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on a route from which there is no turning back and, aware of the dangers threatening the existence of the liberal way of life in Western Europe should this integration fail, the Community has repeatedly stood the stresses and strains and has thus indeed long since reached, contrary to all criticism, the "point of no return". Exactly four years prior to the signing of treaties of Rome, which founded the EEC, Professor Ludwig Erhard made a statement in Zurich on February 23, 1953, which indicated how much he recognized the fatefulness of the decision for close cooperation

between the states of Western Europe for their freedom and well-being: "Economic cooperation in Europe only represents one aspect of the European approach and the European problems. Whatever our standpoint may be, and whatever policy an individual country may pursue, the danger threatening us from the part of the world which does not live in freedom is so great that we shall in any case have to join together in safeguarding human freedom" ⁵.

⁵ Ludwig Erhard, *Die wirtschaftlichen Aspekte* (Economic Aspects), in: *Die Integration des europäischen Westens* (The Integration of the European West), Zurich and St. Gall 1954, p. 124.

EFTA and Its Relations with the EC

by Bettina S. Hass-Hürni, Washington *

With its association with the EC in July 1977, EFTA will have achieved its immediate goal of bridging the economic division of Western Europe. Moreover, the influence of this small but efficient international organization — which due to its pragmatism and liberal principles fits quite well into the world trade order — has spread to the countries behind the iron curtain as well as to the international cooperation inside OECD and might go still further into an even more international economic order emerging from the North-South dialogue.

In post-war Europe, the Organisation for European Economic Cooperation (OEEC), originally entrusted with the implementation of the Marshall-Plan, was quite successfully achieving its aims of trade and payments liberalization. However, after 1955 already, a split became apparent between the 17 Western European members of the OEEC (after 1960 OECD): There were those pressing for an „inward-looking“ European integration with „political finality“, on the one hand, and those, more liberally minded, which preferred an „outward-looking“, enlarged, purely *economic* integration embracing the total of the 17 OEEC members. The split separated the traditionally protectionist, less export-oriented countries (mainly France and Italy) from the economically more liberal, largely export-oriented ones, led by the UK in the „low tariff Club“. The first group favored a customs union of only six members, all willing to accept the „political finality“ of economic integration, the second group opted for a free trade area for *all* European countries, including those which, for reasons of political neutrality, could not agree to any supranational institutions or political integration.

According to Art. XXIV of the General Agreement on Tariffs and Trade (GATT), these two forms of economic integration, customs union and free trade area, are the only exceptions permitted from the most-favored nation clause, stipulating

absolute non-discrimination, i.e. equal treatment in trade. Both methods of economic integration, the customs union and the free trade area, aim at creating a market without customs duties among their partners, with the fundamental difference of the customs union having a common external tariff, whereas in a free trade area, each partner maintains its national external tariff towards third countries. Hence a customs union is theoretically a more deeply integrated form of economic partnership, with a greater sacrifice of national sovereignty than a free trade area. Yet the practical experiences of the EC since 1958 show that its members were much less willing to give up a part of their national sovereignty or to implement political integration as foreseen in the treaties of Rome.

From 1956–1958 the plan of a large European free trade area was discussed during the „Maudling-negotiations“ ¹ inside OEEC. Mainly due to French resistance, this plan failed. And after the Six (Benelux countries, France, FR Germany and Italy) had formed their own, „closed“ customs union, the European Economic Community, entering into force in January 1959, the seven promoters of the free trade area (Austria, Denmark,

* World Bank.

¹ See Bettina S. Hürni, *Die Europäische Freihandelszone* (The European Free Trade Area), Postgraduate Institute of International Studies, Geneva, 1968, published by the Swiss Ministry of Economics, Bern, pp. 150.

Norway, Portugal, Sweden, Switzerland and the UK) concluded in a short time the Stockholm Convention, founding EFTA, which became operative in 1960. At the time of EFTA's inception, the UK had a clearly predominant position in the Association, being the only larger country, and also because of its political and economic past as a major trading nation. Because of the USSR's unequivocal reservations against full membership of Finland, this country was associated (March 1961) by a separate treaty, but participates through joint organs in the practical work of EFTA.

Aims and Principles

EFTA was by no means founded as a "rival" organization to the EEC. On the contrary, the aims of the Stockholm Convention clearly spelled out that a bridging of the economic division of Western Europe was intended. This was the immediate goal of EFTA, which was only to be achieved 17 years later, in July 1977 through the implementation of the association treaties between the EFTA-members and the EC analyzed below. As more remote goals the Stockholm Convention stipulates (Art. 2):

The objectives of the Association shall be

- (a) to promote in the Area of the Association and in each Member State a sustained expansion of economic activity, full employment, increased productivity and the rational use of resources, financial stability and continuous improvement in living standards,
- (b) to secure that trade between Member States takes place in conditions of fair competition,
- (c) to avoid significant disparity between Member States in the conditions of supply of raw materials produced within the Area of the Association, and
- (d) to contribute to the harmonious development and expansion of world trade and to the progressive removal of barriers to it.

The Stockholm Convention is based on economically liberal and institutionally pragmatic principles. Compared to the treaties of Rome, it is an "open" agreement, aiming at an enlarged, far-reaching less legalized integration, whereas the EC is geared to a more profound, strong integration with limited membership. The Stockholm Convention was designed to only serve as a framework, without creating any supranational powers. Unlike the EC, where a "de jure" solution is always attempted to be hammered out *before* the actual economic problem arises, EFTA solves most difficulties on an "ad hoc" basis: Although a voting procedure (one vote per country) is foreseen (Art. 32, 2.) EFTA has, with very few exceptions, always decided by consensus, and settled

pending questions bilaterally. The official complaints procedure (Art. 31) has only been used four times from 1960–1976.

In order to avoid possible trade diversion due to the maintenance of different levels of national tariffs, origin rules are indispensable in any free trade area. EFTA determines the origin of a product and hence its exemption from tariffs, by a percentage criterion and a more widely used processing criterion. Although complicated in theory, the EFTA origin rules have operated successfully and therefore proved that their implementation does not raise insurmountable obstacles, as sometimes alleged by EC negotiators. The acceptance of "cumulative origin" in the association agreements between the EC and the EFTA-countries have guaranteed free trade between the remaining EFTA-countries and the newer EC-members UK, Ireland and Denmark. Consequently, the unique experience of EFTA in the operation of origin rules was and will be useful in their relations with the EC, using a much more sophisticated, not uniform and administratively cumbersome method for determining origin. The simplification of origin rules will be one of the future tasks where EFTA can make a special contribution towards the establishment of free trade in the whole of Western Europe. The Stockholm Convention also provides for fair rules of competition, non-discrimination, even for public procurement, and all its rules, including the escape clauses, correspond very closely to the relevant GATT-provisions.

Agricultural Trade

Free trade in EFTA is only established for industrial goods (positions 25–99 of the Brussels Tariff Nomenclature) and trade in agricultural products is regulated through bilateral agreements. Until 1976 five such agreements were in force, with concessions mainly given to Portugal. On fish and fishery products, concessions were given to Iceland in particular, but also to Norway. Compared to the EC, EFTA does therefore not have a common agricultural policy. Today however, the question could rightly be asked of *how common* the agricultural policy of the EC really is, and how much benefit the communities globally get from it. Secondly, one may ask, if the EC agricultural policy has not led to a costly, far-reaching misallocation of factors. The agricultural policy could also be judged as the most divisive element among the EC partners, the instrument for pushing the most stubborn national self-interest. Clearly for some countries, the disadvantages of the common agricultural policy by far outweigh the advantages, without mentioning the very cumbersome administrative machinery needed for its implementation. On the other hand, it seems that

the agricultural agreements have worked satisfactorily among EFTA-partners. But agricultural trade inside EFTA is small: In 1974, it amounted to only 2.9 p.c. of total EFTA-trade (US \$ 267 mn at 1974 values), with Norway being the largest importer and Sweden the largest exporter².

Institutional Set-up

So much for the aims and rules set forth in the Stockholm Convention. Turning to the institutional set-up of EFTA, the following organigramm is of interest³:

Since 1974, each EFTA-country is, apart from the institutional structure inside the Association itself, linked to the EC by means of a joint committee.

The pragmatic and "ad hoc" working methods of EFTA make it possible to have a very modest, permanent secretariat in Geneva, Switzerland: Only 70 professionals and on that account a relatively small budget in comparison to other international economic organizations, namely ca. US \$ 3.12 mn in the financial year 1975/76⁴. For comparative purposes, it may be mentioned that in 1976 7,605 permanent officials worked for the EC-Commission in Brussels alone. On all four administrations of the EC (Commission, Council, European Parliament and European Court of Justice), there are 13,306 permanent positions held and the administrative budget for the same year 1976 amounts to 7,576,859,148 UC (Units of Account), which means over US \$ 7.5 bn⁵.

EFTA's public relations activities are accordingly restricted to a modest scale, with the result that the EC as an international institution is much better known by a larger public. Also, EFTA does not provide any "sensations" for the press, and its communiqués are usually rather dull, which however does not necessarily mean that EFTA's work is inefficient or insignificant, as will be shown below. Even though EFTA is a small organization, its operation until 1976 shows that the aims of the Stockholm Convention were reached and that important further developments are within the scope of future work.

Until 1965, all quotas in EFTA were abolished and 1966, three years ahead of schedule, all customs duties for industrial goods were removed i.e. the free trade area was completed. Portugal had however retained a slower tariff reduction scheme (total elimination only in 1985, on grounds of a necessary protection for infant industries). 1970 Iceland became a full member of EFTA, with a similar, less rapid tariff-reduction arrangement. Ever since, these two members remained the "developing countries" of EFTA, receiving concessions and economic assistance. 1973 the

UK, Ireland and Denmark left EFTA in order to become full members of the EC. (Norway, also a candidate for full EC-membership, rejected it by popular referendum.) It is significant for the pragmatic procedures followed by EFTA that these countries, even though members of the EC, continued for some time to participate in a consultative capacity in EFTA-meetings.

The departure of the UK left EFTA with a certainly better balanced power structure under predominantly Nordic influence. Whereas *economically*, the Nordic countries benefitted most from free trade, EFTA continued to be the economic association of the *politically neutral* countries of Europe. During the association negotiations with the EC (December 1971–July 1972), Switzerland played a very important role, so to say as a politically neutral, i.e. unbiased leader for the defence of economic interests. The position of EFTA today illustrates the results of its 16 years of experience in free trade.

EFTA's Present Position

Whereas the EC form a geographical unity inside Europe, EFTA is very heterogenous. But with the exception of Iceland and Portugal, it is an association of highly industrialized nations very dependent on export and with an average per capita income above that of the EC countries, namely US \$5,779 in 1975 compared to US \$ 5,150 in the EC. Its importance in world trade is demonstrated by the fact that although the population of EFTA (ca. 40 mn) only accounts for 1 p.c. of the world's total population, it has a share of 7 p.c. of total world imports and 6 p.c. of total world exports.

After 5 years of operation, intra-EFTA-trade increased by about US \$ 830 mn at 1965 values, which meant that roughly 25 p.c. of the total trade of EFTA members could be attributed to the newly created opportunities of free trade⁶. The trade creation effects can mainly be seen in textiles and clothing, as well as in the pulp and paper sectors. The Nordic countries derived the largest benefits from enhanced specialization and sub-contracting, i.e. from the dynamic effects of free trade. From 1969–1975 intra-EFTA-exports of all partners increased each year by 18.3 p.c. i.e. by more than total EFTA-exports (+ 14.1 p.c.) or EFTA-exports to the EC (+ 13.3 p.c.). Austria, Denmark and Portugal showed the most obvious productivity increases resulting from free trade.

² Sixteenth Annual Report of the European Free Trade Association, EFTA-Secretariat, Geneva, Sept. 1976, p. 15.

³ The European Free Trade Association – Structure, rules and operation, EFTA-Secretariat, Geneva, Sept. 1976, p. 24-25.

⁴ Sixteenth Annual Report, op. cit., p. 33.

⁵ Official Journal of the European Communities, L/66, March 15, 1976, p. 49 and 51.

⁶ The Effects of EFTA on the economies of Member States, EFTA-Secretariat, Geneva, Jan. 1969, p. 23-29.

Even though intra-EFTA-trade increased considerably, and strangely enough more so between the more distant than between the neighbouring partners, the EC members, especially Germany, remained the most essential trading partners for every single EFTA country. Traditionally, the EFTA countries show a trade deficit or import surplus, towards their EC partners. Most interesting is on the other hand the marked increase in EFTA trade with Eastern European countries by 31.4 p.c. in 1975, with an export surplus of US \$ 403,000 (exports US \$ 4.765 mn, imports US \$ 4.362 mn).

East-West Cooperation

The Eastern European countries have steadily increasing external debts towards the West, yet their product offer is not attractive in Western markets. Nevertheless, the integration method of EFTA, through its loser forms and pragmatic approaches appeals more to the Eastern European countries grouped in the COMECON, than the economic "bloc" of the EC, still viewed with political apprehensions from their side. Hungary and Yugoslavia being each partners in one of the conventions for mutual recognitions of tests analyzed below have made a start in what could possibly become an EFTA endeavour of bridge-building across the Iron Curtain, after achieving the bridge-building inside Western Europe intended by the Stockholm Convention and drawing to its completion in July 1977.

Although progress in economic cooperation between Eastern and Western Europe has not been very encouraging along the lines of the proposals in basket II of the Conference for Security and Cooperation in Europe, where a multilateralization of trade is aimed at, cooperation between EFTA partners and Eastern European countries could slowly be improved in the future on a more traditional, but pragmatic basis. The EFTA partners Austria and Finland have already long-standing, rich experiences in bilateral trade with Eastern Europe. Hence, stimulation of East-West trade inside Europe could perhaps become one of the more significant future tasks of EFTA.

Assistance to Weaker Partners

Another aspect of EFTA's present position are the special treatments given to its weaker partners, Iceland and Portugal. Upon its accession in 1970, Iceland was granted by the five Nordic countries an "Industrialization Fund" of US \$ 14 mn, interest-free, with a grace period of 10 years and repayment spread over 15 years, from 1980-1995.

In 1976, EFTA established an "Industrial Development Fund"⁷ for Portugal, with a capital of

US \$ 100 mn (84,604,516 Special Drawing Rights), which is unique in its history: Each member pays contributions into the Fund during 5 years according to its EFTA budget quota, i.e. Sweden 30 p.c., Switzerland 25.5 p.c., Austria 15.1 p.c., Norway 12 p.c., Finland 10.2 p.c., Portugal 6.1 p.c. and Iceland 1 p.c. This Fund should be used for financing individual industrial projects and sales from EFTA countries to Portugal. In addition to this "solidarity fund" which has a Portuguese State guarantee and might indirectly also strengthen the socialist government against the communist opposition, Portugal applies a slower tariff-reduction scheme. It also received bilateral concessions for portwine and horticulture products, particularly from Austria, Norway and Sweden, as well as bilateral technical assistance for its fishing and forest industries, social housing, professional training, social security system and financial administration.

Reluctance to Institutional Expansion

Since 1975 the trade-union representatives in the EFTA Consultative Committee are pressing for an expansion of the Association's activities and institutions, aiming at a "concertation" in the field of anti-inflation measures, employment and social policy, following the model of the European Communities' Economic and Social Council. But so far the governments and representatives of employers' associations have not been very enthusiastic and refused an institutional expansion of the Association. Moreover, it is especially in these fields of inflation fighting and social policy, where the diversity of the economic structures of EFTA partners becomes most evident: The Association consists of hard and soft currency countries, of land-locked highly industrialized and sea-faring, mainly agricultural nations, of economies with a very diversified export structure and others, whose main export is fish and fishery products, of the potential OPEC-member Norway and others with nearly no natural resources. Hence tripartite meetings like in the Economic and Social Council of the EC or in the International Labour Organization cannot eliminate such fundamental differences, but might rather intensify the centrifugal forces of the Association.

As the declared immediate goals of the Stockholm Convention have been reached and the above-mentioned disparities remain so obvious, does this mean that EFTA has lost its purpose or right of existence? The refusal to expand its institutions does certainly not mean that. On the contrary, its comparatively small bureaucracy might make its routine work more efficient and its new ventures more successful, like for in-

⁷ Sixteenth Annual Report, op. cit., p. 58-63.

stance the "development aid" to Portugal and Iceland, the stimulation of East-West trade inside Europe, the improvement of the operation of free trade embracing all of Western Europe through its association agreements with the EC to be accomplished, i.e. by means of simplifying the origin rules.

Relations between EFTA and EC

In order to guarantee free trade as achieved in EFTA, it was extremely important that the non-membership candidates to the EC (Austria, Norway, Portugal, Sweden and Switzerland) negotiated their association parallel with the membership candidates UK, Ireland and Denmark negotiating their accession, and that their individual agreements were homogeneous. This was achieved in a relatively short negotiation period (December 1971–July 1972) through the conclusion of 14 bilateral agreements (7 with the EC and 7 with the European Coal and Steel Community) of identical wording modelled on the "master" treaty between Switzerland and the EC⁸, allowing nevertheless for special provisions in each country's individual economic interests.

These agreements between the EC and Switzerland, Austria, Portugal, Sweden, Iceland, Norway and Finland, listed in the order of their entry into force, became effective simultaneously with the membership treaties for the UK, Ireland and Denmark. The separate protocols however provide *inter alia* for the following special rules: Protocol 6 of the agreement with Iceland regulates the latter's fishery product exports. The EC only implemented this protocol after July 1976, when the dispute over the delimitation of Iceland's fishing zones had been settled. Portugal reduces its tariffs again on a slower schedule and received concessions for its agricultural exports. Both protocols 5 of the agreements with Austria and Finland maintain quotas on certain products. Switzerland keeps its domestic storage obligations for war economy in its protocol 5. Common to all agreements is a scheme for tariff removal until July 1977 and, by means of cumulative origin, the maintenance of free trade between the EC associates and the UK, Ireland and Denmark, as well as, except for Finland, the so-called "evolutionary clause" (Art. 32). Cumulative origin is a method whereby a product does not lose its tariff exemption treatment, if it is further processed in another country than that of its origin⁹. The evolutionary clause

provides for a certain "openness" of the free trade agreements, i.e. the opportunity to later extend them to other fields of common economic interest.

On their side, the EC presented a list of "sensitive products", mainly in the paper and metal sectors, for which they need a longer period of protection. Each EFTA country has in turn foreseen a compensatory, slower tariff removal schedule for any one of these products. For some paper products, the UK and Denmark were even obliged to reintroduce tariffs during the transition period. Protocol 2 determines different export regimes for agricultural products in EFTA and EC countries. The origin rules as used in EFTA since 1960 were essentially taken over in protocol 3. The agreements with the European Coal and Steel Community, except the one of Iceland, are again almost identical in their text with the just mentioned EC agreements. Special national requests are also regulated in additional protocols.

After the signature of the agreements, several declarations were made; for example to the effect that transit traffic in Austria and Switzerland should remain unimpeded, for Switzerland the watch-export-regime of 1967 continues to be valid, and the problem of foreign workers, now settled bilaterally with Italy, should be considered.

In the press, these agreements were described as EFTA's association with the EC. Technically speaking however, one could say that the EC joined the free trade area as it was originally planned during the "Maudling-negotiations", which means an economic unification of Western Europe following the less "integrated" method of free trade without political goals. In 1977, when this economic European free trade area will be completed, one might ask just how successful the EC was on the way to its political integration. It seems as if its customs union, with a common external tariff, so grossly undermined by numerous exceptions and complicated waiving procedures that it can hardly be called "common", and its "integrated" agricultural policy ensuing enormous costs with not much efficiency, did not bring about a very deep integration process nor strengthen any supranational approach to political unity. Rather it might appear that the EC members have each built up an insistence on their national sovereignty and the defence of their political and economic self-interest.

EFTA's aims were admittedly less ambitious, perhaps less legalistic and more exclusively oriented towards promoting private business or purely commercial ventures. Its political impact is hardly felt by public opinion. But it seems as if a certain "EFTA solidarity" had evolved since 1960 and

⁸ See Willy Zeller, Die Schweiz in der europäischen Freihandelsordnung – Kommentar zum Abkommen mit den Europäischen Gemeinschaften (Switzerland in the European Free Trade Order – Comment on the Agreement with the European Communities), in: Neue Zürcher Zeitung, Schriften zur Zeit, No. 28, Zürich 1972, pp. 80.

⁹ The European Free Trade Association, op. cit., p. 40-41.

should not be underestimated, although the EFTA members do not count among the politically most powerful nations of Europe. EFTA's unique contribution to an outward-looking, larger European integration may illustrate this point.

Acceptance of National Differences

EFTA is the only well functioning free trade area in compliance with Art. XXIV of GATT grouping industrialized nations of some importance in world trade, except Portugal and Iceland. Its practical experience shows that the much feared origin rules avoiding harmful trade diversion, can be applied without causing any disturbances. Hence the argument that free trade cannot function without the negative effects of trade diversion becomes groundless. However, EFTA's unique achievements do not lie in harmonization or "levelling" of national conditions, as attempted by the EC, but rather in the recognition and respect of national diversity. This presupposes a similar level of industrialization and living standards in its partners' economies, as well as a certain confidence in the partners' political systems, and in the authorities' and the individual businessman's goodwill.

The acceptance of national differences and the resulting effective *modus vivendi* of economic partnership is perhaps best demonstrated by the agreements for mutual recognition of tests and inspections concluded by EFTA members in fields *not* mentioned by the Stockholm Convention. There are six such agreements, on ships equipments (in force since 1970), on pharmaceuticals and on pressure vessels (both in force since 1971), on gas appliances and on agricultural machines and tractors (both in force since 1972), and on the control and marking of precious metals with the first international control hallmarks (in force since 1975). Two more such agreements, on lifting appliances and on heating equipment using liquid fuel, will probably become operative during 1977.

The basic concept of all those schemes is the maintenance of *national* standards which are recognized by the partners. The agreements are open: Yugoslavia and the Netherlands joined the one on ships equipments, Hungary the one on pharmaceuticals, the UK all of them. The membership of Eastern European countries is noteworthy as a possible starting point for further expansion of East-West trade in Europe through EFTA co-operation. These agreements also provide a valuable method for the reduction of non-tariff barriers to trade, a major task negotiated in GATT: They are relevant for the elaboration of the proposed "codex of good conduct for the prevention of non-tariff barriers to trade" in the Tokyo-

Round". EFTA has also designed its own, particular system of prior notification when a country introduces new standards, which can often constitute non-tariff barriers. This system should give its partners the necessary time for adjusting their own standards and works since 1960. Until 1974 there had been 191 such prior notifications, and 1975 the system was revised and improved. On international level, EFTA cooperates in all standardization organizations (ISO, CEN, CENELEC). Its preparatory work has also been significant for the conclusion of a European Patent Convention in 1973.

Future Tasks

As an institution, EFTA is geared to letting the business world benefit from the opportunities created by free trade. Although it is an inter-governmental organization as defined by the classic rules of international public law, it functions quite often through creating an atmosphere of an English gentlemen's Club, despite the preponderant influence of the UK being gone. As one of the smallest international economic organizations and having, until 1976, resisted the temptation of increasing its permanent bureaucracy, EFTA works, although with little press coverage, neither inefficiently nor in vain. Its activities might often even be more related to economic realities than those of many others. Due to its pragmatism and liberal principles, it fits quite well into the world trade order design of GATT. The influence of EFTA has spilled over from the territories of its members into the whole of Western Europe's economic structures, and further beyond the Iron Curtain. It did spread to the interregional economic cooperation inside OECD and might go still further into an even more international economic order emerging from the North-South dialogue. The immediate goals of bridging the economic gap inside Western Europe will be fully achieved in 1977. This might lead to the conclusion that the free trade area, as illustrated by the practical example set by EFTA, is an effective and viable method of economic integration, and because of its flexibility, remains useful in the future.

The more distant aims of promoting a sustained expansion of economic activity, full employment, increased productivity and the rational use of resources, financial stability and continuous improvement of living standards inside EFTA remain among the Association's future tasks. An even more distant goal to the achievement of which EFTA will contribute, consists in fulfilling these same aims also on a worldwide level, in a movement towards the liberal economic ideal of a sustained, balanced, unimpaired expansion of world trade.