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**REPORT 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 their participation in the Internal Market**

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## 1. INTRODUCTION

On 20 November 2012, the Commission adopted a Communication<sup>1</sup> on enhancing the EU's relations with the Principality of Andorra, the Principality of Monaco and the Republic of San Marino, and its accompanying Commission Staff Working Paper<sup>2</sup> on obstacles to these countries' access to the EU's internal market and cooperation in other areas. The Communication described the current close relations between the EU and these small-sized European countries. Its assessment was that there was significant potential to develop relations further for mutual benefit.

In particular, in the context of the current economic and financial crisis, it highlighted the contribution that closer economic ties could make to achieving sustained economic recovery in Europe and the EU's 2020 Strategy, including greater employment, trade and investment activity in EU regions neighbouring these countries. Importantly, it concluded by setting out five options for the small-sized countries' participation in the internal market.

In its conclusions<sup>3</sup> of 20 December 2012, the Council welcomed the Communication and selected two of the options as most viable:

- i) participation of these small-sized countries in the European Economic Area (EEA); and
- ii) the negotiation of one or more Framework Association Agreement(s) with them, 'with a view to giving them access to the EU's internal market, its flanking measures and horizontal policies, and including institutional mechanisms following the model of the Agreement on the European Economic Area'.

Moreover, the Council referred to the need to 'ensure the homogeneity and the good functioning of the internal market, while taking into account the specificities of the three countries, as well as [...] the importance of developing a coherent approach for all three countries'.

Therefore, the Council invited the Commission and the High Representative (as appropriate) to continue their analysis of these two options and in particular:

- 'to hold consultations with the Governments of Andorra, Monaco and San Marino and other relevant parties, starting in the first semester 2013, with a view to identifying the feasibility of and the degree of support for these two options, taking into account, in particular, the institutional conditions referred to in the Communication'; and
- 'to submit to the Council, before the end of 2013, a report, including an analysis of the impact and of the main institutional, political and economic implications of these options, as well as recommendations regarding further steps'.

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<sup>1</sup> Commission Communication on EU relations with the Principality of Andorra, the Principality of Monaco and the Republic of San Marino — Options for closer integration with the EU (COM(2012) 680 final/2), Brussels 20.11.2012.

<sup>2</sup> Commission Staff Working Paper Accompanying the Commission Communication on EU relations with the Principality of Andorra, the Principality of Monaco and the Republic of San Marino — Obstacles by Andorra, Monaco and San Marino to the EU's Internal Market and Cooperation in Other Areas (SWD(2012) 388 final), Brussels 20.11.2012.

<sup>3</sup> Council Conclusions on EU relations with the Principality of Andorra, the Republic of San Marino and the Principality of Monaco, 20.12.2012, adopted at the 3213<sup>th</sup> Transport, Telecommunications and Energy Council meeting.

This report responds to the Council's invitation. It has been prepared on the basis of consultations with the small-sized countries and the EEA-EFTA states<sup>4</sup>. It incorporates information gathered during visits by the European External Action Service (EEAS) and Commission services to Andorra, Monaco and San Marino in March 2013, complemented by the countries' responses to a detailed questionnaire on their legislation and administrative capacity.

## **2. ANALYSIS OF THE OPTIONS**

### **2.1. Option One: Participation in the EEA**

#### *2.1.1. Assessment*

This option would entail the participation of the small-sized countries in the European Economic Area (EEA) on the same basis as the current European Free Trade Association (EFTA) members of the EEA<sup>5</sup>. The EEA's main strength is that it is based on a proven treaty and institutional framework, including the EEA-EFTA institutions (Secretariat, Surveillance Authority and Court). However, the small-sized countries would first need to become members of the European Free Trade Area (EFTA) — requiring the unanimous support of its members<sup>6</sup> — to accede to the EEA Agreement<sup>7</sup> subsequently. To date, the small-sized countries have not applied for membership of EFTA. The EFTA states have, therefore, not given formal consideration to such a possibility.

This option may entail some additional drawbacks, given that the EEA-EFTA states act on the basis of a common position in the joint EEA institutions<sup>8</sup>. If the small-sized countries were to participate in the EEA, reaching such a position might become more complicated due to the need to reconcile the positions of six states rather than the current three. This could exacerbate the challenges that the EU and its EEA-EFTA partners already face in ensuring timely EEA decision-making. Moreover, the small-sized countries would need to accede to EFTA trade agreements with third countries.

#### *2.1.2. Small-sized country positions*

Andorra has expressed openness to considering participation in the EEA, provided it is based on a stable institutional framework and takes into account Andorra's specific situation. San Marino is also open to considering this option. Monaco has ruled it out because it cannot easily be adapted to the country's specific circumstances.

### **2.2. Option Two: One or Several Framework Association Agreement(s)**

#### *2.2.1. Assessment*

The negotiation of one or several Association Agreements between the EU and the small-sized countries is the second option. This would provide for the participation of the small-sized countries in the internal market, but could also cover cooperation in other areas as appropriate, such as justice and home affairs, agriculture, fisheries, regional policy, and foreign policy. Unlike the first option, it would be separate from the EEA and would not require the support of the EEA-EFTA states. Flexibility is another advantage of this option, as Association Agreements could be tailored to the specific needs of the EU and the small-sized

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<sup>4</sup> Norway, Iceland and Liechtenstein.

<sup>5</sup> Norway, Iceland and Liechtenstein.

<sup>6</sup> Switzerland, Norway, Iceland and Liechtenstein.

<sup>7</sup> Article 128 of the EEA Agreement.

<sup>8</sup> EEA Agreement, Articles 90 & 93.

countries. Finally, it would be perfectly possible to draw up an appropriate institutional framework to underpin such Agreements (see below).

#### 2.2.2. *Small-sized country positions*

Andorra has expressed openness to considering an Association Agreement, provided it is based on a stable institutional framework and fully takes into account Andorra's specific situation. Monaco and San Marino are also open to this option, provided their particularities are fully taken into account. Andorra and San Marino are open to considering a multilateral Association Agreement involving all three small-sized countries. Monaco has not ruled out this possibility, but would prefer a bilateral agreement with the EU that is tailored to its specific situation and takes into account its close links with France.

#### 2.2.3. *One or several agreement(s)?*

The Commission's initial assessment is that a single multilateral Association Agreement between the EU and all three small-sized countries would probably be preferable to three separate agreements, as the latter scenario risks opening the door to complexity and unnecessary differentiation. A multilateral agreement could include a common framework consisting of key principles and institutional provisions, but should nevertheless be sufficiently flexible to take into account each country's unique circumstances. This could be achieved by including separate provisions for each country, either within the main text of the agreement or in the form of protocols. A single agreement could also cover the countries' mutual relations, if they so wished. Nevertheless, this issue would need to be discussed further with the governments of the small-sized countries with a view to identifying the right solution.

#### 2.2.4. *Horizontal and institutional issues*

The aforementioned Communication referred to a number of horizontal and institutional issues with a view to ensuring the homogeneity of the internal market and legal certainty for economic operators and citizens. Any agreement(s) with the small-sized countries would therefore need to address:

- (a) the dynamic adaptation of the agreement(s) to the evolving *acquis*;
- (b) the homogeneous interpretation of the agreement(s);
- (c) independent surveillance and judicial enforcement;
- (d) dispute settlement.

As regards dynamic adaptation (a), an Association Agreement could follow the EEA model<sup>9</sup>, such that, in general, the small-sized countries would accept an obligation to apply the *acquis* in areas falling within the scope of the Agreement. This would be subject to sovereignty safeguards, taking into account their respective constitutional procedures. Decision-making in joint institutions should be as efficient as possible to allow for the prompt adaptation of the Agreement to the *acquis*. A mechanism would need to be established to inform the small-sized countries of developments, especially proposed changes to the *acquis*, and to allow them to make their views known on draft legal acts that particularly concerned them. However, they would not be granted any formal decision-making rights (often referred to as 'decision-shaping' in the EEA context).

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<sup>9</sup> Article 102 of the EEA Agreement.

In the EEA context, the EFTA Secretariat plays an important role in assessing new EU legal acts for their EEA relevance and compiling lists of possible acts to be incorporated into the EEA Agreement. It would be worth exploring the possibility of information-sharing between the Secretariat and Andorra, Monaco and San Marino in this respect, rather than creating a new institution. This would require consultations with the EEA-EFTA states, the small-sized countries and the EFTA secretariat itself.

Concerning the homogeneous interpretation of the agreements (b) and independent surveillance and judicial enforcement (c), solutions would need to be found to guarantee the homogeneity and good functioning of the internal market. One solution would be to allocate these roles to the Commission and the EU Court of Justice, respectively, thus obviating the need to establish new institutions. The involvement of a designated EU Member State to assist the Commission in surveillance could also be envisaged if there were support from all parties concerned.

An efficient, fair dispute settlement system (d) would need to be designed. Finally, the Agreement would also need to define the extent to which and under what conditions decisions by EU agencies with executive competences would be directly applicable in the small-sized countries.

### **3. ALIGNMENT TO THE *ACQUIS* AND ADMINISTRATIVE CAPACITY**

As non-members of the EU, the small-sized countries currently have no obligation to align their legal framework and administrative capacity to the *acquis*, except where these requirements are part of agreements they have concluded with the EU. For example, the Monetary Agreements that all three countries have signed with the EU on the use of the Euro as their official currency provide for the taking on of large segments of the *acquis* in the areas of financial services, anti-money laundering and anti-counterfeiting, among others.

Nevertheless, the small-sized countries' alignment to the relevant *acquis* and adequate capacity to implement and enforce it are essential pre-requisites for their participation in the internal market. In this regard, the Council conclusions of 20 December 2012 noted 'efforts made by Andorra, Monaco and San Marino'. The Council further encouraged them to 'pursue their efforts in order to further increase the convergence of their legislation with EU internal market *acquis* and strengthen their administrative capacity in view of facilitating the implementation of further relevant EU *acquis*'<sup>10</sup>.

In general, the small-sized countries' alignment ranges from partial to limited, except for a small number of sub-sectors in which they are fully or mostly aligned. The areas in which — broadly speaking — their respective legal frameworks are partly aligned include the free movement of goods and financial services. There is limited-to-partial alignment in a number of areas, including the free movement of capital and public procurement, and only limited alignment regarding intellectual property rights, competition policy and information society and media, among others. Their alignment in the field of environment and climate change is very limited.

The small-sized countries have functioning public administrations that deal with most of the areas covered by the internal market. However, they would need to invest in their respective administrative capacity in a number of areas to meet the criteria for participation in the

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<sup>10</sup> Council Conclusions on EU relations with the Principality of Andorra, the Republic of San Marino and the Principality of Monaco, 20.12.2012, adopted at the 3213<sup>th</sup> Transport, Telecommunications and Energy Council meeting.

internal market. Andorra, with a population of about 76 000, has approximately 5 800 public administration employees. Monaco, whose resident population numbers around 36 300, has about 3 500 employees active in the state administration. In San Marino, whose population is around 32 400, the public sector has about 4 065 employees, including 2 297 working in public administration and 1 048 for the Social Security Institute. These numbers provide a general indication of the human resources available to the three countries. However, administrative capacity in relation to the implementation of the *acquis* must also be judged against other criteria, such as organisational effectiveness, technical competence, and human and financial resources attributed to monitoring and enforcement tasks.

#### 4. ECONOMIC ASSESSMENT

From a macroeconomic perspective, the potential economic impact of the three small-sized countries participating in the EU internal market would be, for the EU as a whole, very limited. With a combined population of approximately 145 000 and a combined GDP of EUR 8 billion, they represent 0.03 % of the EU's total population (508 million) and 0.07 % of its GDP (EUR 13 trillion). Such a huge difference of volume and scale shows how difficult it is to extrapolate a measurable economic impact. The analysis below focuses on the EU side. If these countries were to participate in the internal market, the impact would likely be relatively more significant on their economies than on the economy of the EU.

Generally speaking, the economies of the small-sized countries are characterised by strong interdependence with their neighbouring countries, with which they have traditionally had, and currently still have, the closest relationships. There are significant economic differences between the three states.

Andorra's economy relies on tourism as well as financial and retail services (estimated 9 million visitors per year, representing approximately 80 % of GDP). In San Marino, the share of tourism is lower and the economy is more diversified (e.g. industry represents about 40 % of GDP). Monaco's economy is mainly based on services (including financial services and tourism) and high value-added light industry (8 % of GDP, 9 % of employment).

Financial services represent, respectively, 16 % of GDP in Andorra, 15 % in Monaco and 11 % in San Marino. This sector thus plays a significant role in their national economies without, however, being dominant. Supervision is carried out by the national supervisors in Andorra (INAF), and San Marino (its Central Bank), whereas in Monaco this task is devolved to the French Autorité de Contrôle Prudentiel (ACP). The Monetary Agreements that all three countries have signed with the EU commit them gradually to take over, in the period up to 2017, the EU *acquis* on banking and anti-money laundering.

However, the small-sized countries are not active in all areas of financial services. For example, there are no securities markets in any of the three states. Another specificity is that in San Marino, there are no foreign-owned banks. In Andorra, out of six banks, one is a subsidiary of an EU company. In Monaco, all banks are branches or subsidiaries of foreign groups (mostly from the EU or Switzerland).

The economic situation in Andorra and San Marino has deteriorated significantly since the onset of the economic crisis. San Marino's GDP fell by 25 % between 2008 and 2011. In Andorra, the equivalent decline was 15.2 %. In Monaco, after a decline of 11.2 % in 2009, GDP grew again by 3.2 % in 2010 and 8.0 % in 2011 to recover almost to the level of 2008. The crisis is one factor that has spurred Andorra — as well as, to a lesser extent, San Marino and Monaco — to adapt and/or reconsider their respective economic models. As a result, they are now more open to seeking closer economic relations with the EU.

Despite the economic crisis, unemployment is still remarkably low in all three countries (San Marino has the highest level of unemployment of the three, with 5.3%). This can be explained by two factors.

In all three countries, there is a considerable ‘buffer’ of incoming seasonal/temporary workers and border commuters (living in neighbouring regions in surrounding countries) who do not appear in the national unemployment figures when they lose their jobs.

The other explanation is the existence of a heavily protected job market in all three states, which gives preference to nationals or residents, and requires authorisations from the authorities for many activities and/or establishment.

When the three economies are in good health, the beneficial effects of the small-sized countries’ employment offer is felt well beyond their borders in neighbouring EU Member States. Out of Monaco’s 50 000 workers, almost 40 000 live in neighbouring France or Italy; in Andorra, 1 600 workers (out of 36 000) commute daily from neighbouring Spain or France; and San Marino’s companies employ 5 500 border commuters from Italy (out of a total workforce of 20 500).

The approximate proportion of foreign residents — mostly EU citizens — in the three countries is 18.5% in San Marino (of the order of 6 000 out of 32 400), 55% in Andorra (of the order of 42 000 out of 76 000) and 80% in Monaco (of the order of 29 000 out of 36 300).

It can be assumed that many of the new jobs created in the three countries if they were to participate in the internal market would be filled by non-nationals (mainly EU citizens), as the local pool of labour available to employers is limited. The possible effect on the EU in terms of job creation could thus be measured in terms of ‘overspill’ to neighbouring regions, as well as on jobs created in the country, from which EU citizens could benefit.

The biggest of the three states in terms of population, Andorra, is surrounded by structurally poorer areas, so this benefit could be measurable in the neighbouring Spanish province Lérida, or the French *départements* Pyrénées-Orientales and Ariège. However, at this stage, it is impossible to quantify this effect with any degree of precision.

Since 2007, the EU has run a trade surplus with San Marino (EUR 183 million in 2011). In 2011, total EU imports and exports to San Marino amounted to EUR 325.5 million. In the same period, the EU also ran a trade surplus with Andorra (EUR 1 105 million in 2011). In 2011, total imports and exports to Andorra were EUR 1 158 million. EU trade with Monaco is more difficult to assess, as it is mostly conducted through France (and is therefore not quantified separately). Currently, 95% of San Marino’s exports go to Italy, whereas a majority of Andorra’s exports go to Spain. It is not expected that EU exports to the three countries would rise substantially if the three countries participated in the internal market, given, amongst other factors, the existing customs unions between the EU and, respectively, Andorra and San Marino on the one hand, and Monaco being part of the EU customs territory on the other hand.

In sum, given the population and GDP of the three countries concerned, stronger economic links would have only a marginal impact on the EU’s economy as a whole. At regional and local levels, however, especially in EU regions neighbouring these countries, the beneficial effect, especially on the labour market and the resulting positive knock-on effects, might be more pronounced.



## **5. CONCLUSIONS AND RECOMMENDATIONS**

### **5.1. Next steps**

The Commission stands ready to build a closer relationship with the Principality of Andorra, the Principality of Monaco and the Republic of San Marino, in particular through their participation in the EU's internal market. As outlined in its Communication of November 2012, such participation could bring benefits to both sides, including by breaking down barriers to cross-border economic activity. The Commission has assessed the two options retained by the Council in its December 2012 conclusions — i) participation of these countries in the EEA; and ii) the negotiation of one or several Framework Association Agreements with these countries — with a view to identifying solutions that would grant these countries access to the EU's internal market, while meeting the criteria laid down in the Communication.

Considering the principles outlined above, the Commission considers that the negotiation of (one or several) Association Agreement(s) is the more viable of the two options. Importantly, the scope and content of such (an) Agreement(s) could be adapted to suit EU requirements, as well as the specificities and unique circumstances of each of the small-sized countries. If there were mutual interest, the scope of such (an) Agreement(s) could also cover areas beyond the internal market. Moreover, the Agreement should also establish its relationship with existing agreements such as the customs union agreement with Andorra, the customs and cooperation agreement with San Marino and the agreements on the taxation of savings income between the EU and the three small-sized countries (amendments to the latter are currently under negotiation). In contrast, the participation of the small-sized countries in the EEA is not judged to be a viable option at present due to the political and institutional reasons discussed in section 2.1.

The Commission recommends that the Framework Association Agreement option be the basis for the strengthening of the EU's relations with Andorra, Monaco and San Marino, taking into account the principles set out below. The Agreement(s) would need to include — as appropriate — relevant provisions tailored to the specific situation of each country, either in the main body of the text or in accompanying Protocols.

### **5.2. Key principles**

The following principles should underpin the negotiation of the Association Agreement(s).

#### *5.2.1. Shared values*

In line with the EU's general practice in its relations with third countries, any Agreement with the small-sized countries should make reference to the values shared by the parties and their commitment to uphold them. In particular, the Agreement(s) could make reference to Article 2 of the Treaty on European Union (TEU)<sup>11</sup>.

#### *5.2.2. Internal market principles*

As set out in the aforementioned Communication, common rules and thorough enforcement are essential to the correct functioning of the internal market. The Council, in its conclusions of 20 December 2012, also underscored the need to ensure the homogeneity and good functioning of the internal market.

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<sup>11</sup> 'The Union is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities. These values are common to the Member States in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail'.

### *5.2.3. Specificities*

The Council conclusions of December 2012 state that the Commission's analysis of the two options should take account of the small-sized countries' specificities. These include their small territorial dimensions and populations, their close links with their neighbour(s) and their political and economic characteristics. It is also important to recall that Article 8 of the Treaty on European Union 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'. Declaration No 3 on Article 8 states that 'the Union will take into account the particular situation of small-sized countries which maintain specific relations of proximity with it'.

### *5.2.4. Current developments*

It is important that the EU maintains a coherent approach to its relations with partners in its neighbourhood. Any agreement(s) with the small-sized countries should take into account relevant developments in these relations. In particular, given the positive impact on the good functioning of the internal market of cooperation in the field of customs and taxation, the EU would need to consider whether its approach to the horizontal and institutional issues, as outlined above, should be extended to the agreements in this field, including the protocol(s) resulting from the current negotiations on amendments to the EU's agreements on savings taxation with the small-sized countries.