"Pining for Norway - The EEA Models" – an IEA Briefing

Victoria Hewson

Senior Counsel, International Trade and Competition Unit, Institute of Economic Affairs

As the Article 50 negotiations have progressed and Parliament has debated the draft Withdrawal Agreement, there have been calls for the UK to continue its membership of the European Economic Area ("EEA") either as an interim step before progressing to a more usual free trade agreement arrangement, or as an end state. This has been called 'Norway then Canada', 'Norway+' and now 'Common Market 2.0' and the various iterations have included EFTA membership, a customs union, neither or both. This briefing looks at the mechanics by which continued EEA membership might be achieved, and describes the reasons why (even if it could be agreed) remaining as a member of the EEA even for a short period could be damaging to the UK.

Far from being a compromise, the EEA option even without the Customs Union attachment (the 'plus' of Norway plus) is even more restrictive for the UK than the draft Withdrawal Agreement as it stands.

Summary

- There seem to be three broad variations to the EEA model:
  - Not joining the European Free Trade Association (EFTA) and 'continuing' as party to the EEA Agreement
  - Joining EFTA, and then becoming party to the EEA Agreement as an EFTA member
  - Joining EFTA as an Associate Member and then becoming an EFTA party to the EEA Agreement.
- At present the EU position appears to be that all of these options require the UK, or at least Northern Ireland, to remain in a customs union with the EU to avoid a 'hard border' in Ireland.
- All of these options require other parties to concede to the UK's actions, whether in joining EFTA, or renegotiating the EEA agreement:
  - time is running out for any such negotiations, even if carried out during a transition period (if agreed) and there is little evidence of political will.
- Variation one (non-EFTA) can be discounted as the EEA Agreement is explicit about only applying to EFTA or EU members

    - This is not easily altered as it is built into the 'institutional provisions' of the EEA Agreement
- The EU could still claim there needs to be a backstop to address the possibility that the UK might eventually leave to pursue a 'Canada-style' free trade agreement ("FTA").
- Variation two precludes membership of the Customs Union, as EFTA members must apply to become party to all EFTA FTAs. Article 50 does not give the EU competence to negotiate an existing member state's joining of the EFTA pillar of the EEA Agreement. The UK would need to leave first.
- Variation three would require a renegotiation of the EFTA convention, and it would not be guaranteed that a new 'associate member' would be allowed into the EEA by the EU. As with option two, the UK would need to leave the EU and then negotiate this.
- Even if the legal and political difficulties could be surmounted, all of these options simply delay the process of leaving, creating additional work in the interim for businesses, without dealing with uncertainty over the final arrangements. The difficulty of leaving the current arrangements demonstrates how challenging it would be to move out of EEA membership once in.
- Once in there are also further difficulties:
    - The UK would not have meaningful input into lawmaking in key areas including financial services.
    - The UK would be unable to end free movement of workers.
    - It would be difficult to pursue significant trade deals with third countries or blocs like the Comprehensive and Progressive Agreement for Trans Pacific Partnership (CPTPP), and all but impossible if the UK were also to be in a customs union.

Part 1 – Getting in

1. The Proposal

Proposals for the UK to remain a member of the EEA have been in circulation, including among some Leave supporters, for some time, predating the 2016 referendum. The proposition was adopted and promoted by some MPs after the referendum, and has gone through a number of iterations and re-brands. Initially the 'Norway then Canada' idea seemed to be: joining EFTA in order to accede to the EEA Agreement with immediate effect. There would be no need for a transitional period under the Article 50 Withdrawal Agreement because that is what the EEA membership period would effectively be. It would enable the UK to negotiate and implement a more usual state to state free trade agreement with the EU, often called "Canada +". Variations on this theme include not joining EFTA because the UK's membership of the EEA Agreement will continue as a contracting party in its own right, and becoming an 'associate member' of

EFTA. The proposal has since evolved, and been rebranded as 'Common Market 2.0'. This endorses the draft Withdrawal Agreement as agreed by negotiators in November 2018, but would amend the Political Declaration to include EEA membership and a customs union arrangement to come into place at the end of the Transition Period, such that the backstop in the Protocol to the Withdrawal Agreement on the Irish border would exist but never need to come into effect.

This briefing considers the routes by which the UK could continue to be an EEA member, and then the consequences that would follow from that.

EFTA

First, a point of clarification. Although EEA and EFTA sometimes seem to be used interchangeably, EFTA membership (currently comprising Norway, Iceland, Switzerland, and Liechtenstein) does not by itself give continued preferential single market access. EFTA is a free trade agreement between its parties. The link with the EU for EFTA countries requires signing the European Economic Area (EEA) Agreement, as Norway, Iceland and Liechtenstein have, or negotiating separate bilateral deals as Switzerland has done.

This briefing focuses on the EEA route, which its proponents consider to be an off the shelf route to achieving continuity and frictionless trade, either as a permanent solution or as the UK continues to negotiate a bespoke free trade agreement.

Option 1 – Remaining in the EEA

In this variation of the Norway model the UK simply relies on being a member of the EEA Agreement at present and does not give notice to withdraw. This assumes that because the UK is named as a party to the agreement, the rights and obligations under the agreement must continue whether or not it is a member of the EU or EFTA. On the face of the wording of the EEA Agreement, **it is clear that this is not the case**. It is specifically stated to apply only to the territories of the EU and the EFTA parties, known as the two pillars – the EU pillar and the EFTA pillar. The provisions that deal with managing and decision making under the agreement, the so-called "institutional provisions" are expressly designed to create a balance between the EU pillar and the EFTA pillar. The EFTA Secretariat is of the view that these provisions would not allow the UK to continue as a functioning EEA party in its own right. In its FAQs on its website it states the following:

> *Article 126 of the Agreement on the EEA makes it clear that the EEA Agreement only applies to the territories of the EU, in addition to Iceland, Liechtenstein and Norway. Under the present wording of the EEA Agreement, it is therefore impossible to be a party to the EEA Agreement without being a member of either the EU or EFTA.*

Even if the UK government were to change course and seek to claim that the UK's membership of the EEA Agreement continues unabated by having left the EU, if the other parties don't agree there would be protracted negotiation and even potentially litigation. Given the current state of negotiations, such a change of course would not, one imagines, be popular with the EU and EFTA members, and would be unlikely to be resolved by 29 March 2019, or even, if a transition period is agreed, by December 2020.

Joining EFTA

So why not join EFTA and then accede to the EEA Agreement in the normal course? Again this is not an off the shelf model. Membership of these agreements is not available as of right. It must be applied for and conditions must be met. Although both EFTA and EEA membership can be terminated on 12 months notice, neither envisage temporary membership (other than in order to move from EEA membership into full membership of the EU). It is highly questionable that the four EFTA members, all of whom would have to agree the UK's accession to EFTA, and then the 27 EU member states who would have to agree the UK joining the EFTA group of the EEA Agreement, would agree such a disruptive process and time consuming negotiation in the knowledge that it would only apply for a period of two or three years.

A more recent iteration of the 'Norway then Canada' model proposed by Nick Boles MP conceded this and proposed that the UK would agree not to exercise its right to terminate EEA membership "*while the EU is working in good faith to conclude a new set of agreements that preserve in perpetuity no hard border on the island of Ireland".* The prospect of ever leaving the EEA in that scenario seems remote, given that the effort to guarantee no hard border in perpetuity is exactly what has led to the current impasse. The newer Common Market 2.0 proposal effectively accepts this, on the basis that it recommends entering into the draft Withdrawal Agreement as it stands, including the Irish border backstop, and relying on EEA and customs union membership to ensure that it is never activated. 'Norway for Now' is no more, and has been replaced, for these MPs, with 'EEA Forever'.

A pitfall of the early EFTA/EEA models is that there is not enough time to negotiate EFTA membership and transition to the EEA pillar of the EEA Agreement before 29th March 2019 (or during a brief extension), because this would require new negotiation guidelines to be agreed by the EU27 and ratification, by the UK, all the EFTA states, and all EU Member States. Relevant schedules and governance arrangements would all have to be renegotiated if the UK wished to be able to have any special arrangements to reflect its circumstances, for Gibraltar, for example or for the needs of financial services or other sectors. No doubt the EU would wish to negotiate arrangements on fishing rights. Even if there were the political will to do so (which seems most unlikely for a time limited arrangement), in practical terms the process could not be completed to take effect as a transition. The Prime Minister of Norway has already indicated that the interim membership approach would not be welcomed by the exiting members, noting that "to

enter into an organisation you are preparing to leave at the same time is also a little bit difficult for the rest of us".

In any event there is a more structural obstacle before any such negotiations could even be contemplated. The EU's position is that it cannot negotiate such agreements with an existing member state, as Article 50 does not give sufficient competence and the other relevant provisions of the EU treaties do not cover negotiations with current EU members. Many commentators consider that the boundaries of Article 50 have already been strained to their limits by including in the Withdrawal Agreement an ongoing customs union and single market arrangement for Northern Ireland, and still further by extending this to the whole of the UK, even on a temporary basis, and even as a backstop. It would be very difficult for the EU to stretch this further and re-negotiate the EEA Agreement under Article 50 and doing so would almost inevitably be subject to legal challenge, making it risky and uncertain.

This means that to join the EEA as an alternative to the Withdrawal Agreement, the UK would have to leave the EU with no deal in March 2019, or shortly thereafter, and continue negotiations for the future relationship. This would take away a large part of the claimed benefits of the EFTA/EEA model, as the disruption from leaving with no deal would already have happened and it would be more sensible at that point to focus on bilateral negotiations with the EU and wider trade policy. The other critical reason why EEA membership does not resolve the current impasse is that whether it is temporary, permanent or indefinite, an EFTA/ EEA arrangement does not resolve the issues that the EU has raised in respect of the Irish border.

In recognition of all of these points, Common Market 2.0 recommends a future relationship including EEA membership and a customs union with the EU, to be achieved by entering into the Withdrawal Agreement and negotiating the EEA/customs union relationship during the transition period. This would then come into force instead of the backstop, but the backstop would remain in place and would presumably be triggered if the UK ever wished to withdraw from the EEA or customs arrangement in the future.

The customs union aspect, on the face of it is incompatible with the EFTA Convention, which prohibits customs duties and quantitative restrictions between members (which the UK could not commit to if it were bound to the EU's tariffs, quotas and trade remedies) and binds acceding members to apply to become party to FTAs concluded by EFTA members. The UK would not be able to do this if in a customs union with the EU. It could only enter into FTAs with countries that the EU has FTAs with, and only on the terms agreed by the EU. The Common Market 2.0 proposal does not resolve this, it simply assumes that the EFTA countries will have no objection to agreeing the necessary derogations from the EFTA Convention. It also seems optimistic to assume that the EFTA/EEA accession and new customs union could be negotiated during the 19-month Transition Period, as once again the EU and EFTA states would be in a

strong position knowing that unless the UK accepted all of their requirements and pre-conditions, it would once again be up against a cliff edge time frame.

Option 3 – Associate EFTA membership

It has also been suggested that the UK could work around the need to be an EFTA member to join the EEA Agreement in the EFTA pillar by becoming an "associate member" of EFTA. This would presumably be intended to allow the UK to be in a customs union with the EU but still an EFTA member for the sake of EEA Agreement formalities. There is formally no such thing as associate membership of EFTA. The EFTA Convention provides for the creation of an association between EFTA and any other country or body in agreement with reciprocal rights and obligations, common actions and procedures. This is not a form of membership. It would be open to the EFTA members and the UK to create a form of associate membership if they wished (and this has been done in the past when Finland became an associate member in 1961), but this would be a matter of negotiation between them, requiring amendment to the EFTA Convention and they would not be able to compel the EU to recognise such associate status as qualifying for the EFTA Pillar of the EEA Agreement as of right.

The Irish Border

Much of what has been proposed across all of the Norway-style models is justified, in part at least, as being necessary to maintain an open border, free of infrastructure between Ireland and Northern Ireland. While many experts and commentators, as well as Northern Irish politicians such as Lord Trimble consider that it is in fact possible to for goods trade to pass between Northern Ireland and Ireland without physical infrastructure or routine interventions at the border, this has not been accepted by the EU side to date. An EFTA/EEA solution does not appear any more viable for the whole UK than a normal ("Canada-style") FTA is, given the EU's current negotiating position. The EU's insistence on the backstop as a commitment that would apply in perpetuity means that even EEA membership and a customs union would not remove the perceived need for the backstop: the EU would wish to be able to trigger the protections they consider necessary for the Irish border if in the future the UK gives notice to leave the EEA or customs union, or both, and the EU side does not consider that the border arrangements meet its requirements.

Part 2 – Why would the UK want to be in the EEA?

Having considered the technicalities of agreeing EEA membership we will now consider the substance of what this would mean in practice.

Law making and regulation

What is the EEA? According to the EEA Agreement itself, it is an association formed to "promote a continuous and balanced strengthening of trade and economic relations between the Contracting Parties with equal conditions of competition, and the respect of the same rules, with a view to creating a homogeneous European Economic Area".

Already this indicates why continuing to be part of this arrangement would not achieve the objective of giving the UK Parliament control of law making, and why, even if intended to be for a short period, it could be damaging to the UK's interests. In order to achieve the "same rules" and "homogeneous" conditions, the EEA Agreement permits for the EU to harmonise laws in in-scope fields with the EFTA/EEA members. This is monitored by the EFTA Surveillance Authority and enforced through the EFTA Court, which broadly follows the rulings of the European Court of Justice.

EFTA/EEA members have to adopt EU laws that are relevant to the EEA into their laws. Such laws are incorporated into the EEA Agreement through updates to its Annexes. This is not optional – there is no veto and they have no vote in the European Council or Parliament. Norway's Prime Minister has said clearly "We do accept that decisions on the four freedoms are done in Brussels".

Whether an EEA act should be incorporated is determined by the EEA Joint Committee. Such decisions are by agreement between the EU on one hand and the EFTA states "speaking with one voice" on the other.[1] The EFTA states must come to a decision between themselves as to whether a new law is EEA relevant and on any 'adaptations' that they consider necessary to make it work in their countries. This is known as the right of reservation of the EFTA/EEA countries, but it is not a veto. Article 102 of the EEA Agreement requires that they "***shall*** take a decision concerning an amendment of an Annex to this Agreement as closely as possible to the adoption by the Community of the corresponding new Community legislation" (emphasis added). If no decision is reached and no mutually acceptable solutions can be agreed, the affected part of the EEA Agreement will be suspended.

The consequences of this are serious, as Norway found out when it sought to exercise its right of reservation on implementing a directive on postal services and was threatened with losing market access for its fisheries products. As a result, the right of reservation in the EEA

[1] Article 93 EEA Agreement

Agreement has never been followed through, and is, in essence, a theoretical construct that allows EFTA/EEA states to respect their constitutional formalities.

It is often claimed that the EFTA/EEA countries can shape and influence EU laws as they are consulted at an early stage in the law-making process, and that this is somehow an acceptable alternative to being able to vote on legislation. Although the EEA Agreement provides for consultation and communication at the early stages of formulating single market legislation, in practice, as described by the European Parliament, EFTA countries "have little influence on the final decision on the legislation on the EU side". As noted by the EFTA Secretariat "EEA EFTA States have little influence on the decision-making phase on the EU side". The UK's former European Commissioner for Financial Stability, Financial Services and Capital Markets Union, Lord Hill, described his experience of the relationship between the EU and the EFTA/EEA members as

> *"not a relationship of equals or anything remotely approximating it. My recollection is that EEA ministers were extremely grateful just for a meeting and even pleasantly surprised to get a reply to their correspondence. No EEA country had any material "rule-shaping" effect on financial services."*

This illustrates the severe immediate political costs of even temporary EEA membership without a known end date (which, as explained in Part 1, is unlikely to be negotiable so indefinite membership is the more likely scenario). It is instructive to consider how this would work in the context of issues that are important to the UK economy. EU financial services regulations are EEA relevant so EFTA/EAA members are obliged to implement them. It is well known that the stated aim of many EU member states is to win business away from the UK, and that the direction of travel of EU rules in financial services has been towards greater levels of intervention and integration, often in ways that have been detrimental to the UK even while it was a member. There would be a significant risk of regulation being passed that would, deliberately or otherwise, undermine the UK's competitiveness in this area. And if Parliament were to resist, the EU would be able to respond by withdrawing market access not just in financial services, but in unrelated fields like food or motor vehicles. This is why firms and industry bodies in the City have moved on from prioritising passporting rights in the single market. Lord Hill reports that from his ongoing discussions with regulators, politicians and financial services businesses in the EU "I haven't met one who thinks that being in the EEA could work for London and Britain's financial services industry".

This does not just concern arcane matters of technical regulations of goods, and indisputable safety requirements. Fundamental issues that go much wider than simple harmonisation of goods standards are in play, from the use of gene editing technology to freedom of expression on the Internet to defence procurement, and would effectively be determined without British voters and businesses having representation.

Immigration

Another issue that is of vital interest to the British people is immigration. Free movement of workers is a fundamental part of the EEA Agreement and EFTA/EEA members are subject to all the EU legislation supporting it. Consideration of the relevant provisions and precedents indicates that it is unrealistic to suggest that a Lichtenstein-style immigration control could be agreed, or that the UK government could simply make better use of the controls on free movement that are already available. The emergency brake under article 112 of the EEA Agreement that supporters of the Norway model often cite would be very unlikely to apply to the UK. Liechtenstein was able to negotiate an enduring safeguard due to its unique position with a tiny population and mainly rural geography. It was made clear to David Cameron during his attempted renegotiation before the referendum that the EU does not consider that the UK is encountering any difficulties that would justify deploying such emergency measures. It is also clear that the existing controls that allow member states to remove immigrants from EEA countries who do not meet the criteria of being a worker or economically self-sufficient cannot be utilised to their full extent by the UK unless it introduces registration and identity systems (which would have to be for UK nationals as well as immigrants, otherwise they would be discriminatory) and make access to welfare benefits and healthcare much more rigorous. These would be serious changes to the way the UK is governed and, in many respects, would operate directly against the concerns of voters. There are, however, strong arguments for retaining an open and liberal immigration policy, especially with respect to EEA countries, and polling after the referendum suggests that public support for this will be greater if it is delivered as a matter of UK policy rather than pursuant to EU or EEA membership.

Wider Policy Implications

The UK cannot cherry pick its model as a member of the EEA. The foundational principle of the EEA and its institutions is homogeneity of regulations and their application across the single market. And the direction of travel is towards more areas becoming more integrated. Iceland's finance minister recently said "Those that are for integration are stepping up the pace and if that is realised there will be even less tolerance for special implementation in the European Economic Area". Carving out special treatment for sectors or to deal with movement of workers would mean seeking to reverse this and undermine the principle of homogeneity. Why would the 30 EEA members agree to unbalancing their relationship and destabilising established structures for the UK, especially if they think we will leave in a couple of years? It is noted in the Common Market 2.0 plan that Norway and Iceland have successfully negotiated a number of derogations from specific EU measures over the years, highlighting the need for all legislation to be actively incorporated by parliaments, as a national right of reservation. However, this illustrates both why the EU would be unlikely to support UK EEA membership without stricter conditions, and why such membership would be inherently unstable, and unattractive for the EFTA/EEA members who need to speak with one voice if the agreement is to function. Delays

and obstruction by Norway in implementing a package of hygiene regulation would not threaten the operation of the whole system. Such action by the UK in financial services, or other important sectors surely would.

It should also be noted that the derogations, or adaptations as they are technically called, are not to accommodate the policy preferences of the EFTA countries. They are technical adaptations to make the legislation function in its institutional context or substantive adaptations to reflect "geography, topography, climate, infrastructure or the economic or demographic situation" for example, as described by the Standing Committee of the EFTA States.

The impact of EEA membership on financial services and immigration alone should rule it out for the UK post-Brexit (even if the basic argument for democracy and accountability in who makes the UK's laws, and how, are not considered sufficiently persuasive). Even if the supporters of this model are right that these matters could be satisfactorily negotiated, for example to give UK regulators a voice in financial services regulation, or by allowing the UK a Liechtenstein-style 'brake' to cap immigration, which are both unlikely as they would put the UK in a position of greater influence than EU member states, there is no way that they could be negotiated in time to take effect on 30 March 2019, or even, given the balance of negotiation positions if negotiating under the shadow of the backstop, by December 2020.

International Trade

EFTA/EEA membership would also have a serious impact on the UK's international trade policy, pursuit of which is present government policy.

If not combined with a customs union, as an EFTA/EEA member the UK would be technically able to negotiate free trade agreements in the way that EFTA members do, either individually or as a bloc. But the FTAs that EFTA countries have are not the kind of comprehensive and truly progressive deals that the UK would be looking for, addressing services and regulatory barriers, because these matters would remain subject to EU laws so could not be negotiated by the UK with other countries.[2] All of the reasons why the EU and the USA were unable to progress the proposed FTA between them (the Transatlantic Trade and Investment Partnership or "TTIP") would still apply, and the UK would be even less able to work through them, so a UK/US FTA, considered to be one of the great opportunities from Brexit, would be unobtainable.

[2] Protocol 12 of the EEA Agreement provides that only the EU can negotiate mutual recognition agreements with third countries and the EFTA/EEA countries can follow in parallel.

Conclusion

Even if it were politically and practically deliverable, a Norway then Canada proposal would not make life easier for business. It would mean another system they would need to adjust to, in between EU membership now and fully leaving EU regulation later. This would suggest that, even if the EU were satisfied on the Irish border, the eventual move out of the 'Norway phase' would be met with as much resistance as leaving the EU is encountering at present. Even entering into the Withdrawal Agreement on the basis of using the transition period to negotiate EFTA/EEA membership and a permanent customs union is fraught with uncertainty as the new deadlines of the end of the Transition Period, its possible extension and the activation of the backstop would loom as soon as the Withdrawal Agreement were signed.

A Norway option, whichever version is chosen, would be hard to get into and likely harder still to leave. Once inside, the EEA Agreement would prevent the UK from exercising control over its borders and would give control of important areas of lawmaking in goods and services to the EU without the UK having a vote or real influence. EEA membership does not remove the need for a backstop, under the EU's current position, as the UK could leave the EEA Agreement on notice. Proponents of the model have now accepted, and in fact now actively support, EEA membership, and probably a customs union, as the end state for the UK/EU relationship. This is still unlikely to be politically deliverable in the UK and it is questionable that it could be negotiable with the EU and EFTA/EEA members without the UK making serious concessions on areas like fisheries and financial contributions.

Victoria Hewson
Senior Counsel for the International Trade and Competition Unit

Institute of Economic Affairs
2 Lord North Street, Westminster, London. SW1P 3LB
vhewson@iea.org.uk
www.iea.org.uk