EUROPE: Small states prefer partial EU integration

Wednesday, August 25 2010

SUBJECT: The prospects of Europe's smallest states.

SIGNIFICANCE: Europe's smallest states face a big challenge -- how to respond to the ongoing process of European integration when they are not regarded as capable of full EU membership. Go to conclusion

ANALYSIS: Europe's four smallest states -- Liechtenstein, Andorra, San Marino and Monaco -- often occupy economic niches. They have survived by their neighbours' willingness to respect their independence. These neighbours have largely incorporated the smallest states' economies and indirectly guarantee their defence.

Relations with EU. Partial engagement in European integration has strengthened the smallest states' ability to survive in the new globalised world. Access to the internal market has brought enormous economic benefits. Andorra, San Marino and Monaco shelter within the euro. Liechtenstein is an associate EU member through the European Economic Area (EEA), and the European Commission has discussed the possibility of Andorra, San Marino and Monaco joining too. All benefit from the EU's freedom of movement -- Monaco and San Marino are de facto integrated in the Schengen area, while Liechtenstein is preparing formal accession.

It is unlikely that any of the smallest states will join the EU in the foreseeable future. They want to preserve their banking and tax privileges, which have provided them with enormous wealth, and to protect their national identities (**see EUROPE: National identity prevails as policy tool - March 12, 2010**). Nor does the EU wish to include them fully in the European project, for they are considered too small to deserve the same representation (eg a commissioner) as bigger EU member states and, in terms of administrative capacity, to take part in the EU's work. Also, they are viewed as too dependent on their close neighbours.

While the current arrangement would seem pleasing to all parties, in fact this partial engagement in European integration denies the smallest states access to EU decision-making (except for Liechtenstein's limited impact on decision-shaping in the EEA and Schengen). Hence, they must adjust to the international environment without having a chance to influence it.

Financial regulation. The smallest states must also respond to growing European and international pressure to improve transparency and harmonise their banking and tax systems with international standards. They all have agreements on savings taxation with the EU. As regards fraud, Liechtenstein will soon conclude a comprehensive agreement with the EU to combat this and any other illegal activity to the detriment of their financial interests, and the Commission has declared that it would be appropriate to negotiate similar agreements with the other three states.

International relations. The smallest states are increasingly involved internationally to guarantee their interests. They still enjoy a considerable bureaucratic assistance from their neighbours in their overseas activities, and Liechtenstein benefits from European Free Trade Association (EFTA) membership. All have become members of the UN: Andorra and Monaco in 1993, San Marino in 1992 and Liechtenstein in 1990.

Liechtenstein. The EEA created a rift in its close relationship with Switzerland; their bilateral treaties have since been renegotiated. Previously, Liechtenstein also enjoyed shelter from Austria:

- **EU aspirations**. Liechtenstein is deeply involved in European integration through its membership of EFTA and the EEA.
- **Economy**. Liechtenstein has developed into a free-enterprise economy with a vital financial services sector. Low business taxes and easy incorporation rules have induced many holding companies to establish nominal offices there. However, the economy is widely diversified and highly industrialised, with a large number of small businesses.
- **Currency**. Liechtenstein uses the Swiss franc.
- **Movement**. An agreement for Liechtenstein to join Schengen has been concluded.

Andorra. Throughout its history, Andorra played off France and Spain against each other to maintain its independence. France and Spain provide large markets for Andorra, whose duty-free status has generated significant income. More recently, Andorra enjoys a wider shelter by these states' EU membership:

- **EU aspirations**. Andorra has recently shown an interest in joining the EEA or finding another form of closer relations with the EU.
- **Trade with EU**. Andorra has a customs union agreement with the EU. It is treated as an EU member for trade in manufactured goods and as a non-EU member for agricultural products. Andorra's cooperation agreement with the EU covers a wide range of issues: environment, communications, information, culture, transport, regional and cross-border cooperation, and social issues.
- **Tax policy**. Andorra is a tax haven (**see INTERNATIONAL: Tax havens face growing pressure - February 17, 2009**) and is keen to maintain this identity.
- **Currency**. Andorra has never maintained its own currency. It is negotiating with the EU to issue its own euro coins.
- **Movement**. Andorra is not part of the Schengen area -- border control is carried out at the border with Spain and France.

San Marino. Under the 1939 Friendship and Cooperation Treaty, Italy protects San Marino's borders, offers financial assistance in the form of direct treasury transfers and provides several other economic privileges:

- **EU aspirations**. The government explicitly acknowledges that it is too small to join the EU and would not do so even if it could.
- **Trade with EU**. The government views the EU as an important economic partner and wants to engage with European integration to avoid isolation. A cooperation and customs union agreement with the EU has given San Marino access to European markets and reduced the cost of imports from Italy.
- **Currency**. San Marino adopted the euro along with Italy and has been granted the right to issue a limited number of its own euro coins.
- **Movement**. San Marino is de facto integrated in the Schengen area and no checks are carried out at its border with Italy.

Monaco. In 2002, France and Monaco signed a treaty that guarantees the continued existence of Monaco, should there ever be no direct male heir to the throne. France also reaffirmed its place as protector of Monaco in terms of defence and recognised Monaco as a sovereign and equal state:

- **Trade with EU**. In terms of imports and exports, Monaco is indistinguishable from France. Monaco has been included in the EU's customs territory since its inception owing to its customs union with France. Hence, it applies directly most measures related to the free movement of goods within the EU. However, Monaco is not part of the EU's common commercial policy and its participation in the Union's customs territory does not extend to the area of external trade. Unlike the other three smallest states, Monaco has no direct relations with the EU in this field.
- **Tax policy**. Monaco's ability to restrict residence and have a separate tax system has created an economic imperative that has led to its wealth.
- **Currency**. Monaco had the right to issue French francs before the adoption of the euro. Now it has the right to issue a limited number of its own euro coins.
- **Movement**. Through France, Monaco is integrated into the Schengen area.

Key features

	Population July 2010 (est.)	Area sq km	GDP*	GDP per capita
			PPP, US dollars	
Monaco	30,586 (212)	2 (248)	976.3 mn	30,000 (45)
San Marino	31,477 (211)	61 (228)	1.662 bn	41,900 (18)
Liechtenstein	35,002 (210)	160 (218)	4.16 bn	12,2100 (1)
Andorra	84,525 (198)	468 (195)	4.22 bn	44,900 (12)

Brackets designate: rank out of 248 states/independent territories
PPP: Purchasing Power Parity
*** Andorra: 2008, Liechtenstein and San Marino: 2007, Monaco: 2006 out of 248 states/independent territories**
Source: CIA Factbook

CONCLUSION: The partial engagement of Liechtenstein, Andorra, San Marino and Monaco in European integration enables them to enjoy the benefits of the EU without giving up their special economic niches. They are less reliant on their more powerful neighbours, though they still enjoy very close relations with them. Rather than being on the verge of abandoning their statehood, the independence and identities of these smallest states have been strengthened by their partial engagement in European integration.

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Primary Keywords: EUR, Andorra, Austria, EU, France, Italy, Liechtenstein, Monaco, San Marino, Spain, Switzerland, economy, international relations, politics, banking, defence, foreign trade, international law, policy, talks, trade, treaty

Secondary Keywords: exchange rate, finance, fiscal, integration