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Article — Digitized Version

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Intereconomics

*Suggested Citation:* Kleps, Karlheinz (1972) : Free trade in Western Europe, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 07, Iss. 11, pp. 335-339, <https://doi.org/10.1007/BF02929663>

This Version is available at:

<https://hdl.handle.net/10419/138730>

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### Free Trade in Western Europe

by Professor Karlheinz Kleps, Linz \*

**Independently of the results of the Summit Conference in Paris it can be said that the entry of Great Britain, Ireland and Denmark into the EEC and the Free Trade Treaties between the enlarged Community and the remaining EFTA countries have decisively advanced the integration process in Western Europe.**

Western Europe is reshaping itself. This fact which in the past few months has been stated again and again is the result of two things: the signing on January 22, 1972 of the Treaties concerning the accession of Great Britain, Denmark, Norway and Ireland to the European Communities (EEC, EURATOM and the European Coal and Steel Community) and the agreements reached on July 22, 1972 which established free-trade relations between the enlarged Communities and the remaining EFTA states (Austria, Iceland, Portugal, Sweden, Switzerland and the associated Finland).

Since the years 1957 when the Treaties of Rome were signed and 1958 when the negotiations about the formation of a large free-trade zone failed there has been no such decisive and far-reaching decision affecting West European integration as these treaties concerning the entry of new states into the Common Market and the establishment of free-trade relations with what remains of the EFTA countries. This remains true in spite of the regrettable fact that Norway has meanwhile withdrawn to a position of outsider.

#### **Free-Trade Area**

In the commentaries which have so far appeared on the new treaties which take effect as from January 1, 1973 two aspects have again and again been stressed: Firstly, that these treaties will put an end to the economic division of Western Europe by creating a free-trade area which will embrace nearly all West European countries. By a simple addition of the economic capacities of all the member countries one arrives at an economic potential which has already given rise to proud comparisons with the USA and the Soviet Union. The second point is that in spite of

all the new arrangements the independence of the Communities and of the EFTA rump-states is to be as far as possible preserved. These two concepts are obviously not easy to reconcile or at least the connection between them is unclear. The question that must be asked therefore is this: What concrete shape will the future free-trade order in Western Europe take and what prospects for future development will it open up?

The plan to set up a large free-trade zone failed in Autumn 1958, and already early in 1960 the treaty was signed creating a little free trade zone which came to be known as the European Free Trade Association or EFTA for short. In the preamble of this treaty the signatory states declared their firm intention to contribute to the abolition of the trade barriers and to the promotion of closer economic cooperation between the members of the then OEEC. For this purpose they were to try to bring about soon a *multilateral association* with the European Communities.

#### **Bilateral Agreements**

The treaties which have now been signed between the EFTA rump-states and the European Communities differ from the originally proclaimed aims in two essential aspects: For one thing, instead of a multilateral agreement the pacts now signed are *bilateral*. They differ in many details from one another and their execution is to be supervised in each case by a body consisting of an equal number of representatives of the European Communities and the respective EFTA rump-state. For another thing, association has been discarded. Association would have opened up wider vistas beyond the creation of free-trade relations and might have led to increasing harmonisation of policy. Instead, one has confined oneself to the establishment of *free-trade rela-*

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tions in order to safeguard as far as possible the autonomy of the contracting parties. Moreover, if one takes into consideration that the relations between the former EFTA states—a few exceptions for the interim period apart—have remained essentially what they were before and that the agricultural sector has been largely excluded from the bilateral treaties, it is for the time being at least only possible to speak of a partial abolition of the trade-political division of Western Europe. In this connection three different degrees of integration seem to emerge from the various institutional arrangements made:

### **Three Degrees of Integration**

☐ The highest degree of integration has undoubtedly been reached by the enlarged European Communities which are by now on the way to economic and monetary union and whose institutions have relatively far-reaching powers. The independence of their further development has been safeguarded by the Hague Conference in December 1969 which established the principle that relations with the remaining EFTA states should be shaped in such a manner as to preserve to the fullest extent the autonomous power of the decision making of the Community, its common policies, its smooth functioning and prospects of further development.

☐ A "medium" degree of integration has been reached in the relations between the present EFTA states (including Great Britain and Denmark). The free-trade zone established by these countries is essentially confined to the free interchange of industrial and commercial products. In comparison with the European Communities, EFTA's regulations concerning competition are less casuistical and less drastic; they are also more liberal than the newly concluded bilateral free-trade agreements. But the old EFTA rules will have to be altered as from April 1, 1973 to correspond to the new regulations. Compared with the institutions of the European Communities the powers of the EFTA institutions are relatively limited.

☐ The "lowest" degree of integration will be represented by the relations between the Communities and the EFTA rump-states. This emerges clearly from the fact that the free interchange of goods is almost completely confined to the industrial and commercial sectors. It becomes, however, even more evident if one looks at all those rules which in the six bilateral treaties lay down what is to be considered the country of origin of products and deals with competition, protective clauses and common institutions. Expressed in very general terms, what one finds is

this: the new regulations are intended to take into account the interests of the contracting parties—particularly those of the Communities but also those of the neutral EFTA rump-states (Austria, Sweden, Switzerland and Finland)—and to safeguard in particular their continued independence. They therefore merit special attention when one considers how the future free-trade order in Western Europe is likely to work out in practice. But first of all it seems necessary and at the same time highly enlightening to describe at least in outline the most important provisions for the dismantling of trade obstacles during the interim periods which have been agreed for this purpose.

### **Dismantling of Trade Barriers**

As in the case of the multilateral free-trade zone of the former EFTA states, the six bilateral free-trade areas will be created by a gradual demolition of the barriers to the interchange of industrial goods between the contracting parties who at the same time will preserve their trade-political autonomy vis-à-vis third countries. This procedure corresponds also to the relevant provisions of the GATT-statutes (article XXIV) which deal with the creation of free-trade zones.

The timetable for the removal of customs duties lays down that in general both parties must lower their import duties between April 1, 1973 and July 1, 1977 at the same pace as the customs barriers are lowered between the old and the new members of the European Communities. As starting point are to serve the import duties which were levied on January 1, 1972 and which since that date had to be kept at that level. This also means that in principle the former EFTA states are not allowed to erect new customs barriers between each other.

There are mainly four exemptions from this general dismantling of import duties:

☐ A special interim agreement between Austria and the Communities about the gradual lowering of tariffs became already effective on October 1, 1972 but it will also not be completed until July 1, 1977.

☐ In contrast hereto, the lowering of the import duties on the so-called low-priced watches from Switzerland will be delayed until January 1, 1976, but will also be completed 18 months later.

☐ For a number of products of the metallurgical sector (top quality steel, ferro-alloys, aluminium, lead, zinc and several others) the interim period for the dismantling of duties has been extended until January 1, 1980 and that of most of the paper products even until January 1, 1984. In the case of these so-called "sensitive products" the

duties will thus be reduced more gradually. Not only that: the European Communities have at the same time reserved to themselves the right to lay down certain quantitative import ceilings for these goods beyond which the normal import duties are to be applied.

□ As an exception to the principle of maintaining the hitherto duty free interchange of goods between EFTA states, Great Britain and Denmark as new members of the Communities may—apart from certain duty free quotas—reintroduce as partial and temporary measures duties on paper imports from their former EFTA partners.

### Retention of Market Shares

The exceptions to these general provisions for the removal of import duties are for the most part at the expense of the EFTA rump-states; they have encountered much opposition particularly in Austria, Sweden and Finland. But apart from these exceptions, the treaties also contain a number of provisions for the removal of other obstacles to trade. Quantitative import restrictions for instance must be lifted at the moment the treaties come into force on January 1, 1973, while "all other measures having the same effect" must be removed by the beginning of 1975. Whereas quantitative export restrictions are not subject to these treaties, export duties and levies, having the same effect as quantitative restrictions, must be abolished with few exceptions by the beginning of 1974 at the latest. Revenue duties which in principle are also liable to be dismantled can be replaced by an internal excise duty, if they serve no protectionist purpose. In some cases they may even be temporarily retained (as for instance the Swiss duties on imported mineral oil products, motor vehicles, spare parts for motor vehicles and films).

All these arrangements with their highly complicated details are evidence of a frequently hard struggle to retain a share in some market or other. Furthermore they will be much more expensive to administer than the old EFTA rules. They are of course interim arrangements between countries on the way to a new free-trade zone. On the other hand, they already convey some idea of how difficult it is to reconcile the realities of a policy of integration with the widely held conception of a comprehensive unified free-trade area which in future is to embrace nearly the whole of Western Europe.

### Origin of Goods-Rules

The problem of how to control the origin of goods springs from the trade-political autonomy of the members of a free-trade zone vis-à-vis third

states. In EFTA a relatively simple and liberal basic rule is applied (with only minor deviations). According to this rule, goods are allowed to enter free, if of their export price no more than 50 p.c. is accounted for by primary products coming from outside the zone.

The bilateral free-trade areas by contrast apply the principle that a product has originated within the zone, if it has either been completely manufactured in the free-trade area or has been subjected there to a "sufficient treatment or processing". What is regarded as "sufficient" in this context is measured by the so-called "tariff jump", that is the difference it makes, if the product in question is allowed in under a tariff group different from its component basic materials from outside the zone. This is of course no more than a rough and ready formula which in no way does justice to the many sided complexities of the goods traffic. For this reason numerous and rather complicated additional provisions have been introduced in which individual processes have been defined and certain percentage increases to the value of the goods in question have been laid down to determine whether these goods are eligible for duty-free entry.

All these individual provisions together make up a system of regulations to determine in which country goods have originated. The system bears unmistakable evidence—similar to that noticeable in the case of "sensitive products"—of the endeavour to meet certain needs and wishes for protection. These desires are particularly strong within the European Communities. For a few products, it is true, the rules are more liberal than the previous EFTA regulations as to origin, but in the majority of cases they are more restrictive. It is therefore all the more regrettable that as from the beginning of April 1973 the new regulations will also apply to trade exchanges between the EFTA rump-states. This is undoubtedly a disadvantage which is in no way offset by the administrative simplification which is thereby achieved and the cumulative principle which can be put into practice in this manner.

Under the cumulative principle any product to be eligible for duty-free entry must have undergone all stages of its manufacture in one or more than one of the various free-trade zones (including the EFTA rump-states). For the EFTA rump-states this cumulative principle is undoubtedly of great advantage. But as against this must be set the high administrative cost of applying this principle, quite apart from the fact that the cumulative principle solves a problem which would not have arisen at all, if a multilateral free-trade agreement had been concluded of the kind which in the past few years has been repeatedly advocated.

Import duties, quantitative restrictions and administrative obstacles are not the only factors that impair and falsify international trade relations. The interchange of goods can also be adversely affected by cartels, monopolies and government subsidies. This is why the bilateral free-trade agreements mention them as being in principle incompatible with the smooth functioning of these treaties.

### Competition and Protective Clauses

The difficulty results from the fact that the laws governing competitive behaviour differ from country to country. In the European Communities these laws are based on the principle that cartels, monopolies and government subsidies are forbidden, whereas in the EFTA rump-states they are allowed but must not be abused. As harmonisation such as would have had to be achieved in the case of association agreements is not one of the essential elements of a free-trade zone, the conflict is solved in much the same way as it was done in EFTA: Cases of allegedly unfair competition are investigated only, if a justifiable complaint has been submitted by an injured party. If the accused party is not willing or not in a position to remove the restraint of trade complained of, the complainant has the right to take appropriate countermeasures.

The basis for such countermeasures, which may lead to the reintroduction of duties, are the protective clauses approved of in the treaties. They may be applied not only in cases where the existing rules concerning fair competition have been violated in one way or another but also when serious economic disturbances occur in some specific economic sector or region of the contracting parties or when balance of payments difficulties are likely to occur or have already occurred.

The limits of discretion within which these protective clauses may operate without being thought abusive or obstructive to the free flow of trade are thus very wide. These powers may be regarded as being in a way the price the contracting parties have had to pay for preserving their autonomy. All the more important seems therefore the question of how, and if so to what extent, the necessary legal stability can be maintained and how the common institutions and the planned consultation procedures will be able to stop discriminating practices.

### Institutions and Consultation Procedures

During the negotiations on the free-trade agreements the representatives of the European Communities have from the very beginning taken the

view that the creation of special relations with non-member states must in no way affect the institutional autonomy of the Communities. It is the application of this principle that accounts for the relatively narrow limitation of the legal competence of the mixed committees, one of which is provided for in the treaties as the sole common institution for each one of the six free-trade zones.

The tasks and powers of these committees which are composed of an equal number of high-ranking officials consist above all in seeing to it that the particular agreement with which they are concerned is being carried out "in an orderly manner". They have moreover to ensure that the necessary information is exchanged and are responsible for holding consultations when contentious questions arise and are expected to make recommendations or settling such questions. Such consultations are almost always mandatory in cases where there is a danger that the protective clauses may be applied. In other cases the committee must be convened at the request of one or the other of the two parties represented on the committee.

It is important to add that the decisions taken by the committees must be "mutually agreed" and that these common bodies have no powers whatever to issue instructions, let alone to impose sanctions. The "orderly execution" of the treaties is thus ultimately and decisively dependent on the good will of the participants. This applies in particular to the protective clauses which can be so obstructive to free trade.

### Outlook

The experiences of EFTA have shown that the relatively loose combination of several states into a free-trade zone need not lead to any serious difficulties. In so far as disagreements occurred, they have been outweighed by far by the common advantages of the zone, the internal trade of which increased during the period from 1959 to 1971 by 278 p.c.

Whether, as some believe and hope, it will be possible readily to transfer these experiences to the six bilateral free-trade areas is highly doubtful, particularly in view of two fundamental differences:

□ In Western Europe, the basic political questions which arose at the beginning of the integration process have by now been nearly forgotten, economic interests have come more and more to the fore and the administrative authorities within the European Communities have been increasingly strengthened. The European technocrats have developed a mentality which is now also clearly reflected in the bilateral free-trade agree-

ments. This mentality leaves little room for hope that a free upward surge will occur similar to that which was experienced in EFTA as long as the power to bring about a drastic change of direction continues to lack.

□ Whereas conflicts in EFTA used to be settled between more or less equal partners, they will be faced in the bilateral free-trade zones by partners of enormously unequal economic weight. The rules according to which this game is to be played—and this applies to the protective clauses in particular—involve the inevitable danger that in case of conflicts the greater economic power will impose its own terms all the more so as it is not subject to direct parliamentary control.

These are the problems which already appear in clear outline even before the start of the new free-trade agreements, but they must not be allowed to obscure the chances which have been opened up by the Brussels treaties. These

chances lie not so much in the economic advantages which will accrue not only to those directly concerned as Western Europe progressively overcomes its economic division. Rather do they lie in the "development clause" which has been incorporated in the bilateral treaties. This clause is in a way an invitation to go beyond the creation of unhampered trade relations and to continue the cooperation thus begun in what is called "integration areas of the second generation", and these are in particular the areas of general economic and monetary policy and those of industrial, research, regional and ecological policies.

Whether, and if so to what extent, this chance to further Western Europe's economic and political integration will be seized should primarily depend on conditions inside the European Communities. A decisive impulse in this direction could be given by direct elections to the European Parliament which in any event is a step long overdue.

## Australian Tariff Preferences for LDCs

by Dr P. J. Lloyd, Canberra \*

**In the course of the discussion of the tariff preferences granted by various developed nations to less developed countries (LDCs) it should be noted that it was Australia which first set up a comprising preference scheme. The author of this article outlines the scheme and appraises the Australian experience.**

Australia's unilateral decision to introduce its own limited preference scheme for imports from the less developed countries (LDCs) was announced in May 1965 and these preferences first came into effect in April 1966. While the Australian scheme<sup>1</sup> was actually the very first country scheme to grant preferences in selected commodities to *all* developing countries<sup>2</sup>, it is now much smaller in scope and importance than the preference schemes of the EEC, USA, Japan and other countries which were introduced in 1971 and 1972.

Australia has accepted as LDCs in this scheme all UNCTAD members, Papua-New Guinea, the British territories and former British territories and all other LDCs that have applied for inclusion. The current list is more comprehensive than that of some of the schemes now operated by other developed countries, such as the EEC, as it in-

cludes Israel, Greece, Spain, Turkey and Yugoslavia as well as 130 LDCs from Asia, the Americas, Africa and island groups.

### The Principle of Competitive Need

Imports from the developing countries under the scheme consist of two broad groups: specified manufactures and semi-manufactures admitted at

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<sup>1</sup> Detailed features of the scheme, such as the documentation requirements and the method of allocating quotas among importers, can be found in a booklet published by the Commonwealth Department of Trade and Industry, "The Australian System of Tariff Preferences for Developing Countries", Third Edition; Canberra, July 1, 1971. The author has previously considered some aspects of the scheme in greater detail, including an estimate of the net effect of the scheme on Australian imports from the preference-receiving countries; "The Value of Tariff Preferences for the Developing Countries: Australian Experience", *Economic Record*, March 1971, pp. 1-16.

<sup>2</sup> There were of course preferences in the EEC, British Commonwealth countries and in other developed countries to limited groups of developing countries.