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Back to the Future? Lessons from the EFTA Countries for the UK's Withdrawal from the EU

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1. Introduction: back to the future?

On 23 June 2016, the voters in the United Kingdom (UK) decided by 51.9% to 48.1% that their country should leave the European Union (EU). Whereas clear majorities in England (73%) and Wales (71.7%) voted for a withdrawal, majorities in Northern Ireland (55.8%), Scotland (62%) and Gibraltar (95.9%) were in favour of remaining in the EU (Phinnemore & McGowan 2016: 7). The referendum has revived the debate on differentiated integration in Europe and more specifically on how the UK can organize its future relations with the EU. References have in the debate been made to the 'Swiss model', the 'Norwegian model', and even to Liechtenstein's 'special solution', in particular for the free movement of persons (see, for instance, Emerson 2016; Phinnemore & McGowan 2016: 19-28; Burke, Hannesson & Bangsund 2016). These countries are currently all members of the European Free Trade Association (EFTA). The UK – a founding member of EFTA in 1960 – had left the Association in 1973 in order to join the European Community (EC).

The EFTA countries are closely associated to the EU's internal market, be it through a plethora of bilateral agreements as in the Swiss case or through membership in the European Economic Area (EEA), an EU-EFTA association agreement in force since 1994. For some observers, they appear to enjoy more sovereignty than an EU member, for instance in the conduct of their own trade policy or because they seemingly are outside the reach of supranational institutions like the European Commission or the European Court of Justice (ECJ). This raises the question whether the UK – or parts thereof – could or should not go 'back to the future' and (re-)join EFTA and/or the EEA, and under which conditions such an EFTA-related association of the UK would function well.

For several months after the Brexit vote, a number of British politicians still floated the idea that the UK could remain in the single market or even the customs union while leaving the EU. The Scottish government (2016: 3) argued that the UK should remain in the internal market as a member of the EEA and within the EU customs union. Alternatively, Scotland should remain in the single market even if the rest of the UK would leave. In the latter case, Scotland would become 'a full or associate member of EFTA' and thereafter join the EEA or 'enter a direct association with the EEA' (ibid.: 29). Also the Welsh government (2017: 6) came out in favour of a 'soft Brexit', stressing that the UK should search for 'full and unfettered access to the Single Market for goods, services and capital' by way of membership of EFTA, of the EEA or through 'a negotiated bespoke arrangement unique to the UK'.

In her Lancaster House speech on 17 January 2017, the Prime Minister finally made clear that her government was not seeking 'partial membership of the European Union, associate membership of the European Union, or anything that leaves us half-in, half-out', nor any 'model already enjoyed by other countries' (May 2017a). On 29 March 2017, the British government triggered Article 50 TEU, starting the clock for two years to negotiate – according to the Prime Minister's notice of withdrawal letter – 'a deep and special partnership' with the EU in economic and security cooperation and 'a bold and ambitious Free Trade Agreement' (May 2017b). In this context, the International Trade Committee of the House of Commons (2017: 4) recently recommended the government to evaluate the implications of the UK's re-joining EFTA, and possibly EFTA's free trade agreements (FTAs) with third countries, yet not the EEA.

This paper examines the lessons to be learned from EFTA for the post-Brexit EU-UK relations, in particular with regard to the British priorities concerning the internal market and its four freedoms: an own trade policy, curbing immigration and 'taking back control'. The paper argues that the case of the EFTA states shows that a far-reaching participation in the internal market which excludes immigration from the EU, as envisaged by the British Leave campaign, is not an option. Moreover, for the sake of market homogeneity, a dynamic form of deep and comprehensive integration requires an efficient institutional set-up for taking over relevant new EU acts and case law and for ensuring the surveillance and enforcement of these obligations. The paper shows that even the highly institutionalized EEA suffers from shortcomings in terms of violated market homogeneity, resulting in legal adaptations in order to protect the EFTA states' sovereignty and regulatory preferences, while granting them limited participation in EU 'decision-shaping', a 'process of contributing to and influencing policy proposals up until they are formally adopted' (EFTA Secretariat 2009: 20).

The paper first sets out the analytical framework, followed by the UK's preferences with regard to the Brexit negotiations. It then analyses the lessons to be drawn from the EFTA experience with regard to trade in goods and services, the free movement of persons and the institutional questions.

2. Analytical framework

Leuffen, Rittberger and Schimmelfennig (2013: 17-18) distinguish internal differentiation, where EU rules do not apply uniformly to all member states, from external differentiation, where outsiders also take over EU *acquis*. These non-members do so either by way of adopting 'mirror legislation' like in the EEA and Schengen area or based on the principle of equivalence of law as in the case of most EU-Swiss agreements. In a nutshell, external differentiation means a formal opt-in of a non-member state into a specific policy area of the EU. In this way, the EU and the respective country define common rights and obligations for their citizens and businesses. The extent and validity of those obligations are usually defined by the scope and institutionalization set out in the agreement itself. The EU's neighbourhood is characterized by patterns of external differentiated integration which vary not only with regard to the scope of the sectors covered in the internal market – defined as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured' (Art. 26(2) TFEU) – but also the degree of institutionalization (see, for instance, Gstöhl 2015).

The EU has concluded various bilateral agreements with the EFTA states, but over 90% of the references to EU secondary law contained in these agreements are part of the EEA Agreement (Frommelt 2017). The EEA's functional scope allows for a far-reaching internal market association, or a 'single market-minus' (Pelkmans & Böhler 2013: 2).

Treating Switzerland as a case of external differentiated integration, Jenni (2016) finds with regard to federal laws that the incorporation of EU rules was a steady characteristic since the 1990s, either based on 'autonomous adaptation' or the implementation of bilateral sectoral agreements. Similar to

the EEA, the sectoral agreements cover substantial parts of the EU's internal market. Although less far-reaching, the integration process based on the Swiss-EU agreements follows the same lines as the one based on the EEA Agreement. In addition to this formal, legal integration, all four EFTA states have become politically highly Europeanized (see Gava & Varione 2014; EEA Review Committee 2012; Jónsdóttir 2013; Frommelt & Gstöhl 2011).

The paper proceeds with three steps of analysis: based on a brief analysis of the UK's preferences with regard to its future relationship with the EU internal market, it examines to what extent 'a deep and special partnership' is possible in light of the lessons learned by the EFTA countries.

3. UK preferences: 'Leave' the EU but 'Remain' close to the single market

In reaction to the 'hot issues' of the referendum campaign, which concentrated on the internal market rather than the Common Foreign and Security Policy (CFSP), the UK government identified in particular three 'red lines' for its post-Brexit relations with the EU: (1) conducting an independent British trade policy, (2) containing immigration to Britain from Europe, and (3) taking back control of laws (and the interpretation thereof).

3.1 British 'red lines'

The British government aims at 'the freest possible trade in goods and services', including 'strong cooperative oversight arrangements' for financial services and 'a new customs agreement', a vague term which most likely refers to trade facilitation (UK Government 2017: 35, 42). The UK should no longer be part of the EU's customs union and common commercial policy. In the words of the Prime Minister, 'I want Britain to be able to negotiate its own trade agreements. But I also want tariff-free trade with Europe and cross-border trade there to be as frictionless as possible' with 'the greatest possible access to the single market' (May 2017a). The UK will thus have to develop a national trade policy, including autonomous instruments such as anti-dumping procedures or preferences for developing countries and an own position in the World Trade Organization (WTO). As a member of the WTO, the UK plans to 'replicate as far as possible' the EU's tariff schedules and commitments, while it hopes to somehow continue the EU's trade agreements with non-EU countries, 'to strike deals better suited for the UK and to make quicker progress with new partners' (UK Government 2017: 55-56). Yet any WTO member might object and demand to negotiate with the UK, including about the disentangling of the EU's agricultural commitments. As a priority, the UK needs to clarify its trade relations with the EU and in the WTO before it can negotiate any trade agreements with other countries. Holmes, Rollo & Winters (2016: 22) argue that 'the workload and time pressure that even a least-change version of Brexit entails suggest that deciding, let alone negotiating, a completely new regime is unrealistic' in the next few years.

The third freedom – the free movement of capital – poses no particular challenge since Art. 63 TFEU prohibits all restrictions on the movement of capital or on payments between member states and between member states and third countries. The fourth freedom, however, the free movement of persons, took centre stage during the referendum campaign. Therefore, the UK government aims to ensure it can control and reduce immigration to Britain from Europe but still 'encourage the brightest and the best to come to this country' (UK Government 2017: 26). It has, however, not specified how a new system could look like, except that the status of EU citizens in the UK and of UK citizens in the EU should be secured and the Common Travel Area (CTA) with the Republic of Ireland maintained. In particular, the border between Northern Ireland and Ireland should remain open – although it will become the external border of the EU – and the CTA should continue to allow for free travel without passport controls. This is also imperative in the context of the 1998 Belfast-Good Friday Agreement which had settled the conflict in Northern Ireland.

Most important for many voters was probably the desire to repatriate the power to make rules from the EU. Parliamentary sovereignty is a fundamental principle of the UK's unwritten constitution. The UK government plans to repeal the 1972 European Communities Act by the 'Great Repeal Bill' and convert the current *acquis* (including directly applicable regulations) into British law. According to the Prime Minister, this means 'we will take back control of our laws and bring an end to the jurisdiction of the European Court of Justice in Britain' (May 2017a). Taking back control also means that future 'laws will be made in London, Edinburgh, Cardiff and Belfast, and will be based on the specific interests and values of the UK' (UK Government 2017: 13).

3.2 Challenges for the Brexit negotiations

Like the United Kingdom, the EU institutions want an orderly exit of the UK from the EU and have underlined the need for legal certainty and sincere cooperation as well as the importance of Northern Ireland, of continuing security cooperation and of prioritizing citizens' rights (see European Council 2017; European Commission 2017; European Parliament 2017). Furthermore, the EU expects the UK to settle its financial obligations and to maintain the supervisory role of the Commission and the jurisdiction of the ECJ during the transition phase.

Whereas the UK government wanted to negotiate the withdrawal agreement and an ambitious free trade agreement alongside each other, the EU has made clear that negotiations on a transitional arrangement and a future partnership can only start once substantial progress has been made towards a withdrawal agreement, and can only be concluded once the UK has become a third country.

Regarding a future agreement, the EU had repeatedly insisted that 'membership of the internal market and the customs union entails acceptance of the four freedoms, the jurisdiction of the ECJ, general budgetary contributions and adherence to the European Union's common commercial policy' (European Parliament 2017). After many ambiguous statements to the contrary, the Prime Minister's notice of withdrawal letter acknowledged that membership of the internal market was not on the table since 'the four freedoms of the single market are indivisible and there can be no "cherry picking"'.

Finally, any agreement must respect the integrity of the EU's legal order and decision-making autonomy, be based on a balance of rights and obligations for both parties and preserve the integrity of the single market, thus excluding a sector-by-sector approach. The future partnership should also include appropriate enforcement and dispute settlement mechanisms (European Council 2017).

In sum, a main economic challenge for the UK is the establishment of an own trade policy as fast and far-reaching as possible and of a new immigration system for EU/EEA citizens. A major political challenge are the devolved administrations in the United Kingdom, in particular those parts that voted in favour of remaining in the EU. While a hard land border needs to be avoided in Northern Ireland, Scotland is considering a new referendum on independence, and the British Overseas Territory Gibraltar faces pressure from Spain, which had long advocated shared sovereignty over the rock. The biggest institutional challenge is how the UK can in future avoid diverging legal orders with the EU, both in terms of new legislation and case law.

4. EFTA lessons for trade in goods and services

The EEA Agreement has since 1994 extended the internal market's four freedoms as well as cooperation in horizontal and flanking policies (such as research and development, environment, and consumer protection) to the EFTA members, except for Switzerland. In brief, the four freedoms

removed technical, regulatory and legal barriers between the EEA states, liberalized monopolistic public utility markets such as energy supply or telecommunication services, and harmonized rules, for instance the mutual recognition of professional qualifications, intellectual property and financial supervision. Harmonization guarantees equal protection for all citizens and a level playing field for economic operators. From the EEA excluded are the common agricultural and fisheries policies, the customs union and common commercial policy, taxation, the CFSP, justice and home affairs and the economic and monetary union.

When it comes to trade policy, EFTA is an intergovernmental organization establishing a free trade area. It thus has no common commercial policy or external tariff. This enables the EFTA states to pursue their own trade policy both jointly and individually. Prominent examples for this flexible approach are the FTAs that Switzerland and Iceland have concluded with China or the FTA between Switzerland and Japan – cases in which the EFTA states were not able to agree on a common approach. EFTA currently runs a worldwide network of 27 FTAs covering 38 countries, although initially its third-country policy was established to 'emulate' the EU's trade policy (EFTA 2017). In the meantime, however, the EFTA countries sometimes conclude FTAs earlier than the EU does.

4.1 Fuzzy freedoms in external differentiated integration

In case of external differentiation, the four freedoms are difficult to disentangle, and the actual scope of internal market coverage in the EEA is in most areas indistinct as the degree of correspondence between EU and EEA law varies greatly. The free movement of goods, for instance, comprises various EU acts relying on a legal basis that refers to the (excluded) EU treaty chapter of agriculture and fisheries. Moreover, the lines between the internal market *per se* and other parts of EU law have become increasingly blurred. Consequently, an EU act can include both EEA relevant provisions and non-EEA relevant provisions. This indistinctness complicates the selection and incorporation of the relevant secondary law by the EEA EFTA countries. The EEA is also affected by the spill over of issues which are traditionally linked to integration in 'core state powers' such as fiscal affairs, defence and foreign policy, migration, citizenship and internal security. For example, the EFTA Surveillance Authority (ESA) and the EFTA Court (2011) forced Liechtenstein to adjust its tax act which had infringed on the EEA rules governing state aid. The EEA EFTA states also had to incorporate the Directive 2008/99 on the protection of the environment through criminal law (32008L0099) or the Directive 2009/43/EC on simplifying terms and conditions of transfers of defence-related products (32009L0043) into the EEA Agreement.

In contrast to the EEA Agreement, the sectoral agreements between Switzerland and the EU do not cover the free movement of services (except for some aspects such as civil aviation and overland transport or direct insurance for damage). According to the Swiss Federal Council (2006: 6897), negotiations on an agreement failed because the EU insisted on the incorporation of horizontal policies like competition, state aid or company law. Moreover, Switzerland was not willing to liberalize its state-controlled sectors such as telecommunication, electricity or postal services by the speed and to the extent required by EU law. The Swiss government also faced domestic opposition towards the incorporation of EU acts combatting money laundering or insider trading (Nufer 2006: 11). However, the lack of an agreement governing the free movement of services increasingly impedes market access for Swiss businesses. The Swiss Bankers Association (2017) thus favours in the longer run at least a new sectoral agreement on financial services with the EU. The Swiss banks – as London's finance industry – are particularly interested in the so-called EU passport system which allows banks or financial companies that are authorized to do business in their home country to trade across the entire EU without separate authorization in the other member states. The EEA EFTA states are currently the only non-EU countries to which such passporting rights were granted. By contrast, Switzerland has to ask for an 'equivalence' treatment which is much more of a 'piecemeal approach'

because the rights granted by equivalence mostly cover specific parts of an EU act and can be withdrawn by the Commission at any time (European Parliament 2017: 2). However, passporting rights are only available if the respective agreement ensures the literal and dynamic adoption of the relevant EU *acquis*.

4.2 'Parallel marketability' as a solution?

Frommelt (2017) shows that there are various opt-outs and tailor-made arrangements for the EEA EFTA states, and – not surprisingly – in particular for Liechtenstein which is by far the smallest EEA member. By the end of 2015, 42% of the EU law in force in the EEA did not fully apply to Liechtenstein. By contrast, Iceland had opt-outs in place for 7.8% of the EU acts in force and Norway for 1.6%. Most of Liechtenstein's specific opt-outs are technical exemptions that are related to its smallness or its close relations with Switzerland (Frommelt 2016). Two tailor-made arrangements for Liechtenstein are of particular interest in the Brexit debate: its special solution for the free movement of persons (see below, section 5.2) and the principle of parallel marketability.

When in December 1992 the Swiss people and cantons rejected EEA membership, whereas the citizens of Liechtenstein approved it one week later, the maintenance of the much appreciated customs union and open border between the neighbouring countries posed a challenge. To allow Liechtenstein to join the EEA, innovative adaptations of several bilateral Swiss-Liechtenstein agreements were necessary. This 'squaring of the circle' was rendered possible by the political will on all sides in view of the democratic votes, the tiny territory of the principality and the fact that Art. 121(b) EEA Agreement had already recognized the regional union between Switzerland and Liechtenstein (see Gstöhl 1997). A reintroduction of border controls would have been contrary to the very idea of European integration. Part of the solution was the 'parallel marketability' of goods that enables Liechtenstein to apply Swiss technical regulations and standards deriving from its regional union with Switzerland on the Liechtenstein market in parallel with the legislation implementing the EU acts incorporated into the EEA Agreement. However, Liechtenstein had to create a national market surveillance and control system in order to prevent that Swiss products differing from EEA standards are exported into EEA countries and products following different EEA standards are marketed in Switzerland.

The parallel marketability mainly covers goods with different tariffs (such as fish or agricultural products) as well as products with different technical standards (like chemicals or medicinal products). Due to the various sectoral agreements between Switzerland and the EU, the number of products subject to parallel marketability decreased significantly over time. Overall, the system has worked well, but it also has its limits. For example, a judgment of the ECJ (2005) related to the calculation of the term of protection of specific certificates for medicinal products approved by Switzerland – and thus also by Liechtenstein – has forced both countries to confine the parallel marketability in order to protect the economic interests of Swiss businesses (Frommelt & Gstöhl 2011: 43).

The Scottish Government (2016: 35) argues that the 'principle of "parallel marketability" whereby goods and services originating in Scotland may be legally marketed in both the UK and the EEA' could in future ensure Scotland's simultaneous membership in the EU internal market and the UK customs union. However, despite the success of the parallel marketability in Liechtenstein, the functioning of such a model in Scotland or Northern Ireland – in the unlikely case that the EU would accept it – is highly questionable as the territories of Scotland and Northern Ireland are much bigger than Liechtenstein. Furthermore, it would require that the EU and the UK formally agree on some kind of harmonization of technical barriers to trade in order to keep the number of products with different

standards as low as possible. Put simply, due to the different political context and its smallness Liechtenstein cannot be treated as a precedent.

To sum up this section, there are five EFTA lessons for trade in goods and services. First, for all EFTA states a traditional FTA with the EU was insufficient, and they were willing to harmonize their national rules with EU rules by concluding agreements with the EU to ensure further access to the internal market. Moreover, the practice of 'autonomous adaptation' to EU rules in Switzerland shows that due to its high economic interdependence with the EU, the harmonization of rules goes *de facto* beyond formal agreements. Second, the regulatory boundary of the EFTA states' relations with the EU is difficult to draw as the scope of their external differentiated integration is diffuse and indistinct. Third, the principle of homogeneity, as stated in the EEA Agreement, indeed guarantees non-member states a non-discriminatory access to EU internal market. Due to the often low speed of incorporation in the EEA, however, market homogeneity is not always achieved. Subsequently, the EEA EFTA states may temporarily be impeded from access to the EU internal market. Fourth, Liechtenstein is the only EFTA state that was able to acquire a substantial number of opt-outs and tailor-made arrangements such as the principle of parallel marketability. Yet, due to its smallness, Liechtenstein cannot serve as a precedent for other countries. Fifth, as a free trade area and intergovernmental organization, EFTA allows its members to conduct an own trade policy vis-à-vis third countries, but also offers the advantage of negotiating together in case of common interests.

5. EFTA lessons for the free movement of persons

One of the most salient issues in the Brexit debate has been the free movement of persons. The UK government aims to ensure it can control and reduce immigration from Europe.

5.1 Non-discrimination as a core principle

The free movement of persons gives EEA nationals the possibility to live, work and study in any EEA state. To this end, members shall eliminate any discrimination on grounds of nationality as well as 'non-discriminatory measures which are liable to prohibit, impede or render less advantageous the use of the freedoms' (Fredriksen 2016: 404).

Switzerland concluded in 1999 an agreement on the free movement of persons (AFMP) with the EU in the framework of the first package of bilateral agreements which entered into force in 2002. It contained a so-called 'guillotine clause', a contractual stipulation that links all treaties. If only one of them was not ratified, or cancelled later, all of the agreements would be deemed terminated. The AFMP has from the start met some domestic opposition, and since 2000 four popular votes related to the agreement took place. A majority of the Swiss people and cantons supported the first package of bilateral agreements in 2000 as well as the extension of the AFMP to the new EU member states in 2005 and 2009. However, in 2014 a popular initiative requiring the introduction of immigration quotas was accepted by a slim margin of 50.3% (Swiss Federal Council 2017). This constitutional amendment, which the Swiss government had to implement within three years, was not compatible with the agreement. The non-extension of the AFMP to Croatia after its accession to the EU in 2013 triggered Switzerland's (partial) loss of access to the EU's 'Horizon 2020' and 'Erasmus+' programmes. The Commission rejected the Swiss proposal of a unilateral safeguard clause with a national ceiling on EU migration to Switzerland as a solution, while the 'guillotine clause' risked terminating the entire series of bilateral treaties. Finally, in December 2016 the Swiss Parliament adopted a more flexible and much weaker implementation which does not include quotas or any kind of discrimination on grounds of nationality and can thus be considered compatible with the AFMP. The negotiations were complicated by the Brexit debate as the EU was 'wary of creating a flexible precedent that Britain might be able to use in negotiating a new bilateral relationship with the bloc' (The Guardian 2016).

The experience with the EEA and the sectoral agreements of Switzerland show the fundamental character of the principle of non-discrimination on grounds of nationality. Likewise, it highlights the indivisibility of certain aspects of the EU internal market in order to maintain a balance between benefits and obligations. In EFTA history, this is known as one of the so-called 'Interlaken principles' that the EU had stressed since the late 1980s (see De Clercq 1987). The EU does not grant any *à la carte* integration with its internal market in terms of picking and choosing. Indeed, rich countries such as the EFTA states contribute as well to cohesion in the EU through special financial cooperation mechanisms. Moreover, the EU has in return for internal market access also sought additional bilateral agreements in areas of its own interest such as taxation. This also means that a comprehensive participation in the internal market without free movement of persons is hard to imagine. The Council of the EU (2017b) reiterated vis-à-vis Switzerland 'that the free movement of persons is a fundamental pillar of EU policy and that the internal market and its four freedoms are indivisible'.

Despite constituting an essential part of the EEA and the Swiss-EU relations, the scope of the free movement of persons differs between the two models of association but also compared to the EU. This becomes particularly visible in relation to the so-called 'Citizenship Directive' (32004L0038). After long negotiations and after the EU invoked Art. 102 of the EEA Agreement, which stipulates that the parts of the Annex of the EEA Agreement directly affected by the EU act in question are suspended if a conciliation procedure is unsuccessful, the EEA EFTA states in 2007 finally agreed to incorporate this directive. However, the Decision No 158/2007 of the EEA Joint Committee included some specific adaptations as well as a Joint Declaration by the contracting parties. This Joint Declaration states, for instance, that the concept of union citizenship has no equivalent in the EEA Agreement and thus excludes any prejudice to the evaluation of the EEA relevance of future EU legislation as well as future case law of the ECJ based on the concept of union citizenship. Hence, the exact demarcation of the free movement of persons in the EEA remains uncertain. According to Fredriksen (2016: 400), the EFTA Court has so far done 'its outmost to preserve homogeneity in the interpretation and application' of the Citizenship Directive. In contrast to the EEA EFTA states, Switzerland has successfully resisted the EU pressure to adjust the AFMP to the Citizenship Directive. This affects in particular the rights of economically inactive EU nationals (for instance with regard to 'social assistance') as well as the practice of family reunification in Switzerland.

Another challenge for the EFTA states is the growing political connection between the free movement of persons and EU migration policy. For instance, in its review of the EEA Agreement the European Commission (2012: 4) states that it 'would be important as well to include the [EU] policy on trafficking in human beings in the EEA Agreement'.

Norway and Iceland are associated with the Schengen area and Dublin convention since 2000, Switzerland since 2008 and Liechtenstein since 2011. These associations are located outside the EEA on a bilateral level. The EFTA countries are required to adopt the relevant *acquis*. In return, similar to the EEA, they have the right to participate in decision-shaping but not a formal right of decision-making in the further development of the *acquis* in this field. In the updated EFTA Convention, which entered into force in 2002 in parallel with the EU-Swiss bilateral agreements, the free movement of persons (as well as trade in services and other issues) was also granted among the four EFTA states themselves.

5.2 Liechtenstein's 'special solution' in the EEA: a precedent?

The most prominent and politically most sensitive opt-out of Liechtenstein is the 'special solution' which allows a quantitative restriction on the number of new residents. This arrangement was the

outcome of a longer process. The EEA Agreement contained in Protocol 15 a standard transitional period (until the end of 1997) and a review clause which foresaw to jointly review the transitional measures 'duly taking into account the specific geographic situation of Liechtenstein'. In the context of the negotiations adapting the EEA Agreement to the revised Liechtenstein-Swiss regional union, the Liechtenstein government obtained in 1995 an additional joint declaration with the EEA Council (Decision 1/95). This declaration recognized Liechtenstein as a very small area of rural character with an unusually high percentage of non-national residents and employees. It also acknowledged the principality's vital interest in maintaining its own national identity.

In view of the expiry of the transitional period as of 1998 and the failure to negotiate a solution on time, the Liechtenstein government invoked the safeguard clause of the EEA Agreement (Art. 112) which allows a contracting party to take unilateral measures 'if serious economic, societal or environmental difficulties of a sectorial or regional nature liable to persist are arising'. In 1999 the EEA Joint Committee agreed in Decision 191/1999 under Liechtenstein's chair to extend the transitional period until the end of 2006 because the principality's situation still justified the maintenance of special conditions. The special solution was incorporated as a 'sectoral adaptation' to Annexes V (free movement of workers) and VIII (right of establishment) of the EEA Agreement and therefore did not require specific ratification by the contracting parties. Before the expiry of that second transitional period, the EU had to enter negotiations with the EEA EFTA countries on the enlargement of the EEA to the ten new EU member states (Art. 128 EEA Agreement). On this occasion, the special solution for Liechtenstein was in 2004 slightly amended. It thus no longer expires automatically but became a 'quasi-permanent' exception, subject to a review every five years. The later EEA enlargement agreements (Bulgaria, Romania, Croatia) followed this example.

As a result, the free movement of persons applies to Liechtenstein citizens, but EEA citizens wishing to live in the country have to obtain a residence permit. The number of permits is limited, with a yearly net increase. There are no restrictions preventing family members of holders of a residence permit from joining and they also have the right to take up an economic activity. The authorities shall grant the new permits in a way that is not discriminatory and does not distort competition. In order to guarantee equal chances, half of them are granted by a ballot procedure. The number of applications for residence permits exceeds the allocable quota by multiple times. Yet, obtaining a residence permit is not a requirement to work in Liechtenstein, and many people commute on a daily basis from neighbouring countries.

The special solution applying to Liechtenstein is closely linked to its tiny territory (160 km^2) and high number of foreigners in its resident population of 38'000 people (about one third and two thirds of the workforce). It has emerged over time as a complex, tailor-made solution institutionally embedded in the EEA. No EU or EEA EFTA state has so far contested Liechtenstein's limited absorption capacity (see European Commission 2015). This is also in line with the declaration on Article 8 TEU, introduced by the Lisbon Treaty, in which the EU promises to 'take into account the particular situation of small-sized countries which maintain specific relations of proximity with it'.

The lessons to be drawn from EFTA's participation in the free movement of persons are, first and foremost, the importance of safeguarding non-discrimination and a balance of benefits and obligations. This also means that a comprehensive participation in the internal market without free movement of persons is hard to imagine for countries such as the EFTA members or the UK. Second, the actual scope of the free movement of persons may slightly differ between the EU and a case of external differentiation, but still includes particularly salient issues such as free movement of economically inactive persons, family reunification or coordination of social security systems. Third, the special arrangement for Liechtenstein in this field (which is not an opt-out nor a suspension) is closely linked to its small territory and high share of foreigners. The fact that Liechtenstein was

embedded in a multilateral institutional framework was conducive to a tailor-made solution and could hardly have been negotiated bilaterally.

6. EFTA lessons for the institutional structure

The EEA is an elaborate two-pillar system whereas Switzerland's bilateral relations with the EU are largely based on agreement-specific joint committees. Both cases show that far-reaching participation in the internal market poses important institutional challenges (see also Gstöhl 2015).

6.1 Two-pillar system in the EEA: decision-shaping in return for market homogeneity

The EEA negotiations launched in 1989 between the then 12 EU member states and seven EFTA countries were a difficult process regarding the institutional questions (see Gstöhl 1994). In December 1991, the ECJ delivered its Opinion 1/91 according to which the proposed new joint EEA Court, composed of judges from the ECJ and the EFTA side, but functionally integrated with the ECJ, was incompatible with EU law (European Court of Justice 1991). In order to avoid the risk of undermining the autonomy of the Community legal order by infringing on the jurisdiction of the ECJ, the EFTA countries ultimately accepted to create an own EFTA Court of Justice. The EEA Joint Committee was tasked with reviewing the development of the case law and settling any disputes between the two Courts. The institutional set-up of the EEA can best be described as a two-pillar system with the EEA EFTA institutions matching those on the EU side for decision-making as well as the supervision and judicial control of EEA law.

The 'dilemma' of the EEA EFTA states consists in the fact that they do not have the right to vote in the EU policy-making and are unable, constitutionally, to accept decisions made by the EU institutions directly. Despite their objection to transfer legislative and judicial power to the EU, the actual level of centralization in the EEA transcends the narrow confines of its initial conceptualization as an agreement subject to public international law. Against this background, the EFTA Court (1998) has interpreted the EEA Agreement as an 'international agreement sui generis with a distinct legal order of its own' that is closer to supranational EU law than to public international law. Indeed, over the last two decades, the EEA's two-pillar structure has been filled with a multitude of *ad hoc* rules for EEA decision-making that alternate between intergovernmental cooperation within the EEA Joint Committee (for instance for the flanking policies) and the EEA EFTA states' subordination to the EU pillar with an exclusive decision-making of EU bodies (like the EEA EFTA participation in the European Aviation Safety Agency).

The deepening of the EEA's institutionalization takes place along two lines. First, there is a transfer of decision-making power from the EEA EFTA states to EFTA and EU bodies. Second, there is an institutional spill over of EU-specific patterns of governance, for instance through the increasing importance of EU agencies for EEA-relevant policies, which ties the EEA decision-making more closely to the one of the EU. This deepening mostly occurs during the incorporation of EU legal acts since the main parts of the EEA Agreement remained largely unchanged since 1994.

The degree of the EEA EFTA states' organizational inclusion in EU policy-making ranges widely from no to almost full inclusion (in EU committees that do not have legislative power). There are various types and mechanisms of decision-shaping such as the submission of written comments, the participation in expert groups of the Commission or in comitology committees. Nonetheless, the incorporation of EU secondary law into the EEA Agreement is determined by an 'inherently asymmetric process' (EFTA Secretariat 2009: 7). The most prominent examples of institutional asymmetry are: the lack of a right to vote in the above-mentioned committees and expert groups; and the fact that access to the European Parliament and the Council of the EU was refused. Moreover,

reports from experts of the EEA EFTA states show that they may in practice face further restrictions, for instance, a limited or late access to documents (Jónsdóttir 2013).

For forms of external differentiation such as the EEA, which extend the internal market based on the *acquis*, the common rules must be identical in substance, making homogeneity a key principle. In the dynamic EEA, the common rules are continuously updated by adding new EEA-relevant EU legislation. At the same time, the institutions of the EU and the EFTA pillar ensure the supervision and identical interpretation of those rules. In practice, homogeneity means that the contracting parties have to select the EEA relevant EU acts from the EU secondary law, ensure the timely and complete incorporation of those EU acts into the EEA Agreement as well as their correct transposition and application within the national legal orders.

The assessments of the EEA's functioning in the past two decades have overall been positive (Council of the EU 2016; EEA Review Committee 2012; European Commission 2012). However, the EEA is plagued by various shortcomings, in particular a slow speed of incorporation of new EU secondary law into the EEA Agreement (Frommelt 2017). Taking into account the dynamics of the EU law making and the complexity of the EEA policy process, delays are often unavoidable. This means that the EEA EFTA states may have to comply much later with an EEA relevant EU act than the EU members. Hence, different sets of rules apply for the EU and EEA EFTA states, which temporarily reduces the market's homogeneity. In total only 16% of the 4573 directives and regulations incorporated into the EEA Agreement between 1994 and 2015 had the same compliance dates for the EU and the EEA EFTA states (ibid.). Put differently, the EEA EFTA states could not ensure homogeneity for the entire period of application of EU acts in 84% of the cases. In practice, different compliance dates can have two opposite effects. On the one hand, single market stakeholders may face different legal requirements when operating in the EU or the EEA EFTA states, which can lead to competitive advantages for operators based in the EEA EFTA states. On the other hand, the citizens and businesses of the EEA EFTA states and the products originating in those countries may not be able to benefit right away from the internal market. Both effects infringe on the homogeneity and legal certainty in the EEA.

Frommelt (2017) argues that institutional, country-specific and policy-related factors define the conditions of well-functioning external differentiated integration. That is, the institutional set-up of external differentiation is a necessary but not sufficient condition of effectiveness. In this regard, the specific characteristics of the EEA EFTA states, in particular the combination of their small size, strong economic interdependence with the EU and high state capacity, are likely to mitigate constraints resulting from the institutional complexity of the EEA's two-pillar structure. Yet, over the last two decades the speed of incorporation differed greatly across the different EU acts, which shows that the effectiveness of the EEA is also determined by the specific features of the EU acts in question such as the institutional requirements, functional scope, or salience. The EFTA countries are highly developed, small and 'like-minded' countries that are, in principle, eligible for EU membership. They have to 'speak with one voice' in the EEA bodies. If an EEA EFTA state opposes the incorporation of a new EU act, for instance due to a misfit with its economic preferences or constitutional constraints, this could trigger the suspension of the affected parts of the EEA Agreement for all EEA EFTA states. It is therefore no surprise that the EEA EFTA states are not very keen on more members.

6.2 Switzerland's search for an institutional solution

EFTA member Switzerland opted through a referendum in 1992 not to participate in the EEA. Instead, the country pursued a bilateral approach, building on its 1972 FTA with the EC. In two package deals in 1999 and 2004 it concluded 16 new sectoral agreements with the EU (free movement of persons, technical barriers to trade, public procurement, civil aviation, overland transport, agriculture, research, Schengen and Dublin association, taxation of savings, fight against fraud, processed

agricultural products, environment, statistics, media, education, and pensions). A few more agreements have followed since and some are still under negotiations. Most of these 'bilaterals' are based on the notion of equivalence of laws between the EU and Switzerland and any changes need to be negotiated, albeit with the exceptions of civil aviation and the Schengen/Dublin association. This sectoral approach lacks an overarching structure to deal with the around 20 main agreements, most of which are at a technical level run by a consensus-based Joint Committee, and the more than 100 secondary agreements.

The EU has in recent years insisted on the limits of such a static and selective approach and on finding a more efficient institutional solution for taking over relevant new EU acts and case law. In 2010, the Council of the EU (2010: para 42) concluded that '[d]ue to a lack of efficient arrangements for the take-over of new EU *acquis* including ECJ case-law, and for ensuring the supervision and enforcement of the existing agreements, this approach does not ensure the necessary homogeneity in the parts of the internal market and of the EU policies in which Switzerland participates'. In response, the Swiss Federal Council (2012) submitted a number of institutional proposals to the EU, accepting the overall objective of homogeneity and the incorporation of future changes to the *acquis*, provided that this was not automatic and that Switzerland could in turn participate in the decision-shaping process. However, the EU did not approve the proposed two-pillar model, whereby each party would retain responsibility for ensuring the application and interpretation of the common rules on its own territory (Barroso 2012). In other words, Swiss national surveillance was excluded. Instead, the new 'institutional framework should present a level of legal certainty and independence equivalent to the mechanisms created under the EEA Agreement' (Council of the EU 2012: para 33).

In 2013, it was agreed as a negotiation basis that the ECJ should interpret the EU *acquis* adopted by Switzerland to strengthen legal certainty (Rossier & O'Sullivan 2013). Yet, the talks had been temporarily stalled as a result of the Swiss acceptance in 2014 of an initiative requiring the introduction of immigration quotas (see above). Negotiations on an institutional framework agreement are resumed in 2017 (Council of the EU 2017b).

6.3 UK membership of EFTA, the EEA or association with EFTA?

This section addresses the question whether and how the UK could become a member of EFTA or an EEA EFTA state. Art. 128 of the EEA Agreement stipulates that any European state joining the EU shall, and the Swiss Confederation or any European state becoming a member of EFTA may, apply to become a party. Hence, the UK – currently part of the EEA via its EU membership – would have to adhere to EFTA after Brexit in order to re-join the EEA. A direct accession to the EEA is not foreseen in view of the EEA's two-pillar structure (Baur 2016: 60). The criteria for EFTA membership are not straightforward and there is no specific accession procedure besides negotiations with the EFTA Council, which decides by unanimity.

According to Art. 56 of the EFTA Convention, only (European) states may join and they are expected to become a party to EFTA's FTAs as well. Strictly speaking, this would exclude an application from Scotland or Northern Ireland. The Preamble of the EFTA Convention refers to proximity, longstanding common values and European identity and WTO membership. Baur (2016: 63-64) argues that by analogy, the EU's 'Copenhagen criteria' could serve as guidance for EFTA accession – which the UK would obviously fulfil. Whether a British EFTA membership would be politically feasible is not to be taken for granted though. Not all EFTA states have unconditionally welcomed the idea since the UK would be a very dominant (and potentially difficult) partner. As an EFTA country in the EEA, the UK would have to speak 'with one voice' to the EU together with three small states, and it would replace the jurisdiction of the ECJ by the jurisdiction of the EFTA Court and the surveillance of the Commission by that of the ESA. Compared to the UK's votes and seats in the EU institutions today, the EEA offers

very little participation in EU decision-making yet entails similarly extensive internal market obligations. It should be kept in mind that one of the major reasons for Switzerland's rejection of EEA membership and for Austria, Finland and Sweden to join the EU in 1995 were the institutional shortcomings of the EEA (see Gstöhl 2002).

If the UK would instead follow the 'Swiss model' and join EFTA but remain outside the 'quasi-supranational' EEA, it could establish free trade with the four EFTA countries and negotiate to join the organization's existing FTAs and thus possibly speed up the creation of an own free trade regime. The free movement of persons would be restricted to the small EFTA countries.

Alternatively, an association with EFTA, 'embodying such reciprocal rights and obligations, common actions and special procedures as may be appropriate', might be possible as well (Art. 56(2)). The only associated member so far was Finland between 1961 and 1986, as a result of its special relations with the Soviet Union during the Cold War. The so-called FINEFTA association gave Finland a quasi-membership status as a few years into the association's existence the EFTA Council and the FINEFTA Joint Council held simultaneous meetings (Kinnas 1979: 53-56). Whether such a 'second-class' membership would be acceptable to the UK though remains an open question.

There are various EFTA lessons for the institutional architecture of the UK's future relationship with the EU. First, the 'Interlaken principles' which the EU had set out in the late 1980s are still valid (De Clercq 1987): 'the EU first', meaning priority has to be given to the EU's internal integration and the preservation of its decision-making autonomy. For the EFTA countries, this implies that they have to be very active in the decision-shaping process, which is, however, rather a way to gather information than to exert political influence. Second, the EU is afraid of setting any precedents by giving a non-member state specific rights that could then trigger more demands from others. Third, any close economic association with the EU requires a satisfactory mechanism through which the third countries keep up with the evolution of the *acquis* in order to safeguard market homogeneity. There is an inherent trade-off between the benefits resulting from the internal market and the lack of participation in the law-making process, which also leaves little room for parliamentary control. Fourth, even in the very institutionalized EEA, the EFTA institutions and the joint EEA bodies are not sufficient to ensure an entirely homogeneous market. How effective external differentiation is varies across policy areas since country-specific and policy-related factors play a role for compliance. Fifth, also the bilateral sectoral approach (or 'Swiss model') has its institutional limits: no solely national surveillance or enforcement mechanisms for the interpretation of EU law-based rules is acceptable to the EU. In case of the ongoing association negotiations of the three small-sized European countries Andorra, San Marino and Monaco, for instance, the European Commission (2013: 6) considered that some of these tasks could be carried out directly by the European Commission and the ECJ.

Finally, the EEA option (or 'Norwegian model') would provide the UK with an own trade policy, yet still require full free movement of persons and the jurisdiction of the EFTA Court. An EFTA membership – either full or via an association – would meet all three British 'red lines', but offer no internal market access in the EU, only among the fellow EFTA countries. In both cases, the UK would still have to negotiate an FTA with the EU, and the negotiation of bilateral trade agreements beyond Europe will take time, even if the UK might have faster access to the already existing EFTA FTAs with third countries.

7. Conclusions: Global Britain in Europe

This paper attempted to derive lessons from the EFTA countries' experience with the internal market for the post-Brexit EU-UK relations. It examined whether and under which conditions the UK could go 'back to the future' and (re-)join EFTA and/or the EEA. While specific lessons have been set out in

each section, it is safe to conclude that, overall, 'having the cake and eating it too' in the form of a far-reaching participation *à la carte* in the internal market, which would, for instance, exclude the free movement of persons, is not an option.

The regulatory boundary of external differentiation is difficult to draw; spill over from other – in principle excluded – parts of the EU *acquis* seem unavoidable. While there is some flexibility in how third countries can be associated to the internal market, the EU will insist on a balance of benefits and obligations. This does not mean that all four freedoms will have to be accepted; it all depends on the ambitions. While Turkey is in a customs union with the EU which is limited to trade in goods, Canada has signed a comprehensive agreement on trade in goods and services, while Switzerland's relations cover three and the EEA Agreement all four freedoms of the internal market. However, a dynamic form of deep and comprehensive integration requires an efficient institutional set-up for taking over relevant new EU acts and for ensuring the surveillance and enforcement of these obligations. In such a model the UK would likely face institutional constraints very similar to EU membership – but in a less efficient and transparent way due to the high institutional complexity of dynamic external differentiation. Moreover, such an internal market association will unavoidably come with rather limited participation in EU policy-making. 'Global Britain' (May 2017a) might have freed itself from the 'control' of Brussels, but it still has to find its new place in Europe.

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