

CONFIDENTIAL



Handwritten initials: KLS, CDR, PC

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

10 August 1989

A WIDER EUROPEAN COMMUNITY

Thank you for your letter of 7 August to Caroline Slocock enclosing a draft paper prepared for eventual circulation to OD(E). The Prime Minister was grateful for this material which she has noted without comment.

Paul Gray

Richard Gozney, Esq.,
Foreign and Commonwealth Office.

Handwritten initials: R



10 DOWNING STREET

Prime Minister 2

You saw this is an
earlier box, but
I wasn't clear
whether you had
finished with it.

CRS

9/8

ce/PC

CONFIDENTIAL



Prime Minister

Foreign and Commonwealth Office

London SW1A 2AH

7 August 1989

You may want to touch on this in your meeting tomorrow with the Foreign Secretary.

CPS 7/8

Dear Caroline,

"A Wider European Community"

In Charles Powell's letter of 25 April he reported that the Prime Minister, on seeing the minutes of the OD(E) 20 April discussion of Sir Geoffrey Howe's 17 March minute, wished to be kept closely in touch with further work on actual/potential applications for EC membership, and to be consulted before any conclusions were reached.

Further in-house work in the FCO has been done since 20 April, and the enclosed draft paper has been prepared for eventual circulation in OD(E). FCO officials have also prepared the enclosed note on the Neutrality issue raised by the Austrian Application delivered in Brussels on 17 July. Some OD(E) discussion of both papers will probably be needed in the autumn, but it has occurred to the Foreign Secretary that the Prime Minister might like to see them now, in view of her August contact with Chancellor Vrantisky. For convenience I also enclose a copy of Sir G Howe's 17 March paper.

The Foreign Secretary has not yet had an opportunity to study these papers in detail or to discuss them with officials. But his instinctive view in advance of such discussion is that a wider Europe is unappealing from the UK point of view.

He suspects that the accession of Austria might be difficult in view of

- (a) her neutrality
- (b) her historical links with Germany
- (c) the likelihood that her accession would be the catalyst for further applications.

Yours sincerely,

Richard Gozney

(R H T Gozney)
Private Secretary

Miss Caroline Slocock
10 Downing Street

CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

OD(E) (89)

COPY NO

July 1989

CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

SUBCOMMITTEE ON EUROPEAN QUESTIONS

EFTA AND MEMBERSHIP OF THE COMMUNITY

Note by the Foreign and Commonwealth Secretary

Introduction

1. An earlier paper "A Wider European Community?", circulated under cover of my minute of 17 March (FCS/89/051) took a first look at possible enlargement of the Community, briefly considering the UK interest in relation to each potential applicant, the wider implications of the cross linkages between applications, and possible compromises short of major enlargement. At our meeting on 20 April (OD(E) (89) 3rd Meeting) we agreed that,

we needed a fuller analysis of our general attitude to enlargement, particularly in respect of present members of EFTA. This note therefore, considers:-

temporarily retained

THIS IS A COPY. THE ORIGINAL IS
RETAINED UNDER SECTION 3 (4)
OF THE PUBLIC RECORDS ACT

- (a) the UK's economic interest in EFTAN membership of the Community;
- (b) the implications of EFTAN membership in political, institutional and non-economic policy areas.

Background

2. Prompted on the EFTA side by a desire (largely economic, but also political) not to be left behind by developments within the Community, in particular the Single Market, the EC and EFTA are currently in the process of exploring the options for a closer partnership. But further EFTAN applications for EC membership, following the Austrian application on 17 July, cannot be excluded. Norway is likely to reapply within a few years. Sweden might well not be far behind. Finland and Iceland would have to look more closely at accession if the other three joined. Among EFTA members, only Switzerland is likely to set its face firmly against membership for the foreseeable future.

Economic Implications of EFTAN Membership

3. The EFTA economies are relatively small (total 1988 GDP \$691 bn cf EC \$4745 bn) but well developed (average 1988 GDP per capita \$21,500 cf EC average \$14,600). Collectively they are already the Community's largest trading partner (\$220 bn two-way trade in 1988; EC exports \$114 bn, EC imports \$106; compared with EC two-way trade of \$136 bn and \$60 bn with the US and Japan).

4. There is therefore a strong EC, and UK, economic interest in the closest practicable trading relationship with EFTA. A tariff-free trade area (in industrial goods) has already been established. Removing remaining non-tariff barriers could be expected to produce increased EFTA economic growth, and sharply lower EFTA prices. Consequent

acceleration in EC/EFTA trade might initially add about 0.2% to EC12 GDP, probably followed by larger, albeit unpredictable, gains. The greatest gains for the Community would probably come from the opening up of public procurement, and the services markets, in EFTA. The UK should achieve at least its fair share of such gains. The boost to UK exports might be around \$450 m, compared with increased imports of some \$150 m, a net gain of \$0.3 bn (compared with a trade deficit with the EFTAs of \$11.8 bn in 1988).

5. Accession, rather than just closer trade links, would produce other changes. All the EFTAs except Iceland would be net contributors to the budget of an enlarged Community. Their combined net contributions (which, on 1992 forecast data, and unchanged EC policies, might be some 5 becu - 0.6% of their GDP), might reduce the UK's net contribution (after abatement) by some 400 mecu. But the question is whether EC policies would be unchanged by EFTA accessions.

LIKELY EFTAN ATTITUDES TO COMMUNITY ISSUES

Internal Market, Trade and Competition Policy

6. Within an enlarged Community the EFTAs would generally be useful additions to the liberal camp on core Single Market issues. Some (eg Austria, Sweden) might, however, be on the opposite side from the UK in most deregulation/harmonisation debates. All have economies more regulated than the UK's. All would wish to maintain substantial State aids (Austria, Norway and Sweden have large public sectors); and on competition policy only Sweden would favour an interventionist Commission role. Liberalisation of services (in particular transport) might also be slowed.

Agriculture

7. On agriculture there would be serious difficulties. The EFTANs all protect their agriculture sectors very highly, with support prices typically considerably higher, and import restrictions stricter, than under the CAP. Ex-EFTAN members of the Community would therefore be a serious brake on CAP reform and hence the reform of agricultural trade in the GATT. The EC Budget effect of this would significantly erode the UK gains from EFTAN net contributions.

Structural Funds

8. Paradoxically, ex-EFTAN members of the Community would be strong supporters of increased resource transfers from richer to poorer areas of the Community. Indeed some EFTANs (Norway and Sweden in particular) have already indicated a willingness to contribute to structural funds from outside the Community - in order to buy Southern member states' support for closer EC/EFTA cooperation. As EFTAN accessions would leave the UK well below the average per capita income in the enlarged EC, we might be in a better position to prevent a further erosion of our share of structural fund receipts. But this gain would be very unlikely to outweigh the cost of an overall increase in Structural Funds.

Aid

9. On average the EFTANs spend a considerably larger proportion of their GDP on official aid (0.59%) than does the EC (0.45%) or the UK (0.32%). Several EFTANs spend very high percentages (Norway 1.12%, Sweden 0.87%), and there is widespread political support for such policies. While the EFTANs might be useful allies in seeking to improve the quality of EC aid, they would certainly support an expansion of EC aid volumes (beyond that which would be almost

automatic on enlargement). This could be costly to the UK.

Social Issues

10. Partly because of generally left of centre governments, partly a result of social organisation and custom, all potential EFTA applicants would find themselves in the opposite camp to us in EC debate on social issues. For instance, worker participation on company boards is already a legal requirement in Austria, Norway and Sweden, and consultation on major decisions is mandatory in Finland also. Workers' rights are strongly enshrined in law: in all these countries, there is a statutory right to bargain collectively and strike, along with statutory minimum holidays and provisions for parental leave. In 3 EFTA countries there is a legal right to work; in 2 a statutory minimum wage (see details at Annex A).

Environmental Issues

11. The EFTANs also have rigorous environmental policies. They would be likely to press for very strict environmental standards within an enlarged Community; strongly to support giving enforcement powers to a European Environment Agency; and to argue for Community financing of environment programmes in poorer member states.

Institutional Issues

12. The general institutional difficulties in an enlarged Community (unwieldy Council and Commission leading to pressure for an informal steering group, and more powers for the Commission; proliferation of languages) were outlined in the previous paper. In terms of the long-term structure of the Community, accession by EFTANs might be expected to reduce pressures for greater integration, at least on political issues. But in the economic sphere the picture

would be different: Austria and Sweden have strong traditions of central direction of the economy, and the Austrians in particular would be unlikely to have much difficulty with monetary union given the current de facto union of the Schilling and the Deutchmark.

13. Decision making by Qualified Majority (QM) would also be affected significantly by EFTA membership. If all but Switzerland joined, Austria and Sweden would probably have 4 votes, Norway and Finland 3 and Iceland 2. A QM would probably be 65 out of 92 votes (cf 54 out of 76 at present), and a Blocking Minority (BM) therefore 28 votes (cf 23 at present). The net budget contributors (UK, FRG, France plus the EFTAs except Iceland) would have enhanced voting power (44 votes, compared with 30 now), but ex-EFTAs would exercise it with less rigour (eg on Structural Funds). The economic liberals (UK, Netherlands, FRG: 25 votes) would lose their current BM. On agriculture the UK and Netherlands (15) would need to attract 13 more votes for a BM: not even the support of Denmark and Spain (11) on particular issues would suffice.

Political Issues

14. Politically, Norway or Iceland as NATO members would pose almost no difficulties within the Community. As East/West neutrals Austria, Sweden and Finland would however, be concerned not to compromise their neutrality. This could act as a brake on the development of political cooperation and of a defined political and security role for the Community within the Atlantic Alliance; and would complicate US/Community relations. And in respect of Austria and Finland the Russians might claim that Treaty provisions give them a droit de regard.

Deductions

15. It is thus clear from the above that:

(a) initially, EFTAn membership of the Community would be likely to be modestly in the UK's economic interest, notably in trade terms (the net budgetary gain is uncertain);

(b) overtime there would, however, be substantial costs in political and institutional terms, and in both economic and non-economic policy areas.

Squaring the Circle

16. Are the advantages summarised at 15(a) worth going for, given the likelihood that they would not prove durable, and would be outweighed by the disadvantages of 15(b)? Could one obtain the advantages without the accompanying disadvantages? The major economic advantages come from full integration of the EFTAns into the Single Market. The additional UK economic advantages of their full EC membership are much more debatable: the initial budgetary gains for the UK are likely over time to be significantly eroded, and perhaps reversed, by increased spending on structural funds, aid, the environment and social policies, and by the budgetary consequences of a further brake on CAP reform. On the other hand, the major UK disadvantages spring from EFTAn accession, and would not appear in arrangements short of membership.

17. The UK's interest would therefore best be served by arrangements which fell short of EFTAn accession, but allowed EFTA full access to the Single Market. This broadly is the aim of the current EC/EFTA discussions. There are still difficult issues, both substantive and institutional (not so much mechanisms for EFTAns to influence EC decision making, as problems of enforcement and dispute settlement

across the EC/EFTA boundary). And it is still an open question whether a customs union is feasible or desirable: a common external trade policy could require new mechanisms for decision making, and might be desirable only for non-agricultural goods. But it is clear that the more open the EC/EFTA trading relationship the better for the UK; and that our political interests would also be well served by the success of the current process.

Conclusions

18. (i) with the exception of Norway, EC accession by EFTA states would be a mixed blessing;

(ii) the UK should not therefore encourage new EFTA applications (other than by Norway); and should continue to react cautiously to the Austrian application; but

(iii) the UK should strongly support, for economic and political reasons, the closest possible relationship between the EFTAs and the Community, short of membership.

AUSTRIAN APPLICATION FOR EC MEMBERSHIP

"PERPETUAL NEUTRALITY" AND THE STATE TREATY

Austrian Application

1. The Austrian letter of application of 17 July states:

"....

Austria presents this application on the understanding that her internationally recognised status of permanent neutrality, based on the Federal Constitutional Law of October 26, 1955, shall be maintained and that also as a member of the European Communities by virtue of the Treaty of Accession she will be in a position to fulfill her legal obligations resulting from her status of permanent neutrality and to continue her policy of neutrality, as a specific contribution towards the maintenance of peace and security in Europe." In effect the Austrians appear to be seeking a permanent derogation from certain obligations of the Treaty of Rome and the Single European Act in order to guarantee maintenance of their "perpetual neutrality".

Austrian Neutrality

2. As the letter makes clear, Austria's "perpetual neutrality" derives from the Federal Constitutional Law, in which "Austria declares of her own free will her perpetual neutrality. Austria will maintain and defend this with all means at her disposal. For the securing of this purpose in all future times Austria will not join any military alliances and will not permit the establishment of any foreign military bases on her territory."

3. Although the Constitutional Law is formally autonomous, domestic, legislation, the Austrians consider maintenance of their "perpetual neutrality" an international obligation by virtue of their having notified all members of the UN at the time. And the 1955 Moscow Memorandum (of talks between

the Soviet Union and Austria) - which set out the basis on which the Russians would agree to withdraw from Austria, and to sign the State Treaty - recorded an undertaking by the Austrian Government to make a declaration "in a form which will oblige Austria internationally to practice in perpetuity a neutrality of the type maintained by Switzerland". Our Legal Advisers consider that although substantively the Memorandum was overtaken by the State Treaty and the Federal Constitutional Law, it established a continuing legal obligation on Austria (at least to the Soviet Union) to maintain its neutrality.

State Treaty

4. The Austrian State Treaty of 1955 was signed by Austria and the Four Great Powers - France, UK, USA and the Soviet Union. It makes no reference to neutrality. On the basis of the Moscow Memorandum, the Soviet Union continues to link neutrality and the State Treaty, and hence to strengthen its claim to a droit de regard over the maintenance of Austrian neutrality. But the three western co-signatories to the Treaty successfully resisted any legal association between the State Treaty and "perpetual neutrality".

5. Article 2 of the State Treaty provides that the Great Powers will respect the independence and territorial integrity of Austria. Article 4 (headed "Prohibition of Anschluss") prohibits political or economic union between Austria and "Germany", "in any form whatsoever". Austria undertakes inter alia not to "promote political or economic union with Germany, or to impair its territorial integrity or political or economic independence". There is legal debate on the implications of these Articles for Austrian membership of the Community (in particular whether membership of the Community implies "economic union with Germany"; and indeed whether the "Germany" of the State Treaty can be taken to mean, in this context, the FRG - our view is that the FRG is not the same as "Germany" and is not

the successor to the Reich). Legal Advisers have concluded that there is no absolutely compelling legal argument either way on the compatibility of the State Treaty and membership.

Implications for the Austrian Application to the EC

6. The main issue is therefore Austrian insistence on maintaining "perpetual neutrality". The Austrians are seeking acknowledgement in a Treaty of Accession that "perpetual neutrality" is an obligation "accepted for the purpose of maintaining peace and international security" within Article 224 (EEC), so enabling them to rely on this Article to avoid obligations under the Treaties which are inconsistent with their neutrality. The Austrians have not sought to argue that "perpetual neutrality" is an obligation "arising from agreements concluded before the entry into force of this Treaty" (Article 234, EEC), presumably since the same Article obliges member states to "take all appropriate steps to eliminate the incompatibilities" (between the previous obligation and the Treaty). Our legal advice is not only that Austria is under an obligation (at least to the Soviet Union) to maintain its neutrality (although it does not necessarily follow that it is the type of obligation, such as the UN Charter, envisaged in Article 224); but also that the wide wording of Article 224 would allow Austria to claim a broad exemption from obligations under the Treaty, especially as the exact scope of Austrian neutrality is not well defined and they apparently regard its definition as a matter only for them. It is therefore a political question whether we are prepared to allow a prospective member state to do this.

7. Austria's neutrality cannot be compared with Ireland's. Austrian "perpetual neutrality" is firmly rooted in the post-war settlement between East and West; is enshrined in fundamental Austrian domestic legislation; and is an obligation to the Soviet Union and arguably wider. Irish neutrality is a political policy stemming from Anglo/Irish

history, and is not required by the Irish constitution. The Irish firmly rebut comparison between the two.

8. In practice, Austria might seek to absolve itself from action under the Treaty which it saw as prejudicing its neutrality (in particular trade measures under Article 113 for political or security reasons). Neutrality is not likely to impinge on routine EPC cooperation. But Austria might find difficulty subscribing to certain essentially Western positions of the Twelve: about 40% of EPC activity is related to East/West issues. In the CSCE context the Austrians have already made it clear that they would wish to remain members of the Neutral and Non-Aligned (NNA) Group. They argue (rather implausibly) that the process of change now underway in Eastern Europe will, in any event, make such labelling irrelevant in the timescale of their accession to the Community. Austria may therefore look for a derogation, possibly formalised in a Treaty of Accession, perhaps undertaking to stay silent - and thus not prevent consensus in EPC - provided it is accepted that Austria will not implement certain decisions. This might be difficult for us to accept.

9. However, the real issue is less the operation of the present Community, and more its future development. As the Austrians appear determined not to be drawn closer into the Western camp, their membership of the EC would be likely over time to cause increasing strains within the Community and in the trans-Atlantic relationship. And Austrian neutrality is likely to impede, and perhaps render impossible, the evolution of a security/defence dimension to the EC. With the future structure of European defence, within NATO, as yet unclear, it would be unwise to foreclose any option, and have to rely solely on the potential of WEU.

European Community Department (External)
25 July 1989

A WIDER EUROPEAN COMMUNITY?

Introduction

1. Though no new members will be admitted until after 1992, the possibility of further enlargement of the EC thereafter is a topic of renewed debate. A diverse range of countries aspire to membership, and the Community will shortly begin considering how their aspirations should be handled. This paper briefly considers:

- (a) the UK interest in respect of each potential applicant, considered separately (a static analysis);
- (b) an examination of the linkages between the various potential applications, and their possible cumulative implications for the Community, and UK interests (an outline dynamic analysis); and
- (c) the possibilities for compromise solutions, short of major enlargement.

Background

2. The only current application is Turkey's, on which the Commission's Opinion, or perhaps an interim report, is expected this year. But Austria is likely to apply this summer; Malta has said she will submit an application soon; there are indications that Cyprus may follow suit; and a Norwegian application in the early 90's is on the cards. The other EFTA countries are seeking closer "integration" into the Single Market. The Norwegians and Swedes would wish to go further in this direction than their partners, and if frustrated would be the more likely to apply for Community membership. Within EFTA only Switzerland, Iceland and Finland have said they do not intend to apply in the foreseeable future.

3. The prospect of a series of applications partly reflects the success of the Community in recent years in projecting a more dynamic image, but also reflects fears in neighbouring (and particularly EFTA) countries of the potential consequences of exclusion from the Single Market. Taken singly, admitting almost any of the potential applicants would present economic or political difficulties. Taken cumulatively they raise for current member states the prospect of substantial changes to the Community; and substantial costs, political and economic. The decisions faced by the Community are more radical than those posed by the two most recent enlargements (to 10 and then 12), and more akin to the first enlargement - with the proviso that these precedents make it that much more difficult to bar the door.

The Potential Applicants

4. Each potential applicant's current position is summarised below. Turkey, Malta, Cyprus, Norway (and Morocco) were covered more fully in the paper "Further Enlargement of the European Community?", circulated to OD(E) in October 1987: only an update is given here. A fuller analysis of the Austrian case is at Annex A.

(a) Turkey

Turkey applied to join the Community in late 1987. The Commission's Opinion is in preparation, and M. Delors has spoken of a "first report" this year. Thinking among those close to Prime Minister Ozal appears to have evolved from insisting that only a firm acceptance of eventual Turkish membership within a specified time-frame will do to stressing that the important element for Ozal is that negotiations with the Community should begin, so that he can use them as a lever for internal economic reform. Economically, Turkish accession would be very costly to the UK: we estimate that Turkish membership would have cost

current member states about 6 becu in 1988 - UK share, after abatement, perhaps some 500 mecu. But an outright rebuff from the Community would be seen as a political affront to Turkey's European aspirations and role in NATO.

(b) Malta

Malta intends to apply fairly soon. The Maltese economy is so small - and relatively strong - that absorption would present no particular difficulties.

(c) Cyprus

The Cypriots are considering an early application - although we have warned them that it would be difficult to envisage the Community agreeing to address the question seriously in advance of some settlement of the intercommunal dispute. Economically, assimilation of Cyprus would not be difficult for the Community or costly for the UK: politically it would be difficult to admit Cyprus without Turkey.

(d) Norway

Norway nearly acceded to the Community with the UK, Ireland and Denmark. Though the negative referendum result then left bitter memories, there is a growing feeling in Norway that Community membership should again be the goal. A further referendum would be needed, and no Norwegian government is likely to pursue membership without wide public support. The present Government published a 1987 White Paper to stimulate internal debate on the implications of the Single Market, but did not wish membership to be an election issue until 1993. The Conservative opposition however favour an early application, so the issue will be debated in this year's election campaign. The accession of Norway, a firm NATO ally who would be a net contributor to the EC budget, would be in the UK's interest, economically and politically.

Temporarily retained

THIS IS A COPY. THE ORIGINAL IS
RETAINED UNDER SECTION 3 (4)
OF THE PUBLIC RECORDS ACT

(e) Austria

The Austrians are likely to apply by July. All sectors in Austria (the major political parties; the industrial, business and agricultural sectors; and the trade unions) appear to be in favour. They consider that adaptation to EC membership would pose few economic problems, in view of the considerable existing EC/Austrian economic inter-penetration. Conversely they believe that their economic interest will be harmed if they are not "integrated" into the Single Market, and that EC/EFTA harmonisation/cooperation arrangements will not go far enough. They believe other EFTA countries will eventually come to the same conclusion, and are anxious to beat the rush. Politically they believe they have a Western European vocation, and can act as a useful link with East Europe; and that their "perpetual neutrality" and the State Treaty are no bar to membership. For the UK, the economic effects of Austrian accession would be broadly neutral: the complications would be political (see Annex A).

(f) Sweden

The present Swedish government continue to regard Community membership as incompatible with Swedish neutrality. But they too stimulated a domestic debate with a 1987 White Paper, and Swedish business interests are generally in favour of accession. In the longer term, particularly if another EFTA country had acceded, and especially if that country were a fellow neutral, the government might well change its mind. Swedish membership would not create new economic costs for the UK; but Swedish neutrality would create political inhibitions analagous to those which Austrian accession would bring.

(g) Iceland

Iceland has consistently ruled out membership on economic grounds. With an economy heavily dependent on fisheries, the Icelanders could not contemplate participation in the Common Fisheries Policy which would open their fishing

grounds to other Community vessels. Icelandic accession would have little economic impact on the UK in areas other than fisheries (where the impact would be adverse): politically, as a NATO ally, Iceland's membership would create few problems.

(h) Finland

The Finns have shown no sign of seriously considering accession. Their full membership of EFTA was delayed until 1986 by Soviet pressure. Although recent developments within the Soviet Union and in East/West relations have given them more room for manoeuvre, the Finnish government confirmed in autumn 1988 that they regard membership of the EC as incompatible with their neutrality and that their target is closer EFTA/EC relationships. However, they would have to look more closely at possible accession were Austria and Sweden to apply.

(i) Switzerland

The Swiss government confirmed in September 1988 that they do not contemplate applying for membership in the foreseeable future - they prefer to stand aside from the Community, as from the United Nations. Their form of direct democracy would be unworkable in the Community. They also have deep-rooted objections to free movement of persons from EC member states. They operate a more highly supported/protected agricultural sector than the EC. Though they have major investments in many member states, and have taken a number of bilateral steps to get closer to the Community, they are likely to be the back-markers on EC/EFTA cooperation whenever the establishment of more formal links, EC/EFTA or even intra-EFTA, is at issue.

UK Balance Sheet

5. As with Norway, the immediate economic and commercial impact on UK interests of accession to the Community by

Finland, Sweden, Switzerland or Austria, with their comparatively highly developed industrial economies, would be likely to be generally beneficial, although detailed analysis would be required before reaching a definitive view in each case. The costs to the UK of accession by Cyprus, Malta or Iceland would be small: the costs of Turkish accession very large. From a political point of view accession by Norway would be a plus, whereas any of the Mediterranean or EFTA neutral or non-aligned countries would cause difficulties: the specific case of Austria is discussed in more detail at Annex A: the general issue is addressed at paras 10/11 below. But a static analysis clearly is misleading: there are complex cross-linkages between the various potential applications which could give a dynamic to the process of enlargement; and the cumulative effect on UK interests (economic and political) of several accessions would clearly be much greater than the sum of the effects considered singly.

Cross-Linkages

6. There are 3 obvious, and one more speculative, linkages:

(a) North/South

Norway is the least problematical potential applicant. But even if a case was made for exceptional fast-track procedures because of Norway's previous successfully completed accession negotiations, the Turks might see Norwegian accession, ahead of them, as a slap in the face. This would probably be manageable without a major rift with Ankara, given the 1973 excuse; but similar queue-jumping by Austria, Malta, Cyprus or Sweden (all non-NATO members) would not.

(b) North/North

The Turkish problem aside, the accession of any one EFTA country might produce a domino effect among the others. In this context too Norwegian accession could

conceivably - though with difficulty - be ring-fenced, but Austrian accession could not, for it would bring another neutral into the Community, so weakening the Swedish rationale for remaining outside (and the possible Community rationale for resisting Swedish accession). In the longer term that would put pressure on Finland, and again make it difficult to refuse her. There would similarly then be no convincing rationale for excluding Iceland, leaving among present EFTA members only Switzerland outside the Community.

(c) South/South

Admitting even one or two "northern" EFTA countries would be likely to increase the support of some "southern" members, particularly Italy and Greece, for further balancing southern accessions - perhaps Malta and Cyprus without Turkey. But Cypriot or Maltese accession without Turkish accession would cause serious problems in Ankara. Conversely Turkish accession would make Cypriot accession almost inevitable, and it would then be difficult to find a convincing rationale for not admitting Malta.

(d) East/West

It has been suggested that in the longer term, and if Community membership had expanded widely, some East European countries - in particular Yugoslavia and Hungary - might consider applying for membership. For the foreseeable future this is unlikely, and should be discouraged. Yugoslavia has an Association Agreement with the EC similar to those with other Mediterranean countries, and is not treated as a State Trading Country: but her current economic and internal political status makes her a highly unattractive candidate. And despite the economic and political reforms underway in the Soviet Union and some East European countries, their economies are likely to remain centrally directed, and their political systems far from pluralistic democracies

as understood in Western Europe.

Cumulative Effects

7. Maximally, such a series of linked accessions could eventually produce a Community of 21 members, excluding only Switzerland, the 4 micro-states (Andorra, Monaco, San Marino and Liechtenstein), and Eastern Europe. Such a Community would obviously be considerably more heterogeneous, disparate and unwieldy than the present one, and would impose new economic burdens on the UK. Moreover, few if any of the additional members would willingly embrace the UK's deregulatory Single Market approach (eg on services); even the Austrian economy is affected by seriously structural rigidities; pressure for EC "social dimension" activity would be increased by any of the possible accessions; and progress on CAP reform (and consequent EC Budget rationalisation) would be considerably harder in an enlarged Community.

8. For Southern aspirants, semi-permanent or permanent "transitional" measures would be required, relieving the new member of some of the costs and obligations of membership; enlargement which included a significant increase in the size of the Community's economically underdeveloped regions (eg the admission of Turkey) would be costly in terms of further increases in the Structural Funds; and new Southern states would be likely to flout Community law, particularly in the Single Market area, whether or not they were formally permitted to do so (thus denying to the UK the principal benefit of further enlargement). Such tendencies in the existing Community have been limited by the fact that difference in per capita GNP are relatively small, and the poorest member state, Portugal, represents only 3% of the Community's population. Concessions to poorer member states have been limited to exceptional measures (eg differential time-scales for implementation of the directive on liberalisation of capital

movements) or special measures, built into general legislation (eg on agricultural structures), to help poorer regions without prejudicing the overall principle. If, however, such exceptions were to cover a much larger area and population the likely result would be either a variable geometry Community (ie with a much wider range of optional policies than at present) or a Community of two tiers, moving at different speeds.

9. This would have institutional consequences, not least for representation. Any member state contributing to the budget, however marginally, would have to have some say in its management (so reducing UK voting weight). But it is hard to imagine that it would be the general view, or acceptable to the UK, that a member state participating in only a restricted range of Community activities should have a voting weight on all Community policy issues based only on a relative population size, as now. Whatever the voting arrangements, a Council of more than twelve member states would be hard to manage, and the annual agricultural price fixing an even more laborious and painful affair. A European Council - or General Affairs Council - much larger than at present would be a very unsatisfactory forum for giving overall direction to the Community, and if more than one (or two) new members joined, a small steering group of fully participating member states might well emerge, formally or informally. A Commission further expanded to reflect enlargement would be cumbersome, even if all member states nominated only one Commissioner. Yet a practical effect of substantial enlargement would probably be pressure for more delegation of power to the Commission, if only to ensure that business got done. (Major enlargement would also exacerbate the language problem, with additional staffing consequences - though Norwegian accession would strengthen the anglophone camp.)

10. The accession of almost any of the potential new member states could also affect the development over time of a more

defined political and security role for the Community within the Atlantic Alliance. Only Norway would pose no such problem.

Temporarily Retained

THIS IS A COPY. THE ORIGINAL IS
RETAINED UNDER SECTION 3 (4)
OF THE PUBLIC RECORDS ACT. The EFTA

neutrals (Austria, Sweden, Finland) would seek assurances that their neutrality would not be compromised by EPC decisions, and would a fortiori have difficulties with a security dimension. The Community would be faced with deciding between rejecting these applicants or limiting its political/security horizons. The more such new applicants were admitted, the more horizons would be limited; but even Austrian accession would probably require significant compromise in this area, for Austrian neutrality, as a function of the East/West divide, is much more subject to Soviet scrutiny than is Irish neutrality, which is a function of Irish relations with the UK.

Deductions

11. The above linkages, and their possible cumulative effects, suggest that:

(a) admission of Norway would strengthen the Community economically and politically, would not derail the further development of EPC, but would need to be skilfully managed to avoid unwelcome consequences vis-a-vis Turkey or other EFTA countries. And ring-fencing the Norwegian case would not be easy.

(b) Beyond Norway, any further accession has serious inherent difficulties. And the admission of Austria as well as Norway would probably lead to further expansion to include several EFTA countries, with consequent

pressure for "balancing" accessions by Mediterranean States, and so fundamentally affect the working and future development of the Community.

Temporarily Retained

THIS IS A COPY. THE ORIGINAL IS
RETAINED UNDER SECTION 3 (4)
OF THE PUBLIC RECORDS ACT

(d) A rigid two-tier structure among full members of an enlarged Community is unlikely to work: the Turks could not be excluded from a nascent inner politico-security layer but would not qualify for the inner politico-economic layer. Conversely Austria (and the EFTA neutrals) would not want to participate in the inner politico-security layer, but would qualify for the inner politico-economic layer. But it would hardly be possible to secure this differentiation in the context of accession negotiations. The probable consequence would therefore be the development over time of a form of variable geometry with different countries forming the inner and outer rings for the two areas of cooperation. This would be at best messy; at worst unworkable.

Possible Half-Way Houses

12. This points to a policy of considerable caution about any further enlargement, except for Norway. But turning down any eligible candidate would not be easy, and - as the 1987 paper noted in the case of Turkey - it would be important to ensure that rejection of further applications did not breed resentments, divisive of Western Europe and of NATO, and destructive of EC/EFTA cooperation. The various aspirations reflected by the likely applications need to be recognised, and managed, through some improvement of the

current relationship between the Community and its neighbours. Options might include:-

- (a) Closer bilateral arrangements. The Community could provide a package of bilateral EC/Turkey measures (including a beefed up Association Agreement); push ahead with more extensive bilateral bridging arrangements with EFTA countries particularly in areas covered by the Single Market; in parallel upgrade the Community's Agreements with Malta and Cyprus; and develop the European Parliament's links with the countries in question. This could be expensive for the Community particularly in relation to Turkey (though less costly for the UK, than wide EC enlargement), and would be unlikely to satisfy Turkish, Mediterranean or EFTA aspirations in full.
- (b) New institutional EC/EFTA arrangements. If the Swedes can over-rule Swiss opposition and Austrian indifference, EFTA might acquire a greater institutional underpinning, which would permit the development of closer links between the EC and EFTA collectively. This would suit us well, and we might seek to encourage it during the process of dialogue which is likely to follow the EC/EFTA Ministerial meeting on 20 March. But the problem of the Mediterranean aspirants would remain.
- (c) A Super Association Agreement between the EC and all aspirant members collectively is just conceivable. The latter would not sign the Treaty of Rome, but would have open trade access to the Community (subject no doubt to special arrangements for agricultural products), and perhaps freedom of movement of persons/establishment within defined limits; they might participate in EC research, environmental and cultural etc programmes; and they could enjoy close association with EPC (probably involving a measure of consultation, rather than just briefings, as at present). Super Association Councils

might take place at regular intervals. There would still have to be, as at present, some resource transfers from the Community to the poorer super-associates, but it might be possible also to contrive some such resource transfers from Northern to Southern super-associates (eg Austria/Sweden to Turkey). A package on these lines might stand a better chance of satisfying the Southern aspirants, and rather less expensively (in the case of Turkey) for the UK than a plethora of expanded bilateral arrangements. But Northern aspirants would find it less attractive than (a) or (b); and the disparate super-associates might find difficulty in forming a coherent group.

(d) Look beyond the Community framework to new European structures (perhaps in parallel to elements of (a), (b) or (c)). Admission to an enlarged and revitalised WEU which became the forum for European defence and security cooperation within the Alliance might sufficiently mollify the Turks to make it feasible to develop much closer EC/EFTA economic (Single Market) links which would not extend to Turkey. This could in turn lead to a two-tier form of collective Association Agreement, perhaps making it feasible to use the outer layer as the framework for a new relationship between the Community and certain Eastern European states (once they have proved their economic and political credentials), without in any way jeopardising either Western security cooperation or the task of completing the Single Market.

Conclusions

13(i) The Community faces increasing pressure to admit new members post-1992. We need to begin to develop an outline UK response.

(ii) Norwegian accession, taken in isolation, would be in

the UK interest and would pose few problems.

- (iii) Austrian accession is less obviously in the UK interest, given the high probability that it would make a much wider enlargement inevitable.
- (iv) Wide enlargement would be likely to produce, de facto or de jure, a variable geometry two-tier Community, which would be hard to manage, and would fall short of a genuine Single Market.
- (v) Turkish accession would have particularly high economic costs for the UK and the Community, but an outright rebuff would be dangerous in terms of political and strategic interests.
- (vi) The Turkish factor, and growing EFTA aspirations, suggests a need for lateral thinking about new structures, built onto the Community's outer walls. Some way of deepening the EC's relationship with its neighbours will be required.

THE AUSTRIAN CASE

1. The Austrians are likely to seek Parliamentary approval this spring to apply for Community membership this summer.

ECONOMIC ASPECTS

2. If Austria was a member of the Community the small balance of payments gains to Austria would be broadly counterbalanced by budgetary gains to the Community. In financial terms there would be neither advantage nor disadvantage to the UK in Austrian membership. However, the UK at present has a significant trade deficit with Austria, which, in part, reflects Austrian restrictive and protective practices. The UK would therefore stand to gain from Austrian membership of the Community, not least in the services sector, including the freedom for professionals to practise in Austria. Overall it appears that there could be some modest economic advantage to the UK in Austrian accession. But there would be a high risk that it would slow the process of internal Community liberalisation (in particular of the CAP).

POLITICAL ASPECTS

3. The major difficulties that the UK and other existing Community members would face if Austria were to apply for membership are political. The key factor is Austria's "perpetual neutrality", which was covered by the Soviet - Austrian Memorandum of 15 April 1955 (the so called Moscow Memorandum), recording the results of conversations between Austria and the Soviet Union before the signature of the State Treaty (by the UK, US, USSR and France) on 15 May 1955, and was then enshrined in Austrian domestic law in the Constitutional Law on Nationality of 26 October 1955. The Russians have now warned the Austrians that they do not see

that they do not see neutrality, and the State Treaty, as compatible with EC membership.

4. The Austrians however take the view that the State Treaty does not prohibit them from membership of international organisations (unlike the Swiss, they are UN members), and they are firmly of the view that neutrality is quite separate from the State Treaty. They note that there is already one neutral (Ireland) in the Community (though they admit that the basis of Irish neutrality differs from their own). But they have said that they could have difficulty in associating themselves with certain acts of the Community - such as trade measures against third countries for political reasons. They would be likely to seek as part of their accession arrangements some form of derogation which would absolve them from any Community obligation which would run counter to their neutrality.

5.

Moreover if the Russians acquiesced in Austrian membership they would be likely to state that nothing Austria did within the Community should prejudice her neutrality. This coupled with the State Treaty, could enable them to claim a droit de regard over future Community development. (Arguably, they might come to see their interest as lying in acquiescing to Austrian accession, in the hope of using it to prevent the development of a security/defence dimension to the Community - but there has been no sign of this as yet.)

HANDLING

6. The Germans would be unlikely to oppose Austrian accession, while the French are unlikely to favour it but may not be prepared to say so. The US (the other Western signatory to the State Treaty) are currently taking a relaxed view, virtually encouraging Austria to apply for

Temporarily Retained

THIS IS A COPY. THE ORIGINAL IS
RETAINED BY SECTION 3 (A)
OF THE PUBLIC RECORDS ACT

membership, though this could change once the wider implications are appreciated. It is too early to judge how the debate will go, and there are clear risks in the UK taking too high a profile. However, unless the Community decides to accept no more members (except perhaps Norway) because of the cumulative effect of several accessions, there remains a risk that - as over Greece - member states will not summon the political will to refuse an Austrian application.

7. The short term problems of handling an application this summer should however be manageable, for the Community could without difficulty stand by its view that until 1993 consolidation must take preference over enlargement. The two interim tasks would be for the Commission to produce an economic Opinion, and for the Community to quiz the Austrians on how they would square their continuing neutrality with the continuing development of the Community.

Foreign & Commonwealth Office

17 March 1989

EUCO PA: Engagement

PT3

Attachment to
Grogan/Skovich
7/8/89

