

ANDORRA
AND THE
EUROPEAN UNION

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CENTRE FOR EUROPEAN POLICY STUDIES (CEPS)
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Cover photo: Church of Sant Esteve at Juberri in Andorra's southern-most parish of Sant Julià de Lòria.

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TABLE OF CONTENTS

Executive Summary	i
Part A. The Future of Andorran-EU Relations	1
1. The condition of the Andorran economy	1
2. New needs and opportunities	1
3. The present state of Andorran-EU relations.....	2
4. Core components of a deep Andorran-EU relationship	4
5. Complementary components of a deep integration with the EU.....	6
6. Sequencing and structuring the relationship	10
6.1 Unilateral and preparatory steps	11
6.2 Sector-specific agreements	13
6.3 Comprehensive treaty.....	15
6.4 Virtual membership	19
7. The possible and the necessary.....	23
Part B. Background Study	28
8. The three ages of Andorra.....	28
8.1 A millennium of Malthusian subsistence	28
8.2 A half-century of vertical take-off.....	31
8.2.1 The population.....	31
8.2.2 The economy	34
8.2.3 The constitution.....	37
8.2.4 International relations.....	39
8.3 A new century of sustainable development?.....	42
9. Andorra's relationship with the EU so far	48
9.1 Customs Union Agreement, 1990	48
9.2 Agreement on taxation of savings, 2004	50
9.3 Cooperation Agreement, 2004	53
9.4 Towards an Andorran euro	56
9.5 Schengen cooperation.....	58
9.6 Political dialogue	60

10. How exceptional is Andorra?	61
10.1 Taxation and budget	62
10.2 Financial markets.....	67
10.3 Capital movements.....	72
10.4 Labour market, residence and citizenship	74
11. Perspectives on EU relations with its neighbours.....	76
11.1 Forms of agreement between the EU and its neighbourhood	77
11.1.1 European Economic Area (EEA)	77
11.1.2 The case of Liechtenstein in the EEA.....	80
11.1.3 Switzerland as an alternative model.....	81
11.1.4 EU's agreements with its wider neighbourhood	85
11.1.5 Participation in EU agencies and programmes.....	88
11.2 Relationships with small European states and autonomies	89
11.2.1 Sovereign states	90
11.2.2 The non-state autonomous entities	92
References	96
Annexes	
A. Customs Union Agreement, 28 June 1990.....	99
B. Cooperation Agreement, 15 November 2004	107
C. Taxation of Savings Agreement, 15 November 2004	113
D. Memorandum of Understanding, 15 November 2004	127
E. Allocution de M. Jacques Chirac, 26 April 2007	129
F. Assessment of Andorra's Financial Sector by the IMF	130
G. OECD Tax Model principles of transparency and information exchange.....	133
H. Chapter headings used in EU accession negotiations.....	134
I. Stabilisation and Association Agreement between the EU and Croatia, 2005	136
J. Chapter headings in EU-Ukraine Action Plan, 2004	138
Maps	
1. Andorra.....	28
2. Andorra and Pyrenean regions of France and Spain	56

Tables

1. Population by nationalities, 2006	32
2. Evolution of population by nationality	32
3. School population by system of education	33
4. University population by country of study	34
5. Andorra and EU-15, comparative data	35
6. Visitors entering Andorra by season, 2006	36
7. Number of visitors, 2004-2006	36
8. General government tax revenues as % of GDP	62
9. OECD criteria regarding transparency and information exchange in tax matters.....	66
10. Andorra: banking system and ownership structure, December 2005.....	68
11. Bank deposits per capita in Andorra and six other jurisdictions	69
12. The scope of the European Economic Area	78
13. Europe's smallest states and non-state entities	90

Figures

1. Evolution of the population of Andorra	31
2. Growth of imports and exports, 1991-2005.....	37
3. Industry confidence indicator.....	43
4. Expected trend of business turnover for the next year	43
5. Hotel sector: employment level compared to the previous year.....	44
6. Economic sentiment indicator: European Union, France and Spain.....	44

Boxes

1. Extract from the 'Treaty establishing a Constitution for Europe'	
2. Andorra's participation in international organisations and agencies.....	40
3. The 'Andorra 2020' programme	46
4. Tax free allowances for individual travellers entering the EU from Andorra	49
5. Communauté de Travail des Pyrénées (CTP)	55
6. Agreements between Switzerland and the EU, 1956-2004	83
7. EU-Switzerland: Bilateral I sectoral agreements.....	84
8. EU-Switzerland: Bilateral II sectoral agreements.....	84

Executive Summary

This study has been prepared for the Andorran Minister of Foreign Affairs in order to assess possible futures for Andorran-EU relations over the short to longer term.

The strengths and weaknesses of the Andorran economy

In the second half of the 20th century Andorra saw an extraordinary boom, based on tourism, commerce, financial services and real estate, with its population multiplying 14 times, mainly due to immigration. The drivers of this growth were very low taxation and light economic regulation, combined with the attractive mountain environment.

However since the turn of the century the economy encounters a mounting set of constraints: environmental limits, an apparent shortening of the winter sport season, the erosion of commercial advantages and pressures to apply international fiscal and regulatory standards.

The government recognises that these constraints call for a new model of sustainable development, and has launched its 'Andorra 2020' programme, which envisages new service sector activities and a qualitative upgrading and re-branding of the economy.

Andorra has valuable assets to underpin this programme: its investment in a modern urban infrastructure, its multi-lingual and cosmopolitan population, its substantial financial services sector, and the combination of low taxation and an attractive quality of life. These assets can be paired with the opportunities for location-free business services exploiting the new information technologies.

The role of the Andorran-EU relationship in the new challenges

This transformation of the Andorran economic structure would have to go further with a deeper integration into the modern European economy and its single market. New human and capital resources, as well as new ideas, have to circulate freely in and out of the Andorran economy.

The terms under which this might be achieved would have to be based on the core principles of the European Union's integration model, namely the four freedoms of movement of goods, services, capital and labour accompanied by extensive harmonisation of regulatory standards.

There are many further opportunities for programmes of cooperation with the EU, as seen in the several models of neighbourhood policy already developed. However, as Andorra's experience of recent decade shows, these cannot be expected to develop strongly in the absence of the four freedoms and regulatory convergence. European Union officials are clear on this point.

For Andorra, this means a reversal of economic paradigms. In the last half century Andorra prospered largely by keeping out of the EU's policy framework. In the next half century its model for sustained prosperity will have to rely on inclusion in the European rules of the game. Times have changed.

The present state of Andorran-EU relations

EU-Andorran relations so far are rather limited. There has been a Custom Union since 1990, and this functions satisfactorily.

There is a Cooperation Agreement, signed in 2004, covering a number of possible topics for cooperation, but this has seen hardly any operational results so far.

Also in 2004 there was an Agreement on the Taxation of Savings, following pressures on all European offshore financial centres to apply new EU legislation in this field.

Since 2002, the euro has been Andorra's currency, but there is no agreement yet on the minting of an Andorran euro coin.

Andorra has become de facto a virtual part of the Schengen space, since all travellers to Andorra have to pass through France or Spain, and Andorra accepts Schengen visas.

Core components of a deep Andorran-EU relationship

There are six basic requirements:

- Freedom of circulation of goods, but only this one is largely achieved;
- Freedom of services provision, complying with the EU's new services directive;
- Freedom of movement of workers and persons;
- Liberalisation of capital movements;
- Fiscal reforms, to stay 'low tax', but extinguish the tax haven reputation and
- Financial sector to move into line with EU standards.

Complementary components of a deep integration with the EU

While a long list could be drawn up, it would be best to focus on seven priority areas:

- Participation in EU regional policies, e.g. Pyrenean cross-border projects;
- Transport infrastructure projects, for road, rail and air;
- Full participation in euro area;
- Participation in EU education and research programmes;
- Cooperation with justice and internal security programmes;
- Participation in environmental programmes and
- Political dialogue overarching the relationship.

Sequencing and structuring the relationship

Development of these components would in any case take many years. There are technical and political limits to how much can be done fast. However what is essential is that the whole concept becomes credible as early as possible, which means a combination of up-front concrete steps and sufficient planning and commitment for the rest. The ‘Andorra 2020’ programme is largely silent on the EU relationship, and this could be rectified with a complementary ‘Andorra-EU 2020’ plan. The time horizon of 2020 is good.

The sequencing and structuring of the process could go through the following stages:

1. A preliminary stage of unilateral reforms, preceding negotiations with the EU;
2. Negotiation of further sector-specific agreements with the EU, beyond those that already exist;
3. A comprehensive multi-sector treaty, drawing on the EU’s various neighbourhood agreements, and
4. An original model for virtual membership of the EU.

Stage 1 corresponds to the present policy of the government. This has the merit of not entering into new negotiations from a position of weakness.

Stage 2 would build on the three agreements Andorra has already made (and so the current status quo is a mix of stages 1 and 2). The Swiss

experience is sometimes cited as an ambitious version of this second model. However the EU is against what it calls a ‘cherry-picking’ process, and the Swiss model is not necessarily reproducible.

Stage 3 would raise the level of ambition. There are various examples one can cite. Liechtenstein in the European Economic Area is an example of virtually complete inclusion in the EU’s internal market space, with all four freedoms and extensive harmonisation of regulatory standards. The Balkan ‘stabilisation and association agreements’ are more extensive in policy content, but less demanding in terms of immediate harmonisation. The European Neighbourhood Policy is heading towards a new model of ‘enhanced agreements’, which will also be comprehensive in coverage but less demanding still in legal obligations.

Stage 4 could become relevant in a context in which the EU is increasingly reticent to enlarge its full membership beyond existing commitments. The idea here is for full functional participation in the EU, with full rights for citizens and enterprises, but with a special institutional arrangement to avoid congestion in EU decision-making. There is no full precedent for this so far, but the EU has shown flexibility and ingenuity in devising tailor-made solutions for various European micro-states and autonomies. The relevance of this scenario has now been heightened by the initiative of San Marino of 27 August 2007, requesting discussion of possible membership or in any case a new ‘status’ in relation to the EU.¹

The possible and the necessary

With Andorra so far engaged in a blend of stages 1 and 2, this could continue indefinitely into the future, since there is unlikely to be any initiative or pressure from the EU side to do otherwise.

The case for aiming at stage 3 would depend on whether Andorra sees now in its own economic interest a need to embrace the ‘core components’ for a deepened relationship with the EU. That is matter of basic political judgement, which only the Andorran authorities and people are entitled to make. (However, the present author, as an external observer, considers that Andorra does need to do this.) If this were the case, then the Andorran authorities might plan for a fairly early passage from stages 1 and 2 to stage

¹ See section 4.2.1. of Part B of this report.

3, using the opportunity to aim also to get maximum value out of the possible 'additional components' of deepened relationship with the EU.

If such a stage 3 were to become a successful reality, there would be a basis for considering stage 4. This could see Andorra gain full access to the EU's policies and programmes, for its people to gain EU citizenship, and its representatives to gain an extensive voice and place, if still not full classic membership status, in the EU's institutional system. Stage 4 would be an original development for the European Union itself, and would require in due course a very strong and credible commitment by Andorra to overcome a likely conservative initial response from the EU side. However, with increasing resistance within the EU to its further enlargement, arrangements of this kind would have a rationale.

These are possible features of an 'Andorra-EU 2020' plan. Given the fundamental political and economic implications of these possible choices, the ground would need of course to be prepared thoroughly with full participation of the democratic institutions and civil society. With this in mind the government might begin by preparing for public debate with a 'Green Paper', or consultative document, for 'Andorra-EU 2020'. These consultations would no doubt extend on appropriate occasions to include representatives of the European Union and Andorra's two neighbouring member states. After due processes of consultation and debate the government would adopt a 'White Paper', this time setting out its proposals for action.

Part A. The Future of Andorran-EU Relations

1. The condition of the Andorran economy

In the second half of the 20th century Andorra experienced an extraordinary growth, with the population rising from 6,000 to 81,222 (2006), and transformation into a cosmopolitan society. The drivers of this growth were very low taxation and very light economic regulation, together with a favourable natural mountain environment for winter sports and tourism.

Andorra is now a rich country, with a per capita income above the EU average, based on the four pillars of tourism, real estate development, commerce and financial services.

However this long boom seems to have come to an end, and since the turn of the century business indicators have turned rather negative. This seems to be more than just a cyclical matter. It coincides with increasing optimism over business prospects in the EU. Since European business cycles tend to be strongly correlated, the implication is that Andorra's economy is now facing structural problems. These are in fact apparent in:

- 1) Physical and environmental limits to further growth based on construction activity,
- 2) An apparent shortening of the winter sport season, due maybe to climate change,
- 3) A loss of competitive advantage by the commercial sector in relation to nearby French and Spanish commercial centres and
- 4) Powerful external pressures to constrain offshore financial services worldwide to apply international fiscal and regulatory standards.

2. New needs and opportunities

The government of Andorra recognises these structural constraints and has in response developed a programme called 'Andorra 2020' (indicating the time horizon), in order to revitalise the economy.

The 'Andorra 2020' programme points the way forward, aiming at the attraction of new service sectors, a qualitative re-branding plan, foreign investment facilitation and other measures coupled to tax reforms. These directions are surely the right ones to take. Andorra has actual and potential comparative advantages to support this plan, as enumerated below.

- First, it has invested already in a modern urban infrastructure of some size, capable of becoming the base for growing clusters of high value-added service activities.
- Secondly, its resident population is multi-lingual and cosmopolitan, and offers a favourable human capital base for international service sector activities.
- Thirdly, Andorra can seek to exploit the new advantages of information technologies, which allow many service sectors to choose any location that offers supporting commercial and business services, allowing electronic offices to be plugged into wider European and international markets and corporate structures.
- Fourthly, these 'location-free' business activities are especially sensitive to the offer of a low-tax environment combined with a high quality of life environment (e.g. mountain sport recreations).
- Fifthly, Andorra already has a substantial financial services sector, which can seek its own niche in the rapidly developing European financial services market.

However these favourable factors also link to the crucial argument of the present report, which is that a deepening of integration with the EU could provide a vital support for exploiting and synergising these positive elements. On the other hand, Andorra's substantial self-exclusion so far from three of the EU's four freedoms of movement and its tax haven status, while having served to make Andorra rich in past decades, seem now to have turned from being a plus to a minus, and to have become part of the problem. The paradigm seems to be reversed. A comprehensive opening to all the four freedoms and elimination of the tax haven designation now look essential for revitalising the economy, as well as for establishing a sound basis for deeper integration with the EU.

3. The present state of Andorran-EU relations

EU-Andorran relations so far are quite limited.

Custom Union. There has been a Custom Union since 1990, and this functions satisfactorily, providing freedom of movement of all goods except agricultural products without payment of customs tariffs. Since Andorran indirect taxes are low by comparison with those of France and Spain, there are franchise limits on the quantities and value that travellers can take back with them after visiting Andorra. This leaves incentives for a certain amount of day-trip tourism, but the statistics show that this has reached a plateau, and is even declining a little.

Taxation of Savings. In 2004 the EU and Andorra made an Agreement on the Taxation of Savings, following pressures from the EU on all European offshore financial centres to apply new EU legislation in this field. For a transition period until 2010, some EU member states (Austria, Belgium and Luxembourg) are able to exercise the option to impose a withholding tax on income from savings, rather than comply with the core EU obligation for fiscal authorities to exchange information on non-resident incomes. This option was also offered and accepted by Andorra and most of Europe's other offshore financial centres. The agreement provides for a staged increase in the withholding tax from 15 to 20 and 35% over a number of years, with three-quarters of the tax revenues to be returned to the country of residence of the saver. This scheme is now functioning reasonably correctly. But the issue of obligatory information exchange will return in a few years time.

Cooperation Agreement. This agreement was also signed at the same time in 2004, covering a number of possible topics for cooperation, including the environment, communications and culture, education and vocational training, social and health issues, trans-European networks and transport, and regional policy. But this Cooperation Agreement has seen hardly any operational results so far. The most promising idea is for Andorra's participation in a programme requesting support from the EU's Regional Fund – the Communauté de Travail des Pyrénées (CTP) – to which we return below.

Euro. This became Andorra's currency in 2002, replacing the prior use of the French franc and Spanish peseta. Monaco, San Marino and the Vatican have made agreements with the EU (along with France and Italy) authorising these states to mint a limited value of euro coins of their own, both for ordinary usage and as a collector's item. These agreements were supported by the introduction of regulatory measures for the financial sector based on EU directives and standards. Andorra has no agreement of this kind yet.

Schengen. Andorra has become de facto a virtual part of the Schengen space, since all travellers to Andorra have to pass through France or Spain, and Andorra accepts travellers with Schengen visas. Andorran citizens are able to pass EU frontiers through the passport control channels reserved for EU and EEA (European Economic Area) and Swiss citizens.

Overall these initiatives have amounted to a limited advance in Andorran-EU relations so far. Fundamentally this is because the EU has

been organised first of all around the four freedoms of movement – of goods, services, labour and capital. More recently it has deepened the integration of its internal market through its member states accepting a major development of common regulatory standards. The introduction of the euro has further intensified both the opening and harmonised regulation of the EU's financial markets. All the EU's arrangements for close relations with its neighbours have been centred on working out how far the EU's four freedoms and regulatory norms could be extended beyond its frontiers. In the case of the European Economic Area, which includes Liechtenstein as the most relevant comparator for Andorra, the answer has been virtually 100%.

In the case of Andorra, only one of the four freedoms (for goods) has been really opened, and the other three (services, labour and capital) have remained subject to significant restrictions, even if there are draft laws that would ease these somewhat. Andorra is still considered by the OECD to be what it calls an 'uncooperative tax haven', and the quality of regulation of its financial markets does not yet meet all EU and internationally accepted standards.

4. Core components of a deep Andorran-EU relationship

There is little prospect that the Andorran-EU relationship can be deepened without Andorra coming to terms with the EU's four freedoms and its basic regulatory system in the fiscal and financial fields.

However it also seems now that there is little chance for the Andorran economy to revitalise itself without coming to terms with the European marketplace and its regulatory standards.

From an EU perspective the following issues are always considered to be matters of core importance in discussions of deep integration with neighbouring countries.

Physical borders and free circulation of goods. While the customs union functions correctly, there remains the question whether Andorra would want at some stage to aim for completely open frontiers with the EU for the movement of goods and people. For the movement of goods there is conceivably an 'EEA + San Marino option'. Liechtenstein, which has a relatively very large industrial sector, adopted the whole *acquis* for product standards. However the EEA excludes agriculture, whereas San Marino has agricultural products included in its customs union with the EU. Andorra's manufacturing industries are so small that the administrative cost of transposing the EU directives and regulations into Andorran law would

only be justified if short-cut procedures were adopted, like accepting to copy French or Spanish texts without translation. Otherwise Andorran enterprises can voluntarily and unilaterally apply EU standards. There would be fiscal implications in scrapping border controls, for example acceptance by Andorra of the EU's minimum excise rates and a value added tax on the EU harmonised model.

Freedom to provide services. Today there are serious impediments to the development of new service sectors, which are of key importance for the government's 'Andorra 2020' programme. There are restrictions on foreigners working in liberal professions and setting up wholly or majority-owned enterprises. There are also punitive withholding taxes imposed by France and Spain on the cross-border supply of services from Andorra to these two countries. To overcome these barriers Andorra could become compliant with the EU's new Services Directive, and make tax reforms sufficient to negotiate successfully the elimination of the present French and Spanish withholding taxes of Andorran service exports.

Freedom of movement of workers and persons. If the objective is to attract new service sector activities of high value-added and modern technological content, there has to be assured freedom of movement of workers and independent professional persons. As Andorra moves towards eliminating its tax haven characteristics, the structure of the foreign population is likely to change, with fewer non-active tax exiles, and more workers and self-employed persons in service sector activities. This restructuring will be a key feature of the economic revitalisation process, and would be facilitated by the liberalisation of all professions and a phasing out of the quota system for regulating foreigners' residence.

Liberalisation of capital movements. New legislation has been before the parliament for a year with a view to liberalising inward capital movements to some extent, but is not yet passed. Authorisation would still be required for investments of over 50% participation in commerce, construction, financial services hotels and real estate, i.e. in the core sectors of the Andorran economy. These remaining restrictions would seem to be an obstacle to full achievement of the objectives of the 'Andorra 2020' programme. Complete freedom of movement of capital is assured in the cases of Liechtenstein, the Channel Islands and San Marino, which are among Andorra's European competitors.

Fiscal reforms to stay 'low tax' but extinguish the tax haven. The government has announced plans to introduce a corporate tax with a low

rate and a reform of indirect taxes, although the draft legislation for these important steps is not yet published. The objective should surely be to achieve removal categorically and once and for all the ‘uncooperative tax haven’ label, while remaining an extremely attractive fiscal location. To illustrate this concretely, Andorra might consider a variant of the Slovakian tax reform of 2003, which introduced an ultra-simple flat tax regime under the slogan 19-19-19. This meant a flat corporate income tax of 19%, similarly a flat 19% personal income tax, and also a 19% value added tax. This tax regime is considered highly competitive by international investors. Andorra, because of its very lean public sector, could do better still, for example with a 10-10-10 regime for the same three main taxes. The addition of a very low personal income tax would be needed in order to install a regular set of double tax and information exchange agreements for persons as well as companies. With these measures Andorra could remain exceptionally attractive as a very low tax location, and at the same time gain an unquestionably correct fiscal reputation (extinction of the negative tax haven branding).

Financial sector regulation and supervision. Andorra has been moving into a higher degree of compliance with European and/or international standards for the regulation and supervision of financial markets. The most comprehensive step would be to adopt measures conforming to the whole of the EU’s Financial Services Action Plan, which consists of 42 legislative measures for all aspects of financial markets. Liechtenstein has already done this in the framework of the EEA, as have Guernsey, Jersey, the Isle of Man and Gibraltar. Among the measures recommended in a recent assessment of the International Monetary Fund are the need to regulate the insurance sector in line with European standards, a reinforcement of the independence of the regulatory authority (INA), and agreements to exchange information with the financial supervisory authorities of main partner countries abroad.

5. Complementary components of a deep integration with the EU

If these core features were put robustly into good shape, the door would be opened for Andorra to share in virtually all EU policies that are relevant to it. We now discuss these possibilities under the headings of seven main groups of sectoral policies.

Participation in EU regional policies. There is a limited possibility in the EU Regional Fund’s current regulations for the EU to finance expenditures in cross-border projects arising in third countries, such as

Andorra. The Regional Fund can finance a maximum amount of 10% of project costs without a contribution by the third country, on condition that the EU member states concerned propose this. More substantial cooperation can be organised on the basis of specific agreements between the EU and third countries for the joint funding of cross-border projects, such as is already the case between France and Switzerland, and between Finland and Norway. These possibilities are not yet activated between Andorra, France, Spain and the EU, but are evidently desirable initiatives.

The most promising idea, as mentioned above, is seen in proposals made to the Regional Fund for the period 2007-2013 by the Communauté de Travail des Pyrénées (CTP). Andorra is a participant in this initiative along with the Pyrenean regions of France and Spain. The CTP prepares many projects, which are organised around four sectoral commissions for i) infrastructure and transport, ii) training and technological development, iii) culture, youth and sport and iv) sustainable development. These headings correspond perfectly with Andorra's priorities for revitalising its economy. The CTP has formed a consortium to serve as an operational legal entity for requesting and managing Regional Fund support. However Andorra is not yet a member of this consortium, apparently for legal reasons, which should not be insuperable given political will.

Transport infrastructure projects, for road, rail and air. The EU has major programmes for supporting transport infrastructures, which receive political backing through the Trans-European Networks, and obtain access to substantial financial support from the European Investment Bank as well as the Regional and Structural Funds. Road connections to Andorra from France and Andorra have been improved in recent years, but Andorra is quite far from being connected with the motorway networks of France and Spain. Railway networks come close to Andorra, but without entering or passing through its territory. The current priorities of the Trans-European Networks include investments in high-speed trans-Pyrenean rail links, whose route is not yet decided. Air connections are through Barcelona and Toulouse 200 km away. There is a project envisaged for rehabilitation of an airport at Seu d'Urgell in Spain, very close to the Andorran frontier, which is the subject of ongoing negotiations. There is another proposed project for a heliport. There is thus no shortage of ideas over how to make major improvements in the accessibility of Andorra, which are surely desirable as part of the plan to revitalise the economy. There remain questions of political priority and financing on the side of France, Spain and the EU,

which link to the overarching political strategy for Andorra in its relations with the EU and its direct neighbours.

Full participation in the euro area. The Andorra ministry of finance is preparing five laws to regulate financial investment activities in line with EU standards, with the intention to return to the question of making an agreement with the EU to mint an Andorran euro in due course. The precedents of Monaco, San Marino and the Vatican suggest that the face value of this coinage might be limited to around €1 to 2 million per year, including the face value of special collectors' coins of higher market value. This is not a large amount, however, by comparison with Andorra's central government budget revenues of €340 million in 2006. More important in due course will be the EU's new legislation to establish a Single European Payments Area, which will reduce the costs and increase the speed of cross-border settlements in the euro area. Monaco and San Marino are preparing for this, which requires further compliance with EU regulatory standards. Andorra's banking sector will be concerned to avoid the emergence of new competitive disadvantages. Both these features, the minting of euro and entry into the single payments area, depend on regulatory compliance with EU standards for banking and financial markets.

Participation in EU education and research programmes. The EU's major programme in the education sector is the Erasmus programme for university exchanges of students and teachers. These programmes can in principle be opened to neighbouring countries, but Andorra is disadvantaged by having only a small and new university, which is not a partner of the Erasmus programme. This is mitigated by the fact that most Andorran students are studying in Spanish and French universities, which do participate in Erasmus. The EU's main research programme, currently the 7th Framework Programme, has agreements with some non-member states for participation as associated countries. The EEA states, Switzerland, Israel and some Balkan states have made such agreements. The interest for Andorra of EU research programmes should not be underestimated for the future, if Andorra is to succeed in building up a new high-tech service sector. Many EU research projects are based on extensive consortia and networks, which in the future could include Andorra's participation without it having to lead a project. This links again however to some of the core conditions already discussed, notably for Andorra to secure access to EU service sector markets and to open fully its own labour market (service sector, liberal professions, etc.) to EU nationals.

Cooperation in justice and internal security. Beyond the de facto inclusion of Andorra in the Schengen space, there is the question how far Andorra might associate with the rapidly growing body of legislation, programmes and agencies of the EU in the broad field of combating cross-border crime. Two key agencies have been established: Europol, for cooperation between national police forces, and Eurojust for cooperation between judicial authorities. Both make cooperation agreements with non-member states, including for Europol Iceland, Norway and Switzerland, and for Eurojust Iceland and Norway. The EU is further intending to establish a European Public Prosecutor's Office within the framework of Eurojust. The EU has also signalled the openness of certain programmes for association by neighbouring non-member states, such as 'Hercules II' for combating fraud and cigarette smuggling, 'Pericles' regarding counterfeiting of the euro, 'Fiscalis 2013' for cooperation between tax authorities, and 'Security and Safeguarding Liberties' to counter terrorism and crime. Interest by Andorra in cooperation with these programmes would presumably be welcomed by the EU.

Environment. Protection of its environment is an obvious strategic necessity for Andorra. New legislation is being largely aligned on relevant EU standards. Participation in the European Environment Agency could also be useful, and this agency is in principle open for the association of non-member states. Another European micro-state recently requested to accede to the European Environment Agency, but was met with the unrelated condition that it becomes more compliant with certain EU standards for the exchange of information between financial and fiscal authorities. As a result the application failed. This illustrates the general aversion of the EU to 'cherry-picking' by its partners, and its tendency to make linkages in multi-sectoral negotiations.

Political dialogue overarching the relationship. Andorra expresses interest in the 'political dialogue' feature of many EU agreements with third countries. In the terminology and practice of the EU, this 'political dialogue' covers first of all major subjects of concern in the field of foreign and security policy. Depending upon the partner this may concern issues of conflict and crisis management, weapons of mass destruction, and political values such as democracy and human rights. In these respects Andorra poses no issues of concern. There is also a growing practice of alignment of neighbouring third countries on the common foreign and security policy positions adopted by the EU. The EU has invited a certain number of

neighbouring countries (candidates, Balkan and East European neighbours) to join in this practice of alignment. The term ‘political dialogue’ is also used to cover discussions at foreign minister or senior official level of the whole relationship between the two parties, which typically takes place at sessions of the bilateral Cooperation Council provided to oversee the agreement. For Andorra such a chapter could feature in a comprehensive agreement.

6. Sequencing and structuring the relationship

We distinguish four possible options or stages for the Andorra-EU relationship, which could also be stages of a process over a considerable number of years. These are stylised cases to serve as a basis for discussion, since in practice there can be overlap between the stages at a given point in time. There are possible variants in each case, which amount overall to a continuum of conceivable cases.

Stage 1: unilateral and preparatory steps. Here the government would be adapting laws and policies with a view to deepening the relationship with the EU, implying progressive convergence on key European and international standards and norms. At this stage Andorra would not be negotiating with the EU, but acting unilaterally to put itself in a better position later to negotiate agreements. This corresponds to the position taken by the present government, which is devoting the present parliamentary period to various reform measures, with a view maybe later to negotiations with the EU.

Stage 2: sector-specific agreements. This stage sees a succession of ad hoc agreements with the EU made at different times, with a gradual deepening of the relationship. The accent would be on a pragmatic process, where the two parties add to or modify the status quo in the light of experience and new circumstances. The three existing agreements with the EU are of this type. This might also be regarded as a defensive strategy in the sense of increasing Andorra’s compliance with EU and international standards to the extent that this was unavoidable, and in seeking specific agreements where most obviously needed.

Stage 3: comprehensive treaty. This stage would see the two parties make an agreement covering simultaneously all sectors of mutual interest. The multi-sectoral content would in principle achieve a more beneficial agreement by achieving synergies between its component parts, and in encompassing a wider range of trade-offs between elements of differing

relative advantage to the respective parties. Such an agreement would normally last for a considerable number of years, and therefore provide certain guarantees of stability. It would imply a more pro-active approach towards inclusion in the processes of European integration.

Stage 4: virtual membership. This model hypothesises Andorra coming very close to complete entry into the European Union. While full membership is considered unrealistic for the foreseeable future, it could be more realistic to envisage an agreement for virtually full participation in its policies and programmes, together with partial institutional inclusion. This would of course imply a categorical choice by Andorra to aim at the fullest inclusion possible into the European Union. It would be assumed that Andorra's 'exceptions' were in any case going to be under irresistible pressures for their substantial erosion or elimination, and that in this case it was better to commit irreversibly to a fully European strategy.

This range of conceivable scenarios has fundamental implications for the future of Andorra's economy, society and political system. The fullest integration process would undoubtedly eliminate or at least reduce substantially some of the exceptional characteristics of Andorra's economic, fiscal and social policy system. This means that Andorra would have to examine very carefully the implications of such scenarios, with an attempt to draw up a cost-benefit analysis of the options.

However far from everything is a matter of Andorra's free choice, since the current processes of globalisation and European integration amount to hugely powerful external dynamic factors whose pervasive influence Andorra can hardly avoid. There are several objective indicators, as mentioned above, warning Andorra about the unsustainability of its development model of recent decades. In addition Andorra has to watch carefully what is happening in other very small states and entities in Europe, with which it competes, since these other jurisdictions are creating precedents, examples and trends that will bear on Andorra's case in various ways.

6.1 Unilateral and preparatory steps

The unilateral approach has some serious arguments in its favour. It would see Andorra making extensive use of EU directives, regulations and policies as a guide for its actions, even to the point of simply copying many texts, especially those of a really technical nature. Andorra is tending to

align its new legislation on EU norms and standards now in any case. There is no need for Andorra to 're-invent the wheel'. Moreover it seems increasingly the case that the EU is the standard-setter in global markets. There are important cases, for example in financial services and accounting, where the EU obliges its member states to adopt standards that are agreed internationally for voluntary application elsewhere. Further advantages of this approach are that it can be pursued at a speed and depth that Andorra finds best, and avoids the burden and complications of negotiating formal agreements. In particular it avoids entering into a negotiation process from a position of unnecessary weakness.

However therein also lay disadvantages. The process may lack strategic coherence and credibility, and may be vulnerable to short-term politics. It may also miss the possibility to negotiate various advantages. These problems of weak strategic coherence and credibility could in principle be overcome by adequate planning, consultations and commitment of medium to long-term plans. The government's 'Andorra 2020' programme could be taken as the time frame for a two-stage process of first a 'Green Paper' and later a 'White Paper' on Andorra's plan to thoroughly work out the European dimension to its 2020 programme. The Green Paper would be in the nature of a consultative document sketching different options for Andorra's future European policy. Such a document might be given a year for debate in parliament, business interest groups and society at large. It would be followed by a White Paper that would set out the government's proposal. This should have the vital quality of informing the population at large and all economic actors – Andorran and foreign – about the nature of the economic regime to be expected over the medium to long-term. A checklist for the contents of these Green and White Papers is effectively available in the lists of topics covered by the EU in its negotiations and agreements with neighbouring countries, including both those with or without membership perspectives (see Table 12 below on the EEA, and Annexes H, I and J for other examples). The agenda is virtually the same in all cases, and the main differences lie in the extent of legally binding obligations that the partner takes on, and the speed of alignment on EU norms.

This still leaves as a matter of political choice whether the stage of unilateral action is to remain the main system indefinitely into the future, or to serve as a preparatory stage before passing to the negotiation of more formalised agreements with the EU. We now therefore consider the options for such agreements.

6.2 Sector-specific agreements

A pragmatic approach would be to make step-by-step progress in negotiating sector-specific agreements with the EU, sequenced to follow a stage of unilateral preparatory measures. The status quo in fact already consists of a hybrid regime of some unilateral acts of convergence on EU standards alongside some sector-specific agreements.

There is certainly room for a higher level of operational effectiveness for the several sectoral headings written into the 2004 Cooperation Agreement – environment, transport, education and regional policy. As remarked above, this agreement has so far remained largely an empty letter. From our consultations it is our impression that at the present time any ambitious requests from the Andorran side to upgrade the sectoral chapters of the 2004 Cooperation Agreement would encounter requests from the EU or its most interested member states for a *quid pro quo*, consisting of greater convergence by Andorra on the EU's four freedoms, and its regulatory standards and fiscal norms.

The 2004 Cooperation Agreement is conspicuous for the absence of all the core features of the European Union's priorities, first of which are the four freedoms. This implies that the 2004 Cooperation Agreement was from the start structurally defective in supposing that major progress could be made on the soft agenda of Andorra's preferences, while neglecting the hard core of the EU's concerns. It represents the reverse of the logic presented above in discussing first core requirements of a deeper Andorra-EU relationship and then the additional agenda items for deeper cooperation. It may be possible to negotiate on both together, but to take these two groups of agenda items in reverse order is not succeeding at present, and is no more likely to do so in the future.

The EU for its part has been taking no initiative, except when it had its own strong reason to do so as in the case of the taxation of savings, otherwise leaving it to the Andorran side to come up with proposals.

There are other examples of the current step-by-step approach. Andorra initiated discussions about joining fully the euro area, with a view to an agreement for minting Andorran euro coinage. This led to the conclusion that it was first necessary to pass a set of laws on the regulation and supervision of Andorra's financial markets.

There are also the proposed reforms for introducing a corporate tax, which the government sees as a preliminary to seeking agreement with

France and Spain to reduce or abolish their withholding taxes on Andorran enterprises that supply cross-border services.

A step-by-step evolutionary approach certainly allows for a careful process, avoiding dramatic ruptures in the system, and giving time for Andorrans to adapt to new conditions for doing business. It takes time to make far-reaching changes, such as introducing accounting systems corresponding to international standards in companies, which until now had no obligation to draw up audited accounts, since there has been no tax on profits.

The most developed example of this evolutionary approach, with multiplication of sector-specific agreements, is seen in EU-Swiss relations. The Swiss model stands for a long and progressive process, a continuous sequence of negotiations, with the objective of combining deep integration with avoidance of excessive or automatic harmonisation on EU policies. As detailed below (in section 4.1.3 of Part B), Switzerland has concluded no less than 42 agreements with the EU (or its earlier institutions) between 1956 and the present day.

However the availability and relevance of this model for Andorra should not be overestimated. The EU for its part strongly resists what it calls 'cherry-picking' by European partner states, which are otherwise seeking the benefits of deep integration with it. The Swiss government for its part sought to join the European Economic Area with the other EFTA states in the 1990s, and negotiated the treaty to do this, only for it to fail in the referendum for its ratification. The subsequent packages of agreements negotiated between 1994 and 2004 were a salvage operation to repackage much of the EEA agreement. Even so the EU imposed the condition that all the sector-specific agreements would have to be ratified on the Swiss side, such that if one failed ratification all others would be rendered null and void. In addition the institutional provisions of the Swiss packages turn out to be less satisfactory from the standpoint of having a voice in EU policy-shaping than for the EEA partners. It is therefore something of an illusion to suppose that there is a Swiss model on offer that gives a more favourable balance of advantages because it is more selective and tailored to its national needs.

There are further risks in the step-by-step approach, which turn on questions of interdependence and synergies between the components, and of credibility of the whole. Consider for example just one circuit of interdependencies. Andorra wishes to create new, dynamic and higher-tech service sectors. This will require tax measures in Andorra to get France and

Spain to lift their withholding taxes on Andorran service exports, and also liberalisation of the Andorran labour market to attract new skills and entrepreneurship. However the Andorra labour force will be apprehensive about increased competition for jobs in the absence of a more substantial social security safety net in the event of becoming unemployed. On the other hand the tax reforms will increase the capacity of the state to make such provisions. This example thus sees a possible chain of linkages between freeing movement of people and capital, removal of external fiscal sanctions, domestic tax reforms and domestic social security provision.

These are reasons why a more comprehensive approach deserves consideration, simultaneously for the programme of domestic reforms as well as the relationship with the EU.

6.3 Comprehensive treaty

The EU has an active policy for establishing special relationships with neighbouring countries, based on comprehensive treaty level agreements.

It is instructive to look at the contents of the several categories among the EU's comprehensive agreements and negotiation processes with close neighbours. One can compare in particular:

- The accession negotiation process (see Annex H for the standard chapters of the accession negotiations),
- The Stabilisation and Association Agreements with Balkan states (see Annex I for the chapters of the agreement with Croatia) and
- The Action Plans of the European Neighbourhood Policy (see Annex J for the contents in the case of Ukraine).

The outstanding message from all these examples is that while the EU regards its several of neighbours as being categorically different from political and institutional standpoints, the content of these negotiations and agreements has much the same structure and content. The main difference is the degree of flexibility in the precise agenda, and in the degree to which EU norms and standards become legally binding obligations. In all cases the four freedoms occupy a prime place. The justice and home affairs field also becomes important in all cases. The long list of sectoral policies is the same, only that for the Neighbourhood Policy these are largely matters for 'cooperation', whereas for the candidate states they become legally binding obligations and the Balkan agreements are somewhere in between.

Apart from ongoing developments in the EU's neighbourhood policies, a specific article (No. 1-57) on the special relationship between the EU and its neighbours was included in the Constitution signed on 29 October 2004, which is reproduced in Box 1. In addition several small neighbouring states, including Andorra, pushed for and were successful in securing a Declaration attached to this article for the EU to take into account the particular situation of small-sized neighbouring countries.

Box 1. Extract from the 'Treaty establishing a Constitution for Europe'

Title VIII - The Union and its neighbours - Article 1-57

1. The Union 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.

2. For the purposes of paragraph 1, the Union may conclude specific agreements with the countries concerned. These agreements may contain reciprocal rights and obligations as well as the possibility of undertaking activities jointly. Their implementation shall be the subject of periodic consultation.

.....Declaration on Article 1-57

The Union will take into account the particular situation of small-sized countries which maintain specific relations of proximity with it.

Source: European Union, Treaty establishing a Constitution for Europe, signed 29 October 2004, published 2005, Office of Official Publications of the European Communities, Luxembourg.

In the event, the Constitution failed to be ratified, after the negative referenda results in France and the Netherlands in May 2005. However in June 2007 the European Council agreed a mandate for negotiations to overcome the impasse, through preparing amendments to the existing treaties instead of a *de novo* text. The agreed mandate goes a long way, however, towards rescuing the institutional innovations of the Constitution. The mandate proposes in particular to retain Article 1-57 of the Constitution. The current Portuguese Presidency has retained both this article and the annexed declaration in the text of the draft treaty that the EU member states are now due to negotiate to a conclusion before the end of 2007.

The significance of this article, whether it is retained or not, should not be overestimated. The EU is able to make agreements with third countries in any case. This item was itself hardly controversial, and so its inclusion in the draft Constitution can be regarded as a broad statement of intent on the part of the EU, without direct legal force.

In any case the EU is already in practice tending towards new models of treaty-level agreements with close neighbours and partners. The emerging model goes in the direction of a single treaty combining provisions relating to all three pillars of EU competences, for (I) economic integration, (II) foreign and security policy, and (III) justice and home affairs, which will now be facilitated by the European Union acquiring a single international legal personality under the forthcoming treaty amendments. Already the EU begins to negotiate a treaty with these characteristics with Ukraine. The past agreements with the more limited scope of a single pillar, such as the European Economic Area, are becoming increasingly obsolete with the growing importance of pillar II and III activities.

Mr Pedro Solbes, in his report prepared for the Andorran government in 1999,² devoted particular attention to the model of the European Economic Area (EEA), which currently brings Iceland, Liechtenstein and Norway into the EU's single internal market. Of these three countries that case of Liechtenstein is of special interest as comparator for Andorra. As described below (in section 4.1.2 of Part B) accession to the EEA has entailed transposition into the laws of the non-EU member states of over 1,000 EU directives, covering the whole internal market field. It is worth noting that Liechtenstein, as a state of similar size to Andorra, managed to apply this huge body of EU law without crippling the administration of its enterprises with excessive burdens. Short cuts were possible, either by copying the German language laws of Austria, or by simplifying legislative procedures where the measures were essentially technical and without political implications.

² P. Solbes, *Éléments de définition d'un modèle de relation entre l'Union Européenne et l'Andorre*, Andorra La Vella: Govern d'Andorra, Ministeri d'Afers Exteriors, 2000.

In the particular field of financial market regulation and supervision, moreover, the same obligations have been taken up not only by Liechtenstein within the EEA, but also by several of Andorra's other European competitors – Gibraltar, Guernsey, Jersey and the Isle of Man – in adopting the whole package of 42 measures of the EU's Financial Service Action Plan. This has been accompanied by the latter four cases entering into information-sharing agreements with the regulatory and supervisory authorities of other financial centres, in conformity with the standards set by the G-7-sponsored Financial Action Task Force, administered in cooperation with the OECD and IMF.

The EEA model is in itself interesting, but in some respects perhaps not so well adapted now to Andorra's needs. The EEA Treaty, of 1992, has since been overtaken by important developments in the EU's economic policies falling outside the precise internal market agenda of the EEA, and in its Justice and Home Affairs competences. From an Andorran perspective, looking ahead for a model for the next decade, the EEA could be viewed as both too much (excessive detail with the 1,000 directives) and too little (in excluding new areas of EU policies). It is also uncertain whether the existing EEA states would want to enlarge their membership.

A more plausible approach would therefore call for Andorra to think in terms of its own comprehensive treaty model with the EU, bearing in mind certainly the important experiences of the Swiss and Liechtenstein/EEA models, as well as the EU's wider set of neighbourhood policies. This might become feasible as and when Andorra had achieved recognition as a 'cooperative' low-tax jurisdiction, and a financial centre fully compliant with the EU's Financial Services Action Plan.

Andorra would also have to come to terms with the EU's four freedoms, maybe with some limited negotiated exceptions. However this seems necessary in any case to revitalise the economy and to develop new service sector niches, with the aid of liberalised labour and capital markets. In the new era of mobile locations for many service sector activities, based on IT and internet communications, Andorra is favourably placed to profit from its huge investment in recent decades in the most substantial and modern urban conglomeration in the Pyrenees. It already has a cluster of business services and infrastructure as a basis for this development, coupled to valuable language skills of the population and a highly attractive mountain quality of life. But to exploit these comparative advantages, the labour and capital markets must be completely open, since mobile resources will not come there otherwise, given that today's

European standard is one of complete openness. Without this the objectives of the 'Andorra 2020' programme are going to be very hard to achieve.

This hypothetical reform package would be a sound basis for seeking the most favourable possible comprehensive agreement from the European Union. Given the strategic interest now of the major powers in Europe and the international community to see best standards prevail in all the world's offshore centres, one could expect a serious response to a credible and comprehensive reform process in Andorra. Full participation in projects such as that of the Communauté de Travail des Pyrénées and its funding by the EU Regional Development Fund would become plausible. An agreement over full participation in the euro zone, as part of the European payments system would be feasible. Upgraded or new transport infrastructure connections with France and Spain, by motorway, rail and air, could also be considered for possible financing from the European Investment Bank as well as the Regional Fund. Full participation in EU education, research and SME development programmes would be plausible. Andorran citizens could achieve full access to the EU labour market.

6.4 Virtual membership

Given the extent of regulatory convergence on EU standards, and of participation in EU policies hypothesised in the preceding section, the question naturally arises whether Andorra might envisage a final, logical step, and seek full EU membership. This would seem to be conceivable in principle on the basis of the legal texts, since from the Treaty of Rome to this day "any European state that respects the principles [of democracy] may apply" (Article 49).

However the right to apply does not mean the right to be accepted. The criteria for accession have been spelled out since in more detail as the 'Copenhagen criteria', adopted by the European Council at their meeting in Copenhagen in 1993. These criteria concern first democracy, the rule of law and human rights, secondly the capacity to implement the EU's legislated *acquis* and thirdly the capacity of the economy to cope with competition in the EU economy.

Andorra's political institutions already satisfy the first criterion. The legal and administrative burden of *acquis* compliance would be very substantial. However the example of Liechtenstein in the European Economic Area shows that a very small state can adopt the whole single

market *acquis* without insuperable difficulty. As regards the competitiveness criterion the key sectors – tourism, financial services and commerce – are already subject to wholly or largely competitive conditions.

The main obstacle to a hypothetical Andorran application for membership does not therefore arise with the Copenhagen criteria, but rather around the so-called ‘absorptive capacity’ question, now officially termed by the Commission as ‘integration capacity’. In 2006 considerable attention was paid to this issue, as a result of the growing resistance to further enlargement following the huge jump from 15 to 25 and now 27 member states, as well as French and Dutch failures to ratify the Constitution. The nature of this ‘integration capacity’ has been extensively discussed in an official Commission Communication,³ as well as in an independent CEPS study.⁴

The Commission’s main concern is over the adequacy of the institutions to function with a growing number of member states, which is essentially a problem for the decision-making procedures of the Council of Ministers. Here there is a very real issue of the burdening of decision-making procedures with an ever growing number of seats round the table. The number of ‘tables’ in question is huge, since there are hundreds of working groups and committees of the Council and Commission where all member states are represented, with dozens of them meeting each day. Actually the EU of 27 member states has not encountered decision-making gridlock.⁵ Nonetheless this concern over further expansion is perceived to be a very real one.

Even existing commitments to further enlargement are under tension politically within the EU, bearing in mind the commitments for full membership extended to all the Balkan states (Croatia, Bosnia & Herzegovina, Serbia, Montenegro, Macedonia, Albania and presumably soon Kosovo). Their accession would raise the number of member states to 34. While the case of Turkey has supporters and opponents, there are also constituencies in the EU in favour of Ukraine and Moldova, with far from

³ European Commission, Integration Capacity, Annex to the Regular Report on Enlargement, December 2006.

⁴ M. Emerson, S. Aydin, J. De Clerk-Sachsse, and G. Noucheva, *Just what is this absorptive capacity of the European Union?*, CEPS Policy Brief No. 113, October 2006.

⁵ S. Hagemann and J. De Clerk-Sachsse, *Decision-making in the Enlarged Council of Ministers: Evaluating the Facts*, CEPS Policy Brief No. 119, January 2007.

unanimous support in all these cases. Iceland, Norway and Switzerland could easily become member states if they wished, in which case Liechtenstein might also seek to follow suit. This exercise in hypothetical futures already touches up to 40 sovereign states.

Today it is not possible to forecast how the EU will respond to the continuing dynamics of Europe's widening and deepening, which seem nonetheless to be long-term endogenous processes of great force. Responses will have to be found to sincere and justified demands for inclusion from democratic European states. It is not inconceivable that the EU might in due course restructure itself to have a formal wider European structure (viz. President Mitterrand's proposal for a European Confederation), alongside a more compact structure consisting of all member states that were fully participating in all its policies and willing to adopt a more strongly federal constitution (such is the essence of the 'core Europe' proposal advocated by various independents from the original six member states). On the other hand at some point in the future, maybe in the 2020s or 2030s, the European Union's institutional system might find a way of accommodating a further substantial increase in the number of member states. The United States, with 50 states, can function because of its maturely developed federal structures, in which inter-state decision-making hardly exists at all. Perhaps the EU will be getting closer, but surely not fully, to a maturely federal system in the second half of the 21st century.

The point to bear in mind is that the EU is a living political organism, which has shown great ingenuity over the last 50 years in adapting its structure to new demands, and may well continue to do so over the next decades if faced with continuing requests for further enlargement from other European democracies. The question for Andorra to consider is whether it could in some way anticipate these future developments in ways acceptable both to it and to the EU. The initiative of San Marino of 27 August 2007, in formally requesting discussions with the EU over possible membership of a new 'status', illustrates the constant emergence of new dynamics in the European integration process that Andorra has to bear in mind; these are ranging across the whole of the map of Europe, from the biggest to smallest of its component states.⁶

⁶ See section 4.2.1 of Part B.

The main problem on the EU side is to avoid congestion around the tables of the Council and its numerous working groups. Would it be possible to devise an interim system of 'virtual membership' of the EU, which would mean full functional membership for the people and businesses of Andorra, while making special arrangements in relation to the institutions?

The starting point for a 'virtual membership' hypothesis would be for the citizens of Andorra to become citizens of the European Union (their passports would bear the title 'European Union' as well as 'Andorra', as in the case of existing member states), sharing the same fundamental rights at the individual level (freedom of movement, residence, employment etc.) without discrimination. Andorra would be considered 'part of the EU'. All EU law, policies and programmes would be applicable to it, except in the event of specific derogations.

Regarding institutional issues, the number of Commissioners is soon going to be reduced to less than the number of member states in any case. On the other hand Andorran citizens could be eligible to become European civil servants, with access on the basis of merit to high positions in all the institutions (Commission, Council, Parliament, European Central Bank, Court of Justice, EU agencies, etc.).

In the European Parliament the average constituency size is now over 500,000 people. For Andorra the number of non-Andorran residents of EU nationality is substantial, and these people are able to vote in their home countries. It would be a considerable concession, but not an inconceivable one, for the EU to grant one seat in the Parliament for Andorra in spite of the very small number of Andorran citizens. Alternative formulae might be for there to be one Andorran observer member, or for Andorran citizens to be granted the right to vote in neighbouring Spanish or French constituencies. Already EU citizens can vote in European Parliament elections in their country of residence even where this is not their country of citizenship. There should be no problem in granting a seat to Andorra in the EU's two consultative bodies – the Economic and Social Committee and the Committee of the Regions.

This would leave the Council as the biggest problem. Could there be innovative solutions, given the inevitable resistance to a new seat at the table representing so few people? Might Andorra be granted the right to have its voice represented in the Council by another member state of its choice? Alternatively might Andorra be granted the right to attend and voice its case selectively on issues of vital importance to it? Would Andorra

itself see such arrangements as compatible with its status as an independent sovereign state (this is of course a highly sensitive issue, but it can be argued that a voice in the EU's policy-shaping process, even without a vote, would be a plus rather than a minus).

Following the age-old principle of 'no taxation without representation', there could be a compromise in the event of incomplete institutional representation. If Andorra had no seat or vote in the Council it might be agreed that it contribute only part of the normal budget contribution. For example it might surrender the customs duties own resources, but only part of the value added tax contribution.

7. The possible and the necessary

'Politics is the art of the possible' is a well known dictum. For Andorra this concerns the politically feasible speed of adaptation to new circumstances, both new problems and new opportunities. The politically feasible is the constant concern of any democratic government having to balance the interests of different segments of society. Andorra is a typical European country in this respect, with a real political competition between government and opposition parties. Changes to the status quo may open new possibilities, but they will also threaten or be perceived to threaten at least some existing interest groups. It is not for the present author to discuss these aspects of the Andorran political scene, beyond understanding that there are natural constraints on the speed of policy reform processes, although these constraints may be eased in the course of informed political debate.

'The necessary' refers to pressures bearing down on Andorra from the outside world, which may be more or less irresistible. There are indeed new realities in both Europe and the world that Andorra cannot escape, since it cannot conceivably revert to some earlier historical model of a tiny self-sufficient community isolated in the mountains. Moreover the processes of Europeanisation and globalisation have both been accelerating to the point of having made qualitative changes not only over recent decades, but even perceptibly in the few years already of the 21st century.⁷

⁷ For a detailed presentation of these considerations, see M. Camdessus, *L'Andorre, des exceptions à l'exemplarité*, Paris, 2005.

The EU's multiple achievements of the single market, single currency and single space for the movement of people and now single area for freedom, justice and security have been decades in the making. But only in the last few years have all these elements come together. Much is made in the media about the shortcomings in the EU's foreign policy and the failure of the Constitution to be ratified, but this should not for Andorra obscure the fact that the EU has become a massive legal and regulatory space. Moreover, even as the enlargement process now slows, the external projection of the EU's norms and standards is continuing way beyond its frontiers.

The globalisation phenomenon, while an obvious reality for all, has two features of importance to Andorra that have only in the last years achieved a qualitative change. First has been the explosive growth of globalised offshore financial markets. It is estimated that the world's offshore centres now manage between \$5-7 trillion of assets, or about 6-8% of global wealth. This has led the world's leading economic powers to develop a comprehensive array of standards for fiscal systems and for the regulation and supervision of financial markets with which to review the performance of every offshore entity in the world, going as far as the tiniest island in the Pacific Ocean. The G-7 summits have mandated the International Monetary Fund and the OECD to be the agents of review of the fiscal and financial policies of all states and entities, even those that are not members of these organisations (Andorra thus included). As Part B to this report shows, these reviews are done and published in great detail, and do not fail to criticise laggards in the process of converging on international standards.

This process was in motion already before the seminal terrorist event of 9/11/2001, but has been further reinforced by the new strategic security concern to combat the financing of terrorism and the partly related matter of money laundering.

These several landmark features of the early 21st century – European integration, globalisation of the world economy and finance, and global terrorism – have come together as the rationale of a drive to make internationally accepted standards prevail world-wide. No single state or entity is targeted, but none is granted exemption from the process.

More than that, the major powers have put a competitive dynamic into the process, whereby the best-performing offshore centres are rewarded with favourable reports and publicity, and the lagging entities are penalised with official 'black marks'. This has prompted several leading

offshore centres to adopt pro-active regulatory policies and strive for explicitly 'whiter-than-white' brand reputations, which has tended to result in good business success. This is beginning to suggest a model of the dynamics of competition between offshore centres, in which there can be observed parallel processes of virtuous and vicious circles, in which the centres with best reputations attract the best clients, and vice versa for the centres with less good reputations.

The major powers and international organisations are respecting the legal prerogatives of internationally recognised sovereign states. But at the same time they are developing increasingly powerful carrots and sticks to achieve the application of minimum global standards, in order to avert security risks and systemic risks in the financial system, and to ensure a more level playing field for competition. The carrots and sticks are essentially made up of the same instruments of reputational branding, either positive or negative.

What is 'necessary' for Andorra, as for other offshore centres, has to mean not only moving progressively in the direction of dominant European and/or international standards, but also not proceeding slower than the competitors. To move slower in a given positive direction than the competitors risks becoming a negative in the perception of mobile international resources.

The government of Andorra recognises the challenges. The Head of Government stated in his speech to the parliament on 14 June 2007 that "to be considered a tax haven costs us too dear ... The Government bases the ineluctable internationalisation of the economy on three pillars: transparency, orthodoxy and international accepted standards of control and supervision". This is also reflected in the 'Andorra 2020' programme for revitalising the economy, through improving infrastructures, upgrading the tourist sector, encouraging the emergence of new service sectors and more generally strengthening Andorra's 'brand image' in the European and international economy.

At the same time technological progress is working in favour of these plans. In particular advances in information technologies, at the heart of modern service sectors, bring new opportunities in the competition for attracting investment, with increasing numbers of niche activities now becoming 'foot-loose', i.e. capable of being located almost anywhere geographically, and indeed in mountainous locations that were earlier unsuitable for most economic activities.

Put in other words, a reversal of economic paradigm is called for. To sustain its achievements Andorra needs to put into reverse some of the factors that made it rich in the last half century. How is this possible, it may be asked? Is this not an illogical contradiction? Actually there is a robust explanation of this. It is not that extremely light taxation and economic regulations are no longer attractive to mobile resources; of course they remain so. It is rather that the global and European economic environment, within which Andorra has to find the sources of its prosperity, has been changing fast under the headings of the three key words: *globalisation, Europeanisation and technology*.

The optimum has to find its way of reconciling the 'possible' and the 'necessary'. This should in principle correspond to an enlightened long-term view of Andorra's interests, while avoiding either excessively brutal ruptures to the status quo, or excessive short-run protection of the status quo that would impede the emergence of new dynamic factors crucial for the longer-term future. A classic technique for managing the inevitable dilemmas that arise in any reform process is to announce the final objectives for a medium-term process with sufficient credibility that actors have time to adapt, and to schedule individual measures over time according to practical considerations. But the question is then how to achieve the *vital credibility factor*, when much of the policy action is spread over a multi-year period, in which there could be changes of government with different ideas.

This is where the European Union could be the key, crucially providing 'anchorage' for the reform process. The idea of 'anchorage' is based on two factors. First there has to be the bedrock on which to anchor, which exists in the EU's corpus of operational laws and policies, and is quite transparent as information for strategic business planning. Second there is the mechanism of anchor and chain for attaching the ship to the bedrock. The EU's legal and institutional infrastructure ensures not only enforcement but also stability. EU laws cannot be simply changed by a new government in a member states. With non-member states in the neighbourhood, the EU is making treaty-level agreements, entailing legal obligations at the highest level of international law, backed up by legal remedies (European Court of Justice or other procedures). A non-member state that concludes a treaty-level agreement with the EU, with legally binding obligations to become compliant with identified EU laws, makes a credible commitment. It is noteworthy here that the EEA system goes as far as accepting the legal obligation to implement *future* EU laws or

amendments to laws in the single market field, thereby guaranteeing against problems of obsolescence of the agreement. This is a clear reinforcement of the credibility of the 'EU anchorage'.

In this situation Andorra has an important latent advantage and resource to draw upon in its two neighbouring states and the European Union. If it made the big break, to become an unquestionably cooperative player by best European and international standards within a small number of years, and to make binding political commitments to such a plan at the outset, Andorra could then seek the most favourable possible deal with its neighbours and the EU. As pointed out above, there is plenty of room still for Andorra to remain 'exceptionally' attractive as a very low tax jurisdiction, while coming entirely into line with the key standards of international cooperation.

As a final word, we return to summarise some key features of the four stages, or sequence of models presented above. The present situation consists of some unilateral reform measures in the governmental pipeline, alongside some sector-specific agreements with the EU, which however are not developing very substantially. It is suggested that the current stage of unilateral actions be enhanced by the publication first of a Green Paper on 'Andorra-EU 2020' to complement the existing 'Andorra 2020' programme that has set out the domestic agenda for this time horizon. After a period of political consultation, there could be a White Paper, in which the government would set out plans to anchor its 'Andorra 2020' programme on a comprehensive and deep integration with the EU. This would mean coming to terms with the EU's four freedoms and other core requirements. As soon as the government was ready with these plans, and had advanced a sufficient number of them concretely, the way would be open negotiations for a comprehensive treaty level agreement with the EU, which would include full access to all relevant EU policies and programmes. While full membership is understood in both Andorra and the EU to be implausible along the classic lines for the EU's enlargement for institutional reasons, these steps might lead to a conceivable model of 'virtual membership' by around 2020, if Andorra chose to pursue a fully European vocation.

Part B. Background Study

8. The three ages of Andorran history

8.1 A millennium of Malthusian subsistence

A little history is called for.⁸ It is certainly intriguing for non-Andorrans to know how it came about that this independent and democratic state's head of state consists of two 'Co-Princes', who are the President of France and a Spanish bishop. More important for Andorrans is that their special identity and place in Europe are understood which requires the presentation of a little historical background.

Andorra is a natural geographic valley space, a triangle with sides about 25 km long, in the Pyrenean mountain range between France and Spain. The highest peaks reach almost 3,000 meters on the French side, whereas the main valley descends into Spain.

Map 1. Andorra



⁸ This section draws especially on M. Mateu and F. Luchaire, *La Principauté d'Andorre*, Paris: Economica, 1999.

Charlemagne is believed to have granted a charter to the Andorran people in return for their fighting to keep the Moors out of France. It is documented that Charlemagne crossed the Pyrenees with an army in 778, and favoured a system of defensive buffer states in the region. While the authenticity of a Foundation Document of 784 held in the official Andorran archives is contested, it is established from a document of 843 that Charles the Bald, Charlemagne's grandson, appointed the Count of Urgell as overlord of Andorra, Urgell being a town close to the border of Andorra on the Spanish side. In 1133 this possession was transferred to the Bishop of Urgell. (His church remains today an outstanding example of Romanesque architecture, of which there are also several notable examples in Andorra itself.) However the Bishop placed himself under the protection of a Spanish noble family, de Caboet, whose rights were later transferred by marriage to Count of Foix in 1208. This family's seat was the imposing fortress at Foix, about 100 km north of Andorra into France, and a major centre of regional power in medieval times.

In the early decades of the 13th century there were many tensions and hostilities over Andorra between the Bishop of Urgell and the Comte de Foix, which was only resolved in 1278, and confirmed in 1288, though mediation by the King Perre II of Catalonia and Aragon. On these two dates, treaties (*paréages*) were signed between the church and the lay seigneur. These documents are regarded as the first legal foundation of today's Andorra, establishing a condominium, which conferred equal rights and powers on both the bishop and the count as 'Co-Princes'. The texts spelled out arrangements governing fiscal issues, military obligations and a kind of magistrates' court (*batlles*). The inhabitants of Andorra had to recognise allegiance to both the Bishop and Count, and to pay tribute to them each on alternative years. This practice did not entirely disappear until Andorra adopted its present constitution in 1993. Such is the longevity of Andorra's political identity.

Andorran society was that of a small, poor and closed mountain community, with the population stagnating for centuries at around 3,000 inhabitants. By the 19th century the population was still only around 4,000-5,000. The shortage of agricultural land meant a Malthusian regime, with

emigration becoming necessary whenever the population risked increasing substantially.⁹

Their economic survival was helped by exemptions from customs duties extended by the Conseil du Bearn in 1532, the Parliament of Toulouse in 1604, Louis XIV in 1644 and by the Conseil d'Etat du Roy in 1767. However significant taxes, according to 17th century records, had to be paid to the Co-Princes. In the early 18th century there were wars and troubles between Catalonia and Castille, which resulted in 1728 in the imposition of a 10% import duty on Andorran exports to Spain. This was of vital concern to the Andorrans, and it took until 1738 for the Andorran leadership to negotiate with Spain a special agreement for exemption from these duties.

The French Revolution of 1789 sent shock waves into Andorra, since all feudal privileges were abolished, inter alia those of the Compte de Foix. It was not until 1806 that the situation was clarified, with Napoleon Bonaparte becoming Co-Prince, a role that subsequent French heads of state have maintained ever since.

Andorran representative government and democracy has remarkably early origins, with some features of the *Paréages* of 1278 and 1288 blending feudalism with elements of representative governance. From medieval times society maintained a distinction between the heads of the leading families (*Caps Grosses or focs*) and the ordinary people (*casalers*). The leading families voted 2 or 3 representatives by parish to a council or parliament (*Consell de la Terra*) created by decree of the Co-Princes in 1419. This council designated individuals (one or more *syndics*) to represent the Andorran people in negotiations with the Co-Princes. The system was upgraded in a reform (*Nova Reforma*) signed by the Co-Princes in 1866-68, which extended the vote to all heads of household (781 in a population of 5,000 at that time), and replaced the *Consell de la Terra* with a *Consell General* consisting of members elected for four years, and reformed mechanisms of local government. The next democratic reform was undertaken in 1933 when the vote was extended to all adult male Andorrans (women were granted the vote in 1970).

Andorra had some iron ore deposits and this permitted a little industrial development from the second half of the 17th century, and

⁹ Robert Malthus argued that population growth is constrained by available food supply in "An Essay on the Principle of Population", first published in London in 1798.

several forges were established, leading to a lively expansion of trade. This meant also some demographic expansion to 4,130 in 1852.

Tobacco was introduced into Andorra and became a profitable product in the 17th century, partly because of opportunities for smuggling into Spain. This was however condemned by the Co-Princes, and the Bishop of Urgell ordered the burning of plantations in 1735. The tobacco smuggling business did not die however, and in 1790 the Bishop called in the troops of the King of Spain to counter the smuggling, and it is recorded that in 1896 a smuggler was punished with a heavy fine.

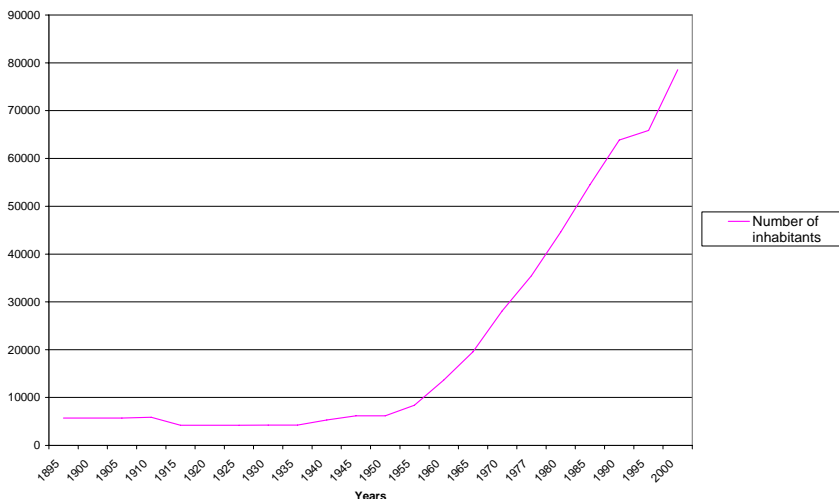
In the 19th century there were the beginnings of tourism. There was an attempt in 1842 to start a casino, but the Co-Princes refused permission, with the Bishop of Urgell objecting on moral grounds and the French side fearing competition for a nearby spa resort.

8.2 A half century of vertical take-off

8.2.1 The population

Demographic statistics give the surest indicator of Andorra's 'vertical take-off' in the second half of the 20th century. From its level of 6,000 in 1950 the total number of recorded residents grew to 78,000 by the end of the century (Figure 1).

Figure 1. Evolution of the Andorran population



Source: Andorra in figures, published by Government of Andorra, Finance Ministry.

This population explosion has been largely due to immigration. Andorran citizens now represent only one third of the resident population. As Table 1 shows this dramatic development has had four main components: first Andorrans, secondly citizens of the two neighbouring states, thirdly immigrant labour from low-income countries, and fourthly non-active immigrants from high-income countries.

Table 1. Population by nationalities, 2006

Andorran	29,535	Italian	428	Uruguayan	113
Spanish	27,638	German	393	American	90
Portuguese	12,789	Filipino	348	Others	1,901
French	5,104	Belgian	245	Total	81,222
British	1,050	Dutch	240		
Argentine	583	Chilean	128		
Moroccan	512	Indian	125		

Source: Andorra in figures, published by Government of Andorra, Finance Ministry.

Table 2. Evolution of population by nationality

	1980	1990	1995	2000	2004	2005
Andorrans	9,792	15,616	19,653	23,697	27,465	28,251
Foreigners	25,668	38,891	44,206	42,147	49,410	50,298
Spanish	20,378	27,066	28,778	26,750	28,728	28,073
French	2,474	4,130	4,299	4,283	5,095	5,078
Portuguese	1,092	3,951	6,885	6,748	9,980	11,294
Others	1,724	3,744	4,244	4,366	5,607	5,853
Total	35,460	54,507	63,859	65,844	76,875	78,549

Source: *Andorra and its financial system*, published by Associació de Bancs Andorrans, and *Basic Andorra*, published by Cambra de Comerç, Indústria i Serveis d'Andorra.

The Andorrans themselves have become more numerous, but of the 27,465 total a large fraction have acquired Andorran citizenship by naturalisation, of which many have been Catalans. This means that while Andorran citizens account about one-third of the resident population, those of Andorran ancestry are much fewer. Of the nationals of the neighbouring countries, Spain and France, the Catalan Spanish are especially numerous, no doubt due to their common language with the Andorrans and easier

geographical access. However the Portuguese have now become the second most numerous foreign community, arriving mainly as immigrant workers. In addition there has been immigration of workers from very-low income countries, notably from Morocco, Philippines and India. Finally there is the category on non-active immigrants, who are wealthy individuals from high-income European countries, and even the US and Australia, many of whom are retired and attracted by the low-tax regime.

Andorra follows a stringent policy towards the acquisition of citizenship by naturalisation. For some time the qualification for persons not born in Andorra was 30 years residence, while this has now been reduced to 20 years. Non-Andorrans born in Andorra may elect to acquire Andorran citizenship at the age of 18. Double citizenship is excluded. By comparison, most European countries require 5 to 7 years residence, and permit double citizenship. However other very small European states, such as Monaco, San Marino and Liechtenstein, also follow at least as stringent naturalisation policies, if not more so.

The direct role of France and Spain remains especially important in the field of education. There is a tri-partite school system, with the Andorran government responsible for schools taught in the Catalan language (but these schools also teach some subjects in French and Spanish), whereas France and Spain maintain separate school systems teaching primarily in French and Spanish. Families are free to choose which system to use. At present the schools are evenly balanced between the three systems, meaning that Andorra is very much a trilingual/cultural community.

Table 3. School population by system of education

	1999-00	2004-05
French educational system	3,586	3,650
Spanish educational system	3,510	3,499
Andorran educational system	2,180	3,328
Total	9,276	10,477

Source: Andorra and its financial system, published by Associació de Bancs Andorrans.

For university education there is a quite new and small University of Andorra, established in 1997. Spanish/Catalan universities are attracting the majority of students. This preference seems to be reflecting the use of

the Catalan language in the major universities of Barcelona and the contemporary rise of the Catalan identity.

Table 4: University population by country of study (number of students)

	1999-2000	2004-05
Andorra	227	342
Spain	837	644
France	256	181
Others	21	6
Total	1,341	1,173

Source: Andorra and its financial system, published by Associació de Bancs Andorrans.

8.2.2 The economy

The main driver of this demographic explosion has been the economy. The beginnings of the new economic structure can be traced back to the pre-war period when the first major hydro-electric investments were made. This required a considerable number of immigrant workers from Spain, who in turn needed some banking facilities, so leading to the opening of the first bank in Andorra in 1930.

However the real economic take-off had to wait until the early post-war period. The commercial sector first developed on the basis of trade in some basic commodities that were available in France but not in the protected Spanish economy. Andorra thus became an increasingly active marketplace for small traders, including smugglers. At the same time there was capital flight from Spain and the Andorran banking sector developed rapidly providing services under attractive conditions of bank secrecy. The liberalisation of the Spanish economy led in due course to the disappearance of trade in basic commodities, but meanwhile Andorra developed an expanding line of commerce due to its very low indirect taxation. The tobacco and cigarette industry developed considerably, again with the aid of contraband trade. However this was practically put to an end in 1997 after Spain had taken drastic steps to secure adequate cooperation. The commercial sector carried on expanding, serving today over 8 million day-trip tourists that pass through Andorra each year. Duty-free franchises for tourists re-entering France and Spain are quite limited, but enough to encourage day-tripping.

The economy saw the build-up of major investments developments in the tourist and residential accommodation sectors. The winter tourism

sector profited from excellent skiing resources. The residential accommodation sector saw a huge expansion, partly to serve a wealthy clientele of non-active or retired foreigners. In addition there was strong demand from Spain and elsewhere for secondary residences and speculative real estate investment.

Thus the modern Andorran economy was built up on four pillars of tourism, real estate, banking and commerce. The drivers for the exceptional growth were undoubtedly low taxation and (until recently) a lightly regulated banking sector, coupled with the natural endowment for mountain tourism.

Table 5. Andorra and EU-15, comparative data

	Year	Andorra	EU-15
GDP per capita (€)	2004	28,729	25,516
Consumption of electricity (kWh/capita)	2002	6,898	5,912
Vehicles per 1000 inhabitants	2002	653	495
Central government income per capita (€)	2004	3,151	6,365
Primary schooling rate (%)	2002	89	95
Secondary schooling rate (%)	2002	71	91
Employment rate (over 16-64 years)	2004	73	65
Structure by sector (% of employment)			
Primary	2004	0.3	3.8
Secondary	2004	19.3	27.1
Market services	2004	66.2	38.2
Non-market services	2004	14.2	30.9

Source: Basic Andorra, published by Cambra de Comerç, Indústria i Serveis d'Andorra.

Although macroeconomic statistics are lacking, the Andorran economy must have grown in real terms on average for the entire second half of the 20th century at a rate comparable to the Asian 'tigers'.¹⁰ As a

¹⁰ Actual macroeconomic 'national accounts' statistics do not exist yet, but while the population grew over twelve times the rate of increase of real per capita incomes was presumably not less than that of Spain (increasing five times over the same period).

result Andorra's national income and development level came to exceed that of the EU-15, a little above Spain and a little less than France. Income data are confirmed by the level of electricity consumption and the number of vehicles per capita, both of which exceed the EU-15 average.

By comparison with EU-15 the employment structure is marked by an almost twice as high share of market service workers, alongside half as high share of public service workers, and smaller agricultural and manufacturing sectors. Corresponding to the low public service employment statistics, the total tax burden is about half that of the EU-15. Educational enrolment is significantly lower than the EU-15 average, which must be a matter for concern in order to sustain very high income levels. The employment rate exceeds that of EU-15, which presumably reflects in part the absence of an unemployment benefit scheme in the social security system.

The tourist sector is of huge size, with almost 11 million visitors per year, even if 80% of these are day trippers who are not spending a night in Andorra, but are presumably doing a useful amount of shopping and/or skiing. There are 200 hotels, which together with other facilities have a capacity of 26,000 beds. Andorra is the biggest skiing domain in the Pyrenees.

Table 6. Visitors entering in Andorra by season 2006

	Tourists	Day-trippers	Total
Spanish	1,625,893	4,612,061	6,237,954
French	485,183	3,705,536	4,190,719
Others	115,846	192,203	308,049
Total	2,226,922	8,509,800	10,736,722

Source: Basic Andorra, published by Cambra de Comerç, Indústria i Serveis d'Andorra.

Table 7. Number of visitors 2004-2006

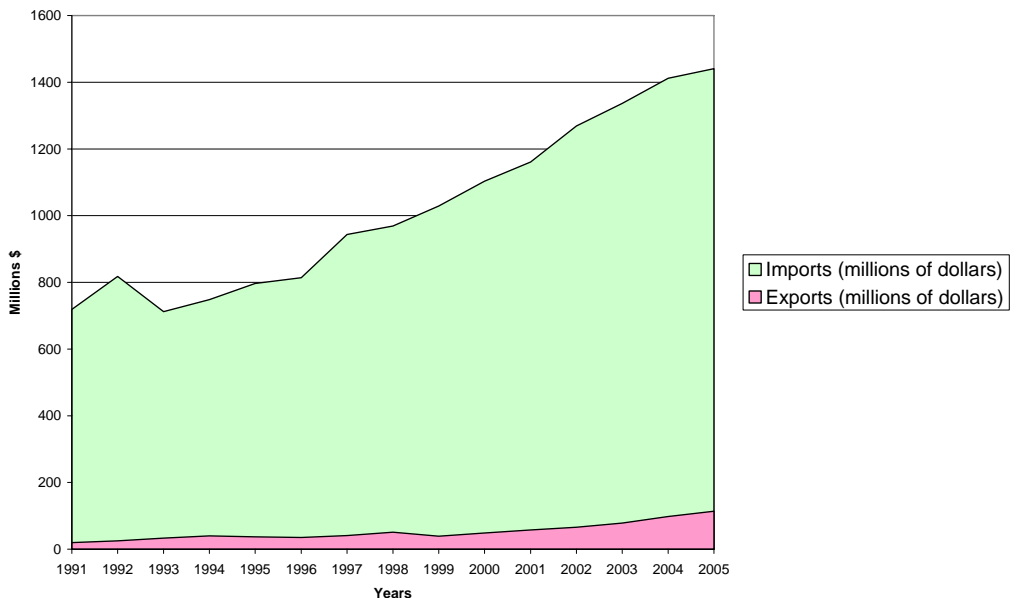
	2004	2005	2006	Var. (%) 04-06
Tourists	2,791,116	2,418,409	2,226,922	-20.2
Day-trippers	8,877,344	8,631,081	8,509,800	-2.8
Total	11,668,460	11,049,490	10,736,722	-8.0

Source: Andorra in figures, published by Government of Andorra, Finance Ministry.

Andorra's trade in goods is characterised by a huge apparent excess of imports over exports (over 10 to 1 in the official statistics). However these figures are deceptive in that while the imports of the Andorran

commercial sector are recorded, their sales to visiting tourists are not recorded as exports, which mean that the true trade deficit will be much less than suggested by Figure 2. According to 2004 data, the main imported commodities are electrical appliances (12.9%), vehicles (11.3%), perfumes and cosmetics (6.8%) clothing (5.3%), tobacco and alcoholic beverages (6.7%). Imported goods are mainly coming from Spain (over half the total) and France (about one-fifth), while other European countries account for 13.5%, with only 12% from the United States and Asian countries.

Figure 2. Growth of imports and exports 1991-2005 (millions of euros)



8.2.3 The constitution

In the last few decades Andorra has transformed itself institutionally into a normal European democratic state.

In spite of the very early elements of democracy referred to already, at the beginning of the post-war period Andorra still exhibited a confusing mix of modernity and vestiges of feudalism. In 1981 a decree of representatives of the Co-Princes established a 'quasi-constitution' using the expression 'federation of Andorran parishes', with an executive council and head of government elected by the parliament. The first head of government took office in 1982. However the distribution of powers

between the Co-Princes, central government and parishes was not totally clarified. Immediately this first government started pressing for a proper constitution.

Significant legislative acts were possible in 1980s, yet in matters of justice the system remained archaic. The Co-Princes continued to nominate judges, while persons condemned to more than three months in prison could choose whether to serve their terms in French or Spanish prisons.

In 1990 the parliament formally requested of the Co-Princes the opening of negotiations to elaborate a real Constitution. Tripartite negotiations between the Andorrans and representatives of the Co-Princes began in 1991. The negotiations received personal support from President Mitterrand for Andorra's internal and international sovereignty, notwithstanding some opposition from his Ministry of Foreign Affairs to the granting of international legal personality to Andorra.¹¹ The resulting text was voted by referendum of the Andorran people on 14 March 1993.

The Constitution declares Andorra to be a legal, independent, democratic and social state, whose sovereignty resides in the Andorran people. Its regime is described as a parliamentary Co-Principality.

The function of Head of State remains with the two Co-Princes, whose role is similar to various contemporary constitutional presidencies or monarchies, albeit with some particular features. Both the President of France and the Bishop of Urgell exercise their roles independently of respectively the law of the French state or the authority of the Pope. Their roles are identical, notably signing legislative acts and treaties, receiving the accreditation of ambassadors, convening elections, etc. They can take issues to the constitutional tribunal, but not otherwise hold up legislation (for example they cannot request a second reading of a bill). A special case concerns treaties that may be concluded with France or Spain on matters of security, defence and juridical and penitentiary cooperation. The Co-Princes participate in such negotiations through a personal representative, and have to agree to the treaty or agreement.

The parliament of 28 members is elected according to a double system, two each from the seven parishes, and the other half from national lists. The head of government is nominated by the Co-Princes after election by the parliament. Legislation is adopted by the parliament, with an

¹¹ See Mateu & Luchoire, *op. cit.*, p. 62.

absolute majority of members required for certain domains (e.g. nationality, or constitutional matters). The parliament can dismiss the government by a motion of censure passed by absolute majority. The government can request a vote of confidence, which may be passed by simple majority. The head of government can dissolve the parliament by a decree signed by the Co-Princes, but without engaging them politically.

The party political structure is conventional, with two main parties inclined respectively to the right (Andorran Liberal Party – PLA) and to the left (Social Democratic Party – PS). The Social Democrats were in power between 1993 and 1997. The Liberals were holding a majority before the last elections in 1995, when they won exactly half the seats in the parliament (14 out of the 28), with the Social Democrats winning 11 seats, with the balance held by two minor parties. The Liberals remain in power.

The system of justice is now in line with standard European practice. It distinguishes civil, penal and administrative categories of litigation. Prison sentences are now served in Andorra, rather than France or Spain. There is also a constitutional tribunal composed of four magistrates, two nominated by the parliament and one each by the Co-Princes. In practice the parliament has nominated French and Spanish citizens to the tribunal, thus enhancing its neutrality in relation to Andorran politics.

8.2.4 International relations

The post-war period soon saw how Andorra's uncertain constitutional status complicated its international affairs. There were negotiations over its accession to some relatively technical international conventions in the 1950s which raised questions over who represented Andorra. The two Co-Princes disagreed between themselves, with France claiming to be the sole international representative, with which the Bishop of Urgell could not agree. It took until 1973 for an agreement to be reached to have Andorra represented in such affairs by members of the Consell General and representatives of the two Co-Princes, but tensions remained.

The Council of Europe became involved in this confused international legal environment, notably through the case of a Spaniard and a Czech condemned in Andorra in 1986 for armed robbery, who took their case to the European Court of Human Rights in Strasbourg. After long dealings the Court finally in 1992 declared itself not competent, the whole affair illustrating institutional and juridical confusion over the residual role of the Co-Princes and the unsettled international status of Andorra.

Box 2. Andorra's participation in international organisations and agencies

International Criminal Police Organisation (Interpol)	Approved 27 November 1987
UN Conference on Trade and Development (UNCTAD)	Joined 23 July 1993
United Nations' Organisation (UNO)	Joined 28 July 1993
UNESCO	Joined 20 October 1993
International Telecommunications' Union (UIT)	Joined 12 November 1993
International Committee of the Red Cross (ICRC)	Joined 2 May 1994
World Organisation for Intellectual Property (OMPI)	Deed of membership deposited 28 July 1994
Council of Europe	Joined 10 November 1994 Deed of membership of deposited 2 December 1994
EUTELSAT	Joined 17 October 1995.
World Tourist Organisation (OMT)	Joined January-February 1996
European Centre for Living Languages	
Organisation for European Security and Cooperation (OSCE)	Joined 25 April 1996
International Office for Animal Health (OIE)	Joined 3 January 1997
World Health Organisation (WHO)	Joined 15 January 1997 Observer status since 22 October 1997
World Trade Organisation (WTO)	
International Studies Centre for the Conservation and Restoration of Cultural Goods (ICCROM)	Joined 5 June 1998
Council for Customs Cooperation (CCD)	Joined 3 September 1998
European Commission for Democracy through Law	Joined 1 February 2000 Member elected 1 January 2001 to 2006
UN Economic and Social Council (ECOSOC)	
Organisation for International Civil Aviation (OACI)	Joined 25 February 2001 Signed 17 July 1998, ratified on 30 April 2001
International Criminal Court	
Organisation for Prohibition of Chemical Weapons (OPCW)	Joined 29 march 2003
Group of States against corruption (GRECO)	Joined 24 November 2004
Unión Latina	Joined 21 October 2004
International Organisation of the Francophonie (IOF)	Associated member since 26 November 2004
International Exhibition Bureau (BIE)	Joined 3 December 2004 Entry accepted 20 November 2004
Ibero-American Summits	

In addition, the accession of Spain to the European Communities in 1986, requiring that Andorra's customs regime be negotiated and regularised with the EC, further pushed in favour of a proper constitutional reform. Given Andorra's uncertain international status the 2000 Customs Union agreement between Andorra and the European Economic Community (to which we return in more detail later) took the form of an 'Exchange of Letters', implying a less than full legal rank.

Adoption of the constitutional reform of March 1993 led immediately to international recognition as a sovereign state. In June 1993 Andorra signed a trilateral state-to-state treaty of 'good neighbourliness, friendship and cooperation' with France and Spain. In July 1993 Andorra entered the United Nations. Between 1994 and 1998, 80 countries established diplomatic relations with Andorra.

Andorra has energetically pursued accession to numerous international organisations, amply consolidating its new status as a sovereign independent state in international law, as shown in Box 2. The politically most significant accessions, after the UN in 1993, were the Council of Europe in 1994 and the OSCE in 1996. Potentially the most important of these steps operationally is the accession to the Council of Europe, coupled with accession to the Conventions on human rights, which are subject to the supreme jurisdiction of the European Court of Human Rights. This removes any remaining doubt over the status of Andorra in this legal domain as a conventional European state.

There have also been some trilateral agreements between Andorra, France and Spain, for example concerning the circulation of people, to which we return later. The main open question at this stage is if and when Andorra may accede as full member to the World Trade Organisation, to which it applied in 1997. Andorra is already an observer member, but the accession negotiations have been stagnating for some time. In 2002 the Andorran government published a detailed analysis of the issues posed by WTO accession, prepared by Paul Dembinski.¹² The author's conclusions were that WTO accession would only make sense if it was accompanying profound structural changes in the Andorran economy and policies, with

¹² P.H. Dembinski, *Andorra al llindar de l'OMC*, Andorra La Vella: Govern d'Andorra, Ministeri d'Afers Exteriors, 2002.

“the shift from one form of growth to another, accompanied by a radical change in the model of society”.¹³ This leads indeed to our next section.

8.3 A new century of sustainable development?

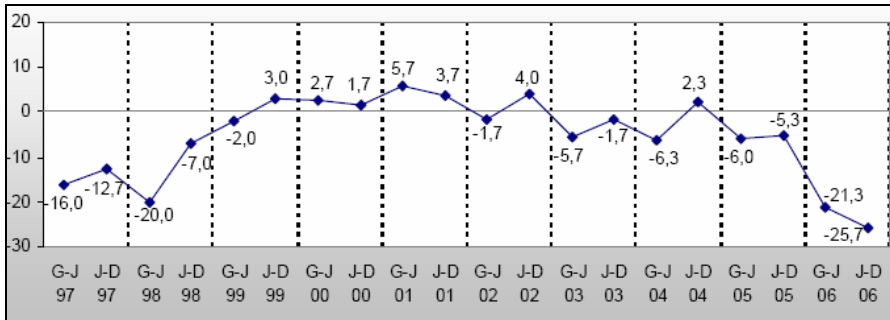
There is little disagreement that Andorra’s economic and population growth cannot continue on the same trajectory as in recent decades. There is simply not enough space in the valleys for continuing the rate of new building, without seriously eroding Andorra’s attractiveness as a tourist destination. Monaco has a higher population density, but this is not a useful comparison. Monaco is open both to the sea and functionally part of the French *côte d’azur*, whereas Andorra is a virtually isolated mountain retreat, which has to preserve the qualities of its natural environment; otherwise people will come there less. Already there are signs of stagnation if not a small decline in the number of tourists. Problems of traffic congestion for the millions of day-tripping tourists are evident.

It is reported that there are about 5,000 completed apartments which are empty to the point of not being connected to the electricity network. The current conjunctural crisis of the real estate sector in Spain may also weaken the demand also in Andorra for new construction of secondary residences and speculative investments in real estate, even if Andorra’s banking system is amply covered for possible credit risks. Given the extent of over-building in both Spain and Andorra it could take a decade for the real estate market to recover buoyant demand.

The Andorran Chamber of Commerce conducts surveys of business sentiment, which in the absence of national macroeconomic accounts give the most solid indicators of economic trends. A selection of these indicators is reproduced in Figures 3 to 5. In general these indicators, of business confidence, expected business turnover and employment in the hotel sector, were mostly positive until 2001, after which there have been serious declines in all sectors, indicating what would presumably be recorded as a recession if full economic statistics were available.

¹³ *Ibid.*, p. 281.

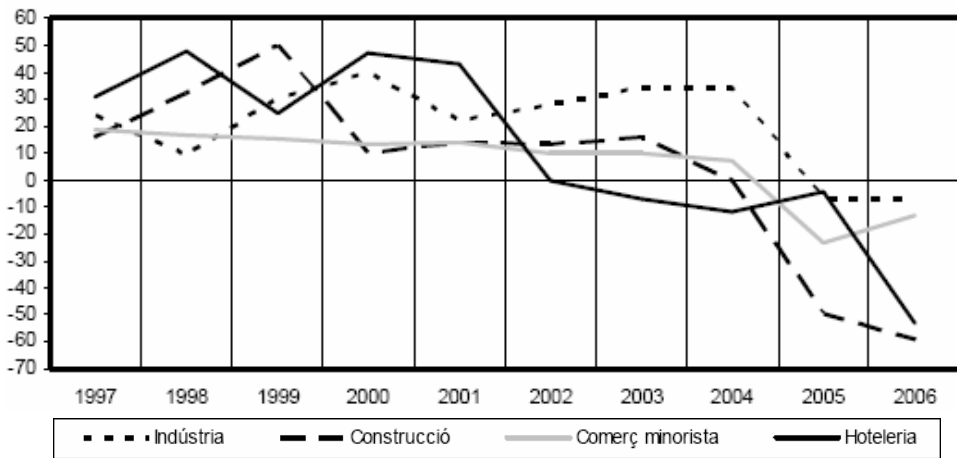
Figure 3. Industry: Confidence indicator



Note: G-J: January-June; J-D: July-December.

Source: Cambra de Comerç Indústria i Serveis d'Andorra, Enquestes de conjuntura Juliol-desembre 2006, p. 7.

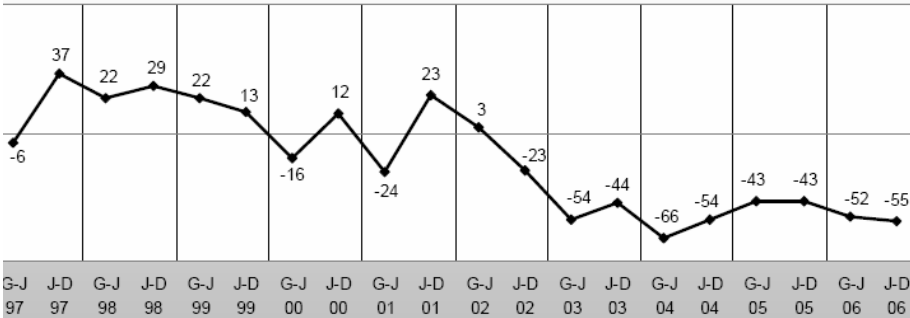
Figure 4. Expected trend of business turnover for the next year



Note: Indústria = Industry; Construcció = Building sector; Comerç minorista = Retail trade; Hoteleria: Hotel sector.

Source: Cambra de Comerç Indústria i Serveis d'Andorra, Enquestes de conjuntura Juliol-desembre 2006, p. 28.

Figure 5. Hotel sector: Employment level compared to the previous year

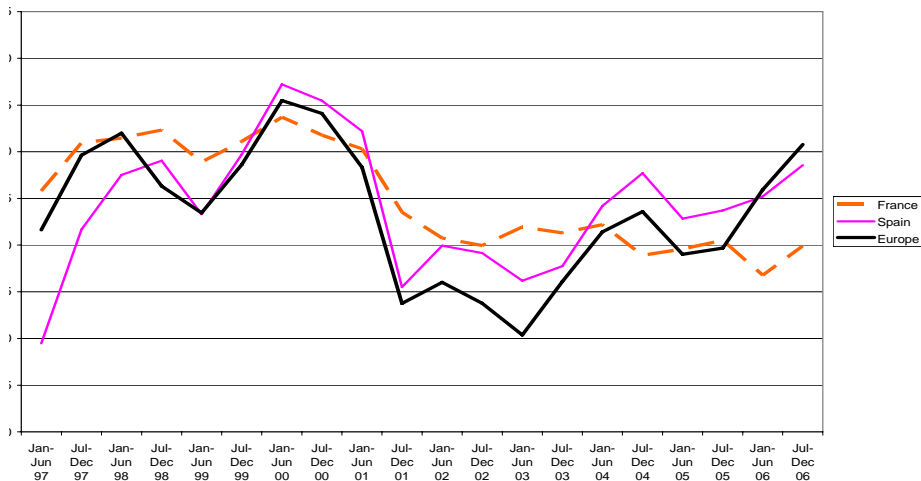


Note: G-J = January- June; J-D = July-December.

Source: Cambra de Comerç Indústria i Serveis d'Andorra, Enquestes de conjuntura Juliol-desembre 2006, p. 13.

It is important to look at these tendencies alongside comparable data for the EU economy, especially France and Spain. Normally the business cycles of the EU member states move together with a high degree of correlation, which of course reflects the high level of mutual economic integration. Andorra is also highly open and integrated with the European economy, but since the turn of the century its business indicators have moved sharply opposite to those for the EU economy, as can be observed in Figure 6.

Figure 6. Economic sentiment indicator: EU, Spain and France



Source: http://ec.europa.eu/economy_finance/indicators/business_consumer_surveys/2007/bcs_2007_05_en.pdf.

The EU began the new millennium at a cyclical low point, but has since been recovering strongly, with rising buoyancy of economic growth and business confidence. During the last five years, therefore there is a story of rising business confidence across the EU and a declining trend in Andorra. This contrast is an important indication concerning whether the adverse trends in Andorra are merely cyclical, thus to last only a few years, or structural and possibly to last indefinitely into the future without major policy reforms; the evidence is suggesting that Andorra is indeed already suffering a structural as well as cyclical recession.

Moreover permanent pressures from the major economic powers at EU and G8 level are crowding in on offshore banking centres and tax havens. These pressures are based on four concerns: risks of financial instability from poorly regulated financial centres, losses of tax revenue because of tax havens, difficulties in combating organised crime at the international level, and finally, the new priority since 9/11/2001, to combat international terrorism and deprive it of financial means of action. We return to these issues in some detail below.

At this stage one has to note that Andorra is facing a tough set of challenges to the status quo, or at least to continuation of the level of prosperity achieved over recent decades: these are a combination of the environmental, conjunctural, structural and systemic.

The Andorran government is of course aware of these factors. The Head of Government, Albert Pintat, observed in his address to the Parliament on 14 June 2007: “The economic conjuncture has ceased to be characterised by a comfortable and east optimism”, and to its credit has embarked on an initiative to address the challenges under its ‘Andorra 2020’ programme. This consists of 20 programmatic priorities for the years ahead to 2020, aimed at securing a renewal of Andorra’s economic comparative advantages and adaptation of its economy to the new challenges.¹⁴ As set out in Box 3, the programme aims at improving the transport infrastructures, developing a more adequate legal environment for business, modernising the tax system, upgrading the tourist sector and developing new service sector business niches.

¹⁴ ‘Andorra 2020 Programme’, Govern d’Andorra, Secretaria d’Estat de l’Agencia Andorra 2020, Andorra La Vella, February 2007.

*Box 3. The 'Andorra 2020' programme***Modernising the economic framework of Andorra**

- 1 Communications & infrastructures plan
 - Road infrastructures, with tunnels and bypasses
 - Road, rail, airport, & heliport connections with France and Spain
- 2 Foreign investments Act
 - Specify protected sectors
 - System of exceptions and open zones
 - Foreign investment Bill submitted in August 2006
- 3 Reinforcement of the legal framework
 - Bills ready: Limited companies, Foreign investment, Business accounting
 - Bills to be prepared: Auditing, Insurance, Commerce, Financial sector
 - Contemplated: Registers, Tax inspectors, Property office
- 4 Tax reform
 - Reform multiple indirect taxes in a general tax (VAT type)
 - Corporate tax bill
 - Double tax agreements
 - Measures to exclude Andorra from list of tax havens
- 5 Employment plan
 - Training and integration of immigrant workers
 - Legal framework

Revitalising tourism and commerce

- 6 Nature improvement plan
 - Cleaning up visual pollution
 - Develop key nature attractions
 - Maintaining livestock farms
 - Develop mountain refuges, improve mountain paths
- 7 Urban improvement plan
- 9 Projection of quality poles
- 10 Valuation of other poles (high quality leisure)
- 11 Trade improvement plan
- 12 Tourist quality plan
- 13 Brand attraction plan
- 14 Tourist promotion campaign
- 15 Creation of the Andorra Tourist Agency

Encouraging the emergence of new sectors

- 16 Business plan competition
- 17 Entrepreneur support network
- 18 New processes to create business
- 19 Innovation financing programme
- 20 Business sectors with potential

Source: Govern d'Andorra, Secretaria d'Estat de l'Agencia Andorra 2020.

A highly ambitious, long-term transport infrastructure plan has been drawn up for road, rail and airports. The alleviation of congestion in road transport is the most advanced, in terms of works underway and planned, with an emphasis on building tunnels through the mountains. A first major tunnel of 2.8 km. connecting with the French border was completed in 2002. In the current period 2003-2008 another major tunnel of 2.9 km is under construction together with bypass roads, costing €123 million. From 2008 to 2015 there will be a further major tunnel of 5.2 km and other bypass roads costing €230 million. From 2015 to 2025 another major tunnel and bypass roads are planned for an estimated cost of €230 million, and from 2025 to 2043 there will be further tunnels and roads costing an estimated €275 million.

While Andorra has at present no airport, there are plans to rehabilitate a disused facility a few kilometres from the Spanish frontier at Seu d'Urgell. This project requires the support on the Spanish side from both Madrid and the Catalan government in Barcelona, and is the subject of ongoing negotiations. There is also a project for a heliport. French and Spanish rail networks pass close by Andorra, but without direct connections, which however Andorra would like to construct.

In 2006 the government proposed three laws, a company law, a law on the accounts of enterprises and a law for limited liberalisation of foreign investment, which are not yet passed by the parliament. These would begin to bring Andorra into line with normal European standards, whereas in the past there was a conspicuous lack of such legislation. With no corporate tax, there was no need for either company law or obligatory accounting standards.

The government has also prepared a plan for the energy sector for 2005-15, which foresees a diversification of energy supplies and an increase in renewable energies to a level of 12% of total energy demand by 2015.¹⁵ It is not the task of the present report to evaluate this programme, but rather to note its orientations and relate them to the options for Andorra's European policy to which we will be turning in detail below.

¹⁵ "Pla Estratègic de l'Energia d'Andorra 2006-2015", Govern d'Andorra, Andorra La Vella, 2006.

We may conclude this chapter with a summary of Andorra's achievements and challenges at the beginning of the new century. In the course of the past half century of 'vertical take-off', Andorra has succeeded convincingly in its political transformation from a quaint historical feature into a modern, European, democratic and internationally recognised state. It was also extraordinarily successful in transforming a poor mountain subsistence economy into one of the world's richest economies on a per capita basis. But now, while the new political structures are very sound and essentially complete, the foundations of its economic prosperity are looking vulnerable. The 'exceptions' that in part drove the economic growth are being eroded. At the same time the relationship with the European Union is both ambiguous yet becoming more intrusive. As we will see below, the options regarding this relationship also relate to the serious economic challenges ahead.

9. Andorra's relationship with the EU so far

9.1 Customs Union Agreement, 1990

The Customs Union Agreement is based on an 'Exchange of Letters' between the European Economic Community and the Principality of Andorra signed on 28 June 1990 and entering into force on 1 July 1991. The agreement establishes a customs union between the EU and Andorra for non-agricultural goods (i.e. chapters 25-97 of the harmonised system trade nomenclature). The agreement was notified to the World Trade Organisation in February 1997, after some debate whether it was compatible with WTO rules, which require that customs unions cover substantially all trade.

The Customs Union means essentially that Andorra applies the EEC's common external tariff for imports from third countries, while trade between the EEC and Andorra is free of customs duties. Agricultural products are subject to import duties, but products with certified Andorran origin are exempt from EEC import duties.

Commercial trade is still subject of course to domestic indirect taxation, namely VAT and excises in importing EU member states, and various indirect taxes imposed in Andorra.

Customs posts and controls at the French and Spanish frontiers are still in place, with queues at times for personal travellers.

Andorran excise duties are generally low by EU standards. For example a typical packet of cigarettes costs €2.0 in Andorra, €3.2 in Spain

and €5.0 in France. Personal travellers are allowed certain franchises for tax-free imports into France and Spain, as indicated in Box 4. These franchises are somewhat more generous than those applied by the EU to imports from other third countries outside the customs union (e.g. 300 cigarettes for Andorra, compared to 200 for other countries; 1.5 litres of alcohol for Andorra compared to 1 litre for other countries; €525 for other goods for Andorra compared to €175 for other countries).

Given the low level of Andorran excises and indirect taxes, the day traveller to Andorra can make some profit, which explains the very large commercial sector servicing the 11 million day visitors per year, 78% of whom are day-trippers who do not spend a night in Andorra. The visitor from France can gain €45 from buying 300 cigarettes in Andorra, and correspondingly more if he uses all the franchises allowed. However if he travels from the nearest urban centre in France, for example Toulouse 200 km away, the journey will hardly be very profitable taking into account the time spent and travel costs, unless he would have been pursuing other tourist attractions at the same time. Coming from Barcelona the benefits will be even less. In general price competition in French and Spanish supermarkets has also been reducing the competitive advantage of Andorran commerce.

Box 4. Tax-free allowances for individual travellers entering the EU from Andorra

Agricultural products

1000 gr. coffee; 200 gr. tea

1.5 lt. of alcoholic drinks; 5 lt. of table wine

300 cigarettes

Up to €150 of other products (milk, butter, cheese, sugar, meat)

Industrial products

75 gr. perfumes

Up to €525 of other industrial goods

In the past tobacco has been a source of friction. The EU wanted tobacco to be included in the Customs Union agreement, but Andorra did not. Andorra grows tobacco and has had a substantial cigarette industry. Tobacco smuggling into neighbouring France and Spain had a long history until quite recently. For many decades small-scale smuggling was a way of life for poor people, who hiked across the mountain frontiers with backpacks of tobacco and cigarettes as a basic source of income. But there was also large-scale industrial contraband. A crisis point was reached in

1997, when Spanish police guarded all the mountain tracks and paths leading into Spain. Andorra took remedial measures, with amendments in 1999 to the law on customs fraud, making smuggling an offence and fixing penalties. The Parliament also adopted a law on control of sensitive goods, as well as making changes to the penal code. This problem is now considered a matter of past history, and the size of the cigarette industry has declined, to the point that one old factory has become a tobacco museum as part of the modern tourist infrastructure.

As part of its anti-money laundering policy the EU introduced in June 2007 a limit of €10,000 in cash amounts that may be carried by persons crossing a frontier into the EU, beyond which declaration is obligatory, with penalties in the case of non-compliance. Andorra has been advised by the Council of Europe's Moneyval programme to introduce a €15,000 limit.

The customs union is generally considered to be functioning well. Although there are always some problems, these are solved in a Joint Committee of Andorra and the European Commission, which meets once a year.

9.2 Agreement on taxation of savings income, 2004

Andorra and the EU signed this agreement on the taxation of savings income on 15 November 2004, as part of major campaign first of all within the EU to curb tax evasion by savers who could place their assets in countries of which they were not resident (see Annex C for the text). The problem was that various 'offshore' financial centres have combined very low or zero taxation on such income with an absence of agreements to share information between fiscal authorities. This resulted in major losses of tax revenue. Within the EU itself Germany suffered very substantial revenue losses through its residents placing savings in Luxembourg. Pressure therefore built up among EU finance ministers to introduce a harmonised withholding tax and/or to have a system of automatic information exchange between fiscal authorities. When these intra-EU negotiations became serious, Luxembourg with support from Belgium and Austria pointed out that if there was compliance with such measures only within the EU the savers could easily transfer their assets to other European financial centres, of which Switzerland was the most important, followed by several offshore financial centres such as Andorra, Monaco and the Channel Islands. Beyond Europe there were other such financial centres, such as in the Caribbean.

Concretely the European Commission adopted in 1997 proposals for a tax package, including a code of conduct to eliminate ‘harmful or potentially harmful’ business tax regimes and for a minimum withholding tax on income from savings. Intense negotiations between member states led to two conclusions.

First, the Council opted for a regime based on the automatic exchange of information between fiscal authorities from 2004, although for a transitional period of seven years up to 2010 three member states (Austria, Belgium and Luxembourg) were authorised to rely on withholding taxes. All newly acceding states were obliged to introduce the regime for automatic exchange of information, with no transitional option. The automatic exchange of information could be combined with a withholding tax, which many countries have chosen to do, but the information exchange element became the primary obligation, subject only to the transitional regime for the three EU member states. Second, the EU’s law would only be passed into effect after comparable measures would be agreed and implemented in five European non-member states (Andorra, Liechtenstein, Monaco, San Marino and Switzerland). In addition EU member states concerned “commit themselves to promote the adoption of the same measures in all dependent or associated territories (the Channel Islands, Isle of Man, and the dependent and associated territories in the Caribbean”.¹⁶

Andorra and the other European non-member states have all basically copied the transitional regime adopted by the EU three (Austria, Belgium and Luxembourg), i.e. a withholding tax accompanied by only a voluntary information exchange regime which individuals can choose instead of a withholding tax.

The main operating provisions of the agreement are:

- Andorra will establish the identity and country of residence of the beneficial owner of the assets.
- It will levy a withholding tax on interest payments of 15% in the first three years, 20% in the following three years, and 35% thereafter.

¹⁶ Conclusions of the European Council meeting at Feira of 19-29 June 2000.

- 75% of the withholding tax revenues will be transferred to the EU country of residence of the beneficiary of the income, with 25% retained by Andorra.
- Individuals may voluntarily opt to disclose information to the tax authorities of his country of residence, and then be exempt from the withholding tax.
- The EU member state of the beneficial owner will ensure elimination of double taxation, by granting a tax credit of the amount of the withholding tax.
- Exchange of information is mandatory where a requesting state (i.e. EU member state or Andorra) has reasonable grounds for suspecting criminal tax fraud.
- The agreement only enters into force on condition that the other states and associated or dependent territories (referred to above) do the same.

The Agreement is marking a number of important points for the future of Andorra's relations with the EU.

This is a first example where the EU virtually imposed its own policy collectively on all of Europe's very small non-member states and entities. From a formal standpoint these were negotiations that led to agreement, yet agreement was reached only because the EU's partners felt the pressure could not be resisted.

The agreement with Andorra and the other European sovereign states is likely to be subject to a request by the EU for re-negotiation when the present transitional period (for the three EU member states) runs out in 2010. It can be expected that the EU will seek agreement for the automatic exchange of information. Switzerland can be expected to lead the opposition, and it remains a matter for speculation how this will turn out. However Gibraltar, Guernsey, Jersey and the Isle of Man have already agreed to automatic information exchange.

Andorra took the occasion of the negotiations over this agreement to make several counter requests: for rights of passage at Schengen frontiers, a Cooperation Agreement (which was agreed on the same day), right to mint euro coins, etc. This is suggesting a dynamic mode of interaction with the EU, whereby if one party presses for an agreement meeting its interests the other party may introduce other unrelated requests for bargaining a wider package. This is a pointer therefore in the direction of multi-sectoral agreements, rather than a model of isolated ad hoc agreements

9.3 The Cooperation Agreement, 2004

This agreement was signed at the same time as that on the taxation of savings, and was the result of requests from Andorra for more positive measures, bearing in mind the costs for it of the taxation agreement. It was hoped that the Cooperation Agreement would open up a wide range of activities, as can be seen from its several chapter headings:

(a) *Environment*. Andorra will endeavour to adopt environmental standards equivalent to those of the EU. There is in fact a process of aligning new laws and regulations on EU standards. The agreement foresees a study on the feasibility of opening EC environmental programmes for Andorran participation, and cooperation with the European Environment Agency. The specific issue of transfer and disposal of Andorran waste is mentioned, which is a problem for Spain.

(b) *Communication, information and culture*. It is agreed to undertake joint projects in this area, with specific reference to Pyrenean architectural and cultural heritage and the Catalan language. One idea is for a cross-border project in relation to Romanesque architectural monuments, where Andorra shares a fine endowment alongside neighbouring regions.

(c) *Education, vocational training and youth*. It was agreed to study the feasibility of Andorra participating in EC programmes in this field, but this had not yet materialised. Andorra is not officially part of the important Erasmus programme for exchange studies of university students. However in practice Andorran students in French and Spanish universities are able to participate in Erasmus projects on a personal basis.

(d) *Social and health issues*. There is a provision to avoid discrimination against workers on grounds of nationality. However there is no mention for Andorra to converge on EC labour market and social policy *acquis*.

(e) *Trans-European networks and transport*. It is intended to study projects of common interest, and there is concrete Andorran interest establishing a joint airport at Seu d'Urgell, and railway connections on the French side. These ideas are not yet operational, and depend on decisions on the Spanish and French sides.

(f) *Regional policy*. The parties agreed to step up cross-border, transnational and inter-regional cooperation. The specific idea is mentioned of promoting a cross-border regional project for the Pyrenees comparable to that developed in the Alps. Subsequent to the signing of the Cooperation Agreement in 2004, the new regulations for the European Regional

Development Fund for 2007-2013 include an article of potential interest to Andorra regarding cross-border cooperation, including regions of third countries.

The relevant article reads:

In the context of cross-border, transnational and interregional cooperation, the ERDF may finance expenditure incurred in implementing operations or parts of operations on the territory of countries outside the European Community up to a limit of 10% of the amount of its contribution to the operating programme concerned and where they are for the benefit of the regions of the Community.¹⁷

Thus Andorra, as a third country, could participate in cross-border programmes sponsored by the Pyrenean regions of France and Spain if these two member states agreed this to be beneficial, with a maximum of 10% of the programme spent in Andorra without an Andorran financial contribution. There are also cases of projects where non-member states join in cross-border Regional Fund projects, but make agreements with the EU to pay themselves for the expenditures in their country, while the Regional Fund finances the part of the project within the EU regions (Sweden-Norway, France-Switzerland). Where the non-member states are rich, it is not to be expected that use of the 10% provision will be agreed on a large scale, but that negotiations would take place over specific contributions by the third country.

There is in fact a regional organisation capable of advancing projects of the highest interest to Andorra, the Communauté de Travail des Pyrénées (CTP). Andorra is a member of the CTP, although not yet a member of its operational Consortium, which has been formed to manage projects operationally and to secure funding (see Box 5). The CTP's domains of interest largely coincide with the sectoral chapters of Cooperation Agreement. This suggests that in the course of the EU's current financial period 2007-2013 there could be activation of various chapters of the Cooperation Agreement through cross-border regional projects, e.g. for infrastructures, environment, culture, health, etc. The priorities for Pyrenean cross-border cooperation for the period 2007-2013 were presented to the European Commission in June 2007, with multiple

¹⁷ Article 21.3 of Regulation (EC) No 1080/2006 on the European Regional Development Fund, O.J. L210, 31 July 2006.

projects concerning transport infrastructures, research for SMEs, IT technologies, renewable energies, environmental projects, labour market and human capital formation measures.

In 2005 the CTP created a Consortium, which has legal personality, and competence to manage projects that could be funded by the EU and the governments of participating states. For the time being Andorra is not a member of this consortium for various formal legal reasons, but a solution is currently being sought to allow this.

Box 5. Communauté de Travail des Pyrénées (CTP)

The CTP has eight participating territories:

- Andorra
- French regions of Aquitaine, Midi-Pyrénées and Languedoc-Roussillon
- Spanish regions of Aragon, Catalonia, Euskadi (Basque) and Navarra

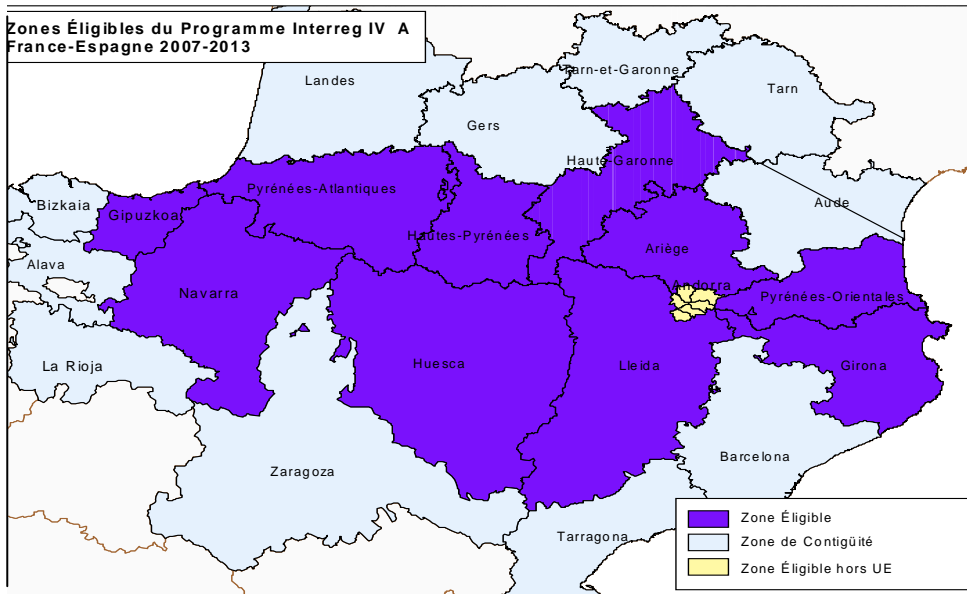
The organisation was initiated in 1983, and now has a structure consisting of a leadership, a secretariat (provided by Catalonia) and four sectoral commissions for:

- Infrastructure and transport
- Training and technological development
- Culture Youth and Sport
- Sustainable development.

(g) *Institutional provisions.* The agreement is administered by a Cooperation Committee, composed of a high official of the European Commission and the Foreign Minister of Andorra, with alternating chairmanship. The Cooperation Committee meets annually. The agreement runs for an unlimited period. Disputes over implementation of the agreement are to be submitted to the Committee, but none have arisen so far.

In general the Cooperation Agreement, while functioning correctly from a formal and procedural standpoint, is considered to have been disappointing on the Andorran side. The European Commission remarks that Andorra might come up with proposals. The agreement established a quite extensive possible agenda, but with no directly operational or binding content. The several chapter headings have seen little activity develop as a result.

Map 2. Andorra & the Pyrenean regions of France & Spain



Source: http://go.hrw.com/atlas/norm_map/andorra.gif

9.4 Towards an Andorran euro

Before the euro, both the French franc and Spanish peseta were used in Andorra. The euro became the new currency of Andorra from the time that the franc and peseta were withdrawn on 1 January 2002.

Andorra does not yet mint its own Andorran euro, unlike Monaco, San Marino and the Vatican. Andorra has entered into discussions with the European Commission with a view to making a monetary agreement with the EU for coining euro and other monetary policy issues. These discussions are not yet at a conclusive stage. However the other three cases that have seen monetary agreements provide information on possible conditions for Andorra and the EU also to reach agreement.¹⁸

¹⁸ See “Monetary and exchange-rate agreements between the European Community and Third Countries”, Baudoin Lamine, European Commission, Economic Papers No. 255, September 2006.

In all three cases (Monaco, San Marino and the Vatican) the euro is the official currency with legal tender status granted to all euro banknotes and coins (i.e. including euro coin minted by other states). They shall not issue any banknotes, coins or surrogates unless on conditions agreed with the EU.

Coins may be minted for maximum face value annually of €1 million in the case of the Vatican, €1,944,000 for San Marino, and for Monaco 1/500th of the quantity minted by the Banque of France. Euro collector coins may also be produced but their face value is to be included in the amounts indicated, and these coins shall not be legal tender.

Regulatory requirements include in all cases the application of Community rules applicable to euro banknotes and coins. The three states agree to cooperate with the EC on measures against counterfeiting, and to suppress and punish counterfeiting in their territories.

Further provisions applicable only to Monaco are of likely interest to Andorra, since both states have banking and financial sectors of significance. Monaco shall apply the measures adopted by France to implement EC acts regulating credit institutions and payment and security settlement systems; and also measures equivalent to EC member states regarding investment compensation schemes, and the EC's money laundering directive.¹⁹

The three states also have access to the payments system of the euro area, in Monaco on the same conditions as for financial institutions located in France, and in the case of San Marino and the Vatican on conditions determined by the Banca d'Italia and the European Central Bank.

The Andorran Ministry of Finance intends to re-launch discussion with the European Commission after they have progressed with five pieces of legislation, which will prepare the ground in terms of Andorra's

¹⁹ The set of regulatory requirements, in which EU/EC legislation has been transposed into the law of Monaco covers monetary operations, minimum reserves, other monetary instruments, penalties/sanctions, statistics, credit institutions (activity, monitoring and prudential supervision), investment services regulation, payments and settlement systems, prevention of systemic risks in payment and settlement systems, the fight against fraud and money laundering. See Lamine, *ibid.*

regulatory policies regarding various types of financial institutions and instruments.²⁰

Overall the possible way ahead seems to be quite clearly marked out. Andorra could well make a monetary agreement with the EC in due course, with benefits from the minting of coins and access to the euro payments system, on conditions that would bring Andorra's regulation of financial institutions into line with established euro-area standards.

9.5 Schengen cooperation and the European area of Freedom, Security and Justice

Given its virtually open frontiers with France and Spain, and no airport, Andorra is *de facto* part of the Schengen space. No citizen of a non-EU state can enter Andorra without first satisfying the Schengen visa requirements, if any, applied by France and Spain. In these circumstances Andorra issues no visas of any kind. Third country nationals wishing to visit Andorra need a multi-entry Schengen visa, since to leave Andorra they must enter a second time into the Schengen space.

According to a Convention adopted by Andorra, France and Spain in 2000,²¹ Andorra agreed to coordinate its visa policy with that of the Schengen area. However this remains a theoretical provision with Andorra retaining the right to impose visa requirements on non-EU citizens, but not so far making use of it.

Andorra has been concerned by its citizens encountering delays by being required to pass through the 'rest of the world' corridor at EU external border crossings, rather than being able to use the privileged corridor reserved for EU, EEA and Swiss citizens. In 2004 the EU agreed to meet Andorra's concern, and now allows that "citizens of Andorra and San

²⁰ These concern laws on minimum capital requirements for financial investment entities and for non-banking financial/credit entities, on regulation of collective investment organisms, asset management activity and the creation of new non-banking financial/credit entities.

²¹ *Convention entre la République française, le Royaume d'Espagne et la Principauté d'Andorre relative à la circulation et au séjour en Principauté d'Andorre des ressortissants des États Tiers*, 4 décembre 2000.

Marino may use EU corridors at external borders of the member states applying the relevant provisions of the Schengen acquis".²²

However the same document underlined that any relaxation of border checks going beyond the above approach would have to be "subject to the conclusion with Andorra and San Marino of an agreement on the free movement of citizens, as is the case for the EEA countries and Switzerland".

The EU position is thus that the EEA states and Switzerland have entered into much more far-reaching commitments with the EU than Andorra regarding the free movement of persons and the conditions for foreign workers on the Andorran labour market.

If the project to build a joint airport at Seu d'Urgell close to the Andorran frontier goes ahead, there could be issues of arranging a special access corridor into Andorra, rather like Basle and Geneva airports shared by France and Switzerland. This would require a specific agreement related to Schengen rules, but the project itself is still a long way off a decision point on the Spanish side.

For the EU the Schengen system is part of a much vaster agenda for the Common Area of Freedom, Security and Justice, which has been the fastest growing field of EU legislation in recent years. The priorities set out by the European Commission for the five years from 2005 may be summarised as follows:²³

- Monitoring and promoting respect for the fundamental rights of people, and enhancing European citizenship;
- Fighting against terrorism in the global context;
- Establishing a common asylum area, with harmonised procedures in accordance with the EU's values;

²² Note of the Council Presidency to the Working party on Frontiers on the subject of Andorra and San Marino, 13020/1/04, Rev 1, 6 October 2004.

²³ European Commission, Communication on The Hague programme: Ten priorities for the next five years. The partnership for European renewal in the field of freedom, security and justice, COM(2005)184 final, 10 December 2005. See also T. Balzacq and S. Carrera, *Migration, Borders and Asylum – Trends and Vulnerabilities in EU Policy*, CEPS, 2005.

- Defining a balanced approach to migration, maximising the positive impact of legal migration, and with strengthened measures against illegal migration, smuggling and trafficking in human beings;
- Developing an integrated management of the external borders of the Union, with a common visa regime, while ensuring the free movement of peoples;
- Striking the right balance between safeguarding privacy and sharing information among law enforcement and judicial authorities;
- Developing a strategic concept for combating organised crime and
- Guaranteeing a European area of justice, building mutual trust and mutual recognition in judicial cooperation.

This long list of objectives is not going to be achieved overnight, and indeed the agenda will need more than five years. However the scale of these activities in the linked fields of border and migration management, crime prevention and the fight against global terrorism represents a fundamental development for the European project, ultimately on a scale comparable in political importance to the economic and monetary union. Given Andorra's virtually open borders with the EU, there will be the closest attention paid to ensuring that Andorra is not in any way a haven for any of the several categories of illegal activity – be it illegal migration, crime or terrorism. This whole area therefore presents an inevitable agenda for deep cooperation between Andorra and the EU in the years to come.

9.6 Political dialogue

Andorra, as a member state of the UN, OSCE and Council of Europe, has a voice and vote in these organisations. Its foreign minister wishes to have adequate means to discuss with EU opposite numbers foreign policy issues of common concern. The EU has a system for associating certain neighbouring states with the declarations on foreign policy issues regularly made by the Council of foreign ministers. The countries concerned at present are the candidate states, other Balkan countries, and certain Eastern European neighbours such as Ukraine. The procedure for this is that after Council meetings at which declarations have been adopted, the texts are circulated to the agreed list of neighbouring countries, which have a short period to indicate whether they wish to be associated or not with each specific declaration. No formal procedures of this kind have been made with Andorra so far.

10. How exceptional is Andorra?

In 2005 a report was prepared for the Andorran Head of Government by Michel Camdessus.²⁴ This report addressed the ways in which Andorra was still an exception in relation to the predominant European norms of economic and monetary policy, and asked in what degree these exceptions might be sustained in the future, concluding with recommendations that Andorra should aim at the paradigm of the 'exemplary' rather than the 'exceptional'.

Such issues are highly relevant to the present report in addressing the future relations between Andorra and the EU. For any state to be very closely integrated with the EU, be it full membership or something close to that, there arises the question whether its laws and policies are compatible with those of the EU; or in Brussels terminology whether they are consistent with the *acquis communautaire*. To the extent that the neighbouring state's laws and policies are not compatible, the state has to assess the costs and benefits of remaining non-compatible. Such an assessment has to include whether the 'exceptions' are in any case sustainable in the light of underlying developments in the world economy and the realities of European integration. Or, put in another way, it may be asked whether the optimal degree of 'exception' for the state in question may be changing over time as a function of factors that are beyond its control.

Of course a non-member state has no general obligation to make itself compatible with the EU *acquis communautaire*. All options are open in principle to the independent sovereign state. Moreover the EU never takes the initiative to request or even invite non-member states to apply for membership; it even tends more to the contrary position of discouraging applications, being worried about the institutional problems posed by the continuously expanding membership.

In the present context there are four sets of Andorran 'exceptions' to be considered, which concern taxation and the public finances, the regulation of financial market, and the free movement of capital and labour.

²⁴ M. Camdessus, *L'Andorre: des 'exceptions' à l'exemplarité*, Paris, 2005.

10.1 Taxation & public services

Andorra remains a very low tax state, with zero direct personal income tax and zero direct corporate income tax. Its total tax burden is 18.6% of GDP or well under half the EU average. The lowest tax burdens within the EU are seen in Latvia (28.7%) and Ireland (31.2%).

There is no harmonisation of personal income tax in the EU. It has no legal basis to influence the personal income tax, and there seem to be little or no prospects of this changing. Such steps would require unanimity of all member states, which today is virtually inconceivable.

Table 8. General government tax revenues as % GDP

Country	% of GDP
Andorra	18.6
EU-25	41.5
France	45.7
Spain	36.5
Ireland	31.2
Malta	34.2
Latvia	28.7

Source: Standard & Poors, A Survey of Credit Ratings on Small European Sovereigns, October 2005 (Andorran data for 2002); Eurostat, Statistics in Focus – Tax revenues in EU Member States, No 3/2005 (EU data for 2003).

The situation for corporate taxes is more complicated. There is no harmonisation of corporate tax so far, but there are proposals being prepared by the Commission for a harmonisation of the corporate tax base, without harmonising tax rates. This proposal is opposed by some member states, which leads to another idea that a group of member states, acting under the ‘reinforced cooperation procedure’ of the treaties, might adopt a harmonised tax base, for example the members of the eurozone. Many independent economists have sympathy for this proposal, since it would lower the cost of accounting for companies with multinational operations in Europe and provide for greater transparency for companies assessing different investment locations.²⁵

²⁵ See M. Gammie et al., *Achieving a Common Consolidated Corporate Tax Base in the EU*, CEPS, 2005.

However the EU is already active on the question of corporate tax rates, out of concern for fair conditions of competition. Ireland had for many years a regime of very long corporate tax grace periods for new investments. The Commission put pressure on Ireland to levy a significant corporate tax in order to ensure something of a level playing field from the standpoint of competition for investment. Ireland now has a regular corporate tax of 12.5%. Cyprus has acceded to the EU with a 10% corporate tax, which is now the lowest rate in the EU. Estonia has an unusual corporate tax system, with a zero rate for retained earnings, but a 26% tax on distributed dividends. However this system is the subject of concern for the EU on grounds of breaching competition policy rules, and is the subject of ongoing discussions between Estonia and the Commission. In general there are serious competitive pressures in the direction of driving down corporate tax rates, led by some of the new member states, and followed by some Balkan non-member states such as Montenegro (9%). Overall one can say that the EU has more or less established 10% as a minimum corporate tax rate standard, even if this has not been explicitly legislated.

The government of Andorra is preparing legislation to introduce a corporate tax, for which it might choose a rate similar to the minimum already seen in the EU, such as in Cyprus and Ireland; in which case this Andorran 'exception' will be eliminated.

The EU has adopted legislation on the taxation of income from savings. At the insistence of Luxembourg, with support from Austria and Belgium, the conclusion of the savings directive became politically dependent on reaching agreement with European non-member states specialising in low tax offshore financial centres. This led to the 2004 agreement with Andorra, which eases a further 'exception', but we must return to this in more detail below.

The EU has long had a harmonised value-added tax, and this system has become a general standard throughout Europe. The government of Andorra prepares an indirect tax reform, under which the present set of multiple indirect taxes would be rationalised in a single consolidated system, but it is not yet evident whether this would be an EU-type value-added tax. The EU has established minimum harmonised rates of 15% for the standard rate, 5% for a reduced rate, and in addition some member states have agreements to apply a zero rate for some commodities.

The EU has also established harmonised minimum rates of excise duties for tobacco, alcohol and petrol. For cigarettes the combination of

excise duties and VAT should not be less than 57% of the retail selling price; for petrol the minimum is €421 per thousand litres; and for the minimum for alcohol is €550 per hundred litres of pure alcohol. Andorra's rates for cigarettes and alcohol are notably lower.

The absence so far of any direct taxation has led France and Spain to levy severe fiscal penalties against Andorra's service-sector suppliers, corporate or individual persons, who invoice from Andorra services supplied to French or Spanish clients. The penalties amount to 33% of the invoiced amount in France and 25% in Spain, and thus make it extremely difficult for Andorrans to be competitive. This is a serious problem in relation to the important objective of the Andorran government to develop new service sector activities, as set out in the 'Andorra 2020' programme. The Andorran head of government indicated in his speech of 14 June 2007 that an objective of the proposed tax reforms was to persuade the French and Spanish governments to lift these penalties.

There is also the broader political question how the EU may view a very low tax neighbour. On several accounts there can be no objections. For example there can be no objections to Andorra's low tax burden because it does not need or want to have expensive military forces, or because it may function with a very lean public administration. However other features cause more concern, principally the loss of tax revenue through the use of offshore tax haven facilities. Also in the case of Andorra the extreme flexibility of the Andorran labour market, without an unemployment benefit scheme, prompts the concern that it tends to export to the countries supplying migrant labour the burden of social assistance when labour demand weakens.

The EU is working with the international community on policies towards low tax jurisdictions, as in the case of the OECD which has established a Forum on Harmful Tax Practices. This work does not seek to dictate to any country what its tax rates should be, but to support fair tax competition, so as to minimise tax induced distortions of financial flows and investment. The OECD member states agreed in 1998 to act collectively to eliminate harmful tax regimes within the OECD area. It published its definition of harmful tax practices under four main categories:

- Zero or low effective tax rates
- Lack of transparency
- Lack of effective exchange of information and
- Preferential tax regimes for offshore activities insulated ('ring-fenced') from the domestic economy.

In 2000 the OECD's Committee on Fiscal Affairs applied these criteria in detail to all OECD member states (but not to non-member states such as Andorra) and identified 47 preferential tax regimes in categories considered potentially harmful (insurance, financing and leasing, fund managers, banking, headquarter regimes, distribution centre regimes, service centre regimes). To give an indication of actual trends in policies, in its 2004 Progress Report on harmful tax practices the OECD noted that of the 47 cases initially identified, 18 had been or were being abolished, 14 had been amended to eliminate harmful features and 13 were found upon further analysis not to be harmful.²⁶

The OECD has also since 2000 extended its work beyond its member states, in establishing its 'Global Forum on Taxation'. This involves analysis of the tax policies of 82 jurisdictions world-wide. 'Participating Partner' states and entities have committed themselves to the principles of effective exchange of information and transparency. These 'cooperative' non-OECD member states and entities number 33 in all, and in Europe included Cyprus, Gibraltar, Guernsey, Jersey, Isle of Man, Malta and San Marino; but not Andorra. A number of these 'Participating Partners' of the OECD worked together to develop a *Model Agreement on Exchange of Information on Tax Matters*.²⁷ The Model Agreement covers information exchange for both civil and criminal tax matters. Parties adopting the Model Agreement must provide information requested even if the country receiving the request does not need the information for its own tax purposes. They must further have the authority to obtain information held by banks and other financial institutions.

The OECD Committee of Fiscal Affairs has published since 2000 "*List(s) of Uncooperative Tax Havens*",²⁸ which are those states and entities which have declined the invitation to join the OECD Global Forum on Taxation, or to make commitments for the exchange of information and transparency. Andorra has neither joined in this OECD Forum nor subscribed to the Model Agreement. The list of 'uncooperative tax havens' identified by the OECD has become shorter over time, and currently

²⁶ "The OECD's Project of Harmful Tax Practices: the 2004 Progress Report", OECD, 2004.

²⁷ Available at <http://www.oecd.org/ctp>

²⁸ Published at www.oecd.org

consists of three jurisdictions: Andorra, Liechtenstein and Monaco. The OECD indicates that it would welcome dialogue with these jurisdictions and the prospect of their accession to the Model Agreement.

The OECD's most recent report on tax cooperation, of 2006, includes comprehensive information on all 82 states and entities, listing compliance or non-compliance with elements in the Model Tax Agreement.²⁹ Of the 82 jurisdictions reviewed, Andorra is one of 11 that have no tax information agreements (i.e. either double tax agreements, or tax information exchange agreements). Of the same 82 jurisdictions, Andorra is one of only four that apply the principle of dual incrimination (in both requesting and requested country) to admit information exchange on tax matters.

Table 9. OECD criteria for transparency and information exchange in tax matters

	Andorra	Other 82 countries/ entities
A. Exchanging information on taxation		
A.1 Number of Double Taxation Conventions and Tax Information Exchange Agreements	Zero	10 of 82 countries/entities have no such agreements
A.3 Application of dual criminality principle	Yes	4 of 82 countries/entities apply this principle
B. Access to bank information		
B.1 Bank secrecy reinforced by statute	Yes	60 out of 82 reinforce bank secrecy
C. Access to ownership, identity and accounting information		
C.2 Statutory confidentiality provisions restricting disclosure	Yes	30 out of 82 restrict disclosure
D. Availability of ownership, identity and accounting information		
D.1 Domestic trust law	No	53 out of 82 have such laws

Source: OECD, 2006, op. cit. See Annex G below for a complete listing of the OECD criteria.

²⁹ OECD, *Tax Cooperation – towards a level playing field. 2006 Assessment by the Global Forum on Taxation.*

As Table 9 shows, on other accounts Andorra has much more company, such as over the reinforcement of bank secrecy and confidentiality provisions. Moreover Andorra has no domestic trust law, which in many offshore jurisdictions provides the legal basis for controversial transactions.

Overall one can say that Andorra is preparing several steps in the direction of reducing or in some cases eliminating Andorra's fiscal 'exceptions', but there is likely to be continuing external pressures for a higher degree of conformity with European and international standards. However these pressures will not go as far as preventing Andorra from remaining a low tax jurisdiction.

It is evident that there is considerable momentum behind the international community's efforts to curb harmful tax practices, including the issue of information exchange. Many low tax jurisdictions, beyond OECD member states, have joined in the work of the OECD's Global Forum on Taxation. It can only be expected that the number of OECD designated 'uncooperative tax havens' will get smaller, and the pressures on those few remaining will increase.

10.2 Financial services

Andorra has developed a substantial offshore banking sector. In recent years the international community has become increasingly concerned with offshore financial centres, seeking to bring them into closer compliance with the standards of major world financial markets. There have been multiple initiatives, decided at the highest level, involving all the major international organisations and forums (G-7 Summits, IMF, OECD, EU, Council of Europe, Bank for International Settlements), which set the external environment in relation to which Andorra has to define its future policies.

The Financial Stability Forum (FSF) was established by the supervisory authorities of mainly OECD countries in 1999, with the aim of strengthening international financial supervisory standards. It has a base at the Bank for International Settlements in Basle. It has created a Working Group on Offshore Financial Centres, intended to help offshore financial centres come into line with international standards of regulation, supervision, disclosure and information-sharing. Following endorsement by the G-7 at their Okinawa Summit meeting in July 2000, the IMF was tasked with monitoring this process.

As a result the IMF has conducted two detailed reviews of Andorra's financial markets, the second published in February 2007.³⁰ The banking sector was summarised as in Table 10.

Table 10. Andorra: Banking system ownership structure, as of December 2005 (millions of euro)

Banks by Controlling Shareholder	Assets	Percent of Total	Deposits	Percent of Total	Capital	Percent of Total	Employees	Percent of Total
Majority Andorran	6,273	55.4	5,211	56.1	701	52.6	664	57.7
Andbanc	2,084	18.4	1,648	17.7	333	25.0	283	24.6
Banc Internacional 1/	2,189	19.3	1,820	19.6	203	15.2	227	19.7
Banca Mora 2/	1,123	9.9	996	10.7	100	7.5	–	–
Banca Privada d'Andorra	877	7.7	747	8.0	66	4.9	154	13.4
With Spanish participation	5,055	44.6	4,078	43.9	631	47.4	486	42.3
CaixaBank	1,022	9.0	819	8.8	142	10.6	126	11.0
Credit Andorra	3,578	31.6	2,858	30.8	459	34.5	284	24.7
Banc Sabadell	455	4.0	402	4.3	30	2.3	76	6.6
Total banking system	11,328	100.0	9,289	100.0	1,333	100.0	1,150	100.0

Source: Institut Nacional Andorrà de Finances.

1/ Banc Internacional has majority Andorra ownership since March 2006.

2/ Banca Mora is fully owned by Banc Internacional and information on employees corresponds to the total for both banks.

The data relate to 2005, but there have been some important changes in bank ownership, with the two main sources of Spanish participation sold in 2006 to Andorran interests. The financial services sector has grown to 15% of GDP and employs 1,523 persons (3.6% of all employment). This is also the highest paid sector in the economy, with salaries above twice the national average.³¹ The financial system consists of 7 banks, 1 specialised credit institution, 7 collective investment entities, 4 wealth management companies and 28 insurance companies, 15 of which are branches of foreign insurance companies. Total bank assets and deposits amounted in 2005 to €11.3 and €9.3 billion, respectively. About €2.7 billion of loans were extended to non-residents.

³⁰ IMF, *Andorra – Assessment of the Supervision and Regulation of the Financial Sector*, August 2002 (first report), February 2007 (second report), Washington, D.C.

³¹ International Monetary Fund, *Andorra – Assessment of Financial Sector Supervision and Regulation*, staff paper, 5 February 2007.

The banks are highly profitable, capitalised and liquid, and according to the IMF “far above” the minimum requirements of the standard (Basel I) prudential requirements.³² For the banking system as a whole the capital adequacy ratio (minimum capital to risk weighted assets) was 28.8% in 2005, compared to the 10% minimum. The ratio of liquid assets in relation to short-term liabilities was 66.2% compared to the minimum 40% required.

Comparison may be made between statistics of bank deposits per capita of Andorra and relevant countries, as in Table 11. Although data on non-resident bank deposits in Andorra are not so far available, Andorra has evidently developed a significant offshore banking business, with deposits per capita about six times the levels found in France and Spain. However, its score is relatively modest by comparison with Liechtenstein (4 times higher still), Monaco (12 times higher) and Jersey (20 times higher).

Table 11. Bank deposits per capita in Andorra and six other jurisdictions

	Bank deposits (millions of euro)	Population	Bank deposits per capita resident population (euro)
France 2005	1,225,577	60, 500,000	20,257
Spain 2005	976,176	43,060,000	22,670
Switzerland 2005	320,213	7,250,000	44,137
Andorra 2005	9,289	75,000	123,853
Liechtenstein 2001	19,300	32,491	594,010
Monaco 2005	19,780	29,972	659,949
Jersey 2002	210,618	85,200	2,472,044

The financial sector is supervised by the Institut Nacional Andorra de Finances (INAF), which is an independent public body established in 1993. The legal environment has been under constant development since then, with new draft laws pending on company establishment, accounting, auditing, fiduciary and prudential duties, business conduct and market disclosure and supervision.

While the IMF recognises Andorra’s high level of compliance with the basic international (Basel I) standards, its reports contain detailed

³² Ibid.

proposals for further improvements.³³ For example it is recommended that INAF have greater powers, independent of the government, to undertake all types of remedial action, including suspension of bank licenses. The staff of INAF needs to be strengthened. A formal agreement on cooperation with the banking authorities of Spain is desirable. Accounting standards need revision to be brought into line with International Financial Reporting Standards (IFRS), as used in all major European financial centres. Details of the IMF's recommendations, together with the responses of the Andorran authorities, are given in Annex G below.

The life insurance sector in Andorra has grown with a big jump in gross premiums in 2005 to €1,758 million, from only €61 million in 2004. This was due to the beginning of the retention by Andorra of EU taxes on income from savings. As a result there was a tendency for EU customers of Andorran banks to move into other financial instruments not covered by the EU directive. This is illustrating the difficulty of partial attempts to regulate and tax financial markets, and suggests that there may be more extensive requests put by the EU in due course. The IMF notes the need for proper regulation of Andorra's insurance sector, which should be supervised by INAF.³⁴ The EU in 2007 has adopted new proposals for risk-based regulatory standards, known as 'Solvency II', intended to set an international benchmark for regulation of the insurance sector.

The EU is engaged in a huge programme of harmonisation and integration of its entire range of financial markets. Its Financial Services Action Plan (FSAP) was initiated in 1999, with proposals for 42 measures, with the following broad characteristics:

- Accounting and auditing, 6 measures, 2 of which are legislative
- Banking and financial conglomerates, 3 measures, all legislative
- Company law and corporate governance, 3 measures, 1 of which is legislative
- Financial markets infrastructure, 3 measures 1 of which is legislative
- Insurance and pensions, 6 measures, 4 of which are legislative
- Securities markets, 1 legislative
- Retail financial services and payments, 8 measures, 2 of which are legislative
- Securities and investment funds, 7 measures, 5 of which are legislative

³³ Ibid.

³⁴ Ibid.

- Taxation, 1 legislative.

By 2005 this programme was 98% adopted by the legislative or policy-making institutions of the EU. Of the measures 24 are directives, meaning that the member states have to proceed with their transposition into national implementing regulations, which as of today remains work in progress. The EEA member states (Liechtenstein, Iceland and Norway) are also implementing this programme in full, as also Guernsey, Gibraltar, Jersey and the Isle of Man.

A further initiative relevant to Andorra, given its use of the euro as its currency, is the EU's proposed Payments Services Directive, which will lay the foundation for the Single European Payments Area. This will create a single market for electronic payments, including credit transfers and direct debit and card payments. It is intended to make cross-border payments as easy as national transactions, and also to intensify competition among banks and non-banking institutions to enhance quality and reduce costs. This Single European Payments Area will add a certain number of further regulatory requirements. Liechtenstein and Monaco are already preparing to join this initiative.

The Financial Action Task Force (FATF) on Money Laundering was set up by the G-7 Summit at its meeting in Paris in 1989. It is serviced by a unit in the OECD, and published 40 recommendations in 1990, which have become the international benchmark for money laundering legislation. The FATF established four regional groups, with Europe entrusted to the 'Moneyval' committee of the Council of Europe, and which is concerned with anti-money laundering (AML) and combating the financing of terrorism (CFT). Moneyval has undertaken three evaluations of Andorra.³⁵ The first report in 1999 expressed a positive overall impression concerning Andorra's anti-money laundering regime, but noted concerns over the bank secrecy law which restricts responses to foreign authorities' requests for information and allows the existence of numbered bank accounts. Furthermore, it was noted that there were no provisions sanctioning failure to declare suspicions as criminal offences. The second report in 2002

³⁵ Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures, "First Evaluation Report on the Principality of Andorra", Council of Europe, 18 June 1999; "Report of the Second Cycle of Evaluation of the Principality of Andorra", 13 December 2002.

welcomed progress made since the first report, for example legislation requiring the identification of clients and adopting a more open definition of suspicion. The report recommended measures concerning cash operations exceeding €15,000. It remained concerned by the continued use of numbered bank accounts, and noted that only two cases of money laundering had been subject to condemnations, due to an excessively strict burden of proof. The third evaluation is in the course of being completed in 2007. On the basis of preliminary results the IMF reported that progress was continuing, with need still for further improvements.³⁶

The EU's current directive on prevention of money laundering and terrorist financing was adopted in October 2005. The importance attached to this is evidenced by the directive's first recital: "Massive flows of dirty money can damage the stability of the financial sector and threaten the single market, and terrorism shakes the very foundations of our society." The directive requires member states to forward information regarding suspected money laundering or terrorist financing to other member states concerned.

Overall Andorra is steadily moving towards fuller conformity with international standards, while the official international bodies concerned are keeping all offshore financial centres under systematic, regular and detailed surveillance. At the same time the pace of regulatory reform at the European and global levels is accelerating. It has to be expected that Andorra's degrees of 'exception' in the areas of supervision of financial institutions will be under increasing pressure, from market pressures as well as official policies, to converge on European and/or international standards.

10.3 Capital movements

Foreign direct investment in Andorra remains until now severely restricted, with maximum participation in Andorran companies limited to 33% in all sectors with the exception of banking. A new law 'On foreign investment in the Principality of Andorra' proposes to liberalise the regime for foreign investment to a significant degree, from a very restrictive starting point. This legislation has been before the parliament for a year without yet being adopted. The proposal is to distinguish three categories

³⁶ IMF, 2007, op. cit.

of foreign investment: direct investment, portfolio investment and real estate investment.

For direct investment the sectors of the economy would be divided into three groups:

- sectors for which foreign investment is free and subject only to ex-post declaration to the government;
- sectors where authorisation is required for share capital participation that would exceed 50%; and
- sectors for which authorisation is required in any case.

The free sectors would be mainly manufacturing industries and some service sectors like consulting and management.

The sectors for which participation over 50% would require authorisation include tobacco, construction, wholesale and retail commerce, sale and servicing of automobiles, hotels, restaurants, banking and financial enterprises, real estate and insurance agencies.

The sectors requiring authorisation in any case would include agriculture, silviculture, aquaculture and energy production.

It can be noted that the second category, requiring authorisation for participation over 50% account for most of the important sectors of the Andorran economy in tourism, real estate and financial activities. The third category requiring authorisation in any case includes the important hydro-electric sector. The free sectors are those where there is little or no activity at present. Overall this new law has to be regarded as only a limited step in the direction of the European norm of freedom of capital movements, contrasting for example with the case of Liechtenstein which under the EEA assures complete freedom of direct investment.

Portfolio investments are free, and subject only to ex-post declaration to the government.

Real estate investments in Andorra by individuals are subject to the granting of permission by the government, and are normally restricted to one residence only. Limitations on personal real estate investment exist in the EU in a small number of special cases. In its accession negotiations Malta, which like Andorra has an acute shortage of land, reached agreement that non-Maltese EU citizens could buy a single residence freely, and that they could buy second or more properties only if they have been resident for at least five years.

Why should Andorra want to keep the restrictions on direct investment when the EU and other major advanced economies have opted for total liberalisation? The advanced economies of the world have opted for liberalisation in order to boost investment and therefore economic growth, and also to enhance the efficiency of investment through open competition. For Andorra these considerations are also valid for the purpose of achieving a new model of economic growth, based on more diversified service sectors. Of course the increased competition would also mean reduction in the ‘economic rents’, or exceptional profits, created by the combination of low tax and regulatory burdens and restricted market entry. It is of course rational for the rent-owners to want to keep the status quo. However this cannot avoid the question whether, of how far and for how long, such rents can continue to be protected, and what the cost for the broader Andorran economy is in terms of dampening the prospects for new investments.

10.4 The labour market, residence and citizenship

Any ambitious degree of integration with the EU necessarily raises the issue of freedom of movement of people. Here Andorra has many exceptions.

Andorra’s immigration law can grant three types of authorisation:

- Frontier workers, allowing work without residence
- Active residents, allowing both work and residence
- Non-active residents, allowing residence without work.

The number of active resident permits granted is regulated by quotas that are opened at given points in time. The current quota decision allows up to 2,000 new residence and work permits to be delivered. Enterprises are able to make new or extended employment contracts until the quota is full. Preference is given within the quotas to French and Spanish citizens, and after that to EU and EEA citizens. The current quota is already fully used. Decisions on the quotas are strongly influenced by the labour demand of Andorran enterprises, and are an instrument for flexible management of the labour market. Labour turnover for foreign workers is quite high, since many do not establish long-term residence, preferring to save money for a while before returning home. The flexibility of the labour market for foreigners is heightened by the fact that there is no unemployment benefit scheme in the social security system.

A quota system also applies for non-active residents. The current quota allows for 400 new residence permits, but this is only being taken up

at a slow rate, and so is not presently a constraint. Applicants have to make an interest-free deposit of about €25,000 with the government, which is returned as and when the individual leaves.

Andorra has agreed with France and Spain a trilateral convention on the movement of persons, residence and professional establishment of their citizens in Andorra and vice versa.³⁷ The main provisions are:

- For stays of up to 90 days there is freedom of circulation without visa or permit
- For stays longer than 90 days a residence permit is required
- France and Spain extend to Andorran citizens conditions of establishment at least as favourable as for citizens of other EU member states, and Andorra extends to French and Spanish citizens conditions at least as favourable as for other EU member states
- Students have the same rights of access and social security coverage for their studies in France and Spain or Andorra as the case may be
- Person without gainful employment have to assure their own resources, including health and accident insurance
- Salaried persons benefit from the same conditions as nationals of the host country
- However French and Spanish citizens can only undertake non-salaried professional activity after ten years of uninterrupted residence
- Access to the liberal professions depends on the law of the host country, which in Andorra is subject to specific authorisation
- These provisions on non-salaried activity might be made more favourable in an agreement between Andorra and the EU.

Andorra and Portugal have also signed a Convention on 23 July 2007, which is identical to the trilateral Convention regarding their nationals, reflecting the importance of the Portuguese community in Andorra, now easily the third largest in number.

These rules are asymmetrical. France and Spain are extending conditions equal to those for other EU nationals, which mean complete

³⁷ Convention entre la République française, le Royaume d'Espagne et la Principauté d'Andorre relative à l'entrée, au séjour et à l'établissement de leurs ressortissants, décembre 2000.

freedom of access to the labour market. Andorra remains especially restrictive with regard to the liberal professions.

A comparison may be made with the labour market regime negotiated by Liechtenstein with the EU over the terms of its membership of the European Economic Area. The EEA covers only part of the EU *acquis* in the field of labour market and social policy. Basically the EU regulations on the free movement of labour/people have to be implanted in full. However Liechtenstein has negotiated special derogations allowing it to limit the number of resident permits granted to foreigners (see section 4.1.2 below for detail).

Other elements of EU labour market law, such as governing employment contract (working time, rest time, paid holidays, part-time and temporary work contracts), are not included in the EEA. Similarly the EU's Charter of the Fundamental Rights of Workers is neither included in the EEA, nor is it a legally binding text for the EU member states. These fundamental rights include chapters such as social protection, which however are only the subject of recommendations by the Commission. In 1993 a Protocol on Social Policy was adopted, supplementing the Treaty on European Union of 1992, which sets the rules for the EU to legislate by qualified majority or unanimity on matters of social and employment policy, from which the UK obtained an opt-out clause. This means that within the EU and EEA there is a continuum of social and labour market policy matters, which range from hard legal obligations for both the EU and EEA (essentially free movement), through to those that are obligatory for the EU but not the EEA (essentially employment contract), and finally elements that are the subject of only recommendations at EU level (social protection), or for which special opt-out provisions have been agreed for one member state.

11. Perspectives on EU relations with its neighbours

The future of Andorra's relations with the EU has to be placed in the context of the EU's complex and growing set of systemic relationships with its wider neighbourhood. While the 'neighbours' are highly differentiated by geography, culture, size and political regimes - from Iceland to Russia and on to Morocco via the Balkans and Middle East - the EU has revealed by its actual policies the tendency to project its norms, standards and many of its policies externally beyond its frontiers. This takes place through negotiation of treaties of association bearing different names, but with many common features. As the prospect of the EU's further enlargement

encounters increasing resistance within the EU itself, while the demands from the ‘neighbours’ are still increasing, it seems highly likely that the EU’s policies towards its neighbourhood will continue to deepen.

11.1 Forms of agreement between the EU and its neighbours

11.1.1 *The European Economic Area*

The example of most relevance to Andorra is undoubtedly the European Economic Area (EEA), whose membership today comprises Iceland, Norway and Liechtenstein.³⁸ These small or very small European democracies have achieved very high levels of prosperity alongside deep integration with the EU without membership.

Negotiations over the EEA began in 1990 after the President of the Commission, Jacques Delors, proposed to the EFTA member states a relationship of virtual economic membership of the EU without political membership. The impetus for this came from the EU’s apparent success in completing its internal market under the so-called ‘1992’ programme. Delors was motivated by the desire to avoid over-expanding the EU with numerous small states, especially given the special political preferences of some of the EFTA states, for example the neutrality of Switzerland and Sweden. The deal with the EEA was to grant to the participating states full and guaranteed participation in the four freedoms of the EU’s internal market – with its complete freedoms of movement for goods, services, labour and capital.

The condition, however, was that the EEA states adopt all the EU’s internal market laws (*acquis communautaire*), and not only the stock of such laws at the time of signing the EEA Treaty in 1992, but also all future legislation in this area. The EEA Treaty was thus quite extraordinary in its dynamic aspect, since the non-EU states were signing an open-ended commitment to adopt all future EU legislation in the internal market area, without advance knowledge what this might consist of. The initial commitment entailed adopting no less than 1,089 Directives from the EU’s

³⁸ For a detailed account of the implications for Andorra, see Pedro Solbes, *Elements de definition d’un modèle de relation entre l’Union européenne et l’Andorre*, Govern d’Andorra, Ministeri de relacions exteriors, 1999.

acquis, with the EEA states having also to adopt implementing legislation of their own to achieve conformity with the EU law (see Table 12).³⁹

Table 12. *The scope of the European Economic Area*

Policy area	Number of directives in the EEA <i>acquis</i>	Cases of non- or partial implementation		
		Norway	Iceland	Liechtenstein
Technical barriers to trade	486	20	16	4
Other trade in goods	13	0	0	0
Veterinary and related measures*	235	15	33	0
Free movement of persons	71	3	4	4
Free movement of capital	1	1	1	0
Financial services	53	2	1	4
Information technology and audio-visual	22	1	0	6
Transport (road, rail, maritime and air)	70	5	10	4
Social (health and safety, labour law and equal rights)	50	2	1	4
Consumer protection	12	3	2	2
Environment (air, water and waste)	43	1	0	0
Public procurement	9	0	4	0
Company law	12	0	0	0
State aid	3	0	0	0
Statistics	9	0	0	0
Total	1,089	53	72	28

* Iceland and Liechtenstein are exempt from many of these measures.

Source: Emerson, Vahl & Woolcock, op. cit.

The largest number of these directives concerned technical barriers to trade in industrial and agricultural goods (721), which would not be of great concern to Andorra, given its predominantly service sector economy.

³⁹ For a detailed account see M. Emerson, M. Vahl and S. Woolcock, "Navigating by the Stars – Norway, the European Economic Area and the European Union", CEPS, 2002.

However important sets of directives are relevant to priority interests of Andorra, including the free movement of persons (71), free movement of capital (1), financial services (53), social policy (health and safety, labour law and equal rights) (50), consumer protection (12), environment (43) and company law (12).

In order to alleviate the conspicuous ‘democracy deficit’ of the EEA system for the non-EU states, since they could not be part of the EU’s legislative and policy-making process, it was further agreed to devise special institutional arrangements for the EEA states to enter into the policy-shaping system, and to have autonomous executive and legal institutions. An EEA Council brings together ministers of EEA and EU member states with the EU institutions, and an EEA Joint Committee prepares their work at senior official level. A Surveillance Authority was established within the EFTA secretariat in Brussels to ensure that the EEA states are correctly implanting the *acquis*. An EFTA Court has been created to decide on cases of non-compliance. The most significant concession to the EEA states has been the obligation under Article 99 of the EEA Treaty to seek the advice of EEA experts on draft legislation, and Article 100 which calls upon the Commission to ensure “as wide a participation as possible” in preparatory stages. This means participation in as many as 200 committees of the Commission and Council.

There are some important borderline categories of EU internal market law regarding what is ‘in’ the field of EEA jurisdiction, and what is ‘outside’, i.e. not having to be adopted by EEA partner states. Agricultural policy market mechanisms are outside the EEA. Taxation is also outside, except to the extent of newly negotiated provisions regarding the taxation of savings income. Social and labour market law are ‘in’ for the freedom of movement of labour, but not otherwise for the EU’s labour market legislation.

These arrangements all function, but with a much smaller EEA than originally envisaged for all EFTA states. The governments of Austria, Finland, Sweden and Norway quickly reached the conclusion that full membership of the EU would be preferable. Referenda were held on EU accession in all four countries. In Austria, Finland and Sweden, the results were positive, but the Norwegian people voted against, and so Norway reverted to its EEA membership. Switzerland also signed the EEA Treaty, but here also the referendum over ratification gave a negative result, and so

Switzerland had to re-start negotiations bilaterally over its own special relationship with the EU (see further below)

11.1.2 The case of Liechtenstein in the European Economic Area

The case of Liechtenstein is of particular interest as a comparator for Andorra, being a micro-state of even smaller size (about one-third by population and territory). There are both political and more technical aspects to consider.⁴⁰

At the political level, in opting for the EEA Liechtenstein chose to go the whole way in adopting EU law of the internal market. In principle there are no derogations either for past or future EU law. However Liechtenstein requested one important derogation from the standard package, namely on the movement of persons and residence of non-nationals of Liechtenstein on its territory. Given Liechtenstein's very small size, an agreement was made effectively limiting the number of non-Liechtenstein citizens to one-third of the total population. In 1999 the EEA Joint Committee agreed to a further rule, that the number of resident permits granted annually to EU and other EEA citizens could be controlled, but in such a way that the increase in their number cannot be restricted to less than 1.75% per annum.

This derogation would be of interest to Andorra in the hypothesis of its seeking to accede to the EEA. On the other hand other parts of the EU *acquis* that Liechtenstein has entirely taken on would represent a challenge for Andorra as of today, namely strict implementation of all EU financial market *acquis*, and complete freedom of movement of capital. Thus in Liechtenstein there are no restrictions on foreign investment. Some parts of the Liechtenstein banking sector was initially worried about adopting the whole of the EU financial markets *acquis*, but the sector has adapted and become more specialised, for example in fund management. The number of banks in Liechtenstein has grown from three in the 1990s to 15 in 2007. Some of these banks are subsidiaries of EU-based banks, and thus subject to home country supervisory control (in the EU member states). However several Liechtenstein banks have for their part established subsidiaries in the EU.

At the more technical level Liechtenstein found ways of legislating and implementing the huge EU internal market *acquis* in a manageable

⁴⁰ For a detailed study see Peter Ludlow, *Liechtenstein in the New European & Global Order – Challenges and Options*, CEPS, 2000.

way. As a general rule, the law of Liechtenstein (like Switzerland) regards the international law of organisations of which it is member as being directly applicable. In this respect Liechtenstein has a lighter legislative procedure than Norway, whose parliament requires explicit legislation for each act. In the case of Liechtenstein the procedure is different for EU regulations that are directly applicable, and EU directives that require more detailed implementing legislation. For all EU law there was no translation burden, since all texts existed in German in any case. A standard legal template was devised to preface EU legal acts that had to be confirmed by parliament. For EU regulations the German language texts were directly transposed into Liechtenstein law by a special simplified procedure agreed with the parliament. In the case of directives that require detailed implementing legislation, the task is passed to a coordination department of the government to prepare the legal acts. However short-cuts are used where feasible, for example by copying the implementing legislation adopted by Germany or Austria.

Liechtenstein's tax, social security and labour market law is notable for being mostly very 'unexceptional' by average European standards. While the EEA does not cover taxation, Liechtenstein has a personal income tax of 18%, in addition to which social security charges are quite heavy. There are wealth and capital gains taxes. The social security system is of standard coverage, including an unemployment benefit scheme that applies without discrimination to Liechtenstein citizens and legally resident foreigners.

11.1.3 Switzerland as an alternative model

The term 'Swiss model' is being frequently used in discussions of the variety of arrangements seen in the EU's relationships with its neighbours. The Swiss case is certainly unique in some respects, but whether it should be viewed as a model is itself debatable, given its accidental origins following the unexpected rejection of ratification of the EEA by referendum.

The distinguishing characteristic of the Swiss relationship is that it is built on a series of sector-specific agreements, rather than a comprehensive

multi-sectoral treaty.⁴¹ No other country has as many agreements with the EU as Switzerland. However the EU itself has increasingly developed an ‘anti-cherry picking’ doctrine in its negotiation of agreements with close neighbours. By this the EU expresses its negative attitude towards third parties that try to negotiate agreements for close association with the EU only on those selected items that appeal to it. This doctrine, which has no official standing but is a real feature of EU negotiating practices, says that the third parties that wish to come close to the EU should be willing to accept complex agreements consisting of a mixed bag of items, where individual items may have different cost-benefit qualities for the one and other side.

For this reason the early Swiss experience of making numerous isolated agreements with the EU on an ad hoc basis came under pressure from the EU side when the question arose what to do after Switzerland’s failure to ratify the EEA. When Switzerland proposed that the substitute to the EEA should be a number of sector-specific agreements, the EU responded by insisting that there should be multiple agreements bunched in packages, with the proviso that failure to agree or to ratify any one of the packages would nullify the whole set. Two such packages, called ‘Bilaterals’, have subsequently been negotiated, Bilateral I being negotiated between 1994 and 1998, and Bilateral II between 2001 and 2004. The following three tables give an idea of the content. Box 6 lists 25 trade and industry agreements negotiated between 1956 and 2004 outside the Bilaterals. Boxes 7 and 8 list the contents of the two Bilateral packages.

The Bilaterals contain much of what Switzerland would have undertaken in the EEA, especially in Bilateral I regarding technical barriers to trade. To this extent it amounts to a re-packaging of the EEA matter, although outside the institutional structures of the EEA. Here lies an important point for those who suppose that the so-called ‘Swiss model’ is less subject to the democratic-deficit objection to the EEA. In fact Switzerland ends up with a less strong position than the EEA states in the policy-shaping process, and in some respects on matters of legal procedures.

⁴¹ For a detailed treatment see Marius Vahl and Nina Grolimund, *Integration without Membership – Switzerland’s Bilateral Agreements with the European Union*, CEPS, 2006.

*Box 6. Agreements between Switzerland and the EU, 1956-2004***Trade and industry agreements**

- 1967 Tariffs on certain cheeses
- 1972 Agreement between the EC and Switzerland (the 'free trade agreement')*
- 1974 Clock and watch industry
- 1985 Trade in soups, sauces and condiments
- 1986 Trade in non-agricultural and processed agricultural goods
- 1989 Trade in electronic data interchange systems
- 1990 Simplification of inspections and formalities in respect to the carriage of goods
- 1995 Trade in certain agricultural and fishery products
- 2001 Tariff preferences under the General System of Preferences (GSP)

Transport agreements

- 1956 Railway tariffs for the carriage of coal and steel through Swiss territory
- 1992 Carriage of goods by road and rail

Research agreements

- 1978 Thermonuclear fusion and plasma physics
- 1985 Scientific and technical cooperation
- 1988 R&D in the field of wood, including cork, as a renewable raw material
- 1988 R&D in the field of advanced materials (Euram)
- 1991 European Stimulation Plan for the Economic Sciences (SPES)
- 1991 EEC R&D programme in the field of applied metrology and chemical analysis

Other bilateral agreements

- 1957 Consultation agreement between Switzerland and the ECSC High Authority
- 1984 Prevention of fraud
- 1988 Terminology
- 1991 Direct insurance other than life insurance
- 2004 Europol

Multilateral agreements: EEC/EFTA conventions

- 1987 On the simplification of formalities on trade in goods
- 1987 On a common transit procedure
- 1990 Procedure for the exchange of information in the field of technical regulations

* The 1972 agreement (formally consisting of two agreements, one with the European Community and one with the ECSC) is frequently referred to as the 'free trade agreement', despite the fact that there is no reference to free trade in the title. Hereafter, it is referred to as the 1972 agreement.

Source: European Commission.

Box 7. EU-Switzerland Bilateral I sectoral agreements 1994-1998

1. Research
2. Technical barriers to trade
3. Free movement of persons
4. Air transport
5. Land transport
6. Agriculture
7. Public procurement

Source: Vahl & Grolimund, op. cit.

However Bilateral II went wider, notably including agreements of the taxation of savings (comparable to Andorra's agreement of 2004), inclusion in the Schengen area and other items relating to the EU's area of Liberty, Justice and Security (Pillar III of EU competences). In this respect the 'Swiss model' is an example of a flexible updating of the content of the EEA Treaty. The EU's own policies have advanced substantially since the EEA was conceived, which means that the EEA states have themselves had to make sector-specific agreements outside the scope of the EEA Treaty. In particular Norway and Iceland have become full members of the Schengen area. Moreover the EEA excluded obligations under the EU's *acquis* in the area of taxation, and as a result both Switzerland and Liechtenstein (as well as Andorra and other very small states and entities) found themselves requested by the EU to enter into negotiations for agreements on the taxation of savings.

Box 8. EU-Switzerland, Bilateral II sectoral agreements, 2001-2004

1. Processed agricultural goods
2. Statistics
3. Media
4. Environment
5. Pensions
6. Education, occupational training, youth (declaration of intent)
7. Taxation of savings
8. Schengen
9. Dublin
10. Fight against fraud

Source: Vahl & Grolimund, op. cit.

Overall the comparison of the EEA multilateral model and Swiss bilateral model shows increasing convergence between the two. The EEA states have had to make further sector-specific agreements outside the field of the EEA Treaty, whereas the Swiss bilaterals now amount to much of the EEA matter plus the same sector-specific agreements as the EEA states have made.

11.1.4 Agreements with the wider European neighbourhood

The collapse of the Soviet Union and the Communist regimes in all of Central, Eastern and South-Eastern Europe in the period 1989-1991 has led the EU to seek to bind these countries into the norms and standards – both political and technical – of modern Europe. The result has been an extraordinary proliferation of comprehensive agreements between the EU and its neighbours in the wider Europe. These agreements have had different names, but they have important common characteristics.

The first model was that of the *Europe Agreements* designed for the Central and East European states that were applying for full EU membership. These agreements were basically a pre-accession strategy, and were structured along the lines of the EU's existing competences in the early 1990s, thus mainly in the economic area, but before the arrival of the euro as common currency. There was a long list of chapters, corresponding roughly to what became subsequently the 31 chapters of the accession negotiation process (see Annex H). The agreements also provided for the rapid move to free trade and also massive financial and technical assistance.

Because of this essentially economic content, the Europe Agreements were not very explicit on political criteria. However this lacuna was filled in 1993 when a summit meeting in Copenhagen established what became known as the 'Copenhagen criteria', which included the requirement of stable democracy, respect for human rights and an effective rule of law, as well as compliance with the EU *acquis* and a competitive economy.

For the non-accession candidate states of the former Soviet Union, a weaker derivative of the Europe Agreements was devised – Partnership and Cooperation Agreements (PCA). The first PCA was negotiated with Russia, testing how far this country would be willing to go in taking on the same agenda as the Europe Agreements. The result was a model PCA which had the same structure of chapters, but with much lower levels of commitment. Typically whereas the Europe Agreements and parallel

accession negotiations required categorical alignment on the EU *acquis*, and supporting implementation measures, the PCAs simply advocated non-binding 'cooperation' in the same fields, with correspondingly weak results. The PCA with Russia was then used as a template for negotiations with all other CIS states, starting with Ukraine, but going on to include PCAs with all the Southern Caucasus and Central Asian states. The content got progressively weaker as the process reached out even to Kyrgyzstan and Tajikistan bordering on China.

For South-East Europe the context was marked by the post-Yugoslav wars, involving Serbia, Croatia and Bosnia in 1992-93, and then Kosovo in 2000. However for all these states the EU was willing to acknowledge their aspirations for full membership at least in the long-run, and so a graduated process was devised. For states not yet deemed ready for the status of 'candidate', a two-step procedure was devised around a new model agreement called the Stabilisation and Association Agreement (SAA). The first preliminary step was for the partner states (all of the former Yugoslavia, plus Albania, and minus Slovenia which was already an accession candidate) to reach certain basic criteria as functioning states. It took time indeed for Bosnia and Albania to meet these conditions. The second stage was negotiation of the SAA, the model for which again started as a derivative of the Europe Agreements with their long list of chapters of EU competences (see Annex I for the case of the Croatian SAA). However the SAAs had also to address the special post-conflict or conflict prevention contexts in much of the region. In addition the political parts of the Copenhagen criteria were given prominent attention, as well as the EU's new competences in the field of Liberty, Justice and Security. The agenda for combating organised crime and corruption was given high priority. Overall the SAA process couples the conventional matter of alignment on the EU *acquis* with the more dramatic matters of conflict resolution/prevention and state-building, including fundamental constitutional issues in the cases of Bosnia, Serbia and Montenegro, and Macedonia.

These major developments in the EU's external relations to the North, East and South-East in turn spilled over into new initiatives for the Southern Mediterranean region, reflecting the enduring balance of interests within the EU between the Northern and Southern member states. In 1995 the Barcelona process was launched as a regional multilateral initiative with political, economic and security chapters, coupled with the negotiation of *Euro-Mediterranean Association Agreements* progressively with all South and East Mediterranean states. The hard core of these agreements

was the commitment to a phased introduction of bilateral free trade with the EU, alongside the usual very long list of areas for possible cooperation. In addition major economic aid and investment facilities were created.

The next major phase in these developments came when the 2005 enlargement was becoming a firm prospect. Concern was expressed about the relative disadvantage that the EU's 'new neighbours' (e.g. Ukraine, given Poland's accession) might perceive and indeed actually experience. As a result pressures grew for what has become the European Neighbourhood Policy (ENP), which was initially targeting the new European neighbours of the former Soviet Union. However again the EU's North-South balance had to be respected, and so the ENP was extended to the Mediterranean states of the Barcelona process as well as to the South Caucasus states. The ENP process had led to the negotiation of bilateral Action Plans, which are once again structured along the lines of the chapters of the accession process, even though it is stressed that the ENP brings no commitments to membership perspectives. The Action Plans contain a mix of specific and operational commitments and looser exhortations to make domestic political and economic reforms (see Annex J for the chapter headings of the Ukrainian Action Plan).

The ENP does contain the prospect of moving on from the (usually) three-year Action Plans to the opening of negotiations for new comprehensive agreements, to replace for the Eastern neighbours the PCAs. The process is most advanced in the case of Ukraine, where negotiations have actually begun for an 'Enhanced Agreement'. Two features of this likely new generation of agreements should be noted, as Andorra reflects on the nature of its future relations with the EU.

First there is the matter of content. The EU system has deepened and matured considerably over the last two decades under the so-called 'pillar' system for the EU's old and new competences. The internal market has been completed, the euro has been introduced (Pillar I), the common foreign, security and defence policies have advanced considerably (Pillar II), and the Schengen system has been introduced together with an expanding jurisdiction in the field of justice and home affairs (Pillar III). Put in terms of the EU's legal categories, all three pillars have advanced to the point that they become subjects also for the EU's external relations, especially with its close neighbours, therefore leading to a new model of more comprehensive multi-pillar agreements.

Second, there is the question how these agreements are named. All the above categories of agreement are legal treaties with the highest legal status in international law, subject to ratification by all the parliaments of EU member states. The term 'association agreement' is being used in some cases, but there is no clear definition or legal meaning attached to the use of the word association, or its non-use. For example the word association is used in the case of the Balkan SAAs, which contain a membership perspective, and in the case of the Euro-Mediterranean agreements which do not. The EU's recent free trade agreement with Chile is also designated an association agreement. The new agreement envisaged with Ukraine is for the time being called 'Enhanced Agreement' reflecting its likely multi-pillar content, but also the Ukrainian side considered the Commission's initial proposal for a 'European Neighbourhood Agreement' to be too exclusionary in implication. Ukraine is currently proposing the appellation 'Political Association and Economic Integration Agreement'.

11.1.5 Participation in EU agencies and programmes

The Commission has recently, in the context of the measures to improve the European Neighbourhood Policy, addressed comprehensively the question how far non-member states can participate in the work of the EU's fast-growing number of specialised agencies, and also the operational programmes of various policies.⁴² The principles set out in the Commission document apply more widely to third countries, and so this is relevant to the interest that has been expressed by Andorra in certain agencies and programmes.

There are now 21 agencies dealing with EC (Pillar I) competencies and a further 6 under EU (Pillars II and III) competencies. The Commission has reviewed the statutes of these agencies and has determined that 20 out of the total of 27 agencies are in principle open to third country participation. Of those that might be of mutual interest in the case of Andorra, one might mention the European Environment Agency and the European Police Office (Europol).

The document further identifies 34 EC programmes of which 18 are considered to be potentially open to third countries. Of those that might be

⁴² European Commission, *Communication on the general approach to enable ENP partner countries to participate in Community agencies and Community programmes*, com(2006) 724 Final, 4 December 2006.

of mutual interest in the case of Andorra, one might mention Hercule II (activities combating fraud, including cigarette smuggling), Pericles (against counterfeiting of the euro), Customs 2013 (for cooperation between customs authorities of the EU and neighbouring countries), Fiscalis 2013 (for cooperation between tax authorities of the EU and neighbouring countries), the Competitiveness and Innovation Framework programme (fostering SMEs and eco-innovation), the Security and Safeguarding Liberties programme (counter terrorism and crime), the Intelligent Energy-Europe programme and the European Regional Development Fund.

It is for third countries to express their interest in participation, with decisions to be taken on a case-by-case basis on the basis of identified mutual interests. Participating third countries are expected to make financial contributions.

11.2 Relationships with small states and autonomous entities

While the case of Liechtenstein has already been discussed for some of its aspects, the present section looks comparatively at the complete set of very small sovereign states in Europe (Andorra, Liechtenstein, Monaco, San Marino, Vatican), as well as the several highly autonomous non-state entities dependent in various ways on EU member states (Guernsey, Jersey, Ile of Man, Gibraltar in relation to the UK, the Aaland Islands as part of Finland and the Faroe Islands as part of Denmark). These various cases are interesting for the present study for two reasons. First they reveal various precedents for how the special interests of these very small states and entities may be accommodated in the context of EU laws and policies. Second, it is important for Andorra to be aware of trends in these relationships and the policies of these other states and entities, since the European Union and international community will be making these comparisons as they decide on positions to be adopted in relation to each of them individually.

Table 13. Europe's smallest states and non-state entities

	Population	Territory (km ²)	Status
Sovereign states			
Andorra	81,222	468	Sovereign state
Liechtenstein	33,000	160	Sovereign state
Monaco	32,000	2	Sovereign state
San Marino	28,000	61	Sovereign state
Vatican	783	0.44	Sovereign state
Non-state entities			
Jersey	80,000	72	UK Crown Dependency
Guernsey	60,000	48	UK Crown Dependency
Isle of Man	70,000	572	UK Crown Dependency
Gibraltar	30,000	6	UK Crown Colony
Aaland Islands	25,000	300	Finland – autonomous entity
Faroe Islands	45,000	375	Denmark – autonomous entity
Smallest EU states			
Malta	400,000	316	Sovereign state
Luxembourg	451,600	2,586	Sovereign state

11.2.1 The sovereign states⁴³

San Marino's relations with the EU seem to have been interacting with the case of Andorra. The EC-San Marino Customs Union Agreement of 1991 followed shortly after Andorra's Customs Union agreement of 1990, and its trade policy provisions are modelled on the Andorra agreement, except that for San Marino agricultural products are included (contrary to their exclusion in the case of Andorra). However the San Marino agreement already envisaged wider cooperation in the fields of diversification of the economy, environment, tourism, communications, information and culture. These fields of cooperation in turn seem to have been the model for the Andorra's 2004 Cooperation Agreement with the EU. The San Marino agreement also ensures non-discrimination on grounds of nationality for workers in each other's territory, including social security coverage. Since

⁴³ This section benefits from Marc Maresceau, « Les Micro-Etats Européens et l'Union Européenne: Une Relation de Proximité sous Tension », in C. Lequesne, *Les Dynamiques du Droit Européen en Début de Siècle*, Paris: Editions Pedone, 2004.

this last aspect involves the competences of member states the agreement had to be ratified by all member states, which was only completed 11 years later in 2002. The government of San Marino has expressed its disappointment that the areas opened for cooperation have not given greater results, which seems to correlate with Andorra's experience under its Cooperation Agreement of 2004. San Marino was able however to negotiate a monetary agreement with the EU for minting euro coins on the condition of applying EU financial market and monetary directives. San Marino has also signed an agreement on the taxation of savings similar to Andorra. San Marino is the only European micro-state not to have been on the OECD's first 2000 list of 'uncooperative tax havens'. Indeed San Marino has significant personal and corporate income taxes. Its recent reforms include strengthening the bank supervisory system and removing restrictions on the employment of non-resident workers.

In February 2007, the IMF completed its report on San Marino economic and financial policies with the following positive assessment: "San Marino is reinventing itself in response to global competition. A slew of reforms has been initiated, which, combined with stronger growth in neighbouring Italy and the euro area, have improved macroeconomic prospects. Growth has rebounded".⁴⁴

On 27 August 2007, there was a new development, when the foreign minister of San Marino, Mr Fiorenzo Stolfi, wrote to the Presidency of the Council of the EU in the following terms:

... I wish to inform the Council of the European Union that San Marino Government has expressed its willingness to achieve increasing integration within the European Union and to further discuss the possibility of submitting its candidature for membership of the European Union. ... I thank you in advance, Dear Minister, for the attention you will pay to the process that my Government intends to start in order to achieve a new *status* of San Marino vis-à-vis the European Union. ..." [*Italics retained as in the original letter*].

This initiative by San Marino, which seems to have come as a surprise to Brussels, will put the spotlight on some of the scenarios discussed in this

⁴⁴ IMF, *Republic of San Marino, Staff Report for the 2006 Article IV Consultation*, IMF Country Report No. 07/94, March 2007.

report (in section 6 of Part A), and oblige Europe's other micro-states to reflect on their own position in this regard.

Monaco has a stronger bilateral relationship with France than in the case of Andorra, notwithstanding the unique role of Andorra's Co-Princes as Heads of State. The France–Monaco bilateral treaty of 2002 stipulates that Monaco's international relations should always be subject to agreement with France. Monaco is part of the EU's customs union by virtue of its bilateral relations with France, without a specific agreement with the EU. Given the agreement with France over the free movement of persons, the introduction of the Schengen regime required clarification of the status of Monaco's seaport and heliport. The Schengen executive committee concurred that these could be accepted as authorised points of crossing the EU's external frontiers. Monaco has agreed with the EU terms for becoming fully part of the euro area, accepting the full EU *acquis* for financial markets. In addition the French Commission Bancaire shares responsibility for supervising the financial sector. Monaco is still listed by the OECD as a 'non-cooperative tax haven', the main point of criticism being the absence of information-sharing agreements with regulatory and fiscal authorities other than those of France. This designation is mitigated by the fact that French citizens resident in Monaco are subject to French income tax, and there is also an information exchange agreement with France. It has a 33% corporate tax.

11.2.2. *The non-state autonomous entities*⁴⁵

Jersey, Guernsey and the Isle of Man are self-governing in all matters except international relations and defence, for which the UK is responsible. All three entities are small island economies based on financial services and tourism. They are neither colonies nor part of the UK, and have limited international legal personality. Their relations with the EU is set out in Protocol 3 of the UK's act of accession to the EU, according to which they are part of the EU for the purposes of the customs tariff and the free movement of goods. This is equivalent to Andorra's customs union agreement, although it goes further with respect to trade in agricultural goods and aspects of the Common Agricultural Policy. The three entities are also "part of the EU", and their passports bear the triple designation

⁴⁵ This section benefits from Fiona Murray, "*The EU and Member State Territories – The Special Relationship under EU Law*", Sweet and Maxwell, 2004.

“European Union, British Isles, Bailiwick of Jersey [or Guernsey, etc.]”. This could prove an interesting precedent for other very small states and entities, in that a way seems to have been found for the citizens of these islands to gain full rights of movement and residence of EU citizens without their entities having the status of member state.

All three entities have joined in the withholding tax system linked to the EU taxation of savings directive, with the three staged rates of 15, 20 and 35%. The three entities also cooperate now with a view to implementing the so-called ‘Basel II’ standards for the regulatory requirements of banks, involving risk assessment, which have become mandatory within the EU under the financial services directives.⁴⁶

The IMF completed assessments in November 2003 of all three, noting high levels of compliance with the key sets of international standards for financial markets, namely the core principles of Basel, the International Association of Insurance Supervisors (IAIS), and the International Organisation of Securities Commissions (IOSCO) statement of best practices of the Offshore Group of Banking Supervisors (OGBS) and the recommendations of the Financial Action Task Force (FATF) with regard to Anti-Money Laundering (AML) and Combating the Financing of terrorism (CFT). Their respective Financial Services Commissions are “commended for the high level of compliance with these major international standards”.⁴⁷

They have low but still significant income tax for individuals (20% for Guernsey and Jersey, and 10-18% for the Isle of Man). For the corporate income tax all three are intending to introduce ‘0-10%’ regimes, with 0% as the standard rate and 10% for financial services by 2010. However the 0% rate is likely to be contested by the European Commission on grounds that it would contradict the EU’s Code of Conduct on fiscal matters. All three are regarded as ‘cooperative’ by the OECD Global Forum on Taxation, and

⁴⁶ Financial Services Commissions of Guernsey, Isle of Man and Jersey, “National Discretions for the Standardised Approaches to Credit and Operational Risk under the Basel II Capital Framework”, November 2006.

⁴⁷ IMF, *Review of Financial Sector Regulation and Supervision – Jersey*, IMF Country Report No. 3/368, November 2003; *idem – Isle of Man*, IMF Country Report No. 03/366, November 2003; *idem – Guernsey*, IMF Country Report No. 03/364, November 2003.

share information with other fiscal and financial market supervisory authorities.

The three islands take a pro-active view with regard to the setting of international standards for financial markets, and are invited to participate in international standard-setting bodies. In the words of the director-general of the Jersey Financial Services Commissions: “Seats at the table can only be obtained by those jurisdictions that meet international standards. We have those seats and are able to participate in the development of international standards – raising those standards, achieving a level playing field, applying our own values and acting in our own economic interest”.⁴⁸ The three islands may be viewed as adopting a high quality branding strategy, in the interest of building, and gaining from, a comparative advantage.

Gibraltar is a colony and overseas territory of the UK, and part of the EU. It is largely self-governing, except for international relations, defence and internal security. Gibraltar is part of the EU by virtue of Article 299(4) of the EC Treaty, which provides that “The provisions of this Treaty shall apply to the European territories for whose external relations a Member State is responsible”. However the UK’s Treaty of Accession allows Gibraltar to be excluded from the common customs tariff, common commercial policy, common agricultural policy and the value-added tax directives. Gibraltar is however applying the EU internal market *acquis*, including the free movement of labour and the financial services directives. Almost all its banks are subsidiaries or branches of EU-controlled banks, which means they are subject to home country control for supervisory purposes (i.e. controlled by the authorities of EU member states), and therefore obligatorily in compliance with EU standards. Gibraltar is not a low tax jurisdiction, with personal income tax in the 20-40% range, and a domestic corporate tax of 35%. The IMF has noted that “the Gibraltar authorities are to be commended for the resources they have devoted to international cooperation in the field of information exchange with financial supervisory authorities”, and as part of the EU for their “full cooperation with criminal investigations in EU member states”.⁴⁹

⁴⁸ Richard Pratt, “Setting International Standards – The Advantage of Being at the Table”, public speech, 6 June 2003 (www.jerseyfsc.org).

⁴⁹ IMF, *Gibraltar – Assessment of Financial Sector Supervision and Regulation*, IMF Country Report No. 07/154, Washington, D.C., May 2007.

The Aaland Islands are an autonomous, Swedish-speaking part of Finland. Their relationship with the EU is defined in Protocol 2 to the Finnish Act of Accession, according to which the Islands are part of the EU in all respects, subject however to two derogations concerning citizenship and taxation. These two derogations are however of high relevance for Andorra.

Regarding citizenship, the Aaland Islands can restrict the rights of access to regional citizenship, without which permission is required to own property, establish businesses or provide services. Newcomers to the Islands can only apply for regional citizenship after five years of continuous residence and proficiency in the Swedish language.

Regarding taxation, the Aaland Islands are exempted from EU harmonisation of indirect taxes, including the value-added tax and excise duties. This allows the Islands to base their prosperity on a combination of tourism, and duty-free sales both onshore and offshore on shipping lines that serve routes with Finland and Sweden. In these respects the Aaland Islands bear some comparison as a maritime version of the mountainous Andorra. However the Aaland Islands do apply Finnish income taxes.

The Faroe Islands are part of Denmark with a large measure of autonomy, although some policies are the joint responsibility of both the Islands and Denmark. They elect two members of the Danish parliament, and passports indicating that the holders are both Danish citizens and Faroese residents. However the Islands are not part of the EU, and so EU laws do not apply. The relationship with the EU is currently defined in practice in a fisheries agreement of 1980 and a trade agreement of 1997 providing for free trade. The issue of independence for the Faroe Islands is a continuing matter of political interest, and in March 2001 the Faroese parliament set out a proposal for a gradual move to independence by 2012. The case of the Faroe Islands is of interest in the present context only to illustrate how the EU has managed all kinds of special relationships with very small yet historically distinct entities – in this case an entity that can be part of an EU member state without being part of the EU.

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Annex A

Customs Union

[signed 28 June 1990]

The Principality of Andorra, and the European Economic Community,

Desirous of introducing, in respect of their trade relations, arrangements to take the place of national arrangements currently in force and respecting the specific situation of the Principality of Andorra,

Considering that, owing to geographical, historical and social and economic factors, Andorra's exceptional situation justifies special arrangements, particularly as regards exemption from import duties, turnover tax and excise duties collected on goods imported by travellers from Andorra into the Community,

Have agreed as follows:

Article 1.

Trade between the European Economic Community, on the one hand, and the Principality of Andorra, on the other, shall be governed by the provisions set out below.

Title I

Customs Union

Article 2

A customs union shall be established between the European Economic Community and Andorra for the products covered by Chapters 25 to 97 of the Harmonised System in accordance with the procedure and conditions set out under this Title.

Article 3

1. The provisions of this Title shall apply to:

(a) goods produced in the Community or in the Principality of Andorra, including those obtained wholly or in part from products which come from third countries and are in free circulation in the Community or in the Principality of Andorra;

(b) goods which come from third countries and are in free circulation in the Community or in the Principality of Andorra.

2. Products coming from third countries shall be considered to be in free circulation in the Community or in the Principality of Andorra if the import formalities have been complied with and any customs duties or charges having equivalent effect which are payable have been levied, and there has been no total or partial drawback of such duties or charges in respect of the said products.

Article 4

The provisions of this Title shall also apply to goods obtained in the Community or in the Principality of Andorra, in the manufacture of which were used products coming from third countries and not in free circulation either in the Community or in the Principality of Andorra. These provisions shall, however, apply to those goods only if the exporting Contracting Party levies the customs duties laid down in the Community for third country products used in their manufacture.

Article 5

The Contracting Parties shall refrain from introducing between themselves any new customs duties on imports or exports or charges having equivalent effect, and from increasing those already applied in their trade with each other on 1 January 1989.

Article 6

1. Customs duties on imports and charges having equivalent effect in force between the Community and the Principality of Andorra shall be abolished in accordance with paragraphs 2 and 3.

2. On 1 January 1991, the Principality of Andorra shall abolish customs duties and charges having equivalent effect on imports from the Community.

3. (a) From 1 January 1991 the Community, with the exception of the Kingdom of Spain and the Portuguese Republic, shall abolish customs duties and charges having equivalent effect on imports from the Principality of Andorra.

(b) From 1 January 1991 the Kingdom of Spain and the Portuguese Republic shall apply the same customs duties in respect of the Principality of Andorra as they apply in respect of the Community as constituted on 31 December 1985.

(c) In the case of processed agricultural products covered by Chapters 25 to 97 of the Harmonised System and referred to in Regulation (EEC)

No.3033/80, sub-paragraphs (a) and (b) shall apply to customs duties constituting the fixed component of the charge on imports of those products into the Community from the Principality of Andorra, while the variable component provided for in the Regulation shall continue to apply.

(d) By way of derogation from sub-paragraphs (a), (b) and (c), imports covered by the provisions relating to tax relief for travellers referred to in Article 13 shall be exempt from customs duties from 1 January 1991.

Article 7

1. For products covered by the customs union, the Principality of Andorra shall adopt, with effect from 1 January 1991:

- the provisions on import formalities applied by the Community to third countries,
- the laws, regulations and administrative provisions applicable to customs matters in the Community and necessary for the proper functioning of the customs union.

The provisions referred to in the first and second indents shall be those currently applicable in the Community.

2. The provisions referred to in the second indent of paragraph 1 shall be determined by the Joint Committee provided for in Article 17.

Article 8

1. (a) Over a period of five years, and beyond that period if no agreement can be reached in accordance with (b), the Principality of Andorra shall authorise the Community, acting on behalf of and for the Principality of Andorra, to enter goods sent from third countries to the Principality of Andorra for free circulation. Entry into free circulation will be effected by the Community customs offices listed in Annex I.

(b) At the end of this period, and under Article 20, the Principality of Andorra may exercise right of entry into free circulation for its goods, following agreement by the Contracting Parties.

2. Where import duties are payable on goods pursuant to paragraph 1, these duties shall be levied on behalf of the Principality of Andorra. The Principality of Andorra shall undertake not to refund these sums directly or indirectly to the parties concerned.

3. The Joint Committee provided for in Article 17 shall determine:

(a) possible changes of the list of the Community customs offices competent to clear the goods referred to in paragraph 1 and the procedure for forwarding the said goods to the Principality of Andorra referred to in paragraph 1;

- (b) the arrangements for assigning to the Andorran Exchequer the amounts collected in accordance with paragraph 2, and the percentage to be deducted by the Community to cover administrative costs in accordance with the relevant regulations in force within the Community;
- (c) any other arrangements necessary for the proper implementation of this Article.

Article 9

Quantitative restrictions on imports and exports and all measures having equivalent effect between the Community and the Principality of Andorra shall be prohibited from 1 January 1991.

Article 10

1. Should either Contracting Party consider that disparities arising from the other Party's application, in respect of imports from third countries, of customs duties, quantitative restrictions or any measures having equivalent effect, or of any other measure of commercial policy, threaten to deflect trade or to cause economic difficulties in its territory, it may bring the matter before the Joint Committee, which shall, if necessary, recommend appropriate methods for avoiding any harm liable to result therefrom.
2. Where deflections occur or economic difficulties arise and the Party concerned considers that they call for immediate action, that Party may itself take the necessary surveillance or protection measures, notifying the Joint Committee without delay; the Joint Committee may recommend that the said measures be amended or abolished.
3. In the choice of such measures, preference shall be given to those which least disturb the operation of the customs union and, in particular, the normal development of trade.

Title II

Arrangements for products not covered by the Customs Union

Article 11

1. Products covered by Chapters 1 to 24 of the Harmonised System which originate in the Principality of Andorra shall be exempt from import duties when imported into the Community.
2. Rules of origin and methods of administrative cooperation are set out in the Appendix.

Article 12

1. The arrangements applied to goods from third countries imported into the Principality of Andorra shall not be more favourable than those applied to imports of Community goods.
2. Products covered by headings No. 24.02 and 24.03 of the Harmonised System which are manufactured in the Community from raw tobacco and which meet the conditions of Article 3(1) shall be eligible, when imported into the Principality of Andorra, for a preferential rate corresponding to 60 per cent of the rate applied in the Principality of Andorra for the same products vis-à-vis third countries.

Title III
Common Provisions

Article 13.1. Exemptions from import duties, turnover tax and excise duties levied on imports by travellers between the Contracting Parties and applicable to goods contained in the personal luggage of travellers coming from one of the Contracting Parties shall be those currently applicable in the Community in respect of third countries, provided imports of those goods are strictly non-commercial.

2. With regard to the products covered by Title II of this Agreement and listed below, the exemptions referred to in paragraph 1 shall be granted within the following quantitative limits for each traveller entering the Community from the Principality of Andorra:

- milk powder 2.5 kilograms
- condensed milk 3 kilograms
- fresh milk 6 kilograms
- butter 1 kilograms
- cheese 4 kilograms
- sugar and confectionery 5 kilograms
- meat 5 kilograms

3. Details of quantitative limits

4. Within the quantitative limits laid down in the second indent of paragraph 3, the value of the goods listed therein shall not be taken into consideration for determining the exemptions referred to in paragraph 1.

Article 14

The Contracting Parties shall refrain from any domestic tax measure or practice leading directly or indirectly to discrimination between the products of one Contracting Party and similar products from the other Contracting Party. Products sent to the territory of one of the Contracting Parties shall not be eligible for a refund of domestic charges which is higher than the charges which have been levied directly or indirectly.

Article 15

1. In addition to the cooperation provided for in Articles 11(2) and 17(8), the administrative authorities of the Contracting Parties responsible for implementing the provisions of this Agreement shall assist each other in other cases so as to ensure compliance with the provisions.
2. Arrangements for the application of paragraph 1 shall be determined by the Joint Committee referred to in Article 17.

Article 16

The Agreement shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security, the protection of health and life of humans, animals or plants, the protection of national treasures possessing artistic, historic or archaeological value, the protection of industrial or commercial property or controls relating to gold and silver. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between the Contracting Parties.

Article 17

1. A Joint Committee shall be set up with responsibility for administering this Agreement and ensuring that it is properly implemented. To that end, it shall formulate recommendations. It shall take decisions in the cases provided for in the Agreement. The decisions shall be executed by the Contracting Parties in accordance with their own regulations.
2. With a view to the proper performance of this Agreement, the Contracting Parties shall carry out exchanges of information and, at the request of either Party, shall consult together in the Joint Committee.
3. The Joint Committee shall draw up its own rules of procedure.

4. The Joint Committee shall be composed, on the one hand, of representatives of the Community and, on the other, of representatives of the Principality of Andorra.
5. The Joint Committee shall take decisions by common accord.
6. The Joint Committee shall be chaired by each of the Contracting Parties in turn in accordance with the arrangements to be laid down in its rules of procedure.
7. The Joint Committee shall meet at the request of either of the Contracting Parties, to be lodged at least one month before the date of the intended meeting. Where the Joint Committee is convened under Article 10, it shall meet within eight working days from the date on which the request is lodged.
8. In accordance with the procedure laid down in paragraph 1, the Joint Committee shall determine methods of administrative cooperation for the purposes of applying Articles 3 and 4, taking as a basis the methods adopted by the Community in respect of trade between the Member States; it may also amend provisions in the Appendix, referred to in Article 11.

Article 18

1. Any disputes arising between the Contracting Parties over the interpretation of the Agreement shall be put before the Joint Committee.
2. If the Joint Committee does not succeed in settling the dispute at its next meeting, each Party may notify the other of the designation of an arbitrator; the other Party shall then be required to designate a second arbitrator within two months.
3. The Joint Committee shall designate a third arbitrator.
4. The arbitrator's decisions shall be taken by a majority vote.
5. Each Party involved in the dispute shall be required to take the measures needed to ensure the application of the arbitrator's decision.

Article 19

In trade covered by this Agreement:

- the arrangements applied by the Principality of Andorra vis-à-vis the Community may not give rise to any discrimination between the Member States, their nationals or their companies.
- the arrangements applied by the Community vis-à-vis the Principality of Andorra may not give rise to any discrimination between Andorran nationals or companies.

Title IV
General and Final Provisions

Article 20

This Agreement is concluded for an unlimited duration. Within five years of its entry into force, the two Parties shall begin consultations to examine the results of its application and, if necessary, to open negotiations on its amendment in the light of that examination.

Article 21

Either Contracting Party may denounce this Agreement by notifying the other Contracting Party in writing. In that case, the Agreement shall cease to have effect six months after the date of such notification.

Annex B

Cooperation Agreement

[Signed 15 November 2004]

The European Community of the one part, the Principality of Andorra of the other part,

Resolved to consolidate and extend the existing close relations between the European Community and the Principality of Andorra,

Considering that trade relations between the European Community and the Principality of Andorra are governed by the agreement in the form of an exchange of letters signed in Luxembourg on 28 June 1990, which establishes a Customs Union,

Considering that European integration has made considerable progress since that date,

Considering the exceptional situation of the Principality of Andorra, which is surrounded by the territory of the European Union but is not a member of it,

Considering the desire of the Principality of Andorra to play a greater part in the current integration of Europe and therefore to expand the scope of its relations with the European Union,

Considering that the European Community and the Principality of Andorra should conclude an agreement to provide the broadest possible basis for their cooperation in all areas of common interest within their fields of competence,

Have agreed as follows:

Principles

Article 1

The European Community and the Principality of Andorra (hereinafter the Contracting Parties) undertake, within the limits of their respective powers, to cooperate on the broadest possible basis and to their mutual advantage in matters of common interest, and in particular the priority areas referred to in Articles 2 to 8.

Areas of cooperation

Article 2

Environment

The Contracting Parties shall cooperate to protect and improve the environment with a view to sustainable development. Their cooperation shall cover the following areas: climate change,

Protection of nature and biodiversity, environment and health, management of natural resources and waste management. To this end, they shall seek to reconcile the conservation of the Pyrenean environment with economic development.

The Contracting Parties shall cooperate, in a spirit of shared responsibility, to resolve the environmental problems confronting the Principality of Andorra and the Pyrenean regions of the European Community. They shall take account of the fact that certain problems, such as that of waste, are connected with the movement of goods and persons between their respective territories. The Contracting Parties shall, in particular, cooperate in the transfer and disposal of waste.

In so far as its means allow, and provided such standards are relevant in terms of the protection of the environment and sustainable economic development in the Principality, the Principality of Andorra shall endeavour to adopt environmental standards equivalent to those of the European Community. The European Community shall, on request, cooperate with the Principality of Andorra to this end.

The Contracting Parties shall study the feasibility and practicalities of involving the Principality of Andorra in such Community environmental programmes open to non-member countries as may be of interest to it.

The European Community shall help establish cooperation between the European Environment Agency and the Principality of Andorra.

Article 3

Communication, information and culture

Within the scope afforded by Community initiatives and Andorran law, the Contracting Parties agree to undertake joint projects in the area of communication, information and culture

in the spirit of Article 151 of the Treaty establishing the European Community.

Such projects may include:

- exchanges of information on topics of mutual interest in the fields of culture and information,
- the organisation of cultural events,
- cultural exchanges,
- the conservation of the Andorran and Pyrenean architectural heritage and the restoration of monuments and sites,
- the conservation and promotion of the Andorran and Pyrenean cultural heritage,
- the establishment of cross-border research programmes on history, art and languages,
- measures to preserve, enhance and disseminate the Catalan language,
- the participation of the Principality of Andorra in European cultural projects.

Article 4

Education, vocational training and youth

Guided by Articles 149 and 150 of the Treaty establishing the European Community, the Contracting Parties shall undertake to cooperate in the field of education and vocational training

With a view to helping create a European education area.

The Contracting Parties shall study the feasibility and practicalities of involving the Principality of Andorra in such European Community education, vocational training and youth programmes as may be of interest to it.

Article 5

Social and health issues

The Contracting Parties shall undertake to study ways of strengthening coordination in social matters through exchanges of experts, cooperation between administrations, cooperation between businesses and training.

The Contracting Parties shall use the same approach for the purposes of cooperating in the field of public health.

The Contracting Parties shall avoid all discrimination based on nationality against workers who are nationals of the other party and legally resident on their respective territories with regard to

Working conditions, pay and redundancy.

The Contracting Parties' cooperation on labour issues shall cover, *inter alia*, the development of careers guidance services, planning and the promotion of employment at local and regional levels.

Article 6

Trans-European networks and transport

The Contracting Parties shall undertake to pursue their cooperation on trans European transport, energy and telecommunications networks and on transport in general. This cooperation shall be aimed, *inter alia*, at promoting the study of projects of common interest which show due regard for the Pyrenean environment. In their cooperation, the Contracting Parties shall be guided by the objectives set out in Articles 154 and 155 of the Treaty establishing the European Community.

Article 7

Regional policy

The Contracting Parties, each in accordance with its own legislation, hereby agree to step up their regional cooperation, in line with the European Community's policy of cross-border, transnational and interregional cooperation.

To that end, they shall encourage the following courses of action:

— the study of a concerted approach to the development of the regions situated on the frontier between the European Community and the Principality of Andorra with a view to promoting a policy on the Pyrenees comparable to that on the Alps. Similarly, the European Community will offer the Principality of Andorra the possibility of taking part in future programmes of the Interreg type on the same terms as other non-member countries,

— the organisation of visits and exchanges of officials and experts, with a view to exploring the scope for cooperation,

— cooperation in matters of mountain policy, drawing on the Community policy aimed at ensuring continued and sustainable agricultural land use, economic development and the preservation of the countryside.

Article 8

Other areas of cooperation

The Contracting Parties may by mutual consent extend this Agreement by concluding agreements on specific matters.

General provisions

Article 9

1. A Cooperation Committee shall be responsible for administering this Agreement and ensuring that it is properly implemented.

2. For the purpose of the proper implementation of this Agreement, the Contracting Parties shall exchange information and, at the request of either Party, shall hold consultations within the Cooperation Committee.

3. The Cooperation Committee shall draw up its rules of procedure.

4. The Cooperation Committee shall be composed, on the one hand, of representatives of the European Community and, on the other, of representatives of the Principality of Andorra.

5. The Cooperation Committee shall take decisions by common accord.

6. The Cooperation Committee shall be chaired by each of the Contracting Parties in turn, in accordance with the arrangements to be established in its rules of procedure.

7. The Cooperation Committee shall meet by common accord at the request of either of the Contracting Parties. The Cooperation Committee's rules of procedure shall specify the practical arrangements for the organisation of meetings.

Article 10

The Contracting Parties agree that any dispute arising between them over the implementation or interpretation of this Agreement shall be submitted to the Cooperation Committee.

Article 11

This Agreement shall be concluded for an unlimited period.

Article 12

Either Contracting Party may denounce this Agreement by notifying the other Contracting Party in writing. In that case, the Agreement shall cease to have effect six months after the date of such notification.

Article 13

This Agreement shall apply, on the one hand, to the territories to which the Treaty establishing the European Community is applied and under the conditions laid down in that Treaty and,

on the other, to the territory of the Principality of Andorra.

Article 14

This Agreement shall be approved by the Contracting Parties in accordance with their own procedures.

This Agreement shall enter into force on the first day of the second month following notification that the procedures referred to in the first subparagraph have been complied with.

Article 15

1. This Agreement shall be drawn up in duplicate in the Czech, Danish, Dutch, English, Estonian, Finnish, French, German, Greek, Hungarian, Italian, Latvian, Lithuanian, Polish, Portuguese, Slovak, Slovene, Spanish, Swedish and Catalan languages, each of these texts being equally authentic.

2. The Maltese language version shall be authenticated by the Contracting Parties on the basis of an exchange of letters. It shall also be authentic, in the same way as for the languages referred to in paragraph 1.

Done at Brussels on the 15th November 2004.

Annex C

Agreement on Taxation of Savings Income¹

[signed 15 November 2004]

The European Community and the Principality of Andorra,

hereinafter referred to as ‘Contracting Party’ or ‘Contracting Parties’ as the context may require, with a view to introducing measures equivalent to those laid down in Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, hereinafter referred to as ‘the Directive’, within a framework of cooperation which takes account of the legitimate interests of both Contracting Parties and in a context where other third countries in a situation similar to that of the Principality of Andorra will also be applying measures equivalent to the Directive,

have agreed as follows:

Article 1

Aim

1. Within a framework of cooperation between the European Community and the Principality of Andorra savings income in the form of interest payments made in the Principality of Andorra to beneficial owners who are individuals identified as residents of a Member State of the European Community in accordance with the procedures laid down in Article 3 shall be subject to a withholding tax to be levied by paying agents established on the territory of the Principality of Andorra under the conditions laid down in Article 7. This withholding tax shall be levied unless the voluntary disclosure measures are applied in accordance with the rules set out in Article 9. The income corresponding to the amount of withholding tax levied in accordance with Articles 7 and 9 shall be shared between the Member States of the European Community and the Principality of Andorra according to the rules set out in Article 8. To ensure that this

¹ *[Full title]* 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 in the form of interest payments

Agreement is equivalent to the Directive, these measures shall be supplemented by rules on the exchange of information on request set out in Article 12 and by the consultation and review procedures described in Article 13.

2. The Contracting Parties shall take the necessary measures to implement this Agreement. The Principality of Andorra shall in particular take the necessary measures to ensure the tasks required to implement this Agreement are carried out, irrespective of the place of establishment of the debtor of the debt claim which produces the interest, by the paying agents established on its territory, and shall expressly provide for provisions on procedures and penalties.

Article 2

Definition of beneficial owner

1. For the purposes of this Agreement, 'beneficial owner' means any individual who receives an interest payment or any individual for whom an interest payment is secured, unless he provides proof that this payment has not been made or secured on his own account, where:

(a) he acts as a paying agent within the meaning of Article 4; or

(b) he acts on behalf of a legal person, an entity whose profits are taxed under the general arrangements for business taxation, an undertaking for collective investment in transferable securities established in a Member State of the European Community or in the Principality of Andorra; or

(c) he acts on behalf of another individual who is the beneficial owner and informs the paying agent of the identity of this beneficial owner in accordance with Article 3(1).

2. Where a paying agent possesses information suggesting the individual receiving an interest payment or for whom an interest payment is secured may not be the beneficial owner, it must take reasonable measures to establish the identity of the beneficial owner in accordance with Article 3(1). If the paying agent is not able to identify the beneficial owner, it shall treat the individual in question as the beneficial owner.

Article 3

Identity and residence of beneficial owners

1. The paying agent shall establish the identity of the beneficial owner in the form of his name, forename and address according to the anti-money-laundering provisions applying in the Principality of Andorra.

2. The paying agent shall establish the residence of the beneficial owner on the basis of rules which may vary according to the time at which the relations between the paying agent and the beneficial owner of the interest are entered into. Subject to the conditions set out below residence shall be considered to be in the country where the beneficial owner has his permanent address:

(a) for contractual relations entered into before 1 January 2004, the paying agent shall establish the residence of the beneficial owner according to the anti-money-laundering provisions applying in the Principality of Andorra;

(b) for contractual relations entered into, or transactions carried out in the absence of contractual relations, on or after 1 January 2004, the paying agent shall establish the residence of the beneficial owner on the basis of the address mentioned in the official identity document or, if necessary, on the basis of any documentary proof presented by the beneficial owner and according to the following procedure: for individuals presenting an official identity document issued by a Member State of the European Community who declare that they are resident in a State which is not a Member of the European Community, residence shall be established by means of a residence certificate or a document authorising residence issued by the competent authority of that third country in which the individual declares he is resident. If such a certificate of residence or document authorising residence cannot be provided, residence shall be considered to be in the Member State of the European Community which issued the official identity document.

Article 4

Definition of paying agent

For the purposes of this Agreement, 'paying agent' means any economic operator established in the Principality of Andorra who pays interest to, or secures the payment of interest for the immediate benefit of, the beneficial owner, whether the operator is the debtor of the debt claim which produces the interest or the operator charged by the debtor or the beneficial owner with paying interest or securing payment of the interest.

Article 5

Definition of competent authority

1. For the purposes of this Agreement the ‘competent authorities’ of the Contracting Parties means those listed in Annex I.

2. For third countries, the competent authority is that defined for the purposes of bilateral or multilateral tax conventions or, failing that, such other authority as is competent to issue certificates of residence for tax purposes.

Article 6

Definition of interest payment

1. For the purposes of this Agreement, ‘interest payment’ means:

(a) interest paid or credited to an account relating to debt claims of any kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures; penalty charges for late payment shall not be regarded as interest payments;

(b) interest accrued or capitalised on the sale, refund or redemption of the debt claims referred to in (a);

(c) income deriving from interest payments, either directly or through an entity referred to in Article 4(2) of the Directive distributed by:

(i) undertakings for collective investment established in a Member State of the European Community or in the Principality of Andorra;

(ii) entities which qualify for the option under Article 4(3) of the Directive;

(iii) undertakings for collective investment established outside the territory referred to in

(d) income realised on the sale, refund or redemption of shares or units in the following undertakings and entities, if they invest directly or indirectly via other undertakings for collective investment or entities referred to below, more than 40 % of their assets in debt claims as referred to in (a):

(i) undertakings for collective investment established in a Member State of the European Community or in the Principality of Andorra;

(ii) entities which qualify for the option under Article 4(3) of the Directive;

(iii) undertakings for collective investment established outside the territory referred to in

Article 17

However, the Principality of Andorra shall have the option of including income mentioned under (d) in the definition of interest payment only to the extent that such income corresponds to gains directly or indirectly deriving from interest payments within the meaning of (a) and (b).

2. As regards paragraph 1(c) and (d), when a paying agent possesses no information concerning the proportion of the income which derives from interest payments, the total amount of the income shall be considered to be an interest payment.

3. As regards paragraph 1(d), when a paying agent possesses no information concerning the percentage of the assets invested in debt claims or in shares or units defined in that paragraph, that percentage shall be considered to be more than 40 %. Where it cannot determine the amount of income realised by the beneficial owner, the income shall be deemed to correspond to the proceeds of the sale, refund or redemption of the shares or units.

4. As regards paragraph 1(b) and (d), the Principality of Andorra shall have the option of requiring paying agents in its territory to annualise the interest over a period of time which may not exceed one year, and treating such annualised interest as an interest payment even if no sale, redemption or refund occurs during this period.

5. Income derived from undertakings or entities that have invested up to 15 % of their assets in debt-claims within the meaning of paragraph 1(a) are not considered as a payment of interest within the meaning of paragraph 1(c) and (d).

6. From 1 January 2011, the percentage referred to in paragraph 1(d) and paragraph 3 shall be 25 %.

7. The percentages referred to in paragraph 1(d) and paragraph 5 shall be determined by reference to the investment policy laid down in the fund rules or instruments of incorporation of the undertakings or entities concerned and failing that, by reference to the actual composition of the assets of the undertakings or entities concerned.

Article 7

Withholding tax

1. Where the beneficial owner of the interest is resident in a Member State of the European Community, the Principality of Andorra shall levy a withholding tax at a rate of 15 % in the first three years of application of this Agreement, 20 % in the subsequent three years and 35 % thereafter.

2. The paying agent shall levy withholding tax as follows:

(a) in the case of an interest payment within the meaning of Article 6(1)(a): on the amount of interest paid or credited;

(b) in the case of an interest payment within the meaning of Article 6(1)(b) or (d): on the amount of interest or income referred to in those paragraphs or by means of a levy of equivalent effect to be borne by the recipient on the full amount of the proceeds of the sale, redemption or refund;

(c) in the case of an interest payment within the meaning of Article 6(1)(c): on the amount of income referred to in that paragraph;

(d) where the Principality of Andorra exercises the option under Article 6(4): on the amount of annualised interest.

3. For the purposes of points (a) and (b) of paragraph 2, withholding tax shall be levied pro rata to the period of holding of the debt claim by the beneficial owner. When the paying agent is unable to determine the period of holding on the basis of information in its possession, it shall treat the beneficial owner as having held the debt claim throughout its period of existence unless he provides evidence of the date of acquisition.

4. Tax imposed on and tax withheld on an interest payment other than the withholding tax provided for under this Agreement shall be deducted from the withholding tax calculated in accordance with paragraphs 1 to 3 on the same interest payment.

5. Subject to the provisions of Article 10, the levying of withholding tax by a paying agent established in the Principality of Andorra shall not preclude the Member State of the European Community of residence for tax purposes of the beneficial owner from taxing the income in accordance with its national law. Where a taxpayer declares income from interest paid by a paying agent established in the Principality of Andorra to the tax authorities of the Member State of the European Community where he

resides, this income shall be taxed at the same rate as that applying to interest earned in this Member State.

Article 8

Revenue sharing

1. The Principality of Andorra shall retain 25 % of its revenue from the withholding tax referred to in Article 7 and transfer 75 % to the Member State of the European Community of residence of the beneficial owner.

2. Such transfers shall take place in one single operation for each Member State for each calendar year at the latest within a period of six months following the end of the calendar year in which the tax was levied. The Principality of Andorra shall take the necessary measures to ensure the proper functioning of the revenue-sharing system.

Article 9

Voluntary disclosure

1. The Principality of Andorra shall provide for a procedure allowing beneficial owners not to bear the withholding tax referred to Article 7 where the beneficial owner provides his paying agent with a certificate drawn up in his name by the competent authority of his Member State of residence in accordance with paragraph 2 of this Article.

2. At the request of the beneficial owner, the competent authority of his Member State of residence shall issue a certificate containing the following information:

(a) the name, forename, address and tax identification number or, failing such, the date and place of birth of the beneficial owner;

(b) the name and address of the paying agent;

(c) the account number of the beneficial owner or, where there is none, the identification of the security.

This certificate shall be valid for a period not exceeding three years. It shall be issued to any beneficial owner who requests it within two months of the date of submission of the request.

Article 10

Elimination of double taxation

1. The Member State of the European Community of residence for tax purposes of the beneficial owner shall ensure the elimination of any double taxation which might result from the imposition of the withholding tax

referred to in Article 7, in accordance with paragraphs 2 and 3 of this Article.

2. If interest received by a beneficial owner has been subject to the withholding tax referred to in Article 7 in the Principality of Andorra, the Member State of the European Community of residence for tax purposes of the beneficial owner shall grant him, in accordance with its national law, a tax credit equal to the amount of tax withheld. Where this amount exceeds the amount of tax due in accordance with its national law on the total amount of interest subject to withholding tax, the Member State of residence for tax purposes shall repay the excess amount of tax withheld to the beneficial owner.

3. If, in addition to the withholding tax referred to in Article 7, interest received by a beneficial owner has been subject to any other type of withholding tax and the Member State of the European Community of residence for tax purposes grants a tax credit for such withholding tax in accordance with its national law or double taxation conventions, such other withholding tax shall be credited before the procedure in paragraph 2 is applied.

4. The Member State of the European Community of residence for tax purposes of the beneficial owner may replace the tax credit mechanism referred to in paragraphs 2 and 3 by a refund of the withholding tax referred to in Article 7.

Article 11

Negotiable debt securities

1. From the date of application of this Agreement and as long as the Principality of Andorra imposes the withholding tax referred to in Article 7, and at least one Member State of the European Community applies a similar withholding tax, but until 31 December 2010 at the latest, domestic and international bonds and other negotiable debt securities which were first issued before 1 March 2001 or for which the original issuing prospectuses were approved before that date by the competent authorities within the meaning of Council Directive 80/390/EEC, or by the responsible authorities in the Principality of Andorra, or by the responsible authorities in third countries shall not be considered to be debt claims within the meaning of Article 6(1)(a), provided that no further issues of such negotiable debt securities are made after 1 March 2002.

2. However, as long as at least one of the Member States of the European Community also applies similar measures, the provisions of this Article shall continue to apply beyond 31 December 2010 in respect of negotiable debt securities:

- which contain gross-up and early redemption clauses, and
- where the paying agent defined in Article 4 is established in the Principality of Andorra, and
- where the paying agent pays interest to, or secures the payment of interest for the immediate benefit of, a beneficial owner resident in a Member State of the European Community.

If and where all Member States of the European Community cease to apply similar provisions, the provisions of this Article shall continue to apply solely in respect of negotiable debt securities:

- which contain gross-up and early redemption clauses, and
- where the paying agent of the issuer is established in the Principality of Andorra, and
- where that paying agent pays interest to, or secures the payment of interest for the immediate benefit of, a beneficial owner resident in a Member State of the European Community.

If a further issue is made on or after 1 March 2002 of an abovementioned negotiable debt security issued by a government or a related entity acting as a public authority or whose role is recognised by an international Treaty, the entire issue of such security, consisting of the original issue and any further issue, shall be considered a debt claim within the meaning of Article 6(1)(a).

If a further issue is made on or after 1 March 2002 of an abovementioned negotiable debt security issued by any other issuer not covered by the preceding subparagraph, such further issue shall be considered a debt claim within the meaning of Article 6(1)(a).

3. This Article shall not prevent Member States of the European Community and the Principality of Andorra from taxing the income from the negotiable debt securities referred to in paragraph 1 in accordance with their national laws.

Article 12

Exchange of information on request

1. The competent authorities of the Principality of Andorra and the Member States of the European Community shall exchange information concerning the income covered by this Agreement on conduct constituting a crime of tax fraud under the laws of the requested State or the like. The like includes only an offence with the same level of wrongfulness as conduct constituting a crime of tax fraud under the laws of the requested State. Until it introduces the concept of the crime of tax fraud in its internal law, the Principality of Andorra shall undertake, where it is the requested State, to treat as tax fraud for the purposes of the first subparagraph, conduct which, as a result of deception, damages the financial interests of the tax authorities of the requesting State and constitutes under the laws of the Principality of Andorra the crime of fraud. In response to a duly justified request, the requested State shall provide information concerning matters mentioned above in this Article which are subject to, or likely to be subject to, an investigation by the requesting State on a non-criminal or criminal basis.

2. In order to determine whether information may be provided in response to a request, the requested State shall apply the statute of limitations under the law of the requesting State instead of the statute of limitations applicable under the law of the requested State.

3. The requested State shall provide information where the requesting State has reasonable grounds for suspecting that such conduct constitutes the crime of tax fraud or the like. Where the Principality of Andorra is the requested State, the acceptability of the request must be determined within a time limit of two months, by the judicial authorities of the Principality of Andorra in relation to the conditions laid down in this Article.

4. The requesting State's grounds for suspecting that an offence may have been committed may be based on:

(a) documents, whether authenticated or not, including books of accounts or accounting documents or documents relating to bank accounts;

(b) statements by the taxpayer;

(c) information obtained from an informant or third person that has been independently corroborated or otherwise appears credible; or

(d) circumstantial indirect evidence.

5. Any information exchanged in this way shall be treated as confidential and may be disclosed only to persons or the competent authorities of the Contracting Party with competence for taxation of the

interest payments referred to in Article 1, either as regards withholding tax, and the revenue deriving there from referred to in Articles 7 and 8, or as regards the voluntary disclosure arrangements referred to in Article 9. Those persons or authorities may disclose the information received in public court proceedings or in judicial decisions concerning such taxation. Information may be communicated to another person or authority only with the written and prior agreement of the competent authority of the party providing the information.

6. The Principality of Andorra will agree to enter into bilateral negotiations with any Member State wishing to do so, in order to define the individual categories of cases falling under ‘the like’ in accordance with the procedure applied by that State.

Article 13

Consultation and review

1. The Contracting Parties shall consult each other at least every three years or at the request of either Contracting Party with a view to examining, and — if they consider it necessary — improving the technical functioning of this Agreement and assessing international developments. Consultations shall be held within one month of the request or as soon as possible in urgent cases.

On the basis of such an assessment, the Contracting Parties may consult each other in order to examine whether changes to the Agreement are necessary in the light of international developments.

2. Once they have acquired sufficient experience of the full implementation of Article 7(1) of the Agreement, the Contracting Parties shall consult each other in order to examine whether changes to this Agreement are necessary in the light of international developments.

3. For the purposes of the consultations referred to in paragraphs 1 and 2, the Contracting Parties shall inform each other of any developments which could affect the proper functioning of this Agreement. This shall also include any relevant agreement between one of the Contracting Parties and a third country.

4. In the event of disagreement between the competent authorities of the Principality of Andorra and one or more of the other competent authorities of the Member States of the European Community in accordance with Article 5 of this Agreement on the interpretation or

application of the Agreement, they shall endeavour to resolve their differences amicably. They shall immediately notify the Commission of the European Communities and the competent authorities of the other Member States of the European Community of the results of their consultations. The Commission of the European Communities may take part in the consultations at the request of any of the competent authority on issues of interpretation.

Article 14

Application

1. Application of this Agreement is conditional on the adoption and implementation by the dependent or associated territories of Member States mentioned in the report from the Council (Economic and Financial Affairs) to the European Council of Santa Maria de Feira of 19 and 20 June 2000, and by the United States of America, Monaco, Liechtenstein, Switzerland and San Marino of measures which are respectively identical or equivalent to those laid down in the Directive or in this Agreement and providing for the same dates of implementation.

2. The Contracting Parties shall decide by mutual consent, at least six months before the date referred to in paragraph 6, whether the condition set out in paragraph 1 is satisfied as regards the dates of entry into force of the relevant measures in third countries and the dependent or associated territories concerned. If the Contracting Parties do not decide that this condition is met, they shall fix by mutual consent a new date for the purposes of paragraph 6.

3. Notwithstanding its institutional arrangements, the Principality of Andorra shall implement this Agreement from the date referred to in paragraph 6 and shall notify it to the European Community.

4. Implementation of this Agreement or parts thereof may be suspended by either Contracting Party with immediate effect by means of notification addressed to the other party where the Directive or a part thereof ceases to be applicable either temporarily or permanently in accordance with European Community law, or where one of the Member States of the European Community suspends the application of its implementing legislation.

5. Each Contracting Party may also suspend implementation of this Agreement by notifying the other if one of the five third countries referred

to above (United States of America, Monaco, Liechtenstein, Switzerland or San Marino) or one of the dependent or associated territories of the Member States of the European Community referred to in paragraph 1 subsequently cease applying measures identical or equivalent to those of the directive. Suspension of implementation shall not come into effect until two months after notification. The Agreement shall begin applying again once measures have been reincorporated.

6. The Contracting Parties shall adopt the laws, regulations and administrative provisions necessary to comply with this Agreement by 1 July 2005 at the latest.

Article 15

Signing, entry into force and termination

1. This Agreement shall be ratified or approved by the Contracting Parties in accordance with their internal procedures. The Contracting Parties shall notify each other when these procedures have been completed. This Agreement shall enter into force on the first day of the second month following the last notification.

2. Either Contracting Party may terminate this Agreement by giving notice addressed to the other. In such a case, the Agreement shall cease to have effect twelve months after the serving of said notice.

Article 16

Claims and final account

1. Termination or the total or partial suspension of this Agreement shall not affect claims by individuals.

2. In such a case, the Principality of Andorra shall draw up a final account before this Agreement ceases to apply and make a final payment to the Member States of the European Community.

Article 17

Territorial scope

This Agreement shall apply, on the one hand, to the territories where the Treaty establishing the European Community applies, and under the conditions provided in the said Treaty, and on the other hand, to the territory of the Principality of Andorra.

Article 18

Annexes

1. The two Annexes shall form an integral part of this Agreement.
2. The list of competent authorities featured in Annex I may be modified by a simple notification to the other Contracting Party by the Principality of Andorra in so far as it concerns the authority identified in point (a) of the said Annex, and by the European Community insofar as it concerns the other authorities. The list of related entities featured in Annex II may be amended by common accord.

Article 19

Languages

1. This Agreement is drafted in duplicate in the following languages: Catalan, Czech, Danish, Dutch, English, Estonian, Finnish, French, German, Greek, Hungarian, Italian, Latvian, Lithuanian, Polish, Portuguese, Slovak, Slovenian, Spanish and Swedish; the texts in each language being equally authentic.
2. The Maltese language version shall be authenticated by the Contracting Parties on the basis of an Exchange of Letters. They shall also be authentic, in the same way as for the languages referred to in paragraph 1. *In witness whereof*, the undersigned plenipotentiaries have signed the present Agreement.

Annex D

Memorandum of Understanding

[signed 15 November 2004, accompanying the Agreement on the Taxation of Savings Income]

The European Community, [the member states] and the Principality of Andorra

Have agreed as follows:

When an Agreement providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of income from interest payments (hereinafter referred to as the Directive) was concluded, the European Community, its Member States and the Principality of Andorra signed this Memorandum of Understanding supplementing this Agreement.

1. The signatories to this Memorandum of Understanding consider that the said Agreement between the European Community and the Principality of Andorra and this Memorandum of Understanding are an acceptable agreement protecting the legitimate interests of the Parties. Consequently, they shall apply in good faith the measures agreed and shall refrain from taking any unilateral action which might jeopardise this Agreement without reasonable cause. If a serious discrepancy is discovered between the scope of the Directive adopted on 3 June 2003 and that of the Agreement, in particular as concerns Articles 4 and 6 of the latter, the Contracting Parties shall consult each other forthwith in accordance with Article 13(4) of the Agreement to ensure that the equivalent nature of the measures provided for by the Agreement is safeguarded.

2. The European Community undertakes to enter into, within the transitional period provided for in the abovementioned Directive, discussions with other major financial centres to ensure that measures equivalent to those of the Directive are applied by these jurisdictions.

3. With a view to applying Article 12 of the said Agreement, the Principality of Andorra undertakes to introduce into its legislation during the first year of the application of the Agreement, the concept of the crime of tax fraud, consisting at least of the use of documents which are false, falsified, or recognised as being incorrect in terms of their content, with

intent to deceive the tax authorities in the field of taxation of savings income. The signatories to this Memorandum of Understanding note that this definition of tax fraud concerns only needs relating to the taxation of savings, within the framework of the Agreement, and is without prejudice to developments and/or decisions relating to tax fraud under other circumstances and in other forums.

4. The Principality of Andorra and each Member State of the European Community wishing to do so shall enter into bilateral negotiations to define the administrative procedure for the exchange of information.

5. The signatories to this Memorandum of Understanding solemnly declare that the signing of the Agreement on the taxation of savings, together with the opening of negotiations for a monetary agreement, constitute a significant step in the deepening of cooperation between the Principality and the European Union.

In this context of deepening relations, in parallel with the bilateral negotiations provided under point 4, the Principality of Andorra and each Member State of the European Community shall enter into consultations with a view to defining a wider field of application for economic and fiscal cooperation. These consultations will take place in a spirit of cooperation that takes account of the efforts for alignment in the fiscal area achieved by the Principality of Andorra and solidified by the signature of this Agreement.

In particular, these consultations might lead to the implementation:

- of bilateral programs for economic cooperation in order to promote the integration of the Andorran economy into the European economy,
- of bilateral cooperation in the area of taxation aimed at examining the conditions in which withholding taxes levied by the Member States on receipts from the provision of services and financial products, might be eliminated or reduced.

Drawn up at Brussels, 15 November 2004

Annex E

Allocution de M. Jacques Chirac, Président de la République²

Palais de l'Élysée, Paris, le jeudi 26 avril 2007

[Extraits]

[...] Aujourd'hui, l'Andorre est un État reconnu par la communauté internationale, et les Andorrans ont, entre leurs mains, la maîtrise et la responsabilité intégrales de leur destin.

Depuis 1993, ils ont su, avec talent, assumer la difficile responsabilité de faire connaître et entendre la voix de l'Andorre sur la scène internationale, dont témoigne le nombre croissant d'Ambassadeurs accrédités auprès de ce pays.

La qualité de vos représentants, au sein des nombreuses instances internationales dont l'Andorre est membre, a permis de vous faire apprécier de tous, dans le monde entier, et j'ai été heureux de vous apporter, au nom de la France, un soutien qui ne s'est jamais démenti et que vous m'avez toujours rendu.

Il reste cependant à Andorre de nombreuses étapes à franchir, comme dans toute démocratie, et notamment dans le cadre de ses relations avec l'Union européenne.

La Principauté, par sa géographie, son histoire, ses hommes et ses femmes, est européenne et ne peut rester à l'écart des évolutions des États voisins. L'Andorre dispose ici d'une large variété d'options allant du maintien de l'accord commercial actuel aux arrangements plus ambitieux, tels que la négociation d'un accord d'association. Ces choix seront déterminants pour votre avenir et pour celui des générations futures. Ils doivent cependant être précédés d'une large concertation démocratique et d'une réelle compréhension par la société civile, sans laquelle, dans une démocratie, on ne peut rien. L'Andorre peut compter sur la bienveillance de ses voisins, et de la France en particulier, pour l'aider dans ses démarches, mais il vous revient évidemment de les entreprendre avec confiance et détermination. Par définition, nous soutiendrons les options que vous aurez arrêtées.

[...]

² Prononcée à l'occasion de la cérémonie de remise des lettres de créance des Ambassadeurs accrédités en Principauté d'Andorre.

Annex F

Assessment of Financial Sector Supervision and Regulation in Andorra³

[Extract] Key Recommendations of the International Monetary Fund and Authorities' response

Recommendation	Term	Authorities' Response
Cross Sectoral Issues		
<ul style="list-style-type: none"> • Adopt international accounting standards for all the financial sector, as proposed in draft legislation to be submitted to Parliament, and adapt prudential rules as necessary 	ST	This law is a priority for the MF and should be approved by the General Council in the short run
<ul style="list-style-type: none"> • INAF to develop its capacity for on-site supervision by stepping up training of new staff and gradually hiring additional staff, as needed. 	ST	INAF plans to start on-site exams in late 2007.
<ul style="list-style-type: none"> • INAF to clarify requests to external auditors and reach an understanding of what is expected from them. Hire independent audit firms to assess the quality of external audit reports, as needed. 	ST	INAF already clarifies its requests to auditors when necessary and comments when requests are not addressed as required.
<ul style="list-style-type: none"> • INAF to revisit the frequency of requests made to auditors and consider options to implement rotation work plans. 	ST	INAF will consider implementation of rotation work plans once INAF's on-site exams are implemented.
<ul style="list-style-type: none"> • Integrate all norms for external auditors into a single body of rules. 	ST	INAF will present this proposal in the October 2006 meeting with banks and external auditors.

³ Document of February 2007, available at <http://www.imf.org/external/pubs/ft/scr/2007/cr0769.pdf>.

Banking Regulation and Supervision		
<ul style="list-style-type: none"> • Full authority to grant and revoke bank licenses based on technical elements, should be vested in the INAF. 	MT	The final authority to grant and revoke licenses should remain with the government.
<ul style="list-style-type: none"> • INAF should be empowered to undertake all types of remedial actions, including issue an orderly resolution of a problem bank and the revocation of a financial institution's license. 	MT	The authorities accept that it's necessary to strike a balance between INAF's technical decision and the approval of the government for revocation of financial institutions' license.
<ul style="list-style-type: none"> • Connected Lending: INAF should ensure that credits to insiders and related interests are not granted at preferential rates and that transactions to insiders, such as credits to the members of a bank's Board of Directors, are required to be approved by the Board. 	ST	INAF is considering issuing a communication on this matter.
<ul style="list-style-type: none"> • INAF should intensify its efforts to enter into a formal agreement with the banking authorities of foreign supervisors that will allow full compliance of Andorra as a home and host country supervisor. The INAF should share with the home country supervisor information about the local operations of the foreign banks, provided its confidentiality is protected. 	ST	The authorities reaffirm their intention to enter into a formal agreement with the banking authorities of foreign banks.
Regulation and supervision of Collective Investment Schemes		
<ul style="list-style-type: none"> • Review the draft law on CIS to: i) ensure proper and disclosed basis for asset valuation, pricing and redemption; and ii) strengthen provisions on disclosure to allow evaluation of the suitability of a CIS for a particular investor. 	ST	The authorities intend to work on this as soon as possible.

<ul style="list-style-type: none"> • The government should table the draft law on CIS in the General Council with a view to its adoption as soon as possible. 	MT	Draft laws have been sent to the financial sector entities for comments. This law is a priority for the government.
Regulation and Supervision of Insurance Companies		
<ul style="list-style-type: none"> • The MF should require external auditors to produce a complementary report on policies, systems and processes of insurance companies, including internal controls, and strengthen its oversight capacity. 	ST	Efforts will be concentrated to implement this recommendation in the short term.
<ul style="list-style-type: none"> • Transfer the responsibility for supervision of insurance companies to INAF with sufficient supervisory staff to carry out this responsibility. 	MT	Once the new insurance law is approved, this responsibility will be carried out by INAF.
<ul style="list-style-type: none"> • A new insurance law should be tabled in the General Council, codifying, inter alia, prudential requirements and requirements with regards to internal controls, conduct of business, policy holder protection, public disclosure and international cooperation requirements. 	MT	The MF will prepare a draft law during 2006, in conformity with the International Association of Insurance Supervisors (IAIS) principles. This law is a priority for the MF.

Annex G

OECD Model principles of transparency and information exchange

The headings below correspond to the content of the questionnaire of the OECD's Global Forum on Taxation, addressed to 82 tax jurisdictions (countries and entities), and which provides the basis for establishing a global level playing field in the areas of transparency and effective exchange of information. It is also the basis for OECD's overall assessments of whether jurisdictions are 'cooperative' or 'non-cooperative'⁴.

A. Exchanging information

A.1 Existence of mechanisms for exchange of information upon request

A.2 Scope of information exchange

A.3 Dual criminality and domestic tax interest

A.4 Safeguards and limitations

A.5 Confidentiality requirements

B. Access to bank information

B.1 Bank secrecy rules

B.2 Access to bank information for tax purposes

B.3 Specificity required

B.4 Powers to obtain information in case of refusal to cooperate

C. Access to ownership, identity and accounting information

C.1 Information gathering powers

C.2 Specific secrecy provisions

C.3 Bearer securities

D. Availability of ownership, identity and accounting information

D.1 Ownership information – for companies, trusts, partnerships, foundations

D.2 Accounting information – for companies, trusts, partnerships, foundations

⁴ OECD, *Tax Cooperation – towards a level playing field*, 2006

Annex H

Chapter headings used in EU accession negotiations

Economic issues

Free movement of goods, customs union

Freedom of movement for workers

Right of establishment and freedom to provide services

Free movement of capital

Economic and monetary policy

Taxation

Social policy and employment

Sectoral & structural policies

Agriculture and rural development

Food safety, veterinary and phytosanitary policy

Fisheries

Financial services

Information society and media

Transport policy

Energy

Trans-European networks

Regional policy and coordination of structural instruments

Environment

Competition policy

Enterprise and industrial policy

Public procurement

Company law

Intellectual property law

Consumer and health protection

Education and culture

Science and research

Justice, freedom and security

Judiciary and fundamental rights

Justice, freedom and security

Foreign and security policy

External relations

Foreign, security and defence policy

Horizontal issues

Financial control

Financial and budgetary provisions

Statistics

Institutions

Annex I

Stabilisation & Association Agreement with Croatia, 2005

Political dialogue

Democracy

Regional cooperation

International issues

Common Foreign and Security Policy

Four freedoms

Free movement of goods

Movement of workers, establishment

Supply of services

Current payments and movement of capital

Approximation of laws

Competition policy

Intellectual property

Public contracts

Product standardisation

Consumer protection

Justice and home affairs

Reinforcement of institutions and the rule of law

Visa, border control, migration

Money laundering and drugs

Criminal matters

Cooperation matters

Economic policy & statistics

Financial services

Investment promotion and protection

Industrial cooperation

Small and medium sized enterprises

Tourism

Customs

Taxation

Social policy

Agriculture, agri-industries & fisheries

Education and training

Culture

Information society

Transport

Energy

Environment

Research

Regional development

Financial cooperation

Institutions

Annex J.

EU-Ukraine Action Plan, 2004

Political dialogue and reform

Democracy, rule of law and human rights

Cooperation on foreign and security policy (WMD non-proliferation and disarmament, conflict prevention and crisis management)

Economic and social reform and development

Functioning market economy

Monetary exchange rate and fiscal policies

Trade market and regulatory reform

Movement of goods

Right of establishment, company law and services

Movement of capital and current payments

Movement of persons including workers

Taxation

Competition policy

Intellectual property rights

Public procurement

Cooperation in Justice and Home Affairs

Major sectoral policies

Transport

Energy

Information society

Environment

People to people contacts

Research & technology

Education, training and youth

Culture

Civil society cooperation

Cross-border and regional cooperation

Public health