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### **SWITZERLAND-EU RELATIONS – BETWEEN ECONOMIC INTEGRATION AND BILATERALISM**

#### **Abstract**

Switzerland's foreign policy priorities include, among other things, relations not only with neighbouring countries, but also with the EU. Being a country which is located in the heart of Europe, Switzerland considers the relations with the European Union (EU) and its Member States to be of special importance. The paper aims to present mutual relations between Switzerland and the European Union over the past years, demonstrate benefits and threats arising from Switzerland's decision to choose, as the only one of all third countries, a path of "bilateral agreements", as well as describe possible scenarios for mutual relations following the rejection of an institutional agreement, which was expected to put that relationship on a new path. The strategy of bilateralism brings many benefits to Switzerland. However, due to the firm position of the EU, it will be necessary to look for new scenarios for the development of mutual cooperation. Perhaps such a solution would be to renegotiate the free trade agreement with Switzerland and turn it into a next-generation trade agreement.

**JEL classification:** F13, F15, F53

**Keywords:** Common Commercial Policy, the European Union, trade agreements, Switzerland-EU relations, economic integration, bilateralism.

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## Introduction

Switzerland's foreign policy priorities include, among other things, relations not only with neighbouring countries and their border regions, but also with the EU. Being a country which is located in the heart of Europe, Switzerland considers the relations with the European Union (EU) and its Member States to be of special importance. The country has very strong economic, political and social ties with the bloc. One of the goals of Switzerland's European policy is to create the best possible framework for long-lasting and mutual relations with the most important economic and political partner, while bringing benefits to all parties.

Switzerland is one the EU's major trading partners (in 2021, it was the fourth largest player, in terms of trade volumes (exports + imports), following China, the USA and the United Kingdom, having a share of 6.5%). Trade dealings with the European Union account for almost a half of Switzerland's trade (45% in 2021). The export of Swiss goods to the EU is concentrated on several sectors, specifically, the chemical/pharmaceutical and medical industry (EUR 54.4 billion, 44%), machinery and equipment (EUR 15.6 billion, 12.6%), pearls and precious stones (EUR 13.8 billion, 11.2%) and optical and photographic instruments (EUR 11.3 billion, 9.2%) (Table 1). Switzerland is a very relevant partner of the EU as regards trade in services, in particular, services provided for commercial purposes. In 2020, the total bilateral trade in services amounted to EUR 162.7 billion, accounting for 9.1% of the aggregate trade in services in the EU (Eurostat data).

**Table 1. EU-Switzerland Trade in EUR billion and %**

	IMPORTS					EXPORTS				
	2017	2018	2019	2020	2021	2017	2018	2019	2020	2021
<b>Value</b>	99.1	101.9	109.9	108.9	123.7	132.0	134.6	146.5	142.3	156.5
<b>Share in Extra-EU, in %</b>	5.6	5.3	5.7	6.3	5.8	6.6	6.5	6.9	7.4	7.2
<b>Main Goods (% of the total) (HS section)</b>	Products of the chemical or allied industries (44,1)(VI); Machinery and appliances (12,6)(XVI); Natural or cultured pearls, precious or semi-precious metals, stones and articles thereof (11,2)(XIV); Optical, photographic, measuring, medical instruments, parts and accessories thereof (9,2)(XVIII)					Products of the chemical or allied industries (23,3)(VI); Machinery and appliances (15,5)(XVI); Vehicles, aircraft, vessels and transport equipment (9,2)(XVII); Natural or cultured pearls, precious or semi-precious metals, stones and articles thereof (7,0)(XIV)				
<b>Switzerland's Major Trading Partners (% of the total, 2021)</b>	IMPORTS					EXPORTS				
	EU27 (49.1); the United Kingdom (11.3); the USA (7.4), China (6.2)					EU27 (41.7); the USA (16.6); China (8.7); India (8.3)				

Source: Own elaboration based on: (European Commission Trade Statistics, 2022)

The European integration has been a political and economic challenge to Switzerland throughout the past 60 years, the Swiss could not be, nor are they now, indifferent to the progressing integration of Europe. Most referenda on the European integration was held in Switzerland, where citizens voted at least 17 times, directly or indirectly, on the issue concerning their relations with the EU (Schwok, 2020, p. 60).

The paper aims to present mutual relations between Switzerland and the European Union over the past years, demonstrate benefits and threats arising from Switzerland's decision to choose, as the only one of all third countries, a path of "bilateral agreements", as well as describe possible scenarios for mutual relations following the rejection of an institutional agreement, which was expected to put that relationship on a new path. One scenario is to renegotiate the free trade agreement of the 1970s and turn it into a new-generation trade agreement. Possible scenarios for the development of mutual relations, indicating the real possibilities of their implementation are the added value of this study.

### **1. Stages of Switzerland's European Policy – Genesis and Main Provisions of Bilaterals I**

Given the relations between Switzerland and EEC/EU, four main stages can be distinguished (Kozłowski, 2015, p. 59):

- Stage 1 (1951-1972), covering the period from establishing European Communities to signing the 1972 Free Trade Agreement between Switzerland and the EEC;
- Stage 2 (1973-1987), the beginning of which was marked by the entry into force of the Free Trade Agreement with the EEC, and the end – by the creation of the single European market;
- Stage 3 (1987-1992), which was characterised by a policy for strengthening Switzerland-EU relations, as well as the European Economic Area (EEA) Agreement signed in Porto in 1992;
- Stage 4, after 1992, the beginning of which can be seen as a substantial change in the course of action for Switzerland's integration policy, following a referendum held in December 1992, when Switzerland refused to be a member of the EEA.

The free trade agreement covering trade in industrial articles (goods included in sections 25-99 of the Brussels Nomenclature) was concluded on 19 December 1972, entered into force on 1 January 1973, and as a consequence of the said instrument, customs duties imposed on industrial products in trade between the European Community and Switzerland were abolished on 1 July 1977. This is one of the oldest trade agreements signed by the EU. It does not contain any provisions on services,

investments, intellectual property rights, government procurements, nor social and environmental issues (Regulation (EEC) No 2840/72 of the Council of 19 December 1972).

On 26 May 1992, the Federal Council filed an official application for the commencement of accession negotiations. However, Switzerland did not conduct a referendum on its membership of the European Union (Kux, Swerdrup, 2000, p. 252).

Three of EFTA countries, namely Iceland, Lichtenstein and Norway, are currently bound by the 1992 European Economic Area (EEA) Agreement. Switzerland signed the Agreement, but eventually, did not join the EEA on account of the unfavourable result of a referendum conducted on that issue (6 December 1992)<sup>2</sup>. The 1992 vote divided the country (Seitz, 2014, p. 149; Mueller, Heidelberger, 2019, p. 188). The idea behind the EEA is to create for Member States a common market in industrial goods (without agricultural and fishery products), persons, services and capital. EFTA countries being the members of the EEA have not adopted the Union customs tariff and are not involved in the common commercial policy, nor in the common agricultural or fisheries policy.

As the vote on the EEA was “no”, there were no grounds for entering into accession negotiations, hence in January 1993, the Bundesrat declared that the commencement of accession negotiations would be suspended for some time. After the negative result of the December 1992 referendum, the Swiss government had to hastily reframe its concept of integration policy with the European Union. At that time, a new strategy of Switzerland’s integration policy was implemented, and its main instrument was bilateral agreements, also known as sectoral agreements – a strategy of bilateralism (bilateralism)<sup>3</sup>. The EU accepted bilateralism as an interim solution, expecting that it would result in Switzerland’s full membership over time<sup>4</sup>. Key importance must be attached to two basic elements of the strategy of bilateralism, both of which are correlated with each other (Kozłowski, 2015, p. 62):

- Entering into sectoral bilateral agreements, which cover important areas of co-operation;
- Adapting or incorporating the EU *acquis* into the Swiss legal system.

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<sup>2</sup> In Switzerland, all important international treaties must be put to a mandatory referendum.

<sup>3</sup> The strategy of bilateralism was referred to in the literature also as virtual membership, integration without membership or quasi-membership (Popławski, Starzyk-Sulejewska, 2012, p. 73; Kozłowski, 2015, p. 59).

<sup>4</sup> However, that never happened, and, conversely, in 2006, Switzerland announced that EU Membership was no longer a strategic goal of the integration policy (Europabericht, 2006, p. 6825).

That strategy has been pursued so far under two packages of bilateral agreements – *Bilaterals I* (BAI) and *Bilaterals II* (BAII). This two-way method of regulating mutual relations can be divided into three periods. The first period began in 1993, when negotiations on the first series of bilateral agreements, BAI, were opened. The first agreement package is comprised of seven co-operation agreements between Switzerland and the EU, which were signed on 21 June 1999, but entered into force on 1 June 2002. These agreements concerned:

- Freedom of movement;
- Land transport;
- Air transport;
- Scientific and technological cooperation;
- Public procurement;
- Trade in agricultural products;
- Technical barriers to trade (the mutual recognition of standards and conformity assessments).

All bilateral agreements, except for the Agreement on Scientific Research, take the form of arrangements providing Switzerland with access to a specific segment of the European market<sup>5</sup>. These seven agreements are legally related to each other by a so-called “guillotine clause”, which stipulates that where one agreement is terminated, the other instruments will cease to have effect six months later.

The Agreement on the Free Movement of Persons is considered the most important of all agreements included in the BAI package (*Abkommen zwischen der Schweizerischen Eidgenossenschaft einerseits und der Europäischen Gemeinschaft und ihren Mitgliedstaaten andererseits über die Freizügigkeit*). That agreement enables Swiss citizens to enjoy the freedom of choice as regards a workplace or a place of residence within the EU, the same right is applicable in Switzerland to EU nationals. The condition which Swiss and EU citizens must fulfil in order to be allowed to settle in another country is having health and accident insurance, and if they are employed, they need to have a valid contract of employment or, where they conduct an activity as self-employed persons or are not employed, must have enough funds to meet the cost of living. The agreement also governs the mutual recognition of professional qualifications and the coordination of national social security systems. And finally, the agreement enables the cross-border provision of services on a short-term basis (not longer than 90 days in a year) (*Agreement between the European Community and the Swiss Confederation on trade in agricultural products*).

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<sup>5</sup> For more information about *Bilaterale I* see: (Kozłowski, 2010; Oesch, 2020b).

The free movement of persons is supplemented in Switzerland with so-called accompanying measures (*Begleitendemaßnahmen*), in order to prevent wage and social dumping. It refers, among other things, to the rule under which own citizens are given the priority to be employed, and as part of so-called accompanying protection measures, inspections were carried out to check wages and work conditions (Abkommen vom 21. Juni 1999 zwischen der Schweizerischen Eidgenossenschaft einerseits und der Europäischen Gemeinschaft und ihren Mitgliedstaaten andererseits über die Freizügigkeit).

In 2020, about 1.4 million EU citizens lived in Switzerland, compared to about 400,000 Swiss citizens residing in the EU. Another 343,809 EU nationals cross the border every day to work in Switzerland. Given the total workforce of 5.1 million people, around 25% – that is to say, more than 1.28 million people – are EU citizens (of which 343,809 are cross-border workers (European Commission, 2021).

The Agreement on Land Transport opens the road and rail transport market for the carriage of persons and goods between Switzerland and the EU. The purpose of the agreement is to create comparable conditions for market access and competition for transport companies from Switzerland and the EU. At the same time, it forms a contractual basis for introducing and gradually raising a charge on heavy vehicles (trucks) (Leistungsabhängige Schwerverkehrsabgabe, LSVA), in transit via Switzerland, which is aimed at reducing road transport in favour of carriage by rail. In exchange, Switzerland accepted a gradual increase in weight limit for trucks from 28 to 40 tonnes (since 2005). Under the agreement, Swiss carriers are allowed, e.g., to transport goods from one EU country to another (“large-scale cabotage”). The only exception to opening the market is so-called “small-scale cabotage” (domestic transport by foreign companies). Other restrictions in Switzerland, such as a ban on night and Sunday truck traffic, remain in force.

In the area of carriage of goods, railway companies have better mutual access to rail networks. In particular, this has a beneficial effect on transport companies which are engaged in international combined transport (trucks or containers loaded onto a train). Both parties have also committed themselves to improve railway infrastructure.

The air traffic agreement provides Swiss airlines with equal access to the deregulated EU market on a reciprocal basis. Unlike the other agreements included in the Bilaterale I package, the air agreement meant the incorporation of the whole EU *acquis* regarding air law by Switzerland, that is to say, it is updated on a continuous basis in accordance with new EU regulations. As a consequence of being admitted to air traffic on the liberalised EU market, Swiss airline companies have attained the position equal to that of European competitors (Integrationsbüro EDA/EVD, 2008, p. 39). The fact that

the European prohibition of discrimination on grounds of nationality applies to them and that they have the right to acquire majority shareholdings of EU airline companies reflects the foregoing view. Further, important solutions were introduced, e.g. the freedom to choose flight routes, transport rates and the size of aeroplanes. As regards airline passengers, the agreement ensures lower prices and the greater availability of air connections.

The Agreement on Scientific and Technological Cooperation, made as part of the Bilaterals I package, is a considerable improvement of the 1985 Agreement, making Switzerland one of the five “associated countries” (the others include the remaining EFTA countries and Israel) taking part in five EU framework programmes for research.

The EU-Switzerland Public Procurement Agreement is based on the WTO agreement on public procurement markets. This multilateral agreement laid down rules for calls for tenders made by national, regional and district authorities in the area of the water, public transport, power and construction sectors (with certain restrictions) based on the equal treatment (non-discrimination) principles, transparent procedures and law, legal appeal against the outcome of a tendering procedure and contract awards (of a specific value) (Abkommen zwischen der Schweizerischen Eidgenossenschaft und der Europäischen Gemeinschaft über bestimmte Aspekte des öffentlichen Beschaffungswesens). The bilateral agreement on public procurement goes beyond the APM scope and covers also the telecommunications industry and railway companies, the power sector (i.e. gas, oil and coal, except for electricity), as well as contracts awarded by local governments and private companies (Vahl, Grolimund, 2006, p. 28-29).

The whole idea behind the agreement on trade in agricultural products is to reduce tariff and non-tariff barriers, covering those market segments which are of particular importance to Switzerland and the EU. As regards tariff concessions aimed at reducing customs duties, full liberalisation – taking place from 1 June 2007 – of trade in cheeses, fruits, vegetables and wine was of the greatest relevance to Switzerland.

Another agreement provides for the mutual recognition of conformity assessments relating to standards (certificates, tests, marketing authorisations, etc.) for several groups of industrial products (which in the EU are governed by so-called new approach directives): such as construction machinery, medicinal products, the control of the production of pharmaceuticals (although this does not apply to permissions for sale of medicines), toys, motor vehicles, tractors, telecommunications systems, measurement instruments; boilers and gas heating equipment, electric and electromagnetic compatibility equipment, equipment for potentially explosive atmospheres, personal protective equipment, pressure vessels. Under the agreement, the Swiss law is regarded as equivalent with EU legislation, which simplifies procedures and reduces exporters’ costs

for exporters and importers from the EU/EEA and Switzerland. In respect of the areas which are not covered by the agreements, where Swiss and EU requirements do not converge, for instance, in the case of some chemicals, plant-health products, biocides and construction products, still two conformity tests will be necessary, even though both of them may be carried out by Swiss authorities (Vahl, Grolimund, 2006, p. 26). In other words, the agreement reduces bureaucratic impediments to and administrative costs for exporters and importers from the EU/EEA and Switzerland. It must be updated on a regular basis to incorporate relevant new EU legal acts into the agreement (i.e. relating to product standards). This is usually a routine procedure, however, in view of a lack of progress in negotiations of the framework agreement, which will be discussed below, the EU announced that it would refuse to incorporate new EU legal acts into the agreement on mutual recognition or had already taken such measures. The Medical Devices Regulation 2017/745 has been effective in the entire EU since May 2021 – however, it has not been incorporated into the agreement so far (Swiss Medtech, 2021), which hinders free access to the market and has already resulted in administrative impediments and extra costs (SQS, 2021). Similar consequences are expected soon in relation to the failure to incorporate the In-Vitro Diagnostics Regulation 2017/746 into the agreement (Meier, 2021). As far as the value is concerned, the agreement covers two-thirds of trade in industrial products between Switzerland and the EU (SECO, 2021).

A report prepared by the federal government one year after the entry into force of Bilaterals I contained an assessment which was “cautiously positive” (Bilaterale Abkommen I Schweiz-EU: Erste Erfahrungen ein Jahr nach Inkrafttreten). It was based on a survey conducted in private and public institutions. Concerns over “the flood of immigrants” and “an avalanche of trucks”, which were voiced by many opponents, have never proved to be true. Relatively small migration from the EU and reducing truck transit traffic through the Alps were considered the greatest achievements. In 2002, the number of trucks at four transit points declined by 9%. The number of trucks decreased, despite a 2% rise in the volume of goods transported by road through the Alps. This means that greater transport volume was handled by fewer trucks, whereas average vehicle load capacity rose considerably.

## **2. Second Period of Bilateralism – Bilaterals II**

The second period of bilateralism was marked by the consolidation and expansion of the bilateral way. It began in 2002 with the effective implementation of a set of BAI agreements and the signature of a series of new BAI bilateral agreements. After entering into BAI, the European Commission was essentially sceptical about new negotiations with



Switzerland. The reason why the second round of bilateral talks took place, despite that scepticism, was the fact that the following two issues became relevant to the EU: firstly, Switzerland should be included in a cross-border savings taxation system planned by the EU. Secondly, closer co-operation with Switzerland on the fight against indirect tax frauds (especially cigarette smuggling) was desired.

In mid-2002, Switzerland and the EU resumed negotiations on ten areas, of which seven were leftovers (LOs) (omitted in the package I). In autumn 2004, Switzerland and the EU signed Bilaterals II, which, unlike Bilaterals I, do not have any legal relationship. The agreements are not linked by a guillotine clause. The link exists only for the Schengen and Dublin Association Agreements (a “mini guillotine”). In Switzerland, these two agreements – the only ones which were disputable – were approved in a referendum, receiving 54% of the vote (Oesch, 2020a, p. 23). They were introduced gradually in the period from 2005 to 2009. Another package of sectoral agreements includes:

- Switzerland’s participation in the Schengen and Dublin agreements (co-operation between the police and judicial authorities, the coordination of an asylum and migration policy (LO));
- Processed agricultural products;
- Statistical collaboration (access to Europe-wide data and the conformity of Swiss data with Eurostat’s standards);
- Education (participation in EU educational programmes): Socrates, Erasmus, Leonardo da Vinci, Youth);
- Fight against tax frauds (LO);
- Pensions;
- Participation in the EU Media programme (promoting the production and distribution of European films). Under the media agreement, the EU provides now financing for Swiss-EU co-productions through Media Plus, whereas film-makers from Switzerland qualify for MEDIA training programmes);
- Joining the European Environment Agency;
- Tax on proceeds from bank deposits (savings) (LO);
- Switzerland’s financial contribution to economic and social cohesion in new Member States of the EU.

The Schengen and Dublin Association Agreements, which – on account of the link connecting them (the “mini guillotine”) and their similar nature, but not only, are perceived by Swiss people as “appertaining to each other” – can be considered the most important arrangements of all bilateral agreements included in the BAIL package. The Schengen/Dublin Agreement promotes close co-operation among EU Member States and associated countries on borders, a judicial system, the police, visas and asylum.

As a result of the Schengen co-operation, participating countries lifted essentially all identity checks on internal borders and made the decision about compensatory measures to strengthen internal security. The Dublin co-operation ensures that every application for asylum is considered only by one country. In 2004, Switzerland and the EU entered into the Schengen Association Agreement as part of BAI to facilitate travelling. The agreement covers also further measures ensuring the internal and external security of Europe. With regard to Switzerland, this means, among other things, financial and staff support for the European Border and Coast Guard Agency – FRONTEX (Oesch, 2020a, p. 151-154).

Another agreement provides the liberalisation of trade in the processed agricultural goods which were only to a certain extent included in the 1972 Agreement. In some areas, Switzerland eliminated customs duties and export subsidies completely, with respect to such products as coffee, cocoa, jams, mineral water, alcohol-free beverages, beer and spirit drinks. Whereas as regards other areas, customs duties and export subsidies were reduced by Switzerland. This applies to such products as flour, powdered milk, butter and vegetable fat and has implications for a wide variety of products, such as chocolate, pasta, biscuits, bread, ice cream and other processed food. Furthermore, the scope of application of the agreement was extended to include additional products, for example, dietary supplements and phytopharmaceuticals. At the same time, trade in meat, some processed agricultural products, fisheries products, food and tobacco is subject to customs duties, including 10% on tobacco and 13% on beef (European Commission, Market Access Database). What deserves attention is the fact that customs duties on agricultural goods in Switzerland are significantly higher than in the EU, both in the case of an average MFN rate and an import-weighted average rate. Moreover, as regards agricultural products, more than 86% of the value of imports from the EU comprises duty-free import (almost 34% of tariff lines), while in the EU, it is only 41% (32% of tariff lines) (Table 2). Switzerland does also not participate in a customs union, nor in a VAT system in the EU, hence for export purposes, customs declarations, tax authorities' inspections and certificates of origin are required before goods can be exported to the EU.

**Table 2. Rates of Customs Duties in European Union's and Switzerland's Customs Tariff in 2020 (%)**

Specification	Total	Ag	Non-Ag
<b>European Union</b>			
Simple average MFN applied	5.2	11.7	4.1
Trade weighted average	3.2	8.4	2.8
Duty-free tariff lines (% of all tariff lines) (MFN applied)	27.0*	31.7	28.6
Simple average of MFN duties based only on tariff lines in relation to imports from Switzerland	–	34.5	1.3
Trade-weighted average MFN duty in relation to imports from Switzerland	–	20.9	1.0
Duty-free imports from Switzerland (% TL)		32.1	99.0
Duty-free imports from Switzerland (Value in %)		41.2	99.9
<b>Switzerland</b>			
Simple average MFN applied	5.6	32.4	1.3
Trade weighted average	1.7	22.1	0.7
Duty-free tariff lines (% of all tariff lines) (MFN applied)	26.9**	29.7	31.6
Simple average of MFN duties based only on tariff lines in relation to imports from EU	–	15.7	4.3
Trade-weighted average MFN duty in relation to imports from EU	–	11.5	1.9
Duty-free imports from EU (% TL)	–	33.8	98.9
Duty-free imports from EU (Value in %)	–	86.2	100.0

\*data relating to the European Union for 2019

\*\*data relating to Switzerland for 2021

Source: (WTO, 2019, p. 63; WTO, 2022, p. 61)

Switzerland and the EU negotiated a bilateral agreement relating to participation in long-term framework research programmes. This strengthened the position of national research institutions in European networks.

Under Bilaterals II, Switzerland and the EU made an agreement on the taxation of savings income. Swiss banks charge tax on interest accrued on deposits of EU Member States' citizens in the amount of 35% (since 2011) and pay back three-thirds of that sum to the countries of origin of account holders. The remaining 25% is held in Switzerland. The federal budget receives 90% of that sum, while cantons 10%. This means that savings income earned by EU nationals may be effectively taxed in Switzerland, while maintaining the Swiss legal system and banking secrecy.

In February 2006, the EU signed the Memorandum of Understanding (MoU) with Switzerland, which concerned its financial contribution of CHF 1 billion over a five-year period to cohesion in the EU. In December 2014, the Parliament approved the CHF 45 million contribution for Croatia, which is the only country where projects will be implemented until 2024. (Basic Facts on the Framework of EU-Switzerland Relations, 2021).

In order to avoid double taxation of pensions received by former EU officials residing in Switzerland, the agreement on pensions was concluded. In accordance with the agreement, Switzerland grants income tax exemption on revenue from pensions of retired EU officials residing in Switzerland, on condition that such revenue is taxed at source (i.e. in the EU). The EU imposes a so-called withholding tax, namely, which is levied by an entity paying up a benefit, whereas Switzerland charged federal, cantonal and communal tax on such pensioner's net income, i.e. from which a withholding tax has been deducted. Originally, that agreement referred to around 50 Swiss citizens, but due to a growing number of people who, on reaching the retirement age, decide to settle in Switzerland, these figures may continue to rise (Vahl, Grolimund, 2006, p. 31).

Compared to the 1972 EU-Switzerland Free Trade Agreement, the anti-fraud agreement updates the protocol on co-operation on combating frauds. The scope of legal assistance was extended to include tax frauds, fiscal offences relating to indirect taxes in the EU, totalling above EUR 25,000. In such cases, representatives of EU law enforcement authorities are permitted to participate in investigative activities and inspect bank accounts (Kozłowski, 2011, p. 29).

On 27 May 2015, the EU and Switzerland signed a historic new agreement on tax transparency (replacing the 2005 Agreement on taxation of savings income), which will considerably contribute to strengthening fight against tax evasion (Europa, 2015). Under the agreement, both parties have been automatically sharing information on financial accounts of their residents (since 2018). This means the end of the Swiss banking secrecy for EU citizens and precludes tax fraudsters from hiding untaxed income in Swiss accounts.

### **3. Third Period of Bilateralism – Institutional Agreement**

The third period is characterised by uncertainty. It began in 2014 with the success of a social initiative against “mass immigration”, which was a threat to the entire package of bilateral agreements. The referendum committee (9 February 2014) put forward a proposal to stifle the process of mass immigration to Switzerland. This could be achieved by setting annual immigration quotas applicable also to seasonal workers, asylum seekers and people coming to the country to join their families. The committee's initiative was supported in the referendum by a slight majority of votes –

50.3% (Porębski, 2021, p. 278). Another referendum of 30 November 2014: “Stop overpopulation – protect the natural basis for life” also deserves mentioning. The initiators of the proposal requested that the upper limit for the number of immigrants be set. The committee’s proposal was rejected in the referendum by a majority of 59.2% votes (Porębski, 2021, p. 279).

Although bilateral agreements strengthened economic relations, they also built a complex and partially incoherent network of obligations. Apart from that, almost all bilateral agreements must be updated regularly. Furthermore, they do not contain any arrangements relating to supervision or effective dispute resolution mechanisms. To remedy these deficiencies, on 22 May 2014, the EU and Switzerland entered into negotiations on the Institutional Agreement (IFA). The negotiations were aimed at solving several difficult issues, from conditions for EU service providers in Switzerland, to the role of the Court of Justice in resolving disputes. The EU expressed the hope that the new agreement would modernise the existing bilateral agreements (Overton, 2021).

The framework agreement would set an overriding framework for Swiss-EU relations that could provide the basis for the protection and extension of Switzerland’s access to the single market and would replace the mosaic of bilateral agreements. The new framework agreement would be tantamount to Switzerland joining the dispute resolution system and accepting the jurisdiction of the European Court of Justice (ETS) in all matters concerning the interpretation of the EU law. The IFA negotiations ended on a political level on 23 November 2018.

The contents of the framework agreement were questioned in the Swiss political circles from the very beginning of the negotiations, however, they became more politicised in 2019, when the Swiss government commenced internal consultations on the text of the framework agreement, which had been, as a matter of fact, already negotiated with the EU. Talks on the IFA were resumed in January 2021, when circumstances relating to Covid-19 permitted. Eventually, on 26 May 2021, the Swiss Federal Council notified the European Commission of its decision to end the negotiations of the framework agreement once and for all, stating that the document could not be signed (Walter, 2021). The Swiss Federal Council referred to the following three major contentious issues: state aid rules, wage protection and EU citizens’ access to social security benefits in Switzerland. Swiss cantons were concerned that their system of providing unlimited state guarantees to banks would be no longer permitted under the EU state aid regulations. As regards wage protection, Swiss trade unions and companies voiced the fear that the framework agreement would lead to “wage dumping”. Switzerland endeavours to protect its higher wages and working conditions by employing “social accompanying measures”, however, the EU wanted

to remove them to create conditions ensuring a level playing field for competition.

Since the withdrawal from the framework agreement, the matter of mutual relations, possible political scenarios for the development of relations, has been still open.

#### **4. Bilateralism vs EU Membership**

In aggregate, 20 sectoral bilateral and about 120 accompanying agreements were concluded (Fedlex, 2022). Many of these agreements need to be updated on a regular basis, in particular those which are based on the harmonisation or equivalence of relevant Swiss and EU regulations. The majority of Switzerland-EU bilateral agreements are classic co-operation agreements. The parties to the agreement are, in principle, independent and each of them is individually responsible for implementing and applying the agreements within their respective territories. Switzerland does not grant any legislative rights, nor other decision-making powers to a higher, supranational authority – except for air traffic. Simultaneously, it must be mentioned that there is no mechanism for Switzerland's implementation of the EU *acquis* with regard to the internal market, designed to update bilateral agreements. In particular, Switzerland is not required to dynamically transpose EU legal acts into its own *acquis* (Oesch, 2020a, p. 100), nor is it bound by any arrangements between two contracting parties on the legal interpretation of and supervision over agreements or on dispute resolution. Bilateral agreements provide Switzerland and EU Member States with mutual sectoral access to the market. Hence, compared to other third countries, Switzerland has a privileged status (*Sonderfall*) in trade with the EU. A bilateral approach thus allows for pursuing a policy of openness and co-operating closely with European neighbours. Simultaneously, the institutional independence of Switzerland is maintained. On the other hand, as a non-EU member, Switzerland is not allowed to participate in a co-decision process on the EU level.

Apart from being a party to the Convention establishing the European Free Trade Association and the Free Trade Agreement (FTA) with the European Union, Switzerland has now a network of 33 free trade agreements with 43 partners. The majority of trade agreements with Switzerland was signed under the EFTA; however, Switzerland can conclude free trade agreements with non-EFTA countries, as was the case with the United Kingdom, Japan and China. The Free Trade Agreement between the EFTA and Mercosur countries in South America was negotiated, but it has not been signed yet (Swiss Secretariat for Economic Affairs' website, 2022).

**Table 3. Juxtaposition between Bilateralism and Switzerland's Accession to EU**

Aspect	Bilateral agreements/Comments	Accession to EU/Comments
Trade	↑A growth, but it concerns only certain goods for which customs duties and other trade barriers were eliminated (hence it does not apply to some agricultural goods or those which are covered in the EU by anti-dumping duties)	↑The complete removal of trade barriers should contribute to an increase in mutual trade
Border formalities	→In spite of facilitations, customs formalities and checks are still in place	↑No customs clearance and customs formalities
Commercial policy	↑Decisions regarding trade agreements with third countries can be made independently	↓↑A commercial policy can no longer be shaped independently, the Union customs tariff must be applied to trade with third countries, an average level of MFN duties on agricultural goods drops, revenue from customs duties also declines. At the same time, benefits could be derived from joining the treaty-based commercial policy and a vast network of trade agreements made by the EU worldwide
Certificates, market surveillance, rules for admission to trading	↑Due to the BAI on mutual recognition, but this does not apply to all goods	↑Due to the implementation of the Union rules for the elimination of technical barriers to trade
Budget revenue	↓Switzerland will bear the costs of approx. CHF 80 million arising out of reduced revenue from customs duties on processed agricultural products, contributions to MEDIA programs and the European Environment Agency, as well as compliance with statistics and the implementation of the Schengen/Dublin Agreements.	↓A further decline in revenue from customs duties, obligatory allocation of 75% of revenue from import duties to the EU budget, transfers to the EU budget, the possible adoption of the Union customs tariff would result in a drop in an average level of MFN duties
Land and air transport	↑Due to the signature of the BAI relating to transport, the collection of charges for transit through Switzerland	→Major issues were settled in the BAI
Movement of persons	↑ Due to the signature of the BAI	↓The EU's migration policy must be adopted, which is a matter of concern to the Swiss

**Continued table 3.**

Tax system	→	↓ Adopting taxation rules for VAT in the EU would mean that the base VAT rate is to be raised from 7.7% to the minimum level required in the EU, i.e. 15%. This would be also tantamount to higher contributions to the EU budget (on account of VAT). A positive effect could be seen if an increase in a VAT rate was accompanied by a decline in direct taxes.
Real wages	→	↓
Employment	↑	↑ Bigger rise
Direct democracy, federalism	→	↓
Migration and asylum policy	↑	→
Environmental policy	→	→

↑ Better

→ Neutral

↓ Worse

Source: Own elaboration.

As the summary presented in Table 3 shows, compared to the bilateralism strategy pursued so far, the full EU membership of Switzerland would not bring too many benefits to it. The key issues associated with market access, movement of persons, transport policy were, as a matter of fact, dealt with in sectoral agreements. Bilateralism introduced also liberalisation and requisite structural adjustments in sensitive areas. It is also the guarantee that Switzerland will preserve the fundamental principles of the state's functioning, i.e. direct democracy and federalism (including, but not limited to, the high level of autonomy that communes and cantons have), which, in the case of EU membership, would have to be limited considerably, if not excluded at all. Further, it must be mentioned that the matter of Switzerland's accession to the EU was no longer considered after the withdrawal of the application for EU membership in 2016. It seems that in the case of Switzerland the economic theory of integration has been proved. It points to the economic balance of membership. And as far as economic balance is concerned, for relatively small economies, such as Switzerland, indeed, considerable importance is attached to access to a huge single European market, however, the decision on whether membership is to be applied for or not is influenced by political factors, which in the case of Switzerland play an essential role.



**Table 4. SWOT Analysis of Switzerland's Bilateral Strategy**

<b>Weaknesses</b>	<b>Strengths</b>
<ul style="list-style-type: none"> <li>- Agreements form a complex and partially incoherent network of obligations;</li> <li>- Almost all bilateral agreements must be updated regularly and are not dynamic in nature;</li> <li>- There are no arrangements relating to supervision or effective dispute resolution mechanisms;</li> <li>- The guillotine clause in the BAI and a threat to the effectiveness of the whole agreement package;</li> <li>- Liberalisation through the negotiation of sectoral agreements is not possible in every area (e.g. services);</li> <li>- No possibility of co-deciding about shaping the EU law and EU policies, as well as further dynamic development of the EU law;</li> </ul>	<ul style="list-style-type: none"> <li>- Switzerland's access to the specific segment of the European market;</li> <li>- A broad range of issues to be regulated (in aggregate, 20 sectoral bilateral and about 120 accompanying agreements were concluded – Euro-compatible legislation of Switzerland);</li> <li>- Liberalisation and requisite structural adjustments in sensitive areas (trade in agricultural goods, air transport);</li> <li>- Special quality of mutual relations, which provides the basis for considering them a form of privileged partnership* or integration without membership;</li> <li>- The right to pursue own monetary and foreign exchange policy;</li> <li>- Lower fiscal costs than in the case of full members, under bilateral agreements, Switzerland does not make any contributions to the general budget of the EU; furthermore, it controls the manner of spending the funds designated for new Member States;</li> <li>- Participation in long-term framework research programmes, strengthening the position of national research institutions;</li> <li>- Switzerland's ability to influence the form and contents of agreements, negotiate favourable solutions;</li> <li>- Safeguarding own interests in a selective and pragmatic manner;</li> <li>- Union authorities are not superior in a decision-making process;</li> <li>- Preserving neutrality, federal structures and direct democracy – three main and fundamental pillars of Switzerland;</li> <li>- Financial sector: the interests of the Swiss financial sector are safeguarded (taxation of savings, fight against frauds) and banking confidentiality is maintained in relation to direct taxes (Schengen/Dublin);</li> <li>- Food industry: Reduced customs duties improve export opportunities for the food industry. This also brings benefits to the Swiss agriculture (processed agricultural products);</li> <li>- Tourism: A Schengen visa encourages tourists to come to Switzerland (the Schengen/Dublin Agreement);</li> <li>- Security policy: Cross-border crime can be effectively combated only through international co-operation involving the police and courts. Schengen provides tools necessary to achieve that goal.</li> </ul>

**Continued table 4.**

	<ul style="list-style-type: none"> <li>- Asylum policy: The Dublin co-operation counteracts "asylum tourism", and consequently, reduces the pressure on the national asylum system.</li> <li>- Environment: The European Environment Agency is an important tool of international co-operation on environmental protection. As a member of the Environment Agency, Switzerland can contribute to such co-operation.</li> <li>- Statistics: The agreement on statistics ensures the harmonisation and optimisation of the exchange of comparable statistical data between Switzerland and the EU.</li> <li>- Culture: Participation in Union film promotion programs (MEDIA) strengthens the role of a film as an important part of Swiss cultural heritage.</li> <li>- Education: Co-operation as part of Union educational programs provides Swiss citizens with access to a wide range of trainings. This creates better opportunities on the labour market.</li> <li>- Except for the Schengen and air transport agreements, Switzerland is not required under other agreements to adopt changes to the "EU acquis" applicable to these bilateral agreements.</li> <li>- Bilateral agreements do not grant any supranational institution, such as the European Commission, control powers to check whether Switzerland complies with the European law correctly;</li> <li>- Switzerland is not obliged to abide by decisions issued by the Court of Justice of the European Union (CJEU).</li> </ul>
<b>Threats</b>	<b>Opportunities</b>
<ul style="list-style-type: none"> <li>- The EU is of the opinion that bilateral agreements are insufficient because they give Switzerland too many opportunities to deviate from the European law and challenge the uniformity of the common market;</li> <li>- Opposition to any changes concerning a more supranational solution, which would grant European institutions greater powers.</li> <li>- The conclusion of negotiations of the institutional agreement;</li> <li>- The EU has now a much bigger network of bilateral agreements and is able to promote its interests on third countries' markets more effectively;</li> <li>- The EU, due to the size of its market, has much greater negotiating power.</li> </ul>	<ul style="list-style-type: none"> <li>- The volume of mutual trade and significance of bilateral trade to both parties;</li> <li>- The replacement of the 1972 Free Trade Agreement with a new-generation trade agreement and the renegotiation of its provisions or, optionally, considering the negotiation of an interim agreement regulating major contentious matters in mutual relations;</li> <li>- Switzerland's capacity to independently conclude agreements at the WTO and EFTA preferential agreements.</li> </ul>

\*(Calliess, 2008).

Source: Own elaboration

The SWOT matrix for the strategy of bilateralism demonstrates that it is advantageous for Switzerland to continue the two-way path. What deserves particular attention is the fact that when deciding to opt for this solution, Switzerland chooses the solution which is not only the most viable, but also has the most desirable beneficial effects (Table 4). Nevertheless, an emphasis must be put on the main threat to bilateralism, namely, the EU's clear position that bilateral agreements are insufficient and give Switzerland too many opportunities to deviate from the European law. On the other hand, an opportunity created by the volume of mutual trade and the significance of partners in that trade, not to mention the geographical proximity and the fact that Switzerland shares many of its values with Europe and builds the area of security and peace, gives grounds for the partners' efforts to strengthen mutual relations.

### **Conclusions**

The strategy of bilateralism aimed at entering into sectoral agreements, which has been being pursued since the late 1990s, brings many benefits to Switzerland and is, at it appears, a more favourable solution (to Switzerland) than full EU membership. However, the European Union has been pushing Switzerland for years to transform more than 120 separate agreements into a framework agreement covering everything, from access to the labour market to energy supply and scientific research. This was manifested through the negotiations of the institutional agreement. Nevertheless, in May 2021, as everybody knows, the Swiss government decided to withdraw from the negotiations of the so-called "framework arrangement", assuming that voters would disapprove of such an agreement in a referendum.

In this situation, the question arises as to what happens next, which solutions would be beneficial in the future? Full EU membership is rather unlikely for the reasons given in the research. Hence which options are available? It seems that the solution which would be the most advantageous for both parties includes the renegotiation of the 1972 Free Trade Area Agreement and its transformation into a new-generation trade agreement. As regards their contents, new free trade agreements have a comprehensive scope and mean the greatest possible liberalisation of trade, including well advanced liberalisation of services and investments, as well as the elimination of non-tariff barriers or quantitative restrictions. New free trade agreements contain also provisions on trade facilitations, specifically, with respect to customs matters. These are thus issues that were covered by sectoral agreements (as part of Bilaterals), although they could be contained in a new-generation trade agreement with Switzerland. One must not forget that, as a matter of fact, it is an older-generation agreement made with Switzerland in 1972 that constitutes a framework agreement governing mutual trade relations. The EU concluded

new-generation trade agreements with South Korea, Canada, Japan, Singapore and Vietnam, hence mainly with developed countries. In addition, the EU is currently renegotiating older-generation agreements with Turkey (a customs union), with selected Mediterranean countries, why not with Switzerland? Such an agreement would regulate mutual relations in the future, negotiations could enable, apart from the liberalisation of mutual trade, the partners to set the conditions for a dispute resolution system and the possible superiority of the European Court of Justice in certain areas. That agreement would be also not tantamount to Switzerland joining a customs union, which would be problematic due to its political system. In fact, Swiss people dismissed the possibility of joining the European Economic Area (a common market), yet this took place 30 years ago, in other realities. Entering into Bilaterals I and II shows that mutual arrangements and compromises can be made with respect to selected areas, specifically, those related to access to the Union market. It is true that negotiations of an interim (framework) agreement can be considered, after several years, yet this will be difficult, as was proved by the outcome of the negotiations covering the framework agreement in 2018.

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