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**Research Report**

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SWP Comments, No. 27/2014

**Provided in Cooperation with:**

Stiftung Wissenschaft und Politik (SWP), German Institute for International and Security Affairs,  
Berlin

*Suggested Citation:* Forster, Nicola; Mallin, Felix (2014) : The association of European microstates with the EU: Integration test with model value, SWP Comments, No. 27/2014, Stiftung Wissenschaft und Politik (SWP), Berlin

This Version is available at:

<https://hdl.handle.net/10419/256295>

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# The Association of European Microstates with the EU

Integration Test with Model Value

Nicola Forster / Felix Mallin

The European microstates Andorra, Monaco, and San Marino have only been partially integrated into the European single market. Consequently, there are several regulatory gaps in areas such as financial markets, the free movement of workers, as well as within the Schengen Agreement. Moreover, the smooth adaptation of Community *acquis* is being hampered. In December 2013, the European Council called for the negotiation of a framework Association Agreement with the three countries. For Brussels, the rapprochement of these countries might also serve as a test run for dealing with other European countries whose full membership is rejected either by the EU or by the state concerned.

Due to their limited internal markets and foreign political capacities, the European microstates rely on smooth foreign policy cooperation with the EU. For a long time, they smartly agreed to attach themselves to the EU via bilateral treaties with their direct neighbours. Hence, the microstates adopted the euro as their common currency, while San Marino and Andorra are also part of the EU Customs Union. As a consequence of ever-deepening European integration, the microstates have had to call upon the EU more frequently instead of their direct neighbours – France, Spain, and Italy. For a few years, Andorra, Monaco, and San Marino (here: AMS countries) have been endeavouring to redefine their hitherto fragmentary and incoherent relations with the EU. Their goal is to make better

use of the potential that the single market offers. They also hope to increase legal certainty and achieve greater independence from their neighbours. Because of their comparative political insignificance, they have hardly been able to stimulate much political interest on the part of the Member States. Although, in principle, most Member States support a continuing rapprochement, effective political and economic interest is limited to the respective neighbours of the AMS countries.

## Conformity of the EU legal realm

Brussels is interested in deeper institutional integration in order to close regulatory gaps in the midst of Europe and to ensure the uncomplicated comprehension of Com-

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June 2014

munity acquis. If Switzerland, the micro-states, and the special territories are not progressively integrated, these entities will persist as regulation exclaves that block the EU's efforts at conformity and coherence.

For a long time, this was the case in finance and tax regulation affairs, until the microstates sought to dissociate themselves from their stigmatisation as tax havens. In the meantime, all AMS countries have been crossed off the OECD's list of uncooperative tax havens and are currently negotiating an anti-fraud agreement with the EU. Still, Andorra, for instance, has not yet introduced an income tax or an inheritance tax.

Also the free movement of workers is almost exclusively dealt with through bilateral arrangements with the respective neighbours. San Marino, for instance, has concluded a free movement agreement only with Italy, as a result of which the flexibility of workers and enterprises in San Marino is significantly limited. Especially since the beginning of the economic crisis in Italy, this represents a major challenge for the volatile economy of the small country.

### **Strengthening of sovereignty**

The foreign ministries and diplomatic representations of the microstates only have a few dozen diplomats at their disposal – too few to cope with the increased exigencies of foreign policy.

The focus, thus, is directed on the diplomatic representations to the EU, the United Nations, and the neighbouring countries.

To be able to manage the administrative requirements of common legislation with the EU, the microstates have streamlined their politics towards Europe. EU legislation is absorbed with immediate effect. EU regulations are only introduced if absolutely imperative. Andorra, for instance, which for a long time had no direct aviation connections to Europe, saw itself obliged to introduce the European Aviation Regulatory Framework in order to build a heliport.

The implementation of foreign policy can easily create dilemmas for the microstates as they pursue their own interests while also taking the interests of their powerful neighbours into consideration. While San Marino – the world's oldest republic – enjoyed comparatively unrestricted decision-making in the past, the co-principality of Andorra has repeatedly been exposed to restrictive stipulations by Paris, Madrid, and – due to the constitutional role of the Bishop of Urgel – sometimes also the Vatican. Hence, the decision over the recognition of Kosovo became a diplomatic balancing act for Andorra, which was entrapped between the conflicting positions of Spain and France. Despite pressure from Madrid, in the end a decision was taken to favour recognition. Similarly, the debate about the possible independence of Catalonia has the potential to set off a fuse in Catalan Andorra. The government, however, has a strong interest in not sacrificing its good relations with Madrid.

Since the French president, as acting co-prince of Andorra, occupies an exceptional position – and because of the political entanglement with Monaco – France, as a protecting power, is able to directly exert political co-determination in two countries. Monaco, on the other hand, which is the smallest of the AMS states by far, is the least independent with regard to foreign policy. Deeper European integration would therefore also increase its sovereignty vis-à-vis France and, as such, provide more legal certainties and political calculability. With the perspective of integrating the AMS countries more thoroughly, the special status of France may, in the long term, prove to be unsustainable.

### **Liechtenstein as a model**

It is hardly surprising that, for inspiration in their own endeavours, the AMS countries are turning to Liechtenstein, which has achieved an advantageous position in Europe in terms of conducting its own foreign policy. The principality, which is interna-

tionally acknowledged as the prime example of a successful microstate, was able to strengthen its sovereignty vis-à-vis Switzerland through its membership in the European Economic Area (EEA). Since EEA legislation is directly adopted as state law, there are no legal uncertainties. As a geopolitically irrelevant microstate – and therefore strongly dependent on the protection provided by international law – Liechtenstein has earned itself a reputation in multilateral organs as being an advocate for the consolidation of international law. Liechtenstein's diplomats and legal experts have demonstrated their commitment to the EEA. Hence, the small country was able to overcome prejudices against the insufficient institutional capacities of a microstate with regard to constructive participation in multilateral organs. Liechtenstein was also able to secure a special provision for the free movement of persons. Citizens of the country enjoy full freedom of movement within the EU, whereas quotas remain in place for EU citizens. This derogation exemplifies the ability of the EU to take the specific circumstances of microstates into consideration, if necessary.

### **Status of negotiations with the EU**

When the relationship of the EU with the members of the European Free Trade Association (EFTA) came under scrutiny for the first time during the rotating EU Presidency of France in 2008, the question about the relationship with the remaining Western European states – the AMS countries – was also raised. In 2011 open-ended consultations were initiated, with the goal of working towards closer cooperation with the three states. Originally, it was not only the Association Agreement currently being debated, but also EEA and even EU membership under consideration. Both latter options have since been put on the back burner, as Brussels doubts the AMS states' abilities to fulfil all obligations tied to membership.

The belief is that the administrative capacities of the microstates are insufficient to absorb new Union legislation. Furthermore, the complex decision-making mechanisms of the EU are not designed for such small states. With regard to potential EEA accession, it is especially Norway that is opposed to the idea. The official reason given is to avoid any complications in the EEA's internal decision-making. However, Norway may also be interested in obviating a shift of influence towards a microstate alliance.

This stonewalling attitude is incomprehensible for the AMS countries, which point out that neither the EU (with the accession of Malta) nor the EEA (with Liechtenstein) have seen any subsequent lack in operational capabilities.

The signals sent by the AMS states also vary, depending on the different integration options in question. Current political ambitions and existing integration regimes vary widely amongst all three. Andorra is showing the strongest political will to further its integration and seems to be increasingly modelling itself on Liechtenstein. Thus, it is not unlikely that Andorra will attempt to accede to the EFTA and, in the medium term, also the EEA. For that purpose, however, Andorra would need to be able to demonstrate corresponding administrative capacities and be able to contribute financially to the EFTA Secretariat.

San Marino is also interested in furthering its integration: A referendum held in September 2013 resulted in a narrow majority opting for the submission of a formal accession request to the EU. However, the necessary quorum was missed. Therefore, the EU membership objective has now given way to the elaboration of an Association Agreement with the EU.

Monaco, on the other hand, is seeking to facilitate certain trade activities. Contrary to Andorra and San Marino, the country participates in the Customs Union only through an indirect treaty via Paris and is aspiring to direct single-market access.

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ISSN 1861-1761

(English version of  
SWP-Aktuell 21/2014)

Monaco has no democratically legitimised parliament and, hence, does not fulfil one of the necessary accession requirements. Moreover, the country would not be willing to accept all four freedoms of the EU in their entirety: Owing to its small internal labour market, the country fears in particular the introduction of the freedom of establishments and services. France, which does not want to relinquish its dominant position in the triangular Monaco-Paris-Brussels relationship, is keen for Monaco to achieve a special status, or even a tri-lateral agreement. For that reason, the official wording in the Commission documents reads “one or several agreements” with regard to the association of the AMS countries.

In order to guarantee a uniform approach and to minimise the time and effort involved, one option would be the conclusion of a framework Association Agreement. Several enclosed protocols could explicitly cater to the particular specificities of all microstates. Such a framework Association Agreement could determine the institutional rules and provisions, which would then form the basis for future treaties between the EU and the AMS countries. First and foremost, mechanisms and terms for the adoption of EU legislation would need to be determined. Furthermore, a monitoring authority for the implementation of new treaties and the arbitration of disputes would be required. The Court of Justice of the European Union could likely take on this role.

### **AMS integration as a test run for other states**

Even though the last word has not been spoken, the message from Brussels is clear: More integration through association, but most likely no EU or EEA accession. From the perspective of the AMS countries, the quest for an appropriate association solution is not only an economic imperative, but also an important signal to their own citizens, who generally have a strong Euro-

pean identity and wish for preferential treatment compared to other third countries.

Although the political and economic embedding of the AMS countries in the EU is advancing, the countries have not been given any powers of co-decision. Thus, they are increasingly becoming underprivileged, passive, quasi-members of the EU. For third countries that are willing and able to integrate, the EU needs solutions beyond purely economic involvement – as provided by the EEA, for instance.

In a broader context, Brussels needs to reflect on a number of conceptual considerations: How to proceed with third countries whose participation in the single market is desired, but whose full accession is unrealistic? The expected commencement of negotiations with the AMS countries could, in this respect, prove to be a model for the handling of candidates for independence such as Catalonia, the Faroe Islands, and Scotland. The stipulated principles could then be applied to integration-opposed states such as Switzerland, and even to current members wanting to withdraw from the Union voluntarily.

An association regime designed particularly for the AMS countries could extend the spectrum of integration options of the EU in the long run, and might later serve as a promising alternative for other candidates.