



and using the full leverage of its economic weight on third countries.

While (i) the EU had launched a review of the various existing differentiated integration agreements even before the 2016 referendum, (ii) Brexit has been an additional incentive to increase EU control over preferential partners. Brexit led to a harder EU stance on unified framework agreements with stronger institutional mechanisms to ensure a level playing field with third countries. From this, it follows that (iii) **rather than facilitate differentiation in integration, Brexit might even be a turning point to upgrade the Single Market's leverage.**

## 1 ■ Existing forms of external differentiated integration in the Single Market and their evolution

Starting in the 1980s, the deepening of the Single Market and creation of the EU induced a process of intra-European harmonisation. Together with the end of the Cold War, this led to important steps of differentiated third-country integration into the Single Market during the 1990s. The microstates of Andorra and San Marino established bilateral customs unions with the EU, in 1990 and 1991 respectively; the European Free Trade Association countries Norway, Iceland and Liechtenstein integrated into the EU through the 1992 European Economic Area (EEA) agreement; Turkey signed its long-awaited customs union in 1995; and Switzerland negotiated a number of bilateral agreements with the EU, leading to the Bilateral Agreements I (1999) and II (2004). More recently, Ukraine, Moldova and Georgia, as well as some Western Balkans countries, benefited from Association Agreements, like Deep and Comprehensive Free Trade Agreements (DCFTAs) and Stabilisation and Association Agreements.<sup>3</sup> In addition, the

EU has been actively negotiating comprehensive free trade agreements with partners worldwide over the last years (e.g. Canada, Japan, South Korea).

All these various modes of external integration in the Single Market rapidly created **a high degree of differentiation and complexity**, aggravated further by subsequent joint committee decisions modifying the individual agreements. The practical difficulties in managing this diversity **have led the EU to reform the governance of various modes of external differentiated integration over the last decade**, to (i) ensure a more level playing field through the coherent interpretation of EU law and dynamic alignment to the evolving EU acquis; (ii) have an effective system of dispute settlement; (iii) rebalance rights with obligations for third countries accessing the Single Market; and (iv) reduce the number of exceptions in all agreements. In a sense, the objective was to negotiate arrangements that are similar to the EEA, which is generally perceived as a rather successful form of third-country integration in the EU Single Market.

The renegotiation of existing agreements started in the early 2010s with Switzerland and the microstates Andorra, San Marino and Monaco. Simultaneously, the EU experimented with a new form of association agreements: DCFTAs (at least, partly) integrating the EU's new policy priorities. However, while they created unified institutional frameworks, including mechanisms for the interpretation of EU law and dispute settlement (and a role for the European Court of Justice), the DCFTAs also contained much intersectoral complexity in terms of its approximation to the EU acquis.

<sup>3</sup>. While negative public referenda (e.g. Switzerland on European Economic Area membership in 1992, Norway on EU membership in 1994), small country size, insufficient economic development and political conflicts hampered some third countries' progress towards EU membership, different forms of external differentiated integration have been conceived as pragmatic alternatives.

## 2 ■ A hardened EU stance in the renegotiation of external differentiated integration due to Brexit

While the ongoing renegotiations have increased the awareness that the governance of the post-Brexit agreement must be well anticipated, Brexit has become a further incentive for the EU to regain better control over third countries' access to the Single Market. As the EU has rejected the possibility of the UK 'cherry-picking' parts of the EU acquis, Brexit negotiations have contributed to the hardening of the EU position in the renegotiation of several existing agreements even further.

The EU chief negotiator, Michel Barnier, has been extremely cautious about restraining post-Brexit options to the existing modes of partial integration. He even went as far as to remove the option of the excessively complex Swiss arrangement – considered a 'cherry-picked' solution that is quite advantageous for Switzerland – from the table. While the famous 'Barnier steps' seemed to suggest that the Swiss model was an option for the UK,<sup>4</sup> this would only apply if a deal which is along the lines of the new institutional framework agreement negotiated between the EU and Switzerland in 2018 is struck. This new agreement, which covers five of the Bilateral Agreements I, would introduce dynamic alignment in these policy areas,<sup>5</sup> establish a dispute settlement mechanism with a binding interpretive role for the European Court of Justice (ECJ) on

EU law, and mandate all additional agreements to be integrated into this framework, including a modernised free trade agreement. While not yet ratified, the EU pointed out that the new agreement with Switzerland includes comprehensive provisions on competition and state aid, stressing that the status quo of the current Swiss model is not available to the UK.<sup>6</sup>

Interestingly, the persistent intention of the British government to negotiate a 'cherry-picked' agreement has led the EU to increase pressure on Switzerland to ratify the agreement. A key measure in this regard has been the suspension of stock market equivalence for Swiss shares in mid-2019, which was not based on actual divergence from EU Single Market rules but on a political move to break Switzerland's delaying tactics.<sup>7</sup> In addition, concerns that the microstates would use their small size to pursue distinctive economic strategies based on tax competition have hardened the EU position<sup>8</sup> in the ongoing renegotiations of their access to the Single Market.

## 3 ■ Constrained Brexit options due to existing forms of external differentiated integration

In light of Brexit, the European side has become acutely aware of the potential consequences of exceptions to the functioning of the Single Market's level playing field. **There are clear limits to what the EU can concede to the UK without risking discontent, complaints and potential calls for**

4. Task Force for the Preparation and Conduct of the Negotiations with the United Kingdom under Article 50 TEU (2017), Slide presented by Michel Barnier, European Commission Chief Negotiator, to the Heads of State and Government at the European Council (Article 50) on 15 December 2017, TF50 (2017) 21, European Commission. See also Zuleeg, Fabian (2017), "Brexit: Towards a deep and comprehensive partnership?", Brussels: European Policy Centre.

5. The five policy areas by dynamic alignment in the new institutional framework agreement with Switzerland would be the free movement of persons, civil aviation, overland transport, technical barriers to trade and agriculture.

6. Baczynska, Gabriela, "EU's Barnier eyes loose association deal as basis for new British ties", *swissinfo*, 29 January 2020.

7. Ahead of the May 2020 free movement referendum in Switzerland, the EU has not increased its political pressure on Switzerland to avoid a backlash from the Swiss public.

8. The objective with the microstates is – in a way – to create a second European Economic Area, but without the two-pillar structure for its governance.

#### renegotiations from other third countries.

The latter could even include EEA countries which are rather satisfied with the current set-up of their relationship with the EU.

If the UK were to enjoy frictionless market access in specific sectors and complete divergence from others, and avoid being bound by the ECJ's interpretations of EU law, this would seriously undermine the objectives the EU has set for external differentiated integration in the Single Market over the last decade. It could lead Switzerland to never ratify the negotiated institutional framework agreement, and the microstates to terminate the ongoing negotiations. If the UK manages to gain access into some of the EU's discussion fora and its decision-shaping and -making processes, this could also affect the latter's relationship with Turkey, which has long sought better information and representation to handle the EU Customs Union. In fact, already ridden with problems, it might also mean the factual end of the Customs Union between the EU and Turkey.

#### 4 ■ Brexit as a stepping stone for the leverage of the Single Market?

Rather than suggesting much leeway for concessions, the EU27 negotiating mandate could actually mark the next step in the promotion of the Single Market. The UK is not any third country. Its geographical proximity and high level of economic integration in the Single Market does not allow for a Canada-style deal.<sup>9</sup>

Rather, the EU calls for a broad association agreement with the UK. In addition to an economic partnership agreement, this would offer a unified institutional framework providing consistent governance for the various areas of cooperation. It mentions, as in the renegotiations of the Bilateral Agree-

ments I with Switzerland, the introduction of a dispute settlement mechanism with a role for the ECJ to interpret EU law in arbitration cases. Most notably, it contains level playing field requirements on labour, social and environmental standards; carbon pricing; and competition and state aid. The latter is also accompanied by a very stringent requirement of dynamic alignment on EU legislation over time. Therefore, the EU's proposal resembles the new institutional framework negotiated – but not ratified – with Switzerland, giving the UK more room regarding some of the four freedoms (e.g. free movement of people) while entailing less frictionless access to the Single Market in some other policy areas.

This is also very consistent with the EU27's initiatives to restore a more level playing field with China, notably in the field of state aid. It would prevent the UK from developing the kind of competition distortions that the EU is also pressuring China to stop. However, state intervention will be needed direly to overcome the COVID-19 pandemic and the unprecedented, looming economic crisis.

**While temporary exclusions are already applied to the EU's competition and state aid policy, increasing the level playing field with third countries will be more complex than ever in what might become a 'free festival' of state aid.** Nevertheless, upgrading the leverage of the Single Market might be the only way for the EU to survive.

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<sup>9</sup>. Task Force for Relations with the United Kingdom (2020), *Trade Agreements: Geography and trade intensity*, UKTF (2020) 13, European Commission.