

# EU Relations with European Micro-States. Happily Ever After?

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**Abstract:** *The last decade has seen the EU striving to bring uniformity into its relations with its immediate neighbours. Such endeavor has led the EU to adopt the European Neighbourhood Policy towards countries with no immediate prospects of accession and to follow more or less similar pre-accession strategies towards candidate and to-be candidate countries. However, European micro-states (Andorra, Liechtenstein, San Marino and Monaco—the Vatican not being the subject of this article) have always occupied an exceptional position in the EU's web of external relations. This article provides a brief but concise overview of the international legal framework governing the bilateral relations of the EU with these small countries. Through the examination of their peculiar historical, social, geographic and economic attributes, it is argued that the advantages that micro-states have been able to reap so far from the unique position they enjoy in the EU and the global economy may not be easily reconcilable in the future with the EU's ever-increasing appetite to unify, standardise and harmonise.*

## I Introduction

The examination of the framework governing the relationship of the EU with the European micro-states (Andorra, Liechtenstein, Monaco and San Marino)<sup>1</sup> reveals that EU strategy towards these small non-member countries has not been a one-size-fits-all policy. Although size has been undeniably a factor taken into account in a majority of the agreements concluded in the area (for instance the Preamble to the agreement establishing a customs union between the EEC, on the one hand, and the Principality of Andorra, on the other, states that '[o]wing to geographical . . . factors, Andorra's exceptional situation justifies special arrangements'),<sup>2</sup> the unique historical context seems to have been predominant in shaping the bilateral relations between the Community and the micro-states. Indeed, the history of these states displays a

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<sup>1</sup> The relations between the State of the Vatican and the EU will not be discussed.

<sup>2</sup> Agreement between the European Economic Community and the Principality of Andorra [1990] OJ L374/14.

perpetual struggle for independence and for the effectuation of their right to self-determination. Surrounded by much larger players on the international scene, these small countries have often found themselves to be the object of the territorial ambitions of their bigger neighbours (the most striking example being that of Andorra, which essentially derives its independence from an agreement accorded between the Bishop of Urgell—today, Spanish territory—and the Count of Foix—today, French territory—in 1268).<sup>3</sup> Whilst it is true that each micro-state has a unique and peculiar story of its own, there nevertheless exist common features of their history which have influenced their current relations with the Community in a broadly similar way. From the point of view of the micro-states, albeit sharing similar characteristics (*inter alia* their small size, small population and similar economic attributes), what is apparent is the lack of concerted action to promulgate their common interests.<sup>4</sup> The reason may be found in the historical evolution of their statehood, which has always shown a degree of interdependence with one—or more—of their larger (and thus more powerful) neighbours.

The detailed overview of the history of the European micro-states would go beyond the boundaries of this short article. Instead, first, a brief description of their largely similar economic (and social) peculiarities will be provided which is of paramount importance in understanding the underlying rationale of the international legal environment that these small countries have been trying to shape and take advantage of (indeed, quite successfully) so far. Second, the bilateral agreements in force between the EU, on the one hand, and each of the micro-states, on the other, will be analysed, and the similarities of their respective legal relationships will be uncovered.<sup>5</sup> It will be demonstrated that the similar economic context in which these agreements have been concluded has played (alongside historical predetermination) a decisive influence in the shaping of the bilateral relations of the Community with its smallest neighbours. Lastly, at the end of this article, the future perspective of their bilateral relations will be discussed.

## II Size Does Matter

There is no commonly accepted definition of micro. Some studies characterise micro-states as countries with a population of less than 1 million,<sup>6</sup> leading current EU Member States Cyprus, Luxembourg and Malta to fall within the ambit of the

<sup>3</sup> By virtue of this agreement, and its subsequent afterlife, today the Bishop of Urgell and the President of the French Republic exercise their sovereignty as co-princes of Andorra. The framework of the friendly relationship between the three countries is provided by the treaty of vicinage, friendship and cooperation of 1993. For a comprehensive analysis, see J. Duursma, *Fragmentation and the International Relations of Micro-States. Self-Determination and Statehood* (Cambridge University Press, 1996), at 317–320 and 335–338.

<sup>4</sup> See M. Maresceau, 'Les micro-Etats européens et l'Union Européenne: Une relation de proximité sous tension?', in *Les Dynamiques du Droit Européen en Debut de Siecle, Etudes en l'Honneur de Jean Claude Gautron* (Editions Pedone, 2004), 752: 'de la part des micro-Etats il n'y a pas eu jusqu'ici d'approche ou de stratégie concertée ou coordonnée de leurs relations avec l'UE'.

<sup>5</sup> For a comprehensive overview of the agreements in force between the EC and the micro-states see the Appendix.

<sup>6</sup> See, for instance, *Applying the EU Regulatory Framework in Microstates, A report to the CYTA, EPT and MaltaCom by Ovum and Indepen* (June 2005), n 1, available at [http://www.independen.co.uk/panda/docs/applying\\_the\\_eu\\_regulatory\\_framework.pdf](http://www.independen.co.uk/panda/docs/applying_the_eu_regulatory_framework.pdf).

definition. Other studies put the threshold higher, at a population of 3 million,<sup>7</sup> a parameter which could in theory allow the conclusion that EU members Slovenia, Latvia and Lithuania are also micro-states. However, there appears to be a wide—although not too scientific—consensus in legal literature that besides population, really small size is what makes a country a full-fledged micro-state. In addition, the term itself seems to have been carefully avoided once a country had become a Member State of the EU,<sup>8</sup> an interesting phenomenon which could in fact be attributed to the exceptional and sometimes controversial status that non-member European micro-states enjoy in the palette of EU external relations and, indeed, in the global economy. Hence, it seems appropriate to conclude that the micro-states examined in this article create a category of their own, not only because of their extremely small size and population (the most densely populated being Andorra, which counted well below 90,000 citizens in 2006), but also because of the very peculiar legal and economic structures with which they have been able to take advantage of being extremely small.<sup>9</sup> The ‘importance of being unimportant’<sup>10</sup> has so far allowed these small states to develop a business climate of extremely flexible financial and commercial regulations and, thereby, the attraction of large amounts of foreign capital. The main commodity with which they have been trading with—it has been argued—is exactly what they had initially been trying to obtain and then vigorously to maintain: their sovereignty.<sup>11</sup> These endeavours, while often subjecting them to external pressure to eliminate their ‘tax haven’ status,<sup>12</sup> have also afforded them the possibility to overcome the serious disadvantages inherent in their economic, social and geographic attributes, namely the scarcity of human and material resources and, as a consequence, their vulnerability to exterior economic fluctuations, which could have had devastating effects on their trade over-dependent economies.<sup>13</sup> As a matter of fact, it has been established that all Western European micro-states had been able to outperform their contiguous neighbours in terms of gross national product per capita values.<sup>14</sup>

It is apparent that the token of success of the European micro-states has so far been their ability to neutralise the limitations stemming from their distinctive geographic, social and economic attributes, and to turn these potentially negative characteristics to their advantage in the international playing field. In addition, the peculiar close relationship that all of them enjoy with their direct neighbours has often been instrumental

<sup>7</sup> See H. W. Armstrong and R. Reed, ‘Small States, Islands and Small States that are also Islands’, (2003) 33(1) *Studies in Regional Science* 238.

<sup>8</sup> I refer to the above-mentioned Cyprus, Luxembourg and Malta, which are never publicly referred to as ‘micro-states’.

<sup>9</sup> It is important to note, however, that there are other territories in Europe (such as Jersey, Gibraltar or the Faroe Islands) that display similar characteristics to those of the micro-states examined in this article; however, since they enjoy only limited sovereignty, I have excluded them from the scope of this article.

<sup>10</sup> Term taken from Armstrong and Reed, n 7 *supra*, at 241.

<sup>11</sup> See A. Cooley, ‘Thinking Rationally about Hierarchy and Global Governance’, (2003) 10(4) *Review of International Political Economy* 679. By the term ‘sovereignty’, he refers to the prerogative of the state to perform regulatory and supervisory functions involving the exercise of official authority, such as legislation, fiscal supervision or the collection of taxes and other dues.

<sup>12</sup> With the possible exception of San Marino, discussed in detail further below.

<sup>13</sup> See, e.g., the International Monetary Fund (IMF), *Article IV Consultation with San Marino, Preliminary Conclusions* (11 December 2006) at point 3, where it is stated that ‘[g]iven its small size and location, San Marino remains especially vulnerable to international developments . . .’; available at <http://www.imf.org/external/np/ms/2006/121106a.htm>.

<sup>14</sup> See Armstrong and Reed, n 7 *supra*, at 244.

in leveraging their political influence and, thereby, in achieving their special status among non-member countries, having in mind the EU's ever-increasing efforts to bring uniformity to its external relations with instruments such as the Euro-Mediterranean Partnership or the European Neighbourhood Policy (ENP).<sup>15</sup>

This brief description of the economic and political context must be given particular emphasis when trying to understand the background forces that have forged so far the complex, and far less than transparent web of relations that exist between the EU and the European micro-states, outlined below in detail.

### III Andorra

The Principality of Andorra is situated on a rocky land area of approximately 470 square kilometres, wedged between France and Spain.<sup>16</sup> Andorra had roughly 81,000 inhabitants, of which approximately 29,500 (36%) were of Andorran nationality in 2006.<sup>17</sup> The economy is strongly export oriented and, notably, there are no direct taxes whatsoever in Andorra.<sup>18</sup>

From the point of view of the Community, Andorra has always been considered a third country, thus falling outside the ambit of Article 229 [ex Article 227] (4) EC,<sup>19</sup> which states that 'the provisions of this [EC] Treaty shall apply to the European territories for whose external relations a Member State is responsible'.<sup>20</sup> In practice this means that in areas not covered by bilateral agreements providing for the contrary, the *acquis communautaire* is generally not applicable in Andorra. The first agreement entered into by the EC (at that time EEC) and Andorra dates back to 1990, whereby a customs union was established between the two parties.<sup>21</sup> The customs regime established concerns, in principle, only trade in industrial products.<sup>22</sup> However, agricultural products of Andorran origin may be exported free from import duties into the Community (but not *vice versa*).<sup>23</sup> The asymmetry of the agreement has been subject to criticism;<sup>24</sup> it could nevertheless be argued that such provisions constitute the embodiment of the principles laid down in the preamble of the agreement, which states that the exceptional situation of Andorra (in terms of its geography, history, social and economic circumstances) justifies 'special arrangements'.

<sup>15</sup> It must, however, be mentioned that the bilateral relations of the micro-states with their bigger neighbours have not always been harmonious. One could refer to the past tensions arising out of the tobacco (smuggling) dispute between Andorra and Spain.

<sup>16</sup> With this area, Andorra is the largest of all micro-states discussed in this article, and, notably, it is also bigger than the EU member Malta (which comprises a territory of 457 square kilometres).

<sup>17</sup> The rest of the population comprised Spanish, French, Portuguese and other nationals. See the official site of the Government of Andorra available at <http://www.estadistica.ad/indexdee.htm>.

<sup>18</sup> People carrying on business activities in Andorra are subject to an annual flat-rate duty, the amount of which varies according to the type of business activity a person is involved in. The duties, however, are at best symbolic. By way of example, the annual tax levied for (co-)owning a Société Anonyme (plc) is 735 euros: website of the Embassy of Andorra in Belgium, available at <http://www.andorra.be/en/3.4.htm>.

<sup>19</sup> Treaty establishing the European Community (Nice consolidated version) [2002] OJ C325/33.

<sup>20</sup> See Duursma, n 3 *supra*, at 359.

<sup>21</sup> Agreement between the European Economic Community and the Principality of Andorra [1990] OJ L374/14, entered into force 1 July 1990.

<sup>22</sup> *ibid*, Art. 2.

<sup>23</sup> *ibid*, Art. 11.

<sup>24</sup> See Maresceau, n 4 *supra*, at 756: 'Il faut toutefois remarquer que la Cour des comptes de la CE a fortement critiqué l'Accord de 1990 comme étant « très avantageux pour les autorités d'Andorre ».

The field of customs is not the only area of cooperation between the Community and Andorra. An agreement dating back to 2004 sets out (in a rather broad and general fashion) the following areas of possible cooperation: environment, communication, information and culture; education, vocational training and youth, social and health issues, trans-European networks, and transport and regional policy.<sup>25</sup> Although the wording of the agreement may indeed appear vague, this characteristic may be due to the fact that it provides in its Preamble for '[c]ooperation in all areas of common interest . . .' and therefore its scope of application may be extended by mutual consent.<sup>26</sup> Having entered only recently into force, the fruitfulness of the agreement remains to be seen.

The absence of direct taxes in the Principality of Andorra undeniably provides an incentive for individuals and companies to establish themselves in the country and thereby attempt to evade corporate, personal income and other direct taxes. As a direct consequence, Andorra is on the Organisation for Economic Cooperation and Development (OECD) list of uncooperative tax havens.<sup>27</sup> In this respect however, noteworthy is that following pressure exerted from the EC, an agreement on taxation of savings interest income has been entered into between the Community and Andorra,<sup>28</sup> which essentially provides for the exchange of information between the Andorran tax authorities and the tax authorities of the Member State the national of which is to receive interest payments of Andorran source. Nevertheless, a considerable shortcoming of the agreement is the fact that the procedure of exchange of information can be easily avoided by sacrificing a certain percentage of the interest to be received by way of payment of a withholding tax.<sup>29</sup> Therefore, the core problem of tax evasion has not been solved; merely the price of anonymity has risen significantly.

Finally, an interesting peculiarity of the Andorran fiscal system must be mentioned. Although there is currently no agreement in force between the Community and Andorra on the subject, the Principality uses the euro as its official currency. The reason for the current practice can be found—again—in the historical context: before the introduction of the euro, Andorra had been using the French franc as its legal tender alongside the Spanish peseta, which was also accepted in commerce. Following the change of currency in France and Spain, Andorra naturally converted to the use of the euro, as its *de facto* legal tender.

#### IV San Marino

The Republic of San Marino is an enclave in the north-central part of Italy, with a land area of approximately 61 square kilometres. San Marino had roughly 28,400 inhabitants in 2005, of which approximately 82% were of San Marinense nationality.<sup>30</sup>

<sup>25</sup> Cooperation Agreement between the European Community and the Principality of Andorra [2005] OJ L135/14, entered into force 1 July 2005.

<sup>26</sup> *ibid.*, Art. 8.

<sup>27</sup> See the official OECD website, available at [http://www.oecd.org/document/57/0,2340,en\\_2649\\_37427\\_30578809\\_1\\_1\\_1\\_37427,00.html](http://www.oecd.org/document/57/0,2340,en_2649_37427_30578809_1_1_1_37427,00.html).

<sup>28</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 [2004] OJ L359/33, entered into force 1 July 2005.

<sup>29</sup> Articles 1–9 of the agreement on taxation of savings income.

<sup>30</sup> Information obtained from the website of the World Bank, available at <http://devdata.worldbank.org/external/CPProfile.asp?PTYPE=CP&CCODE=SMR>.

With regard to the international representation of San Marino, in countries where San Marino has not established consular or diplomatic relations, the Italian consulates provide assistance to San Marinese nationals pursuant to the treaty of friendship between the two countries dating back to 1939.<sup>31</sup> By virtue of the aforementioned agreement, San Marino had been considered part of the Community customs territory as early as 1968,<sup>32</sup> nevertheless an agreement between the Community and the Republic of San Marino on the matter was negotiated in 1991.<sup>33</sup> Following a long ratification process, the agreement entered into force on 1 May 2002 (an interim agreement with substantially the same provisions had been in force in the meantime). Contrary to the agreement concluded with Andorra, the customs union created with San Marino concerns both agricultural and industrial products.<sup>34</sup> In addition, the agreement provides for the adoption of certain areas of the *acquis* (among others, the common commercial policy, regulations relating to agriculture and the Community veterinary, plant health and quality regulations), the abolition of quantitative restrictions and the equal treatment of workers with respect to employment and social security. It must, however, be emphasised that in this context the equal treatment of workers does not include the principle of free movement.<sup>35</sup>

Similarly to the cooperation agreement between Andorra and the Community, the customs agreement between San Marino and the EC also contains a provision that allows the extension of its scope by mutual consent, thereby establishing a dynamic legal framework for future cooperation.<sup>36</sup>

San Marino has also concluded with the EC an agreement on the taxation of savings interest income,<sup>37</sup> with basically identical terms as Andorra. It should however be recalled that San Marino is not on the OECD list of tax havens. Nevertheless, country reports of the International Monetary Fund (of which San Marino is the only member among the micro-states discussed in this article) show that financial sector indicators place San Marino in the category of countries and jurisdictions that are well established as offshore financial centres.<sup>38</sup>

Finally, it must be mentioned that San Marino uses the euro as its official currency by virtue of a monetary agreement concluded with the EC.<sup>39</sup> The peculiarity of this

<sup>31</sup> 1939 Treaty of Friendship between Italy and San Marino as amended in 1968 (Bollettino Ufficiale della Repubblica di San Marino (1970) No 4).

<sup>32</sup> See to that effect Art. 2 of Council Regulation 1496/68 [1968] OJ L238/1.

<sup>33</sup> Agreement on Cooperation and Customs Union between the European Economic Community and the Republic of San Marino [2002] OJ L84/43.

<sup>34</sup> *ibid.*, Art. 2.

<sup>35</sup> Furthermore, a declaration attached to the agreement provides '[t]hat the Community is prepared to negotiate on behalf of . . . the Republic of San Marino with countries with which it has concluded preferential agreements for an appropriate form of recognition of equivalent treatment for products originating in San Marino and products originating in the Community'. The underlying reason for the inclusion of the declaration is the fact that San Marino is not a member of the EU, and as a consequence, San Marinese products do not enjoy in principle the same treatment as products of EU origin in third countries.

<sup>36</sup> See n 33 *supra*, Art 19.

<sup>37</sup> 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 [2004] OJ L381/33, entered into force 1 July 2005.

<sup>38</sup> See, for instance, *IMF Country Report No 04/256 (2004)*, San Marino: Selected Issues and Statistical Appendix, at 4, available at <http://www.imf.org/external/pubs/ft/scr/2004/cr04256.pdf>.

<sup>39</sup> Monetary Agreement between the Italian Republic, on behalf of the European Community, and the Republic of San Marino [2001] OJ C209/1.

agreement is that it has been negotiated by the Italian Republic on behalf of the Community. This was due to the fact that the 1939 treaty of friendship with Italy contained a provision under which San Marino agreed to refrain from the adoption of any financial measure which could influence Italy's monetary system.

## V Monaco

The Principality of Monaco is located on the coast of the Mediterranean Sea, surrounded by French territory. Having a surface area of 1.95 square kilometres, Monaco is the second smallest country in the world after the Vatican. In 2000, Monaco had approximately 32,000 inhabitants of which roughly 19% were of Monégasque nationality.<sup>40</sup> There is no agreement in force between the EC and Monaco on customs matters. However, by virtue of a customs convention concluded with France in 1963, French customs regulations are applicable to the Principality.<sup>41</sup> In practice this means that Monaco is part of the EC customs territory. However, similarly to the case of San Marino, products produced in the territory of Monaco, in principle, may not claim Community origin with respect to third countries, since Monaco is not a member of the EU.<sup>42</sup> Further implications of the aforementioned agreement with France are that Monaco applies the Community provisions on free movement of goods and that it is integrated into the Schengen area.<sup>43</sup>

Certain Community rules on human medicines, cosmetic products and medical devices are also applicable in Monaco pursuant to a bilateral agreement, which entered into force in 2004.<sup>44</sup> A noteworthy provision of this agreement is that the Monégasque authorities and courts are to apply future EC legislation in the subject area along with the relevant rulings of the European Court of Justice.<sup>45</sup>

Similarly to San Marino and Andorra, restrictions on the free movement of workers are in place in the Principality of Monaco, which take the form of fixed quotas based on the number of Monégasque nationals employed in the sector concerned. Although a company tax on profits was introduced in 1963 (at the instigation of the French Republic), Monaco still remains on the OECD list of uncooperative tax havens. As in

<sup>40</sup> The rest of the population comprised French, Italian, English, Belgian, Swiss and German nationals. Information obtained from the official website of the Principality of Monaco, available at <http://www.monaco.gouv.mc/devwww/wwwnew.nsf/1909S/bf4c25af0e203828c1256f8500585a75gb?OpenDocument&7Gb>. Since 2000, no official census of the population has been made available to the public. According to non-official estimates, Monaco counted around 35,600 inhabitants in 2006.

<sup>41</sup> Customs Convention between the French Republic and the Principality of Monaco of 18 May 1963 (text in Gallois, *Le Régime international* 237–242).

<sup>42</sup> Information obtained from the official website of the Commission, available at [http://ec.europa.eu/comm/external\\_relations/monaco/intro/index.htm](http://ec.europa.eu/comm/external_relations/monaco/intro/index.htm). Notably however, there seem to be diverging views on the matter, as Duursma notes: 'Monaco is assimilated with a Community State by non-Community members, which therefore apply the same customs tariffs . . .' (Duursma, n 3 *supra*, at 286). Apparently, his views are based on information provided by the French customs authorities.

<sup>43</sup> Decision of the Executive Committee of 23 June 1998 on Monégasque residence permits (SCH/Com-ex (98) 19) [2000] OJ L239/199.

<sup>44</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 [2003] OJ L332/42.

<sup>45</sup> See Maresceau, n 4 *supra*, at 765: '*Les autorités monégasques s'engagent à appliquer dans le domaine couvert par l'accord une interprétation uniforme des règles communautaires, en tenant compte de la jurisprudence de la Cour de Justice des Communautés européennes*'.

the case of all other European micro-states, an agreement on taxation of savings interest income in the form of interest payments has been concluded between the Community and the Principality of Monaco.<sup>46</sup> Furthermore, a monetary agreement with the Community allows the Principality to use the euro as its official currency, and even to mint a certain amount of Monégasque euro coins, which are to be deducted from the French quota.<sup>47</sup> The agreement further obliges Monaco to apply the Community standards on the fight against money laundering and the falsification of euro bills and coins.

## VI Liechtenstein

The Principality of Liechtenstein, landlocked by Switzerland to its west and Austria to its east, has a total surface area of 160 square kilometres. According to June 2006 estimates, it has 35,010 inhabitants, 34% of which are foreign nationals.<sup>48</sup>

The relations of Liechtenstein with the EU fundamentally differ from those of the other micro-states due to the fact that Liechtenstein is a signatory state of the EEA Agreement.<sup>49</sup> Without going into the specific details of the agreement (which would exceed the boundaries of this short article), two very important points have to be made. First, by making use of Article 112 EEA,<sup>50</sup> Liechtenstein has restricted by decree the free movement of workers to its territory, one of the fundamental principles enshrined in the agreement. The said measures include restrictions on the right of residence. Interestingly, these unilateral acts of the Principality have been given sympathetic consideration from the Community, which considers these acts justified by the 'particular geographic situation' of Liechtenstein.<sup>51</sup> Although safeguard measures under Article 112 EEA are to be, in principle, of a temporary nature, it is difficult to see how the circumstances underlying the restrictions (namely the geographical situation of the country) will change in the future so as to allow the restrictions to be lifted.

Second, having signed a customs union treaty with Switzerland in 1923,<sup>52</sup> customs matters with the EC are governed not only by the EEA Agreement, but also by the various agreements concluded between the Community and Switzerland. Pursuant to an amendment to the customs union treaty with Switzerland, EEA law takes precedence in Liechtenstein over Swiss customs regulations in relation to states party to the EEA Agreement (Switzerland not being a member of the EEA).<sup>53</sup>

<sup>46</sup> Agreement between the European Community and the Principality of Monaco 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 [2005] OJ L19/55, entered into force 1 July 2005.

<sup>47</sup> Monetary Agreement between the Government of the French Republic, on behalf of the European Community, and the Government of His Serene Highness the Prince of Monaco [2002] OJ L142/59.

<sup>48</sup> Information obtained from the official website of the Principality of Liechtenstein, available at [http://www.llv.li/pdf-llv-avw-statistik-bevoelkerung\\_per\\_30.06.2006](http://www.llv.li/pdf-llv-avw-statistik-bevoelkerung_per_30.06.2006).

<sup>49</sup> Agreement on the European Economic Area [1994] OJ L1/3.

<sup>50</sup> Which allows the contracting states to apply safeguard measures in case of 'economic, societal or environmental' difficulties (and thereby to derogate from one or more provisions of the agreement).

<sup>51</sup> For a detailed explanation, see Maresceau, n 4 *supra*, at 761–762.

<sup>52</sup> Customs Union Treaty between Switzerland and the Principality of Liechtenstein of 29 March 1923, League of Nations Treaty Series 21 (1924) No 545 232.

<sup>53</sup> It is further worth mentioning that the Schengen *acquis* and a great part of the *acquis* on agriculture is applicable in Liechtenstein pursuant to several protocols (in particular Protocols 5 and 16) attached to the EEA Agreement.



Liechtenstein is the only European micro-state which does not use the euro as its official currency. Having established a monetary union with Switzerland after the First World War, the Swiss franc is legal tender in the Principality. Liechtenstein—as all the other European micro-states—has signed an agreement on the taxation of savings interest income in the form of interest payments with the EC.<sup>54</sup> Nevertheless, Liechtenstein still remains on the OECD list of uncooperative tax havens.

## VII Conclusions

The overview of the agreements in force between the Community and the European micro-states reveals that there are in fact several similarities between these arrangements. All European micro-states have established close ties with the Community in the area of customs cooperation. The differences in the substance of cooperation derive in part from the particular historical context which has framed—and in part limited—the conduct of these small countries. Thus, Monaco has no bilateral agreement with the EC as such in customs matters, while it nevertheless forms part of the Community customs territory by virtue of its customs union agreement with France; Andorra and San Marino have specific agreements with the Community on the subject, and Liechtenstein partly applies the customs regime of the EEA (and in part that of Switzerland). These arrangements often appear to be tailor-made to meet the particular demands of the micro-states. Thus, rather unusually to inter-state relations in public international law, asymmetric relations have been tolerated by the Community, the most specific example being that of Andorra, which may export agricultural products to the EC exempt from custom duties, while it is still allowed to levy duties on agricultural products of Community origin.

In addition to the partial harmonisation of their trade regimes, the EC and the micro-states have fostered cooperation in other sectors of mutual interest. The extent and scope of harmonisation brought about by the additional cooperation agreements varies to a large degree from one micro-state to another and seems to lack any systematic arrangement or clear political strategy from the part of the Community.<sup>55</sup> From the part of the micro-states, however, some common characteristics can definitely be outlined. All micro-states have gone quite far in protecting their national interests when concluding agreements with the Community. Having in mind the structure of their population (namely the unusually high presence of foreign nationals in their territory),<sup>56</sup> it is not surprising that all European micro-states have introduced restrictions to the free movement of persons. In this respect, the case of Liechtenstein provides perhaps the most descriptive example, as it has managed to introduce permanent derogations (albeit disguised as temporary ones) from one of the main principles of the EEA Agreement.<sup>57</sup> Notably, free movement of persons is not the only area where the micro-states have taken a cautious approach towards the opening up of their borders

<sup>54</sup> Agreement between the European Community and the Principality of Liechtenstein 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 [2004] OJ L379/84, entered into force 15 July 2005.

<sup>55</sup> For instance, no answer can be given to the question why the Community has signed only with Monaco an agreement on the adoption of the *acquis* related, *inter alia*, to cosmetic products, while it has avoided any cooperation in the field of environment protection, although it has established some ties with the other micro-states in the area.

<sup>56</sup> Which varies from 18% (San Marino) to 81% (Monaco).

<sup>57</sup> See n 53 *supra* and accompanying text.

to the Community. Several agreements contain ‘safeguard clauses’ which enable the micro-states to derogate from the main provisions of the agreement in question in case of unforeseen economic or social difficulties.<sup>58</sup>

Apparently, the EU has not been able to standardise the relations with its smallest neighbours so as to make them fit within its general foreign policy framework. The applicability of the ENP has been—and still remains—out of the question, as on the one hand, cooperation with the micro-states has in many respects surpassed the degree of integration envisaged by that instrument, and, on the other, the exceptional treatment accorded to the micro-states would risk running counter to one of the manifest objectives of the ENP, namely that partner countries ‘ultimately share a common regulatory basis and similar degree of market access’.<sup>59</sup> Under these circumstances, what the EU could possibly have recourse to would be the ‘sticks and carrots tactics’, all too well known to EU newcomers and candidate countries. However, it is difficult to see how this less than crystallised pre-accession instrument—the content of which is essentially varied according to daily politics at the discretion of the current Member States—could be of any use to discipline the micro-states without a political will to accede, and a carrot at the end of the road. The benefits of adopting the complex EU legislative framework in almost every sector of the industry (such as labelling requirements, packaging, or telecommunications policies) do not seem to outweigh the costs of regulation and enforcement in the case of extremely small economies, due to the fact that the costs of developing, implementing and enforcing regulations vary relatively with the size of the market being regulated, while the benefits are typically proportionate to the size of the market. Therefore, regulatory approaches and remedies which are appropriate in larger countries could well lead to economic losses (such as steep price increases) in micro-states.<sup>60</sup>

Accession for the micro-states would entail the dissolution of the flexible regulatory environment with which they have been able to overcome the structural disadvantages of their economies. At the same time, they would have to bear the increased costs of (EU) governance, without any clear prospect of the benefits they could reap therefrom. In addition, considering their wealth, European micro-states would be net contributors to the EU budget and, therefore, the unification of the European market could have a negative impact on their respective economies.<sup>61</sup>

The current state of play suggests that bilateral relations between the Community and the European micro-states will continue to be based on the existing legal framework; no watershed can be expected in the (near) future. While from a legal standpoint, the exceptional treatment that micro-states enjoy may become at times difficult to justify, economics and politics will remain always at their disposal to fill in the gaps. Tensions nevertheless—as in the past—can obviously be expected in the future. But nothing that cannot be resolved with a carrot. It is yet unclear though, which party will be waving it.

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<sup>58</sup> See, e.g., Art. 12 of the agreement on customs union between the EEC and San Marino (n 33 *supra*).

<sup>59</sup> Communication from the Commission to the Council and the European Parliament on strengthening the European Neighbourhood Policy (4 December 2006), COM(2006)726 final, at 5, available at [http://ec.europa.eu/world/enp/pdf/com06\\_726\\_en.pdf](http://ec.europa.eu/world/enp/pdf/com06_726_en.pdf).

<sup>60</sup> See the Ovum and Indepen report, n 6 *supra*, at 4.

<sup>61</sup> See *Report of the Committee on Institutional Affairs of 20 April 1989 on the rights of the citizens of small states and territories in Europe* (EP Doc A2—86/89, European Parliament, Session Documents (1989–90)).

**Appendix: The Legal Framework Governing the Relationship of the Micro-States with the EU**

	Customs Matters	Currency	Taxation	Other Areas
Andorra	Agreement between the European Economic Community and the Principality of Andorra <sup>62</sup>	<i>De facto</i> usage of the euro, no agreement has been concluded	Agreement on taxation of savings income in the form of interest payments <sup>63</sup>	Cooperation Agreement between the European Community and the Principality of Andorra <sup>64</sup>
Liechtenstein	Customs matters are governed, on the one hand, by the EEA Agreement <sup>65</sup> and by the several agreements on customs matters in force between Switzerland and the European Community, on the other <sup>66</sup>	Lichtenstein uses Swiss Franc as its currency	Agreement on taxation of savings income in the form of interest payments <sup>67</sup>	By virtue of several protocols <sup>68</sup> forming part of the EEA Agreement, the Schengen <i>acquis</i> is applicable in Liechtenstein as well as a large part of the <i>acquis</i> on agriculture <sup>69</sup>
San Marino	Agreement on Cooperation and Customs Union between the European Economic Community and the Republic of San Marino <sup>70</sup>	Monetary Agreement between the Italian Republic, on behalf of the European Community, and the Republic of San Marino <sup>71</sup>	Agreement on taxation of savings income in the form of interest payments <sup>72</sup>	The current policy of San Marino towards the EU is outlined in the Aide-Memoire sent by the Minister of Foreign Affairs of San Marino to the President of the Commission in 2002 <sup>73</sup>

<sup>62</sup> n 2 *supra*, entered into force 1 July 1990. The customs union established concerns only industrial products.

<sup>63</sup> n 28 *supra*, entered into force 1 July 2005.

<sup>64</sup> n 25 *supra*, entered into force 1 July 2005. The agreement sets out the following areas in which the parties are to enhance their cooperation: environment; communication information and culture; education, vocational training and youth; social and health issues; trans-European networks and transport and regional policy.

<sup>65</sup> n 49 *supra*.

<sup>66</sup> By virtue of the Customs Union Treaty between Switzerland and Lichtenstein, n 52 *supra*, the EC–Switzerland customs agreements apply to the territory of Lichtenstein.

<sup>67</sup> n 53 *supra*, entered into force 15 July 2005.

<sup>68</sup> See Protocol 16 to the EEA Agreement on measures in the field of social security related to transitional periods on the free movement of persons [1994] OJ L1/178.

<sup>69</sup> See Protocol 5 on customs duties of a fiscal nature [1994] OJ L1/157.

<sup>70</sup> n 33 *supra*, entered into force 1 May 2002. The customs union established concerns both industrial and agricultural products.

<sup>71</sup> n 39 *supra*.

<sup>72</sup> n 37 *supra*, entered into force 1 July 2005.

<sup>73</sup> The text is available at [http://ec.europa.eu/comm/external\\_relations/sanmarino/intro/index.htm](http://ec.europa.eu/comm/external_relations/sanmarino/intro/index.htm).

Appendix: continued

	Customs Matters	Currency	Taxation	Other Areas
Monaco	Monaco is part of the EC customs territory by virtue of is customs union with France <sup>74</sup>	Monetary Agreement between the Government of the French Republic, on behalf of the European Community, and the Government of His Serene Highness the Prince of Monaco <sup>75</sup>	Agreement on taxation of savings income in the form of interest payments <sup>76</sup>	Community acts covering medicines for human and veterinary use, cosmetic products and medical devices apply to the territory of Monaco. <sup>77</sup> Monaco is part of the Schengen area. <sup>78</sup>

<sup>74</sup> Customs Convention between the French Republic and the Principality of Monaco, n 41 *supra*.

<sup>75</sup> n 47 *supra*.

<sup>76</sup> n 46 *supra*, entered into force 1 July 2005.

<sup>77</sup> n 44 *supra*, entered into force 1 May 2004.

<sup>78</sup> n 43 *supra*.

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