Senior European Experts

The UK and the EU: Are there Alternatives to EU Membership?

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Introduction

In the on-going debate about British membership of the EU, various suggestions are made as to what trade and economic alternatives there are. Regent's University and the Senior European Experts decided that it would be useful to discuss the most commonly suggested alternatives as the debate continues about British membership. In any referendum it would be essential that those campaigning for Britain to leave the EU set out the alternative trading and other arrangements they would favour so that the debate and the vote can be meaningful.

Opponents of UK membership have focused on the economic and trade issues relating to the UK and the EU without examining the other aspects of the UK's relationship with the EU. Similarly, this paper does not address these other issues, but whilst economic and trade questions are at the core of the UK's relationship with the EU, there are other very important aspects. These include the UK's influence in the world and EU policies in fields including justice and home affairs, the environment, development, agriculture and fisheries and foreign policy.

Background & Summary

The alternatives to EU membership that have been suggested include: joining the European Economic Area (EEA); joining the North American Free Trade Agreement (NAFTA) with Canada, Mexico and the USA; or creating a new free trade area with other Commonwealth countries such as Australia, Canada, New Zealand, India and South Africa. An alternative suggestion is that the UK should not participate in any of these organisations but rely on membership of the World Trade Organisation (WTO) and its most favoured nation treatment to ensure access to global markets including that of the EU. Proponents of these ideas suggest that these potential alternatives are readily available and would afford the UK economic and political benefits at least as good as EU membership.

The benchmark against which trading alternatives to our membership have to be judged is the UK's current privileged access to the Single Market of 500 million people from which the British economy benefits by around £90 billion annually, or £3,300 per household every year.[1] The UK has unfettered access for its goods and much of its services to this market and participates in the rule making for the Single Market through its representation on the Council of Ministers and in the European Parliament.

[1] Department for Business, Innovation & Skills & Department for International Development, *The UK and the Single Market: Trade and Investment Analytical Papers – Topic 4 of 18,* 13 February 2011, p. 3

There are no guarantees of privileged access to the EU's Single Market if the UK left the EU as it would be up to the remaining 27 Member States whether and on what terms the UK would be given access. Given that the other 27 Member States purchase more than half the UK's exports but the UK only buys about 10 per cent of the exports from the rest of the EU, the UK would not be in a strong position when negotiating with the EU.[2] The suggested benefits of these alternative arrangements and their availability and negotiability are unproven, for example, it is not clear that the other Commonwealth countries would wish to be in a free trade area with the UK. Nor is it clear that the members of the EEA or NAFTA would wish the UK to join or, indeed, that the economic benefits to the UK of joining would be as great as those currently derived from EU membership. Finally, it is not clear how the UK would benefit from not being in any free trade partnership but from relying instead on its WTO membership to trade with the EU. While the WTO does provide most favoured nation treatment, it is not a standard setting body like the EU, nor is it a customs union and British exporters would pay the EU's common external tariff. But it is the only one of the alternative which is certainly available and requires no further negotiations.

This paper examines these alternatives in the light of the current UK debate about membership and the growing body of literature considering possible alternatives.

The European Free Trade Area and the European Economic Area

The current members of European Free Trade Area (EFTA) are:

Country	Population
Iceland	325,671
Norway	5,109,059
Liechtenstein	37,132
Switzerland	8,183,800

The EFTA was founded as a result of the Stockholm Convention of 1960. The UK was the prime mover in its establishment as an intended alternative to the European Economic Community (EEC), which had been launched two years earlier. The other signatories included Austria, Denmark, Norway, Portugal, Sweden and Switzerland. Finland later became a member. Since 1960, Iceland and Liechtenstein have joined EFTA but a majority of the founding members have left to join the EU.

The UK applied to join the EEC in 1961 after reconsidering its decision not to join in 1958. The Macmillan Government increasingly took the view that EFTA, the Commonwealth and even the bilateral relationship with the United States did not provide a sound political or economic basis for Britain's prosperity, influence and security in the world. In July 1961 the Macmillan Government accordingly applied for membership of the EEC. When we finally joined the EEC in 1973, our membership of EFTA had lapsed.

[2] Cited in John Springford & Simon Tilford, *The Great British trade-off: The impact of leaving the EU on the UK's trade and investment*, Centre for European Reform, 20 January 2014, p. 7

When the Single Market was in its early stages in the 1980s, EFTA members were concerned over the growing economic power of the EEC and EFTA's dwindling membership. Broader co-operation between EFTA and the EEC was agreed in 1984, which eventually led to the creation of the European Economic Area (EEA) in 1994.

The EEA now comprises Norway, Iceland and Liechtenstein plus the 28 members of the EU. It gives the three non-EU countries access to the Single Market in return for their accepting all the four freedoms of the EU Single Market (that is, free movement of goods, capital, services and people), making a substantial budgetary contribution and applying all Single Market rules. This means that Norway, Iceland and Liechtenstein have agreed to implement the EU's employment, social, environment and research and development policies (but not agriculture and fisheries – see Norway below). In practice this means that they must adopt legislation such as the Working Time Directive and the Capital Markets Directive.[3]

The argument for British membership of the EEA as an alternative to EU membership has often been made. For example, an analysis of alternatives published in 2011 by the Bruges Group suggested that the EEA would be the best option.[4] In November 2014, former Cabinet Minister Owen Paterson MP called for the UK to leave the EU and adopt a Norwegian-style approach to the EU.[5] In fact, EEA membership is considered by many commentators as the 'default option' if Britain leaves the EU, and it appears to have some popular support.[6]

The participation of EFTA countries in the EEA secures the economic benefits of access to the EU's Single Market. However, there are a number of clear disadvantages to EEA membership as opposed to full membership of the EU. In order to gain access to the free movement of goods, capital, services and people, all EEA-EFTA countries must implement all EU regulations pertaining to the Single Market whilst having merely a consultative role in the legislative process – crucially, they are not in the room when the decisions are made. Failure to adopt EU regulations can lead to partial suspension of the EEA Agreement and thus access to the EU's Single Market. If the UK were to seek to join the EEA, the UK would have to accept the four freedoms and comply with all the rules but would have no effective say in the EU's Single Market legislation.

EFTA members have a number of trade agreements with third countries but studies have shown that trade agreements entered into by EFTA with third countries are considerably weaker than the EU's free trade agreements, reflecting the fact that the EU has far more political and economic clout than EFTA.[7]

The UK has a larger, different and more varied economy than that of the current EFTA members and complexities would arise if the UK were to become an EEA-EFTA member. According to the EEA Agreement, EEA-EFTA countries are required to harmonise their positions internally and speak with one voice towards the EU. The UK has been a key actor in the EU since its accession in 1973 and the accession of a major former EU country into the structure of EFTA (consisting of small countries) could potentially make the system of

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[3] Cited in Chapter 6 of CBI, *Our Global Future: the Business Vision for a Reformed EU*, 3 November 2013
[4] Hugo van Randwyck, *EFTA or the EU*, Bruges Group, 15 February 2011
[5] 'Ex-Conservative Minister Owen Paterson urges UK's EU exit', *BBC News*, 24 November 2014
[6] Survation, *Relationship with Europe Poll: Prepared on behalf of The Bruges Group*, 5 July 2013
[7] CBI, *Doing things by halves?: Alternatives to UK EU membership: Lessons from Switzerland and Norway*, 4 July 2013

unanimity difficult and cumbersome.[8] As Dr. Jóhanna Jónsdóttir of EFTA noted on possible UK membership of EFTA:

> For a noisy nation [United Kingdom] accustomed to a place at the table and having its voice heard, that could feel like a very un-splendid isolation.[9]

On joining the EEA, the UK would still have to pay a significant financial contribution to the EU, and face increased costs in trading with the EU. EEA-EFTA members must contribute towards the EEA Grants, which provide financial assistance to reduce social and economic disparities within the EU. From 2009 to 2014, the EEA Grants totalled £1.4 billion. Norway contributes a per capita figure of around £78;[10] the UK's net contribution to the EU currently stands at £135 per capita.[11] As EEA-EFTA members are not part of the EU's Customs Union, customs duties have to be paid when trading with the EU as well as the administrative costs of working out tariffs on EU derived imports.[12]

The UK would not inherit the free trade agreements (FTAs) already negotiated by EFTA countries as the FTAs are agreed bilaterally between the current members of EFTA and the third country concerned. New FTA negotiations could take as long as three to five years to negotiate.[13]

In terms of free movement and migration, the EFTA states are all (non-voting) members of the Schengen passport free area. They have all also been required to adopt the EU's free movement of people legislation, meaning that their citizens can live, work or study anywhere in the EU and equally EU citizens can exercise the same rights in EEA countries. This is an important point given the current focus on immigration in much of the debate about Britain's membership of the EU.

Norway

As Norway's relationship with the EU is often suggested as a potential role model for the UK if it left the EU, it is worth examining Norway's position in greater detail.

Norway was a founding member of EFTA and has been part of the EEA since 1 January 1994. Norway is very different from the UK because of its far smaller population (at five million people it is less than that of Greater London) and its quite different economy. In 2013, 67 per cent of Norway's exports were in the form of energy and its top five export partners are all EU Member States, which account for 65 per cent of all the country's exports.[14] Norway currently has the world's largest sovereign wealth fund, which is estimated will reach £600 billion by 2020, because of its exceptionally large oil and gas resources.[15] By contrast, the UK's oil and gas reserves have dwindled to the extent that the UK has been a net energy

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[8] Vaughne Miller (ed.), *Leaving the EU*, House of Commons Library Research Paper 13/42, 1 July 2013
[9] *Ibid.*
[10] CBI, *supra* n. 7
[11] British Influence, 'How much does being in the EU 'cost' us? Less than a copy of the Express per day', 30 July 2014
[12] John Springford *et al.*, *The economic consequences of leaving the EU: The final report of the CER commission on the UK and the EU single market*, Centre for European Reform, 9 June 2014
[13] CBI, *supra* n. 7
[14] World Integrated Trade Solution, *'Norway Trade Summary 2013'*, 2013
[15] 'Norway: Is world's largest sovereign wealth fund too big?', Matthew Price, *BBC News*, 12 September 2013

importer since 2004. Our exports are over a wider variety of sectors, which, unlike energy, would be subject to import tariffs if we were outside the EU.[16]

As a result of concern in Norway about its long-term relationship with the EU, the Norwegian Government commissioned a report in 2012 on the EEA-EFTA membership. This found that Norway had incorporated around three-quarters of all EU legislation into Norwegian law, and had often transposed them more effectively than many EU Member States.[17] The report concluded that 'the most problematic aspect of Norway's form of association with the EU is the fact that Norway is in practice bound to adopt EU policies and rules on a broad range of issues without being a member and without voting rights'. The chairman of the committee that produced the report for the Norwegian government, Professor Frederik Sejersted, described this as 'a great democratic deficit'. In financial terms, Norway has contributed extensively to the EU to gain access to the Single Market (and continues to do so).

Norway, which was already a member of the Nordic Passport Union, participates in several different aspects of the EU's work, such as: the Schengen Area (the passport free area covering most of the EU but not the UK); the European Defence Agency; Frontex; and Europol. In 2013 the cost of Norway's participation in these agencies was £234 million but it has no voting rights in any of them.[18]

Understandably, participation in EU agencies, programmes and access to the Single Market comes with a price. However, EEA-EFTA membership does not afford the same level or quality of access as EU membership. Norwegian companies have argued that their perceived 'outsider' status has resulted in a loss of investment despite being technically part of the Single Market.[19] Despite Sweden being a top import and export partner to Norway, the Swedish Chamber of Commerce has voiced its concerns that Swedish businesses feel trade with Norway is cumbersome, even though it should be straightforward.[20]

In addition, the EEA largely excludes agriculture and fisheries because the EFTA countries domestic agricultural policies provide a higher level of subsidy than is permitted under the Common Agricultural Policy. But in practice these industries cannot ignore the EU and its rules. Norway negotiates a bilateral fisheries agreement with the EU annually, because many of its traditional fishing grounds are off the coast of EU Member States (including Britain). At the time of the establishment of the EEA, Iceland and Norway had to agree to partial access to their water for EU fishing fleets. In addition, food exports to the EU from the EEA countries face the EU's external tariffs.

Were the UK to be in Norway's position of being in the EEA but outside the EU, agreeing on arrangements covering fisheries would present substantial complications. This is because, quite separately from EU membership, the Dutch, French, Belgians and Irish have reciprocal historic rights to fish in some British waters. There is a similar situation as regards Norway, with which the UK would also need to reach agreement.

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[16] Paul Bolton, Energy imports and exports, House of Commons Library Standard Note 13/4046, 30 August 2013
[17] Norwegian Government, *'Outside and Inside: Norway's agreements with the EU'*, January 2012
[18] *Ibid.*
[19] CBI, *supra* n. 3
[20] Kommerskollegium, Swedish National Board of Trade, Sveriges handel med Norge – grannhandel med förhinder, March 2013

Nikolai Astrup's (Spokesperson on European Affairs for the Norwegian Conservative Party) comment on Norwegian membership of EEA-EFTA makes the case for active UK membership of the EU: 'If you want to run the EU, stay in the EU. If you want to be run by the EU, feel free to join us in the EEA.'[21]

In summary, EFTA-EEA Membership would mean that the UK would face more barriers, both tariff and regulatory, in trading with major partners, would still have to contribute substantially to EU funds, would have to accept free movement of people and would continue to have to abide by EU Single Market legislation (including that for financial services and the Working Time Directive) whilst having no effective say in its formulation.

Switzerland

Switzerland was a founder member of EFTA in 1960 but has not joined the EEA. A referendum on EEA membership failed in 1992, with 50.3% of the electorate voting against. Despite that, the Swiss Government was eager to negotiate Swiss access to the EU's Single Market. Swiss access to the Single Market comes in the form of around 120 bilateral agreements between the EU and Switzerland, known as 'Bilaterals I' and 'Bilaterals II'.

Negotiations for 'Bilaterals I' formally came into force in 2002 after nearly nine years of negotiations, with 'Bilaterals II' signed two years later in 2004. The Swiss Government wanted Bilaterals I to cover up to 15 policy areas, whereas the EU preferred only four areas; the outcome of the negotiations was that seven policy areas were covered by bilateral agreements between the two parties. Nine additional agreements came into force through Bilaterals II (2004), which strengthened co-operation in the economic sphere, including Schengen, taxation of savings, environment, pensions and the fight against fraud.[22] The lengthy negotiations left Swiss businesses in a position of uncertainty for nearly a decade; such uncertainty could cause severe damage to British businesses should the British Government wish to pursue a Swiss-style relationship with the EU in the future.

The functioning of the bilateral approach has from the beginning posed problems of principle for the EU. It does not provide, as the EEA does, for the automatic take-over by Switzerland of new EU legislation and this, together with the lack of external supervision and enforcement on the Swiss side, results in legal uncertainty for firms and citizens in the Single Market. The lack of homogeneity in the Swiss model has led to an increasing desire on the EU side to make the system more automatic – in fact, more like the EEA. Thus, it is doubtful whether the EU would be willing to negotiate a similar pattern of agreements with the UK. More likely it would prefer the EEA model, as applied by Norway.

Switzerland is not within the EEA and does not participate in the free movement of services. Were the UK to seek that option, its service sector (which constitutes up to 75 per cent of the UK economy) would, like the Swiss, be outside the Single Market.[23] Swiss participation in EU agencies, programmes and access to aspects of the Single Market require yearly contributions of £790 million over a period of ten years.[24] Being outside the EEA, the Swiss have no official

[21] 'Leaving Europe would be bad for British business', John Cridland, *The Guardian*, 17 May 2013
[22] European Commission, *EU-Swiss Relations*, MEMO/14/100, 10 February 2014
[23] Office for National Statistics, 'GDP by category of income', February 2014
[24] David Buchan, *Outsiders on the inside Swiss and Norwegian lessons for the UK*, Centre for European Reform, 24 September 2013

participation in EU expert groups, which hinders the flow of information on forthcoming EU legislative proposals. Like the EEA members, the Swiss have no say on the legislation itself.

The EU-Swiss relationship has come under increasing strain as a result of the Swiss referendum in February 2014 calling on its Government to limit immigration through quotas. The EU has voiced its concerns over the referendum and stated that the Swiss result jeopardised Swiss access to the Single Market; they have already cut off Swiss access to the EU's education and research programmes.[25] When Switzerland formally requested a renegotiation of its free movement treaty with the EU in July 2014, the EU refused.[26]

North American Free Trade Agreement

The current members of NAFTA are:

Country	Population
Canada	35,540,419
Mexico	118,395,419
USA	319,309,000

NAFTA is a rules-based trade bloc that was formed in January 1994, consisting of the USA, Mexico and Canada. NAFTA has eliminated trade barriers between the three nations and has sought to increase investment opportunities and create procedures for the resolution of trade disputes. The USA considers the NAFTA to be a success; US goods exports to NAFTA countries have increased 271 per cent since 1993.[27] The idea of the UK joining NAFTA has been around for a long time; the UK Government considered establishing a free trade area with the USA and Canada as an alternative to joining the EEC in the early 1970s.

The UK already has significant bilateral trade relations with all three NAFTA nations. Additionally, the EU is currently negotiating a free trade agreement with the USA (the Transatlantic Trade and Investment Partnership, TTIP) and recently agreed one with Canada (the Comprehensive Economic and Trade Agreement, CETA).

Whilst the USA is a major trading partner of the UK, buying 12 per cent of total UK exports, trade with the EU accounts for far more at 46 per cent of exports.[28] It must be quite unlikely that the members of NAFTA would welcome the UK as a new member. In each case their trade with the EU exceeds their trade with the UK alone. Leaving the EU to join a trade-bloc where the UK's standing is far less well established would be economically dangerous. The UK is thousands of miles away from the NAFTA countries and economic models tend to show positive correlation for trade between comparable sizes of economies and distances between countries.

[25] 'Swiss access to Single Market under threat after Swiss immigration vote', Alex Barker *et al.*, *Financial Times*, 9 February 2014
[26] 'The formal cooling of EU-Swiss relations', Aline Robert, *EurActiv*, 18 September 2014
[27] Office of the United States Trade Representatives, 'North American Free Trade Agreement (NAFTA)', 2013
[28] Observatory of Economic Complexity, 'Trade in the United Kingdom', 2013; Vaughne Miller, *supra* n. 8, p. 25

The Commonwealth

The Commonwealth forms a diverse group of 53 countries (three of which are EU Member States) including six developed countries, 32 developing countries and 15 least developed countries. The UK originally applied to join the European Communities in 1961 because the Commonwealth could not offer the trade and economic opportunities the European Communities did. Most Commonwealth countries are far from the UK and, because of differing levels of economic development, would be far smaller markets than EU Member States for the relatively expensive manufactured goods we produce (e.g. cars and pharmaceuticals) or for services. In addition, Commonwealth countries' trade with the rest of the EU is much greater than their trade with the UK.

Proponents of a free trade area with the Commonwealth tend to argue that the historical and language ties that the UK has with Commonwealth members would enable us to take advantage of increased growth in emerging Commonwealth economies. It is true that there has been strong growth in many Commonwealth economies in recent years, with a real GDP growth rate of 3.7 per cent in 2013.[29] However, the UK's imports and exports to the EU account for 62 per cent and 56 per cent of total imports and exports, respectively.[30] Whilst the economies of the Commonwealth are growing, 88.6 per cent of Commonwealth countries are either developing countries or least developed countries.[31] The UK has far more in common economically with the advanced economies of the rest of the EU and the lack of infrastructure in Commonwealth countries would hinder trade.

Many Commonwealth countries retain protectionist trade and investment policies of the kind the EU has now prohibited in almost all economic sectors. For example, UK retailers have been unable to open branches in India. There is no Commonwealth free trade area and currently no proposals to create one. The Commonwealth does not act collectively on behalf of its members in international trade talks, unlike the EU which uses its size to leverage better trade deals for its members. Commonwealth countries have shown no interest in it developing a major new role as a trading body and if it did, it would effectively be starting from scratch.[32] When the House of Commons Foreign Affairs Committee looked at the possibility of a Commonwealth free trade area they concluded that:

> It is clear that the creation of a free trade area with Commonwealth countries would require a fundamental and potentially risky change in the UK's relationship with the European Union, and the benefits may not outweigh the disadvantages.[33]

Trade with the EU and the rest of the world under World Trade Organisation rules

A more recent proposal has been that instead of trying to join the EEA, the UK should trade with the EU and the rest of the world under the WTO's equality principle (the most favoured nation rule). The UK would not have to abide by EU regulations if it did this (although in

[29] World Economics, 'Commonwealth Growth Tracker', May 2014
[30] Observatory of Economic Complexity, *supra* n. 28
[31] 47 out of 53 Commonwealth countries are classified by the UN as being developing or least developed
[32] Sir Ronald Sanders, *A Commonwealth Free Trade Area is neither likely nor desirable*, Commonwealth Advisory Bureau, 12 December 2012
[33] House of Commons Foreign Affairs Select Committee, *Fourth Report of Session 2012–13: The role and future of the Commonwealth*, HC 114, p. 39, para. 102

practice it might find it impossible to sell its goods in the Single Market if they did not meet the agreed standards adopted by the EU). But the UK would have to pay the common external tariff set by the EU. This would mean, in the case of food for example, paying an average tariff of 15 per cent on our exports to the EU. For cars – the UK's largest goods export – the tariff would be 10 per cent.[34]

Conclusion

There are, in theory at least, a number of potential (preferential) trading alternatives to EU membership for the UK but there are serious doubts as to whether any of them would be on offer.

It is worth noting at this point a few procedural matters. A UK withdrawal would take place under Article 50 of the Treaty on European Union, based on an agreement setting out the arrangements for the withdrawal and any framework for the UK's future relations with the EU. Any eventual agreement would be concluded by the Council acting by a qualified majority after obtaining the consent of the European Parliament (which would therefore have a veto over the arrangements).

If an EEA-type alternative were chosen this would entail the conclusion of an association agreement requiring unanimity in the Council, the consent of the European Parliament, and ratification in all Member States. A free trade agreement could be concluded by a qualified majority in the Council but would still require the consent of the European Parliament.

Norway and Switzerland have a disadvantageous position, through having to adopt EU legislation whilst having no effective input into its formulation and having to pay significant financial contributions. It speaks volumes that all EFTA countries have opted for access to the lucrative EU Single Market. Furthermore, access to the Single Market has only been granted to the EFTA countries (and Switzerland) on the basis that they accept the EU's free movement of persons rules; it is inconceivable that the EU would adopt a different approach for the UK given the number of EU citizens already working here.

It is highly unlikely that the UK Parliament would accept, as an alternative to EU membership, a relationship through EEA/EFTA that would mean ratifying a new treaty granting the EU a major say over UK domestic law without any UK representation in the Council of Ministers, in the European Parliament or in the Court of Justice and involving a continuing, substantial, budget contribution.

The possibility of UK membership of NAFTA is entirely speculative because of geographical considerations and possible objections from its members. UK membership of a Commonwealth free trade agreement is even more speculative on account of the large economic, geographic and infrastructural disparities between the 53 members of the organisation and their current lack of interest in such a proposal.

The EU is the largest single market in the world and one of the most powerful economic bodies. The UK's main trading partners are within the EU and the UK's economy bears the most similarity to other EU Member States. In addition, the UK is the single largest

[34] John Springford & Simon Tilford, *supra* n. 2, pp. 9-10

destination for foreign direct investment (FDI) from other EU Member States and from the US, as well as being a major destination for FDI from other major economies like Japan and China. Much of this foreign investment is driven by the ability of an investor to use the UK as base within the Single Market; outside the EU such investors would face uncertainty.

Judged against the benchmark at the outset of this paper (unfettered access to the EU, as a member, to the Single Market and the ability to influence effectively the rules for that market), none of the suggested alternatives to EU membership for the UK reach this benchmark.

January 2015

Senior European Experts

The Senior European Experts Group is an independent body consisting of former high-ranking British diplomats and civil servants, including several former UK ambassadors to the EU, and former officials of the institutions of the EU.

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