

## 12 Bilaterals II

### Reaching the limits of the Swiss third way?

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The assertions of the Swiss conservative right notwithstanding, the second Bilateral Agreements between Switzerland and the European Union have generally been acknowledged on both sides as another rather favourable deal for Switzerland. Indeed, banking secrecy has been preserved despite great European pressure, and participation in the Schengen and Dublin conventions, which was considered to be of great benefit for Switzerland in the domains of migration and the fight against crime, has been achieved. From this point of view, the second Bilaterals could thus be seen as a simple continuation of the long-standing strategy of Switzerland towards the EU, that is, taking advantage of European integration whilst minimizing its impacts on domestic institutions and economic interests, as outlined by Church's background chapter. However, although the negotiation process proved to be shorter than the first, as Dupont and Sciarini have just made clear, the tortuous nature of the negotiations also highlighted the ever more uncomfortable position of Switzerland vis-à-vis the EU. For many observers, this second batch of agreements may conceivably have marked the end of the Swiss "third way" between adherence and total closure, notably because bilateral negotiations with an enlarged and therefore more heterogeneous EU are very likely to become ever more difficult to conduct in the future.

The chapter provides a comprehensive account of the negotiations and ratification of the Second Bilateral Agreements between Switzerland and the European Union. We begin by presenting the major phases of the negotiations with a focus on its most important dossiers, namely taxation of savings and the fight against fraud on the one hand, and Schengen/Dublin on the other. We then address the ratification process in Switzerland and in the EU, and most notably the main themes and strategies of the actors involved in the referendum against the accession to the Schengen Area. Finally, we provide an assessment of these second bilateral agreements and suggest some possible paths Switzerland might take as regards its relations with the European Union.

#### **The negotiation process**

The second series of bilateral negotiations was meant to be the continuation of the approach developed by the Federal Council after the rejection of the EEA

treaty. Indeed, after the conclusion of the first set of bilateral negotiations, several dossiers of importance to the Swiss were still outstanding (processed agricultural products, statistics, environment, media, education, pensions and services). Accordingly, almost before the first bilaterals were done and dusted, Switzerland requested the opening of a new round of negotiations in order to carry on its strategy of gradual and selective integration. Above all, the Confederation sought to take part in the Schengen/Dublin convention on cooperation in the domains of security and migration.

Initially, the EU was rather sceptical about this option. Nevertheless, the negotiation process started because the EU itself had put in two new requests to Switzerland, which were urgent and decisive for the intensification of European integration. In particular, an agreement with Switzerland was a condition for the implementation of the directive on the taxation of savings, as well as for intensifying cooperation in the fight against fraud. In this context, the two parties agreed that negotiations should be conducted on a parallel basis, that is, taking account of the interdependence between the dossiers, and concluded simultaneously.

Hence, a new round of negotiations started in June 2002, and addressed the seven leftovers from the first series of negotiations; the additional dossier of importance to Switzerland (Schengen/Dublin); and the two topics required by the EU (taxation of savings and the fight against fraud). In March 2003, the two parties decided that negotiations in the area of liberalization of services would be postponed and continued separately, because of the complexity of the dossier. We now proceed to an analysis of the main dossiers and a shorter description of the secondary issues.

### *Taxation of savings*

Since the early stages of European integration, the harmonization of tax systems has been an important objective of the EU authorities. The reinforcement of European integration has been thought to require fiscal harmonization within the Union – in particular as regards the direct taxation of savings – in order to prevent “harmful tax competition”,<sup>1</sup> capital flight towards tax havens and to fight tax evasion.<sup>2</sup> The first draft for a directive providing for a harmonized system of withholding taxes was proposed as early as 1989, but the issue only really became critical in the late nineties, due to the financial difficulties of some member states.<sup>3</sup> In order to achieve this aim, the cooperation of Switzerland, who had been considered a “tax haven” for a long time, notably because of its well-known banking secrecy, was a major requirement for ensuring the compliance of member states. On the one hand, EU countries with a competitive fiscal system refused to take part if key third countries were not submitted to similar conditions. On the other hand, the existence of important loopholes in neighbouring countries would seriously undermine the efficacy of a unified taxation system at the EU level, since it would be easy to bypass it. Third countries would have a competitive advantage over EU members, and would attract a con-

sistent amount of supplementary fiscal resources from EU citizens fleeing harmonization, which was unacceptable for EU authorities.

A concrete proposal for a directive in the domain of taxation of savings, based on the “coexistence model” of different fiscal systems, was presented in 1998. Each member state could choose between imposing a withholding tax on the interest income of citizens who resided in another member state on the one hand, and providing information to those citizens’ state of residence on the other. However, at the Feira Summit of June 2000, there was a radical policy shift. The coexistence model was abandoned in favour of a system focusing on the automatic exchange of information. This was incorporated into a new draft directive on 18 July 2001. Clearly, the acceptance of this directive calls for the adoption and the implementation of “equivalent measures” by certain non-EU countries, particularly Switzerland.

The Confederation was forced to enter these negotiations, since it was eager to conclude agreements on several other topics important to it. The key aim for Switzerland was to have its proposition of a withholding tax recognized as an “equivalent measure”, and not merely as a transitional arrangement. This was done in order to block any form of automatic exchange of information,<sup>4</sup> because of the need to protect banking secrecy<sup>5</sup> which, as Church and his co-authors have shown, has a totemic status in Switzerland. Switzerland was, however, disposed to implement a system of administrative assistance on request to EU member states in cases of tax fraud. Swiss concessions continued in the third phase of negotiations in Brussels on 31 October 2002.<sup>6</sup> A revision clause to come into effect at the end of the transitional period was added to the putative agreement. Then in Zurich on 21 November 2002, the principle of the withholding tax was formally accepted,<sup>7</sup> i.e. the obligation for Switzerland to introduce a withholding tax on EU recipients of interest in Switzerland. This would amount to 15 per cent in the first three years, then 20 per cent for the following three years and 35 per cent in subsequent years. Furthermore, in case of tax fraud,<sup>8</sup> judicial assistance concerning “moral persons” was also admitted. On 28 November 2002 Swiss negotiators admitted mutual aid in case of tax fraud and “equivalent crimes”.<sup>9</sup>

On 12 December 2002 bilateral negotiations were interrupted because of divisions at EU level. Austria and Luxembourg made their renunciation of banking secrecy contingent on the conclusion of an agreement with Switzerland.<sup>10</sup> Subsequently, the ECOFIN Council of 21 January 2003 was able to find an agreement between member states by temporarily reintroducing a system of coexistence.<sup>11</sup> This solution presupposed an agreement with third countries, which would have to be compelled to exchange information on demand according to the 2002 OECD convention, at the same time applying the tax at source. When such a system is implemented, Austria, Luxembourg and Belgium would pass to the automatic exchange of information.

In doing all this Switzerland has agreed to align its policy on the taxation of savings on the European model. Switzerland also made several concessions so as to preserve the essential features of banking secrecy.<sup>12</sup> The point here is that

the OECD convention, cited in the ECOFIN agreement, stipulates that the exchange of information on demand should be possible even if the national legislation of the country from which the information is requested does not consider the object of the request as a crime.<sup>13</sup> This strongly contradicted the principle of “double criminality” advocated by Switzerland, according to which judicial cooperation can be granted only if the offence under scrutiny is punishable in the criminal laws of both the countries involved. As “mere” tax evasion is considered an administrative offence and is thus only punishable with a fine under Swiss legislation (as opposed to most other countries’ legislation), no international cooperation is granted by Switzerland on this subject. This is the real core of Swiss banking secrecy.<sup>14</sup>

The position taken by the EU clearly exceeded the mandate of Swiss negotiators, and would cause severe protestations at the domestic level. At this time, the Swiss government went on the attack over the ECOFIN agreement,<sup>15</sup> proposing a new version of the bilateral draft. Switzerland was now willing to make large concessions, offering especially a system of exchange of information on tax fraud and “similar fiscal crimes”. Moreover, Switzerland agreed to cooperate even if other states did not. It was nevertheless explicit that tax evasion was not concerned.

In compensation Switzerland asked both for the stability of the present agreement (based on taxing at source and some concessions concerning fiscal cooperation) with the aim of protecting the basic features of banking secrecy; and for participation in the advantages of another EU directive (i.e. that on abolition of the tax at source on dividends, interests and royalties paid by affiliated companies between Switzerland and EU member states). It also sought a compromise on other dossiers that were on standby, namely Schengen/Dublin.

Following this changed position, EU negotiators decided to accept the validity of the Swiss stance, thus inducing a real policy paradigm shift. Indeed, the EU went as far as to give up on its desire for a generalized and automatic exchange of information. The condition of respecting the OECD Convention was thus erased from the new draft and replaced by “a tax in conformity with domestic legislation”<sup>16</sup> requirement. This was possible because the EU needed an agreement in order to avoid loopholes in the fiscal system and, above all, because a 35 per cent tax at source with two-thirds of the proceeds from this being redistributed to member States was considered an excellent deal.

On 6 March 2003 an agreement was more or less agreed between the Swiss Federal Councillor Kaspar Villiger, the European Commissioner Frits Bolkestein, and the Greek Finance Minister and ECOFIN President Nikos Christodoulakis.<sup>17</sup> Nevertheless, the formal conclusion of the agreement was delayed once again, this time because of divergences among member states. Indeed, during the two ECOFIN Councils of 7 March, and 19–21 March 2003, Spain, Belgium, Austria and especially Italy were opposed to such an agreement. Their ministers particularly criticized the intrusion of Swiss amendments into the original European directive, claiming that Switzerland was imposing its standards on the EU.<sup>18</sup> Yet, after the resolution of some external questions concerning a few of these member

states (particularly, the cancellation of the fines concerning milk quotas), on 3 June 2003 – just before the end of the Greek presidency – the EU ministers of finance, by conceding the equivalence of the solution proposed by Switzerland, accepted the bilateral agreement on 6 March 2003.<sup>19</sup>

The essential features of the agreement are as follows:

- a final retention of 35 per cent levied by Swiss paying agents on interest payments to EU residents, 75 per cent of which will be shared among member states;
- a mechanism for voluntary notification allowing EU citizens to choose the EU system of exchange of information instead of paying the withholding tax;
- the exchange of information on request in cases of tax fraud or *the like*;
- a review clause that allows the contracting parties to reconsider the terms of the agreement;
- Swiss participation in the directive that abolishes tax at source on dividends, interests and royalties paid by affiliated companies between Switzerland and EU member states.

### **The fight against fraud**

At the same time as taxation of savings was being negotiated, the Swiss were also involved in parallel talks with a view to strengthening “administrative and legal assistance”, in other words international cooperation between administrative and judicial authorities on combating fraud, smuggling and other offences in the area of indirect taxes, subsidies and public procurement. Switzerland and the EU started negotiations in July 2001. Initial positions were somewhat apart.<sup>20</sup> Switzerland was only ready to discuss *specific* cases for which administrative and mutual assistance were to be increasingly provided. Conversely the EU was calling for the inclusion of all illegal activities which harmed their financial interests, by negotiating a comprehensive agreement on administrative and mutual assistance covering all activities that contravened indirect taxation regulations. After the fifth round Switzerland and the EU were still unable to agree upon a common formula for combating fraud.<sup>21</sup> The EU was putting forward the inclusion in the agreement of large tracts of EU legislation. On the contrary, according to the Swiss negotiators, the principles anchored in Swiss law to protect the core of banking secrecy (principle of double criminality, principle of specification<sup>22</sup> and suspension effect of appeal) could not be lifted. The sixth round went by without any appreciable advance being made.<sup>23</sup> Swiss negotiators did concede an extension of the scope of the accord, notably concerning the acceptance of the coercion measures. But the EU still required the adoption of the *acquis communautaire*.

Only during the seventh round of negotiations was it possible to partially overcome the deadlock.<sup>24</sup> Solutions were discussed which would, on the one hand, respect the Swiss legal principle of double criminality and, on the other

hand, also take into account the concerns of the EU about the need to speed up the appeals procedure by limiting it to one appeal and introducing the delegation of criminal prosecution and extradition for serious cases of tax fraud. Therefore, on 18 October 2002, the EU and Swiss delegations conducted negotiations for the first time on the basis of a specific draft agreement.<sup>25</sup> To a large extent, Switzerland accommodated to the EU during the negotiations on the steadily expanding set of issues. Switzerland would be prepared to implement coercive measures in a simplified form of administrative assistance. A new feature was that of implementing sanctions not just in customs duty fraud but also in professional customs duty offences (especially smuggling). Coercive measures would also be applicable in cases of qualified tax evasion and also in the case of administrative assistance.<sup>26</sup> However, the question of double criminality was still left open, because the EU demanded cooperation with regard to offences in case of simple tax evasion.

Although it might have seemed that Swiss negotiators' room for manoeuvre had come to an end, three Federal Councillors entered directly in the negotiations in order to overcome the deadlock. They persevered with the strategy which had inspired the whole bilateral way, that is, the principle of parallelism among all dossiers, and notably between taxation of savings, Schengen/Dublin and the fight against fraud,<sup>27</sup> arguing that nothing could be agreed until everything is agreed.<sup>28</sup> The consequent argument was then twofold. First, Swiss negotiators would not accept the withdrawal of issues already closed in other dossiers, notably the discussion about the principle of double criminality. In other words they considered that the core of the Swiss banking secrecy as defined in the agreement on the taxation of savings could not be threatened by a comprehensive definition of fraud. Second, negotiators asserted that Switzerland, having made several concessions concerning the taxation of savings, was now waiting for a helpful attitude of the EU over the agreement on Schengen/Dublin.

At the same time the authority of EU negotiators was considerably weakened by the positions of some member states, which were opposed to a harmonization of fiscal policy, an issue where unanimity is required. Those member states (particularly Luxembourg, Austria, Belgium) used the threat of veto to refuse any European regulation without the previous full participation of third countries (especially Switzerland), undermining the EU's ability to exert pressure<sup>29</sup> on Switzerland. The EU was then forced to accept the compromise proposed by Switzerland in the negotiations on taxation of savings, recognizing it as binding for all dossiers. As we have explained above, this draft contains several Swiss concessions, but maintains the core of Swiss banking secrecy.

We can summarize the contents of the final agreement, which followed from the EU concession, as follows:

- The agreement on combating fraud will provide for extensive cooperation between the Swiss and EU administrative and legal authorities within the scope of administrative assistance (cooperation between administrative authorities) and legal assistance (cooperation between legal authorities).

- Measures such as these will only be taken if the grounds for double criminality are given and if the amount involved in the offence exceeds EUR 25,000.
- It is requested that a judicial search warrant be provided.
- Switzerland's interpretation of money laundering remains unchanged. There are therefore no new notification obligations for Swiss financial intermediaries.

## **Schengen/Dublin**

On the Swiss side, the negotiations concerning the inclusion of Switzerland in the European Area of Freedom, Security and Justice through the entry into the Schengen and Dublin Conventions<sup>30</sup> were mainly guided by the desire to provide a more efficient response to illegal immigration and trans-national crime and a better – that is, above all, less costly – management of asylum migration. The most important point for Switzerland was to ensure access to the EU's information databases which constituted the main pillars of the Schengen and Dublin system: the SIS (*Schengen Information Service*) would allow Swiss authorities to know if people who tried to enter Switzerland had committed offences in the EU, whilst the Eurodac fingerprint database would permit them to know if asylum seekers arriving in Switzerland had already put in a request in a EU member state.

As argued earlier by Koch and Lavenex, the development of a common asylum policy in the EU (Dublin Convention) provided a strong incentive for Switzerland to cooperate with its neighbours. Since asylum seekers could no longer submit asylum requests in multiple member states, thanks to the rule on unique responsibility, the only alternative for those whose request had been rejected in a EU member state was to ask for asylum in Switzerland. Hence, taking part in the Dublin Convention was thought likely to bring about a lowering of the number of asylum requests and thus reduce the costs of the asylum system, which had become one of Switzerland's most debated issues in recent years, mainly under the pressure of the SVP. As regards Schengen, besides the security concerns which have arisen in Switzerland as elsewhere after the terrorist attacks of 11 September 2001, Swiss participation was also motivated by economic interests. Switzerland notably wanted to take part in the EU's common visa policy (Schengen visas), which was important for the tourism industry. This was because it was thought that extra-European tourists, and notably wealthy Asians, would avoid Switzerland were it necessary to request a supplementary visa. At the domestic level, these agreements benefited from the support of the left and the centre-right alike. For the centre-right, they were thought to improve security and reduce costs in the asylum system. For the left, international cooperation in the domain of asylum was thought to be likely to slow down the toughening of asylum regulations.

Negotiations started on 11 July 2002 in Brussels. Whereas there were no major divergences as regards the Dublin part, the negotiations were for a long

time deadlocked because of several points in the Schengen Convention. Two were particularly contested: automatic judicial cooperation, and the mechanisms of adoption of the Schengen *acquis* by Switzerland in the future.<sup>31</sup> As explained above, the first point was closely linked to the taxation of savings, in which Switzerland notably defended the principle of “double criminality”. As regards the adoption of the Schengen *acquis*, constraints imposed by domestic actors (mainly the SVP) and the institutions of direct democracy were very difficult to reconcile with the conditions imposed by the EU.

On the one hand, the SVP asserted from the outset that it would not accept any concession as regards Switzerland’s legislative sovereignty. According to the party’s direction, adherence to the Schengen agreement would introduce an unacceptable dose of supra-nationality into Swiss legislation, and constituted a backdoor admission: Switzerland could not exert any influence on the future evolution of the Schengen *acquis* and would have to adopt it unilaterally.<sup>32</sup> On the other hand, the EU also adopted a rather tough stance in this domain. As EU officials asserted many times during the negotiations, it was out of the question to negotiate an “à la carte” agreement with Switzerland. An important point of the negotiations on this issue was to determine if Switzerland, although a non-member, could have a say in the evolution of the *acquis*, and whether it could opt out in case this evolution would call its “vital interests”, notably banking secrecy and neutrality, into question.

For most of 2003, under the Greek and Italian Presidencies, negotiations remained in a stalemate. Although the Greek Presidency made several efforts to find compromises, its propositions were judged too generous towards Switzerland by its European partners, who notably refused them in COREPER in April 2003. At the end of 2003, the election of Christoph Blocher, leader of the SVP, as Minister in charge of the Schengen dossier made many observers foresee a definitive rupture in the negotiations. Indeed, no sooner had Mr Blocher been elected than he declared that an agreement on the Schengen issue was unnecessary, thus relaying the claims of his party.<sup>33</sup> However, he seems to have been overruled by his colleagues on the Federal Council, who wanted to go on with the bilateral talks on this dossier as well. Thereafter, Blocher proposed a “light” version of the Agreement comprising merely access to the EU’s SIS database and excluding the lifting of controls at the Swiss border, which was firmly refused by the EU.<sup>34</sup> In many respects, the concrete exercise of power in a collegial government constrained the SVP Federal Councillor to make several concessions at variance with his initial partisan claims.

In March 2004, the desire to conclude the agreement on savings encouraged a few member states, notably Germany, the Netherlands, Belgium and Luxembourg, to adopt a softer stance on the Schengen issue. Since Switzerland refused to sign the agreement on savings without having concluded the talks on Schengen/Dublin, concessions had to be made on this latter issue.<sup>35</sup> At this very time, the Schengen issue gained high media coverage in Switzerland when the German government abruptly decided to reinforce its border controls with “third countries” not part of the Schengen Area, which caused huge traffic jams at the



Swiss–German border. For partisans of the Agreement, this event was a demonstration of what could possibly happen if Switzerland remained outside the Schengen Area.<sup>36</sup>

A compromise was finally found in the spring of 2004, and was tightly linked to the outcome of the agreement on the taxation of savings. The principle of “double criminality” was guaranteed, thus preserving banking secrecy.<sup>37</sup> With regard to the future evolution of the Schengen *acquis*, although Switzerland gained no formal right of co-decision, it gained a participation right in the decision-making process. Moreover, the future evolutions of the Convention which will apply to Switzerland will follow the “normal” Swiss decision-making process, that is, will possibly be subject to referendum.<sup>38</sup> As a last resort, the Schengen Agreement could theoretically be cancelled in case the Swiss people refused a fundamental evolution of the *acquis*, Switzerland’s sovereignty thus “remaining fully respected”.<sup>39</sup>

### **The secondary dossiers**

Although the three related dossiers on tax, fraud and people caused the Swiss most difficulties, we should also not forget that there were a series of other issues which were resolved within the negotiations. And these were often of considerable importance to specific sections of Swiss government and society. They had often suffered some exclusion from wider European cooperation without the new deals. We treat these individually in turn.<sup>40</sup>

#### ***Processed agricultural products***

This agreement provides for the further liberalization of trade between Switzerland and the EU as regards processed agricultural food (namely chocolate, biscuits, soups, sauces, pasta, instant coffee). Customs duties had already been abolished on the manufactured part of these products, but some remained because of their agricultural components. In the framework of this agreement the EU has accepted that it will completely lift its customs duties on such Swiss products, as well as waive export subsidies. For its part, Switzerland will reduce its customs duties and export subsidies or, in certain cases, will abolish them completely as well. This agreement is thought to be of particularly great benefit to the Swiss industrial sector which, as is well known, is very competitive in this domain. For important Swiss agro-industrial companies, such as Nestlé, the conclusion of this agreement was the most important reason for engaging in the campaign for the acceptance of the whole package of bilateral agreements.

#### ***Media***

The main purpose of this agreement is the participation of Switzerland in EU policies on the creation, distribution and marketing of audiovisual production. The main features are provisions for cooperation amongst European producers

and the subsidization of filmmakers and television producers. After the 1992 rejection of the EEA, Switzerland's existing membership of the programme ended. Now, the agreement grants equal rights to the Swiss and EU audiovisual industry, so that they can both benefit from European support measures. This will require changes to Swiss legislation. Before ratification by the EU, a crucial point will be the satisfaction of quotas for European productions (fixed at a minimum of 50 per cent, with 10 per cent from independent producers). This agreement should notably facilitate the co-production of movies and TV programmes between Switzerland and EU countries.

### ***Education***

This agreement concerns the mobility of students, apprentices and young people within the framework of the Community programmes of general education, vocational training and extra-curricular work. The agreement will grant equal rights to Swiss citizens taking part in these programmes, and provide for the involvement of Switzerland in the development of future projects. Switzerland and the EU have decided to set up a series of bilateral meetings preparing the full participation of the Confederation in the next generation of programmes, which will be executed from 2007. This will give Swiss higher education full access to programmes from which they have often been excluded, and facilitate the exchange of students between Switzerland and EU countries.

### ***Pensions***

The aim of this agreement is to avoid the double taxation of pensions of retired EU officials living in Switzerland. Indeed, conventionally the EU enforces a tax at source on pensions paid to retired officials, whereas Switzerland subjects these people to federal, cantonal and local income tax on the net amount, i.e. after deduction of the European tax at source. As a solution, Switzerland has suggested the exemption of income tax on those retired persons. The EU and Switzerland have already ratified this agreement, and it entered into force on 31 May 2005, being applicable to pensions paid from the EU since 1 January 2006. The number of people concerned by this agreement is generally considered relatively small.

### ***Environment***

The agreement on environment provides for the adhesion of Switzerland to the European Environment Agency (EEA). Until now, Switzerland had only informally taken part in the EEA's activities, but will now be able to actively participate in and organize its projects and research. Switzerland will thus gain access to the EEA's pan-European data, and Swiss data will be included in the EEA's database. Swiss environmental policy, which had been an exclusively national matter so far, is thus becoming increasingly Europeanized, as is the case in other European countries.

### ***Statistics***

The agreement regulates the progressive harmonization of statistical data collection between Switzerland and the EU (Eurostat standards) in domains such as trade relations, labour market, social security, transport and environment. Switzerland also gains direct access to data published in the EU. Moreover, a greater proportion of Swiss data will be included in the statistics compiled by Eurostat. This should improve the comparison of data between EU countries and Switzerland, a country where public statistics have suffered from a notable underdevelopment.

### **Ratification**

The second bilateral talks between Switzerland and the EU were finalized in Brussels on 19 May 2004 during a meeting between the European Commission and Federal Councillors Deiss (President), Calmy-Rey (Foreign Affairs) and Merz (Finances), and were signed in Luxembourg on 26 October. In the end, the second series of bilateral negotiations resulted in nine agreements (processed agricultural products, statistics, pensions, environment, media, Schengen/Dublin, the fight against fraud, taxation of savings), which needed to be approved by the Swiss Parliament. The result of the negotiation on education, being formally a declaration of intent, did not need to be submitted to the chambers.

The Federal Council submitted the agreements as separate proposals to Parliament in December 2004. All of them were accepted with a clear majority in the National Council. In the Council of States, the result was unanimous except for Schengen/Dublin. This in fact met with somewhat more resistance in both chambers (accepted by 129 votes to 60 in the National Council and 36 to 3 in the Council of States). Immediately thereafter, the SVP and its “armed wing”, the AUNS, launched a referendum challenge to the Schengen agreement, which was to be voted on in June 2005.

As for the other Bilaterals, the agreement on processed agricultural products, ratified by the EU in January 2005 and by Switzerland in March of that year, came rapidly into force on 30 March 2005. The EU ratified the agreement on pensions in November 2004 and Switzerland followed in May 2005. So it too came quickly into force on 31 May 2005. The agreement on taxation of savings was ratified by the EU in February 2005, by Switzerland in May 2005, and it came into force on 1 July 2005. So far, the agreements on statistics, environment and media, ratified by Switzerland during the year 2005, are still waiting for ratification by the EU. The agreement on the fight against fraud has not yet been ratified either by Switzerland or by the EU. This is because the agreement has a “mixed” form and this requires that it should be approved by the 25 member states as well as by the Union itself. And this obviously takes more time.

***The referendum on Schengen/Dublin***

The referendum against the Schengen/Dublin agreements launched in December 2004 by the SVP and the AUNS was a cause of considerable concern for the Federal Council and business interests associations, who were very eager to see the second package of Bilaterals come into force. The SVP, who had been considerably emboldened by its victory over all other major parties and interest groups<sup>41</sup> in the vote on facilitated naturalization in October 2004, succeeded in collecting 85,000 signatures by April 2005, which was many more than the number required. Besides the SVP, the AUNS and other smaller far-right political groups, a number of extreme-left parties also opposed the Agreement on the grounds that it allegedly paved the way for a European police state that would seriously threaten civil liberties.

At the end of 2004, it was rather uncertain that Swiss citizens would accept the Agreement in the votation due for 5 June 2005. As a consequence, all major pro-bilaterals actors started the campaign very early on, and invested particularly important amounts of money in it. In doing this they showed they, in turn, had learned the lessons of what had worked for the first Bilaterals and what had not in 1992, just as Dupont and Sciarini have shown for the earlier ratifications.

Unsurprisingly, the SVP focused its campaign on the most symbolic and emotional part of the Schengen Treaty, that is, on the removal of systematic border controls within the Schengen Area. By contrast, this issue had not constituted a major point of disagreement in the negotiations, the creation of an area of free movement of people being the AFSJ's *raison d'être*.<sup>42</sup> On the one hand, the SVP claimed that the opening of borders, besides being a backdoor form of EU membership, would lead, amongst other things, to the entry of more foreign criminals, Islamic fundamentalists, clandestine workers and prostitutes. It would also cause greater unemployment and insecurity. Taking advantage of a scandal involving the German Ministry of Foreign Affairs, it strongly insisted on the supposed deficiencies of the visa allocation system of Schengen countries, who were said to distribute visas much too easily.<sup>43</sup> Conversely the government, political parties and major interest groups claimed that Schengen would on the contrary *strengthen* Switzerland's security through the access to the SIS database and the establishment of mobile controls.

The focus of the debates on Switzerland's inner security was a rather difficult area for partisans of the Agreement, since law and order was, as for other national-populist parties in Europe, one of the SVP's themes of predilection. Economiesuisse, Switzerland's most important employers' association, notably financed an advertising campaign in favour of the agreement that used "typical" SVP arguments.<sup>44</sup> Furthermore, one very interesting point of the campaign was the very strong dissensions between employers' associations and the SVP. In Swiss newspapers, the director of the Swiss Employers' Union, Peter Hasler, strongly criticized the stance adopted by the SVP on the Bilaterals issue, accusing the party of sabotaging Switzerland's international competitiveness. As a response, a SVP MP advised employers' associations to merge with trade

unions, for they no longer represented the interests of the Swiss economy. Beyond its anecdotal nature, this conflict raised several questions as regards the SVP's future positioning. The party had made several efforts to appear as the only representative of economic interests in the parliamentary arena, notably by championing financial austerity programmes and reduction in social benefits. In this case, nationalist arguments seemed to conflict with neo-liberal orientations within the party, as had already been the case in the past.<sup>45</sup>

Although opinion polls revealed a very clear lead for the "yes" camp at the beginning of the campaign, it seems that the SVP's publicity had a significant influence on undecided voters throughout the last weeks before the vote. Hence, according to various opinion polls, the opponents' camp grew from 21 per cent at the end of April to 35 per cent by late May, whereas the percentage of people who intended to vote in favour of the agreement declined from 62 per cent to 55 per cent in the same period. Many political actors now feared a further decline of the "yes" camp that would annihilate many years of painful bilateral talks.

In fact, on 5 June 2005 Swiss citizens finally accepted the Bilateral Agreement on Schengen/Dublin by a majority of 54.6 per cent, with a voter turnout of 56 per cent, which was significantly higher than the average turnout for popular votes (44 per cent for the period 1992–2002). The *Vox* analysis of voting behaviour, conducted shortly after the votation, showed that a majority of voters who had made up their mind in the last days of the campaign rejected the Agreement.<sup>46</sup> Hence, whilst the percentage of voters in favour of the Agreement seems to have remained stable in the last days of the campaign, the greater part of undecided voters finally chose to refuse the Agreement, as has already been the case in similar votes.

Unsurprisingly, party affiliation was the most determining factor in explaining voting behaviour. Hence, whereas sympathizers of the Social Democrats approved the agreement by 86 per cent, only 8 per cent of voters who declared themselves SVP supporters accepted it. The percentage of acceptance nearly reached 80 per cent for supporters of centre-right parties (Radical Democrats and Christian Democrats). Broadly speaking, these characteristics were closely linked with the socio-demographic profile of voters: people with a lower education level (compulsory school, apprenticeship), manual workers, independent workers and people with a low income, that is, the core of the SVP electorate, refused the agreement in a majority, whilst people holding a university degree or with an above-average income accepted it by a large majority. Among the reasons given by voters for refusing the Agreement, the most often cited was that they feared an increase of immigration – which might possibly threaten their social position – as a result of the opening of borders, whereas voters who accepted the Agreement mostly evoked the necessity for Switzerland to be open to the world.<sup>47</sup> In many respects, the results of the vote provided further evidence of the rise of a "new structural conflict between losers and winners of globalization" that cannot be explained by the left–right divide.<sup>48</sup> As had already been the case for other popular votes on issues related to the European Union or other supranational institutions, citizens who perceive themselves as possible losers

from this process tended to refuse changes, while people who do not feel threatened accepted them.

The Schengen Agreement will be enforced by the EU only when the European Council has decided unanimously that Switzerland is able to implement it, and after the conclusion of a series of agreements between Switzerland, Norway and Iceland; and between Switzerland and the EU. One contested point as regards the ratification of the Agreement has been the fact that it could be bound to Switzerland's contribution to enlargement. A solution seems to have been found in this issue, Switzerland having proposed a "memorandum of understanding" providing for the payment of one billion francs within five years.

## **Conclusions**

The second bilateral agreements have been considered by the Federal Council and by the vast majority of Swiss political and economic actors (the SVP and the far right notwithstanding) as a very satisfying deal. In fact, Switzerland's key requirements – the conclusion of all dossiers, notably Schengen/Dublin, and the protection of banking secrecy, especially in the dossier on the taxation of savings – have been fulfilled. With regard to Schengen/Dublin, at least in the area of direct taxes, banking secrecy remains protected, and even legitimized. Should a future Schengen provision give rise to an obligation for legal assistance with regard to tax evasion offences, Switzerland has obtained an "opt out" clause. Concerning the fight against fraud, the definition of money laundering according to the Swiss Criminal Code remains unchanged, and there are no new reporting requirements for Swiss financial intermediaries. However, Swiss fiscal policy is now tightly linked with that of the EU. As regards Schengen and Dublin, the main aims of the Federal Council have also been attained.

The outcome of the negotiations has been considered positive on the EU side as well, the main aim of the European negotiators being to find quickly an agreement on the taxation of savings in order to harmonize European fiscal policy.<sup>49</sup> Due to the discrepancy of interests between member states, and in a very stringent institutional environment (unanimity rule), the EU was not able to exert sufficient coercive pressure on Switzerland (whose domestic actors displayed a fairly cohesive position on this issue) to induce a more radical policy shift on the Swiss side. Indeed, a tougher stance could have caused the failure of negotiations. Thus, even if the EU had to give up on the automatic exchange of information, it was realistic enough to accept a solution considered satisfying in the medium term, a global agreement linking Swiss policy to the EU, with a tax levied by Swiss paying agents, the revenue of which will be shared with member states.

On the Swiss side, the bilateral way has constituted a rather good functional equivalent to adhesion to the EEA, and much more than a simple substitute because, thus far, Switzerland has obtained several of the advantages of EU membership whilst paying a very low cost as regards economic interests and domestic institutions. Nevertheless, the bilateral strategy currently suffers from

two sets of related limitations. A first set of problems is inherent in the content of these agreements, and most notably in the domain of taxation of savings. First, many provisions remain quite ambiguous and subject to divergent interpretations, namely the concept of “tax fraud *or the like*” as regards the exchange of information. The effective implementation of this norm could therefore give rise to a certain number of conflicts in the future. Second, the existence of a few *loopholes* in the agreement challenges the efficacy of the tax at source, which is said by experts to be easy to avoid by individuals with some simple measures of fiscal optimization.<sup>50</sup> This point, if it proved to be true, could eventually upset member states. Finally, the existence of a revision clause for the agreement on the taxation of savings is revealing of the willingness of the EU to implement a more constraining version of exchange of information in the long run, which could undermine the entire range of agreements. Indeed, it seems very unlikely that Switzerland will agree to make further concessions on this subject.

The second set of limitations is related to the continuation of the bilateral way. First, bilateral negotiations imply long and difficult procedures, whereas the results, even if satisfactory, are fragile and likely to become rapidly obsolete because of the ever-evolving nature of European integration. For instance, the extension of the free movement of persons to Romania and Bulgaria promises further emotional and uncertain voting battles in the years to come. Second, bilateralism will indisputably become harder with an enlarged EU, where the interests of member states are more and more heterogeneous, in particular on topics where a qualified majority or unanimity is required.<sup>51</sup> Yet, as argued elsewhere in this volume, *Alleingang* is not economically sustainable for Switzerland, and full EU membership is at the moment not a politically feasible solution, mainly because of direct democracy and the importance of the SVP, which has (successfully) built a great part of its electoral strength on opposition to Europe.

Considering these constraints, alternative options that could reconcile domestic constraints and functional needs are rather scarce besides the long and tortuous bilateral path.<sup>52</sup> Among the options evoked, one can mention adhesion to the EEA – more than 15 years after its rejection by the Swiss people – or a “framework agreement” that could merge all existing agreements and be steered by a joint committee empowered to regularly update agreements in line with the evolving *acquis communautaire*. This latter solution has notably been evoked by Micheline Calmy-Rey, Federal Councillor in charge of Foreign Affairs.

Another hypothetical option could be a “light” adhesion of Switzerland to the EU, that is, an adhesion that would provide for derogations in domains affecting domestic institutions. If this solution is very unlikely to materialize in the short term, enlargement might possibly provide a more favourable opportunity structure for such an “à la carte” solution in the medium or long term. Indeed, many analysts think that the increasingly heterogeneous nature of the EU as regards socioeconomic conditions and the discrepancy of interests between member states might require a more flexible and less constraining integration process, which could fit better with Swiss domestic constraints. Yet, in order not to give

up on its main electoral theme, the SVP can be expected to strongly oppose this solution in the future as in the past.

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