

Review of EU-third country cooperation on policies falling within the ITRE domain in relation to Brexit

KEY FINDINGS

- **In all respects, EEA membership is the option that best preserves the benefits to the EU of the UK's EU membership** (including scale economies and regulatory harmonisation), and also the mechanism that best adapts to changes in EU law and regulation over time.
- **Bilateral arrangements in conjunction with EFTA membership (the Swiss case) are clearly inferior to EEA membership** in terms of the degree of consistency achieved, the degree of economic convergence achieved, and the ability to adapt to changes in the EU *acquis*.
- **Participation in the Energy Community (as with Ukraine) can achieve a good degree of legal harmonisation with the EU *acquis*** with regard to energy; however, this harmonisation of rules can be challenging to enforce in practice. The Energy Community makes a positive contribution to stability and security of supply, and to environmental sustainability, but is less effective when it comes to ensuring fair market access for EU firms.
- **A new generation FTA (as with South Korea) that also addresses regulatory issues can provide for reciprocal market access, but it is limited in practice in its ability to drive regulatory convergence.**
- **Participation in the H2020 programme and the COSME programme (as with the US and with Iceland, respectively) can offer benefits both to the EU and to the partner country.** As with the EU's relationships with all of its major trading partners, however, striking the right balance between cooperation and of competition is important, and bears on the EU's preferred choice of relationship with the post-Brexit UK.

The Committee on Industry, Research and Energy (ITRE) of the European Parliament called for a study **Review of EU-third country cooperation on policies falling within the ITRE domain in relation to Brexit** in light of the UK's Brexit referendum of 23 June 2016 in order to help Members of the European Parliament (MEPs) and the general public to understand the possible future relationship between the EU and the withdrawing Member State. This Briefing summarises the report that resulted from that study, which was conducted by Bruegel.

The [study](#) provides a critical assessment of the implications of existing models of cooperation between third countries (countries that are not EU Member States) and the European Union.

It does not provide recommendations as to what approach to Brexit the Parliament should prefer, but instead seeks to inform those decisions.

The scope of the study corresponds to the thematic areas for which the ITRE Committee of the European Parliament is responsible. For each of the four major thematic areas within ITRE's remit (energy, electronic communications, research policy and small business policy), we take three countries as case studies. These are countries that have some existing form of cooperation with the EU, for instance through the European Economic Area and/or the European Free Trade Area (EFTA). For each thematic area, one of the case study countries participates in neither the EEA nor the EFTA, but has some other form of cooperation with the Union.

The strengths and weaknesses of existing models of third country cooperation are best understood through comparison with those of an existing EU Member State. To this end, we use the UK itself as the comparator country, as it exists today and as it has existed in the recent past (i.e. prior to the Brexit referendum). Covering arrangements with the UK has the additional advantage that it provides useful background to those who must negotiate arrangements with the UK.

1. Methodology

The overall approach to the study consisted of the following elements:

- Building the evidence base:
 - Extensive desk research of the relevant treaty, legislative and regulatory instruments, together with assessment of data and reports that indicate how effective (or otherwise) current arrangements may be.
 - Stakeholder interviews to establish how these cooperative instruments work in practice, and the degree to which they are (or are not) effective.
- Tabulation into tables, by sector and by country, to facilitate cross comparison.
- Formulation of findings and conclusions.

2. Membership in the European Economic Area (EEA) and/or the European Free Trade Area (EFTA)

Norway, Iceland, and Liechtenstein enjoy access to the European Single Market by virtue of their membership in the EEA, Switzerland by virtue of numerous EU-Switzerland bilateral agreements. All four are members of the EFTA.

The EEA Agreement and related instruments include mechanisms to facilitate ongoing alignment between the three EEA members and the EU, including the EEA Council (for strategic governance and guidance of the EEA Agreement), the EEA Joint Committee (for implementation), the EFTA Surveillance Authority (for monitoring of implementation), and the EFTA Court (for enforcement and for resolution of disputes, with a role analogous to that of the Court of Justice of the European Union (CJEU)).

3. Strengths and Weaknesses of Existing Models of Cooperation with Third Countries

For **energy** and for **electronic communications**, we have assessed (1) the degree to which policy and regulation are harmonised, (2) the degree to which economic conditions have converged, and (3) the degree to which markets are open in both directions.

The **energy** transition will reshape the roles of individual countries in Europe's energy system. The transition is likely to increase the benefits of market integration. Planned infrastructure

projects (especially between the UK and the Continent) indicate a desire to increase cross-border energy exchanges.

The UK and Norway have largely implemented EU internal energy market rules, while Switzerland and Ukraine have not. All of these partner countries have followed the EU somewhat on climate, renewables, environmental and efficiency policies.

EU electricity and gas companies are dominant in the UK, but have only very limited activities on the Swiss, Norwegian and Ukrainian markets. At the same time, companies from Norway, Switzerland and Ukraine are somewhat active in the EU market. Each of these countries contributes substantially in its own way to the EU's energy system as a producer (Norway, Switzerland), a major market (UK), a transit country (UK, Switzerland, Ukraine) or a provider of flexibility (Norway, Switzerland).

At the same time, each of these countries demonstrates severe bottlenecks in its interconnection arrangements for electricity, gas or both with at least one of its neighbours. Interconnection arrangements with the Republic of Ireland may require careful attention during the Brexit negotiations, inasmuch as the UK provides the Republic of Ireland's interconnection to continental Europe and to Norway. A unique feature is the Single Electricity Market (SEM) of the Republic of Ireland and Northern Ireland, which is a mandatory pool market into which all electricity generated on or imported into the island of Ireland must be sold, and from which all wholesale electricity for consumption on or export from the island of Ireland must be purchased.

For **electronic communications**, EEA membership as exemplified by Norway offers nearly the same advantages as EU membership. Policy and regulation are extensively harmonised, and are synchronised over time, albeit with a time lag that can be significant. Prices between network operators have converged, facilitating market entry and the offering of cross-border services and roaming.

Coordination with Switzerland by means of bilateral agreements is significantly weaker, inasmuch as regulation of electronic communications is not one of the areas covered by a bilateral agreement. The Swiss National Regulatory Authority (NRA) is fully engaged in EU regulatory discussions, but regulatory policy cannot be said to be harmonised. Moreover, the absence of a review process by the Commission means that there is no external brake on any tendency for the NRA to be gentle with Swiss network operators, apparently leading to high wholesale payments to Swiss network operators in comparison to those in the EU. This problem is compounded by an implementation in Swiss law where the NRA is empowered to intervene only when a complaint is lodged. It is particularly striking that Mobile Termination Rates (MTRs) in Switzerland are more than five times as high as the EU average. In fact, Switzerland had the highest MTRs in the OECD as of November 2014.

The arrangements with South Korea, which are based on the Free Trade Agreement (FTA) of 2011, have performed well but in fulfilling very different goals. The objective of the "new generation" Free Trade Agreement (FTA) with South Korea is reciprocal market access. Neither regulatory harmonisation nor scale economies were explicit goals; nonetheless, some modest tendency for the South Korean FTA to promote liberalisation and regulatory convergence in South Korea is visible.

As regards **research policy**, the goals include not only the strengthening of European competitiveness, but also facilitating mobility and training for researchers, and the promotion of international connections. Third countries with an association agreement with the Horizon 2020 (H2020) programme are eligible for funding, and enjoy roughly the same advantages as EU Member States; other third countries, however, are not eligible for funding, except to a very limited degree through Science and Technology (S&T) cooperation agreements.

The UK is a net beneficiary of EU Framework Programme funding, as is Switzerland. Norway, with only modest research and innovation capabilities, demonstrates that being an associated country can offer prospects for collaboration with excellent research partners based in the EU. Switzerland, a leading innovation country, demonstrates the advantages of an associated status even more persuasively.

The February 2014 referendum in which the Swiss effectively called for the introduction of a quota system for foreign workers put these benefits at risk, and led to the suspension of Switzerland's status as an associated third country for H2020 purposes. Swiss participation in H2020 dropped dramatically as a result; indeed, Swiss participation in terms of both numbers of participations and financial contributions plummeted in comparison with the previous Framework Programme 7 (FP7). H2020 Swiss participations were only 7,5% of FP7 Swiss participations. The decline is even more evident with regard to the number of Swiss coordinations in H2020 (only 1,5% of FP7 coordinations). These developments clearly correlate with the switch to partial association in the period 2014-2016, and demonstrate the dramatic impact of Switzerland's loss of full association status. A further concern would be the potential isolation of Swiss based researchers – over the long term, third-country status could have led to a loss of expertise, and could have reduced Switzerland's influence in research circles both in Europe and globally. The matter was resolved in December 2016, but Swiss participation in H2020 has in some respects not yet fully returned to pre-2014 levels.

The experience of the United States further demonstrates the limitations of participation as a third country that does not qualify for an associated status. Indeed, the general openness of H2020 to non-associated third countries is utilised to only a limited degree. There were 866 applicants to FP7 in 2013 from as many as 87 third countries, with a total requested EU financial contribution of € 52,5 million in retained proposals; however, these figures represent just 6,4% of the total number of applicants, and just 1% of the total amount of requested EU contribution in retained proposals.

As regards **small business policy and the COSME programme**, only countries with one of several special relationships with the EU are eligible to participate. For candidate or accession countries such as Turkey, COSME fosters lending to SMEs with the aim of strengthening growth in the economy in order to bring the candidate country closer to the EU's level of development, and also serves to familiarise the country's institutions with the proper and responsible management of EU-provided funds in preparation for their future management of Cohesion Policy funds. For EFTA/EEA members such as Iceland, COSME participation can increase the connection of the country's economy (and specifically of SMEs) to the European Single Market, and is thus a natural extension of granting a country access to the Single Market.

Table 1 provides a summary of the strengths and weaknesses of each established form of third country cooperation with the EU.

Table 1. Overall implications of different models of third country cooperation

Model of cooperation	Strengths	Weaknesses
EU Member State	Achieves most extensive harmonisation. Maximises scale economies.	Some loss of autonomy for the Member State.
EEA membership	Achieves very extensive harmonisation, albeit with time lags. Maximises scale economies.	The thematic areas relevant to this study are harmonised, but others are not. Delays in harmonisation. The third country is less subject to EU influence in selected areas than an EU Member State, but has little influence on EU policy.
Bilateral agreements (EFTA member) i.e. the Swiss case	Achieves harmonisation where mutually agreed, albeit with time lags. Maximises scale economies.	Only certain sectors are covered by bilateral agreements. Harmonisation is limited. The third country is less subject to EU influence in selected areas than an EEA member or an EU Member State, but has little influence on EU policy.
Energy Community	Achieves strong legal harmonisation with the EU <i>acquis</i> and hence provides an anchor for regulatory stability.	Some limitations in enforcing compliance. Does not address issues outside of energy.
Free Trade Agreement (FTA)	Achieves or maintains reciprocal market access, gains in trade. Encourages but does not require limited regulatory convergence.	Neither attempts nor achieves close regulatory convergence or scale economies.
Framework Programme	Strengthens research and innovation. Enhances competitiveness. Facilitates mobility and cross-training for researchers.	Does not address a range of other issues outside of research and innovation.
COSME	Increases the connection of SMEs in the target country with the European Single Market, thereby providing gains in societal welfare thru growth, gains in trade, and job creation.	Does not address a range of other issues outside of SME policy.

Source: Bruegel

4. Which are the preferable models for the EU?

In all respects, EEA membership is the option that best preserves the benefits to the EU of the UK's EU membership, including scale economies and regulatory harmonisation. It is also the mechanism that best adapts to changes in EU law and regulation over time.

Bilateral arrangements in conjunction with EFTA membership (the Swiss case) are clearly inferior to EEA membership in terms of the degree of consistency achieved, the degree of economic convergence achieved, and the ability to adapt to changes in the EU acquis.

Participation in the Energy Community (as with Ukraine) can achieve a good degree of legal harmonisation with the EU acquis in regard to energy; however, this harmonisation of rules can nonetheless be challenging to enforce in practice. The Energy Community makes a positive contribution to stability and security of supply, and to environmental sustainability, but is less effective when it comes to ensuring fair market access for EU firms.

A new generation FTA (as with South Korea) that also addresses regulatory issues in (for instance) electronic communications can provide for reciprocal market access, but is limited in practice in its ability to drive regulatory convergence.

Participation in the H2020 and COSME programmes are somewhat independent of these options. Each offers benefits both to the EU and to the partner country. Indeed, research cooperation potentially benefits all concerned. One must however bear in mind that the EU's relationships with its major trading partners entail elements of both cooperation and of competition. The relative balance of these two elements with the post-Brexit UK is not yet clear, but bears directly on the EU's preferred choice of relationship.

In Table 2, we provide a thematic sector-by-sector assessment of the relative desirability of different models of third country cooperation for all four thematic areas from the perspective of the EU. This is independent of the feasibility of arriving at the arrangements in question. The baseline for comparison is taken to be the case where there is no special relationship between the EU and the UK post-Brexit (depicted in the rightmost column). The rationale for these assessments is explained in the full report.

Table 2. Relative desirability of different models of cooperation in all thematic areas from the perspective of the EU.

Thematic area: Energy					
Country	Pre-Brexit UK	Norway	Switzerland	Ukraine	
Relationship	Member State	EEA member	Bilateral agreements	Energy Community	No special relationship
Legal basis for relationship	TEU/TFEU	EEA Agreement	Bilateral agreements	Energy Community Treaty	Not applicable
Negotiating considerations	Energy collaboration is a positive sum game in which all partners can gain in terms of security of supply, the cost of energy, and advancing environmental sustainability by pooling complementary energy resources.				
Energy exchanges based on proper market signals	++	++	+	+	0
EU companies gain fair access	++	0	-	-	0
Contributes to supply security (infra+solidarity)	+	+	+	+	0
Promotes environmental sustainability	++	++	+	+	0
Thematic area: Electronic communications					
Country	Pre-Brexit UK	Norway	Switzerland	South Korea	
Relationship	Member State	EEA member	Bilateral agreements	FTA	No special relationship
Legal basis for relationship	TEU/TFEU	EEA Agreement	None cover electronic communications	Arts. 7.25 thru 7.36 FTA	Not applicable
Negotiating considerations	Regulatory harmonisation facilitates cross-border services, market entry, and portability and roaming. Together with economic convergence, harmonisation facilitates cross-border market entry.				
Regulatory harmonisation is sought	++	++	0	0	0
Regulatory harmonisation is achieved	++	++	+	0 to +	0
Economic convergence	++	++	0	0	0

Thematic area: Research Policy					
Country	Pre-Brexit UK	Norway	Switzerland	United States	
Relationship	Member State	EEA member	Bilateral agreements	No special relationship	No special relationship
Legal basis for relationship	TEU/TFEU	Association Agreement	Association Agreement	S&T Cooperation Agreement	Not applicable
Negotiating considerations	Research policy is a positive sum game in which all partners can gain. Nonetheless, the balance between cooperation and competition needs careful reflection.				
Cost sharing for research	++	+	++	0 to +	0
Enhanced connections	++	+	+	0 to +	0
Enhanced research capacity for global competitiveness	++	+	++	0 to +	0
Mobility of researchers	++	+ to ++	+	0 to +	0
Thematic area: Small business policy / COSME					
Country	Pre-Brexit UK	Iceland	Turkey		
Relationship	Member State	EEA member	EU candidate		No special relationship
Legal basis for relationship	TEU/TFEU	Art. 6 COSME	Art. 6 COSME		Not applicable
Negotiating considerations	The relative balance of cooperative versus competitive aspects needs careful reflection.				
Regulatory harmonisation is sought	++	0	0		0
Regulatory harmonisation is achieved	++	0	0		0
Economic convergence	++	+	+		0

DISCLAIMER

The content of this document is the sole responsibility of the author and any opinions expressed therein do not necessarily represent the official position of the European Parliament. It is addressed to Members and staff of the EP for their parliamentary work. Reproduction and translation for non-commercial purposes are authorised, provided the source is acknowledged and the European Parliament is given prior notice and sent a copy.

This document is available at: www.europarl.europa.eu/studies

Contact: Poldep-Economy-Science@ep.europa.eu

Manuscript completed in June 2017

© European Union

Internal ref.: IP/A/ITRE/2017-001



ISBN: 978-92-846-1169-0 (paper)
 ISBN: 978-92-846-1168-3 (pdf)
 CATALOGUE: QA-04-17-555-EN-C+N
 doi:10.2861/58815 (paper)
 doi:10.2861/058283 (pdf)