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**Small Island Differentiation In EU Law**  
**- Master's Thesis in Law -**



**HÁSKÓLI ÍSLANDS**

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## **Preface**

As a law student and as an Icelander, I strongly support Iceland's accession as a Member State of the European Union. I currently reside in Brussels and perhaps this gives me a sense of being closer, at least in spirit, to the upcoming negotiations.

Aware of certain objections to accession back home and my curiosity piqued by the various machinations, discourses and arguments used in this type of negotiation, I decided to do some reading, particularly on previous accessions by island nations and whether they received any special considerations by virtue of being islands.

I read literature and EU legislation devoted not only to island states but to small islands within the Union and island possessions and dependencies of Member States; ultimately I decided to compose a paper on this subject. The final result is this treatise but I would not have accomplished it without the encouragement, help and support of several people for which I am extremely and eternally grateful.

In this vein, I particularly mention my learned mentor, Dr. Elvira Mendéz-Pinedo, associate professor of European law at the University of Iceland, who somehow always kept me on track; my very patient and clever friend and editor, Steve, who magically extracted coherence from my tangled words; my equally patient and clever friend, Ricardo, who was able to arrange my paragraphs into some semblance of order; my tolerant husband, who gave me the time and space to pursue this endeavour; my mother-in-law, who assumed the task of looking after my four year old son so I could devote more attention to this project; my small son, to whom I owe a great deal of quality time; and not least, my mother and my father, who provided that special understanding when I most needed it.

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## I. Introduction and Structure

The principle of uniformity in the application of European Union (EU) policy and law has long been institutionally asserted as one of its foundations. Referred to as the *acquis communautaire*, roughly translated from the French as “*that which has been acquired by the Union*”, it is the term for the accumulated legislation, and judicial decisions which constitute the body of EU law and to which immediate and complete compliance is requisite of incoming Member States.

The EU, also referred to as the Union, includes a multitude of Member State small islands and other islands in the Mediterranean, Baltic, North and Caribbean Seas, and in the Atlantic and Indian Oceans. With the accession of Malta and Cyprus and with Iceland’s application for accession, the EU now incorporates two, and the possibility of three, sovereign small island states. It has been recognized by various economists and by Member State declarations that small islands face unique challenges due to inherent geographical and demographic constraints including distance from the continent, isolation, small size and limited population density and therefore merit special and differential treatment to effectively function and interact on a par with larger states.

Iceland, an island with a very small population, is the least populated EU candidate nation to date. It is in the remote North Atlantic and only a small portion of its territory is considered arable. Its export base is largely based on natural resources; fisheries products and industry powered by renewable energy sources.

Notwithstanding the precept of *acquis communautaire*, the Lisbon Treaty<sup>1</sup> contains several instances of special statuses whereby small islands are allowed accrued differentiated treatment from that afforded to other Member States. These are found in Accession Treaties and related annexes and give rise to primary and secondary law differentiation. Additionally, the Lisbon Treaty incorporates a general provision where islands in general are deemed as requiring specific consideration because of extreme natural and demographic handicaps.

This treatise examines the special statutes principally utilized by small islands under EU law and addresses the question of prime importance to Iceland and to the Icelanders: does the EU, within its current legal framework, allow derogations from *acquis communautaire* on the basis of being a small and remote island? Are geographical parameters such as being an

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<sup>1</sup> Treaty of Lisbon, Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, OJ C 83 of 30.3.2010. The heads of state or government of 27 Member States signed the Treaty of Lisbon on 13 December 2007 (OJ C 306 of 17.12.2007). It entered into force in December 2009.

island, legally acceptable arguments for differentiated treatment within EU law? Accordingly, could a debate or discussion on the premise of territorial differentiation provide the means for the establishment of special status within the EU for such countries and otherwise be used in the negotiation process as justification for these exemptions?

The essay's objectives are: a) to assess that differentiation is in fact an integral part of the EU's legal order; b) to deduce whether arguments for differentiation are based on small island constraints as established in pertinent and germane literature and; c) accordingly determine if a small island policy is inherent in EU policy or; d) whether one should be established.

In the paper, scrutiny of the justification utilized for support of differentiated treatment for small islands is foremost, but an analysis of the differentiation mechanism applied and its legal ramifications is also of high relevance because: a) the differentiation mechanism inherently exposes compelling examples of how flexibility is established within the treaties regardless of the general dogma of the uniformity of EU law; b) the author sees variance in the appropriateness of the differentiation instruments – primary law, secondary law or exclusions – and, consequently; c) the type of differentiation mechanism applied as one of the factors that determines whether there is, in fact, a genuine small island policy in EU law.

The scope of this research is EU law small island policy and differentiation. Its perspective is from its relevance to Iceland in its accession negotiations with the Union. The methodologies for this research are largely descriptive, in order to define the data and the characteristics of the topic, and analytical with a comparative approach in that current discussions are compared with this study's conclusions in order to discern their commonalities and their differences.

The study begins in Section II with a summary of the legal principles that apply in EU law to the current legal framework of differentiation.

Section III is a descriptive study of the justifications for differential treatment as recognized by scholars, international institutions and the EU.

Section IV examines the legal basis and justifications for different statuses within the Treaties. In Sections V and VI, two pertinent case studies are introduced, one on the Outermost Regions and one on the Åland Islands and are provided with a comparative analysis of their differentiation mechanism and the justifications for their special status. These two were specifically selected because unlike other mentioned islands, they are fully integrated into the EU and expected to adhere to the whole of the *acquis communautaire* but are afforded a different status because of their small island vulnerabilities

Section VII focuses on the recently entered small island states, Malta and Cyprus. These nations were also granted various temporary or permanent differentiation exceptions from the *acquis communautaire* on accession. These arrangements, particularly in the case of Malta, have been justified by some scholars as considering their unique circumstances as small islands. This section examines whether small island vulnerabilities as presented in relevant publications and in this study, were the sole factor and argument in determining their special and different treatment.

Section VIII deals with the policy of Territorial Cohesion as introduced in Articles 3 TEU and 174 TFEU of the Lisbon Treaty. Its reason for existence is reviewed and whether it might be regarded as the missing link in the development of a coherent small island policy within the EU. Article 170 TFEU (ex-Article 154 TEC) on Trans-European Networks recognizes the need to link islands with the central regions of the EU. However, space and time constraints limit the extent of this review and it solely focuses on the recently added territorial cohesion feature which, up to this point, may be regarded as the clearest instance of a Treaty acknowledgment for the need to address geographic restrictions such as those of small islands.

In Section IX, the final section, the assumptions and conclusions regarding the statuses of small islands within the EU and their relevance to Iceland's membership negotiations, deduced from this study, are summarized.

Certainly other issues have allowed Member States to adopt exemptions within EU law in relation to EU policies on a permanent basis. The Treaties have sanctioned Member State opt-outs from the Economic Monetary Union (EMU), the Social Policy and the Danish second-homes protocol and are examples where the Treaties consent to Member State permanent derogations. These politically motivated instances of differentiation have been classified by scholars and politicians in numerous ambiguous theories such as multi-speed differentiation, *à-la-carte* differentiation and differentiation of variable geometry. As these are examples of differentiation pursued by current Member States and each example reflects an inherently divergent legal nature and motivation, they are outside the scope of this study and are not addressed.

Accordingly, this review concentrates on the effects these various statuses have on internal markets and the 'four freedoms' and does not particularly address their effects on EU law regarding social, citizen or human rights.

In compiling this research, the essay builds on legal sources of a primary and secondary nature, such as the Lisbon Treaty, secondary legislation, and established case law



of the European Court of Justice (ECJ)<sup>2</sup> as the source of EU law, and the doctrines and literature derived from these sources. Scholars have given scant attention to the subject of this treatise so it strongly relies on reports from the Union's institutions as a secondary source of information.

## **II. Differentiation in EU law: Tension between Uniformity and Flexibility**

### **A. Introduction**

The following chapter is an overview of the main arguments for uniformity of EU law within the internal market and the examples of differentiation that have nevertheless prevailed since the signing of the Rome Treaty.<sup>3</sup> The aim of this chapter is to provide an understanding of the concept of differentiation, the variations of differentiation mechanisms applied in the Treaties and the legal order of differentiation. Furthermore, the concept of justifiable differentiation will be reviewed.

### **B. The Uniformity of EU law**

The single market is all about bringing down barriers and simplifying existing rules to enable everyone in the EU - individuals, consumers and businesses - to make the most of the opportunities offered to them by having direct access to 27 countries and [501] million<sup>4</sup> people.<sup>5</sup>

This powerful statement is referring to what is now called “the internal market.”<sup>6</sup> It has generally been regarded as the core of the Union<sup>7</sup> and its “four freedoms” – people, goods, services and capital – the engine that moves its wheels across EU Member State borders as easily as within a single Member State.

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<sup>2</sup> With the Lisbon Treaty changes have been made to the European Court of Justice. Along with the General Court, it is now a sub-court of a new EU institution named the Court of Justice of the European Union.

<sup>3</sup> Treaty establishing the European Economic Community, 25.3.1957. It is also referred to as the EEC Treaty. The European Community was also founded on the Treaty establishing the European Coal and Steel Community, 18.4.1951 and the Treaty establishing the European Atomic Energy Community, 25.3.1957. They will not be reviewed in this essay. When this thesis refers to the Rome Treaty, it is referring to referring to the EEC Treaty.

<sup>4</sup> Eurostat (47/2009), *Population and social conditions*, p. 1.

<sup>5</sup> European Commission website, [http://ec.europa.eu/internal\\_market/top\\_layer/index\\_1\\_en.htm](http://ec.europa.eu/internal_market/top_layer/index_1_en.htm), [accessed on 25.08.2010].

<sup>6</sup> Article 3 TEU (ex Article 2 TEU) of the Lisbon Treaty.

<sup>7</sup> De Búrca (2000) “Differentiation within the Core”, p. 141.

In order for the internal market to function, a set of norms and policies have been created within the Union. This has been accomplished through the provisions of the Treaties that require Member States to remove restrictions to the freedoms and harmonize their regulatory framework to that of the Treaties with regard to taxation, customs regulations, state aid and competition.<sup>8</sup>

Consequently, on par with the Union's interest in the internal market's well-being,<sup>9</sup> EU legislation has, on grounds of its supremacy, spoken in favour of uniform treatment of Member States.<sup>10</sup>

The arguments for supremacy of EU law and uniformity of the EU legal order can be found in various judgments of the Court. In the landmark case *Van Gend en Loos* the Court laid down the supremacy of EU law when it stated that “to secure uniform interpretation of the Treaty by national courts ... Community law has an authority which can be invoked by [a Member State's] nationals before those courts”.<sup>11</sup>

This principle was reinforced by the Court in *Costa v. E.N.E.L*, where the court declared:

“The transfer, by Member States, from their national orders in favour of the Community order of rights and obligations arising from the Treaty, carries with it a clear limitation of their sovereign rights upon which a subsequent unilateral law, incompatible with the aims of the Community, cannot prevail”.

On the question on coherence of EU law the court concluded that: “the executive force of community law cannot vary from one state to another...without jeopardizing the attainment of the objectives of the Treaty”. Furthermore the Court stated that unilateral and subsequent national deviations could not be tolerated without depriving the common rules of their character as community law and without: “the legal basis of the Community itself being called into question”.<sup>12</sup>

These judgements can be summarised as explaining the idea of the Union's legal order, which in effect boils down to supremacy of EU law and its direct effect. Thus the Court confirms that there is a general principle of uniformity of Union law and equal rights and obligations for all Member States that must prevail in order for the Union to function, and that

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<sup>8</sup> Articles 110 -113 TFEU (taxation), Articles 30-33 TFEU, (customs union), Articles 107-109 TFEU (aids granted by state) and Articles 101-106, TFEU (competition). *See also*: De Búrca (2000), “Differentiation within the Core”, p.136.

<sup>9</sup> De Búrca (2000) “Differentiation within the Core”, p. 135.

<sup>10</sup> Ehlermann (1982) “How Flexible is Community Law”, p.1288 and Tuytschaever (1999), *Differentiation in European Union Law*, p. 109.

<sup>11</sup> ECJ, Case C-26/62, *NV Algemene Transport en Expeditie Onderneming van Gend & Loos v. Netherlands Inland Revenue Administration* [1963] ECR 1 at IIB.

<sup>12</sup> ECJ, Case 6/64, *Flaminio Costa v E.N.E.L* [1964] ECR 585.

the Court has the authority and the duty to enforce these obligations upon the Member States of the Treaties.

This commitment to the Union and its Member States is reflected in the concept referred to as the *acquis communautaire*, which can be described as the shared political and legal properties of the Union. It has been defined in the pre-accession criteria of incoming Member States as a “*whole body of rules, political principles and judicial decisions which new Member States must adhere to, in their entirety and from the beginning, when they become members of the [Union]*”<sup>13</sup> where the rules of the Internal Market play a central role and are regarded as a fundamental objective for a successful accession policy.<sup>14</sup>

This procedure is incorporated into the so-called Copenhagen Criteria<sup>15</sup> and enshrined in the Treaties with Article 49 TFEU (ex-Article 49 TEU) of the Lisbon Treaty. This principle, which has led the approach of Member States and the Commission from the start of the first accession negotiations, has, by and large, constrained Member States, which feel obliged to obey the principles and criteria stemming from the Treaties and the Union’s jurisprudence, even when acting as Masters of the Treaties.<sup>16</sup>

Despite the above, EU law has always acknowledged flexibility – ever since the signing of the Rome Treaties – by allowing (territories of) Member States to deviate from the uniform application of EU law. This deviation from the uniformity of EU law is what scholars generally refer to as differentiation, differentiated integration or flexibility.<sup>17</sup> There is no clear distinction between these concepts, and this essay will be using all of these terms when discussing examples of differentiation.<sup>18</sup> The following chapter will review the main attributes of differentiation in EU law.

### C. The Flexibility of EU Law

The Union is a system based on the attribution of competence, which in turn is based on the principle of conferral. According to Article 4(1) TEU of the Lisbon Treaty, competences not

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<sup>13</sup> Gialdino (1995) “Some reflections on the *acquis communautaire*”, p. 1090.

<sup>14</sup> Shaelou (2010) *The EU and Cyprus*, p. 20.

<sup>15</sup> The Copenhagen Criteria was established at a European Council meeting in Copenhagen. Among its requirements is that the candidate country ensures: “*The ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union*”. This is referred to as the *acquis communautaire* criterion. (The European Commission website: [http://ec.europa.eu/enlargement/enlargement\\_process/accesion\\_process/criteria/index\\_en.htm](http://ec.europa.eu/enlargement/enlargement_process/accesion_process/criteria/index_en.htm) , [accessed on 25.08.2010]).

<sup>16</sup> Jean Monnet Chair (2001) “EU-Enlargements”, p.4 and Kölliker (2006) *Flexibility and European Unification*, p. 14.

<sup>17</sup> Ziller (2000) “Flexibility in the Geographical Scope of EU Law”, p. 113.

<sup>18</sup> Thus for example Tuytschaever refers to flexibility and differentiation without trying to make any distinction between the two concepts and he explicitly includes differentiated integration within the concept of differentiation. (Tuytschaever (1999) *Differentiation in European Union Law*, p. 1.)

conferred upon the Union in the Treaties remain with the Member States.<sup>19</sup> In areas outside of EU competence, the EU seldom aims at total harmonization or unification. Within the area of EU competence, differentiation is divided into differentiation *sensu lato* and *stricto sensu*.

Differentiation *lato* refers to instances where (territories of) Member States are not subject to the uniform EU legal regime, even though they concern matters which fall under the scope of the Treaties. In these instances, differentiation is inherent in the integration process because (territories of) Member States are allowed an identical margin of discretion. Differentiation *stricto*, on the other hand, is when primary and secondary law distinguishes between its addressees; that is, where some (territories of) Member States are excluded from the scope of application of primary or secondary law or where the rights and obligations imposed by primary or secondary law on some (territories of) Member States are different from those imposed on others, so as to take into account the situations, interests or successful advocacy of individual Member States.<sup>20</sup> The emphasis of the study that follows lies with differentiation *stricto*, i.e. when primary or secondary law makes a distinction between the Member States.

The legal grounds for differentiation are generally established within primary law. Primary laws are the founding treaties as well as amending and supplementing treaties. Acts such as accession treaties of incoming Member States and protocols annexed to the acts of accession also constitute primary law. Primary law are negotiated by the Member States at an intergovernmental level and are, as such, the highest in the Union legal order and may only be amended or abrogated by recourse to the stringent and time-consuming intergovernmental conference treaty revision procedure laid down in Article 48 TEU of the Lisbon Treaty (ex-Article 48 TEC).<sup>21</sup>

Being law at the highest level, primary law are outside of the uniform EU-law framework<sup>22</sup> in the sense that Member States, acting as Masters of the Treaties, are in principle free to amend and restrict the application of EU law without being subject to judicial

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<sup>19</sup>The principle of conferral is a fundamental principle of European Union law. According to this principle, the EU is a union of member states, and all its competences are voluntarily conferred on it by its member states. The EU has no competences by right, and thus any areas of policy not explicitly agreed in treaties by all Member States remain the domain of the member states. See Article 5 (2) TEU (ex Article 5 TEC) of Lisbon which states: Under the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States.

<sup>20</sup> Tuytschaever (1999) *Differentiation in European Union Law*, p. 2-3.

<sup>21</sup> Fagerlund (1997), "The Special Status of Åland Islands", p. 201.

<sup>22</sup> Ott (2009) "EU Constitutional Boundaries to Differentiation", p. 114.

review.<sup>23</sup> Nevertheless, as will be reviewed later in this Section, the Member States feel bound by the legal principles of EU law and in general, abide by them, even at this level.

Regulations, directives and soft law such as guidelines, joint declarations and options are secondary legislation.<sup>24</sup> They derive their legal basis in primary law and thus have to respect the boundaries of the Treaty framework and obey the general principles of equality,<sup>25</sup> supranationality<sup>26</sup> and coherence of EU law<sup>27</sup> as presented in the Treaties and interpreted by the Court.

In Union law, differentiation has been thought to be acceptable and *de lege lata* lawful if such differentiated treatment is based on justifiable grounds. Justifiable grounds are those based on objective socio-economic differences between (territories of) Member States. In such cases different treatment is not thought to be violating the general principles of EU law, such as the non-discrimination principle, but to be establishing a level playing field between different situations. In this context, differentiated based on objective differences has been accepted but differentiation based on purely political grounds, or subjective differences, is not tolerated. This understanding has been confirmed by the Court on many occasions.<sup>28</sup>

This understanding has been confirmed by the Court on many occasions<sup>29</sup> and has been established in the Treaties as the general rule of justifiable differentiation since the Single European Act.<sup>30</sup> Now, found in Article 27 TFEU, it furthermore states that if differentiation takes the form of derogations, it must be of a temporary nature and must cause the least possible disturbance to the function of the internal market.<sup>31</sup>

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<sup>23</sup> Ott (2009) "EU Constitutional Boundaries to Differentiation", p. 126 and Joined ECJ Cases 31/86 and 35/89, *LAISA v Council* [1988] ECR 2285 and ECJ Case C-93/78, *Lothar Mattheus v Doego Fruchimport und Tiefkühlkost eG* [1978] ECR 2203. In the latter case the Court declared that adaptations resulting directly from acts of accession did not constitute acts of institutions and were therefore not open to review of legality

<sup>24</sup> In contrast to regulations and directives, soft law are not binding on those to whom they are addressed.

However, soft law can produce some legal effects.

<sup>25</sup> Tuytschaever, (1999), *Differentiation in European Union Law*, p. 105.

<sup>26</sup> ECJ Case 6/64, *Costa v. E.N.E.L* [1964] ECR 585.

<sup>27</sup> See for example ECJ Case 166/73, *Rheinmühlen-Düsseldorf* [1974] ECR 33, where the Court states that ex-Article 177 EC [now Article 267 TFEU] is essential for the preservation of the [Union]character of the law established by the Treaty and has the object of ensuring that in all circumstances this law is the same in all States of the [Union].

<sup>28</sup> Ziller (2000) "Flexibility in the Geographical Scope of EU Law", p.113, De Búrca (2000) "Differentiation within the Core", p. 134 and Tuytschaever (1999) *Differentiation in European Union Law*, p. 112-113.

<sup>29</sup> Tuytschaever (1999) *Differentiation in European Union Law*, p. 112.

<sup>30</sup> Ex-Article 8C of the Single European Act, OJ L 169 of 29.6.1987. See also: Fagerlund (1997) "The Special Status of Åland Islands," p. 243. See in general: on the rule that derogations must be temporary, Kochenov (2009) "The Impact of European Citizenship", p. 7

<sup>31</sup> Article 27 TFEU of the Lisbon Treaty states the following: When drawing up its proposals with a view to achieving the objectives set out in Article 26 (ex Article 14 TEC), the Commission shall take into account the extent of the effort that certain economies showing differences in developments will have to sustain during the period of establishment of the internal market and it may propose appropriate provisions. If these provisions

The Unions institutions are bound by this general principle of justifiable differentiation. Thus, at a secondary level, permanent differentiation of (territories of) Member States is not accepted. Consequently, permanent derogations have in principle only been possible if established at a primary law level. However, as addressed above, the Member States, when acting as Masters of the Treaties, have nevertheless felt bound by the main principles of EU law, even at a primary law level. This is reflected in the accession negotiations of incoming member states, but, when asking for differentiated treatment on account of special national or territorial interests, candidate countries have by and large only been able to negotiate so-called transitional agreements;<sup>32</sup> these agreements have had to be grounded on objective justifications and only tolerated for a limited period of time. The longer the transitional period the more exceptional the circumstances have had to be.<sup>33</sup>

However, as will be revealed later in this essay, several instances of derogations with permanent features do exist within the framework of EU law, not only at primary level but also, increasingly, at a secondary level.

The Treaties provides examples of several methods used to differentiate (territories of) Member States because of national diversity or in order to protect their vital interests. These are exclusion from the scope of the treaties, derogations, safeguard clauses and opt-outs and opt-ins. Each differentiation mechanism can be established either at a primary or a secondary law level. Each mechanism represents unique features that yield different legal effects within EU law and with regards to the (territory of the) Member State enjoying the mechanism. For the sake of clarity, an overview of the main differentiation mechanisms will now be provided. However, a deeper analysis of each of these mechanisms will be provided in relevant sections of this essay.<sup>34</sup>

## **1. Exclusion from the Scope**

Exclusion occurs when primary or secondary legislation limits the geographical scope of EU law by leaving out from its scope a (territory of a) Member State, that generally would fall

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take the form of derogations, they must be of temporary nature and must cause the least possible disturbance to the function of the internal market.

<sup>32</sup> The so-called transitional arrangements are the focal point of enlargement negotiations of EU Member States and applicants. They are of two types; either in favour of the candidate country's advantage or his disadvantage. The former type is the dominant form and is applied because the applicants cannot be expected to apply the whole body of the EU *acquis communautaire* on the day of accession and thus the EU grants the new Member State a fixed period where it does not need to comply with fields of the common policy areas. (Schneider (2009) *Conflict, Negotiation and European Union Enlargement*, p. 21, footnote 12.)

<sup>33</sup> *Jean Monnet Chair* (2001) by Becker, "EU-Enlargements", p.12.

<sup>34</sup> This overview will not include review on enhanced cooperation, a differentiation mechanism established in Title IV, Article 20 TEU of Lisbon, replaced the former Articles 27(a) to (e), 40 to 40(b) and 43 to 45 TEU.

within its competence. A territory can be partially or fully excluded and within the excluded policy areas it is regarded as out of the EU i.e. a third country or territory.<sup>35</sup> Consequently, the legal effect is that EU law does not have any competence within that given field and the territory is free to push forward other rules than those of the Union, unless otherwise explicitly declared by the Treaties.

As the territory does not abide by EU law rules such as the one in Article 27 TFEU does not apply. Hence an exclusion from the scope is not bound to be limited in duration. As such, exclusion may be regarded as a simple way to provide a territory with a permanent differentiation mechanism. Furthermore, its relatively frequent use, as seen for instance in Article 355 TFEU, shows that in contrast to permanent derogations it seems to be a politically accepted differentiation instrument.<sup>36</sup>

Article 355 TFEU (ex Article 299(2), first subparagraph, and Article 299(3) to (6) TEC) and relevant secondary legislation incorporates several examples where territories, mainly small islands, have to a varying degree been excluded from the scope of the Treaties. The use of exclusion from the scope of the Treaties as means for differentiation, the degrees of exclusion and the justifications behind them will be reviewed closer in Section IV, V and VI of this essay.

## **2. Derogations**

Differentiation can be established derogations from common rules. Unlike differentiation by exclusion, the territory falls within the scope of the specific policy field and thus the Union's competence applies, except as regards the specific field of the derogation. Falling within the scope of the Treaty entails that the reading of the derogation should be as narrow as possible and its application should pertain to the Member State subject to the derogation, other Member States and to the Commission equally. These key attributes of derogations within EU law, whatever the legal basis and whatever the goals, remain intact.<sup>37</sup>

Derogations can be established at a primary law level and a secondary law level and can be general or specific. Primary law derogations established in accession treaties and acts and protocols annexed to them are always specific as they are established on account of a case-by-case interest of a particular (territory of a) Member State. As mentioned above, if established at a primary law level, the derogations cannot be challenged by the Court.

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<sup>35</sup> A third country or territory is someone that is not a Member State of the EU. *See*: EU glossary, <http://ec.europa.eu/world/agreements/glossary/glossary.jsp#TreatiesOffice>, [accessed on 25.08.2010].

<sup>36</sup> In Section VI on Aland Islands it is revealed that the main reason for deciding to exclude the islands from EU's fiscal frontier i.e. instead of using a derogation, was because it was politically acceptable.

<sup>37</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p. 268

However, the Court can interpret the provisions of the Treaties of Accession, Acts of Accession and Annexes to Acts of Accession.<sup>38</sup> Being outside the scrutiny of the Court, primary-law derogations can in principle, establish a permanent derogation argued on account of political reasons (subjective differentiation).<sup>39</sup> More commonly however, primary law derogations are established to take account to objective differences of (territories of) Member States because of their specific constitutional, economic or other circumstances. Examples of such objective primary-law derogations are the Åland Islands protocol allowing derogations from freedom of establishment and services,<sup>40</sup> and the protocol on secondary homes in Malta, which may be regarded as an exemption in the area of free movement of capital.<sup>41</sup> These primary-law derogations will be reviewed later in this essay.

The Treaties also provide for provisions establishing the legal ground for secondary law derogation measures. These can be both general and specific. An example of a general derogation measure is the previously mentioned Article 27 TFEU which establishes the legal ground for secondary derogations within the internal market. It is general because all (territories of) Member States can adopt this measure, given that they fulfil the criteria established in the article. This entails that all derogations grounded on the Article need to obey the rules of justifiable differentiation and limited durability and its application is subject to the scrutiny of the Court.

An example of a specific derogative measure provided by the Treaties is Article 349 TFEU (ex Article 299(2), second, third and fourth subparagraphs, TEC). The Article provides a group of named islands, jointly known as the Outermost Regions, which a special derogative regime on account of their Treaty established structural and natural handicaps. Other islands or territories are not able to enjoy the derogations there provided.

While Article 349 TFEU is an example of a specific measure the general rule of justifiable differentiation, such as the courts scrutiny and that derogations should be temporary, has generally been employed to the application the article. However, as will be revealed later in this essay, some derogative measures have permanent features. Article 349 TFEU, its unique features and justifications, will be addressed in Section V.

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<sup>38</sup> Kochenov (2008-2009) “Substantive and Procedural Issues”, p. 271 and footnote no. 277.

<sup>39</sup> Tuytschaever, (1999), *Differentiation in European Union Law*, p. 123.

<sup>40</sup> Article 1 of Protocol No. 2 on Åland Islands, OJ C 241 of 29.8.1994.

<sup>41</sup> Protocol No. 6 on the acquisition of secondary residences in Malta, OJ L 236 of 23.9.2003



### 3. Safeguard Clauses

The employment of safeguard clauses in international treaties is a third method used to provide for a certain degree of flexibility. Safeguard clauses can be found in primary and secondary law.<sup>42</sup> The concept of a safeguard clause has often been seen as an abnormality, a so-called *droit en temps de crise*.<sup>43</sup> In primary law, they either allow certain specifically designated Member States, or all of the Member States or the Union's institutions, limited grounds to derogate from normal Treaty obligations<sup>44</sup> if and until a "crisis" is resolved.

As derogations, safeguard clauses can be general and specific. Article 36 TFEU (ex-Article 30 TEC) is an example of a general safeguard measure all Member States can apply.<sup>45</sup> An example of a specific primary law safeguard clause is the Åland Islands protocol.<sup>46</sup> It allows the Union's institutions to react to possible threats to fair competition because of the islands' duty-free sales derogation. Furthermore, Annex XI to Article 24 of the Act of Accession of Malta establishes a safeguard clause whereby Malta may restrict the free movement of workers for seven years after accession if it foresees a serious threat to its labour market.<sup>47</sup> The latter two safeguard clauses will be reviewed in Section VI and VII.

The importance of these flexibility clauses should not be underestimated; Member States or the Union's institutions would perhaps not be willing to accept extensive obligations or accrued differentiation mechanisms if not for these exit clauses.<sup>48</sup>

### 4. Opt-outs and Opt-ins

An opt-out is an exemption in primary (or secondary) law granted to a Member State that does not wish to join the other Member States in a particular area of Union policy or cooperation. Opt-outs pertain to subjective political differences. They reflect political disagreement on the nature and span of the Union activities. Opt-outs usually relate to specific policies.<sup>49</sup>

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<sup>42</sup> Tuytschaever (1999) *Differentiation in European Union Law*, p. 122.

<sup>43</sup> Hanf (2001) "Flexibility Clauses in the Founding Treaties, from Rome to Nice", p. 9.

<sup>44</sup> Tuytschaever (1999) *Differentiation in European Union Law*, p. 122.

<sup>45</sup> Article 36 TFEU of the Lisbon Treaty states the following: The provisions of Articles 34 and 35 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; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States

<sup>46</sup> Article 2(b) of Protocol No. 2 on Åland Islands, OJ C 241 of 29.8.1994.

<sup>47</sup> Article 24, OJ L 236 of 23.9.2003.

<sup>48</sup> Hanf (2001) "Flexibility Clauses in the Founding Treaties, from Rome to Nice", p. 9.

<sup>49</sup> Tuytschaever (1999) *Differentiation in European Union Law*, p. 123.

An opt-out has similar legal effect as an exclusion from the scope, i.e. a Member State excludes itself from a specific policy field. The difference here is that an exclusion from the geographical scope is generally decided upon entry into the Union and refers to current common policies in force while opt-outs are used by full-fledged Member States that do not want to participate in a new policy area or cooperation.

The UK and Danish opt-out from the EMU<sup>50</sup> is an example of an opt-out based on subjective differentiation, i.e. differentiation that lacks any objective justification and is based exclusively on the political unwillingness to participate on the same footing as other Member States. Accordingly, in light of the principle of justifiable differentiation and the Courts scrutiny on the subject, this opt-out had to be authorised by primary law.<sup>51</sup>

The flip side to opt-outs is opt-ins. These are procedures that have for example been provided for in enlargement negotiations regarding small islands of incoming Member States. For example, the Canary Islands, the Åland Islands and the Faroe Islands were totally excluded from the geographical scope of the Treaties by virtue of the Acts of Accession of 1972<sup>52</sup>, 1985<sup>53</sup> and 1994<sup>54</sup> but were provided with an opt-in procedure that enabled them to be brought under it at a later date.<sup>55</sup> As will be revealed in the following sections Åland Islands and the Canary Islands opted in to the Union on a derogative basis but not the Faroe Islands decided to be fully excluded from the Union.

#### **D. Concluding remarks**

To conclude this section, as the above discussion illustrates, despite the dogma of uniformity of EU law, it is more flexible than might appear and uses many differentiation instruments to account for national diversity.

As EU law stands today, it accepts differentiation on account of objective differences of (territories of) Member States i.e. socio-economical differences. As addressed in Article 27 TFEU derogations need to be time-limited. Despite the main rule, as reviewed above there are several examples within the Treaties where territories are awarded a differentiation mechanism with a more permanent characteristic, both in primary and secondary legislation.

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<sup>50</sup> The EMU stands for the economic and monetary union. The Treaty of Maastricht contained detailed provisions on the organisation of the EMU, and a three-stage timetable for its recognition. The third stage, involving the introduction of a single currency, was on 1 January 1999 at the latest and included a formal introduction of euro, the official currency of 11 out of the then 15 Member States. (*See*: Arnulf et al. (2006), *Wyatt and Dashwood's European Union Law*, p. 18-19.

<sup>51</sup> Tuytschaever (2000) "EMU and the Catch-22 of EU Constitution-Making", p. 180.

<sup>52</sup> Act of Accession 1972, OJ L 73 of 27.3.1972.

<sup>53</sup> Act of accession 1985, OJ L 302 of 15.11.1985.

<sup>54</sup> Act of Accession 1994, OJ C 241 of 29.8.1994.

<sup>55</sup> Hanf (2001) "Flexibility Clauses in the Founding Treaties, from Rome to Nice", p. 6

The most exhaustive example of territorial differentiation within the Treaties is to be found in Article 355 TFEU and Article 349 TFEU. These articles, which will be thoroughly reviewed later in this essay, reveal that the majority of the territories enjoying atypical application of EU law are small islands.

But what are these special geographical attributes or challenges and why are small islands especially vulnerable. The next chapter will explore the main schools of thought on the issue of small island vulnerabilities and establish the Unions stands on the issue.

### **III. Islands and the European Union: Different Sets of Geographical, Economic and Social Factors Affecting Small Islands**

The European Union includes approximately 600 inhabited islands.<sup>56</sup> These islands vary greatly with regard to size, geographical location and proximity to the mainland, resources and demographic trends, degree of autonomy and overall level of development.<sup>57</sup>

While islands are not a standardized group is the position of many scholars and institutions that small islands in particular share common structural vulnerabilities that differentiate them from larger islands or territories or countries on the mainland and because of this, small islands are in need of special considerations in an international context.

This section aims to review the main school of thoughts on the subject of small island vulnerability and the position EU law has on the subject. This section is divided into three chapters: an overview of the main schools of thought on the economic effects of smallness on states, especially as this relates to small islands; the legal basis for islands in EU law; and conclusions.

#### **A. The Effects of Smallness on Island States as Established in Literature**

Many scholars and institutions have noted the position that smaller states, especially small island states, have particular structural vulnerabilities or challenges that distinguish them from larger states and are therefore in need of special considerations.<sup>58</sup> This position is supported

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<sup>56</sup> EPSON (05/05/10) *Euroislands*, p. 10.

<sup>57</sup> *See in general*: EPSON (05/05/10) *Euroislands*.

<sup>58</sup>, Grynberg,(2006) “A theory of trade and development of small vulnerable states”, p. 14 and Commonwealth Secretariat/World Bank (2000) Joint Task Force on Small States, p. 2. *See in general*: Brigugilo (1995) “Small

by an economic vulnerability index initially developed by the scholar *Briguglio*<sup>59</sup> and supported by institutions such as the Commonwealth Secretariat<sup>60</sup> and the United Nations.<sup>61</sup> The general conclusion that emerged from these studies is that the small-island developing states, as a group, tend to be more economically vulnerable than other groups of countries.<sup>62</sup>

Vulnerability is not the same thing as poverty or economic backwardness based on income per capita, social or quality-of-life issues, or economic-structure variables, such as the relative size of the agricultural sector.<sup>63</sup> Vulnerability is economic backwardness due to structural factors which are not under the control of national authorities and reflects exposure to outside shocks or threats and the limited resilience and/or ability to cope with and manage these threats.<sup>64</sup> Such threats have been perceived as emanating from three main sources: economic exposure, remoteness and insularity, i.e. island status, and proneness to natural disasters.<sup>65</sup>

According to this view, while there are a number of small-island states that have managed to generate relatively high income per capita, such as Malta or Cyprus, they are nevertheless economically vulnerable<sup>66</sup> because their capacity to deal with external shocks is limited. Moreover, because of their small size, such shocks affect a greater portion of the population of small states than of the population of larger states in a similar position and have a significantly larger economic impact.<sup>67</sup>

The economic characteristics of small states have been widely described as including a small domestic market and a limited ability to exploit economies of scale; a lack of natural resource endowments and high import content (especially of strategic imports such as food and fuel); limitations of diversification possibilities and market thinness; limitations on the extent to which domestic competition policy can be applied; dependence on a narrow range of export products and a tendency towards a high degree of specialization in output; and an

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Island Developing States and their Economic Vulnerabilities”, p.1615-1632 and Briguglio (1998) “Small Country Size and Returns to Scale in Manufacturing World Development”, p. 507-515.

<sup>59</sup> Briguglio (2003) “The Vulnerability Index”, p. 8-9.

<sup>60</sup> Commonwealth Secretariat (2000) “A Commonwealth Vulnerability Index”, p. 3.

<sup>61</sup> United Nations (1998) “Development of a vulnerability index for small island developing states”.

<sup>62</sup> United Nations website, <http://www.un.org/esa/sustdev/sids/sidsvind.htm> and Commonwealth Secretariat (2000) “A Commonwealth Vulnerability Index”, p. 3.

<sup>63</sup> Briguglio (2003) *The Vulnerability Index*, p. 1.

<sup>64</sup> Commonwealth Secretariat (2000) “A Commonwealth Vulnerability Index for Developing Countries”, p. 3 and Briguglio (2003) *The Vulnerability Index*, p. 1.

<sup>65</sup> Commonwealth Secretariat (2000) “A Commonwealth Vulnerability Index for Developing Countries”, p. 3.

<sup>66</sup> Briguglio (2003) *The Vulnerability Index*, p. 1.

<sup>67</sup> Commonwealth Secretariat (2000) “A Commonwealth Vulnerability Index for Developing Countries”, p. 2.

inability to influence international prices.<sup>68</sup> Most of the small states are islands.<sup>69</sup> In addition to their smallness, the unfavourable geographical characteristics of islands leads to higher international transportation costs<sup>70</sup> and uncertainties of industrial supplies<sup>71</sup> as a result of general insularity and remoteness.

Furthermore, smallness in size has also been correlated to problems associated with public administration, i.e. a relatively small manpower base from which to draw experienced and efficient administrators, and that government functions tend to be very expensive per capita, due to the fact that fewer people need to bear the costs.<sup>72</sup>

There is another school of thought that maintains that size is not a condition for economic growth and development but that other determinants affect the growth trajectory of a country, such as geography, trade links, domestic policies and the institutional framework.<sup>73</sup> Thus, while some microstates have GDPs below average<sup>74</sup>, many enjoy some of the highest living standards in the world. Furthermore, island status appears to have no effect on whether a microstate is successful or not.<sup>75</sup> *Easterly and Kraay* maintain that small states have higher GDPs than neighbouring states and conclude that small states are no different from large states, and should therefore fall under the same policies as large states.<sup>76</sup>

According to *Baldacchino*, small, not big, is beautiful when it comes to economic context. Most small jurisdictions have managed to avoid the pitfalls of the protectionist policies of larger states. This structural openness, coupled with the small domestic market, renders non-intervention in trade as the natural, but also optimal, competition policy. As opposed to large states, which rely upon domestic markets and autonomous internal sources of growth, small states have steadily expanded their economic space extraterritorially by building the links with the “great outside” through emigration, employment, education and export-led growth. Furthermore, small islanders have aligned themselves to provide the services and features which are best suited to attract foreign direct investment and other

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<sup>68</sup> Grynberg (2006) “A theory of trade and development of small vulnerable states”, p.14, Briguglio (2003) *The Vulnerability Index*, p. 3, Commonwealth Secretariat (2000) “A Commonwealth Vulnerability Index for Developing Countries”, p. 12, Briguglio (1995) “Small Island Developing States”, p. 1617 and Commonwealth Secretariat/World Bank (2000) *Joint Task Force on Small States*, p. 2.

<sup>69</sup> Azzopardi (2005) *Small Islands and the European Union*, p. 2.

<sup>70</sup> EPSON (05/05/10) *Euroislands 2013*, p. 7.

<sup>71</sup> Briguglio et al. (2004) *Updating and Augmenting the Economic Vulnerability Index*, p. 2

<sup>72</sup> Briguglio (2003) *The Vulnerability Index*, p. 3.

<sup>73</sup> *See in general*: Armstrong, et al. (1995) “Western European Micro-States and EU Autonomous Regions”, p. 1229-1245 and Baldacchino (2000) “The Challenge of Hypothermia”, p. 65-79.

<sup>74</sup> Gross domestic product (GDP) is a measure for the economic activity of a State or a region.

<sup>75</sup> Armstrong et al. (2002) “The importance of being unimportant”, p. 77 and Armstrong et al. (1998) “Comparison of The Economic Performance”, p. 654.

<sup>76</sup> Easterly et al. (2000) “Small States, Small Problems? Income, Growth, and Volatility in Small States Development”, p. 2013.

lucrative industries, such as tourism, knowledge-based services and offshore finance. This makes them more favourably disposed to attracting foreign direct investment and transforms into economic capital.<sup>77</sup> Finally, small countries have positive inherited features, such as internal social cohesion, because of social compression and stronger personal contacts and the fact that against a global scenario of turbulence the vibrant, organic, “just in time”-oriented enterprise is more likely to be small.<sup>78</sup>

The author of this essay sides with the school of thought that regards small islands as more vulnerable than larger economies to outside threats and in need of differentiated treatment in order for them to function effectively on a level playing field with larger states. For sure small islands have many positive features upon which they utilise. However, it cannot be denied that while for instance tourism may be lucrative it is deeply sensitive to factors outside of the islands’ control.<sup>79</sup> Thus, the 2008 global financial and economic crisis severely affected the industry and small island economies highly dependent on tourism and related services such as those of Malta and Canary islands were hit especially hard.<sup>80</sup>

Furthermore, the effects the 2008 crisis had on Iceland, a nation of approximately 318.000 people,<sup>81</sup> confirms that, if affected, a shock touches a greater part of the population and has a greater economic impact on small than large states, but the crisis played an significant role in the total collapse of the Icelandic banking system, leading to major economical contraction, political turmoil and considerable hardship for the population in general.<sup>82</sup>

There is no internationally accepted definition of small countries or small-island states. Attributes such as population, land area, income per capita and the share of world trade are sometimes used either singularly or as part of a composite index, but population<sup>83</sup> is the most widely used variable.<sup>84</sup> However, the threshold that distinguishes small states from larger ones varies. International institutions such as the Commonwealth and the World Bank use a threshold of 1.5 million<sup>85</sup> while others say 1 million<sup>86</sup> or 500,000.<sup>87</sup> To be on the safe side,

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<sup>77</sup> Baldacchino (2000) “The Challenge of Hypothermia”, p. 70-71.

<sup>78</sup> Baldacchino (2000) “The Challenge of Hypothermia”, p. 73

<sup>79</sup> Garín-Munoz (2006) “Inbound international tourism to Canary Island”, p. 289.

<sup>80</sup> UNWTO World Tourist Barometer (2010) *On track for recovery after an exceptionally challenging 2009*.

<sup>81</sup> Hagstofa Íslands, July 2010 estimate, <http://www.hagstofa.is/Hagtalur/Mannfjoldi>, [accessed on 25.08.2010].

<sup>82</sup> COM (2010) 62, *Iceland’s EU application* p. 6.

<sup>83</sup> Azzopardi (2005), *Small Islands and the European Union*, p. 2.

<sup>84</sup> Azzopardi (2005), *Small Islands and the European Union*, p. 3.

<sup>85</sup> Commonwealth Secretariat/World Bank (2000) *Joint Task Force on Small States*, p. 2.

<sup>86</sup> Easterly et al. (2000) “Small States, Small Problems”, p. 214.

<sup>87</sup> Council of Europe (2005) “Development Challenges in Europe’s islands”, p.1.

this thesis regards population less than 500,000 as a very small state in a global market perspective and a population below one million as a small state.

But what is the view of the Union on the effects of smallness on islands? The following chapter will provide a summary of the EU's small-island policy.

## **B. The Legal Basis for Small-island Policy in EU Law**

The Union has no criterion for what constitutes smallness. It has however explicitly recognised the special challenges of islands in general.

The non-binding Member State declaration No. 30 on island regions, annexed to the Final Act of the Amsterdam Treaty<sup>88</sup> “*recognizes that island regions suffer from structural handicaps linked to their island status, the permanence of which impairs their economic and social development*” and affirm that Union law “*must take account of their handicaps*” allowing for “*special measures*” to be taken in favour of these islands in order for them to better integrate into the internal market on fair conditions.<sup>89</sup> Furthermore, Article 174 TFEU (ex-158 TEC) on the Union's Cohesion Policy states that “*particular attention shall be paid to regions which suffer from severe and permanent natural or demographic handicaps such as ...island...regions*”. This article can also apply to island states.<sup>90</sup>

Apart from this general acknowledgement of island realities, the Member States have over time been able to negotiate special arrangements for island territories on the grounds of their specific characteristics. These include Article 349 TFEU on the Outermost Regions and other ad-hoc arrangements that will be reviewed in the next section. These island territories are as a rule either small or very small.

Considering the general and specific provisions and arrangements the Union is acknowledging that islands are faced with special vulnerabilities. In that sense the Union shares the view of scholars and international institutions that there is a need for special treatment of islands. The question is however, whether this is a coherent small island policy applicable to all small islands – regions or states – or whether factors, such as size of the island or its administrative status, plays a role when the Union is addressing small islands. With the accession of two independent small-island states, Malta and Cyprus, into the

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<sup>88</sup> Treaty of Amsterdam, Treaty of Amsterdam, OJ C 340 of 10.11.1997

<sup>89</sup> Declaration No. 30 on island regions, OJ C 340 of 10.11.1997.

<sup>90</sup> Declaration No. 33 on Article 174 TFEU, OJ C 83 of 30.3.2010.

European Union, and the formally opened accession negotiations of another, Iceland,<sup>91</sup> the status of small islands within EU law has become an ever more compelling issue.

The following sections will be reviewing the status of small islands within EU law and thus whether the Union is in effect admitting to small island vulnerabilities.

### **C. Concluding Remarks**

This section has revealed that the Union acknowledges that islands are faced with special permanent natural and demographic handicaps and in need of special attention from the Unions legislative. This view is shared by scholars and international institutions, which, by using a vulnerability index, regard small island states as especially vulnerable regardless of their GDP.

The author of this essay agrees with this view and believes that small island vulnerability justifies the application of differentiation mechanisms in primary or secondary EU law, in order for them to function effectively on a level playing field with other larger states.

But while EU law may acknowledge island handicaps, are they providing a general framework for a small-island policy within which special remedial measures are provided? The following section will evaluate the myriad special island statuses as presented in Article 355 TFEU and whether they, as such, can be regarded as an example of a small-island policy in EU law.

## **IV. Islands in a Special Relationship: In or Out of the EU**

### **A. Introduction**

The most direct and accrued differentiation established in the Treaties is to be found in Article 52 TEU and 355 TFEU, which limit the scope of the Treaties. The aim of this section is to establish which types of territories are enjoying these special relationships, what are the justifications behind them, the legal effects of the differentiation mechanisms and whether the differentiation mechanisms provided are effective, i.e. the right instruments for the job. The question to answer is whether the special statuses are occupied by small islands and if so, why?

The section begins with a broad overview of the meaning of the territorial scope of EU law. This is followed by a review of limitations to the scope of the Treaties as established in Article 355 TFEU and their legal effect in the context of differentiation. This review limits

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<sup>91</sup> Iceland's Ministry of Foreign Affairs website, press release (27.7.2010) "Iceland EU accession negotiations formally opened", <http://eng.utanrikisraduneyti.is/speeches-and-articles/nr/5769>, [accessed on 25.08.2010].



itself to special statuses described in Article 355 TFEU and will not review other special relationships with the Union, such as the German Büsingen am Hochrhein, the Italian Campione d'Italia and Livigno, or the Spanish towns of Ceuta and Melilla in Africa.

This review is further limited to the effect these statuses have within the internal market and the four freedoms and will not put particular focus on the effects of territorial scope and special statuses on the territories in relation to social, environmental or human rights issues as presented in EU law.

## **B. The Territorial Scope of the Treaties and Its Limits**

Article 52 TEU as amended by the Treaty of Lisbon defines the territorial scope of the European Union. It states straightforwardly that:

1. The Treaties shall apply to the Kingdom of Belgium, the Republic of Bulgaria, the Czech Republic, the Kingdom of Denmark, the Federal Republic of Germany, the Republic of Estonia, Ireland, the Hellenic Republic, the Kingdom of Spain, the French Republic, the Italian Republic, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Grand Duchy of Luxembourg, the Republic of Hungary, the Republic of Malta, the Kingdom of the Netherlands, the Republic of Austria, the Republic of Poland, the Portuguese Republic, Romania, the Republic of Slovenia, the Slovak Republic, the Republic of Finland, the Kingdom of Sweden and the United Kingdom of Great Britain and Northern Ireland.
  
2. The territorial scope of the Treaties is specified in Article 355 of the Treaty on the Functioning of the European Union.

According to Article 1(2) TFEU:

This Treaty and the Treaty on European Union constitute the Treaties on which the Union is founded. These two Treaties, which have the same legal value, shall be referred to as 'the Treaties'.

In accordance with this scope it follows that both Treaties shall apply to all twenty-seven contracting parties mentioned therein. According to the general rules of international law, the Treaties, and thus the *acquis communautaire* of the Union, is binding in relation to all nationals of the Member States and all the territories falling under the sovereignty of the

parties,<sup>92</sup> including their territorial waters<sup>93</sup> and ships and aircraft.<sup>94</sup> This means that EU law applies to the whole territory of all Member States, inside and outside Europe.<sup>95</sup>

The Union is an organization *sui generis* in the sense that it does not have a territory of its own.<sup>96</sup> Both the territory of the Union and the citizens of the Union are defined by the Member States. However, any exemptions from the rules of application of EU law *acquis communautaire* need to be granted by the Treaties. Thus, the position taken by the domestic law of a Member State on the issue is not of importance in this regard.<sup>97</sup>

Although guided by the principle that the Treaties apply to all territories of a Member State, there are a number of exceptions. The legal basis for these exceptions is found in the limits to the scope of the Treaties as defined in Article 355 TFEU (ex-Article 299 subparagraph 2-6 TEC), which reveals that the Treaties apply with a variable intensity<sup>98</sup> dependent on geographical location.<sup>99</sup> Some of these exceptions are further outlined in the Treaties while other derogations follow from the protocols and declarations appended to the Treaties.

This section will legally review the special statuses identified in Article 355 TFEU, including their justifications and main characteristics. It will provide a general outline of all the statuses described in Article 355 TFEU. It begins with a short overview of the main legal features of the Outermost Regions status. This review is followed by a summary of the statuses of overseas countries and territories of Member States. Then the rule applied to territories whose external relations a Member State is responsible for will be explained. The status of the Åland Islands will be reviewed, followed by that of the Faroe Islands. The special status of the Sovereign Base of Cyprus will be assessed as will the relationship with the Channel Islands and Isle of Man. Finally, the possibilities that some of these islands have to change from one status to another will be studied.

This section will be followed by two separate in-depth case studies of the islands that are an integral part of the Union: the Outermost Regions in Section V and the Åland Islands in Section VI.

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<sup>92</sup> ECJ, Case C-300/04, *Eman & Sevinger v. College van burgemeester en wethouders van Den Haag* [2006] ECR I-8055.

<sup>93</sup> ECJ, Case C61/77, *Comm'n v. Ireland* [1978] ECR 417 and Case C-63/83, *The Queen v Kent Kirk* [1984] ECR 2689.

<sup>94</sup> ECJ, Case C-148/77, *H. Hansen Jun. & O.C. Balle GmbH & Co. V. Hauptzollamt de Flensburg* [1978] ECR 1787.

<sup>95</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p. 205.

<sup>96</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p. 200.

<sup>97</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p. 201.

<sup>98</sup> Ziller (2007) "Territorial Scope of European Territories," p. 51.

<sup>99</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", footnote 92.

## 1. Article 355(1): The Outermost Regions: Non-European Dependencies Within the Union but with Derogations

Article 355(1) states:

The provisions of the Treaties shall apply to Guadeloupe, French Guiana, Martinique, Réunion, Saint-Barthélemy, Saint-Martin, the Azores, Madeira and the Canary Islands in accordance with Article 349 TFEU.

These territories are generally known as the “Outermost Regions”. They are all geographically situated far from continental Europe and all but French Guiana are islands, and, as will be discussed in the case study later in this section, all but the Canary Islands fall under the category of being small as defined in literature. None of the territories are a part of the European continent but all have a special connection with a Member State of the Union.

As established by a textual interpretation of the Article, the Treaties apply to these territories. Thus the primary rule is that the *acquis communautaire* applies by default, unless and until the contrary is specified in EU legislation. The Outermost Regions are thus fully integrated into the Union. Consequently any atypical application of EU law resulting in differentiated treatment arises not from limitations to the scope of the treaty but by allowing derogations from EU law.

Being within the scope of the Treaties has the legal effect that all derogations fall within the Court’s scrutiny and thus have to follow the general principle of EU law addressed in Article 27 TFEU. Thus all derogations from the *acquis communautaire* should be as narrow as possible<sup>100</sup> and should by default be temporary.<sup>101</sup>

Article 355(1) TFEU explicitly mentions that the Treaty shall apply in accordance with Article 349 TFEU. This article allows atypical and de facto permanent derogations from the *acquis communautaire* within the internal market on account of the Outermost Regions remoteness, insularity, small size, difficult topography and climate and economic dependence on a few products.

As established above, the Outermost Regions are full EU members. This makes the derogative regime they receive all the more interesting in a small-island policy perspective.

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<sup>100</sup> ECJ, Case C-58/83, *Comm’n v Greece* [1984] ECR 2027, ECJ and Case C-192/84, *Comm’n v Greece* [1985] ECR 3967.

<sup>101</sup> Kochenov (2009) “The Impact of European Citizenship”, p. 7 and Fagerlund (1997) “The Special Status of the Åland Islands”, p. 243.

Hence, the Outermost Regions and the small-island arguments as identified in literature, the type of derogations applied and the efficiency in addressing their vulnerability will be reviewed in detail in a case study on the Outermost Regions in Section V.

## **2. Article 355(2): Overseas Countries and Territories: Non-European Dependencies Outside of the Union but with Special Arrangements**

Article 355(2)(1) states:

The special arrangements for associations set out in Part Four shall apply to the overseas countries and territories listed in Annex II.

This article focuses on the association of the Union with the twenty-one territories listed in Annex II of the Lisbon Treaty. These are countries and territories that are not independent and are linked with France, the United Kingdom, the Netherlands or Denmark. They are referred to as overseas countries and territories, (OCTs) and of those territories most are small islands.<sup>102</sup> None of the territories or countries is European and were it not for a special connection with a Member State these areas could not be associated with the Union.<sup>103</sup>

Article 355(2) TFEU establishes a general rule that the *acquis communautaire* is not applicable in the OCT by default. Thus, contrary to the Outermost Regions, these countries and territories are not part of the European Union, even though they are part of their Member State of reference. Subsequently, EU law does not apply unless otherwise explicitly specified. The textual interpretation of Article 355(2) TFEU limits the application of the Union *acquis communautaire* to Part Four TFEU and the relevant articles therein. This reasoning was confirmed in the *Leplat Case*,<sup>104</sup> where the court stated that “*failing express reference, the general provisions of the [EU] Treaty do not apply to [overseas] countries and territories*”.<sup>105</sup>

Such a limitation in applicable Union law is logical given that the OCT status, which was established with the signing of the Rome Treaty in 1957,<sup>106</sup> was designed for territories

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<sup>102</sup>OCT's cover about 2 296 904 km<sup>2</sup>, with a total of 1 200 800 inhabitants. See a detailed list of inhabitants and land coverage in each OCT (Ziller (2007) "Territorial Scope of European Territories" p. 55.)

<sup>103</sup> According to Article 49 TEU (ex-Article 49 TEU) of Lisbon only European States may apply.

<sup>104</sup> ECJ, Case C-260/90, *Bernard Leplat v Territory of French Polynesia* [1992] ECR I-643.

<sup>105</sup> ECJ, Case C-260/90, *Leplat* [1992] ECR I-643, point 10.

<sup>106</sup> Article 227(3) of the Rome Treaty.

only loosely associated with a Member State and not integrated into the domestic market of the Member State.

According to Article 198 TFEU (ex-Article 182 TEC) the purpose of association is:

“...to promote the economic and social development of the countries and territories and to establish close economic relations between them and the Union as a whole.”

“In accordance with the principles set out in the preamble to this Treaty, association shall serve primarily to further the interests and prosperity of the inhabitants of these countries and territories in order to lead them to the economic, social and cultural development to which they aspire.”

A textual interpretation of the article reveals that although the wording is not as explicit as that concerning the Outermost Regions, small-economy vulnerability arguments, as defined in literature, are being used to justify the special arrangements of the OCTs. A rough overview of the association relationship between the Union and the OCTs, as represented in Part Four TFEU, will now be presented.

The EU lays down a development strategy for each OCT in the form of a Single Programming Document (SPD). For the years 2008-2013, OCTs benefit from association arrangements focusing on economic and trade cooperation, with a very advantageous trade system offering duty-free access for their goods to the EU. These arrangements are non-reciprocal – in other words, products originating in the EU may be subject to import duties or charges established by the OCTs.<sup>107</sup> The OCTs do not form part of the single market and must comply with the obligations imposed on third countries with respect to, for example, rules of origin. These rules are nevertheless favourable for the OCTs.<sup>108</sup>

The OCTs benefit from the Union’s sustainable development programme, which focuses on support for policies and strategies relating to production, trade development, human, social and environmental development, and cultural and social cooperation. Furthermore, the OCTs benefit from regional cooperation and integration and sectoral reform policies at the regional level. Finally, the OCTs are eligible for participation in and funding from EU programmes.<sup>109</sup>

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<sup>107</sup> Ziller (2007) “Territorial Scope of European Territories”, p. 56.

<sup>108</sup> Council Decision 2001/822/EC on the association of the overseas countries and territories with the European Community, OJ L 314 of 30.11.2001.

<sup>109</sup> The Ministry of Foreign Affairs in the Faroes (2010) *The Faroes and the EU -possibilities and challenges in a future relationship*, p 87.

As established above, the OCTs are excluded from the scope of the Treaty by default and the view of the Court and most scholars has been that the only exceptions are Part Four TFEU and secondary law adopted therein. However, there seems to be a contradiction between the geographical scope of application and the personal scope of application of EU law in the case of OCTs. Without going into the analysis of EU citizenship development, the introduction of citizenship in the European Union with the Maastricht Treaty<sup>110</sup> had the side effect of making EU citizenship applicable to OCT nationals who have Member State citizenship because of the national constitutional principle of the aforementioned Member States of equality between citizens.

This was confirmed by the Court in the *Eman & Sevinger Case*,<sup>111</sup> which established the general rule that EU citizens cannot be stripped of their status as a consequence of moving outside of Union territory to an overseas country or territory unless explicitly excluded from the scope of EU law. This makes the textual interpretation of Article 355(3) TFEU as used by the Court in the *Leplat Case* obsolete and narrows the gap existing between the statuses of the OCTs associated with the Union on the one hand and that of the Outermost Regions in the sense of Articles 349 and 355 TFEU on the other.<sup>112</sup>

Regarding the future of the OCT relationship with the Union in view of the expiration of the current Overseas Association Decision at the end of 2013, the Commission wishes to carry out a review of the relations between the EU and the OCTs. Thus the new framework of cooperation should not be a relationship between donor and aid partner as is the case today.<sup>113</sup>

Article 355(2)(2) states:

The Treaties shall not apply to those overseas countries and territories having special relations with the United Kingdom of Great Britain and Northern Ireland which are not included in the aforementioned list.

Article 355(2)(2) TFEU clearly states that all territories in relations with the United Kingdom of Great Britain and Northern Ireland that are not included in Annex II shall not enjoy the status described in Title IV TFEU. An example of this is Hong Kong, which was a

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<sup>110</sup> Article 8 of Part Two of the Maastricht Treaty, OJ C 191 of 29.7.1992.

<sup>111</sup> ECJ, Case C-300/04 *Eman and Sevinger* [2006] ECR I-8055.

<sup>112</sup> Kochenov (2009) "The Impact of European Citizenship", p. 5.

<sup>113</sup> COM(2009) 623 final, *Elements for a new partnership with the OCTs*, p. 4

crown colony from 1843-1983 and a dependent territory from 1983-1997 but was never added to the Annex.

### **3. Article 355(3): The Rule of Inclusion Because of Member State Responsibility for External Relations**

Article 355(3) TFEU states:

The provisions of the Treaties shall apply to the European territories for whose external relations a Member State is Responsible.

Logically several territories mentioned in Article 355 would fall under this article, such as the Channel Islands and the Isle of Man,<sup>114</sup> the Åland Islands<sup>115</sup> and the Faroe Islands.<sup>116</sup> However, the special arrangements negotiated on the territories behalf have limited the scope of this article.

By virtue of this paragraph, Gibraltar, a British dependency, with self-government in internal matters but dependent on the United Kingdom for its defence, foreign affairs and internal security, is included in the Union. Gibraltar is located on the southern end of the Iberian Peninsula at the entrance to the Mediterranean. It is thus on the European continent. The territory itself is a peninsula of 6,843 km<sup>2</sup> with a population of 28,877<sup>117</sup> inhabitants. As such, Gibraltar is as a small territory of a Member State, as established in literature.

According to Article 28 of the UK Act of Accession, Gibraltar is excluded from the application of the rules on the Common Agricultural Policy (CAP) and VAT. Gibraltar is not part of the Common Customs Territory or Common Commercial Policy. In all other respects, Gibraltar is subject to EU law.

While Gibraltar is yet another example of a semi-autonomous small territory receiving special arrangements within the Treaties, it is not a small island and will not be discussed further.

### **4. Article 355(4): The Åland Islands: A Member of the Union but with Derogations**

Article 355(4) TFEU states:

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<sup>114</sup> They are British Crown dependencies and the United Kingdom is responsible for their defence and international relations

<sup>115</sup> Åland Islands have self rule and legislative power but Finland is in charge of foreign relations on their behalf.

<sup>116</sup> Faroe Islands have home rule but Denmark is responsible for the foreign policy of Faroe Islands.

<sup>117</sup> CIA World Factbook, Gibraltar, July 2010 estimate, [accessed on 25.08.2010].

The provisions of the Treaties shall apply to Åland Islands in accordance with the provisions set out in Protocol 2 to the act concerning the conditions of accession of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden.

A European group of islands, the Åland Islands are an integral part of Finland, a Member State of the Union, but they are an autonomous region with extended legislative powers and self-rule. As addressed in the above-mentioned article, the Åland Islands are a full member of the Union.

As such the general rule is that the *acquis communautaire* applies in the islands unless otherwise specified in EU law. On account of a “Special Status” established by the League of Nations in 1921 for the protection of the Swedish language and culture on the Åland Islands, Finland negotiated special derogations from the *acquis communautaire* with the European Union.<sup>118</sup> This Special Status, whose legal basis is established in Article 355(4) TFEU and Protocol No. 2 on the Åland Islands, allows permanent derogations (Article 1) from the four freedoms and an exclusion from scope (Article 2) of the Treaties as regards the Union’s indirect tax harmonization.

As mentioned above, the Åland Islands are a full member of the European Union. As in the case of the Outermost Regions, this makes the derogative regime they receive all the more interesting from a small-island vulnerability policy perspective. The case study in Section VI will analyse the arguments behind the Special Status (i.e. whether small-island arguments, as identified in literature, are the motivation), the type of derogations applied and their efficiency in addressing this Special Status.

## **5. Article 355(5)(a): The Faroe Islands: Fully Excluded from the Scope of the Treaties**

Article 355 (5)(a) states:

Notwithstanding Article 52 of the Treaty on European Union and paragraphs 1 to 4 of this Article: (a) the Treaties shall not apply to the Faroe Islands;

The Faroe Islands are a part of the Kingdom of Denmark but since 1948 have had extensive self-government (home rule).<sup>119</sup> According to the main rule in Article 51 TEU or the *lex specialis* in Article 355(3) TFEU, the Faroe Islands should have been included in the

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<sup>118</sup> Fagerlund (1997) “The Special Status of Åland Islands”, p. 189-255.

<sup>119</sup> The Ministry of Foreign Affairs in the Faroes (2010) *The Faroes and the EU -possibilities and challenges in a future relationship*, p. 25.



EU at the time of Denmark's accession in 1972. Article 355(5)(a) TFEU, however, clearly excludes the Faroe Islands from the scope of the Treaties altogether. Being excluded from the scope, they are treated as a third country with regards to the EU.<sup>120</sup> What's more, on account of Protocol No. 2 annexed to the Act of Accession of 1973, Danish nationals who reside in the Faroe Islands are not considered EU nationals during their time of residence there.<sup>121</sup>

The Faroe Islands have a population of 48,805 inhabitants.<sup>122</sup> The islands are European and are situated in the Atlantic Ocean with their nearest neighbour, the Shetland Islands, some 300 kilometres away.<sup>123</sup> As for land area, the islands are an archipelago consisting of eighteen small islands with a total area of 1,393 square kilometres.<sup>124</sup> Economically the islands are dependent on the sea; fish and fish products constitute 95% of the total export value. While traditional fisheries previously accounted for the majority of this percentage, aquaculture has become an important and increasing part of total Faroese fish production.

The above establishes that the Faroe Islands fall under the criteria of a very small and vulnerable island as established in literature. Furthermore, as will now be reviewed, the reasons for not joining the EU can be recognised as small-island vulnerability arguments.

Two issues in particular weighed heavily in the Faroese EEC debate in the beginning of the 1970s. First, there was great concern with regard to the Common Fisheries Policy (CFP). It was feared that large European vessels would empty the Faroese fishing grounds and thereby jeopardise the viability of those regions of the Faroes, which were economically very dependent on access to fisheries, fish exports and fish products. Second, having struggled for increased independence from Denmark, Faroese politicians were not keen to hand over influence to the EEC.<sup>125</sup>

The economical reason not to join - the total dependence on one or two main products of exports - is an argument clearly found in the literature on small-island vulnerability. So,

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<sup>120</sup> The Ministry of Foreign Affairs in the Faroes (2010) *The Faroes and the EU -possibilities and challenges in a future relationship*, p. 39.

<sup>121</sup> Article 4 of Protocol No. 2 on the Faroe Islands states the following: Danish nationals resident in the Faroe Islands shall be considered to be nationals of a Member State within the meaning of the original Treaties only from the date on which those original Treaties become applicable to those Islands". ( Act of Accession 1972 OJ L 73, 27.3.1972)

<sup>122</sup> Hagstova Føroya website, 1. July 2010 estimate.

[http://www.hagstova.fo/portal/page/portal/HAGSTOVAN/Hagstova\\_Foroya](http://www.hagstova.fo/portal/page/portal/HAGSTOVAN/Hagstova_Foroya), [accessed on 25.08.2010].

<sup>123</sup> Europea website, Portrait of the Regions. Available at:

[http://circa.europa.eu/irc/dsis/regportraits/info/data/dk\\_national.htm](http://circa.europa.eu/irc/dsis/regportraits/info/data/dk_national.htm), [accessed on 25.08.2010].

<sup>124</sup> CIA World Factbook. Faroe Islands, <https://www.cia.gov/library/publications/the-world-factbook/geos/fo.html>, [accessed on 25.08.2010].

<sup>125</sup> The Ministry of Foreign Affairs in the Faroes (2010) *The Faroes and the EU -possibilities and challenges in a future relationship* , p. 21.

given the choice, the islands decided to stay outside of the Union to protect their economical interests. That decision reveals that the Union was not, at least at the time of accession, providing a solution that corresponded to the needs of small and vulnerable economies of islands.<sup>126</sup>

## **6. Article 355(5)(b): The Sovereign Base of Cyprus: Not in the Union Unless Otherwise Clearly Specified**

Article 355 (5)(b)states:

Notwithstanding Article 52 of the Treaty on European Union and paragraphs 1 to 4 of this Article: (b) the Treaties shall not apply to the United Kingdom Sovereign Base Areas of Akrotiri and Dhekelia in Cyprus except to the extent necessary to ensure the implementation of the arrangements set out in the Protocol on the Sovereign Base Areas of the United Kingdom of Great Britain and Northern Ireland in Cyprus annexed to the Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic to the European Union and in accordance with the terms of that Protocol.

Cyprus joined the European Union in 2004.<sup>127</sup> The population of Cyprus is around one million people and the island itself covers about 9,250 square kilometres. Its political landscape has been turbulent and complex for decades, dividing the island into four separate territories: the officially recognized (Greek) government of the Republic of Cyprus occupies around two-thirds of the island; the unrecognized (Turkish) Republic of Northern Cyprus occupies a part of the northern part of the island; the United Nations controls the so-called “Green Line”, which amounts to 2.6% of the island; and finally, Akrotiri and Dhekelia, the SBA territory which is occupied by the United Kingdom, takes up around 2.7% of the island.<sup>128</sup>

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<sup>126</sup> When addressing the interests of small islands within the Union it is interesting to mention the case of Greenland. By virtue of the accession of Denmark in 1972 Greenland was included in the Union. However, upon gaining self-rule in the 80’s it decided to leave the Union and is now, according to Article 204 TFEU (ex Article 188 TEC), one of the OCT’s. (*See*: Greenland Treaty 1984, OJ L 29 of 1.2.1985 and Kochenov (2008-2009) “Substantive and Procedural Issues”, p. 262 ). One cannot but speculate that the main reason for this decision was that the Union was not providing an effective small island policy and that until the Union decides to effectively address small island vulnerabilities small islands will be reluctant to join.

<sup>127</sup> Act of Accession 2003, OJ L 236 of 23.9.2003.

<sup>128</sup> CIA World Factbook, Cyprus, <https://www.cia.gov/library/publications/the-world-factbook/geos/cy.html>, [accessed on 25.08.2010].

The SBAs have been excluded from the Treaties since the entry of the United Kingdom and Ireland into the Union with the Act of Accession of 1972.<sup>129</sup> As regards Cyprus, the general rule in Article 51 TEU is that the whole territory of the Member State falls under the geographical scope of the Treaties. Thus logically the SBAs would be included upon Cyprus accession into the Union.

Article 355(5)(b) TFEU establishes that the SBAs are also, as a main rule, excluded from the scope of the Treaties as regards Cyprus. The only exceptions to this rule are those addressed in the protocol attached to the Accession Treaty of 2003.<sup>130</sup> The rule established in Article 355(5)(b) TFEU is very narrow, stating that the *acquis communautaire* “does not apply...except to the extent necessary”. A similar but revised wording can be found in Article 355(5)(c) TFEU on the Channel Islands and the Isle of Man. As will be addressed below, this restrictive language has been interpreted as making impossible any teleological or extensive interpretation of the protocol. Taking into account a textually narrower approach in Article 355(5)(b) TFEU, the same should apply with regards to the SBA territory.

The special status the SBA territory enjoys on account of Article 355(5)(b) TFEU reveals the flexible approach of the Union with regards to its scope and discloses that the scope of the Treaties can be limited on account of politics or military reasons. However, unlike other islands in Article 355 TFEU, this special status is applied purely on the grounds of the political state of affairs in the territory, not on account of distinctive constraints due to their island status. For this reason this status will not be addressed further. However, the status of Cyprus as a small-island state within the Union will be addressed in Section VII later in this essay.

## **7. Article 355(5)(c): The Channel Islands and Isle of Man: Only in the EU to the Necessary Extent**

Article 355 (5) states:

Notwithstanding Article 52 of the Treaty on European Union and paragraphs 1 to 4 of this Article:(c) the Treaties shall apply to the Channel Islands and the Isle of Man only to the extent necessary to ensure the implementation of the arrangements for those islands set out in the Treaty concerning the accession of new Member States to the European Economic Community and to the European Atomic Energy Community signed on 22 January 1972.

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<sup>129</sup> Article 26 of the Act of Accession 1972, OJ L 73 of 27.3.1972

<sup>130</sup> Protocol No. 3 on the Sovereign Base Areas of the United Kingdom of Great Britain and Northern Ireland in Cyprus, OJ L 236 of 23.9.2003

The Channel Islands, i.e. the Bailiwicks of Jersey and Guernsey (the islands of Alderney and Sark), and the Isle of Man are European self-governing dependencies of the British Crown and are not part of the United Kingdom. The islands operate largely as autonomous jurisdictions with wide powers of self-government and their own independent legal, administrative and fiscal systems. The United Kingdom has responsibility for their international affairs and defence.<sup>131</sup>

Jersey has a population of 91,812 inhabitants and a landmass of 116 square kilometres.<sup>132</sup> Guernsey has a population of 65,632 with a total landmass of 78 square kilometres.<sup>133</sup> The Isle of Man has a population of 76,913 and a landmass of 572 square kilometres.<sup>134</sup> All are located in Western Europe. The population of these islands puts them in the category of being very small island states, as established in literature.

According to Article 355(5)(c) TFEU, the general rule is that the *acquis communautaire* does not apply to these territories. The only exemptions to that rule are those listed in Article 1 in Protocol No. 3 annexed to the Act of Accession of 1972.<sup>135</sup> Taking into account the narrow or restrictive language of the article, no teleological or extensive interpretation of the protocol should be possible – neither by the Commission nor the Court.<sup>136</sup> This is in contrast, for example, to the aforementioned Outermost Regions and the Åland Islands and the arrangements for the OCTs, reviewed above.

Essentially, both the Channel Islands and Isle of Man have the same relations with the EU.<sup>137</sup> According to Protocol 3, these islands are only part of the Union for the purpose of free movement of industrial and agricultural goods but not for instance for the purpose of free movement of persons and taxation.<sup>138</sup> In essence, Protocol 3 provides that these islands are in the customs territory of the EU. In this sense, they are part of the Common Customs Tariff

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<sup>131</sup> The British Monarchy website, <http://www.royal.gov.uk/MonarchUK/QueenandCrowndependencies/ChannellIslands.aspx>, [accessed on 25.08.2010].

<sup>132</sup> CIA World Factbook, Jersey, July 2010 population estimate. *See in general* and information on population, <https://www.cia.gov/library/publications/the-world-factbook/geos/je.html>, [accessed on 25.08.2010].

<sup>133</sup> CIA World Factbook, Guernsey, July 2010 population estimate. *See in general* and information on population, <https://www.cia.gov/library/publications/the-world-factbook/geos/gk.html>, [accessed on 25.08.2010].

<sup>134</sup> CIA World Factbook, Isle of Man, July 2010 population estimate. *See in general* and information on population, <https://www.cia.gov/library/publications/the-world-factbook/geos/im.html>, [accessed on 25.08.2010].

<sup>135</sup> Protocol No. 3 on the Channel Islands and the Isle of Man, OJ L 73 of 27.3.1972.

<sup>136</sup> Sutton (2005) “Jersey’s Changing Constitutional Relationship with Europe”, p. 30.

<sup>137</sup> The Ministry of Foreign Affairs in the Faroes (2010) *The Faroes and the EU -possibilities and challenges in a future relationship*, p. 83.

<sup>138</sup> Barnett (2004) *Constitutional and Administrative law*, p. 62.

(CCT), which allows export access to EU Member States without tariff barriers.<sup>139</sup> Certain disciplines also exist in the field of competition and state aids for agricultural products.<sup>140</sup> The islands in question are outside the scope of the Unions Common Agricultural Policy (CAP)<sup>141</sup> and are not benefiting from EU financial support measures, nor do they make any financial contribution to these funds.<sup>142</sup>

Article 4 of the protocol requires the insular authorities to apply the same treatment to all natural and legal persons of the Union. Two rulings have fallen on the scope of this non-discrimination principle in relation to rules not included in the scope of the Treaties or the protocol. Since the Åland Islands protocol has a similar non-discrimination clause, these rulings are of relevance to this study.

The *Barr and Montrose Case*<sup>143</sup> concerned the right of a British national to take up employment in the Isle of Man. According to Article 2 of the protocol,<sup>144</sup> the provisions on freedom of movement for EU workers do not apply in the islands. The Court explained that the non-discrimination clause restricts the islander's freedom to discriminate between EU nationals but not between islanders and EU nationals. By virtue of the narrow wording of Article 355(5)(c) TFEU of the Treaties, Protocol No. 3 and Article 2, the Court confirmed that the non-discrimination clause could not be used as a back door to apply to the territory EU law when that was not explicitly established in [Article 355(5)c)] and Protocol 3. However, the principle of equal treatment in Article 4 was not limited exclusively to the matters referred to in Article 1 of the protocol. Article 4 was an "*independent provision*" so far as its scope was concerned and precludes any discrimination between EU citizens in relation to situations which, "*in territories where the Treaty is fully applicable,*" are governed by Union law.

In the *Alberto Roque Case*<sup>145</sup> this scope of Article 4 was confirmed and on those grounds Jersey authorities were prohibited to base a decision for deportation of a convicted criminal offender on the fact that the deportee was not British as such was "*an arbitrary distinction to the detriment of nationals of other Member States.*"

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<sup>139</sup> The Ministry of Foreign Affairs in the Faroes (2010) *The Faroes and the EU -possibilities and challenges in a future relationship*, p. 83

<sup>140</sup> Sutton (2005) "Jersey's Changing Constitutional Relationship with Europe, p. 32.

<sup>141</sup> Sutton (2005) "Jersey's Changing Constitutional Relationship with Europe, p. 35.

<sup>142</sup> The Ministry of Foreign Affairs in the Faroes (2010) *The Faroes and the EU -possibilities and challenges in a future relationship*, p. 84.

<sup>143</sup> ECJ, Case C-355/89, *Restrictions on the free movement of workers in the Isle of Man* [1991] ECR I-03479.

<sup>144</sup> Article 2 of Protocol No. 3 states the following: "The rights enjoyed by Channel Islanders or Manxmen in the United Kingdom shall not be affected by the Act of Accession. However, such persons shall not benefit from Community provisions relating to the free movement of persons and services".

<sup>145</sup> ECJ, Case C-171/96, *Rui Alberto Pereira Roque v His Excellency the Lieutenant Governor of Jersey* [1998] ECR I-04607.

To sum up, being outside of the scope, Union law has no jurisdiction, except as regards trade. Thus islanders may enact legislation or apply measures that fit their needs. Furthermore, Article 4 does not prohibit them from distinguishing between islanders on the one hand and EU nationals on the other. However, the non-discrimination principle in Article 4, as an independent provision, governs the islander's relations with EU citizens if Union law has competence and if a territory falls under the scope of the Treaty. In these areas, EU citizens and UK citizens shall be treated alike.

According to *Sutton*, the reasons that the Channel Islands did not join the EU were a desire to preserve the islands' traditions based on 800 years of autonomy, but at the same time there was a need to develop market access for their goods and services in order to preserve the islands' economic prosperity and independence into the future.<sup>146</sup> It is likely that similar reasons lay behind the Isle of Man's decision not to join the EU.

So, just as in the case of the Faroe Islands, given the choice, the Isle of Man and Channel islands decided to stay outside of the Union to protect their small island heritage. While not directly established, just as in Faroe Islands, this decision is an indicator that small islands do not perceive the Union as providing small islands with the legal framework within which their vulnerabilities or vital interests are granted sufficient protection or understanding. Hence, the Union's willingness to provide a special, and at the time unprecedented, *sui generis* relationship with these small islands, despite their decision to stay out of the Union, reveals how flexible the Treaties really are.

Nevertheless, as Sutton mentions, since the Union has become one of the main trading partners in the world in recent years, it appears that the islands' economic interests are increasingly affected by EU law and policy.<sup>147</sup> Furthermore, as the Union has evolved and its membership has grown, the consequences of exclusion have also grown. Exclusion can have particularly serious consequences for smaller states or non-sovereign jurisdictions which lack the political leverage to negotiate with the EU on a basis of equality. However, the islands' total economic dependence on their politically and legally controversial tax-haven policy makes it difficult to seek a closer relationship with the Union.<sup>148</sup>

## **8. Article 355(6): Amending the Status of Island Territories**

Article 355(5)(6) states:

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<sup>146</sup> Sutton (2005) "Jersey's Changing Constitutional Relationship with Europe", p. 27.

<sup>147</sup> Sutton (2005) "Jersey's Changing Constitutional Relationship with Europe", p. 17.

<sup>148</sup> Sutton (2005) "Jersey's Changing Constitutional Relationship with Europe", p. 97.

The European Council may, on the initiative of the Member State concerned, adopt a decision amending the status, with regard to the Union, of a Danish, French or Netherlands country or territory referred to in paragraphs 1 and 2. The European Council shall act unanimously after consulting the Commission.

This paragraph refers to the Outermost Regions status and the OCT status. Accepting a status which provides for the possibility of deviating from the letter of the *acquis communautaire* cannot be accepted with derogations. In other words, if one asks for the Outermost Regions *acquis communautaire*, or the OCT *acquis communautaire*, it should be accepted in full by the Member State whose territory is changing its European legal status. If such acceptance is not an option, opting for a sui generis status for the territory is a possibility.<sup>149</sup>

Every change in the status of a territory means inclusion of a particular territory within the scope of one of the provisions regulating the special statuses under the EU Treaty. By embracing one of these statuses, the territory falls within the scope of the relevant provision with all the rules and principles attached to it.<sup>150</sup>

As a general rule, although the territories of the Member States are ultimately in their own hands, the Member States are not empowered, under the rules of Union law, to change unilaterally a status applied by Union law to parts of their territories. The law has required a Treaty amendment in accordance with Article 48 TEU (former Article 48 EU) in order to change the legal status of a particular part of a Member State's territory. Thus an Inter-Governmental Conference (IGC) is required.<sup>151</sup>

The Lisbon Treaty simplified this procedure somewhat. Thus Article 355(6) TFEU now allows for a procedure for changing the European legal status of a Member State's territory where the Member State initiates such a wish to the European Council. The Commission only has to be consulted.

This special procedure can only be applied to change the status of the territories connected with the Netherlands, Denmark, and France. Both directions are possible under the procedure: an OCT can be made an Outermost Region and vice versa.<sup>152</sup> This procedure only applies to the two statuses mentioned in Articles 355(1) and (2) TFEU. Thus, if the Faroe

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<sup>149</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p. 62.

<sup>150</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p. 261.

<sup>151</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p.260-261.

<sup>152</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p. 265-267.

Islands, for instance, would like to change its status into an OCT, it would require the procedure presented in Article 49 TEU.

Several reasons for the adoption of this special procedure can be named, such as the reassessment of the status of the Netherlands' OCT of Aruba and the Netherlands Antilles; the possibility that Greenland will want to change its status if Norway and Iceland were to join the EU; and the declared desire of Mayotte<sup>153</sup> to become an Outermost Region. In such cases, a simplified procedure can be helpful, and the Lisbon Treaty is trying to bridge this gap.

### **C. Concluding Remarks**

To conclude this overview, Article 355 TFEU is dominated by small islands as identified in literature. Furthermore, the article reveals that there are not one but several types of *acquis communaautaire* allowed according to EU law. There are two primary statuses in particular that Member State territories can employ, the Outermost Regions status and the OCT status.

In the former example, the Treaties apply by default since the Outermost Regions are fully integrated into the Union, but it is the ability to derogate from the *acquis communautaire* while still being fully included that sets these regions apart from other territories of Member States. As the derogations are implemented in secondary law all differentiated treatment needs to be based on justifiable grounds.

As regards the latter, the OCTs, they are generally placed outside the territorial scope of Union law but an exception is made in Part IV TFEU. Being outside the scope, the OCTs are free to deviate from the *acquis communautaire* without any need for justification, as long as they respect Part IV TFEU and the association secondary legislation in force. As the *Emand and Sevinger* judgement reveals, by virtue of the construction of the EU legal system, the influence of EU law is growing beyond Part IV TFEU in the OCT territory.

Both these primary statuses are principally dominated by very small and small islands as identified in literature. The arguments applied to justify these special relationships or regimes are the ones used in literature to argue small-island vulnerability in general. Thus, as far as these statuses apply, the Union is acknowledging the need for differentiated treatment on account of their island vulnerability.

The above-mentioned primary statuses are complemented by a third status, which according to Article 355 TFEU seems possible if a territory will not accept or is not acceptable under the above main statuses. Depending on the territory, it may be excluded altogether (the Faroe Islands) or totally excluded but partly included (the Channel Islands and

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<sup>153</sup>Declaration No. 43 on Article 355(6), OJ C 83 of 30.3.2010.



the Isle of Man, and the SBA territory) or included but allowed a primary law derogation and exclusion from the Treaties that result in exotic deviations from the black letter law of the Treaties (the Åland Islands). As Article 355 TFEU has revealed, this third status is dominated by small islands. Furthermore, while not as obvious as in the case of the two main statuses, small island vulnerability arguments, such as economical dependence on few products, are among the main reasons behind their decision to seek a third status.

Exclusion from the scope by default implies that the territory is regarded as a third territory in the eyes of the Union. Thus Union law has no jurisdiction, except within the included field. However, given that a general EU non-discrimination clause is included in the protocol, as revealed in the *Barr and Montrose* and *Alberto Roque* cases, the non-discrimination principle, as an independent provision, governs the territories' relations with EU citizens where EU law has competence. Furthermore, the review on the Isle of Man and Channel Islands reveals, as the Union is one of the main trading partners in the world it appears that EU law and policy is increasingly affecting economic interests even in fields outside its competence.

The decision of these semi-autonomous islands not to join the Union and the diversity in the scope of geographical application of different elements of EU law combined with the rich palette of special statuses enjoyed by certain territories of Member States form a complex picture and indicates the lack of a genuine EU policy to meet the needs of small islands in general. However, this picture also leaves enough room for optimism since it reveals the willingness of the drafters of the Treaties to accommodate island realities if needed and is a most obvious example of flexibility within the Treaties.

The decision to be partly excluded from the scope of the Treaties is of course one of the means a small island can pursue in order to adapt the *acquis communautaire* to its needs. Furthermore, exclusion from the scope is a convenient and simple way for the Union to differentiate between (territories of) Member States without the need to explain. Nevertheless, the dominance of small islands in Article 355 TFEU may be regarded as an implicit recognition of the Union as regards small island vulnerabilities as well as revealing the need for a small island policy within the Union.

This thesis main interest lies in researching whether EU law provide a general legal framework for fully integrated islands, within which a legal basis for derogations based on small island vulnerabilities is sought. To exclude a territory from the scope of the Treaty is one way to differentiate (territories of) Member States. While it sets the grounds for an atypical relationship with the Union exclusion can hardly be regarded as an example of a

coherent small island EU policy strategy. The following two sections will however provide case studies of the two examples of island territories in Article 355 TFEU that are fully included in the Union but nevertheless maintain a special relationship with it – the Outermost Regions and the Åland Islands.

## **V. A Case Study: The Outermost Regions: An Example of Small-island Policy in EU Secondary Law**

### **A. Introduction**

Article 355(1) TFEU ascertains that the Outermost Regions are fully integrated into the Union. More important, however, it establishes a legal basis for a derogative regime from the *acquis communautaire* for the Outermost Regions. The rules that govern this regime are found in Article 349 TFEU.

The Outermost Regions have been regarded as having unique geographical, economical and social features<sup>154</sup> and they have been seen as justifying the derogative regime the Outermost Regions receive. In order to establish whether that is true, a comparison of the handicaps of the Outermost Regions and the handicaps generally regarded to be small-island vulnerabilities in literature will be provided in this section. The underlying question is to establish whether the features of the Outermost Regions are exclusive to these territories alone or whether this status may be regarded as remedying features that are associated with small-island state realities in general, as established by the vulnerability index. If so, what are the possibilities for other small islands to be included in this special derogative regime?

The special status of the Outermost Regions in force today builds on a joint Member State declaration annexed to the Treaty of Maastricht. The declaration states that:

The Conference acknowledges that the outermost regions of the Community (the French overseas departments, Azores and Madeira and Canary Islands) suffer from major structural backwardness compounded by several phenomena (remoteness, island status, small size, difficult topography and climate, economic dependence on a few products), the permanence and combination of which severely restrain their economic and social development.<sup>155</sup>

As this declaration reveals, the Intergovernmental Conference (IGC) is using vulnerability arguments as those established in Section III and thought to justify differentiated treatment on behalf of small islands. These special features of the Outermost Regions were

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<sup>154</sup> COM (2004) 343 final, *A stronger partnership for the Outermost Regions*, point 5.1.

<sup>155</sup> Declaration No. 36 on the Outermost Regions, OJ C 191 of 29.7.1992.

granted a primary law basis when they were adopted into former Article 299(2) TEC of the Amsterdam Treaty. Today the legal basis for their special status can be found in Article 355(1) TFEU (ex-Article 299(2), first paragraph TEC), and the rules that govern the application of their special status in EU law are specified in Article 349 TFEU (ex-Article 299(2), second, third and fourth subparagraph TEC).

This special status was initially established with Article 227(2) EEC, with the signing of the Rome Treaty. The execution of this provision was not without complications and it was completely reversed by the Treaty of Amsterdam. However the legal scrutiny experienced by its predecessor clearly influenced the adoption of Article 299(2) TEC and hence the legal interpretation of current Article 349 TFEU.<sup>156</sup> Being so, it is necessary to begin this review by addressing the legal development of Article 227(2) EEC.

### **B. Article 227(2) EEC: The Development of the Outermost Regions Status**

Right from the outset the drafters of the Treaty of Rome had decided to set up a special association regime for the colonial territories (the OCTs) of the colonial Member States, Belgium, France, Italy and the Netherlands, in Part IV of the EEC Treaty. However, the French had particularly strong constitutional and political ties with Algeria and the so-called *department d'outre-mer* (DOM)<sup>157</sup> and their inhabitants enjoyed essentially the same legal status as those of the French Republic. On those grounds the French requested and were granted special treatment of these territories in ex-Article 227(2) of the EEC Treaty.<sup>158</sup> It reads as follows:

With regard to Algeria and the French overseas departments, the general and special provisions of this Treaty relating to:

- the free movement of goods,
  - agriculture, with the exception of Article 40, paragraph 4,
  - the liberalisation of services,
  - the rules of competition,
  - the measures of safeguard provided for in Articles 108, 109 and 226,
  - and the institutions,
- shall apply as from the date of the entry into force of this Treaty.

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<sup>156</sup> Kochenov (2008-2009) “Substantive and Procedural Issues”, p. 227.

<sup>157</sup> At the time of the signing of the Rome Treaty the DOM's were Guadeloupe, French Guiana, Martinique and Réunion. Algeria was also included in the article until it gained its dependence in the 1960's.

<sup>158</sup> Ziller (2000) “Flexibility in the Geographical Scope of EU Law”, p. 121.

The conditions for the application of the other provisions of this Treaty shall be determined, not later than two years after the date of its entry into force, by decisions of the Council acting by means of a unanimous vote on a proposal of the Commission.

The institutions of the Community shall, within the framework of the procedures provided for in this Treaty and, in particular, of Article 226, ensure the possibility of the economic and social development of the regions concerned.

Ex-Article 227(2) EEC clearly provides for a particular immediate integration into the internal market, as far as its core principles were concerned, and for a special adaptation mechanism for other Treaty provisions.<sup>159</sup> Even though the article stated that the provisions of the Treaty not stated in the article had to be adopted before January 1, 1960, European institutions did not feel bound by the time limit<sup>160</sup> and only the core provisions and principles of the internal market and the Customs Union applied to DOMs many years after the deadline.<sup>161</sup> This had the effect of the Outermost Regions being de facto treated as OCTs.<sup>162</sup>

This practice ended in 1978 with the *Hansen Case*.<sup>163</sup> There the Court ruled that

“after the expiry of that period [January 1, 1960], the provisions of the Treaty and of secondary law must apply automatically to the French overseas departments inasmuch as they are an integral part of the French Republic.”<sup>164</sup>

Nevertheless the Court indicated that the article allowed the possibility of exempting DOMs from applications of specific aspects of legislation in secondary law in order to offset the specific “*geographic, economic and social development of those departments*”<sup>165</sup> Thus the Court ruled that “*it always remains possible subsequently to adopt specific measures in order to meet the needs of those territories.*”<sup>166</sup>

With this judgement it was established that all territories of Member States, by default, fall under the *acquis communautaire*, unless otherwise specified. The DOM’s were no exception. However, the Court also established that special economic, social and geographic circumstances were able to justify the adoption of specific measures and that Article 227(2)

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<sup>159</sup> Ziller (2007) “Territorial Scope of European Territories”, p.58.

<sup>160</sup> Ziller (2000) “Flexibility in the Geographical Scope of EU Law”, p. 121.

<sup>161</sup> Kochenov (2008-2009), “Substantive and Procedural Issues”, p. 234.

<sup>162</sup> Kochenov (2009) “Overseas Countries and Territories”, p. 8.

<sup>163</sup> ECJ, Case C-148/77, *H. Hansen Jun. & O.C. Balle GmbH & Co. V. Hauptzollamt de Flensburg* [1978] ECR 1787.

<sup>164</sup> ECJ, Case C148/77, *Hansen*, point 11.

<sup>165</sup> ECJ, Case C148/77, *Hansen*, point 10. The court was quoting the last sentence of Article 227(2) EEC

<sup>166</sup> ECJ, Case C148/77, *Hansen*, point 11.

EEC provided for such an approach for the DOMs. Being fully within the *acquis communautaire*, the Court established that all such derogative measures could only be provided in secondary law.

But how far could the Council go in deviating from the *acquis communautaire*? The *Hansen judgement* did not make limits to the extent of the derogations entirely clear. Thus the Council and the Commission did not feel any constraints on the contents of measures to be adopted for these territories as long as it was to remedy their specific geographic, economic and social situations.<sup>167</sup>

This changed with the *Lancry Case*.<sup>168</sup> There the Court stated that the list in Article 227(2) EEC applicable to the DOMs immediately with the signing of the Rome Treaty represented the core of Union law and revealed their overwhelming importance, as compared with the rest of the *acquis communautaire*, and the Council could not touch upon this core when using Article 227(2) EEC as a legal basis for derogations. Thus the *Lancry Case* had created a list of untouchable core provisions.

As a reaction, the Member States reaffirmed the DOMs' special status from the *Hansen doctrine*, articulated in the aforementioned declaration of the Maastricht Treaty, by inserting it into the Amsterdam Treaty as Article 299(2) TEC.<sup>169</sup> Furthermore, three new territories, the Canary Islands, the Azores and Madeira, which were regarded to be suffering from essentially similar constraints as the DOMs,<sup>170</sup> were included in this new provision. Now named the Outermost Regions, this provision did not include a list of untouchable principles. However, the question on how far the Council could go in order to remedy the special circumstances of the Outermost Regions had not been answered.

The *Chevassus-Marche*<sup>171</sup> and *Sodiprem-SARL & Roger Alber SA*<sup>172</sup> cases, which were decided under Article 227(2) EEC, but after the text of Article 299(2) TEC had been drafted, made it clear that they stood firmly behind the *Lancry Case* in the sense that the previous “*carte blanche*” approach was not tolerated. However, deviations from the *acquis*

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<sup>167</sup> Kochenov (2008-2009) “Substantive and Procedural Issues”, p. 235.

<sup>168</sup> ECJ, Case C-363/93, *René Lancry SA v Direction Générale des Souanes and Société Dindar Confort, Christian Ah-Son, Paul Chevassus-Marche, Société Conforéunion and Société Dindar Autos v Conseil Régional de la Réunion and Direction Régionale des Douanes de la Réunion* [1994] ECR I-3978.

<sup>169</sup> Ziller (2000) “Flexibility in the Geographical Scope of EU Law”, p. 121-125.

<sup>170</sup> Because of the presupposed similarities of the regions falling under Article 299(2) the claim has been raised that the principle of parallelism should apply to the Outermost Regions i.e. since they are essentially similar all far-reaching differentiations within the group would be impractical, if not illegal. (Kochenov (2008-2009) “Substantive and Procedural Issues”, p. 236).

<sup>171</sup> ECJ, Case C-212/96, *Paul Chevassus-Marche v. Conseil régional de la Réunion*, 1998, ECR I-743, point 49.

<sup>172</sup> ECJ, Joined Cases C-37 & 38/96, *Sodiprem SARL v. Direction générale des douanes*, 1998, ECR I-2039.

*communautaire* that were “*necessary, proportionate and precisely determined*”<sup>173</sup> were considered to be comparable with EU law. On that note the Court allowed for derogation from ex-Article 90 TEC on taxes, which related to the core principle of free movement of goods as established in Article 227(2) EEC.

To summarise this chapter, on account of the Court’s scrutiny on Article 227(2) EEC, the scope of the special status of the Outermost Regions is now clear. As ruled in *Hansen*, the Outermost Regions are an integral part of the Union and the *acquis communautaire* applies to them in full. This is confirmed in Article 355 TFEU. Nevertheless, as established in *Hansen*, because of the geographical, social and economic circumstances of the Outermost Regions, specific measures in secondary law are allowed to compensate for these constraints. The *Chevassus-Marche* and *Sodiprem-SARL & Roger Alber SA* cases established that such derogations had to be necessary, proportionate and precisely determined in order to be compatible with EU law. This specific derogative regime is now in Article 349 TFEU.

The Court and the Treaties have acknowledged that the Outermost Regions are suffering from constraints of such severity that it is compatible with EU law to derogate from the *acquis communautaire* in order to remedy those constraints. The legal basis for this regime is found in Article 349 TFEU. But what are those constraints and what makes them so severe as to justify such derogations? Are there any similarities with the constraints the Outermost Regions are suffering from and the constraints small-island regions in general are suffering from, as established in literature? If so, what, if any, are the requirements for becoming an Outermost Region? The following chapter on Article 349 TFEU aims to answer these questions.

## **C. Article 349 TFEU: The Derogative Regime of the Outermost Regions**

### **1. Introduction**

The special status of the Outermost Regions, initially designed for the DOMs, now covers nine Outermost Regions. The article is divided into three paragraphs. The first reads as follows:

Taking account of the structural social and economic situation of Guadeloupe, French Guiana, Martinique, Réunion, Saint-Barthélemy, Saint-Martin, the Azores, Madeira and the Canary Islands, which is compounded by their remoteness, insularity, small size, difficult topography and climate, economic dependence on a few products, the permanence and combination of which severely restrain

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<sup>173</sup> ECJ, Case C-212/96, *Chevassus-Marche*, 1998, ECR I-743, point 49.

their development, the Council, on a proposal from the Commission and after consulting the European Parliament, shall adopt specific measures aimed, in particular, at laying down the conditions of application of the Treaties to those regions, including common policies. Where the specific measures in question are adopted by the Council in accordance with a special legislative procedure, it shall also act on a proposal from the Commission and after consulting the European Parliament.

Article 349, first paragraph, TFEU clearly concerns the issue of making sure that Union measures take into consideration the specific geographical, social and economic situations of territories that can severely restrain the development of those territories. While it is not a criterion of the article all but one are islands. This article is thus of interest to this study. The article reveals that not all islands are entitled to enjoy this status. Article 349(1) TFEU makes clear to which territories the special status applies.

According to *Kochenov*, there is a legitimate reason why these territories are placed under the article. All are, according to him, essentially similar in that they are influenced by the conditions described in the first paragraph of the article. The article does not presuppose that all the negative factors mentioned in the article must be present in the same territory in order for it to benefit from the status. However, only the criterion mentioned in the Article gives rise to differentiation, and its effect has to be severe enough, that is to say “*this article cannot be applied to relatively well off regions not suffering from at least some of the disadvantages listed.*”<sup>174</sup>

From Article 349 TFEU, first paragraph, and *Kochenov*'s words, it may be understood that the Outermost Regions are suffering from a unique set of handicaps whereby their severity is a key criteria. This entails that the legal criteria is closely connected to proving a socio-economic need, i.e. providing proof of severity as regards geographical constraints and poorness.

As established above, the aim of this chapter is to ascertain the requirements for becoming an Outermost Region and thus establish whether, the requirements are unique or if Article 349 TFEU is identifying a criteria other small-islands can identify with and if so, if other small-islands may expect to be eligible candidates for the status. To answer this question the severity criteria needs to be established. Thus a short overview on the Outermost Regions unique socio-economic features is needed.

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<sup>174</sup> Kochenov (2008-2009) “Substantive and Procedural Issues”, p. 230.

## 2. Insularity and Remoteness

According to a *Planistat Europe* report on the Outermost Regions, requested by DG REGIO, being remote or insular is one of the primary criteria of the status. The common denominator of the Outermost Regions is extreme isolation and remoteness relative to other continental islands.<sup>175</sup> The same report states that the Outermost Regions may be defined by means of two principal and interconnected concepts, namely the geographical and human size on the one hand and extreme isolation on the other. Thus:

“...because of the size of the territory (area, population, resources available, etc.), harmonious development can only be achieved by widening the “relevant” economic and human area so as to be in a position to carry on significant trade. However, the extreme isolation of these regions does not allow this widening, or if it does, then only under excessively difficult conditions. It is because of this that special national policies were launched, policies supported by [Article 349 TFEU].”<sup>176</sup>

This establishes that the question of remoteness and isolation is the principal factor in all aspects of these territories.<sup>177</sup> Viewing that as a handicap is in harmony the view of the Commonwealth Secretariat, addressed in section III, which has established that isolation and remoteness is one of the three main sources of small-island vulnerability.

As far as distance is considered they are not only far away from the European continent but also far away from their motherland. Réunion, which is the farthest away, is over 9,000 kilometres from its capital, Paris, and 1,700 kilometres from the coast of Africa.<sup>178</sup> This remoteness and isolation is considered all the more serious because, with the exception of Guadeloupe and Martinique, the surrounding areas have very small populations or no surrounding population at all, as in the case of Madeira and the Azores.<sup>179</sup>

All islands are by definition insular<sup>180</sup> i.e. isolated because they are not part of a continent. All islands, however, are not equally isolated or remote and the same seems to apply for the Outermost Regions. Thus the Canary Islands are only 250 kilometres off the coast of the European continent and 2,000 kilometres from their capital, and Madeira is 1,000 kilometres from its capital and 660 kilometres from the coast.<sup>181</sup> In that isolation and extreme

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<sup>175</sup> Planistat Europe et al. (2003) *The outermost regions*, p. 7.

<sup>176</sup> Planistat Europe et al. (2003) *The outermost regions*, p. 3.

<sup>177</sup> Planistat Europe et al. (2003) *The outermost regions*, p. 8.

<sup>178</sup> EPSON (2006) *Territory Matters*, p. 37.

<sup>179</sup> Planistat Europe et al. (2003) *The outermost regions*, p. 5.

<sup>180</sup> Merriam-Webster dictionary defines insular as: of, relating to, or constituting an island and dwelling or situated on an island, <http://www.merriam-webster.com/dictionary/insular> [accessed 25.08.2010].

<sup>181</sup> Planistat Europe et al. (2003) *The outermost regions*, p. 9.



remoteness are considered as principal factors of the Outermost Regions, this discrepancy between the Outermost Regions reveals interesting flexibility in the criteria.

This not only indicates that a territory does not need to be extremely remote to be a legitimate candidate for an Outermost region status it also reveals that some of the small-island states might comply with the condition. Thus, as will be addressed later in this essay, while it may be doubtful that Cyprus, and especially Malta, fulfil this criterion, Iceland seems to meet the terms of this clause. Thus, would Iceland become a Member State of the Union it would be 1,842 kilometres away from the nearest Member State, the United Kingdom,<sup>182</sup> and Greenland, 300 kilometres away,<sup>183</sup> would be its closest neighbour.

### 3. Small Size

Small size of the Outermost Regions is one of the criteria mentioned in Article 349 TFEU. As established in Section III of this study, the small size of a state has neither been clearly defined in literature nor in EU law. Many scholars and institutions have nevertheless regarded smallness as one of the principal causes of a vulnerable economy. There is a common threshold as regards population of a state is 500,000 to a million. This study uses that threshold. As for island regions, a newly published *EPSON* report on European islands however set the threshold for very small island regions at less than 5,000 inhabitants and a very large island region at above 50,000.<sup>184</sup>

Turning the focus to the smallness of the Outermost Regions, the smallest of them in population size and land area is the island of Saint-Barthélemy, which has a population of around 8,500 inhabitants and an area of 21 square kilometres.<sup>185</sup> The largest of the Outermost Regions in landmass is French Guiana, which has an area of 83,534 square kilometres. However, the territory, which is largely covered by the Amazonian rainforest, has an extremely low population density with only 209,000 inhabitants.<sup>186</sup> Of the total population living in the Outermost Regions, the Canary Islands account for 40% of the about 4 million people<sup>187</sup> or about 2,100,000 inhabitants, and have a land area of 7,447 square kilometres.<sup>188</sup>

Considering the statistics it is clear that Article 349 TFEU is closer to the smallness criterion for small island states reviewed in Section III not the small island region criterion in

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<sup>182</sup> True Knowledge, [http://www.trueknowledge.com/q/distance\\_from\\_uk\\_to\\_iceland](http://www.trueknowledge.com/q/distance_from_uk_to_iceland), [accessed on 25.08.2010].

<sup>183</sup> Vísindavefurinn, "Could a polar bear swim from Greenland to Iceland", 9.12.2005, <http://visindavefur.hi.is/svar.php?id=5469>, [accessed on 25.08.2010].

<sup>184</sup> EPSON (05/05/10), *Euroislands*, p. 79-80.

<sup>185</sup> European Commission (2010) *The Outermost Regions*, p. 19.

<sup>186</sup> European Commission (2010) *The Outermost Regions*, p. 11.

<sup>187</sup> European Commission (2004) *Interim Territorial Cohesion Report*, p.37.

<sup>188</sup> European Commission (2010) *The Outermost Regions*, p. 7.

the *EPSON* study mentioned above. This seems logical since being semi-autonomous and extremely remote; their status is more similar to that of small island states in the sense that they are more dependent on their own resilience and resources than European small island regions closer to the Mother State.

Compounded with remoteness and insularity, the objective unequal situation for these small islands in comparison to other “larger” islands or territories situated on the continent or closer to it seems clear in most cases. However, as will be addressed in Section V later in this essay, it cannot be overlooked that with regards to population and size, the Union’s newcomers, the island states of Malta and even Cyprus, are clearly within the threshold criteria used for the Outermost Regions. Furthermore, Iceland, a nation of 318, 000 people, would fulfil this criterion.

#### **4. Difficult Topography and Climate**

Difficult topography is a criterion of Article 349 TFEU. Mountainous areas, i.e. altitude, have been identified as natural handicaps within Article 174 TFEU and the Common Agricultural Policy (CAP).<sup>189</sup> The Azores, the Canary Islands, Guadeloupe, Madeira, Martinique and Réunion are considered mountainous. Mountain regions are considered as having permanent natural handicaps due to topographic and climatic restrictions on economic activity. Furthermore, with the limited usable land area due to the combination of mountains and being an island the Outermost Regions possibilities to cultivate their land are limited.<sup>190</sup>

In addition to mountains, the Outermost Regions’ tropical landscape makes the grazing land very sensitive in some areas, further aggravating these territories’ agri-environmental situation.<sup>191</sup> They, as other islands, are highly sensitive to climate change.<sup>192</sup>

As mentioned in Section III, proneness to natural disasters, such as volcanic activity or flooding, is one of the Commonwealth’s three main sources of threats to a vulnerable small-island economy. Topography and climate is not regarded as the primary factor that defines the Outermost Regions from other islands of the Union.<sup>193</sup> However, as the review on Malta later on in this essay reveals, difficult topography and climate, is one of its vulnerabilities.

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<sup>189</sup> In the context of European cohesion mountain regions are considered as having permanent natural handicaps, due to topographic and climatic restrictions on economic activity and/or peripheral (NORDREGIO (2004) *Mountain Areas in Europe*, p. 1).

<sup>190</sup> Planistat Europe et al. (2003) *The outermost regions*, p. 2.

<sup>191</sup> Article 14 of the preamble of Council Regulation (EC) No 247/2006, OJ L 42 of 14.2.2006.

<sup>192</sup> COM (2009) 147 final, *Adapting to climate change*, point 2.1.

<sup>193</sup> According to the Planistat Europe report, remoteness/isolation is the most significant factor setting them apart from most European Islands. (See: Planistat Europe et al. (2003) *The outermost regions*, p. 7).

Furthermore, as addressed later in this section, Iceland may be categorized as exposed to a difficult climate.

## **5. Economic Dependence on a Few Products**

Economists that support the idea of the vulnerability index, such as *Briguglio*, claim that small geographical size or landscape restricts a country's ability to diversify its exports, and this renders the country dependent on a very narrow range of goods and services. This in turn makes such a country economically dependent on a few products and thus its economy highly dependent on foreign exchange earnings and outside economy threats.<sup>194</sup> This view is supported in Article 349 TFEU, which establishes economic dependence on a few products as one of the distinctive characteristics of the Outermost Regions.

The Outermost Regions are communities that specialize in agriculture and tourism services.<sup>195</sup> Most of them rely on a few relatively homogeneous export products (e.g., bananas, dairy products, fish, sugarcane, etc.).<sup>196</sup> Furthermore, these territories are highly dependent on imports for industrial use and local consumption. Because of their inherit land limitations, in most cases the growth potential lies in tourism and many of the regions have a large or growing tourist industry.

The smallest islands, such as Saint-Barthélemy, can safely be said to be extremely vulnerable, since their small landmass makes agriculture highly unfeasible. The Canary Islands are one of the world's major tourist attractions, with around 10 million visitors each year,<sup>197</sup> and tourism and related services account for at least 50% of the Canary Islands' GDP.<sup>198</sup>

Tourism is deeply sensitive to factors outside of the islands' control, such as and the economic conditions of the origin markets or terrorist attacks.<sup>199</sup> For example, as briefly mentioned before, according to the World Tourism Organization, because of the global economic recession in 2008 international travel suffered a strong slowdown beginning in June 2008, and this declining trend intensified during 2009, resulting in a reduction from 922 million international tourist arrivals in 2008 to 880 million visitors in 2009, which amounts to a worldwide decline of 4% and an estimated 6% decline in international tourism receipts.<sup>200</sup> In

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<sup>194</sup> Brigugilo (1995) "Small Island Developing States", p. 1616.

<sup>195</sup> Euobserver.com (28.5.2010) "EU's remote islands slam Brussels for ignoring their problems", <http://euobserver.com/886/30153> [accessed 25.08.2010].

<sup>196</sup> Behrens et al. (2006) "Developing the 'outermost regions' of Europe", p.7.

<sup>197</sup> INSTITUTO DE ESTUDIOS TURÍSTICOS (2006) *Spanish tourism in figures*, p. 13.

<sup>198</sup> Garín-Munoz (2006) "Inbound international tourism to Canary Island", p. 282.

<sup>199</sup> Garín-Munoz (2006) "Inbound international tourism to Canary Island", p. 289.

<sup>200</sup> UNWTO World Tourist Barometer (2010) *On track for recovery after an exceptionally challenging 2009*.

the Canary Islands alone, visitor numbers fell by 14.5% during the first five months of 2009 compared with the previous year, resulting in a heavy blow to this sensitive economy.<sup>201</sup>

This economic dependence on a few products can be said to create the disadvantages associated with having too many eggs in one basket and inevitably establishing an economic exposure to outside threats.<sup>202</sup> This is hardly a phenomenon unique to the Outermost Regions, however. As reviewed in earlier sections, it is a common denominator of small islands, and the Commonwealth Secretariat regards this as being the main source of economic vulnerability of small islands. Thus, economic dependency on a few products is true of the Isle of Man, the Channel Islands, the Åland Islands and the Faroe Islands. Furthermore, as will be established below, Malta's, Iceland's and Cyprus's economies are relatively homogeneous as compared to larger Member States.

## **6. Severely Restrained Development**

Within the Union's cohesion or regional policy, which aims for harmonious development of the Union<sup>203</sup>, the main indicator used to measure disparities between regions, and thus their development, is GDP per capita.<sup>204</sup> Since the latest EU enlargements, the Outermost Regions as a whole are no longer part of the group of the poorest regions. Thus the Canary Islands (GDP per capita 93.7) and Madeira (GDP per capita 94.9) are edging close to the Union average in 2005 (EU-27=100) with a GDP similar to that of Cyprus and quite a bit higher than Malta's. Even the French dependent Saint-Barthélemy tops the EU average, with a GDP of 111 per capita in purchasing power.<sup>205</sup>

However, while there are a number of Outermost Regions that have managed to generate a relatively high GDP, these are still vulnerable. As addressed in a 2007 Commission report on the strategy for the Outermost Regions:

“they still suffer from the permanent nature and the cumulative effects of the factors restraining their development. The effort to adapt the specific Community and support policies whenever necessary must therefore continue.”<sup>206</sup>

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<sup>201</sup> BBC NEWS (18.7.2009) “Revamp for struggling Canaries”, <http://news.bbc.co.uk/2/hi/europe/8156241.stm> [accessed on 25.08.2010].

<sup>202</sup> Brigugilo (1995) “Small Island Developing States”, p.1616.

<sup>203</sup> Article 174 TFEU, OJ C 83 of 30.3.2010.

<sup>204</sup> European Commission (2003) *Structural policies and European Territories*, p.8. The volume index of GDP per capita is expressed in relation to the European Union (EU-27) average set to equal 100. If the index of a country is higher than 100, this country's level of GDP is higher than the EU average and vice versa.

<sup>205</sup> COM(2008) 642 final, *The outermost regions*, point 6.

<sup>206</sup> COM (2007) 507 final, *Strategy for the Outermost Regions*, p. 10.

Previously, Kochenov scrutiny, that the Outermost Regions status cannot be applied to relatively well off regions, was cited. Considering the statement of the Commission mentioned just above and the fact that Canary Islands, Madeira and Saint-Barthélemy are still, despite a newly revised Lisbon Treaty, listed among the Outermost Regions, it seems clear that the GDP of the Outermost Regions is no longer a primary criterion for their derogative regime, but their economic restraint because of cumulative permanent natural handicaps. Kochenov's view is thus obsolete.

This line of reasoning is on par with the arguments of scholars and institutions in favour of the vulnerability index as an indicator for economic backwardness. As established in Section III, vulnerability is not the same as economic backwardness based on income per capita.<sup>207</sup> Vulnerability is economic backwardness based on exposure to threats which are not under the control of the territory and the limited resilience to manage those threats because of factors such as smallness, remoteness and insularity.

## **7. Assessment**

To conclude this chapter, *Kochenov* states that the Outermost Regions are all essentially similar in that they are influenced by the conditions described in the first paragraph of the Article 349 TFEU.

What this socio-economic review has revealed is that the Outermost Regions are not as homogenous a group of islands as first presumed. Although all of them suffer from severe permanent handicaps, the degree of severity is varying. Furthermore, the handicaps of the Outermost Regions are not unique. Most, if not all of them, fall under the same criteria used in the vulnerability index connected with very small-island states. Also, just as with the vulnerability index, Article 349 TFEU focuses on the natural and structural handicaps, as the cause of vulnerability. Subsequently, the GDP of the Outermost Region is not what sets them apart from other islands.

As regards the extreme remoteness and isolation of the Outermost Regions, this review has established that not all are as remote. Furthermore, remoteness is not unique to them alone but could also apply to small island states as Iceland.

On the issue of the smallness of the Outermost Regions, it is clear that Article 349 TFEU is referring to the smallness criterion used by scholars to measure small island state vulnerability, not the island region criterion used in the EPSON study mentioned above. This seems logical since being semi-autonomous and extremely remote; their status is more similar

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<sup>207</sup> Briguglio, (2003). The Vulnerability Index, p. 1.

to that of small island states in the sense that they are more dependent on their own resilience and resources than small island regions closer to the Member State.

Comparing Iceland with the Outermost Regions criterion reveals striking similarities. Iceland may be big in land area but as mentioned above, its population is very small and its location can be categorised as extreme remote. It is entirely north of the 62<sup>nd</sup> latitude, and only around 15% of the land is considered flat and suitable as arable land. This creates a harsh climate for agricultural conditions. Iceland's export base is relatively narrow and largely based on natural resources, namely fisheries products and industries powered by renewable energy sources.<sup>208</sup>

This economic-statistical review of the Outermost Regions has established that the legal criterion of Article 349 TFEU, first paragraph, is far more flexible than it first appears. Judged on the criteria alone Iceland, Malta and perhaps Cyprus should fulfil the requirements for becoming an Outermost Region. However, as will be revealed later in this essay, there seem to be some obstacles in the way.

Putting the socioeconomic justifications aside, how does this derogative regime present itself and what is the scope of the legislative power of the Council to remedy these handicaps? The following chapters will briefly highlight the main issues in that regard.

#### **D. The Council: An Obligation of the Legislative to Compensate for the Outermost Regions' Handicaps**

Article 349 TFEU, first paragraph, second intent, establishes the legislative power to compensate for the handicaps of the Outermost Regions. It states:

[The Council] on a proposal from the Commission and after consulting the European Parliament *shall* adopt specific measures aimed, in particular, at laying down the conditions of application of the Treaties to those regions, including common policies. Where the specific measures in question are adopted by the Council in accordance with a special legislative procedure, it shall also act on a proposal from the Commission and after consulting the European Parliament.

It is the Council, through legislative procedures, that adopts the specific measures that lay down the conditions of application of the Treaties to the regions in question. This is an obligation of the Council. Obliging the Council to adopt special measures on the Outermost Regions behalf reflects the severity of their handicap.

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<sup>208</sup> COM (2010) *Analytical Report on Iceland's application for membership of the European Union*, p. 20.

In order for these measures to fulfil the legislative procedure of the article, they need to be proposed by the Commission and the Council needs to consult with the Parliament. The same procedure is also required when deciding *where* the measures are to be adopted. This last requirement is new to the Lisbon Treaty and it emphasizes a deviation from the principle of parallelism<sup>209</sup> or their essential likeness that generally has been thought to apply to all of the Outermost Regions.<sup>210</sup> This confirms that the Outermost Regions do not form a standardized group and that their problems vary amongst themselves. However, some of their challenges are similar and Article 349 TFEU provides a basic provision which serves as a foundation to build upon special demands by particular Outermost Regions.

The Council adopts special measures in various policy fields. The following chapter will provide an overview off some of these measures.

### **E. The Practical Application of Article 349 TFEU as a Source of Derogations**

The areas within which the Council can apply its derogative power are specified in the second paragraph of Article 349 TFEU.

The measures referred to in the first paragraph concern in particular areas such as customs and trade policies, fiscal policy, free zones, agriculture and fisheries policies, conditions for supply of raw materials and essential consumer goods, State aids and conditions of access to structural funds and to horizontal Union programmes.

With Article 349 TFEU as a legal basis, secondary legislation allows for derogations from common provisions of the internal market in several fields, such as agriculture, fisheries, taxation, customs, state aid, aid to small businesses, craft firms and tourism, energy and transport, etc.

Even though the article reveals a broad coverage of fields within which the Council may provide the Outermost Regions with specific measures, it does not mean that the derogations in question are altering the norm of the *acquis communautaire*. Most of these derogations are strictly limited in time and quantity and restricted in other ways so as to preserve the integrity and coherence of the internal market. However, some exceptions have a stronger effect, such as those regarding taxation.

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<sup>209</sup> Because of the presupposed similarities of the regions falling under Article 299(2) the claim has been raised that the principle of parallelism should apply to the Outermost Regions i.e. since they are essentially similar all far-reaching differentiations within the group would be impractical, if not illegal. (Kochenov (2008-2009), “Substantive and Procedural Issues”, p. 236).

<sup>210</sup> Kochenov (2008-2009), “Substantive and Procedural Issues” p. 236.

A detailed analysis of the application of derogations in all areas goes beyond the scope of this essay. Nevertheless, a few examples within agriculture and fisheries, and taxation and state aid will be reviewed.

### **1. POSEI – Agriculture and Fisheries**

Since 1987, agriculture in the EU's Outermost Regions has benefited from the POSEI arrangements (Programme of Options Specifically Relating to Remoteness and Insularity), which are designed to take into account the Outermost Regions geographical and economic handicaps as identified in Article 349 TFEU.

Council Regulation No. 247/2006 of January 30, 2006, as amended, governs the POSEI-Agriculture programme.<sup>211</sup> It focuses on derogations from agricultural policies and allows compensation mechanisms from Union funds and state aid. This regulation is open-ended in the sense that there is no end date upon which the renewal of the program should be reviewed. However, forecast reports and assessment reports are regularly provided by Member States.

According to the regulation the particular geographical situation of the Outermost Regions makes them dependent on the importation of products that have been established in the Treaties as essential for human and animal consumption or for the production of other products.<sup>212</sup> The regions' remoteness imposes an additional transport cost that raises the costs of essential products. The aim of this regulation is to lower the prices of these essential products and guarantee supply.<sup>213</sup> According to the regulation, no import duty is paid on a fixed quantity of certain types of sugar imported into the Azores, Madeira and the Canary Islands and<sup>214</sup> certain types of rice imported into Réunion,<sup>215</sup> and supplies of skimmed milk powder with vegetable imported into the Canary Islands are granted aid.<sup>216</sup> Finally, the regulation allows Madeira to produce a prohibited type of UHT milk for local consumption.<sup>217</sup> This derogation has recently been expanded to include Madeira.<sup>218</sup>

In order to avoid undermining the integrity and the coherence of the internal market, products that have benefitted from the arrangements of this regulation may not be exported to the internal market of the Union unless import duties are paid and aid is repaid. This rule does

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<sup>211</sup> Council Regulation (EC) No 247/2006, OJ L 42 of 14.2.2006.

<sup>212</sup> Those are the agricultural products listed in Annex I to the Treaty of Lisbon, OJ C 83 of 30.3.2010.

<sup>213</sup> Article 1 of the preamble, OJ L 42 of 14.2.2006.

<sup>214</sup> Article 5, OJ L 42 of 14.2.2006.

<sup>215</sup> Article 7, OJ L 42 of 14.2.2006.

<sup>216</sup> Article 6, OJ L 42 of 14.2.2006 as amended by L 194/23 of 24.7.2010.

<sup>217</sup> Article 19(4), OJ L 42 of 14.2.2006.

<sup>218</sup> Article 1(6), as amended by 194/23 of 24.7.2010.



not apply to exchanges between French overseas departments.<sup>219</sup> Furthermore, under certain circumstances, products which have benefited from the arrangements of the regulation may be introduced into the internal market.<sup>220</sup>

Council Regulation No. 247/2006 also makes provisions for derogations and exemptions in order to assist local agricultural products that are specific to the Outermost Regions in four sectors – wine, milk, livestock farming and tobacco. For example, the Azores and Madeira are allowed to plant prohibited varieties of vines,<sup>221</sup> the DOM's and Madeira are exempt from applying customs duties because of imports of bovine animals from third countries,<sup>222</sup> Spain may grant aid for the production of tobacco in the Canary Islands<sup>223</sup> and no customs duties are applied to direct imports into the Canary Islands of certain raw and semi-manufactured tobaccos.<sup>224</sup> Some of these exceptions have no fixed end date but are subject to review.<sup>225</sup>

As regards POSEI – Fisheries, the Outermost Regions have benefited from financial support for fisheries through projects for shipbuilding and modernization, aquaculture, improvements to fishing ports, processing and marketing.<sup>226</sup> One example of differentiated treatment received on behalf of the Outermost Regions is Council Regulation No. (EC) 791/2007, but it compensates their remoteness by allowing a special system of reimbursement for additional costs in bringing fisheries products from the Outermost Regions to European markets.<sup>227</sup>

According to the findings of studies published by the Commission, overall, the support has enabled the fisheries sector to cope with growing competition on the internal market, which is increasingly being opened to non-EU countries and has made them able to compete on equal terms with companies in mainland Europe.<sup>228</sup>

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<sup>219</sup> Article 4, OJ L 42 of 14.2.2006.

<sup>220</sup> If they fall under the derogations addressed in Article 4(2), OJ L 42 of 14.2.2006. An example is Article 4(3) of the regulation which allows, for a period of five years, the dispatching of sugar from the Azores to the rest of the Union in quantities exceeding the traditional flows until 2010.

<sup>221</sup> Article 18(2), OJ L 42 of 14.2.2006, as amended by L 194/23 of 24.7.2010. The exception has no fixed end date but shall be gradually eliminated.

<sup>222</sup> Article 20, OJ L 42 of 14.2.2006.

<sup>223</sup> Article 21, OJ L 42 of 14.2.2006. The limit is 10 tonnes per year.

<sup>224</sup> Article 22, OJ L 42 of 14.2.2006.

<sup>225</sup> *See for example:* Article 18(2), OJ L 42 of 14.2.2006, where the exception to produce prohibited vine varieties has no fixed end date but shall be gradually eliminated.

<sup>226</sup> COM (2000)147 final, *the outermost regions of the European Union*, point A1.

<sup>227</sup> Council Regulation (EC) No 791/2007, OJ L 176 of 6.7.2007.

<sup>228</sup> COM (2006) 734 final, Report from the Commission on the implementation of the measures provided for in Council Regulation (EC) No 2328/2003, point 3.2.

## 2. State Aid

Regarding the issue of state aid to agriculture and fisheries, according to Article 107(1) TFEU, aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market. Article 107(3)(a) TFEU exempts the Outermost Regions from this rule. Thus state aid is not considered incompatible with the internal market if the receivers are the Outermost Regions.

The rules applying to agriculture and fisheries are laid down primarily in the Community Guidelines for State Aid in the Agriculture and Forestry Sector for 2007-2013 and in the Community Guidelines for the Examination of State Aid to Fisheries and Aquaculture. For example, according to Article 4(7) of the Guidelines:

Member States may grant aid to Outermost Regions for quantities of fishery products eligible in application of Article 4 of above mentioned Council Regulation (EC) No 791/2007 of 21 May 2007 introducing a scheme to compensate for the additional costs incurred in the marketing of certain fishery products from the Outermost Regions from 2007 to 2013, *and exceeding those for which compensation has been paid in accordance with that Regulation.* [Italics inserted by author]

National Regional Aid is state aid granted to promote the economic development of certain disadvantaged areas within the European Union. Within this area the Outermost Regions receive special treatment. According to the Guidelines on National Regional Aid for 2007-2013<sup>229</sup>, the guidelines for applicability are that the regions have a GDP per capita of less than 75% of the Union average.<sup>230</sup> Because of the Outermost Regions handicaps, this requirement does not apply to them.<sup>231</sup> Furthermore, the Outermost Regions will be eligible for a bonus of 20% GGE if their GDP per capita falls below 75% of the EU-25 average and 10% GGE in other cases. This bonus, which only the Outermost Regions are eligible for, will be added to the amount received in regional aid.<sup>232</sup>

## 3. Taxes

In order for the internal market to be effective, goods need to be able to move within it without barriers. Title II TFEU on the free movement of goods is entitled to ensure a smooth and coherent internal market. According to Article 28 TFEU (ex-Article 23 TEC):

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<sup>229</sup> Guidelines on National Regional Aid for 2007-2013, OJ C54/13 of 4.3.2006.

<sup>230</sup> Article 16, OJ C54/13 of 4.3.2006.

<sup>231</sup> Article 17, OJ C54/13 of 4.3.2006.

<sup>232</sup> Article 44, OJ C54/13 of 4.3.2006.

The Union shall comprise a customs union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries.

According to Article 110 TFEU (ex-Article 90 TEC), on the prohibition of direct and indirect taxes that discriminate against products of other Member States

However, on the basis of 349 TFEU and its predecessors, the Council has adopted several derogations from this main principle of free movement of goods. As a result, the Outermost Regions enjoy quite differentiated treatment relative to other (territories of) Member States as regards tax on imported products for consumption, value-added tax and excise duties.

#### **4. Dock Dues**

Dock dues are a very old form of tax which was originally levied on all products arriving to the DOMs by sea. Dock dues are taxes on consumption which apply mainly to products from outside the DOMs but which can also be applied to locally manufactured products. Council Decision, of 10 February 2004 currently governs the dock dues tax for the DOMs.<sup>233</sup>

According to the Directive, the DOMs may differentiate manufactures by applying tax that distinguishes between local products and products from outside the DOM (including France). These tax exemptions or reductions have a percentage threshold that depends on the products in question.<sup>234</sup> Dock dues are not particular to the DOM. The Canary Islands enjoy a similar taxation system, called AIEM tax.<sup>235</sup>

The justification for this derogation are that local manufacturers have to contend with a number of handicaps, caused especially by their smallness and remoteness, the effect of which is to push up the cost of their products, thereby making them uncompetitive with products from elsewhere. Thus tax exemptions or reductions for local products serves to encourage productive industrial activity, safeguard their competitiveness with outside products, and thus increase the proportion of the DOMs' GDP accounted for by industrial

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<sup>233</sup> Council Decision, L 52/64 of 21.2.2004.

<sup>234</sup> The dock dues may not result in tax differentials of more than 10, 20 or 30%. The AIEM tax may not result in tax differentials of more than 5, 15 or 25%.

<sup>235</sup> Council Decision, L 179/22 of 9.7.2002.

activity. This Decision which is valid until July 1, 2014, extended the former dock dues Decision 89/688/EEC.<sup>236</sup> Although it is de jure temporary, this derogative regime is persistent.

The Council decision concerning the AIEM tax is valid until December 31, 2011. However, a review mechanism is built into the decision.<sup>237</sup> In 2008, the Commission submitted a report to the Council on the application of AIEM tax in the Canary Islands.<sup>238</sup> The report concluded that the AIEM tax was still justified in its present form and therefore no proposal from the Commission for adapting the existing provisions was required.

## 5. Union VAT Legislation

The European Union Value Added Tax Area, currently governed by Council Directive 2006/112/EC,<sup>239</sup> is an area consisting of all the European Union Member States and certain non-member states which follow the harmonization value added tax (VAT) rules of the European Union. The VAT system is tailored to the internal market and, in principle, operates within the EU area in the same way as it would within a single country. Among its tasks is to establish harmonised rates of taxation. Currently the minimum VAT rate is 15%.<sup>240</sup>

The predecessor of the current directive in force, Directive 80/368/EEC,<sup>241</sup> amending Directive 77/388/EEC<sup>242</sup>, established the rule that the DOMs are not within the scope of the Union for the purposes of VAT. Later, the Canary Islands were also excluded.<sup>243</sup> The justifications for such differentiation as regards the Outermost Regions were addressed in the preamble of Directive 80/368/EEC. There the Council referred to the position of the Court in the *Hansen Case*, which stated:

“Whereas, for reasons connected with their geographic, economic and social situation, the [DOM] should be excluded from the scope of the common system of value added tax as established by Council Directive 77/388/EEC.”<sup>244</sup>

The effect of this directive is that these regions are, for fiscal purposes, outside the scope of EU or third countries. Thus they are under no obligation to follow Union law on tax

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<sup>236</sup> Council Decision 89/688/EEC, OJ 1989 L 399

<sup>237</sup> Article 2, L 179/22 of 9.7.2002.

<sup>238</sup> COM (2008) 528 final, *on the application of the special arrangements concerning the AIEM tax applicable in the Canary Islands*, p. 4.

<sup>239</sup> Council Directive 2006/112/EC, OJ L 347 of 11.12.2006.

<sup>240</sup> Moussis, *Access to European Union*, [http://europedia.moussis.eu/books/Book\\_2/5/14/02/02/?all=1](http://europedia.moussis.eu/books/Book_2/5/14/02/02/?all=1), [accessed on 25.08.2010].

<sup>241</sup> Eleventh Council Directive 80/368/EEC, OJ L 90 of 3.4.1980.

<sup>242</sup> Sixth Council Directive, 77/388/EEC, OJ L 145, 13/06/1977.

<sup>243</sup> Council Directive 91/680/EEC, L 376 of 31/12/1991.

<sup>244</sup> Preamble in Council Directive, OJ L 90 of 3.4.1980.

harmonization, including Union VAT. This allows these Outermost Regions to lower their VAT percentage on products and services as compared to other Member States or to establish a tax-free zone.

## **6. Excise Duties**

In several cases the Council has adopted special rates on excise duties on behalf of the Outermost Regions on grounds of Article 349 TFEU and its predecessors. Thus “traditional rum” produced in the French DOMs enjoys a reduced excise duty in that the rate is lower than set by Union law. This derogation is strictly limited as regards the type and quantity of liquor, the duration of the derogation, etc.<sup>245</sup>

A similarly constructed derogation, albeit limited to consumption on the local market, has been established on behalf of traditional alcohol produced in the Azores and Madeira, where the tax is reduced by 75% of the standard national rate on alcohol.<sup>246</sup> In another example, Portugal may apply a tax rate 50% less than the standard national rate on locally produced beer in Madeira intended for the local market.<sup>247</sup>

The justification for these derogations builds on Article 349 TFEU. Thus as stated in Article 1 in the preamble of Council Decision OJ L 297/9 of 13.11.2009, in view of the high cost of those activities arising mainly from factors inherent to the situation of Madeira and the Azores as outermost regions (remoteness, insularity, small size, topography and climate), it was considered that only a reduction of the rate of excise duty on the locally produced and consumed products concerned could enable them to continue to compete on an equal footing with similar products imported or supplied from other parts of the Union and thus ensure the survival of the industries.

## **7. Assessment**

This short review has revealed that the Outermost Regions are allowed atypical derogations from some of the main principles in agriculture, fisheries, taxation and state aid. Most of these derogations are strictly limited in time and quantity and restricted in other ways so as to preserve the integrity and coherence of the internal market. A few of the derogations, however, establish quite extreme differentiation, such as the VAT regime whereby the Outermost Regions are excluded altogether from the scope of EU law in that area.

Furthermore, some of these derogations provide differentiation mechanisms on a permanent basis. The POSEI-agriculture regulatory framework and the exclusion from the

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<sup>245</sup> Council Decision, L 270/12 of 13.10.2007.

<sup>246</sup> Council Decision, OJ L 297/9 of 13.11.2009.

<sup>247</sup> Council Decision, OJ L 147 of 06.06.2008.

VAT are examples of that. Others, such as the dock dues, have been reinstated again and again and hence provide a de facto permanent derogation.

The arguments for such derogations are always similar – the remoteness of the Outermost Regions, which severely increases transportation costs for both exports and imports, thus creating an unjust competition level both in the Union’s internal market and within the Outermost Regions local market. However, as this review reveals, although the arguments may be similar, the Council is not approaching the Outermost Regions as a uniform group but is, on the basis of Article 349 TFEU, providing a framework within which special solutions are often tailored for each Outermost Region.

The above-mentioned review reveals substantive flexibility in this derogative regime. Although secondary law legislation is subject to the scrutiny of the Court and derogations may be dismissed as not compatible with the scope of Article 349 TFEU and the *acquis communautaire*, the Council has the means to tailor its measures to each Outermost Regions needs, subject to circumstances at a given time. These are qualities that are needed in a small island policy.

Having reviewed the justifications for this derogative regime and some main examples of how it is implemented, the following chapter will establish the legal scope of this derogative regime.

## **F. The Limits to the Legislative Power of the Council**

Article 349 TFEU, third paragraph, states:

The Council shall adopt the measures referred to in the first paragraph taking into account the special characteristics and constraints of the outermost regions *without undermining the integrity and the coherence of the Union legal order*,<sup>248</sup> including the internal market and common policies. [italics inserted by author]

This last paragraph of Article 349 TFEU establishes the legal boundaries of possible derogations, i.e. the scope of the derogative regime. Thus the Council may not undermine the integrity and the coherence of the Union’s legal order when exercising its duty.

This means that the derogations may deviate from the *acquis communautaire* only as little as possible and only to achieve specific goals. Moreover, as addressed in the Commission Report on the Implementation of 299(2) TEC, the article (and its successor Article 349 TFEU) “*does not provide a generalized opt-out*”<sup>248</sup>. In other words, the Council

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<sup>248</sup> COM (2000) 147 final, *the outermost regions of the European Union*, p. 31.

does not have the power to grant permanent derogations from the *acquis communautaire*. Thus derogations are required to have a strictly limited period of validity.

As established above by the Hansen doctrine, the *acquis communautaire* applies in full in the Outermost Regions. Thus their derogative regime is based on secondary law legislation with Article 349 TFEU as the legal basis. As a result they need to comply with settled case law and all derogations on their behalf are subject to the scrutiny of the Court. Thus all derogations should be as narrow as possible and should apply equally to the Member State subject to the derogation and other Member States and be necessary, proportionate and precisely determined. Considering the above and the clear message of Article 349 TFEU, the Council needs to be cautious when implementing its remedial measures.

The above examples of derogations from the *acquis communautaire* based on Article 349 TFEU and its predecessors show that the Council is conscious about not undermining the integrity of the internal market. The derogations are generally limited to consumption, production or distribution within the Outermost Region zone or a particular local market of an Outermost Region.

Although the rule that derogations should be temporary has *de jure* been respected, the aforementioned chapter has revealed that some derogations are prolonged again and again. Furthermore, recent developments in the POSEI programme reveal that the Outermost Regions differentiation mechanisms are gaining more permanent features. However, while the mechanism may be without time-limits the differentiation mechanisms are subject to strict criteria and forecast reports and monitoring of the particular Outermost Region(s) on a regular basis. Furthermore, the Commission, on a regular basis, provides general strategic reports as well as progress reports of special measures based on Article 349 TFEU. Such up-to-date analysis is conducted in close relationship with the Member States concerned and the Outermost Regions.<sup>249</sup>

In addition, while it may be reasoned that the “permanent” nature of for instance the POSEI-agriculture regime is violating the general rule of temporary derogations it can also be argued that this is a long overdue acknowledgement to clearly established facts, i.e. that the handicaps of the Outermost Regions “*are permanent and cannot change*”<sup>250</sup> and by

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<sup>249</sup> Kochenov (2008-2009) “Substantive and Procedural Issues“, p. 281.

<sup>250</sup> Parliamentary question ( 30.11.2009) "Permanent validity of Council Regulation (EC) No 791/2007", <http://www.europarl.europa.eu/sides/getDoc.do?type=WQ&reference=E-2009-5980&language=EN#ref>

providing a permanent derogative framework, the Union is finally taking an “*adequate account of the special feature of the [outermost regions]*”.<sup>251</sup>

## **G. Concluding Remarks**

This review has analysed a differentiation mechanism designed by the drafters of the Treaties to take into account special geographical, economic and social constraints of the Outermost Regions. The beneficiaries of this derogative regime are principally small islands.

An overview of settled case law and the legal function and scope of the differentiation mechanism has clarified that the Outermost Regions are fully integrated into the Union and the *acquis communautaire* applies to them in full. Nevertheless, on account of the Outermost Regions’ unique handicaps, specific measures are allowed in secondary law to compensate for these constraints. The rules that govern this derogative regime are found in Article 349 TFEU. In order for such secondary law derogations to be compatible with EU law, they need to be temporary, apply equally to all Member States, follow the principles of being necessary, proportionate and precisely determined, and not undermine the integrity of the internal market.

A review of the practical application of Article 349 TFEU as a source of derogations revealed that the Council is conscious about not undermining the integrity of the internal market. However, one cannot but notice that some derogations have permanent features. It may be reasoned that this “permanent” nature is violating the general rule that derogations should be temporary, but it can also be argued that it is a long overdue acknowledgement to clearly established evidence of the permanence of the Outermost Regions’ natural and structural handicaps and be regarded as an indication of a change in EU law perspectives as regards the nature of derogations in such instances.

The Outermost Regions’ secondary law derogative regime provides substantive flexibility for the legislator by providing tools that enable him to react to a situation in place at a given time. Furthermore, this review reveals that the Council is not approaching the Outermost Regions as a uniform group but is providing a framework within which special solutions are often tailored for each Outermost Region. Thus, the Outermost Regions derogative regime is essentially a framework for cooperation between the islands and the Unions institution, constantly under revision, but built on the solid acceptance of the Union that the Outermost Regions are in a different situation than other (territories of) Member States and that without special arrangements the Outermost Regions would not be on equal

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<sup>251</sup> COM (2004) 343 final, *A stronger partnership for the Outermost Regions*, point 2.2.



footing with the rest of the Union. These are most certainly essential features of an effective small island policy.

The Outermost Regions have been regarded as having unique features and those have been looked upon as justifying the derogative regime they receive. The underlying question in this section was to establish whether the features of the Outermost Regions are exclusive to them or whether this status may be regarded as remedying characteristics that are associated with small-island state realities as established by the vulnerability index and described in Section III. Furthermore, given that the criterion established in Article 349 TFEU is fulfilled, is this derogative status accessible to other small-islands – especially small island states. To put it more bluntly, is this a genuine small island policy?

A comparison of the handicaps of the Outermost Regions and those of small-island states, as described in literature, has revealed interesting similarities. In that respect, one of the main discoveries is that, as regards the Outermost Regions, the Union does not define economical backwardness as income per capita or GDP. On the contrary the Commission has revealed that Article 349 TFEU focuses on the permanent natural and structural handicaps themselves and that the GDP or poorness of an Outermost Region is not the critical factor explaining the islands derogative regime. This is in compliance with the views of the scholars supporting the vulnerability index. Furthermore, as established in the review, extreme remoteness and isolation combined with very low population and economic dependence on few products is not unique to the Outermost Regions.

It can, however, not go unnoticed that while it is not a part of the criterion in Article 349 TFEU, all of the territories mentioned in the article are non-European semi-autonomous former colonies of the Member States in question. This logic is underlined in the saga behind the creation of its ancestor, Article 227(2) EEC. Thus the Outermost Regions are not only remote with regards to the internal market but also as regards dependence on a government and institutions administered in the mother state far away.

Given that this is the hidden key criterion for applicability of other island regions or island states, the Outermost Regions derogative regime seems, at this given date, not to be regarded as a general policy for small islands in the Union.

However, not being a semi-autonomous, non-European entity can hardly be regarded a critical criterion if a small island state fulfils most of the other criteria. It must be emphasised that while small island Member States such as Malta and Cyprus and Iceland, may be independent and thus have a different administrative level as to semi-autonomous islands, their population remains below or well below one million of inhabitants. This means that they

have to face their vulnerability difficulties connected with smallness and over-costs associated with insularity from the mainland out of their own resources, whereas the Outermost Regions at least have the backing of a mainland-based national authority with more substantial means.

Furthermore, as established in this section, when employing a differentiation mechanism on the Outermost Regions behalf the Union does not regard this as a discriminating act against other (territories of) Member States but as correcting an uneven situation. Thus, the differentiation mechanisms are simply placing these small islands on a level playing field with larger better located territories. This uneven situation cannot be dismissed simply because a small island is European or has a different administrative status than the ones benefitting from a derogative regime. Considering the above, Iceland would be remiss in not emphasising to the Union its vulnerability similarities with the Outermost Regions, and the Union would be short-sighted in dismissing or ignoring these similarities.

Whatever the scope of applicability of small island states, Article 349 TFEU reveals an example of an efficient small island policy. Furthermore it establishes the Treaties' flexibility and the willingness of the drafters of the Treaties to account for territorial diversity.

The Åland Islands are the other example of a fully integrated territory that the drafters of the Treaties have recognised as in need of differentiated treatment relative to other territories of Member States. Although the Åland Islands' status has not been justified on the grounds of territorial handicaps that follow island status, the exotic deviations from the black letter law of the Treaties the islands received can at least partly be regarded as taking into consideration attributes often connected to small-island realities. The following chapter will address this status, how it came about and its legal effect and justification.

## **VI. Case Study: The Åland Islands as an Example of Differentiation in Primary Law Justified by a Special Status and a Fragile Economy**

### **A. Introduction**

The Åland Islands are European islands and are an integral part of Finland, a Member State of the Union. They are an autonomous region with extended legislative powers and self-rule. As mentioned above, Article 51 TEC establishes the general rule that the entirety of a Member State's territory falls under the scope of the Treaties unless otherwise specified.

The legal basis for the Åland Islands relationship with the Union is established in Article 355(4) TFEU, which states the main rule that the Åland Islands fall under the scope of

the Treaties. Thus the Åland Islands are full members of the Union. However, the article also provides a legal basis for a derogative relationship with EU law. It is described in Protocol No. 2 on Åland Islands annexed to the 1994 Act of Accession.<sup>252</sup>

From the point of view of differentiation, mechanisms the protocol reveals two separate types of differentiation: a derogation from certain aspects of the four freedoms and an exclusion from the scope of the Treaties. Their location establishes them as primary law. This sets them apart from the Outermost Regions, which are provided derogations in secondary law. Furthermore, as will be established later in this essay, unlike the Outermost Regions, these derogations are permanent.

The Åland Islands are located in the northern Baltic Sea, at the entrance of the Gulf of Bothnia between the Finnish and Swedish mainlands. The main island, the “Åland mainland”, is surrounded by archipelagos, of which some are inhabited.<sup>253</sup> Like most of the Outermost Regions, the Åland Islands fall under the category of being very small (27,000 inhabitants and a combined land area of 1,527 square kilometres) and isolated in the sense that the sea restricts access to mainland Finland and the other islands in the archipelago. Considering the distance between the islands and the mainland (531 kilometres to Finland), they cannot be regarded as suffering from extreme remoteness as is true for most of the Outermost Regions.<sup>254</sup>

Like the Outermost Regions, the Åland Islands economy is highly dependent upon only a few products. Their primary industries are agriculture, forestry and fishing. Water transport, however, predominates in the Åland Islands’ economy.<sup>255</sup> The islands are the hub for ferry services between Sweden and Finland and other Baltic Sea traffic, which accounted for almost 40% of employment in 2006.<sup>256</sup> This ferry traffic is highly connected with the islands’ tourist industry.

The Åland Islands were the twentieth wealthiest of the EU’s 268 regions in 2006 and the wealthiest in Finland, with a GDP per capita 47% above the EU-27 average.<sup>257</sup> Thus, unlike some of the Outermost Regions, they are not suffering from low GDP. In fact the islands have an unusually favourable GDP per capita. The special arrangements the Åland Islands negotiated with the Union are therefore not established on the grounds of the islands

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<sup>252</sup> OJ C 241 of 29.8.1994.

<sup>253</sup> Jansson (1997) “Introduction”, p. 1.

<sup>254</sup> ÅSUB (2008) *Åland in Figures*, p. 1.

<sup>255</sup> EPSON (05/05/10) *Euroislands*, p. 21.

<sup>256</sup> Eurostat (2009) *Eurostat Statistical Books*, p. 77.

<sup>257</sup> EPSON (05/05/10) *Euroislands*, p. 16.

lagging behind socio-economically, an argument commonly used as justification for differentiated treatment.

Despite a positive economic environment, the Åland Islands were able to negotiate highly favourable derogations from the common rules of the internal market. As may be construed from the preamble of the Åland Islands protocol, reviewed in the following chapter, these derogations have generally not been viewed as taking into account small-island vulnerabilities, but were granted because of the Union's acknowledgement of an internationally recognised special status for the islands guaranteeing Ålanders Swedish language and culture.

The aim of this case study is to review this special status and, on account of its established scope in international law, establish whether its scope, as implemented in EU law by the protocol, has expanded to include, at least partly, small-island vulnerability arguments. In addition, the type of differentiation mechanisms provided and their effectiveness as instruments to protect the interests of the islands will be assessed.

The case study begins in Chapter B with an overview of the Åland Islands special status and its scope as established in international law. This is followed by Chapter C on Article 1 of Protocol 2, which allows primary law derogation from the Treaty enshrined freedom of establishment<sup>258</sup> and services<sup>259</sup> and from the right to acquire and hold real property.<sup>260</sup> Chapter D reviews Article 2 of Protocol 2, which establishes primary law exclusion from the EU's fiscal regime. In Chapter E, the Union's safeguard clause will be reviewed. Finally, Chapter F will draw conclusions from the findings of this case study and assess their importance within in the context of island vulnerability.

It needs to be mentioned that while writing this section, especially Chapter D, finding relevant up to date secondary sources was not an easy task. While the silence surrounding the arrangement described in Chapter D indicates that the differentiation mechanism provided is generally not perceived as controversial, it made the work the author of this thesis the more challenging. Nevertheless, it is the belief of the author of this thesis that the quality of the review has not been confiscated.

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<sup>258</sup> TITLE IV, Chapter 2, TFEU, Right of establishment, OJ C 83 of 30.3.2010.

<sup>259</sup>TITLE IV, Chapter 3 TFEU, Services, OJ C 83 of 30.3.2010.

<sup>260</sup> Can be regarded an exemption in the area of free movement of capital as expressed in TITLE IV, Chapter 4 TFEU, Capital and payments, OJ C 83 of 30.3.2010.

## **B. The International Special Status of the Åland Islands**

The preamble preceding Article 1 and Article 2 in Protocol 2 on the Åland Islands states the following:

Taking into account the special status that the Åland islands [sic] enjoy under international law, the Treaties on which the European Union is founded shall apply to the Ålands islands with the following derogations:

In order to understand the Union's legal obligation according to this protocol, i.e. the scope of the internationally established special status, there is a need to briefly review its legal historical source.

The special status of the Åland Islands rests on two main pillars: demilitarization and neutralization on the one hand and political and cultural autonomy on the other.<sup>261</sup> Due to the limited relevance to this essay of the former pillar, this review will only assess the latter pillar, i.e. the political and cultural aspect of Åland Islands special status.

The special status of the Åland Islands derives from a League of Nations binding resolution from 1921.<sup>262</sup> Based on its minority protection system, the League of Nations declared that Finland had sovereignty over Åland, that Åland was autonomous<sup>263</sup> and that Finland would guarantee the preservation of the Ålanders language, their culture and local Swedish heritage. The autonomy of the islanders was legalised with the Act on the Autonomy of Åland No. 124/1920.<sup>264</sup> In the 1922 Guarantee Act No. 189/22,<sup>265</sup> the rules guaranteeing the Ålanders Swedish heritage were laid down. Ålanders only needed to officially support schools that taught in Swedish and severe restrictions were on landed estate sold to a person not legally domiciled in the Islands as well as on voting rights and to stand candidate in municipal and regional elections.

After World War II, the League of Nations was dissolved.<sup>266</sup> The Åland Islands status under international law now became vulnerable and questions rose as to the legal value of Finland's international guarantee obligations.<sup>267</sup> In Finland's negotiations with the Union, the

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<sup>261</sup> Rosas (1997) "The Åland Islands as a Demilitarised and Neutralised Zone", p. 23-24.

<sup>262</sup> Hannikainen (1997) "The international Legal base of the Autonomy and Swedish Character of the Åland Islands", p. 57 - 58.

<sup>263</sup> Jansson (1997) "Introduction", p. 3.

<sup>264</sup> FFS 124/1920, of 6.5.1920.

<sup>265</sup> FFS 189/1922, of 11.8.1922.

<sup>266</sup> Hannikainen (1997) "The international Legal Basis of the Autonomy and Swedish Character of the Åland Islands", p. 60.

<sup>267</sup> Hannikainen (1997) "The international Legal Basis of the Autonomy and Swedish Character of the Åland Islands", p. 65.

Finnish were reluctant to raise the special status of the Åland Islands,<sup>268</sup> but following discussions with the islands it was decided to submit a unilateral declaration on the islands' established status under international law.<sup>269</sup>

With Protocol No. 2 on Åland Islands, their special status was, to the joy of Ålanders, unexpectedly mentioned.<sup>270</sup> In addition, the Union accepted Finland's demands for permanent derogations for the existing restrictions on land ownership and the right to trade in the islands as established in the Act of Autonomy of Åland Islands then in force,<sup>271</sup> as well as a permanent exclusion from the scope of the Treaties with regard to the Unions indirect taxation harmonisation regulations. Following a favourable outcome in the Ålandic referendum, the legislative assembly gave its assent to join the Union.<sup>272</sup>

A textual interpretation of the preamble of Protocol 2 confirms that the derogations concern the internationally established status, i.e. protection of the Swedish language and culture. The following chapters will review the legal nature of the two articles in the Åland Islands protocol, their relation with the non-discrimination principle in Article 3 and compare their justification (the internationally established special status) with the scope and justification of Article 1 and 2 as enshrined into EU law by the protocol. The review begins by addressing Article 1 in the protocol on the Åland Islands.

## **C. Article 1: Permanent Derogations from the Four Freedoms**

### **1. Introduction**

Article 1 of Protocol No. 2 on the Åland Islands states:

The provisions of the EC Treaty shall not preclude the application of the existing probations in force on 1 January 1994 on the Åland islands

restrictions, on a non-discriminatory basis, on the right of natural persons who do not enjoy *hembygdsratt/kotiseutuoikeus* (regional citizenship) in Åland, and for legal persons, to acquire and hold real property on the Ålands islands [sic] without permission by the competent authorities of the Åland islands

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<sup>268</sup> Especially the demilitarization and neutralization pillar. (*see*: Fagerlund (1997) "The Special Status of Åland Islands", p. 196).

<sup>269</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 194.

<sup>270</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 196.

<sup>271</sup> Act on the Autonomy of Åland, 1991/1144 of 16.8.1994.

<sup>272</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 194.

restrictions, on a non-discriminatory basis, on the right of establishment and the right to provide services by natural persons who do not enjoy *hembygdsratt/kotiseutuoikeus* (regional citizenship) in Åland, or by legal persons without permission by the competent authorities of the Åland islands.

This article is clear in its aim. Restrictions in the provisional law concerning regional citizenship will apply as regards the right to acquire and hold real property, the right of establishment or to provide services. This chapter will provide an overview of the legal nature of this derogation, its practical application and relationship with the non-discrimination principle as established in EU law, and its justification as a special internationally established status.

The relevance of this derogation to this study has mainly to do with the fact that it is an example of another type of differentiation mechanism in order to accommodate for national or territorial diversity. Furthermore, as a study comparing how effective differentiation mechanisms are in protecting the specific interests of islands, Article 1 of the protocol provides a valuable insight. As such this review is of relevance for this study. Finally, this review provides an interesting example of the slippery line between arguments based on objective and subjective justifications for differentiation.

Due to limited relevance and the scope of the study this review on Article 1 of the protocol will be far from exhaustive. Chapter 2 will highlight the legal effects of the mechanism itself and compare it to the secondary legislation regime provided for the Outermost Regions. In chapter 3 the practical application of the derogations will be touched upon and the derogations relationship with the Unions non-discrimination principle will be described. Chapter 4 will be gaining the main focus but it will compare the scope of the international status with the scope of the status established by the Union in the protocol.

## **2. The Nature of Article 1: A Permanent Primary Law Derogation**

The Åland Islands are full members of the Union. As such they fall within the territorial scope of the Union. Article 1 however allows derogating from some provisions of the Treaties. As established above, falling within the scope of the Treaties entails that the reading of the derogation in Article 1 of Protocol 2 should be as narrow as possible and its application should apply to the Member State subject to the derogation, other Member States and to the Commission equally. These key attributes of derogations within EU law, whatever their legal basis and goals, remain intact.<sup>273</sup>

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<sup>273</sup> Kochenov (2008-2009) “Substantive and Procedural Issues”, p. 268.

Article 1 establishes derogation from the core freedoms of the Treaties. The location of the derogation establishes it in primary law, which is the highest category in the Union's legal order.<sup>274</sup> Unlike secondary legislation, derogations at such a level cannot be challenged in Court. The Court can however interpret the provisions of the Treaties of Accession, Acts of Accession and Annexes to the Acts of Accession.<sup>275</sup> Furthermore, being of a primary law nature, secondary law that is conflicting with the Åland protocol could be challenged by Finland in the EU Court.<sup>276</sup>

Because of the principal rule in EU law that all derogations are temporary, in general, primary law derogations have a fixed time limit. However, as established in the preamble to Article 1 of Protocol 2, the Åland Islands derogations have no end date. As established in Section II earlier in this essay, all treaty amendments (such as primary law derogations) are subject to the time-consuming review of Article 48 TEC and the acceptance of all Member States. This entails that derogation without an established time limit is de facto permanent.

The preamble establishes another rule. This derogation is a so-called *stand-still* clause<sup>277</sup> in the sense that the scope of the derogation is fixed to the law in force on January 1, 1994. The effect of this is that the Ålandic authorities may not make the restrictions which existed on that date more severe.<sup>278</sup> This can be regarded as constraining the development of the autonomy of the Åland Islands. In fact, the stand-still effects have already been noticed. In 1996 the provincial government suggested changes in its law on the right to exercise trade in the islands so as to subject agriculture and fisheries to authorisation. According to the law in force on January 1, 1994, agriculture and fisheries were not included within the scope of industries subject to restriction of freedom of establishment. As a result of the stand-still clause, further restrictions to the freedom of establishment were not allowed.<sup>279</sup>

Finally, concerning the rule that derogations should be interpreted narrowly, Article 1 of Protocol 2 is not clear on if the expression "*existing provisions in force*" covers only legislative provisions or also guidelines codifying existing administrative practice and similar provisions. However, the wider interpretation, i.e. that they should be included, appears reasonable because of the general rule in EU law on narrow interpretation of derogations.<sup>280</sup>

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<sup>274</sup> Fagerlund (1997) "The Special Status of Åland Islands", p.201.

<sup>275</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p. 270 and footnote 277.

<sup>276</sup> ÅLANDS FREDSSINSTITUT (2008) "Ålandsprotokollet och EG-rättens icke-diskrimineringsprincip", p. 6.

<sup>277</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 7.

<sup>278</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 206.

<sup>279</sup> ÅLANDS FREDSSINSTITUT (2008) "Ålandsprotokollet och EG-rättens icke-diskrimineringsprincip", p. 7.

<sup>280</sup> ÅLANDS FREDSSINSTITUT (2008) "Ålandsprotokollet och EG-rättens icke-diskrimineringsprincip", p.7 and Fagerlund (1997) "The Special Status of Åland Islands", p. 208.



Having analysed the legal nature of Article 1, the following chapter will provide an assessment of the practical application of Article 1 and its relationship to EU law.

### **3. The Practical Application of Article 1 and the Non-discrimination Principle**

As established above, Article 1, paragraph 1, of Protocol 2 allows Ålanders to restrict, on a non-discriminatory basis, the right of legal persons and that of natural persons who do not enjoy regional citizenship in Åland, to acquire and hold real property. Regional citizenship translates to *right of domicile* in Ålandic legislation. According to the protocol, the rules for right of domicile as they were on January 1, 1994, apply. They are laid down in the aforementioned Autonomy Act 1144/1991.<sup>281</sup>

According to Article 10 of the Autonomy Act, the limitations on the right to acquire real property are provided by the Act on the Acquisition of Real Property in Åland 3 January 1975/3. Article 11 of the Autonomy Act limits the rights to establishment and services. In both instances the requirement for full rights in those fields is right of domicile. If the right to domicile is not at hand the legal or natural person needs special permission. The general rule in both these provisions is that after five years of residence all legal persons have a right to acquire or holds real estate and enjoy the freedom of establishment and services. The same applies for natural persons except with respect to the right to own real property, where right of domicile continues to be required. As established in Article 7 of the Autonomy Act, one of the criteria's for the right to domicile in Åland Islands is Finnish citizenship. This puts more restraint on non-Finnish EU citizen than Finnish citizen.

By establishing the derogations within the framework of primary EU law, the derogations became a part of the Union's *acquis communautaire*, and thus the Union is bound to respect these restrictions. However, as can be seen above, Article 1 establishes that the practical implementation of these derogations needs to be applied on a non-discriminatory basis. This is further enforced in Article 3 in Protocol 2, which states:

The Republic of Finland shall ensure that the same treatment applies to all natural and legal persons of the Member States in the Åland Islands

As mentioned in the review on the Channel Islands and the Isle of Man in Section IV, a similar non-discrimination clause is found in their protocol. There the Court established that the principle of non-discrimination is required in all areas that fall under Union competence. Article 1 derogates from areas that fall under Treaty competence. This means that while

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<sup>281</sup> Article 7, 1991/1144 of 16.8.1994. It establishes the criteria for right of domicile in the islands.

Ålanders may discriminate against Ålanders and non-Ålanders, they may not discriminate between non-Ålandic EU citizens, including Finnish citizens, unless objectively justified.<sup>282</sup> Without going into further detail, as established above, in the case of right to real property, this does not seem to be the case.

Being full members of the Union, Ålanders are bound to obey the Union's non-discrimination principle in Article 18 TFEU (ex-Article 12 TEC) regardless of whether a non-discrimination clause is in the protocol or not. Thus Articles 1 and 3 of the protocol are superfluous.

The Republic of Finland is obliged "not to discriminate between persons who are nationals of the Member States". This does not divest the Åland authorities from responsibility. According to Union law, all authorities vested with public power are obliged to ensure that Union law is implemented.<sup>283</sup>

#### **4. The Expanded Scope of the International Special Status as Applied in EU Law**

When the Union accepted the internationally established special status of the Åland Islands, it agreed that there was a need to protect the Swedish language and culture. From the outset other motives, such as economic arguments, have been used to argue the need to preserve their special Swedish language and culture. This especially applies to the freedom of establishment and services in the islands.

For example, in preparing documents for the 1957 Trade Right Law governing the right of establishment in the Åland Islands, one motivation behind the established restrictions on Finnish companies was that they were perceived as a threat to the economic viability of Ålandic companies.<sup>284</sup> In the current Trade Rights Law in force, its preparation documents reveal that the granting of trade permissions to non-Ålanders, are, among other things, meant to be an instrument to prevent the Åland traders and professionals from being exposed to unhealthy competition by outside traders.<sup>285</sup> The right to exercise a trade or a profession in Åland has in other words been seen as an instrument entitled to guard the Swedish language and culture as well as be a protector of the economy. In that respect the question inevitably arises as to whether a denial of an application on the basis of the need to protect the internal market is a part of the legitimate goals established in 1921.

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<sup>282</sup> See for example: ECJ, Case 106/83, *Sermide v Cassa Conguaglio Zucchero and Others* [1984] ECR 4209 and Davies (2003), *Nationality discrimination in the European internal market*, p. 15.

<sup>283</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 209.

<sup>284</sup> ÅLANDS FREDSTINSTITUT (2008) "Ålandsprotokollet och EG-rättens icke-diskrimineringsprincip", p. 15.

<sup>285</sup> ÅSUB (2002) den åländska näringsrätten, p. 18.

During the membership negotiations between Finland and the Union, the importance of Åland's special rights as a means to protect language and culture on Åland was stressed, while the need to protect the internal market from competition was not mentioned.<sup>286</sup> This could mean that the Union perceives the restrictions to freedom of establishment in Ålandic trade rights law as a protection against nationality and language and not as a form of protection against competition.<sup>287</sup> If that's the case, the position taken in these preparation documents hardly suffices.<sup>288</sup> In fact it might be argued that the Ålanders are taking advantage of the fact that it is sometimes difficult to distinguish between objective and subjective differences.

While just speculations of the author of this study, it may also be argued that the Union was aware that they were acknowledging an expanded scope of the internationally established special status. This does not seem unlikely considering that limits to freedom of establishment and services were not acknowledged as part of the Ålanders special status until the 1951 Autonomy Act<sup>289</sup> and thus never a part of the League of Nations guarantee.

Taking this into consideration, it can be argued that the Union was willing to connect national identity arguments with economic ones and thus differentiate not only on account of minority concerns but also because of an established small-island vulnerability associated with small market size, etc.

This logic may not be as far-fetched as it first appears. As addressed in the review on Article 355 TFEU, islands have been able to negotiate special statuses, tailored to their needs. In addition, as will be reviewed in the following chapter, the derogation in Article 2 of Protocol 2, which also falls under the scope of the internationally established special status statement in the preamble, explicitly states that it is aimed at "maintaining a viable local economy in the island", hence at protecting a small and vulnerable island economy.

Although the reasons for the Union accepting to tie economic reasons with national identity arguments are in the end only speculations of the author of this essay, it remains that the scope of the internationally established special status, as acknowledged by the Union, has expanded to include the protection of the internal market of the islands.

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<sup>286</sup> ÅSUB (2002) *den åländska näringsrätten*, p. 18, footnotes no. 13 and ÅLANDS FREDSTITUT (2008) "Ålandsprotokollet och EG-rättens icke-diskrimineringsprincip", p. 16.

<sup>287</sup> ÅLANDS FREDSTITUT (2008) "Ålandsprotokollet och EG-rättens icke-diskrimineringsprincip", p. 16-17.

<sup>288</sup> ÅLANDS FREDSTITUT (2008) "Ålandsprotokollet och EG-rättens icke-diskrimineringsprincip", p. 19.

<sup>289</sup> FREDSTITUT (2008) *Ålandsprotokollet och EG-rättens icke-diskrimineringsprincip*, p. 15.

## **D. Article 2: An Exclusion from the Scope of the Union’s Fiscal Regime**

### **1. Introduction**

In the introduction to this section it was established that the Ålandic economy is highly specialised and economically dependent on its shipping industry, in particular the ferry operation passing between Sweden and Finland. At the time of the 1994 accession negotiations over half of the ferry operators’ income derived from tax- and duty-free sales, which was considered to be vital to the ferry operation and the related services, i.e. shipping, tourism and financial services, which accounted for more than 70% of employment and 80% of the GDP gross product in Åland. According to *Fagerlund*, the Ålandic government feared that their economy would shrink by up to 50% if duty-free shopping was abolished on the flight and ferry routes between Sweden, Åland and Finland.<sup>290</sup>

Considering the logic of an internal market with no barriers, duty-free sales relying on the concepts of importation and exportation of goods seems unfitting. The requirements of the internal market imply that all traders in the Union must be allowed to compete on equal terms. This won’t be the case if some goods are taxed and others are not, depending on whether an internal frontier is crossed using certain means of transport. Such a practice distorts the market in relation to the goods sold, the mode of transport used and selection of routes used.<sup>291</sup>

The Union abolished fiscal frontiers as of January 1, 1993.<sup>292</sup> As a result of intense lobbying, interested parties affected by the cessation of duty-free sales negotiated a postponed deadline until June 30, 1999.<sup>293</sup> This was just a postponement and not a fitting solution for the Åland Islands, which viewed duty-free sales as being vital to its economy. Thus, understandably, the Ålanders requested a lasting tax exemption from the Union’s harmonious tax rules, at least on the ferries.

Considering the vital arguments against tax-free sales, it was generally assumed that of all Finland’s requests with respect to the Åland Islands, this was the one most likely to be rejected.<sup>294</sup> However, the Union accepted the Ålanders derogation. Article 2 of Protocol No. 2 of the Act of Accession in the 1994 Treaty of Accession states the following:

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<sup>290</sup>Fagerlund (1997) “The Special Status of Åland Islands”, p. 213-214.

<sup>291</sup>Fagerlund N., *The Special Status of Åland Islands* (1997), p. 214.

<sup>292</sup>Council Directive, OJ L 376 of 31.12.1991.

<sup>293</sup>Article 28k, OJ L 376 of 31.12.1991.

<sup>294</sup>Fagerlund (1997) “The Special Status of Åland Islands”, p. 213.

(a) The territory of the Åland islands – being considered a third territory, as defined in Article 3(1) third indent of Council Directive 77/388/EEC as amended, and a national territory falling outside the field of application of the excise harmonization directives as defined in Article 2 of Council Directive 92/12/EEC – shall be excluded from the territorial application of the EC provisions in the field of harmonization of the laws of the Member States on turnover taxes and on excise duties and other forms of indirect taxation. This exemption shall not have any effect on the Community's own resources.

This paragraph shall not apply to the provisions of Council Directive 69/335/EEC, as amended, relating to capital duty.

2 b) This derogation is aimed at maintaining a viable local economy in the islands and shall not have any negative effects on the interests of the Union nor on its common policies. If the Commission considers that the provisions in paragraph (a) are not longer justified, particularly in terms of fair competition or own resources, it shall submit appropriate proposals to the Council, which shall act in accordance with the pertinent Articles of the EC Treaty.

This article is clear in its aim. As stated in Article 2 b), the aim is to maintain a viable economy in the islands. As such it is an example of the Union acknowledging its consideration of economic surroundings as vulnerable, irrespective of GDP per capita. Furthermore, being a small, vulnerable island as expressed in literature, and economically dependent on few products, the statement may be regarded as an implicit recognition to the special economic environment of small islands. Thus the derogation is fairly relevant to this study. Furthermore, Article 2 b) is providing yet another example of the differentiation mechanisms available to the Union when it feels compelled to address national or territorial diversity.

The aim of this chapter is to legally analyse this differentiation instrument provided in Article 2 in Protocol 2, its main legal principles and practical application, and how effective the differentiation instrument provided is at addressing the established intent. In addition, an assessment of the safeguard clause presented in Article 2 b) will be provided. Finally, some thoughts on the internationally established status and its connection with Article 2 will be provided. This overview of Article 2 in the Åland Protocol, however, begins by reviewing the main legal principles of Article 2 a), in other words, its nature.

## **2. The Legal Effects of an Exclusion from the Scope of the Treaties**

Article 2 excludes the Åland Islands from the Union's fiscal policy. This arrangement, i.e. exclusion, may as such be regarded as a derogation in the sense that a territory is escaping common rules other (territories of) Member States have to obey. However, this exclusion differs from the primary law derogation in Article 1 in several ways.

The legal effects of exclusion from the scope were reviewed in Section IV. There it was established that an exclusion from the geographical scope entails that EU law has no regime within the excluded policy area unless the reverse is especially established. As established in Article 2 on the Åland Islands protocol, capital duty and the Union's own resources are included within the scope of the Treaties. Apart from those two inclusions, in the eyes of Union law the territory is simply out of the EU or a third territory.

Thus, unlike the stand-still effects in Article 1, the exclusion established in Article 2 is not hindering the Ålanders with regard to future modifications of its VAT and excise duties. However, the safeguard clause in Article 2 b), reviewed later in this section, may be regarded as having a hampering effect on that freedom since if the Commission deems this fiscal exclusion “*no longer justified*” it can be invoked by the Council.

Just as Article 1, Article 2 establishes a primary law exemption from the Union's fiscal territory. This differs from the status of the Outermost Regions reviewed in Section V. They owe their fiscal exclusion status to secondary legislation, i.e. the directives themselves,<sup>295</sup> with a legal basis in Article 349 TFEU. As mentioned previously, a guarantee on a secondary law level has the effect that the exclusion can be changed or abolished on a secondary level as well.

The Åland Islands are also explicitly mentioned in those directives, alongside the Outermost Regions. However, their derogative regime is not bound to the directives but to the primary rule established in Protocol 2. Thus, regardless of whether they are named in the directives, the Åland Islands are excluded from their scope and only a Treaty amendment can change that.

To sum up, the primary law exclusion from the scope of the directives establishes a permanent exemption from the Union's indirect taxation regulations. The Åland Islands are a third territory and thus not under EU jurisdiction in that respect. However, the safeguard clause may be regarded as a protection against serious deviations from Union policy.

### **3. The Practical Application of Article 2 a) and the Union's Non-discrimination Principle**

Article 2 in Protocol 2 establishes that the Åland Islands are excluded from the application of the Union's VAT and excise tax directives. As established in the review on the Outermost

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<sup>295</sup> Article 6(1) of Council Directive 2006/112/EC, OJ L 347 of 11.12.2006 and Article 5(2) of Council Directive 2008/118/EC, OJ L 9/12 of 14.1.2009.

Regions, the VAT directive in force is Council Directive 2006/112/EC of 28 November 2006.<sup>296</sup> The excise tax directive in force is Council Directive 2008/118/EC.<sup>297</sup>

Being outside of the scope of these directives means being outside the *fiscal territory*.<sup>298</sup> This has the effect that Ålanders are not bound by the tax-rate harmonization imposed on the EU by the above-mentioned directives. Thus it can tax products and services at a lower rate than other Member States. Most important for the Ålanders, however, sales of duty free goods to passengers during the voyage on board ships or aircraft in service with a residence in Åland, can continue.

Being outside the fiscal territory does not only bring about the possibility to sell products at a lower price. Being a third territory, fiscal tax border are governed by the same Union procedure to exports and imports of trade as those established with third countries. Thus the Ålanders do not enjoy the benefits of free movement of goods.<sup>299</sup>

A total exclusion from the Unions fiscal tax regime reaches farther than what was needed for the Åland Islands, which only wanted to preserve their right to duty-free sales. This legal construction was however needed because a specific derogation on account of duty-free sales specifically would have been too dangerous a precedent for the Union on such a highly sensitive issue.<sup>300</sup> The enjoyment of special statuses with regard to the customs and/or fiscal territories of the EU were however a politically and legally accepted model that had been used for other Member State territories. Thus, exclusion was perceived as the only way to enable the Åland Islands to continue their duty-free sales.<sup>301</sup>

Article 3 of the protocol establishes the rule of non-discrimination in Ålanders' relations to EU citizens. Finland must ensure that natural and legal persons from all Member States are given same treatment in all matters governed by Union law. This means that the fiscal frontier around Åland applies equally to relations between Åland, the EU and the Finnish mainland.<sup>302</sup> Thus because of Article 2 in the Åland Islands protocol, the free movement of goods between Finland and Åland seized to exist.

Åland and Finland seem not to have been aware of these legal effects and because of the inconvenience this placed on their trade relations, they were both having second thoughts and wanted to set aside the tax exclusion. Thus, in 1995 Finnish Finance Ministry officials

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<sup>296</sup> Council Directive 2006/112/EC, OJ L 347 of 11.12.2006.

<sup>297</sup> Council Directive 2008/118/EC, OJ L 9/12 of 14.1.2009.

<sup>298</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 215.

<sup>299</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 219.

<sup>300</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 220.

<sup>301</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 250, endnote 91.

<sup>302</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 219.

and Ålandic representatives met with the Commission and suggested a temporary suspension of the fiscal frontiers using the safeguard clause in Article 2 b). However, being primary law derogation it was not legally possible for the Commission to use the safeguard clause to lift it.<sup>303</sup>

As this brief review reveals, this indirect tax exclusion, being established in primary law, provides much-needed security for the Åland Islands vulnerable economy. As a differentiation instrument, its scope is however too wide and this security comes at the cost of flexibility. For instance, according to Articles 5(4) - (5) of the Excise Directive, the Outermost Regions enjoy the flexibility of selecting goods that shall be governed by the directive. Apart from that, they enjoy the principle of free movement of goods. This flexibility is not a possibility for the Åland Islands, which only seem to have the possibility of being in or out of the fiscal tax regime.

To conclude, the application of differentiation mechanisms to protect economic interests reveals that given enough hard facts the drafters of the Treaties are willing to acknowledge the need for differentiation. In such cases a low GDP of the (territory of the) Member State is not a criterion for differentiation. Taking into consideration that the island is very small and economically dependent on few products, the willingness of the drafters of the Treaties to accommodate this may be regarded as an implicit acknowledgement of small-island vulnerability as identified in literature.

This differentiation mechanism i.e. exclusion from the scope, was the only politically available legal construction available. This clearly reveals that, at least at that time, there was a lack of a genuine acknowledgement within the Union of small-island vulnerabilities and an absence of a general small-island policy in EU law.

#### **4. Article 2 b): The Union's Safeguard Clause**

Article 2 b) of Protocol 2 on the Åland Islands establishes a safeguard clause<sup>304</sup> for the Commission to submit proposals to the Council, in order to be able to act if the fiscal tax exclusion is no longer justified. As mentioned in Section II earlier in this essay, safeguard clauses are generally seen as anomalies, i.e. as *droits en temps de crise*, which, provided that the conditions established in a safeguard clause are met, can be invoked.<sup>305</sup>

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<sup>303</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 219-221.

<sup>304</sup> Fagerlund (1997) "The Special Status of Åland Islands", p. 223.

<sup>305</sup> Tuytschaever (1999) *Differentiation in European Union Law*, p. 131.



The aim of the derogation, “*maintaining a viable local economy in the islands*”, is established in Article 2 b). At the same time, it is requested that the derogation has no negative effects on the interests of the Union or its common policies and that the derogation must be justified in terms of fair competition and the Union’s own resources. This narrows the Council’s scope of action because the interests of the Union and its common policies need to be weighed against the interests of maintaining a viable economy in the islands before the Council decides to use its powers.<sup>306</sup>

The derogation needs to be deemed “*no longer justified*” by the Commission in order for the safeguard clause to be invoked. Considering the aim of protecting the “*local economy*”, a regional GDP in the top twenty of the EU is obviously not regarded as a justification for the activation of the safeguard clause. However, one may expect that the derogation needs to be directly related to the protection of the Ålandic economy. Thus an economic operator enjoying this fiscal regime needs to have a genuine economic link to the Ålandic economy.

As regards the requirement of “*fair competition*”, speculations on when this exclusion may be deemed as not fair from the point of view of the Unions competition policy go beyond the scope of this essay. To name one example, however, if for instance the duty-free trade to and from Åland expanded to an unjustified extent, it could be regarded as having a negative effect on the interests of the Union in terms of fair competition.<sup>307</sup>

One key question is whether the safeguard clause may be used to amend or even abrogate the derogation as such. According to Article 2 b) the council may upon a request from the Commission “*act in accordance with the pertinent Articles of the EC Treaty*” if the Commission regards the derogation unjustified because of fair competition. The wording “*no longer justified*” does seem imply a permanent cessation, taking into consideration that safeguard clauses are by their nature a temporary act, i.e. a reaction to some sort of a crisis. When that crisis has passed a “normal state of affairs” is to be established again, which in the case of the Åland Islands, would be a fully functional exclusion from the Union’s fiscal regime as established in primary law.

To offer an assessment on this safeguard clause, it provides the Union with a tool to react against possible misuse creating a real threat to fair competition caused by the derogation in Article 2 a). The article establishes a balance of interests between the need for equal treatment in terms of competition and the Åland Islands’ economic needs, which need

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<sup>306</sup> Fagerlund (1997) “The Special Status of Åland Islands”, p. 223.

<sup>307</sup> Fagerlund (1997) “The Special Status of Åland Islands”, p. 224.

to be weighed against each other before the Council decides to use its safeguard powers. This clause should not be underestimated. It is likely that the Member States would not have been willing to accept this accrued differentiation mechanisms without it.

Since Article 2 a) constitutes primary law, permanently altering it or abolishing it would not be in the hands of the Commission or the Council but would follow the procedures in Article 48 TEC. Thus, Article 2 b) is not threatening the permanence of Ålanders exclusion from the Union's fiscal policy.

## **5. The Internationally Established Special Status in the Light of the Union's Goal of Maintaining a Viable Economy in the Islands**

As addressed above, the international status of the Åland Islands is based on a League of Nations resolution from 1921 and was guaranteed through their minority rights protection system. At that time Finland guaranteed to protect Swedish language and culture in the Åland Islands.

The general declaration of the Union in the preamble to Protocol 2 on the Åland Islands, reviewed above, states that the Union will take "*into account the special status that the Åland islands enjoy under international law*" by allowing the derogations established in Article 1 and 2 of the protocol.

Taking a textual analytical approach, this declaration is clearly addressing both Article 1 and Article 2. Article 2 of the protocol establishes the aim of safeguarding the economic vitality of the islands. As such, it cannot be regarded as a protector of the Swedish language and culture. By including Article 2 within this general statement in the preamble, the Union seems to be enlarging the scope of the Åland Islands internationally special status.

As mentioned above, during the membership negotiations, Finland only stressed Åland's special status as a protector of language and culture. Accordingly, it may be presumed that the Union was aware of the scope of the internationally established special status. It's possible, because of the controversy concerning duty-free sales within the Union, that the drafters of Åland Islands accession arrangements thought it was convenient to position the indirect tax exclusion within the sphere of the special status. Whatever the reason, the Union clearly went out of its way to accommodate for the vulnerable economy of this small island.

## **E. Concluding Remarks**

Coming to the end of this case study on the Åland Islands protocol, some final conclusions need to be provided. Permanent derogations for (territories of) specific Member States are

rare. As a rule, primary derogations have a fixed end date and are generally related to transitional agreements of incoming Member States. Åland is an example of the contrary, i.e. a small semi-autonomous group of islands that was able to negotiate an accrued differentiation on a permanent basis from the core functions of the internal market while still being, for the most part, wholly integrated into the Union.

In the EU Treaties, this atypical status of the Åland Islands is justified on the basis of its international special status established by the League of Nations in 1921. While the status goals, at first sight, seems to be coinciding with the goal of Article 1 of the protocol, a review of the article revealed some interesting discrepancies with the League of Nations Guarantee. Thus, Ålandic trade law are not only protecting the Swedish language but also the Ålandic traders from outside competition. Hence it seem as if the restrictions to freedom of establishment and services are dressed up as objective arguments when the islanders are actually, or at least partly, using the international special status guarantee as a cover for commercial interests.

While the islander's emphasis on protecting their economy may be regarded as a useful indicator of the vulnerabilities of small islands realities it cannot be overlooked that the protection of the economy was not the established goal of the League of Nations Guarantee when the Union accepted the permanent derogation in Article 1. Thus, it seems as EU law, perhaps unknowingly, are providing Åland Islands with an enlarged version of the internationally established status. As regards Article 2 of the Åland Islands protocol, which is also positioned under the League of Nations Guarantee, this divergence with the Guarantee is obvious. Article 2 has the explicit aim of protecting the Ålandic economy and, thus clearly isn't protecting the Swedish language or culture. Consequently Article 2 is a clear example of the Union expanded version of the internationally established special status.

Apart from the scope of the internationally established status, the aim of this case study was to review whether this special status includes, at least partly, small-island vulnerability arguments.

Viewing Article 1 as an example of a small-island-vulnerability clause may be far-fetched. However, it is an example of the Union's flexibility towards the national diversity of Member States and provides this study with an example of the elements of primary law derogations. As regards Article 2 however, establishing a protective shield around Åland's economy reveals an underlying Union understanding of the effects of smallness on small island economies. As such, Article 2 may be regarded as recognition of small-island

vulnerability arguments as established in literature and an example of the Unions acceptance to special vital interests of small islands.

However, while small-island considerations and acceptance seem to have been guiding the Unions approach, the case of Åland Islands cannot, unlike the Outermost Regions, be established as fitting into a coherent small-island EU policy. On the contrary, the differentiation mechanisms used to provide Åland Islands with the protection they wanted lack flexibility and can as such not be regarded as an example of a coherent Union solution for small island vulnerabilities. The choice to totally exclude the islands from the Unions indirect taxes supports this assumption, but it seems to have been applied because it was politically convenient for the Union, but not necessarily so convenient for the islands.

In fact, it may be speculated that a lack of a small island legal framework in EU law within which justifications for the Åland Islands derogations could be sought was the reason why Article 2 was positioned under the League of Nations Guarantee i.e. that the placement of Article 2 was not due to a misunderstanding, on the Unions behalf, as to the true meaning of the internationally established status but that the Union was conveniently using it to mask the differentiation mechanisms provided for on Åland Islands behalf.

While the Åland Islands case is an example of the lack of a small island policy in EU law, at least at the time of accession, nevertheless, what stands out is the willingness of the drafters of the Treaties to go out of their way to secure the vital interests of a small and vulnerable semi-independent island economy. Furthermore, the review confirms that an islands GDP is not an issue in that respect.

Economic vulnerability is not only a distinctive character of island regions such as the Åland Islands or the Outermost Regions. In fact, as established in Section III, this is a general characteristic of small-island States. There are currently two island states within the Union that may be regarded as both “small” and insular. Both have protocols addressing mechanisms that allow different application of EU law. The following Section will review their status within EU law.

## **VII. Island States within the EU: An Example of a Lack of EU Flexibility Towards Small-island Member States**

### **A. Introduction**

This thesis has thus far focused on semi-autonomous island regions of Member States that have a special relationship with the Union as addressed in Article 355 TFEU. In the article it has been established that the Treaties do not always apply a uniform integration method. The review of the arguments behind these special small island relationships reveals the Union's implicit and explicit acknowledgement of small island vulnerabilities. This section aims to study whether the Union is likewise taking into consideration the specific constraints that follow small-islands when they have the administrative status of small-island states.

There are four European Member States that can be categorized as islands: the United Kingdom, Ireland, Malta and Cyprus. As mentioned above, small population has been the main indicator for smallness in literature. Since only the latter two fit the profile of being small in population, the focus will be on them.

Malta and Cyprus joined the Union in the 2004 enlargement.<sup>308</sup> On that occasion the islands negotiated several transitional arrangements. The aim of this chapter is to review whether the Union, as presented in the arrangements, took account of Malta's and Cyprus's small-island vulnerabilities. In order to establish the islands' relationship with the Union, this section will describe the main legal arrangements provided for the islands in the accession negotiations as compared with the other larger candidate Member States of the 2004 enlargement and the case study island regions previously discussed.

Due to the limited scope of the study, this review will be far from exhaustive and will mainly focus on the arrangements that can be interpreted as examples of small-island vulnerabilities as described in the literature reviewed in Section III.

The importance of this review centres on the fact that Iceland is now a formal applicant state of the Union. As such, the arrangements Malta and Cyprus received can provide valuable insight as to what the approach of the Union will be towards Iceland in the negotiation process and possibly provide a negotiation strategy for Iceland as it strives to best protect its interests. The case of Iceland will be shortly reviewed in the closing remarks in Section IX.

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<sup>308</sup> Act of Accession 2003, OJ L 236 of 23.9.2003.

This section is structured into three chapters, one each on Malta and Cyprus and then a chapter reserved for final conclusions. The review begins by addressing Malta's features as a small-island state.

## **B. Malta**

### **1. Introduction**

Malta consists of a series of small islands or archipelagos in the Mediterranean Sea, 97 kilometres south of the Italian territory of Sicily and 288 kilometres north of Africa. It is at the crossroads of Africa, Europe and the Middle East. Only the three largest islands — Malta, Gozo, and Comino — are inhabited. Malta has a land area of 316 square kilometres and the coastline of the Maltese islands combined is 140 kilometres. It has a population of 405,000 people and a population density of 1,160 people per square kilometre, making it the smallest and most densely populated Member State in the Union.<sup>309</sup>

The small size of the country means that there is a lack of natural resources in most areas, so that in most industries local manufacturers depend heavily on imports of industrial supplies and raw material.<sup>310</sup> Malta produces only about 20% of its food needs, has limited freshwater supplies, and has no domestic energy sources.<sup>311</sup> This means that local manufacturers are always price-takers and can never influence market conditions and international prices. The smallness of the market and limited resources had driven manufacturers in the past to forego diversification and focus on a very narrow range of products.<sup>312</sup>

Malta's economic development since the beginning of the 1990s has been based on tourism, which accounts for roughly 30% of their GDP, and exports of manufactured goods, mainly semiconductors, which accounts for some 75% of the Maltese exports.<sup>313</sup> The global financial crisis hit the tourist industry hard in Malta. The first quarter of 2009 saw a sharp downturn of 17.8% from the previous year, after having declined by 10.3% in the previous quarter. The performance of the tourism industry remained weak in the second quarter of 2009 with a decline of 9.2% from the same period in 2008, and continued to perform badly

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<sup>309</sup>See CIA World Factbook, Malta, July 2010 estimate, <https://www.cia.gov/library/publications/the-world-factbook/geos/mt.html>, [accessed on 25.08.2010].

<sup>310</sup> Buttigieg (2004) "Challenges Facing Malta as a Micro-State in an Enlarged EU", p. 2.

<sup>311</sup>Australian Government, *Malta country brief*, [http://www.dfat.gov.au/geo/malta/malta\\_brief.html](http://www.dfat.gov.au/geo/malta/malta_brief.html), [accessed on 25.08.2010].

<sup>312</sup> Buttigieg (2004) "Challenges Facing Malta as a Micro-State in an Enlarged EU", p. 3.

<sup>313</sup> Malta Central Bank & Financial Policy Handbook (2005) p. 23.

for the rest of the year. There are signs of recovery in 2010.<sup>314</sup> Malta's GDP per capita was 78% of the EU-27 average in 2009.<sup>315</sup>

This short assessment on Malta reveals that it is facing challenges recognized in literature as small-island vulnerabilities. As mentioned, it is the smallest Member State as regards population. In comparison to the Outermost Regions, it is smaller in landmass than five of the seven regions and is about two times smaller than Madeira and 2,800 times smaller than French Guiana. As regards population, Malta has fewer inhabitants than three of the Outermost Regions. While it may not be regarded as extremely remote, as an island it is by definition insular, its economy is dependent on few products and on imports, and its tourist-oriented economy makes it vulnerable to economic conditions outside of its influence. Furthermore, its GDP per capita is lower than that of the Canary Islands and the Åland Islands.

## **2. Malta's Status with the Union**

Malta is one of the twelve Central and Eastern European Countries (CEEC)<sup>316</sup> constituting the fifth European Union enlargement, occurring in 2004 and 2007.<sup>317</sup> Negotiations with Malta began in February 2000. As the smallest prospective EU Member State Malta needed to maximise its position and relative uniqueness.<sup>318</sup> Malta obtained many transitional arrangements and permanent derogations. Transitional periods granted to new Member States are pointed out in Article 24 of the 2003 Act of Accession. Transitional arrangements and derogations granted to Malta are listed in detail in Annex XI of the same act.

Compared to the other prospective Member States, Malta received the largest number of arrangements. Most of these are time-limited transitional periods, mostly of a short duration, but some have an extended duration, such as those in the field of competition policy and agriculture, which will expire in 2011-2015.<sup>319</sup> According to a 2001 working paper by Jean Monnet Chair, transition periods of approximately ten years were, at the time of the

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<sup>314</sup> Australian Government, *Malta country brief*, [http://www.dfat.gov.au/geo/malta/malta\\_brief.html](http://www.dfat.gov.au/geo/malta/malta_brief.html), [accessed on 25.08.2010].

<sup>315</sup> Times of Malta, "Malta GDP per inhabitant is 22% short of EU average", 21.6.2010, [accessed on 25.08.2010].

<sup>316</sup> They were Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia Bulgaria and Romania. (*See*: OJ L 236 of 23.9.2003 and OJ L 157 of 21 6.2005).

<sup>317</sup> Ten countries joined in 2004. Bulgaria and Romania joined in 2007.

<sup>318</sup> Pace (2006) "Malta and EU Membership", p.42.

<sup>319</sup> Azzopardi (2005) "Small Islands and the European Union", p. 9.

CEEC enlargement, the upper limit.<sup>320</sup> These extended transitional periods for Malta, therefore, can be regarded as taking into account a vulnerable economy.

Reviewing all of the arrangements goes beyond the limited scope of this essay. However, a quick glance will be given to the measures that the scholar *Buttigieg*<sup>321</sup> regarded as especially taking into account Malta's small-island status.

**a) *Limitations to the Free Movement of Workers***

It was feared that the small labour market in Malta would not handle the free movement of workers guaranteed in the Treaties, i.e. that it would be flooded by an influx of EU nationals taking jobs away from Maltese workers, resulting in increased unemployment.<sup>322</sup>

Because of these concerns Malta negotiate a transitional provision in the Accession Treaty to Article 45 TFEU (ex-Article 39 TEC) of the Lisbon Treaty, providing that until 2011, whenever Malta undergoes, or foresees that it will undergo, disturbances in its labour market that could seriously threaten the standard of living or level of employment in a given region or occupation, it may resort to a safeguard procedure that suspends in whole or in part the application of Regulation 1612/681 on the freedom of movement for workers,<sup>323</sup> in order to restore the situation to normal in that region or occupation. Maltese nationals, however, continue to enjoy the benefits of the regulation.

To monitor the labour market and have advance warning of any such situation, Malta was allowed to retain until 2011 its work-permit system, although EU nationals seeking work in Malta will receive such permits automatically.<sup>324</sup>

In addition, in a joint declaration attached to the Accession Treaty it is declared that should Malta's accession, at any time even after 2011, give rise to difficulties relating to the free movement of workers, the matter may be brought before the Union institutions in order to obtain a solution to this problem.<sup>325</sup>

Malta was the only candidate country that sought and obtained an arrangement of this nature. These restrictions have been regarded as taking into account the size of the labour market, but this arrangement was not especially awarded to small states or islands. Some Member States, including the largest ones, faced the same concerns from their own citizen's vis-à-vis the CEEC's workers. In fact, workers from Malta and Cyprus were the only ones

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<sup>320</sup> Jean Monnet Chair, "EU-Enlargements", p. 11.

<sup>321</sup> Buttigieg (2004) "Challenges Facing Malta as a Micro-State in an Enlarged EU", p. 1.

<sup>322</sup> Buttigieg (2004) "Challenges Facing Malta as a Micro-State in an Enlarged EU", p. 4.

<sup>323</sup> Council Regulation, OJ L 257 of 19.10.1968

<sup>324</sup> Buttigieg (2004) "Challenges Facing Malta as a Micro-State in an Enlarged EU", p. 4.

<sup>325</sup> Declaration 14 on the Free Movement of Workers, OJ L 236 of 23.9.2003



who from day one enjoyed full rights to seek work in these Member States, which is a clear indicator of their small size.<sup>326</sup>

As addressed in Section II joint declarations constitute soft law. This is confirmed in Article 60 of the 2003 Accession Treaty, which states that annexes and protocols form an integral part of the Treaty.<sup>327</sup> Declarations are not mentioned. Hence, they are not legally binding. Therefore, the declaration must be regarded as a common international agreement as such and does not have a binding effect towards other Member States or the European Union.<sup>328</sup> Furthermore, should the occasion arise and the Commission take action because of overflow of workers, those legal acts would be of a secondary nature. As has been established previously, these are subject to the scrutiny of the Court and need to obey the non-discrimination principle.

As established above, the Åland Islands are allowed extensive limitations to the freedom of establishment and services in primary law. The declaration in question does not provide a similar protection to Malta. However, the declaration does signal that the Union acknowledges that small market size has permanent features and that it can affect a Member State's capacity to fulfil some of the Union's obligations, and that flexibility may be needed to accommodate for that.

#### **b) *Protocol 6 on Acquisition of Property in Malta***

A matter of major concern for Malta relates to its very limited land area and extreme population density. In terms of the Union *acquis communautaire*, at the time of accession, property in Malta would have had to be made available for purchase without any restrictions to all EU nationals – so that even though they did not reside in Malta, non-Maltese EU nationals would have been entitled to buy as much immovable property as they wished. The social effect would be a significant increase in demand for property, which would lead to a hefty increase in property values.<sup>329</sup>

Since Malta's conditions had no precedents within any other candidate country or even any Member State,<sup>330</sup> an agreement was reached on derogation on that issue. Established in Protocol No. 6 to the Act of Accession, the agreement states that:

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<sup>326</sup> Christoffersen (2007) "The Preparation of the Fifth Enlargement", p. 279.

<sup>327</sup> Article 60 states: "Annexes I to XVIII, the Appendices thereto and Protocols No. 1 to 10 attached to this Act shall form an integral part thereof."

<sup>328</sup> Óttar Pálsson et al. (2003) *Fiskveiðireglur Íslands og Evrópusambandsins*, p.203-204.

<sup>329</sup> Buttigieg (2004) "Challenges Facing Malta as a Micro-State in an Enlarged EU", p. 5.

<sup>330</sup> Denmark has a special arrangement in this area, although not on the same grounds (*See*: Protocol No. 32 on the acquisition of property in Denmark, OJ C 83 of 30.3.2010)

“bearing in mind the very limited number of residences in Malta and the very limited land available for construction purposes, which can only cover the basic needs created by the demographic development of the present residents, Malta may, on a non-discriminatory basis<sup>331</sup> maintain in force its current restrictive rules on the *acquis communautaire* on and holding of immovable property for secondary residence purposes by EU nationals who have not legally resided continuously in Malta for at least five years.”<sup>332</sup>

The effect of this agreement is that non-resident EU nationals, Maltese or otherwise, may acquire their first residence or property for business purposes in Malta without the need to seek authorisation. However, irrespective of nationality, non-residents in Malta for a minimum of five years need to apply for authorisation to buy a second house or other property and satisfy the relevant objective criteria.<sup>333</sup>

Regarding the nature of the derogation, it is a permanent primary law derogation. As such it resembles the derogation established in Article 1 of Protocol 2 on the Åland Islands. According to the protocol it builds on the Immovable Property Act (Acquisition by Non-Residents Act), Chapter 246.

It bears the mark of a stand-still clause, i.e. the derogation applies to current restrictions in national legislation to the *acquis communautaire*. As established in the section on the Åland Islands, such primary law derogations are subject to a narrow legal interpretation. In addition, as in the Åland Islands, the non-discrimination prevents arbitrary discrimination of EU citizen.. Unlike the Åland Islands derogation, this derogation provides a limited degree of flexibility. Thus while it sets limits to the value of apartments (Lm 30,000) and other types of property (Lm 50,000), these thresholds may be adjusted to reflect market realities.

The justification for this derogation is explicitly established on the basis of the extremely high population density of the island, because of lack of land. The derogation is thus expressing the realities of small islands, i.e. the geographical constraints that follow limited land area. However, there is no real connection here to small-island-vulnerabilities arguments. Rather, given the extreme circumstances this decision is based on, it may be

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<sup>331</sup> The Protocol requires that the criteria for authorising acquisition of immovable property shall be applied in a non-discriminatory manner and shall not differentiate between nationals of Malta and of other Member States. Malta shall ensure that in no instance shall a national of a Member State be treated in a more restrictive way than a national of a third country.

<sup>332</sup> Protocol No. 6 on the acquisition of secondary residences in Malta, OJ L 236, 23.9.2003.

<sup>333</sup> Buttigieg (2004) “Challenges Facing Malta as a Micro-State in an Enlarged EU”, p. 5.

argued that if the case presented before the Union is strong enough, the Treaties will show flexibility.

**c) *The 25-mile Exclusive Fishing Zone***

Malta has managed an extended 25-mile fisheries management zone, beyond its territorial waters, since 1971 and has maintained a strict licensing scheme, keeping large-scale industrial fishing at a minimum.<sup>334</sup> As an island, Malta's dependence on the sea and its many resources is an obvious asset. The Maltese fisheries are characterised by a fishing fleet that exercises sustainable fishing and its fishing zone has served as a refuge for several species within the heavily exploited central Mediterranean. The fishing industry is mainly artisanal in nature since the vast majority of its vessels are less than eight metres in length and are engaged in coastal and small-scale fishing.<sup>335</sup> The picturesque nature of traditional seaside villages has been regarded as an important selling point of Malta from a tourist industry point of view.<sup>336</sup>

As seen from the above, the social and cultural importance of the Maltese fishing industry far outweighs its economic contribution. This is apparent in its economic input but the gross value-added contribution of the fisheries sector to the Maltese national economy amounts to approximately €33 million or 0.76% of Malta's GDP.<sup>337</sup>

In the Union's Common Fisheries Policy (CFP), Member States with a coastline have wide discretion within a zone of twelve nautical miles (nm). Within this zone, fishing is in practice limited to fishing vessels traditionally sailing from adjacent ports – which may, or may not include vessels from other Member States. Prior to the 2004 enlargement, the Union had not adopted any measures addressing fisheries conservation and management specifically for the waters situated outside twelve nautical miles.<sup>338</sup>

From the start of its accession negotiations, Malta stated that its fisheries should be safeguarded and resources within its fishing zone should continue to be kept at sustainable levels. Malta began by requesting that access to these waters be exclusively reserved for its own nationals. Due to its discriminatory nature, Malta had to withdraw this request.<sup>339</sup> However, in light of the scientific and economic data provided by Malta concerning the

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<sup>334</sup> Fisheries Operational Programme for Malta, 2007-2013 (2008), p. 17.

<sup>335</sup> Caruana, (2007) "The Accession of Malta to the EU", p. 282.

<sup>336</sup> Fisheries Operational Programme for Malta, 2007-2013 (2008), p. 18.

<sup>337</sup> Fisheries Operational Programme for Malta, 2007-2013 (2008), p. 17.

<sup>338</sup> Tenketank Europa (2003) *Iceland, Norway and the EC, Common Fisheries Policy* p. 14-15.

<sup>339</sup> Bossche (2005) "EU Enlargement and Fisheries", p. 126-127.

particular situation of the region, the Union recognised Malta's conservation efforts and established, within the Union framework, a 25-nm regime grounded on conservation needs.<sup>340</sup>

Thus, on account of sustainability and conservation Malta did obtain a specific management regime within 25 nm of its baselines. This is laid down in Regulation 813/2004.<sup>341</sup> According to this arrangement, fishing in the 25-mile management zone is limited to small-scale coastal fishing, meaning fishing vessels of less than twelve metres in length.<sup>342</sup> This arrangement, without undermining the non-discrimination principle, in practice excludes all but fishermen from Malta,<sup>343</sup> since the size limits for vessels will prevent foreign vessels from envisioning economic interest in fishing in Malta's seas.<sup>344</sup>

The 25-nm zone implemented into the Union's legal framework is an example of how the EU can adjust its legal framework to fit specific needs of Member States without granting formal derogations from the *acquis communautaire*. However, in the context of small-island vulnerability, unlike the Outermost Regions' POSEI-fisheries programme, the justifications for a special regime are not based on the handicaps of small islands but on legal arguments such as sustainable development<sup>345</sup> and conservation issues. Although it is unlikely, it may be speculated that Malta's status, as a small and vulnerable island highly dependent on industries such as tourism, had an influence on the Union's response to their request.

#### **d) Declaration No. 36 on the Small-island Region Gozo**

Malta is an archipelago of three islands – Malta, the largest of the three; Gozo, to the north of Malta, separated by a stretch of 8 kilometres of sea; and Comino, which is very small and largely inhabited.<sup>346</sup> Gozo has a landmass of 67 square kilometres<sup>347</sup> and a population of about 31,000 inhabitants<sup>348</sup>. The main means of transport available between Malta and Gozo is a

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<sup>340</sup> Caruana (2007) "The Accession of Malta to the EU", p. 282.

<sup>341</sup> Council Regulation (EC), OJ L 150 of 30.4. 2004.

<sup>342</sup> Bossche (2005) "EU Enlargement and Fisheries", p. 126-127.

<sup>343</sup> Tenketank Europa (2003) *Iceland, Norway and the EC, Common Fisheries Policy*, p. 14-15.

<sup>344</sup> Audunn Arnórsson (2009) "Inni eða úti?" p. 100.

<sup>345</sup> The concept of sustainable development refers to a form of economic growth which satisfies society's needs in terms of well-being in the short, medium and - above all - long term. It is founded on the assumption that development must meet today's needs without jeopardising the prospects for growth of future generations.

The principle of integrating environmental concerns into the formulation and implementation of other policies, which is essential if we are to achieve sustainable development, was confirmed in the Maastricht Treaty.

The Amsterdam Treaty added the principle of sustainable development to the objectives of the EU. The Lisbon Treaty enshrines the goal of sustainable development in Article 3 TEU (ex Article 2 TEU) and links it to the Unions environmental protection requirements in Article 11 TFEU (ex Article 6 TEC).

<sup>346</sup> Buttigieg (2004) "Challenges Facing Malta as a Micro-State in an Enlarged EU", p. 7.

<sup>347</sup> *EUROPA Research and Consultancy Services*,

<http://www.ercs.com.mt/article.aspx?ObjID=6ba22858-e5db-473d-af59-ee1bc494ac96>, [accessed on 25.08.2010].

<sup>348</sup> Gozo.gov.mt, About Gozo, <http://www.gozo.gov.mt/pages.aspx?page=96> [accessed on 25.08.2010].

ferry service. The combined effect of this double insularity, environmental fragility, small population size and its inherent limited resources establishes a highly vulnerable island economy.<sup>349</sup>

A unilateral declaration by the government of Malta<sup>350</sup> attached to the accession treaty recognizes Gozo as having special needs because of its above-mentioned very-small-island-status handicaps, and declares that in the event that Malta as a whole would no longer be eligible for certain measures of the regional policy, Gozo would nevertheless receive those measures.

The Maltese perceived this declaration as an acknowledgement of a special status for Gozo within EU law.<sup>351</sup> However, in response to a European Parliament question tabled by *MP Scicluna*, the Commission dismissed the value of this declaration. The Commission's reply stated not only that the declaration was "*a unilateral declaration of Malta*" but also that any future analysis of Gozo's economic and social situation will be made in a purely EU context.<sup>352</sup>

The Commission's reply clearly indicates that a unilateral declaration is not legally binding and hence not a source for special EU island status. Thus, despite Malta's request and contrary to the Outermost Regions and the Åland Islands, Gozo, a small, vulnerable island territory of a Member State, is not provided with any atypical protection or differentiation mechanisms.

### **3. Assessment**

Malta (and Gozo) clearly resembles a small vulnerable island as established in literature. Malta did receive a larger number of temporary transitional arrangements than other incoming Member States. Some of these arrangements, such as those concerning competition policy and agriculture, had unusually long terms of validity. As such these arrangements may be regarded as taking into account a small and vulnerable economy as established in literature. In general, however, it does not seem as if Malta has negotiated any special conditions regarding either their size or their insularity, except perhaps the derogation obtained by Malta to retain existing conditions in terms of the sale of secondary homes to non-Maltese EU citizens.

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<sup>349</sup> Buttigieg, E. (2004), Challenges Facing Malta as a Micro-State in an Enlarged EU, p.7.

<sup>350</sup> Declaration 36 by the Republic of Malta on the Island Region of Gozo, OJ L 236 of 23.9.2003.

<sup>351</sup> In 2003, prior to the referendum on EU accession, both the Government and the MIC promised Gozitans that Declaration No. 36 would secure Gozo's economic future after Malta joined the EU. (See: Maltastar.com "EU Commission reveals no special status for Gozo", 4.12.2009, <http://www.maltastar.com/pages/r1/ms10dart.asp?a=5867>), [accessed on 25.08.2010].

<sup>352</sup> Parliamentary questions, "Gozo", by Edward Scicluna (S-D) to the Commission. No. E-4470/09,

Whether or not Malta tried to use the vulnerable small-island argument in its negotiations with the Union is unclear. It seems fair to conclude, however, that such reasoning was used in the case of Gozo, but without real success. The Malta arrangements are nevertheless examples of the flexibility of the Treaties.

## C. Cyprus

### 1. Introduction

The population of Cyprus consists of around one million people. It is the third largest island in the Mediterranean (after the Italian islands of Sicily and Sardinia), measuring 9,251 square kilometres.<sup>353</sup> Its closest neighbours are not the European continent but Turkey to the north (75 kilometres away) and Syria and Lebanon to the east (105 and 108 kilometres respectively). It is 800 kilometres to the Greek mainland and the distance to the Pentagon locations is: Hamburg, 2,599 kilometres; Paris, 2,956 kilometres; and London, 3,222 kilometres.<sup>354</sup>

The services sector, including tourism, contributes 78.6% to the GDP and employs 72.1% of the labour force. In recent years, the services sector, and financial services in particular, have provided the main impetus for growth, while tourism has been declining in importance. Manufactured goods account for 58.3% of domestic exports, while potatoes and citrus constitute the principal export crops. The island has few proven natural resources and must import fuels, most raw materials, heavy machinery and transportation equipment.<sup>355</sup>

Among the Member States that have joined the EU since 2004, Cyprus is one of the wealthiest, with a GDP per capita 4-6% lower than the EU average.<sup>356</sup> Irregular growth rates over the past decade reflect the economy's reliance on tourism, which often fluctuates with political instability in the region and economic conditions in Western Europe.<sup>357</sup>

Cyprus fulfils the criteria of being an insular small island as established in literature. While it is more than thirty times larger in landmass than Malta and larger than eight of the Outermost Regions, it has far fewer inhabitants than the Canary Islands and may be regarded

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<sup>353</sup> CIA World Factbook, Cyprus, <https://www.cia.gov/library/publications/the-world-factbook/geos/cy.html>, [accessed on 25.08.2010].

<sup>354</sup> Timeanddate.com, <http://www.timeanddate.com/worldclock/distanceresult.html?p1=680&p2=136>, [accessed on 25.08.2010].

<sup>355</sup> TDS website, <http://www.traveldocs.com/cy/economy.htm>, [accessed on 25.08.2010].

<sup>356</sup> Eurostat, 2009 estimate, [http://epp.eurostat.ec.europa.eu/statistics\\_explained/index.php/GDP\\_per\\_capita\\_consumption\\_per\\_capita\\_and\\_comparative\\_price\\_levels](http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/GDP_per_capita_consumption_per_capita_and_comparative_price_levels), [accessed on 25.08.2010].

<sup>357</sup> CIA World Factbook, Cyprus, <https://www.cia.gov/library/publications/the-world-factbook/geos/cy.html>, [accessed on 25.08.2010].

as remote as the Canary Islands with respect to distance from both the European continent and the Pentagon region. Its economy shows dependence on few products and industries and its focus on tourism makes it vulnerable to economic conditions outside of its influence.

The question to be explored here is whether these small-island features had any influence on the accession arrangements negotiated with the Union.

## **2. Cyprus's Status Within the Union**

Formal membership talks with Cyprus opened in June 1998. Cyprus obtained several transitional arrangements and two permanent derogations. Transitional periods granted to Member States are enumerated in Article 24 of the Act of Accession. Cyprus's transitional periods are listed in detail in Annex VII and Protocol No. 10 of the Act of Accession.

Cyprus received seventeen transitional measures within the fields of free movement of goods, freedom to provide services, free movement of services, free movement of capital, competition policy, agriculture, transport policy, taxation, energy and the environment. In only one case, the treatment of urban waste-water, does the transitional period extend as long as to the end of 2012. The other transitional periods have already expired. Reviewing all of these arrangements goes beyond the scope of this essay. However, a quick glance will be taken at one of these temporary arrangements – that concerning Cyprus's offshore banking sector – since it may be regarded as important to the vitality of the small-island economy.

The growing significance of the offshore banking and financial service sectors in Cyprus was one of the most notable developments in the island's economy at the time of accession.<sup>358</sup> The protection of these sectors was thus a major concern to Cyprus. Cyprus did not, however, receive any special treatment in this regard but was granted a transitional period regarding the exclusion of cooperative credits and savings societies until the end of 2007, thus giving the country sufficient time to adopt the *acquis communautaire*.<sup>359</sup>

This shows that the motivation of Cyprus to be a member of the Union was not for economic reasons. Rather, it is considered to be political and related to the turbulent geopolitical environment experienced on a daily basis in this politically fragmented island.

Cyprus does not have any declarations attached to the Treaty. However, there are two protocols annexed to the Cyprus Accession Treaty. Protocol No. 3 deals with Akrotiri and Dhekelia, the Sovereign Base Areas of the United Kingdom in Cyprus. It was reviewed earlier in this essay and will not be discussed further. Protocol No. 10, the other protocol annexed to

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<sup>358</sup> Regular Report from the Commission on Cyprus (1998) *Progress towards Accession*, p. 25.

<sup>359</sup> Directive 2000/12/EC, OJ L 126 of 26.5.2000.

the Accession Treaty, refers to the issue of the Turkish part of Cyprus.<sup>360</sup> Since the subject of this protocol reflects the political state of affairs in Cyprus and is thus not related to small-island vulnerability, it is out of the scope of this essay. As an example of the flexibility of the Treaties, however, it is very relevant. A short assessment highlighting its main elements will therefore be provided.

As reviewed previously, the general rule of EU law is that the entirety of a Member State territory should be included in the *acquis communautaire* and permanent derogations from its applicability are rare. As mentioned earlier, Cyprus is geopolitically divided. Thus the officially recognized (Greek) government of the Republic of Cyprus does not have de facto power over the northern part of the island, which is under Turkish command. In order to find a solution to the Cypriot problem, the Union adopted Protocol 10. In Article 1 of the protocol, the full application of the *acquis communautaire* is suspended as regards the area of Cyprus de facto under Turkish command.

Thus, although the general rule in EU law is temporary transitions periods that have exact timelines, because of the special circumstances of Cyprus the Union has allowed for primary law derogation with no fixed end date, excluding a part of the island from applying to EU law, while other parts of the island are fully integrated. Also, if the political situation in Cyprus should be resolved, Article 4 of the protocol consents to a simplified procedure for incorporating the northern part into the European Union.<sup>361</sup> It should be noted that because of Article 20 TFEU (17 TEC) this exclusion from the scope of the Treaties does not affect the inhabitants of northern Cyprus's personal rights as EU citizens since they are de jure citizens of a Member State.<sup>362</sup>

Protocol 10 is an extreme example of a sui generis status and the flexibility of Union law. However, as established above, this special status is argued purely on political grounds and not on distinctive constraints due to their island status.

### **3. Assessment**

Cyprus matches the criteria of a small island as established in literature. In addition, it is remote from the European continent when compared to the Canary Islands. However, the accession arrangements that Cyprus and the Union negotiated, do not show any major

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<sup>360</sup> Protocol 10 on Cyprus, OJ L 236 OJ L 236 of 23.9.2003.

<sup>361</sup> Article 4 states: "In the event of a settlement, the Council, acting unanimously on the basis of a proposal from the Commission, shall decide on the adaptations to the terms concerning the accession of Cyprus to the European Union with regard to the Turkish Cypriot Community."

<sup>362</sup> European Community website, [http://ec.europa.eu/enlargement/turkish\\_cypriot\\_community/index\\_en.htm](http://ec.europa.eu/enlargement/turkish_cypriot_community/index_en.htm), [accessed on 25.08.2010].



differences in favour of the size and insularity characteristics compared to the somewhat larger and mainland new Member States.<sup>363</sup> Furthermore, with the exception of waste management, the temporary arrangements Cyprus received were not unusually long.

The permanent derogations Cyprus did receive were only on account of its vulnerable political situation and not on account of its vulnerability as a small island. The Cyprus protocols are nevertheless an example of the flexibility of the Treaties and the willingness of the drafters of the Treaties to take into account national diversity.

#### **D. Concluding Remarks**

Coming to the end of this comparative review on Malta's and Cyprus's negotiation arrangements, some final conclusions need to be drawn.

Cyprus and especially Malta are small-island states facing vulnerability issues associated with smallness, isolation and remoteness. Because of their smallness, their economies lack versatility and are highly dependent upon industries such as tourism, which are dependent on outside factors.

The Union has over the years recognised that small islands are facing particular vulnerabilities. This is not only evident in the earlier-reviewed Declaration No. 30 on island regions but also by reviewing the myriad special statuses small-island territories are enjoying in Article 355 TFEU and protocols annexed to Member States' Acts of Accession and Accession Treaties.

If the EU acknowledges that small-island status implies the need for specific arrangements, it clearly doesn't apply to small-island states. Malta did receive the largest number of arrangements of all the acceding Member States and Protocol No. 6 on acquisition of property in Malta may perhaps be regarded as an example of a derogation that takes Malta's smallness into account. However, other derogations were temporary or argued on grounds of other motives, such as conservation. Thus, all in all Malta did not receive any special treatment on account of its small island vulnerabilities. Cyprus did not receive any special small-island treatment and the only derogations it received were related to its fragmented political environment.

As regards island regions, the Gozo case, a poor and very small island region of Malta with a similar population as the prosperous Åland Islands and Saint-Barthélemy, reveals that small-island regions are not enjoying any special treatment - despite the fact that Malta clearly hoped for such an arrangement.

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<sup>363</sup> Azzopardi (2005) "Small Islands and the European Union", p. 11.

But what can be the reason for this inconsistent treatment of islands within the Union? Considering the Åland Islands and even the Canary Islands, extreme remoteness or low GDP are not the main criteria for small-island special status. It cannot go unnoticed that although it has not been directly included in any EU island criteria, it seems as if the key to a special status is a degree of autonomy of the island prior to the accession of the Member States of the island.

If a constitutional connection with a Member State is the key to being able to successfully negotiate special-status derogations from Union policies, this clearly points to a lack of a genuine recognition within the Union of small-island vulnerabilities. As mentioned before, enjoying the prerogatives of statehood and thus a different administrative status in EU law does not necessarily entail that small island states are better equipped to address the common handicaps accompanying a small island status. In fact, it may be argued that small island states are in an even more vulnerable situation than the semi-autonomous islands addressed earlier in this essay for, unlike semi-autonomous islands, island states do not have the backing of a mainland-based national authority but need to rely solely on their own financial and natural resources.

It may also be argued that the reason for this lack of small-island arguments in the Malta and Cyprus accession treaties is rooted in the want and thus arguably the need for a legal framework within which legal justification for differentiation mechanisms is sought. Thus, at the time of the fifth enlargement, the treaties did not provide a legal environment within which the permanence of island handicaps was directly addressed. Instead the focus was on the least favoured island regions and grounded on the solidarity between richer and poorer Member States. Furthermore, the Union defined islands not by their distinctive characteristics, such as being surrounded by water, but by whether they claimed a capital city.<sup>364</sup> If they did, they were not islands according to this criterion. While this is not a legal definition, it has been the one used by the Union's institutions in the past.<sup>365</sup>

The Lisbon Treaty introduced a new territorial dimension to the Union's cohesion policy. As addressed in Article 174 TFEU, it reveals a new and more explicit acknowledgement of island realities than previous EU Treaties have done. In addition, a joint Member State Declaration No. 33 has been annexed to the Treaties, which acknowledged that,

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<sup>364</sup> Opinion of the European Economic and Social Committee, point 2.1. C 27/123 of 3.2.2009.

<sup>365</sup> Opinion of the European Economic and Social Committee, point 2.2., C 27/123 of 3.2.2009.

with reference to Article 174 TFEU, island regions can include island states in their entirety, subject to the necessary criteria being met.<sup>366</sup>

The following chapter will review loosely this territorial aspect to the Union's cohesion policy and whether it may be the missing link to a coherent EU island policy that provides basic provisions for all islands by focusing on the permanent natural handicaps of small islands and not on their constitutional connection with a Member State.

## **VIII. Territorial Cohesion: The Future of EU Island Policy?**

### **A. Introduction**

Economic and social cohesion has been one of the principal objectives of the European Union since the Maastricht Treaty.<sup>367</sup> It is the Union's regional policy. Its aim is to ensure economic and social solidarity between the regions of the Union through the redistribution of its funds. Its main focus historically has been on the underdeveloped, less favoured or poor regions that are markedly worse off than the Union as a whole.<sup>368</sup>

With the ratification of the Lisbon Treaty in 2009, the European Union found itself assigned with a new objective, to promote economic, social as well as territorial cohesion. This has been regarded as a shift in focus from solidarity based on income to solidarity based on geography.<sup>369</sup>

The aim of this section is to legally analyse the scope of the Union's cohesion policy with a special focus on the newly added territorial-cohesion dimension and assess if it may be regarded as a legal basis for a coherent small-island policy within the Union. The importance of this review has to do with the fact that when Malta and Cyprus joined the EU in 2004, the effects of permanent and natural geographical attributes, such as those of islands, were not directly addressed within the Treaties. Regarding the case of Iceland, then, territorial cohesion can provide a new legal framework upon which Iceland can argue their arrangements with the Union in their own accession negotiations.

This section will begin with an overview of the cohesion policy. In Chapter C the focus will shift to a descriptive and legal analysis of the Union's territorial cohesion policy and its main legal paragraphs. Chapter D will assess the main conclusions and review whether

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<sup>366</sup> Declaration No. 33 on Article 174, TFEU, OJ C 83 of 30.3.2010.

<sup>367</sup> Notre Europe (2008) "Territorial Cohesion", p. 5.

<sup>368</sup> Eiríkur Bergmann (2009) *Frá Evróvision til Evru*, p. 121.

<sup>369</sup> Notre Europe (2008) "Territorial Cohesion", p. 2.

territorial cohesion as presented in the Treaties can be argued as a general framework for a small-island policy.

## **B. The Union's Cohesion Policy**

The current legal basis of the Union's cohesion policy derives from Article 3(3) TEU (ex-Article 2 TEU) of the Lisbon Treaty, which states that the EU shall “*promote economic, social and territorial cohesion and solidarity among Member States.*” Thus Union cohesion is among the fundamental objectives and priorities of the Union. Title XVIII of Part Four of the Lisbon Treaty, on the Union's cohesion policy, further defines this aim and provides the instruments that, according to the Union, are needed to achieve these goals.

While a definition of cohesion has never been written into the Treaties, it can be identified as the aim for “*economic equilibrium*” between (territories of) Member States and its citizens with regard to an equal chance of benefiting from the opportunities created by the unification of markets and the realization that without concrete Union action, that would be at risk.<sup>370</sup> This builds on the premise that the people of the Union share fundamental interests and therefore progress should be measured in terms of lifting the entire community in a fair and equitable manner.<sup>371</sup>

The issue of solidarity is the foundation of cohesion. According to *Jacques Delors*, the founder of the Union's economic and social cohesion policy,<sup>372</sup> solidarity is a crucial factor for the future development of the Union. If there is not a clear commitment to redress regional imbalances, the weaker economies may feel less inclined to participate in the further integration of the Union.<sup>373</sup> As such, cohesion has been perceived as central to the institutional unity and political solidarity of the European Union, not just on grounds of fairness or equality but on grounds of fears that any weakening in the resolve of richer Member States to promote cohesion will bring about a fragmentation of the Union.<sup>374</sup>

The Union's cohesion policy supports and generates differentiated treatment between (territories of) Member States “*in terms of the redistribution of resources*” “*...narrowly in terms of financial resources...from one Member State to others.*”<sup>375</sup> More than one third of the EU's budget is devoted to this policy.<sup>376</sup> The policy has typically looked to GDP per capita in

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<sup>370</sup> Barca (2009) “An Agenda for a Reformed Cohesion Policy”, p. 12.

<sup>371</sup> European Commission, *First Report on Economic and Social Cohesion*, 1996, p. 13.

<sup>372</sup> Barca (2009) “An Agenda for a Reformed Cohesion Policy”, p. 15.

<sup>373</sup> Michie (1997) “The Evolution of the Structural Funds”, p. 16.

<sup>374</sup> Roberts (2000) “*The Concept of Economic and Social Cohesion*”, p. 37.

<sup>375</sup> Tuytschaever (1999) *Differentiation in European Union Law*, p. 223.

<sup>376</sup> European Commission (2008) *Working for the regions*, p. 1.

purchasing power relative to the EU average, focusing on underdeveloped and backward regions that are markedly worse off than other territories as the main indicator and rationale for support from regional funding.<sup>377</sup>

Over the years, the Union has made specific provisions to meet specific situations. For example, on account of Protocol 6 annexed to the 1994 Act of Accession, a special Objective 6 was created within the framework of the cohesion policy for the ultra-peripheral areas in Finland and Sweden – in spite of a lack of the correlated GDP parameter – thus recognizing that they suffered from a development lag due to their low population density and harsh climate.<sup>378</sup> The same situation applies to the Outermost Regions, which, while no longer among the poorest regions, still benefit from a specific aid programme<sup>379</sup> “*to the offsetting of the additional costs resulting from their specific economic and social situation.*”<sup>380</sup>

As regards islands, they were not explicitly mentioned in the Treaties until ex-Article 158 TEC of the Amsterdam Treaty. However, the inherited geographical handicap relating to island status seems not to have been recognized. Rather the focus was on the islands’ GDP, singling out the poorest ones, and not on their geographical constraints.<sup>381</sup>

As mentioned above, with the Lisbon Treaty the European Union assigned itself with a new objective, that of promoting economic, social as well as territorial cohesion. In Article 174 TFEU, the predecessor of Article 158 TEC, islands are, for the first time, explicitly recognized as suffering from permanent natural handicaps unrelated to GDP. The following chapter will review this interesting legal development and whether territorial cohesion as presented in Article 174 TFEU may be regarded as a legal framework for a small-island policy within the Union.

### **C. Article 174 TFEU: Is This the Missing Link to a Future Island Policy?**

The concept “territorial cohesion” builds on the European Spatial Development Perspective (ESDP), which put the lack of a balanced and efficient sustainable structure of the European territory on the EU political agenda in 1999.<sup>382</sup>

A precise definition of this concept is not provided by the Lisbon Treaty, and at this point in time European institutions, local authority networks and scholars are still developing their own analysis as to its dimension and scope within the Union’s policy framework.<sup>383</sup>

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<sup>377</sup> European Commission (2003) *Structural policies and European territories*, p. 8.

<sup>378</sup> Protocol No. 6 on special provisions for Objective 6 in the framework of the Structural Funds in Finland, Norway and Sweden, OJ C 241 of 29.8.1994.

<sup>379</sup> Article 11, Regulation (EC) No 1080/2006, OJ L 210 of 31.07.2006.

<sup>380</sup> Point 12 in the preamble, Regulation (EC) No 1080/2006, OJ L 210 of 31.07.2006.

<sup>381</sup> Planistat Europe et al (2003) *Analysis of the island Regions*, p. 3.

<sup>382</sup> European Commission (2009) “Territorial Cohesion under the Looking Glass”, p. 1.

Reviewing the countless opinions available on the subject of territorial cohesion goes beyond the scope of this essay, and I invite interested parties to go further down that road. However, to date the following assumption may be drawn: Article 174 TFEU establishes that territorial cohesion is, among other things, a policy which is directing the Union's focus towards regions with permanent geographical handicaps. Furthermore, within the context of geographical handicaps, scholars and institutions alike seem to agree that territorial cohesion has a wide scope within EU law, which is to say, in order for the policy to reach its goals it needs to be more than a single remedial regional policy.<sup>384</sup>

Article 174 TFEU defines the aims for economic, social and territorial cohesion as follows:

In order to promote its overall harmonious development, the Union shall develop and pursue its action leading to the strengthening of its economic, social and territorial cohesion.

In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions.

Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition and regions which suffer from severe and permanent natural or demographic handicap such as the northernmost regions with very low population density and islands, cross border and mountain regions.

It is the last paragraph that adds the territorial focus to the cohesion policy by adding a sharper and more precise definition than the former Treaties of regions that *shall* be given particular attention within the framework of the cohesion policy. Specific natural and permanent geographical conditions are now by definition considered entitled to benefit under the EU regional policy. As *Kramer* points out:

the value of this legal statement is that the tendency to “limit regional and cohesion policies to only the poorest areas of the EU should be considered inconsistent with the Lisbon Treaty - an important indication for the ongoing controversial debate on Cohesion policy after 2013”.<sup>385</sup>

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<sup>383</sup> See examples of opinions on the issue of territorial cohesion in: Faludi (2006) “From European spatial development to territorial cohesion policy” p. 667 – 678, Notre Europe (2008) “Territorial Cohesion” and Informal Meeting of Ministers for Regional Policy (2009) *Reflection paper on future Cohesion Policy*.

<sup>384</sup> See for example: Notre Europe (2008) “Territorial Cohesion” p. 15 and non-legislative Resolution (24.3.2009) *Green Paper on territorial cohesion and the state for the debate on the future reform of cohesion policy*

<sup>385</sup> Kramer (2010) “The Impact of the Treaty of Lisbon on Regional Policy“, p. 6.

Article 174(3) explicitly refers to “*areas which suffer from severe and permanent natural or demographic handicaps*”. This conveys the idea of the relative inertness of territorial features. It suggests that the aim is not so much “*at reducing disparities*”, which seems to have been the aim of former Article 158 TEC, since permanent handicaps are hardly reducible, but rather to compensate for them in order to progress towards a similar level of competitiveness and sustainable development.<sup>386</sup> In other words permanent handicaps need permanent interventions.<sup>387</sup>

So, how will Article 174 TFEU and territorial cohesion apply to the status of islands and are they the missing link to a general and coherent small-island policy?

There are several new features provided by Article 174 TFEU. Thus, the Treaty-sanctioned handicaps and their permanent features may be regarded as creating a new perspective on the general rule of limited duration of differentiation mechanisms. Furthermore, as reviewed above, it is agreed that territorial cohesion needs more than a single remedial regional policy. Hence, while territorial cohesion is established within the framework of cohesion policy and therefore, *de jure*, only applies to regional aid as addressed in Article 174 TFEU, the horizontal nature or wide scope of territorial cohesion is generally acknowledged. Accordingly, territorial cohesion should become a part of all Union policies<sup>388</sup> establishing a legal basis to argue not only financial aid but also specific measures at a broader level on the basis of their handicaps.<sup>389</sup>

There is another interesting new feature associated with Article 174 TFEU. As loosely mentioned previously, the Union’s cohesion policy has used a specific definition of island when adopting its policies. This definition states that in order for a territory to be categorized as an island, it must fulfil specific criteria. An island has to have an area of at least one square kilometre, be situated more than one kilometre from the continent, have a permanent resident population of at least fifty people, have no permanent link with the continent and not house an EU capital. Obviously this last criterion excluded all island states from being regarded as islands.

When the small island states of Malta and Cyprus joined the Union, the limits of this definition became evident and the government of Malta suggested a change to include island

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<sup>386</sup> Schön (2005) “Territorial Cohesion in Europe?”, p. 391-392.

<sup>386</sup> Schön (2005) “Territorial Cohesion in Europe?”, p. 394.

<sup>387</sup> EPSON (05/05/10), *Euroislands*, p. 84.

<sup>388</sup> Notre Europe (2008) “Territorial Cohesion”, p. 15.

<sup>389</sup> Notre Europe (2008) “Territorial Cohesion”, p. 30.

states with an EU capital.<sup>390</sup> This is now addressed in Joint Declaration No. 33 of the Treaty of Lisbon. There it is stated that in reference to Article 174 TFEU on economic, social and territorial cohesion, island regions *can include island States in their entirety, subject to the necessary criteria being met.*<sup>391</sup> This would expand the scope of Article 174 TFEU to include Malta and Cyprus. Furthermore, Iceland, an extremely remote and isolated island in the North Atlantic Ocean, inhabited by 318,000 people, would obviously also fulfil these criteria.

Finally, Article 174 TFEU is designed to allow for a flexible interpretation in the sense that the rule establishes similar setback or handicap but is open to a case-by-case interpretation upon which specific demands of islands can be met. This is in line with small-island realities. EU island regions and island states are not a standardised group and their individual problems are unique and varied. Measures and solutions cannot be uniformly applied to all EU islands without taking this diversity into account. The complex conditions of islands (archipelagos, mountainous islands with low population density, offshore islands) need to be assessed on independently. As such, Article 174 TFEU can be regarded as providing a general legal acknowledgement of island realities and a foundation for a general legal small-island framework upon which to build special demands tailored to particular islands.

While Article 174 TFEU has many features that may be interpreted as a positive sign in relation to a general coherent small-island policy in EU law the position of the article gives rise to speculation about the scope of territorial cohesion. As it is defined within the framework of regional policy, territorial cohesion may be regarded as referring to the redistribution of funds. Hence, while a territorial approach is likely to be integrated into other Union policies with territorial features, it may become the position of the Union that the focus of territorial cohesion will be that of financial assistance and that it will not be perceived as a derogative legal framework in line with that of, say, the Outermost Regions. If interpreted in such a way, the legal effects of this otherwise general acknowledgement of island handicaps is narrowed somewhat.

It is likely that it will take some time before scholars, EU institutions and politicians reach an agreement about what constitutes an island status and what measures are to be provided in order to compensate for island handicaps. In this process it will be the task of the small-island regions and especially small-island states to increase the Union's understanding of how small-island vulnerabilities are affecting the islands.

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<sup>390</sup> Azzopardi (2005) *Small Islands and the European Union*, p. 12.

<sup>391</sup> Declaration No. 33, OJ C 83 of 30.3.2010.



Whatever will be the scope of Article 174 TFEU and territorial cohesion, it is nevertheless providing a generalised acknowledgement that islands have special handicaps and are in need of special attention from the Union, regardless of the islands' GDP per capita. This raises the awareness of policy makers and the public of territorial imbalances encountered by islands relative to mainland territories. As such this acknowledgement is an important step forward for the development of a small-island policy within the Union.

#### **D. Concluding Remarks**

Coming to the end of this section, its main findings need to be assessed. Territorial cohesion became the goal of the Union with the recently revised Lisbon Treaty and to date its meaning and scope is still being scrutinized by Member States, scholars, politicians and the Union's institutions. However, as Article 174 TFEU reveals it can be established that among its tasks is to focus the Unions attention towards regions with geographical handicaps and that from now on not only economic and social but geographical solidarity between (territories of) Member States needs to be addressed by the Union.

Article 174 TFEU clearly acknowledges that specific permanent geographical conditions, such as being an island, entitle a territory to benefit under EU regional policy. Focusing on the geographical handicaps of island status, not only the poorness of the region, and being established as permanent and hence unchangeable Article 174 TFEU is putting the general rule of limited duration of differentiation mechanisms and low GDP into a new perspective. Furthermore, it has been established that territorial cohesion is to have a broad scope within in the Unions policy areas. Thus his territorial focus of the Lisbon Treaty may be viewed as the grounds for a legal framework for not only financial regional aid but also "specific measures" at a broader level. However, the fact that territorial cohesion placed within Article 174 TFEU, the Union's regional policy framework, seems to indicate that the Union will be inclined to limit the function of territorial cohesion to the distribution of funds.

However, since territorial cohesion is still in its development stage the exact scope and aim of the Unions territorial cohesion can still be influenced and moulded to suit the needs of small islands and perhaps established as the framework for a general small-island policy. In that respect it will have to be the responsibility of small island regions and states to provide the Union and Member States with a thorough understanding of the vulnerabilities small-islands are facing and how small-island status can hinder economical development and competitiveness. In this pursuit the work of scholars and international institutions, especially the vulnerability index, will be of great value.

In that regard it is important to emphasise that, as this essay has revealed, islands are not a standardised group and their problems vary among themselves. Consequently, measures and solutions cannot be uniformly applied to all EU islands without taking their diversity into account. It may, for instance, be argued that small island vulnerabilities affect small-islands differently, depending on whether they are states or (semi-autonomous) regions. Thus, small-island states may be closer to their national government bodies than the remote non-European island regions, but the island states, in turn, have to confront their vulnerabilities with their own resources, whereas island regions at least have the backing of a larger national authority with more substantial means.

Finally, while it may be too early to determine in what direction territorial cohesion will develop the assumption may nevertheless be drawn that a treaty acknowledgement confirming that geography matters is, in its own right, an important statement which for instance Iceland could employ as a general legal argument when arguing differentiation demands in its prevailing accession negotiations with the Union.

## **IX. Closing Reflections**

This study was essentially aimed at determining whether there is a general small island policy within the European Union that allows differentiation in consideration of small island vulnerabilities and if there is a need for one. Small island policy is closely related to the somewhat controversial concept of differentiation within the Union. Accordingly, the various differentiation instruments in EU law, and their efficacy in providing a solution for small islands, were also a prominent part of this study.

Space constraints and the complexity of this largely unexplored topic prevented a more comprehensive review and consequently omitted many details. Having reviewed the Treaties' general and special provisions that permit differentiated treatment for islands, these final assumptions are presented.

Section II determined that regardless of the dogma for the uniform application of EU law, there exists more flexibility than meets the eye and that many differentiation instruments are used in light of national divergences. Sections IV, V and VI revealed that the most obvious exemplification of the flexibility of the Treaties is exhibited in the special statuses small islands are allowed within the Treaties. In fact, as the DOM and OCT status in Article 227(2) and (3) EEC of the Rome Treaty reveals, small-island differentiation has been a part of

the Union since the signing of the Treaty of Rome in 1957. This being established, one can state that not only uniformity but differentiation as well, is an integral part of the Unions legal order.

Some economists and international institutions, as well as the author of this study, maintain that small island states have specific and inherent characteristics that render them more vulnerable, indicating a need for special treatment for them to function on a par with states on the continent. The Member States of the Union seem to share that view and have declared that islands are suffering from specific permanent and structural natural handicaps.

A study of Article 355 TFEU reveals that small-island vulnerabilities have been considered in some of the agreements the EU has made with Member States regarding their islands. The two case studies in Sections V and VI determined that, with the Åland Islands and particularly the Outermost Regions, geographic and/or economic small-island vulnerability considerations were the criteria used in justifying differentiated treatment. Nonetheless, further examination of the Treaties reveals that there is inconsistency within the EU in the manner in which it deals with islands.

This inconsistency is not only shown in the complex picture of special relationships in Article 355 TFEU but one also notices a certain variation in the treatment of autonomous or semi-autonomous islands as opposed to the treatment of independent small island regions such as the Maltese Gozo and small-island states such as Malta and Cyprus. Thus, Section VII determined that while both Malta and Cyprus received permanent derogations, they were not based on small island vulnerabilities and in general their arrangements, particularly those of Cyprus, were no different from those of larger acceding Member States. If the EU acknowledged that islands have special needs, that acknowledgement was not considered nor applied in these instances.

It may be argued that the reason small island vulnerability arguments were not used in Malta's and Cyprus's accession negotiations is because the prevailing legal environment did not provide basis for such arguments. Thus, as determined in this study, island states were not categorized as islands at the time of the 2004 enlargement negotiations. Additionally, Article 158 TEC then in force, while acknowledging islands' less favourable circumstances, focused its attention on poor island regions.

However, it is my opinion that the Union has evolved in important areas since the 2004 enlargement and is now more openly admitting the realities and vulnerabilities of islands. As Section VIII reveals, the Union's goal for territorial cohesion as presented in Article 3 TEU and 174 TFEU is currently on the agenda and the Treaties now specifically

establish that islands, regardless of GDP, suffer from severe natural and demographic handicaps and merit special attention from the Union, for that reason alone. Interestingly, as Section V revealed, the same has occurred in the case of the Outermost Regions. Thus, their key criterion is no longer poor socio-economical development but their territorial differences as presented in Article 349 TFEU. This indicates a significant change in the Unions interpretation of “suffering” EU territories or a shift from a focus on GDP to that of geography, and establishes that the Union is essentially in agreement with the school of thought that views small islands vulnerability as related to permanent structural factors.

In the search for a small-island policy within the Union this study also researched the types of derogations or differentiation mechanisms available under EU law with the aim of establishing the unique features of each mechanism, its particular strengths and weaknesses when addressing small-island vulnerabilities and thus, what type of derogations are best suited as a framework around small island vulnerabilities.

It is my opinions that while the primary law derogations and exclusions reviewed in the Åland Islands case study have the advantage of security their lack of flexibility makes them an unattractive choice when addressing small-island vulnerabilities and that secondary law seem better suited as a legislative framework. In that regard, it is my view that the Outermost Regions status, as presented in Article 349 TFEU, has the attributes of a small island policy. The regime focuses on characteristics that are clearly related to small islands vulnerabilities and provides flexible secondary law solutions tailored to the needs of each island. However, as its applicants are precisely determined the relevance of Article 349 TFEU as a general small island policy is limited.

The newly added territorial cohesion, as defined in Article 174 TFEU, has the potential of becoming a generalised framework for a coherent small island policy. It establishes a manoeuvre for a rule that is open to a case by case basis interpretation and can change with time and circumstances. This is an important element for a small island policy because islands do not form a standardized group. However, the placement of the article within the Union’s regional policy indicates that Article 174 TFEU will essentially evolve around the redistribution of funds.

Shifting the focus to Iceland, the underlying goal of this essay was to determine whether Iceland could, on the basis of small islands’ inherent vulnerabilities, pave the way for a special status within the EU, or in other ways be used in the negotiation process as justification for derogations from the *acquis communautaire*.

It may be reasoned that Malta's and Cyprus's accession negotiations arrangements are proof that small-island states will not receive differentiation arrangements argued on account of small-island vulnerabilities. However, as the Treaties are now pushing forward a new territorial focus Icelanders now have available other legal arguments than those that were available at the time of Cyprus's and Malta's accession negotiations in 2004.

Furthermore, the comparative analytical method of this thesis has determined that Iceland has very unique features. As put forth in the study, Iceland is not only extremely remote and isolated; it has the smallest population of any island state in Europe and its economy relies on a fairly narrow range of products and Iceland is dependent on imports of essential products. In fact, while reviewing the Outermost Regions, the similarities with Iceland were striking. This should not be ignored as these vulnerabilities are acknowledged in Article 349 TFEU as justifying special arrangements such as derogations from common Union policies, some of which are of a permanent nature. Thus it would be sensible to maximise this position and Iceland's relative uniqueness in the negotiations with the Union.

Considering the determinations from this study it is to be expected that the European Union will be understanding and willing to protect Iceland's vital interests in the accession negotiations. Duly noted, it nonetheless difficult, if not impossible, to project the eventual outcome of the negotiations as it is ultimately the responsibility of the Council and Parliament to make the unanimous decision on the accession of a new Member State. This leads to the conclusion that it is in fact a Member State, which perhaps has a strong position in a particular field, that needs to agree to any eventual differentiation.

However, as summarized in Section II, objective differences are regarded as justifiable differentiation in EU law. Small-island handicaps on par with those of the Outermost Regions are seen as objective differences. It is essential to remember that differentiation mechanisms based on objective grounds are not discriminating towards other (territories of) Member States, but instruments correcting inherent discriminatory treatment which occurs when a territory in an unequal position, is obliged to adopt the one-size-fits-all approach for the sake of uniformity of EU law. As Section V revealed, this is one of the core arguments behind the derogative regime of the Outermost Regions. Thus, by establishing Iceland's uniqueness and similarities with the the Outermost Regions, Iceland might be providing the Union with the legal arguments it needs in order for it to establish grounds for differentiation on Iceland's behalf.

The increased acknowledgement of small-island realities in EU law is an important development, not only for Iceland's current negotiations but for all of the islands of the

Union. This recognition is also important in the context of future enlargement of the Union. Thus it cannot be overlooked that given the choice, small semi-autonomous islands such as the Faroe Islands, Channel Islands and Isle of Man have decided that it was in their best interest stay more or less out of the Union. Furthermore, upon gaining its home rule in the 1980's Greenland decided to leave the Union and is now one of the OCT's.<sup>392</sup> While not always directly conveyed, this decision is an indicator that small islands do not perceive the Union as providing small islands with the legal framework within which their vulnerabilities or vital interests are granted sufficient protection or consideration.

For the Union to truly reach its goals of cohesion and solidarity among its Member States it needs to provide a legal framework that makes it possible for small islands to engage in a European Union endeavour. Until a genuine small-island policy, accepting the differences between small-islands and larger continental states, is provided, it is foreseeable that small-islands will continue to be reluctant to trust the Union with their national interests.

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<sup>392</sup> Kochenov (2008-2009) "Substantive and Procedural Issues", p. 262

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