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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN  
PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL  
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

**EU Relations with the Principality of Andorra, the Principality of Monaco and the  
Republic of San Marino**

**Options for Closer Integration with the EU**

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Republic of San Marino**

**Options for Closer Integration with the EU**

**1. INTRODUCTION**

**1.1. EU relations with Andorra, Monaco and San Marino at a crossroads**

Western Europe comprises a number of independent States of small territorial extension which are not members of the EU: the Principality of Andorra, the Republic of San Marino, the Principality of Monaco, the Principality of Liechtenstein and the Vatican City State<sup>1</sup>. The EU maintains relations with all of them as required by Article 8 TEU<sup>2</sup>.

Relations differ in terms of extent and institutional framework of relations. For instance, Liechtenstein is a member of the European Free Trade Association (EFTA) and closely linked to the EU through the Agreement on the European Economic Area (EEA), which gives it access to the EU's internal market. It also joined the Schengen area in December 2011. In contrast, EU relations with Andorra, Monaco and San Marino (hereafter, “small-sized countries”) are governed by a number of agreements, covering selective areas of the EU *acquis* and policies.

In December 2010, the Council concluded that EU relations with these three states were “**extensive but fragmented**”<sup>3</sup>, as there are still obstacles to an unimpeded movement of persons, goods and services into and out of the EU. This has led to a number of practical difficulties for EU citizens and companies, as well as citizens and companies of the small-sized countries. Therefore, the Council called for an “analysis of the possibilities and modalities of their possible progressive integration into the internal market”.

The Council adopted an initial report in June 2011 under the Hungarian Presidency. It invited the European External Action Service and the Commission to deepen their analysis, including

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<sup>1</sup> EU relations with the Vatican City State and the Principality of Liechtenstein are not addressed in this Communication.

<sup>2</sup> Article 8 TEU states that the EU “shall develop a **special relationship with neighbouring countries**, aiming to establish an area of prosperity and good neighbourliness, founded on the values of the Union and characterised by close and peaceful relations based on cooperation”. According to Declaration No.3 on Article 8 of the Treaty on European Union, “the Union will take into account the particular situation of small-sized countries which maintain specific relations of proximity with it.”

<sup>3</sup> Council Conclusions on EU Relations with EFTA countries of 14 December 2010.

exploring “a **possible new institutional framework** for relations, taking into account the importance of a coherent approach for all three countries”<sup>4</sup>.

All three small-sized countries have expressed the wish to **enhance their relations** with the EU, notwithstanding some differences of emphasis in terms of extent and scope. Andorra has expressed openness to consider various options short of EU accession, while voicing a certain preference for a Framework Association Agreement. Monaco has also expressed interest to further discuss options for its closer integration into the internal market. Finally, San Marino has expressed openness to consider a wide range of options for enhanced European integration, ranging from EEA membership to a multilateral or bilateral Framework Association Agreement with the EU. All three countries wish to safeguard their **specificities and identities** in their relations with the EU.

In light of the continued interest expressed by the small-sized countries<sup>5</sup> in closer integration with the EU, this Communication reviews the EU’s relations with Andorra, Monaco and San Marino and makes some recommendations on how such integration could be achieved. With this Communication, the Commission is seeking views on these recommendations, on the basis of which it will decide on the next steps in this process.

## 1.2. The specific situations of the small-sized countries

Andorra, Monaco and San Marino have a number of **similarities**. They are independent states of small territorial size and population, and all have an EU Member State or States as their only neighbours<sup>6</sup>, with which they have very close relations based on shared history and political and cultural affinities. Financial services and tourism (often in combination with retail services) are the bedrock of their economies, although there are some signs of economic diversification. They are all parliamentary democracies and members of the United Nations (UN), the Council of Europe, and the Organisation for Security and Cooperation in Europe (OSCE).

However, there are also significant geographical and demographic **differences** between them.

- Andorra is the largest country by territory (468 km<sup>2</sup>) and population (around 78,100). It is far from the nearest big city and connected to neighbouring Spain and France by only two main roads.
- Monaco shares a border with France and has a population of around 36,300. Its territory covers 1.95 km<sup>2</sup>, making it the second smallest state in the world after the Vatican City State.
- San Marino is situated on a mountain-top and is an enclave within Italy. It covers 61.2 km<sup>2</sup>, with a population of around 32,300.

Other differences include their official languages and their constitutional, legal and political systems.

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<sup>4</sup> “EU relations with the Principality of Andorra, the Republic of San Marino and the Principality of Monaco” – Report from the Presidency to the Council, 14 June 2011, Council document 11466/11, point 14.

<sup>5</sup> The analysis set out in this Communication is based on informal exchanges of views with all three small-sized countries at working level.

<sup>6</sup> Although Monaco has a port on the Mediterranean sea.

- Andorra is a co-Principality, with the President of France and the Bishop of Urgell (Spain) as co-Princes.
- Monaco is a constitutional monarchy and is closely integrated with France, based on numerous bilateral treaties.
- San Marino is a Republic and has a close relationship with Italy.

## 2. THE EU'S FRAGMENTED RELATIONS WITH THE SMALL-SIZED COUNTRIES

### 2.1. Common Features

On the whole, the EU entertains **very good relations** with the small-sized countries. The EU is by far their largest trading and investment partner. The small-sized countries have no official high-level political dialogue with the EU, but their diplomatic missions are accredited to the EU at Ambassador level and senior members of their governments occasionally travel to Brussels for meetings with their EU counterparts<sup>7</sup>. However, no EU Delegation is accredited to any of the small-sized countries<sup>8</sup>. The EU is represented in each country by one of its Member States<sup>9</sup>.

Concerning the **legal framework** with these countries, bilateral trade in goods between the EU and the three small-sized countries is governed by customs union agreements: Monaco has such an agreement with France and is part of the customs territory of the EU; whereas San Marino and Andorra both have a customs union agreement with the EU. Furthermore, the EU has monetary agreements and savings taxation agreements in place with all three small-sized countries. In addition, the Commission has proposed to negotiate Anti-Fraud and Tax Information Exchange Agreements with them<sup>10</sup>.

#### 2.1.1. Monetary Agreements

The EU now has **Monetary Agreements**<sup>11</sup> in place with each of the small-sized countries, which allow them to use the euro as legal tender and mint euro coins up to a specified maximum value. In exchange, the small-sized countries have committed to incorporate gradually relevant EU *acquis*<sup>12</sup> into their internal legislation, covering: euro banknotes and coins; banking and financial law; prevention of money laundering; fraud and counterfeiting; and the sharing of statistical information. The small-sized countries have accepted the exclusive competence of the Court of Justice of the EU for the settlement of any disputes between the parties in relation to the agreements.

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<sup>7</sup> For instance, the Foreign Ministers of Andorra and San Marino visited Brussels in, respectively, January 2012 and July 2012.

<sup>8</sup> By way of comparison, the EU Delegation in Bern is accredited to neighbouring Liechtenstein.

<sup>9</sup> In Andorra and Monaco, this is on a six-monthly rotating basis. Italy, as the only EU Member State to have an embassy in San Marino, represents the EU there.

<sup>10</sup> Commission Communication on “Concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries”, COM(2012)351 final, Brussels, 27 June 2012.

<sup>11</sup> Monetary Agreement between the European Union and the Principality of Andorra (OJ C 369, 17.12.2011, p. 1); Monetary Agreement between the European Union and the Principality of Monaco (OJ C 310, 13.10.2012, p. 1); Monetary Agreement between the European Union and the Republic of San Marino (OJ C 121, 26.4.2012, p. 5).

<sup>12</sup> As set out in the Annex to each Agreement.

### 2.1.2. *Agreements on Savings Taxation*

The EU has **Agreements on Savings Taxation**<sup>13</sup> with the three small-sized countries, which provide for measures equivalent to those laid down in Directive 2003/48/EC on taxation of savings income in the form of interest payments<sup>14</sup>. Within this framework, savings income in the form of interest payments made in these States to beneficial owners who are individuals identified as residents of a Member State of the EU have to be subject to a withholding tax levied by paying agents established on their territory, whose revenue is mostly transferred to the Member States of residence of the individual concerned.

Consultations held in 2009 with the competent authorities of Andorra, Monaco and San Marino confirmed the countries' availability to **amend their Agreements** with the EU in line with the outcome of the Savings directive review. Once an authorisation to negotiate is adopted by the Council, formal negotiations to update the Agreements will be initiated.

### 2.1.3. *Anti-Fraud and Tax Information Exchange*

The Commission has proposed to negotiate **Anti-Fraud and Tax Information Exchange Agreements** with Andorra, Monaco and San Marino<sup>15</sup>, on the basis of the experience gained in the framework of similar negotiations with Liechtenstein, taking into account international developments in this area. The Commission is envisaging two-pillar agreements, including not only anti-fraud measures but also comprehensive administrative tax cooperation.

## 2.2. **Andorra**

### 2.2.1. *Customs union*

The EU has concluded an Agreement with Andorra establishing a **customs union**<sup>16</sup> for industrial goods. The Agreement provides that Andorran agricultural products entering the EU are free from import duties; whereas Andorra is entitled to levy import duties on imports of agricultural products from the EU. The Agreement works well and in 2011 a **Protocol** was concluded extending it to customs security measures.

In addition, a **Cooperation Agreement**<sup>17</sup> provides a framework for cooperation in a number of areas, notably regional policy in the Pyrenees. In 1997 the EU and Andorra concluded a **Veterinary Protocol** with the aim of maintaining the traditional flow of live animal trade and

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<sup>13</sup> Agreement between the European Community and the Principality of Andorra providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (OJ L 359, 4.12.2004, p. 33); Agreement between the European Community and the Principality of Monaco providing for measures equivalent to those laid down in Council Directive 2003/48/EC (OJ L 19, 21.1.2005, p. 55); Agreement between the European Community and the Republic of San Marino providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments. Memorandum of Understanding (OJ L 381, 28.12.2004, p. 33).

<sup>14</sup> OJ L 157, 26.6.2003, p.38

<sup>15</sup> Commission Communication on "Concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries", COM(2012)351 final, Brussels, 27 June 2012.

<sup>16</sup> Agreement in the form of an Exchange of Letters between the European Economic Community and the Principality of Andorra of 28 June 1990 (OJ L374, 31.12.1990, p. 16); the agreement entered into force on 1 January 1991.

<sup>17</sup> Cooperation Agreement between the European Community and the Principality of Andorra (OJ L 135, 28.5.2005, p. 14).

animal products while guaranteeing compliance with EU standards<sup>18</sup>. Accordingly, Andorra has taken over the *acquis* concerning general food law and hygiene and framework legislation for animal disease control.

### 2.2.2. *Schengen*

Andorra is not part of the Schengen area. **Border controls** are carried out at the borders between Andorra and its neighbours France and Spain. However, it coordinates its visa requirements with the Schengen area and accepts Schengen visas. According to a pragmatic approach taken by the Schengen member states, at the external borders of the EU Andorran nationals are allowed to undergo passport controls at the counters for citizens of the EU and EFTA Member States.

### 2.2.3. *Bilateral Relations with Neighbours*

Andorra maintains privileged relations with **France and Spain**, as well as with **Portugal**, through agreements in several areas such as the free movement of persons, education and justice and home affairs.

### 2.2.4. *Andorra's European policy*

Andorra has shown a **strong interest in, and commitment to**, enhancing its integration with the EU.

In 2010, the Andorran government produced a non-paper announcing its desire for increased cooperation. In 2011, Andorra submitted a memorandum to the EU, detailing the areas in which it perceived obstacles to accessing the internal market. In June 2012, Andorra adopted a revised law to open up further its economy to investment.

Andorra **seeks deeper relations with the EU** by negotiating a new agreement that takes into account that Andorra is geographically located within the EU, as well as the specificities of Andorra, the possibility to apply transitional periods in certain areas, including the free movement of persons, as well as Andorran participation in EU programmes and agencies.

## 2.3. **Monaco**

### 2.3.1. *Part of the EU customs territory*

Monaco has a customs agreement with France; as a consequence, Monaco is part of the **EU customs territory**<sup>19</sup>.

In addition, Monaco and the EU have concluded an **Agreement on the application of certain Community acts** on the territory of the Principality of Monaco<sup>20</sup>. Its purpose is to facilitate the sale of Monégasque medicines for human and veterinary use, cosmetic products and

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<sup>18</sup> Protocol on veterinary matters supplementary to the agreement in the form of an exchange of letters between the European Economic Community and the Principality of Andorra, OJ L 148, 6.6.1997, p.16

<sup>19</sup> Art. 3(2) of Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code (OJ L302, 19.10.1992, p.1).

<sup>20</sup> Agreement between the European Community and the Principality of Monaco on the application of certain Community acts on the territory of the Principality of Monaco (OJ L 332, 19.12.2003, p. 42).



medical devices on the EU market. The Agreement provides for the application of the relevant *acquis* in this area to the territory of Monaco.

### 2.3.2. *Schengen*

Monaco is not a Contracting Party to the Schengen Convention. However, by virtue of two bilateral agreements with France<sup>21</sup>, its territory is within the external borders of the Schengen area; consequently, EU and Monaco nationals can travel freely without a visa throughout the whole of the Schengen area, including Monaco. The agreements provide for the necessary security safeguards and the establishment of controls at Monaco's external borders, which are carried out by the French authorities at the authorised external border crossing points *Monaco-Heliport* and *Monaco-Port*. In addition, Monégasque residence permits are equivalent to Schengen visas.

### 2.3.3. *Bilateral Relations with Neighbour*

Monaco has a number of economic **agreements with France**, which have, in certain cases, the effect that Monaco adopts and applies the same rules as the EU Member States. For example, when France adopts internal legislation transposing EU directives in certain areas covered by bilateral Agreements with Monaco, the Principality directly applies the French legislation in these areas. However, this does not give Monaco automatic access to the EU's internal market in these areas in the absence of an agreement with the EU. Moreover, there are no mechanisms for the EU to monitor implementation or pursue any infringement.

### 2.3.4. *Monaco's European policy*

Monaco has expressed an interest in obtaining greater **access to the EU internal market** in specific areas, including as regards the free movement of persons and goods.

In 2012, Monaco submitted a memorandum to the EU on this topic, detailing the areas in which it perceived obstacles to accessing the internal market.

Monaco is open to discuss further the possibility of concluding a comprehensive agreement with the EU on access to the internal market. Any agreement would need to take into account Monaco's close relationship with France and its political and geographical specificities.

## 2.4. **San Marino**

### 2.4.1. *Customs union*

The EU and San Marino have concluded a **Cooperation and Customs Union Agreement**<sup>22</sup>, which establishes a customs union covering all chapters of the Harmonised System, i.e.

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<sup>21</sup> Two agreements in the form of exchanges of letters between Monaco and France, signed the 15 December 1997, adapted the section of the Convention on Good Neighbourly Relations of 18 May 1963 on the entry, stay and establishment of foreigners in Monaco to the provisions of the Convention on the Implementation of the Schengen Agreement.

<sup>22</sup> Agreement on Cooperation and Customs Union between the European Economic Community and the Republic of San Marino (OJ L84, 28.3.2002, p. 43). This agreement was signed on 16 December 1991, but only entered into force on 1 April 2002; it was supplemented in March 2010 by an Omnibus Decision adopted by the EC-San Marino Joint Committee, covering customs measures, and veterinary and phytosanitary matters (OJ L156, 23.6.2010, p. 13).

including agricultural products<sup>23</sup>. This Agreement further provides for non-discrimination as regards conditions of employment and cooperation in various fields such as environmental protection, tourism and culture.

#### 2.4.2. *Schengen*

San Marino is not part of the Schengen area, but there are **no border controls** between Italy and San Marino. San Marino is not associated to the implementation of other elements of the Schengen *acquis*, such as police and judicial cooperation.

#### 2.4.3. *Bilateral Relations with Neighbour*

San Marino has concluded several bilateral agreements with Italy, including one on the free movement of persons<sup>24</sup> allowing San Marino nationals to work and reside in Italy.

#### 2.4.4. *San Marino's European policy*

San Marino has shown a **strong interest in, and commitment to**, enhancing its integration with the EU<sup>25</sup>.

In 2011, San Marino submitted a memorandum to the EU, detailing the areas in which it perceived obstacles to accessing the internal market.

San Marino has expressed openness to consider various options for closer integration into the EU. San Marino **seeks deeper relations with the EU** by negotiating a new agreement that takes into account that San Marino is geographically located within the EU, as well as the country's specificities.

### 3. **OBSTACLES TO INTERNAL MARKET ACCESS**

Citizens and companies of all three small-sized countries have **limited access** to the EU's internal market (see the accompanying Staff Working Paper for details). The most problematic areas are the free movement of persons and services, and the freedom of establishment. Goods originating in the small-sized countries also encounter obstacles regarding the free movement of goods in so far as EU standards and regulations may prevent these goods from being sold on the EU market. EU citizens and businesses would also benefit from greater integration with the small-sized countries. For example, EU citizens currently require a permit to work and/or reside in the small-sized countries.

#### 3.1. **Free Movement of Persons**

The small-sized States have relations of close proximity with their neighbours. Historically, there have been flows of persons and goods from and through their territory. Yet, despite having free movement of persons agreements with neighbouring countries, the small-sized

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<sup>23</sup> Chapters 1-24 of the Harmonised System.

<sup>24</sup> Bilateral Agreement on Amity and Good Neighbourhood of 31 March 1939 (law of 6 June 1939, no.1320 (1)).

<sup>25</sup> There is a lively internal debate within San Marino on EU membership. In 2010 a referendum initiative was launched on whether the government should submit an application for membership of the EU. The San Marino Constitutional Court has recently ruled that the referendum is admissible but it is not yet clear when it will take place.

countries have no equivalent agreement with the EU providing for the free movement of their nationals in the EU. This often presents an obstacle to their citizens taking up employment or study opportunities, starting a business or investing.

For stays over three months, a residence permit is required. This is granted on the basis of strict criteria, such as the availability of sufficient economic means and accommodation. Currently, the conditions for obtaining a permit vary, depending on the Member State and type of employment<sup>26</sup>. The complexity of procedures for a residence permit is seen as an obstacle to employment in EU Member States. It is difficult to obtain from business a prior declaration of employment, which is necessary in order to apply for a stay permit. The agreements with Andorra and San Marino provide as regards rights of workers only for non-discrimination with respect to the conditions of employment<sup>27</sup>.

In addition to the requirements for residence and work permits, the small-sized countries have raised a number of additional problems in the area of free movement of persons, in particular the lack of the following rights which are granted to citizens of the EU<sup>28</sup>:

- The right to stay in the EU after the end of economic activity;
- The right of residence and pursuit of an economic activity for family members;
- Free movement of persons for the purposes of education and research<sup>29</sup>;
- Opportunities to access EU programmes, including research funding and student exchanges<sup>30</sup>;
- Social security coordination<sup>31</sup> and the mutual recognition of professional qualifications<sup>32</sup>.

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<sup>26</sup> Immigration is a competence shared between the EU and its Member States. Admission of third-country nationals is decided at national level whereas some rights and conditions are harmonised at EU level.

<sup>27</sup> Article 5 of the Cooperation Agreement with Andorra, and Article 20 of the Cooperation and Customs Union Agreement with San Marino.

<sup>28</sup> Unless specified otherwise, provided by Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States (OJ L158, 30.4.2004, p. 77).

<sup>29</sup> Under the conditions referred to in Article 7, Directive 2004/38/EC.

<sup>30</sup> Article 18 TFEU.

<sup>31</sup> Within the EU, the relevant legislation is Regulation 883/2004 on the Coordination of Social Security Systems. The social security systems of the three countries are not coordinated with the security systems of the Member States; however, as the case may be, nationals of the three states can benefit from the coordination between the legislation of Member States (Regulation (EU) No 1231/2010 of the European Parliament and of the Council of 24 November 2010 extending Regulation (EC) No 883/2004 and Regulation (EC) No 987/2009 to nationals of third countries who are not already covered by these Regulations solely on the ground of their nationality (OJ L344, 29.12.2010, p. 1 ).

<sup>32</sup> Within the EU, Directive 2005/36/EC of the European Parliament and of the Council of 7 September 2005 on the recognition of professional qualifications (OJ L255, 30.9.2005, p. 22) confers on persons having acquired their professional qualifications in a Member State the right, under the conditions laid down in the Directive, to have access to the same profession and pursue it in another Member State with the same rights as nationals.

### 3.2. Free Movement of Services and Freedom of Establishment for Companies

The small-sized countries face **significant obstacles** in the area of the free movement of services and of establishment. These freedoms are not provided for in any of the agreements concluded with the EU. In particular, the companies established in the small-sized countries do not have the right to provide directly services in the Union.

There are no restrictions on the creation of a subsidiary in a EU Member State by companies from the small-sized countries which wants to conduct a business activity or to invest in the Union. But the establishment in the Union of a branch may be the subject of restrictions. Indeed, there is no right of establishment for third country legal persons (as for natural persons).

Once **established** as a subsidiary in one Member State, the entity in question is free to provide services in all other Member States in conformity with EU and national law, without discrimination<sup>33</sup>. However, in the case of companies based in the small-sized countries, establishment in the EU may increase their costs due to the need for an economic presence and associated administrative procedures. A presence in the EU may also be necessary to meet the requirements of EU legislation on consumer protection (for instance, after-sales customer service based in the EU). These constraints may particularly discourage small and micro-enterprises from carrying out business in the EU<sup>34</sup>.

### 3.3. Free Movement of Goods

Bilateral trade in goods between the EU and the three small-sized countries is facilitated by customs union agreements: Monaco has a custom agreement with France and is part of the customs territory of the EU, whereas San Marino and Andorra both have customs union agreements with the EU. Nevertheless, the small-sized countries face market access obstacles in the form of technical barriers to trade. In order to be placed on the EU market, goods from these countries must meet the EU's internal market **standards and rules**, such as those on product safety and consumer protection.

Companies based in the small-sized countries may face obstacles to selling their goods in the EU, even if the small-sized country of primary establishment has unilaterally taken over the relevant EU *acquis* - the conclusion of an agreement with the EU is in most cases still necessary, notably to confirm that the legislation and its implementation meet EU standards. What is more, even where a small-sized country has an agreement with the EU, it needs to be updated to keep pace with the evolution of EU legislation.

Given that Andorra and San Marino are third countries, **standard customs procedures**, including a declaration, apply. These formalities may occasionally cause delays.

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<sup>33</sup> Although, as for EU nationals and companies, depending on the kind of service this may be subject to certain safeguards, such as pro forma registration with a professional body.

<sup>34</sup> As regards natural persons, nationals of the small-sized countries need a permit to reside and work (be it as a worker or a self-employed person) in an EU Member State (see section on free movement of persons). In practice, immigration law may therefore constitute a barrier to the provision of services by companies or persons established in the small-sized countries.

## 4. UPHOLDING AND PROMOTING THE EU'S INTERESTS

The previous section outlined the difficulties encountered by citizens and companies of the three small-sized countries in accessing the EU's internal market. While in many respects the interests of these countries and the EU coincide and both sides stand to gain from mutual co-operation, there are, however, some areas where the EU encounters problems that need to be addressed in the relationship.

### 4.1. Greater economic and employment opportunities for EU citizens and companies

The European Council recently highlighted the “heightened tensions” that are slowing down economic recovery across Europe, including the sovereign debt crisis, financial sector weakness and persistent low growth<sup>35</sup>. In response, it adopted a “**Compact for Growth and Jobs**”, encompassing action to be taken by the Member States and the EU with the aim of re-launching growth, investment and employment. In particular, the Compact stresses the need to mobilise all levers, instruments and policies to that end at “every level of governance” in the EU<sup>36</sup>. The October 2012 European Council called for swift, determined and result-oriented action to ensure the full and rapid implementation of the Compact<sup>37</sup>.

With a combined population of around 150 000 and high average GDP-per-capita levels, the small-sized countries make a substantial **contribution to the economy** in their respective regions and beyond. For example, Andorra is a major shopping and tourist destination in the Pyrenees, attracting around 8 million visitors a year; similarly, San Marino is a popular tourist destination in Italy, with over 2 million visitors a year. Monaco is a major provider of employment in its region, with 45,000 cross-border workers commuting there on a daily basis from neighbouring France and nearby Italy.

However, EU citizens wishing to work in these countries as employees or establish themselves as self-employed independents continue to face significant barriers, mainly in the form of work and residence permit requirements. Moreover, the small-sized countries have restrictions on inward investment. EU citizens and companies would stand to benefit from a lifting of these restrictions.

All three countries have major financial services industries and are a source of investment into the EU: taken together, Andorra, Monaco and San Marino are seat to over 50 banks, managing over 100 billion euros in client assets. Moreover, they have increasingly sought to **diversify their economies** and foster high value-added industries<sup>38</sup>. However, the obstacles these countries face in accessing the EU internal market indicate that they hold **unfulfilled potential** as motors of growth, investment, innovation and employment from which the EU could benefit.

**Breaking down barriers** to trade and economic activity between the EU and the small-sized countries could contribute, among other activities, to attaining the objectives of the Europe

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<sup>35</sup> European Council Conclusions, Brussels, 29 June 2012, EUCO 76/12.

<sup>36</sup> Tax policy also figures prominently in the Compact: “Rapid agreement must be reached on the negotiating directives for savings taxation agreements with third countries”. The latter includes the small-sized countries.

<sup>37</sup> European Council Conclusions, Brussels, 19 October 2012, EUCO 156/12.

<sup>38</sup> For example, San Marino and Monaco are both producers of cosmetics; and Andorra and Monaco are home to dental implant manufacturers.

2020 Strategy<sup>39</sup> and the Compact for Growth and Jobs in neighbouring regions of the EU. This would also be consistent with the EU's trade policy, as set out by the Commission's 2010 Communication on Trade, Growth and World Affairs. Moreover, there is significant evidence that the extension of the internal market **enhances economic growth** for all its participants. Lifting obstacles to EU trade with the small-sized countries could further contribute to boosting economic growth in the internal market.

#### 4.2. Mutual benefits through a level playing field

The backbone of the EU's internal market are **common rules and standards** and a thorough policy on enforcement and governance. In principle, both the EU and the small-sized countries should benefit from the extension of the EU's internal market *acquis* to them as this would ensure a level playing field for both businesses and persons. The EU has an interest in encouraging neighbouring states to adopt a legal framework compatible with that of the EU. In this connection, the importance of the **correct transposition and enforcement** of the *acquis* as a pre-requisite for the good functioning of the internal market cannot be underestimated. A common legal framework would facilitate the addressing of shared challenges, ranging from consumer protection to environmental concerns.

#### 4.3. Cooperation in support of shared objectives

There is potential to enhance cooperation with the small-sized countries in support of a wide range of shared objectives in the political, economic, environmental and cultural domains (see the accompanying Staff Working Paper for details). In the area of **regional policy**, the EU-Andorra Cooperation Agreement has facilitated cooperation between Spain, France and Andorra in the context of the EU Regional Policy's Operational Programme of cross-border cooperation in the Pyrenees<sup>40</sup>. There is potential to deepen this cooperation, which could lead to benefits for people living throughout the region.

Both sides have much to gain through cooperation on matters of mutual concern, such as **transparency and exchange of information** in the area of taxation and the fight against crime, including tax fraud<sup>41</sup>, tax evasion and money-laundering. It is important to protect the licit economy against criminal infiltration and corruption and therefore take vigorous action to develop an efficient system to trace, freeze and confiscate criminal assets. Law enforcement and judicial cooperation facilitating **asset confiscation** will hamper criminal activities and deter it by showing that crime does not pay.

In the field of environmental protection, closer cooperation between the EU and the small-sized countries could yield tangible benefits. For example, Monaco has taken international initiatives to preserve maritime ecosystems and biodiversity, and is active on other maritime issues of interest to the EU. It would be worth exploring whether there is scope for more regular consultations in this area.

Regarding **foreign and security policy**, there is no agreement with the small-sized countries on their alignment to EU positions and declarations, but they do align of their own accord on

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<sup>39</sup> Communication from the Commission: "Europe 2020 - A strategy for smart, sustainable and inclusive growth", Brussels, 03.03.2010, COM(2010) 2020 final.

<sup>40</sup> 2007-2013 budget: EUR 168 Million.

<sup>41</sup> Commission Communication on "Concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries", COM(2012)351 final, Brussels, 27 June 2012.

a case-by-case basis. Furthermore, there are contacts between several EU Delegations to international organisations and the small-sized countries. At the UN in New York, the EU Delegation meets with the small-sized countries, which are part of the "Friends of the EU" group, on a monthly basis. Cooperation in this area could be developed further. The small-sized countries sent a positive signal in this regard by voting in favour of the EU's proposed UN General Assembly Resolution on enhanced observer status at the UN in 2010. An agreement with the small-sized countries could provide for more systematic cooperation and exchange of information in major international organisations. The Andorran Chairmanship of the Committee of Ministers of the Council of Europe (9 November 2012-16 May 2013) may provide an early opportunity to explore ways to enhance cooperation between the EU and the small-sized countries on upholding and strengthening democracy and human rights in Europe.

## 5. POSSIBLE OPTIONS FOR CLOSER INTEGRATION

As shown by the above considerations, it is both possible and desirable to aim for a higher degree of integration of the small-sized countries into the internal market.

Closer integration would ensure the **greatest possible freedom** of movement of citizens and businesses between the small-sized countries and the EU, in particular through a clearer and safer legal environment. In turn, this would help reinforce the **appropriate foundations for economic growth** and employment creation in parts of the EU as well as for the small-sized countries. This applies especially in EU neighbouring regions, where the small-sized countries already offer employment to thousands of EU citizens, including cross-border workers. This dynamic could be boosted further through greater access to the internal market. Furthermore, this approach would support the economic diversification of these countries and foster abandonment of banking secrecy and tax haven status. This would engender greatly increased tax revenues to EU Member State treasuries and strengthen the legal framework against illicit financial activities.

In any event, the EU should take account of the **specificities of the small-sized countries** in developing its policy. These countries are all located in the heart of Europe, maintain close relations of proximity with the EU, and have very close ties with their neighbours. From the EU's perspective, it is therefore appropriate to examine ways to integrate them more closely into the internal market. This section evaluates the options available to the EU to achieve these aims, ranging from the least to the most ambitious.

### 5.1. Option One: Status quo

This option would continue the current approach, without the conclusion of any new agreements related to the internal market. The result of this approach would be that the small-sized countries' access to the internal market would continue to be very limited. Consequently, the choice of this option might have repercussions for their overall relations with the EU. Their willingness to negotiate new agreements in areas of interest to the EU might be negatively affected. The existing agreements do not avoid the creation for them of an administrative burden incommensurate with its benefits for the EU, but would perpetuate legal uncertainty for citizens and economic operators in several areas.

### 5.2. Option Two: Sectoral Approach

This option would consist of negotiating **Sectoral Agreements** for access to parts of the internal market, such as in the area of free movement of persons or services. To achieve full

integration of the small-sized countries, separate agreements could be concluded with each country on different policy areas, such as:

- Free movement of persons;
- Freedom of establishment and Free movement of services; (or possibly persons and services together)
- Customs Union and Free movement of goods;
- Flanking measures, horizontal policies and other areas of cooperation.

These agreements would need to be complemented by provisions on shared values and institutions to underpin the relationship and ensure the smooth functioning of the agreements.

This approach would therefore require negotiation and conclusion of up to 18 separate agreements with the three countries (three for each policy area). This approach might allow the tailoring of the provisions of the agreements to each country's specific needs and could offer some flexibility. In particular, a staged approach would allow for the small-sized countries' progressive integration into mutually-agreed pillars of the internal market.

However, the **drawbacks** of this approach are several. First, it is not in the EU's interest to negotiate and conclude such a large number of agreements, as the negotiating effort required would be multiplied in comparison with a single agreement. Second, an approach based on sectoral agreements to meet the most pressing concerns of the small-sized countries would not provide comprehensive solutions to the problems they face and would be poorly adapted to address challenges that might arise in the future. Moreover, if each small-sized country opted for market access in different policy areas, it would result in different arrangements for each country, leading to an incoherent web of unconnected agreements that would be difficult to manage. The EU's experience in its relations with other major partners has demonstrated that the disadvantages of the sectoral approach include unmanageable complexity and legal uncertainty<sup>42</sup>.

### 5.3. Option Three: Framework Association Agreement

A Framework Association Agreement could offer the small-sized countries a high degree of integration, including partial or full access to the EU's internal market, its flanking measures and horizontal policies. It could also provide for participation in other areas of EU activity. The Association Agreement would set out the underlying values, principles and institutional foundations of the relationship. The Agreement could be a single multilateral agreement between the EU and the three small-sized countries, possibly following the **European Economic Area** (EEA) model. The conclusion of a bilateral treaty with each small-sized country would theoretically be possible but not desirable due to the added complexity and tendency for unnecessary differentiation, as mentioned in sub-section 5.2. above. This option would offer the additional advantage to the three small-sized countries of regulating their mutual relations.

It would be necessary to draw up an appropriate **institutional framework** for this option. If feasible, a solution that built on the credibility and efficiency of existing structures would be

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<sup>42</sup> Council conclusions of December 2010 on the EU's relations with EFTA countries.



preferable. Special governance arrangements could be defined, which might include, for example, mechanisms for the consultation of the small-sized countries on proposals for EU legislation that were of particular relevance for them (“decision-shaping”) as well as their participation as observers in EU programmes and agencies. In any case, for a Framework Association Agreement to be viable, a satisfactory solution would have to be found to ensure that the relevant parts of the *acquis* are made applicable in those countries, that the *acquis* is actually implemented and enforced by the small-sized countries or authorities entrusted by them with that task, and that the application of the *acquis* is monitored and, as the case may be, enforced vis-à-vis those countries<sup>43</sup>. Overall, if a suitable institutional framework can be worked out, this is a **viable option** that should be explored further.

#### 5.4. Option Four: Participation in the European Economic Area

This option would provide for full integration into the internal market on the same basis as the current non-EU countries of the European Economic Area (EEA). It has **several advantages**, including the straightforwardness and reliability of using an existing and proven treaty and institutional framework. However, given that the European Economic Area Agreement was concluded between two pre-existing trade and economic areas (the EU and EFTA), it would in principle be necessary for the small-sized countries first to become a member of either one in order to join the EEA<sup>44</sup>.

Membership of the EU is considered below, which leaves accession via EFTA. The EU would need to discuss with the existing members Iceland, Liechtenstein, Norway and Switzerland, the possibility of enlarging EFTA to the small-sized countries. This option would have the added advantage of boosting the EFTA-EEA membership, which would dwindle to only two countries (Norway and Liechtenstein) if Iceland were to join the EU. The enlargement of the EEA would involve re-negotiating the EEA Agreement, not least to provide for an adaptation of the EEA- EFTA institutions. The precise legal construction would need to be examined in more detail if this option were retained. Overall, this is a **viable option** that should be explored further.

#### 5.5. Option Five: Membership of the EU

This option would give the small-sized countries the most comprehensive access to the EU's internal market, programmes and activities. Although no small-sized country has yet applied for membership, they could do so under Art. 49 TEU: any European state that respects the EU's values and is committed to promoting them may apply to become a member of the EU.

The renewed consensus on enlargement requires to take into account the EU's integration capacity and to ensure the effective functioning of its institutions and development of its policies. A possible membership application would face two major difficulties: first, the EU institutions are currently not adapted to the accession of such small-sized countries. In order to ensure adequate democratic representation of all citizens and the functioning of the institutions even after the accession of countries with populations of only a fraction of the smallest current Member States, important changes to the European Treaties and the

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<sup>43</sup> The important role of monitoring and enforcement of the *acquis* in those countries could be assumed by the Commission and the Court of Justice of the European Union; the EEA EFTA institutions (EFTA Surveillance Authority and EFTA Court); or an equivalent supra-national authority. The options would need to be discussed and the preferred option agreed with the small-sized countries.

<sup>44</sup> Article 128 of the EEA Agreement.

institutional setup of the EU would be required. Such changes are unlikely to be agreed within a short timeframe and would require important negotiations within the EU. Second, the limited administrative capacity of the small-sized countries will have a significant impact on their ability to implement the EU *acquis* and to fulfil all obligations as EU Member States.

## 6. CONCLUSIONS

### 6.1. Horizontal and institutional issues

In the event of full integration, in order to ensure the homogeneity of the internal market and legal certainty for economic operators and citizens, any agreement with the small-sized countries would need to address **four horizontal issues** related to: (i) the dynamic adaptation of the agreement to the evolving *acquis*; (ii) the homogeneous interpretation of the agreements; (iii) independent surveillance and judicial enforcement; (iv) and dispute settlement. In this respect, the EU could draw on the successful experience of the EEA Agreement in this respect. However, any agreement should take into account the **specificities and particular identities** of the small-sized countries, in line with the Declaration on Article 8 TEU. To safeguard these principles, it may be necessary to offer the small-sized countries transitional periods and/or safeguard clauses.

### 6.2. Recommendations

The options presented in this Communication, if any were to be pursued further by the EU, would need to be discussed in detail with the governments of Andorra, Monaco and San Marino, in full respect of their sovereignty and independence.

In principle, options three to five would address the key problems faced by the small-sized countries. Option one (status quo) would provide no solution and is therefore not a favoured option. The EU's experience of the sectoral approach has conclusively demonstrated its drawbacks. For this reason, and as it would provide only partial solutions, option two is not the preferred option, but it is not ruled out entirely at this stage. Option five remains a long-term possibility but is not retained here. The small-sized countries have not submitted an application for EU membership, and future accession would not provide any solutions in the short-to-medium term.

In contrast, options three (**Framework Association Agreement**) and four (**participation in the EEA**) have the potential to safeguard the right balance of flexibility and comprehensiveness to address the small-sized countries' concerns while meeting the requirements of the EU. These options are therefore the preferred ones, although they merit further reflection and examination, including on their possible implementation. If it were to prove impossible to move forward with these, then other options, in particular option two, could be given further consideration.

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