efrati, "Uber's Bookings Now Down 80%", in *The Information*, 21 April 2020, <https://www.theinformation.com/briefings/7120d9>.

⁴ Sara Fischer, "Tech Giants Set to Lose Billions in Ad Revenue in Virus Shutdown", in *Axios*, 27 March 2020, <https://www.axios.com/f0e74396-6444-4c44-8aa7-974dd3e89883.html>.

⁵ Robin Wigglesworth, "How Big Tech Got Even Bigger in the Covid-19 Era", in *Financial Times*, 1 May 2020, <https://on.ft.com/3aYaEQ9>.

a remarkable 27.28 per cent. Alphabet closed its first quarter in 2020 with +13.2 per cent in total revenues. Its profitability was driven up by the Google advertising segment (+10.4 per cent), YouTube ads (+33.49 per cent) and Google Cloud (+52.1 per cent).⁶ Facebook also had a positive quarter. Its revenues rocketed by 15 per cent and its net income by 50.4 per cent.⁷

Figure 1 | Percentage change of Big Techs' market capitalisation between October 2019 and April 2020



Source: Author's elaboration from: Financial Times, *Markets Data*, <https://markets.ft.com/data>.

Despite the negative impact of forced shop closures and the temporary disruption of value chains, Apple could emerge stronger from the crisis. The Cupertino-based company has been trying to diversify its business model, finding new sources of income like Apple Music or Apple TV. The results of the second quarter showed a slight decline in net sales of iPhone, Mac and iPad products (-6.65 per cent from the year-ago-quarter) while recording a dramatic increase in the services segment (+16.5 per cent) and in the wearables, home and accessories home (+22.5 per cent).⁸ Overall, Apple ended its second quarter with a gross income greater than the year-ago-quarter figure (+2.45 per cent) and a smaller net income of 11.249 billion US dollars (-2.7 per cent) due to increased expenditure in R&D (+13.5 per cent).⁹

⁶ Alphabet, *Alphabet Announces First Quarter 2020 Results*, 28 April 2020, https://abc.xyz/investor/static/pdf/2020Q1_alphabet_earnings_release.pdf.

⁷ Facebook, *Facebook Reports First Quarter 2020 Results*, 29 April 2020, <https://prn.to/2KRljSb>.

⁸ Apple Inc., *Condensed Consolidated Statements of Operations (Unaudited)*, April 2020, <https://www.apple.com/newsroom/pdfs/Q1%20FY20%20Consolidated%20Financial%20Statements.pdf>.

⁹ Apple Inc., *Apple Reports Second Quarter Results*, 30 April 2020, <https://www.apple.com/newsroom/2020/04/apple-reports-second-quarter-results>.

Amazon reported mixed results, recording a huge jump in sales revenues (+26 per cent) but a slowdown in profits due to an increase in operating costs (shipping costs grew by 49 per cent to 10.9 billion US dollars). However, on a positive note, Amazon Web Services performed very well (+33 per cent), accounting for 77 per cent of Amazon's total operating profit.¹⁰

What these figures show is that, as consumers are locked at home and physical retailers are closed, their behaviour is changing in a way that greatly benefits providers of digital services and products. Even if this shift in preferences is induced only temporarily by the lockdown, it could also affect the long-term habits of consumers. If some people have appreciated the convenience and comfort of receiving their groceries directly at home, using Amazon Grocery Home Delivery for example, they are likely to continue using it even once the situation normalises. Furthermore, the COVID-19 pandemic is forcing many employees to work from home. Corporate clients are driving up the demand for online communication and collaboration platforms and, more importantly, for further digitalising their networks and their underlying infrastructure.

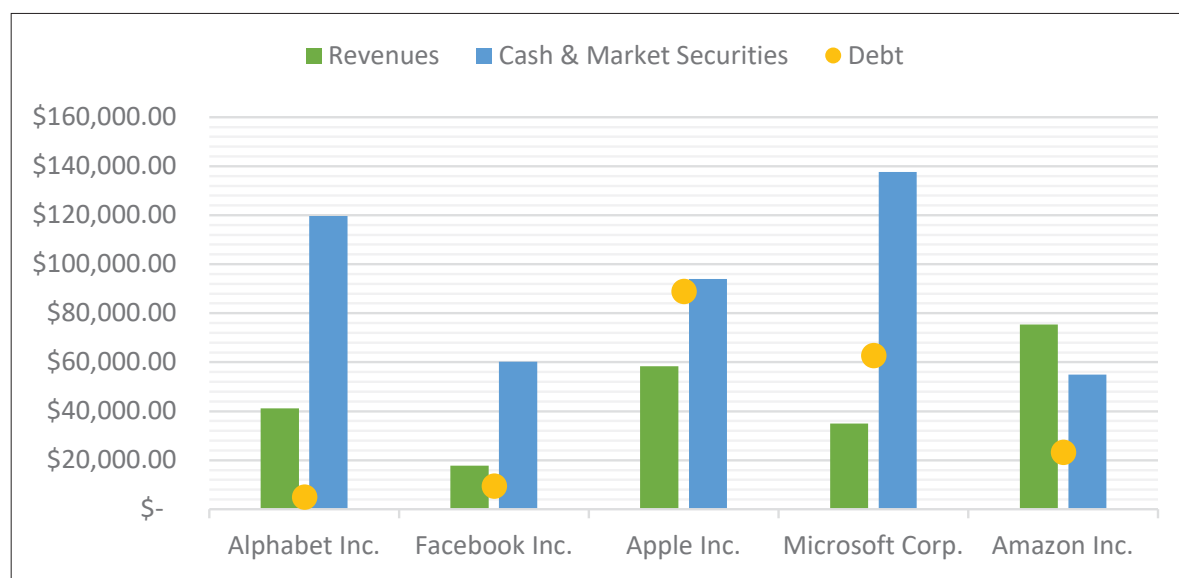
Companies that lack the means to develop their own Internet infrastructure prefer to rely on third-party solutions offered by technology services providers. Even though the global economic downturn is likely to reduce the budget of firms, potentially slowing down digital transformation investments, the COVID-19 pandemic has made the digitalisation of value chains a priority in order to maintain and boost productivity. The solid growth in revenues generated by the cloud computing segment – looking at the market leaders: Amazon Web Services, Microsoft Azure and Google Cloud – clearly underlines this trend (see Figure 2).

In addition to having performed well overall during the emergency, Big Techs seem to be the best equipped to face the global economic challenges in a post-pandemic world. In times of a simultaneous global demand and supply shock such as the current one, the level of cash reserves held by private firms is crucial to weather the crisis and expand thereafter. Cash is king when the stock market plummets, providing the necessary liquidity to fund operations, acquisitions and R&D expenditures. Taken together, Amazon, Alphabet, Apple and Facebook own more than 452 billion US dollars in cash reserves.¹¹ Even when taking their corporate debt into account, Big Techs' balance sheets appear remarkably solid, guaranteeing the availability of huge funds to invest in new businesses, subsidise loss-making activities, purchase other companies to expand their ecosystem and, ultimately, consolidate their market power.

¹⁰ Amazon, *Amazon.com Announces First Quarter Results, 30 April 2020*, <https://ir.aboutamazon.com/news-release/news-release-details/2020/Amazoncom-Announces-First-Quarter/default.aspx>.

¹¹ Pippa Stevens, "Here Are the 10 Companies with the Most Cash on Hand", in *CNBC*, 7 November 2019, <https://www.cnbc.com/2019/11/07/microsoft-apple-and-alphabet-are-sitting-on-more-than-100-billion-in-cash.html>.

Figure 2 | Revenues, cash & market securities and debt of Big Techs in the first quarter 2020 (in million US dollars)



Source: Author's elaboration from the first quarter results of the following corporations: Alphabet, Facebook, Apple, Microsoft and Amazon.

2. Europe, the champion behind the digital tax

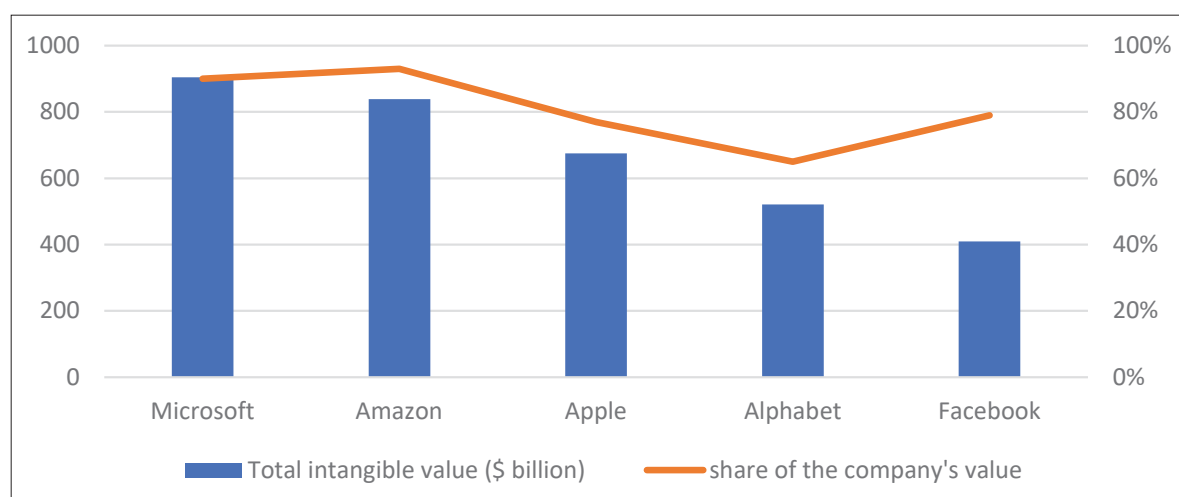
The current international fiscal framework is commonly considered inadequate because it is still built on two main criteria to allocate taxation power: "residency" (the country in which the company has its headquarter and where it normally pays its corporate tax) and "source" (the country in which the company actually sells its products/services, where it pays the value added taxes or VAT). This distinction is straightforward when applied to traditional value chains, based on tangible assets. But its application loses grip when value is generated by intangible assets, facilitating tax base erosion and profit-shifting practices (see Figure 3).

Whereas global digital multinationals pay an average corporate tax rate of around 9.5 per cent, traditional firms have an average figure of 23.2 per cent.¹² In the EU, profit-shifting practices are particularly aggressive as firms can exploit gaps and mismatches in the international tax rules to shift profits to low tax jurisdictions within the EU single market. The European Commission has started to meticulously investigate these practices. The most striking case is the 13 billion euro in unpaid taxes to Ireland requested to Apple. The European Commission has argued that the effective corporate tax applied on the European profits of Apple's subsidiary

¹² European Commission, *Time to Establish a Modern, Fair and Efficient Taxation Standard for the Digital Economy* (COM/2018/146), 21 March 2018, p. 4, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0146>.

registered in Ireland was just 1 per cent in 2003, decreasing to 0.005 in 2014.¹³ The Commission has accused Luxembourg of having provided Amazon with similar tax benefits.¹⁴ These two inquires have engendered a broader discussion on how digital transformations have rendered the current tax frameworks outdated.

Figure 3 | Top five companies by total intangible value (in billion US dollars) and share of company's value in 2019



Source: Author's elaboration from Brand Finance, *Global Intangible Finance Tracker (GIFT™) 2019*, November 2019, <https://brandirectory.com/reports/global-intangible-finance-tracker-gift-2019>.

In 2018, the European Commission presented two proposals to reform the tax framework, aiming to close the existing loopholes.¹⁵ The first proposal suggested to modify the concept of "residency", while the second one, easier to be implemented, championed the introduction of a temporary 3 per cent tax on revenues generated by selling digital services and by creating value from users. The tax would have been applied to global multinationals with an overall revenue over 750 million euro and with revenue over 50 million euro generated in the EU Single Market.

By March 2019, however, the Commission had reached an impasse and failed to come to an agreement with the member states. Some national governments (led by the Netherlands, Ireland and Luxembourg) strongly opposed both initiatives. These countries take advantage of the existing tax asymmetry within the Single Market, attracting large multinationals with lower corporate tax rates in a sort of

¹³ European Commission, *State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth Up to €13 Billion*, 30 August 2016, https://ec.europa.eu/commission/presscorner/detail/en/IP_16_2923.

¹⁴ European Commission, *State Aid: Commission Finds Luxembourg Gave Illegal Tax Benefits to Amazon Worth Around €250 Million*, 4 October 2017, https://ec.europa.eu/commission/presscorner/detail/en/IP_17_3701.

¹⁵ European Commission, *Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services (COM/2018/148)*, 21 March 2018, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018PC0148>.

race-to-the-bottom competition. In Ireland, for example, between 20 and 60 per cent of government revenues from corporate taxes (3–6 billion of the total 10.4 billion) are due to “excess”, meaning they are “[revenues] beyond what would be projected based on the economy’s underlying performance and based on historical/international norms”.¹⁶ According to the independent international network Tax Justice, in 2017 more than 44 billion US dollars in profits of US large multinationals were declared in the Netherlands rather than in the EU country in which they were generated, producing significant tax losses at a national level: 2.7 billion US dollars in France, 1.5 billion in Italy and Germany and 1 billion in Spain.¹⁷ The report found that, due to the tax benefits granted by the Netherlands, for every 1 dollar Amsterdam collected from the shifted profits of US corporations, the other EU member states lost nearly 4 dollars in corporate tax.

Other member states like the Scandinavian countries are cautious on a digital tax because they believe it could slow down innovation and damage their own digital multinationals (Nordic countries are home to several large digital multinationals such as the unicorn Spotify). Therefore, they have refused to support an EU-wide initiative, backing a multilateral effort instead.¹⁸

Due to the European political impasse, several member states have resorted to introducing a national digital tax. However, this has generated significant tensions with the Trump administration. The US is concerned that, once a digital tax is introduced at a national (or European) level, US multinationals could potentially deduct the rise in taxes they pay to EU countries from their US tax liabilities. The main target here is the French government. In July 2019 it approved a 3 per cent tax on the revenues of the largest digital multinationals operating in its national market (with global revenues over 750 million euro with at least 25 million generated in France).¹⁹ According Bruno Le Maire, France’s Economy Minister, the tax would have been applied to around thirty large multinationals (mainly American but also Chinese, German and French) and it could have yielded around 500 million euro per year.²⁰ In response, US President Donald Trump instructed his Trade Representative to start an investigation into France’s digital tax, which concluded that the tax “discriminates against U.S. companies” with the “purpose of penalizing

¹⁶ Irish Fiscal Advisory Council, *Fiscal Assessment Report*, June 2019, p. 7, <https://www.fiscalcouncil.ie/?p=6201>.

¹⁷ Tax Justice Network, *Revealed: Netherlands, Blocking EU’s Covid19 Recovery Plan, Has Cost EU Countries \$10bn in Lost Corporate Tax a Year*, 8 April 2020, <https://www.taxjustice.net/2020/04/08/revealed-netherlands-blocking-eus-covid19-recovery-plan-has-cost-eu-countries-10bn-in-lost-corporate-tax-a-year>.

¹⁸ Francesco Guarascio, “Nordic Countries Oppose EU Plans for Digital Tax on Firms’ Turnover”, in *Reuters*, 1 June 2018, <https://reut.rs/2LdjxsV>.

¹⁹ France, *Loi n° 2019-759 du 24 juillet 2019 portant création d’une taxe sur les services numériques et modification de la trajectoire de baisse de l’impôt sur les sociétés*, <https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000038811588>.

²⁰ Geert De Clercq and Elizabeth Pineau, “French Tax on Internet Giants Could Yield 500 Million Euros Per Year: Le Maire”, in *Reuters*, 3 March 2019, <https://reut.rs/2NDQn8A>.

particular U.S. technology companies”.²¹ The report suggested to retaliate with tariffs as high as 100 per cent on 2.4 billion US dollars in French imports – such as wine and cheese – and to further investigate similar initiatives proposed by Italy, Turkey and Austria.²²

After months of conflict, in January 2020 Trump and his French counterpart, Emmanuel Macron, announced a compromise. The US agreed to suspend the proposed tariffs until the end of 2020 and the French government postponed payment of the digital tax to December 2020, when the Organisation for Economic Cooperation and Development (OECD) is supposed to release a proposal for a reformed tax framework.

The OECD's proposal is at times portrayed as a miracle cure that can reconcile the different interests of governments as well as of private actors. The largest digital multinationals have backed the OECD multilateral effort, acknowledging that a global economy with national digital taxes could multiply their compliance costs, penalising their businesses. From an economic efficiency point of view, a global revised framework would indeed guarantee tax certainty, reducing the risks of negatively affecting investments in innovation.

In January 2020, the OECD released a statement in which it described the framework under negotiation as encompassing (a) the definition of the type of companies affected by the new legislation; (b) the part of their profit the taxation should be applied on; and lastly (c) the indication of the minimum level of tax international businesses should pay. The OECD statement was thus critical in defining the broad architecture of a global tax framework.

First, the OECD framework identifies the kind of businesses that would be targeted. One group includes firms that generate income through automated digital services, such as search engines (for example Google), social media (Facebook) and online intermediation platforms (Amazon). Another group comprises consumer-facing businesses that increase the value of a product (and therefore the profits of the company itself) through, for example, targeted marketing or brand visibility strategies managed without any need for physical presence in the consumer's jurisdiction (for example Apple).

Second, the OECD document maintains that profit measuring should no longer be based on the “separate entity” approach that defines the subsidiary company as a standalone enterprise and should adopt the view of the financial group as a single entity. If this consolidated group exceeds a certain level of profits (still to be defined) and if the profits come from any of the four types of activities described above, it

²¹ US Trade Representative, *Conclusion of USTR's Investigation Under Section 301 into France's Digital Services Tax*, 2 December 2019, <https://ustr.gov/node/10052>.

²² US Trade Representative, *Report on France's Digital Services Tax*, 2 December 2019, https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf.

should pay a percentage of taxes on profits exceeding the chosen threshold.

Third, the OECD proposal addresses the issue of ensuring a minimum level of taxation for each multinational group to market jurisdictions for baseline distribution and marketing activities. The main objective is to mitigate the incentive for large multinationals to shift their profits to jurisdictions with low or non-existent tax rates. The basic concept underlying this (still to be defined) proposal is that, if a country applies a tax regime that allows a multinational company to pay a rate on all its turnover that is lower than a minimum tax (to be defined), other states could increase their tax burden, reducing the deductions and allowances from the tax base to which multinationals are entitled.²³

Having reached a consensus on the theoretical pillars of a global tax framework is a fundamental step. However, states are still negotiating on numerous operational details. Among these, the main problem is defining the minimum level of profits below which the new regime would not be applied, a knot difficult to untie also because of its political implications. Some states also want to adapt the formula that calculates the profits associated with the activities of a business, irrespective of a physical presence, in a market jurisdiction to account for the different degrees of digitalisation of multinationals. There is agreement that an effective dispute prevention and resolution mechanism is required as well as a new method to avoid double taxation, but details for both are lacking. Even more problematic is the ambiguous position taken by the US. Washington would like to make the new regime optional, based on the voluntary accession of multinationals (on a safe harbour basis). This would, however, undermine the effectiveness of the reform. The American proposal has met with opposition from the main EU member states, which have declared the option as non-viable.²⁴

The multilateral solution of the OECD could also gain a boost from the growing pressure of interest groups and public opinion, as well as the unwillingness of countries like Denmark and Poland to grant tax relief to multinationals that have their registered offices in tax havens.

3. COVID-19 and the European ambition of "technology sovereignty"

The divergence between the US and the EU goes beyond the digital tax. In Europe, the debate on implementing a digital tax at a national or at a global level has been

²³ Imagine a calculation based on the relationship between the global turnover of a multinational company (in the denominator) and the total taxes paid globally in the various jurisdictions in which the company operates (in the numerator). If the ratio were to be less than the agreed global minimum tax, those countries with high tax rates may require an even higher taxation on the multinational's profit, reducing deductions and allowances.

²⁴ Francesco Guarascio, "EU Tax Commissioner Slams U.S. Plans on Tech Tax", in *Reuters*, 18 February 2020, <https://reut.rs/2SE8Fut>.

part of a broader discussion about its dependency on digital services provided by foreign companies.

If COVID-19 ends up consolidating the market dominating position of Big Techs, this will increase the digital intermediation function of US multinationals in EU economies. The lockdown has shown that US Big Techs play a core “gatekeeper” function in the European digital architecture, intermediating the interaction between EU consumers and digital services. US digital multinationals have exploited the EU's underdeveloped domestic digital sector and achieved market dominance in EU markets.²⁵ During the COVID-19 lockdown, US Big Techs have assumed a public utility function, de facto supporting national governments and private firms in their response to the emergency. Italian Prime Minister Giuseppe Conte has often streamed his official statements on Facebook; Google and Apple have built changes into their operative systems to enable Bluetooth-based COVID-19 contact tracing, offering this solution to governments;²⁶ the World Health Organisation has used Facebook-owned WhatsApp to circulate information on the virus; and Amazon has supported households during the lockdown with its home delivery. These are only a few examples of the vital functions that US digital giants have played in Europe (and beyond).

This megatrend is likely to have just begun. The case of car manufacturing, which has been one of the industrial pillars of the global economy after World War II, is enlightening. Big Techs are leading R&D on driverless cars, through partnerships with established car manufacturers (like the e-Palette project between Toyota and Amazon), by investing in start-ups (such as Amazon's investment in Aurora, a leading self-driving tech start-up) or by developing their own technology (like Apple, Alphabet or Baidu). Similarly striking are developments in the banking sector, in which Big Techs are consolidating their market positioning by launching their own services and products (such as Google Pay, Apple Pay, etc.) or partnering up with incumbent banks (like Microsoft and Nexi; Apple and Goldman Sachs). This scenario is what Iansiti and Lakhani call the “hub economy”: competition between digital giant multinationals that take network-based assets that “have already reached scale in one setting and then use them to enter another industry and ‘re-architect’ its competitive structure”.²⁷ In so doing US firms are set to further consolidate and expand the already established dominant positions they have in EU digital markets.²⁸

²⁵ For example, Android and iOS – the operative systems of Alphabet and Apple – are installed on 99.49 per cent of smartphones operating in Europe. Google search engine has a market share around 93.51 per cent of the EU market.

²⁶ Mark Scott et al., “How Google and Apple Outflanked Governments in the Race to Build Coronavirus Apps”, in *Politico*, 15 May 2020, <https://www.politico.eu/article/google-apple-coronavirus-app-privacy-uk-france-germany>.

²⁷ Marco Iansiti and Karim R. Lakhani, “Managing Our Hub Economy: Strategy, Ethics, and Network Competition in the Age of Digital Superpowers”, in *Harvard Business Review*, Vol. 95, No. 5 (September-October 2017), p. 84-92, <https://hbr.org/2017/09/managing-our-hub-economy>.

²⁸ Mark Leonard et al., “Redefining Europe's Economic Sovereignty”, in *Bruegel Policy Contributions*,

This dominance raises the question whether it might harm the long-term economic developments of the EU and undermine its global ambitions. A private document of the European Commission that was leaked in 2019 stated that relying on third countries' hardware and software "means relying on their values". Reliance on others could eventually erode "Europe's position and influence in global markets [...], jeopardizing our technological sovereignty in key industrial strategic value chains".²⁹ As a result of this increasing awareness of the EU's technological dependency, European Commission President Ursula von der Leyen reiterated in her political manifesto that the EU should pursue "technological sovereignty" by promoting investments in key areas such as quantum computing, algorithms and data-sharing tools.

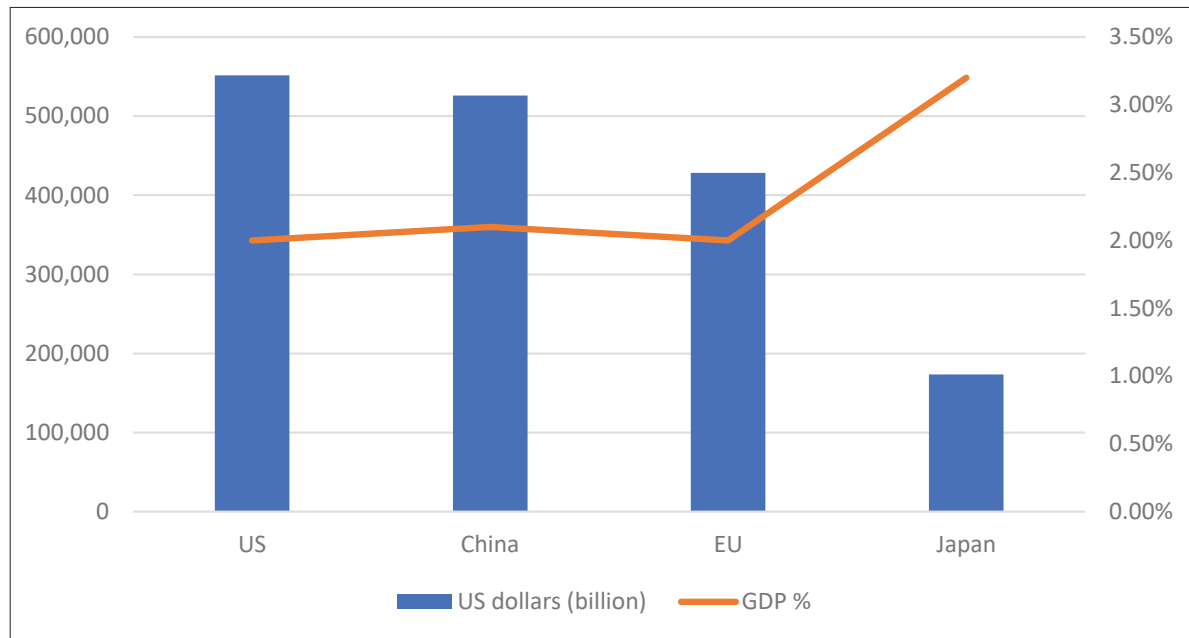
According to the leaked document, EU officials have been urging the set-up of a European Future Fund that could invest more than 100 billion euro in equity stakes in high potential EU companies. The proposal aimed at reducing Europe's over-dependence on digital services provided by foreign companies, acknowledging that technology is (and increasingly will be) the battle ground for economic growth. As EU firms cannot currently compete with either the US stock market size and value or China's state-controlled technology industry, EU officials came up with a hybrid plan that could encourage public interventions in the EU private market (see Figure 4).

Two factors may significantly undermine the EU's technological ambitions. First, with Brexit, the EU will lose one of its innovation epicentres. According to CB Insights, the UK hosted almost 50 billion-US dollar-worth of 1 billion-US dollar-plus unicorn tech companies (such as the Fintech firms Revolut, Monzo, Transferwise and Stripe or the multi-customer data centre Global Switch). Second, the COVID-19 pandemic has severely impacted EU economies, requiring extraordinary fiscal expansionary measures to support household income and firms, at both the national and the European level. Unless the EU shapes its recovery plan with a focus on improving its digital economy, at a national level EU member states are unlikely to have the necessary resources to structure an ambitious digital transformation plan. This focus is supported by the new recovery instrument Next Generation EU which acknowledges that digitalisation is at the core of the EU future. The proposal stresses the ambition to invest in digital infrastructure, tech developments (such as in the realm of artificial intelligence or cloud computing) and data-driven assets. Although too little information is available on the deployment of the plan, this seems to be a unique opportunity for the EU to reduce its technology gaps with the US and China, thereby reducing its dependency on foreign digital services (see Figure 5).

No. 9 (June 2019), <https://www.bruegel.org/?p=31321>.

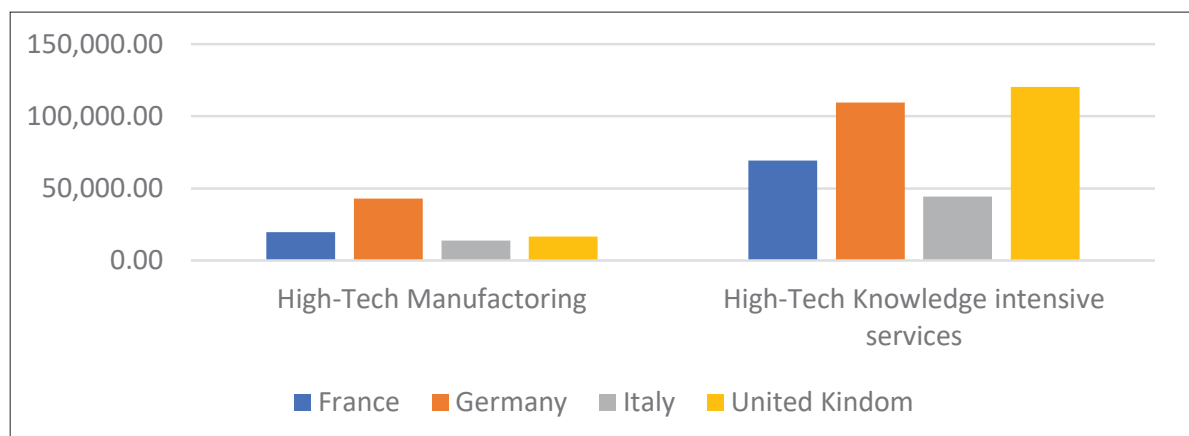
²⁹ Ryan Gallagher and Natalia Drozdiak, "Europe Overly Dependent on Outside Technology, EU Memo Warns", in *Bloomberg*, 30 September 2019, <https://www.bloomberg.com/news/articles/2019-09-30/eu-officials-call-for-technology-push-to-counter-u-s-china>.

Figure 4 | Gross domestic spending on R&D (billion US dollars) and the percentage of GDP in 2018



Source: Author's elaboration from OECD data: *Gross Domestic Spending on R&D*, <https://data.oecd.org/rd/gross-domestic-spending-on-r-d.htm>.

Figure 5 | Value added (million euro) in high-tech manufacturing and high-tech knowledge intensive services in 2018



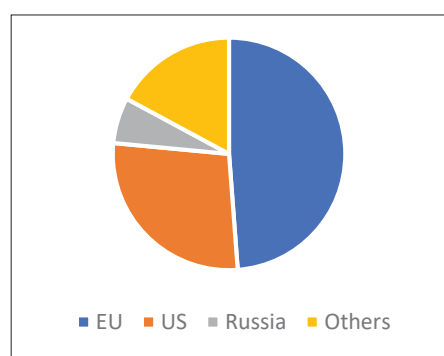
Source: Author's elaboration from Eurostat data.

Despite these critical factors, the EU is likely to keep strengthening its role as a world leader in technology regulation. Given that no digital company is willing to abandon the large and rich EU consumer market, the Union has been able to shape the global discourse on regulating technologies. As the first mover in tech regulation, the EU has influenced other jurisdictions and set up global standards – as attested to by the impact of the General Data Protection Regulation (GDPR),

which has inspired the revision of privacy laws in 120 countries.

In 2020, the EU is expected to grow in its role as a dynamic global regulating actor, introducing its new Digital Services Act that will purportedly impose stricter rules on the governance of Internet platforms and regulations on Artificial Intelligence developments.³⁰ Furthermore, with confirmation of the combative Margrethe Vestager as EU Competition Commissioner, the Commission will follow up with anti-trust investigations on the dominant position in the EU of such US digital multinationals as Alphabet and Qualcomm, fined 3.8 billion and 242 million euro respectively. Between January and June 2019, 49 per cent of global regulatory proposals for the tech industry stemmed from the European Union or from EU member states, and more than half of those proposals regulated competition and company structures.³¹

Figure 6 | Number of regulation proposals on tech industries (June–January 2019)



Source: Author's elaboration from: Madhumita Murgia, "Europe 'A Global Trendsetter on Tech Regulation'", in *Financial Times*, 30 October 2019, <https://on.ft.com/32Y821P>.

The EU's ambition of being a global leader in technology regulation is also expected to generate further tensions with the US. President Trump has strongly criticised the EU's regulatory activism, attacking the European Commission's anti-trust investigations. In an interview, Trump stated that the EU was looking for "easy money" when investigating US digital companies' market behaviours.³² Trump's position is nothing new. Former US President Barack Obama also attacked the EU policies towards US digital multinationals, labelling those actions as technology protectionism against US firms, driven by commercial interests.³³ The growing

³⁰ Mehreen Kahn and Madhumita Murgia, "EU Draws Up Sweeping Rules to Curb Illegal Online Content", in *Financial Times*, 24 July 2019, <https://on.ft.com/2Yexug2>.

³¹ Falk Schöning, Michele Farquhar and Peter Watts, *A Turning Point for Tech. Global Survey on Digital Revolution*, Hogan Lovells, 2019, <https://www.hoganlovells.com/en/publications/a-turning-point-for-tech-global-survey-on-digital-regulation>.

³² Makena Kelly, "Donald Trump on Tech Antitrust: 'There's Something Going On'", in *The Verge*, 10 June 2019, <https://www.theverge.com/2019/6/10/18659619>.

³³ Murad Ahmed, Duncan Robinson and Richard Waters, "Obama Attacks Europe Over Technology Protectionism", in *Financial Times*, 16 February 2015, <https://www.ft.com/content/41d968d6-b5d2-11e4-b58d-00144feab7de>.

tech regulations put in place by the EU may generate a regulatory lag between the EU and the US, potentially raising barriers to transatlantic trade and investments and ultimately undermining the potential of transatlantic economic relations.

Conclusion

Big Techs are emerging as the winners of the COVID-19 crisis. The global lockdown has driven up the digitalisation of the economy, increasing the demand for public, corporate and retail digital services. This megatrend has consolidated the dominant position of US digital multinationals in EU markets, casting doubts on the Union's ability to fulfil its ambition for technology sovereignty. To make things worse, with public expenditures under extreme pressure as EU member states and institutions adopt aggressive fiscal expansionary policies to revive the economy, the room for investments in technology might shrink.

In this context, some European politicians are suggesting to accelerate the introduction of the digital tax to expand the tax base and provide cash-strapped governments with much-needed injection of new revenues. The issue has traditionally been divisive within the EU and has generated tensions with the US. To mitigate both conflicts, the EU has compromised by agreeing to postpone unilateral initiatives and to back the multilateral negotiations carried out by the OECD, which intends to develop a revised global digital tax framework by December 2020. It is anything but certain, however, that compromise is possible, not least because the US sees EU digital tax efforts with great scepticism if not outright hostility. The EU's regulatory activism effort has in effect mainly addressed US digital multinationals.

For the EU, the stakes are high. By setting technical standards and rules in technology, it could shape and influence tech regulatory frameworks internationally and provide the foundations for markets to flourish, enabling interoperability between technologies and lowering trading costs within its domestic market. Tech regulations would also strengthen the EU's geopolitical power thanks to possible spillovers into other countries' regulatory frameworks, thereby shaping standards and preferences regionally and even globally.

Yet this approach will not be enough to fulfil the EU's geopolitical ambition of "technology sovereignty". Global leadership in tech regulation should be accompanied by growing investments to reduce the EU's digital gap with the US and China. EU member states should put all their political weight behind the digital investment plans envisaged in the Commission's Next Generation EU programme. If it wants to eventually be able to compete with US or Chinese strategic technology developments, the EU should start catching up sooner rather than later, because later may well be too late.

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