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EFTA: CONDEMNED TO LIVE

by Jon McLin

An analysis of the recent political and economic events in Europe which have contributed to the unexpected longevity of the European Free Trade Association. Some thoughts on its potential as an alternative to the Common Market.

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ALAN W. HORTON
Executive Director

JON McLIN has been concerned with the study of international organizations and the affairs of Western Europe since 1960. After receiving the B.S. degree in physics from Washington and Lee University, he was awarded a Rhodes Scholarship to Oxford University, which granted him the B.A. degree in 1962. For the following three years he studied at the Johns Hopkins School of Advanced International Studies and did field research in Canada and Europe, receiving the Ph.D. degree in 1966. In 1965, he joined the political science department of the University of Alabama, where in addition to his teaching duties he served as Assistant Dean for International Programs. Mr. McLin is the author of *Canada's Changing Defense Policy, 1957-63: The Problem of a Middle Power in Alliance.* He joined AUFS in 1968 to report from Brussels on the re-emergence of Europe as a political and social entity.

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The most preoccupying problem of the European Free Trade Association (EFTA) as it approaches its ninth birthday is, oddly enough, that it still exists. Formed in 1960 by the so-called Outer Seven countries, which for one reason or another were unwilling or unable to subscribe to the Treaty of Rome, it was viewed from the beginning not as a vehicle to unify all or part of Western Europe but as a way station, a temporary base from which more permanent economic arrangements among all the former OEEC[1] countries, Six and Seven alike, could be created.

Events, however, would not have it so. Not only did the solution initially preferred by EFTA countries—a broad, negotiated settlement in which the Common Market as well as EFTA would make some concessions—prove unattainable, but also the humbler approach whereby individual EFTA members sought to make their own arrangements with the European Economic Community (EEC) largely on its terms, has come to nought. (EFTA's most recent proposals to "build bridges" between itself and the EEC was made, largely at British initiative, in 1965. The EEC made no reply.) Of the seven (in effect eight, if Finland, which is technically an associate member, is counted) EFTA members, three—the United Kingdom, Denmark and Norway—have applied for EEC membership; Sweden has asked for negotiations leading to either full or associate membership; Austria and Switzerland have requested associate membership; and Portugal has requested negotiations leading to undefined arrangements. Since the negotiations for British entry were broken off by France's veto in January 1963, all but one of these applications, including the renewed British and Swedish versions, have lain dormant in the EEC's in-box. The exception is Austria, which alone among EFTA members shows a willingness to proceed with its application—and, if necessary, to drop EFTA for EEC—irrespective of what happens to the British application. While Austria's negotiations with the EEC have at

British application. While Austria's negotiations with the EEC have at least gotten under way, they have, nevertheless, slowed to a virtual stalemate as a result of both technical and political obstacles to an agreement. So willy-nilly, for better or worse, EFTA has had to reconcile itself to unanticipated longevity.

When this first became clear, through General de Gaulle's initial veto in 1963, EFTA reacted by strengthening the intensity and pace of its own internal development. The schedule for the elimination of tariffs and quotas was compressed and the new target date of December 31, 1966—three years earlier than the deadline specified in the Stockholm Convention—was set for the achievement of free trade in industrial goods among members. With only a few minor exceptions, this goal was attained. As the EEC was simultaneously accelerating its own program—its customs union was completed, again with only minor exceptions, on July 31, 1968—the economic division of Western Europe, which EFTA countries had been concerned to prevent, became a fact.

The effects of this division on trading patterns are not so dramatic as might be supposed; the ordinary consumer can easily spot so many anomalies that he might well wonder whether the groupings have any significance at all. Geneva housewives, for example, go next door to French Savoy to buy Austrian butter, which is cheaper and better than what is available at home. Meanwhile, Savoyard housewives can buy the same quality Italian peaches in Geneva more cheaply than at home. Norwegians pay the same import duty on cars coming from Britain or Sweden as on those coming from EEC sources. The same Philips (a company which is Dutch-based) tape recorder sells for half again as much in Belgium as in Switzerland. Each of these curiosities can be explained, of course, although the explanations are less obvious in some cases than in others. Taken together they demonstrate that so many factors in addition to import duties influence the final selling price of an item that trade groupings, whose preferential features consist mainly in the differential application of those duties, frequently do not bestow a telling competitive advantage on their intended beneficiaries.

On the level of macroeconomic analysis, the effects of the division are perceptible but not startling. On the one hand, the proportions of EFTA countries' imports coming from, and of their exports going to, the EEC grew slightly from 1959 to 1966: from 28.1 per cent to 31.2 per cent for imports, and from 23.4 per cent to 25.6 per cent for exports. EFTA exports to the EEC, moreover, grew faster during the period of separate integration (1959-1966) than during the preceding period (1953-1959). This can be attributed, however, to the faster growth of import demand in the EEC during the later period.

On the other hand, EFTA's part of total EEC imports and exports did diminish, especially the former: whereas 17.3 per cent of Common Market imports in 1959 came from EFTA countries, this figure dropped to 14.3 per cent by 1966. The Common Market's external tariff was, it seems, making itself felt. Correspondingly, EFTA's composite trade balance with the EEC worsened; a deficit which measured $1.68 billion in 1959 grew to $3.42 billion by 1966. And in the case of both groups, internal trade showed a propensity to grow faster than trade between the two groups or with third countries.[2] It is improbable, however, that these trends result entirely from the existence of the two trade blocs. A recent study by the EFTA Secretariat estimates that only 25 per cent of the increase in trade among member countries of EFTA from 1959 to 1965 can be directly attributed to the creation of EFTA.[3]

These effects have been far from evenly distributed among EFTA's members. Of the $1.7 billion increase in EFTA's trade deficit with the EEC, about $1.35 billion or 80 per cent was accounted for by three small countries: Switzerland, Austria and Denmark. Not surprisingly, this fact, coupled with certain of their national features, has a great deal to do with their attitudes toward EFTA. In the case of Switzerland, for example, the worsened trade balance stems more from a total increase in imports than from EEC discrimination; Swiss exports diminished only marginally. All the same, the existence of EFTA had a net beneficial effect on the Swiss balance of payments which was welcome at a time when the over-all trade balance was worsening. The study by the EFTA Secretariat shows that the positive effect of EFTA for Switzerland's trade balance is greater, in proportion to the size of the country, than for any other member. It is entirely appropriate, therefore, for the Swiss to be quite happy, as they are, with their EFTA membership and unconcerned about the effects of Europe's economic split. As they never desired nor expected European political unification, EFTA's lack of such goals is regarded by the Swiss as congenial and realistic. One only wonders whether, if they had known in 1959 how little the Common Market would affect their exports to the Six, they would have bothered to join EFTA.

Austria and Denmark, on the other hand, have suffered from Common Market discrimination; accordingly, a note of urgency infuses their efforts to come to terms with Europe's division into economic blocs. We have already noted Austria's efforts to negotiate with the EEC independently of Britain. In Denmark, too, there has been domestic political pressure—mainly from the Agrarian party, which sees the Common Agricultural Policy of the Six as paradise on earth—in favor of an "Alleingang," although the government has not adopted this policy.

And since agreements with the EEC have not been possible for either country anyway, each has naturally sought to make the most of EFTA's potential for relieving its difficulties.

For industrial products, this effort has paid off in both cases. Austria enjoyed an estimated $29 million net advantage in its 1965 balance of trade as a result of EFTA's existence.[4] But while the existence of the EFTA alternative clearly helped, the magnitude of the country's initial dependence on EEC markets (in 1958, 49.6 per cent of its exports went to EEC countries, 10.5 per cent to EFTA countries; in 1966, the corresponding figures were 44.6 per cent and 20.1 per cent meant that such a solution could only be partial. For Denmark, EFTA has had no appreciable effect on the trade balance. Given the relative importance of agricultural products in Danish exports, the increased possibilities offered by EFTA for industrial products have not been sufficiently important to offset the harmful effect of the EEC's Common Agricultural Policy on Danish food exports.[5] The Danish government's (socialist and non-socialist alike) reaction has been to press for greater liberalization of agricultural trade within EFTA. The Stockholm Convention's provisions for the abolition of trade restrictions, however, do not apply to agricultural products, but it does authorize and encourage bilateral agreements among member countries to deal with this problem. A number of such agreements have in fact been concluded, the most important of which gives assured access for some Danish products, notably bacon, to the British market. But these agreements have not sufficed to meet Denmark's expectations, and efforts to make them more satisfactory continually founder on the countries' agricultural protectionism in general, and on the specifically Swedish policy of remaining 80 per cent self-sufficient in food in order to make plausible its political neutrality.

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General de Gaulle's first veto of British entry to the EEC in 1963, as noted previously, prompted EFTA to intensify its own work program. When the veto was exercised again in November 1967, the same reflex operated. In the meantime, however, the guts of EFTA's program—the elimination of tariffs and quotas on intra-area trade in industrial products—had been realized. It was, therefore, less obvious on this occasion what was entailed by the EFTA ministers' renewed determination that, "so long as the establishment of a single European market remained out of reach, their co-operation in EFTA should be actively pursued."[6] There is no question of changing the basic rules of the game in order to include agriculture under the free trade rules—

however much the Danes might fancy the idea—or in order to create a customs union, let alone an economic union. Short of that, the proper area of activity is clear enough; but it is not so clear what the outcome of that activity should be. Such ambiguity lends itself to varying appreciations based on different national interests and judgments, and much of the current internal politics of EFTA revolves around this problem.

The pertinent area here is that of indirect trade barriers; that is, of obstacles other than tariffs and quotas. These barriers include such things as differences in applicable health and safety regulations from one country to another, different kinds and levels of taxation, and different technical standards. They are notoriously numerous, varied, and effective in inhibiting or distorting trade, although their effect may only become apparent when highly protective direct barriers—tariffs and quotas—are dismantled.

The Stockholm Convention refers to these barriers, covered by Articles 13-17, as "the rules of competition." The articles deal with most, though not all, of the practices likely to distort competition in a free trade area: government aids to local industry, including rebates to exporters for indirect taxes; national discrimination in public procurement by government agencies; restrictive business practices by private or public enterprises; infringements of the right of establishment of nationals of other EFTA countries; and dumping and the subsidizing of exports. Some other measures, such as revenue duties, charges assessed for technical reasons when goods cross borders, and "drawback"—i.e., the refund to exporters of duties paid by them on imported materials—are dealt with elsewhere in the Convention.

EFTA prides itself as an organization on its pragmatism and flexibility. One principle in its pragmatic creed is that it does not seek to harmonize the policies of its members—"harmonization," which is music to the ears of a Brussels functionary, is a bad word in Geneva—but only to insure that differences among those policies do not hamper the operation of the free trade area.[7] The application of this principle to the case of indirect trade barriers takes the form of the "frustration clause," which is the key phrase in all but one of the rules of competition. It states that measures under those categories are prohibited if they "frustrate the benefits expected from the removal or absence of duties and quantitative restrictions on trade between Member States."

The problem arises, of course, precisely because there is no objective or agreed understanding of what this clause means in practice.

The EFTA Council was instructed in the 1963 work program to review these provisions in order to reach an agreed interpretation. No sooner had this process been completed, in 1968 (the understandings remaining far from precise), than the new work program directed a second review to be made. This is now under way.

Some progress has been made both in laying down general guide lines, as, for example, the instructions to public procurement agencies that they must treat EFTA suppliers on equal terms with national firms, and in dealing with specific complaints of infringement of the rules as they arise. For the most part, these settlements have been made in an informal way, frequently between the two countries directly involved, rather than by recourse to the formal procedures for the resolution of disputes laid down in the Convention. It is also true that most complaints have been handled in a spirit of compromise and reasonableness. But it is going too far to say, as commentators dismayed with the EEC's acknowledged lack of progress sometimes do, that EFTA has achieved substantially more in this area than have the Six.

The difficulty is not so much that governments are obstinately protectionist as that they have different interests and objectives that get in the way of efforts to apply the rules of competition even-handedly. The British and Swedish governments, for example, and perhaps others as well, use government spending, in part, as an instrument of anti-cyclical policy and of regional development; they are thus reluctant to agree, even in principle, to do away with all discrimination against EFTA suppliers in public procurement. Sweden, on the other hand, is keen to eliminate the import duties legally retained by some EFTA members, for revenue purposes, on car imports. Such duties do not discriminate against Swedish cars, for they are applied equally to all car imports, and the countries in question—such as Switzerland and Norway—have no domestic car industries, but they do deny the Swedes the competitive advantage they would otherwise enjoy over, say, German cars. To change this policy the countries involved would have to alter their own tax systems in order to find alternative sources of revenue, and this is not something that is done willingly. A further example is that Norway is reluctant to agree to a liberal interpretation of the provisions on establishment, for fear that the bulk of its industry would quickly pass under foreign control.

It is not clear how much these obstacles actually interfere with intra-EFTA trade at present, for there have been very few complaints. Perhaps this is to be explained by the vagueness of the frustration clause, which leaves traders uncertain of their rights under the Convention.

On the other hand, it is also plausible that if there were many significant instances of distortion of competition, the businessmen affected would not hesitate to make known their grievances. At any rate, only a low head of steam has built up so far behind the efforts to eliminate the remaining barriers. Only the United Kingdom has made a precise proposal for clarifying the rules of competition, and it is a narrower interpretation than that favored by most of the other members. (The gist of the proposal is that only those policies equivalent, in effect, to a duty should be prohibited under the rules of competition.)

In this instance as in many others, the British are viewed by other members—especially the Nordic countries—as being for EFTA what the French are for the Common Market: the bad boys, the heel draggers. After all, it was the United Kingdom which provoked EFTA's only internal crisis to date, when it imposed a surcharge on imports in 1964. While the 1968 counterpart of that action—the import deposit scheme—got a somewhat more sympathetic reaction from other EFTA countries, to the pleasant surprise of the British, it is not the only current subject of friction between the United Kingdom and its partners. Norway has objected to the British government's policy of encouraging the construction of aluminum smelters in Britain, which will compete directly with the smelting industry that Norway has recently built up with the benefit of its cheap hydroelectric power. Norway again, and to a lesser extent Denmark, was also penalized when Britain recently reintroduced a tariff—at the level of 10 per cent—on frozen fish fillets, which those countries have been exporting in rapidly growing volume. (Fortunately, the import deposit scheme is applicable neither to fish fillets nor to aluminum.) In both instances, the British case is built on fairly defensible arguments, but that does not alter the sensitivity, growing out of the marked disparity in size, that small countries show toward actions that for Britain are relatively minor. In this respect, the British role in EFTA has perhaps more in common with the American role in NATO or the OECD than with the French position in the Common Market.

Finally, the British are rightly suspected to be somewhat reluctant, even while endorsing it in principle, to proceed on Iceland's application for membership in the association. The application raises two problems: how to accommodate Iceland's only major export, fish, when a glutted market is already pressing downward incomes of British fishermen; and the prospect that Iceland's vote will give the Nordic countries (Finland included) a five-to-four majority in the organization. This consideration is not unimportant, notwithstanding EFTA's lack of political pretentions, as it does sometimes take decisions by majority vote.

Underlying these specific disputes, there is a basic divergence of outlook between the British, on the one hand, and the Scandinavians (among whom the differences are more nuanced) on the other. The former, having endorsed not only the commercial aims but also what the French call the "political ideology" of the EEC, are impatient to wind up EFTA and get on with the job of "building Europe." The latter, however much they would like to get rid of the economic inconveniences brought about by the EFTA-EEC split, do not share these political objectives. They are, therefore, less unhappy about EFTA's stubborn longevity and are in favor of, and not merely unopposed to, strengthening the organization. It has, after all, had substantial benefits: its relatively non-political character has made it possible to accommodate Finland in a Western economic framework without provoking sharp Russian reactions and the Swedes got the free access to Danish and Norwegian markets that they had sought earlier, unsuccessfully, in an exclusively Nordic grouping. True, the Scandinavians find it somewhat of a political embarrassment to belong to a "clubby" sort of organization of which Portugal is a member, but that is only a modest liability.

The idea of a closer economic co-operation on a Nordic basis, which has recurred periodically every few years since World War II, is current again. A working party of the four countries (Iceland is not included) has prepared draft proposals for the creation of a Nordic Economic Union. The aim is not to fragment Europe even further nor to derogate from EFTA but to intensify co-operation within the more limited grouping and to strengthen the possibility that the free trade and the ties to Finland already achieved will be secure whatever happens to EFTA. There is also a desire to achieve greater bargaining power in approaching the EEC. Already during the Kennedy Round, the Nordic countries formed a single negotiating team for the later stages (EFTA as a whole consulted closely on the negotiations, but did not negotiate as a unit, as did the EEC), with results that were quite satisfactory for them. It remains to be seen whether the present efforts will succeed in reconciling such special interests as Danish agriculture and Norwegian fears of Swedish industrial dominance, on which the earlier integration schemes foundered.

Since fulfillment, for EFTA, is not an internal thing, it keeps its antenna alert to suggestions from any source for wider economic arrangements. The idea of a North Atlantic Free Trade Area (NAFTA) is followed; but, since it is judged a non-starter for political reasons, it generates little excitement. EFTA remains ready, moreover, to consider proposals that the EEC may eventually decide to make for commercial arrangements between the two groups. (Having itself made the last formal proposals of this kind, which went unanswered, EFTA shows no inclination to take any new initiatives.) There is little enthusiasm for the recent French and German proposals for commercial arrangements, however, as they promise a lot of political trouble (antagonizing the Americans, violating the General Agreement on Tariffs and Trade) in return for very modest tariff adjustments.

In its nine or so years, EFTA has shown itself to be viable: it has demonstrated the workability of an industrial free trade area, based on a declaration-of-origin system. This accomplishment alone is worth while for, during the OEEC's free trade negotiations a decade ago, there was some doubt whether regional free trade without a common external tariff could be operated. Moreover, it has improved the trade balance of each of its members and one country, Denmark, has bettered the overall annual balance of the eight countries by almost half a billion dollars.[8] It has outlived the disfavor of the United States State Department, although whether this is testimony to its own achievements or a result of disillusionment with the EEC is unclear. And it now seems to be regarded as more than a "poor relative": in addition to the Icelandic application, the Yugoslavs are negotiating for some kind of association. This does not quite equal the long queue of suitors who wait, some of them with seemingly endless patience, in Brussels. But it is something.

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NOTES

1. The Organization for European Economic Co-operation, created in 1948 to administer Marshall Plan aid.

2. Statistical Office of the European Communities, Basic Statistics of the Community, Brussels, 1966; and European Free Trade Association, EFTA Trade: 1959-1966, Geneva, 1968.

3. European Free Trade Association, The Effects of EFTA on the Economies of Member States, Geneva, 1969, p. 23. This study is the first part of a broad examination of the economic consequences of the split between the EEC and EFTA.

4. Ibid.

5. In view of the current agricultural situation in Western Europe, characterized as it is by artificially supported high prices and overproduction, it is interesting to note that the origin of Denmark's comparative efficiency in food production lies in the Danish government's refusal to resort to protectionism during the agricultural crisis of the late nineteenth century.

6. From the communiqué of the London ministerial meeting, May 9-10, 1968.

7. The more modest aim has its advantages. The EFTA Secretariat numbers slightly fewer than 100, most of whom are seconded to the organization for periods no longer than two or three years by the member governments. Refreshingly, many come from government departments other than foreign offices, and even from private industry. The present Secretary-General, Sir John Coulson, runs a tight ship so that, for each of the past several years, it has been possible for a part of the member countries' assessed contributions to be returned to them. If one contrasts this picture with that of the EEC Commission, which numbers over 3,000, it is easy to understand that EFTA's self-styled pragmatists view the EEC as a somewhat dark and unwholesome bureaucratic monster.

8. The Effects of EFTA on the Economies of Member States, p. 23. For more detailed information on the development of EFTA, see the publication of the EFTA Secretariat, Building EFTA: A Free Trade Area in Europe, Geneva, 1968, which is not only rather comprehensive, but also fairly candid and specific for an official publication. For an independent (if noticeably Swiss-influenced) discussion of the political context in which the organization operates, see The European Free Trade Association and the Crisis of European Integration, by a Study Group of the Geneva Graduate Institute of International Studies (London: Michael Joseph, 1968).