

EFTA in the 1990s: The Search for a New Identity

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In the 1990s EFTA will be at a crossroads, one of the most critical periods in its history. Thirty years after its creation, EFTA faces several simultaneous challenges of a new nature. First, the EC is bringing into force an Internal Market based on the full realization of the four freedoms of the Rome Treaty. Unlike in the 1960s, EFTA cannot keep up with the EC by implementing parallel measures for tariff reductions, because the Internal Market is a broad legislative programme with complex institutional aspects. EFTA must either upgrade significantly its co-operation with the EC or look for a new relationship. Second, the development of the so-called new technologies opens new opportunities for economic growth and product innovation, and represents a threat to traditional techniques. Outlays for basic and applied research, product development and innovation are such that large integrated markets, important financial resources and often public contracts are needed. Third, the progress of the EC toward a fully-fledged economic union reinforces its position as a world trading power and one of the most prominent of emergent trading blocs. EFTA countries are finding it all the more difficult to promote an open and liberal world trade system. Fourth, relations with third countries are becoming increasingly important as the EC and the USA have concluded free trade agreements with various countries, and as Eastern European countries are showing a growing interest in EFTA.

The main objective of this article is to show that the fundamental changes presently unfolding in Europe and in the world economy call for a serious rethinking of EFTA's own identity and of EFTA's role in international economic relations. The Stockholm Convention, the bilateral free trade agreements with the EC and the Follow-up of the Declaration of Luxembourg of 1984 are no longer an adequate framework in which to guarantee

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a satisfactory competitive environment between EC and EFTA countries within the European free trade zone, and relations with third countries are taking on a new dimension.

This article is organized as follows: the first section sketches EFTA's position in the European and the world economy with trade and economic specialization statistics. The second section analyses the potential and limitations of EFTA countries' traditional integration policy under the multilateral and bilateral approaches. The third section points to several factors leading to a substantial reshaping of EFTA's integration policy and to key issues raised in the negotiations for a treaty covering the European Economic Space (EES). In conclusion, the implications for EFTA's new identity and for relations with third countries are drawn.

EFTA IN THE EUROPEAN AND WORLD ECONOMY

With a population of 32 million, EFTA comprises six small countries whose share in world exports reached 6.5 per cent in 1988. All the countries are highly specialized and trade-oriented; in 1987, exports of goods ranged from 22.1 per cent of GDP in Finland to 27.9 per cent in Sweden and imports of goods were close to 30 per cent of GDP for several countries. On a per capita basis, EFTA's exports (US\$5019) were far larger than those of the EC (US\$2940), the USA (US\$1006) or Japan (US\$1877). During the 1980s, EFTA has been able to maintain a much lower unemployment rate (2.4 per cent in 1988) than the EC (10.3 per cent), including its smaller members (Belgium, Denmark, Ireland) and the USA (5.5 per cent). Two EFTA member countries, Switzerland and Austria, were able to combine low unemployment with low inflation. In Norway, Sweden and Finland inflation was more or less equal to the European OECD average, while Iceland experienced a much higher inflation rate. Over the past two years EFTA's inflation has been, however, slightly above that of the EC.

Intra-EFTA Exports

After increasing substantially from 11.1 per cent (1959) to 19 per cent (1972), the share of intra-EFTA exports in total EFTA exports has declined in more recent years (14.1 per cent in 1988). Between 1959 and 1972, significant trade creation effects occurred but also considerable trade diversion (about 42 per cent of the sum of the import effects for 1965, 1966 and 1967).¹ This was progressively corrected after the signing of bilateral free trade agreements between each EFTA member and the EC in 1972-3; EFTA share in its members' exports then dropped and the EC share expanded. In 1988, the relative importance of exports to EFTA partners

¹This means that almost half of the increase in imports resulted from the substitution of more efficient EC suppliers by EFTA suppliers owing to trade tariff differences. For more detail, see EFTA, 1969.

varied broadly from a low level for Switzerland (7 per cent), to a higher one for Iceland (10 per cent) and Austria (10.7 per cent) and a much higher one for Norway (16.3 per cent), Sweden (19.8 per cent) and Finland (20.2 per cent). During the 1959–88 period, the relative share of EFTA in total exports declined for Switzerland (–2.1 per cent) and Iceland (–6.5 per cent), increased slightly for Austria (+2.1 per cent) and Norway (+2.3 per cent), grew more for Sweden (+4.1 per cent) and much more for Finland (+15.7 per cent). In conclusion, data show that almost 30 years after its creation, the relative importance of EFTA as an outlet has increased substantially only for Finland, and somewhat less so for Sweden.

EFTA's Trade Dependence on the EC

The EC is EFTA's major trading partner with 55.9 per cent of EFTA's exports and 60.3 per cent of EFTA's imports in 1988. On the export side, this share was above the average in 1987 for primary commodities (69 per cent), minerals (67 per cent), fuel (82 per cent), non-ferrous metals (66 per cent) and other intermediate goods (63 per cent) (OECD, 1989). These goods are exported mainly by the Nordic countries. On the import side, the EC was a particularly important supplier for chemical products (73 per cent), machinery for specialized industry (72 per cent), iron and steel (71 per cent), textiles (69 per cent), motor vehicles (66 per cent) and clothing (65 per cent) (OECD, 1989).

At a country level, Switzerland and Austria buy a much larger share of their imports from the EC (71.3 per cent and 68.1 per cent respectively) than the Nordic countries (Sweden 56.0 per cent; Norway 46.2 per cent; Finland 43.5 per cent; Iceland 51.5 per cent). Figure 1 shows that except for Belgium–Luxembourg, the Swiss and the Austrian economies are more closely integrated with the EC as regards foreign supplies for output, investment and consumption than any EC Member State. On the export side, Norway is the most EC-oriented (65.2 per cent) followed by Austria (63.8 per cent), Iceland (58.9 per cent), Switzerland (56.0 per cent), Sweden (52.2 per cent) and Finland (44.2 per cent). Six small EC Member States depend more heavily on the EC for their exports than do the most dependent EFTA countries (Figure 2). The importance of the EC market as an outlet ranges around 15 per cent of GDP for all EFTA countries except Finland (9.2 per cent). EFTA countries are therefore very sensitive to the pace of economic growth in the EC, and also to changes in competitiveness induced by real exchange rate fluctuations and technological progress.

This sensitivity is exacerbated by the fact that trade is concentrated on a few EC members only. In 1988, 78.6 per cent of EFTA's imports from the EC and 75.7 per cent of EFTA's exports to the EC were realized with France, Germany, Italy and the United Kingdom. On the export side, Austria (86.2 per cent), Switzerland (82.9 per cent) and Norway (74.5 per cent) had the

Figure 1: EC share in OECD Countries' Total Imports, 1988

Source: EFTA Secretariat

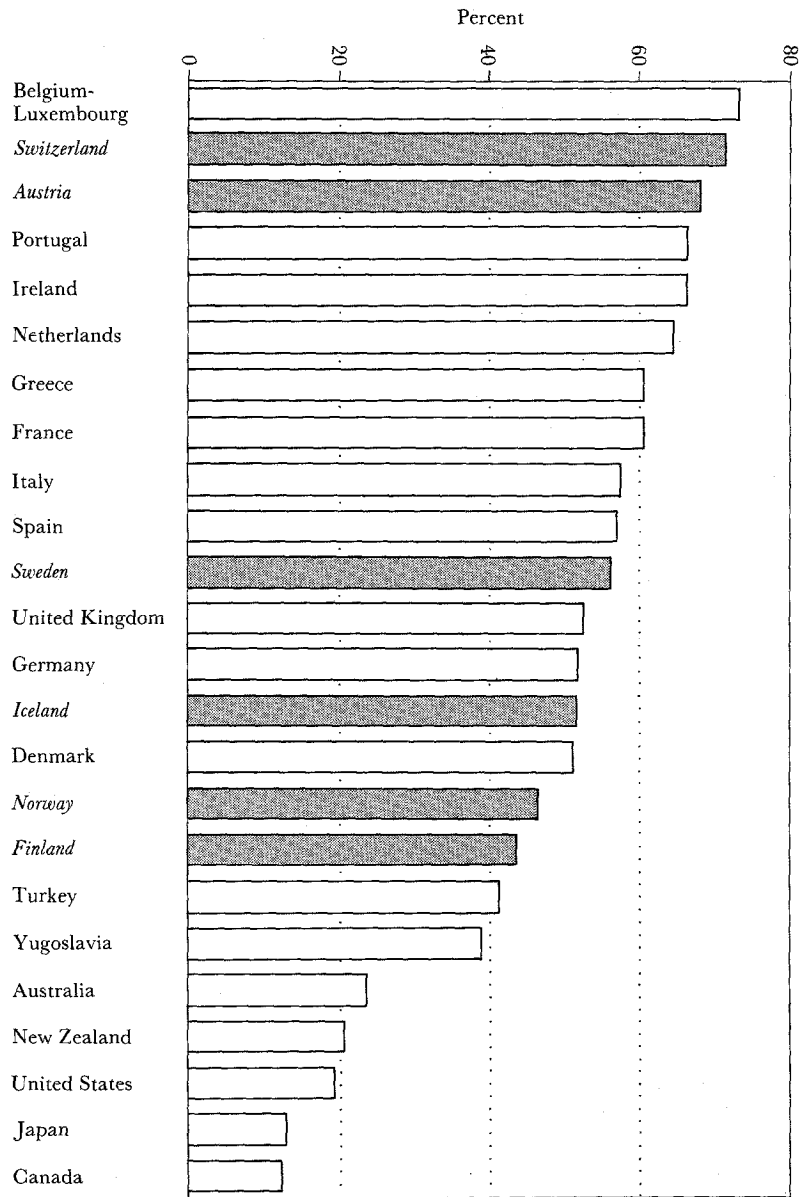
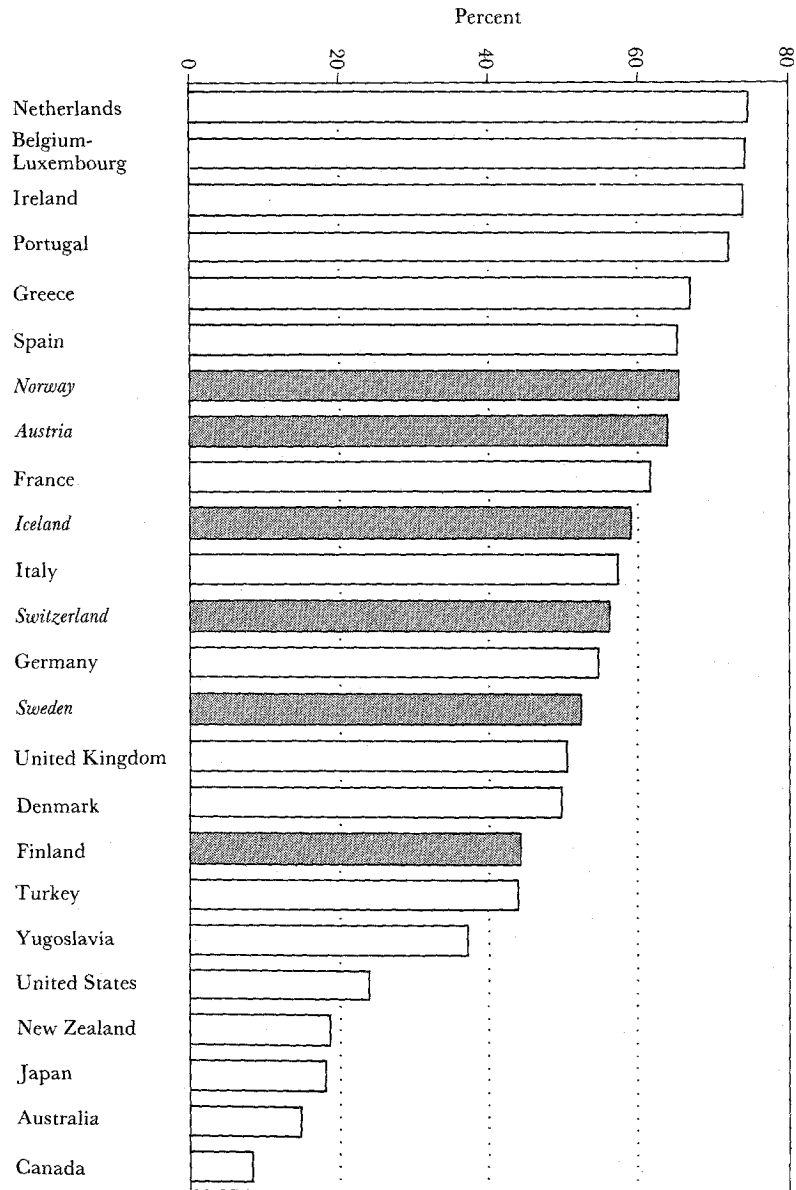


Figure 2: EC Share in OECD Countries' Total Exports, 1988

Source: EFTA Secretariat



highest concentration on the four largest EC markets. Sweden's exports were more broadly distributed, with significant shares for Belgium, Denmark and the Netherlands also. Spain, Portugal and Denmark played a significant role for Iceland and Denmark, and the Netherlands for Finland.

EFTA's Importance for the EC

EFTA is the EC's largest trading partner. In 1987, it accounted for 26.5 per cent of EC's exports and 23.6 per cent of EC's imports. EC's exports to EFTA were larger than to the USA (21 per cent) and six-fold those to Japan. The EC traditionally runs a trade surplus with EFTA which amounted to US\$14.6 bn in 1987;² this surplus enabled the EC to offset almost 40 per cent of its deficit with Japan. EFTA is an equally important outlet for EC exports of primary products (25.8 per cent), intermediate products (24 per cent) and manufactures (26.8 per cent). In manufacturing, EFTA is a particularly significant market for clothing (55 per cent), household appliances (36 per cent), office and telecommunication equipment (31 per cent), textiles (30 per cent), and other consumer goods (36 per cent) (GATT, 1988).

On a country basis, EFTA is a particularly important export market for Denmark (25 per cent, with Sweden 11.5 per cent, Norway 7.5 per cent), Germany (16.7 per cent, with Switzerland 6.1 per cent, Austria 5.4 per cent, Sweden 3.0 per cent), Portugal (11.6 per cent), Italy (9.9 per cent) and the United Kingdom (8.4 per cent). The EC countries' dependence on EFTA's markets is much lower than the reverse, and leads to an asymmetrical relationship. For instance 5.4 per cent of Germany's exports go to Austria, as opposed to 34.8 per cent of Austria's to Germany.

EFTA Countries' Specialization

Since 1959, all EFTA members except Switzerland have experienced important shifts in the distribution of their exports at the SITC (Standard International Trade Classification) one-digit level. In other words, their specialization has changed over time. Between 1959 and 1987 the share of crude materials, inedible except fuels (SITC 2) declined drastically in overall exports in Finland (45 per cent to 12 per cent), Sweden (33 per cent to 9 per cent), Austria (20 per cent to 5 per cent) and Norway (16 per cent to 4 per cent); the share of mineral fuels and related materials (SITC 3) increased drastically in Norway (0.2 per cent to 40.5 per cent); the share of manufactured goods classified chiefly by material (SITC 6) fell in Norway (40.5 per cent to 19.2 per cent) and Austria (46 per cent to 33 per cent) and increased in Iceland (0 per cent to 14.6 per cent); the share of machinery and transport equipment (SITC 7) grew substantially in Austria (15.3 per cent

²The bulk of this surplus was realized with Switzerland (US\$11 bn) and Austria (US\$5 bn); the EC registered a deficit with Norway (US\$2.6 bn).

to 33.4 per cent), Sweden (29.9 per cent to 43.3 per cent), Finland (14.0 per cent to 26.9 per cent) and Norway (7.8 per cent to 17.1 per cent) (EFTA, 1980; 1988a).

These changes in specialization have drawn EFTA countries closer together. Between 1959 and 1987, the share of EFTA exports of manufactured goods (SITC 5-8) in overall EFTA exports of goods increased from 68.2 per cent to 82.5 per cent. Despite this convergence, EFTA countries' specialization remains fairly broad-based, with substantial differences between EFTA countries. Figure 3 provides the specialization coefficients³ for each EFTA country at the SITC two-digit level:

(1) In food and live animals (SITC 0), both Iceland (coeff. 79) and Norway (coeff. 7) are highly specialized in the fish sector which accounted in 1987 for 72.5 and 7 per cent respectively of overall exports. Switzerland has developed a chocolate industry (coeff. 1.4) whose exports reached 0.6 per cent of overall exports.

(2) Crude materials, inedible, except fuels (SITC 2), accounted in 1987 for 12.8 per cent of Finland's exports and 9.2 per cent of Sweden's. These two countries are particularly specialized in cork and wood, and, pulp and waste paper; hides and skins are also important for Finland.

(3) A large part of Norway's exports (40.6 per cent) comes from the petroleum (coeff. 8) and the gas (coeff. 18) industries (SITC 3). Austria also exports electricity (1.3 per cent of exports; coeff. 5.6).

(4) The Nordic countries are also specialized in animal and vegetable oils (SITC 4), a by-product of the fish industry.

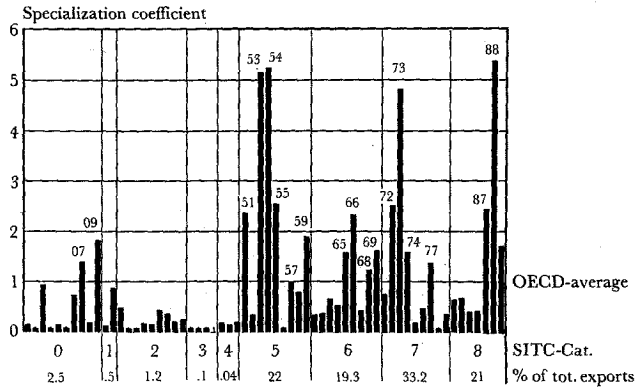
(5) In chemicals and related products (SITC 5), Switzerland is by far the most specialized country in EFTA with strong exports in inorganic chemicals (5.9 per cent of total exports; coeff. 2.4); dyeing, tanning and colouring materials (3.3 per cent; coeff. 5.2) in Finland also; medicinal and pharmaceutical products (6.6 per cent; coeff. 5.2) in Sweden and Austria (coeff. 1.2) also; and in perfume materials, toilet, polishing and cleaning preparations (1.6 per cent of total exports; coeff. 2.5). For the Nordic countries, the only high specialization coefficients are for explosive and pyrotechnic products with Norway (0.1 per cent of total exports; coeff. 4), Sweden (0.06 per cent; coeff. 2.5) and Finland (0.05 per cent; coeff. 2) and for fertilizers with Norway (1.2 per cent; coeff. 3.6)

(6) Manufactured goods classified chiefly by materials (SITC 6) account for a particularly large share of exports for Finland (40.9 per cent), Austria (33 per cent) and Sweden (26.5 per cent). All of them have developed an iron

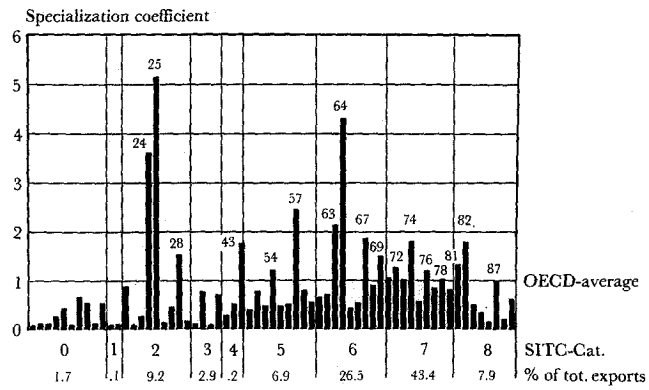
³A specialization coefficient equal to 1 means that a country exports in relative terms as much as the average of all the OECD countries and has no particularly strong comparative advantage.

A specialization coefficient above 1 (2, 3, 4, . . .) indicates that a product category is 2, 3, 4, . . . times more important in a country's export structure than for the average of all the OECD countries, and that a country has a comparative advantage for such a product category; a specialization coefficient under 1 (0.5; 0.3; 0.25; . . .) indicates the opposite.

SWITZERLAND



SWEDEN



AUSTRIA

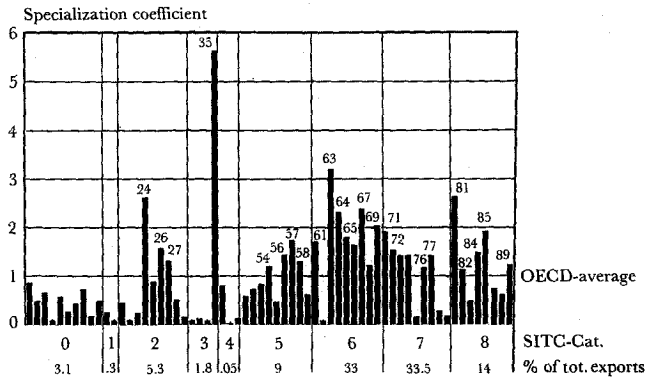
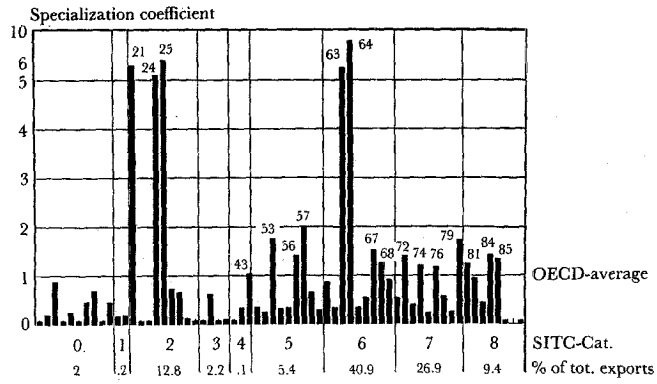
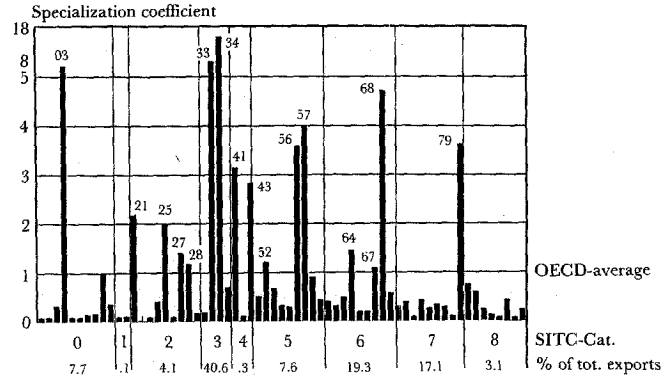


Figure 3: Specialization Ratios¹ 1987

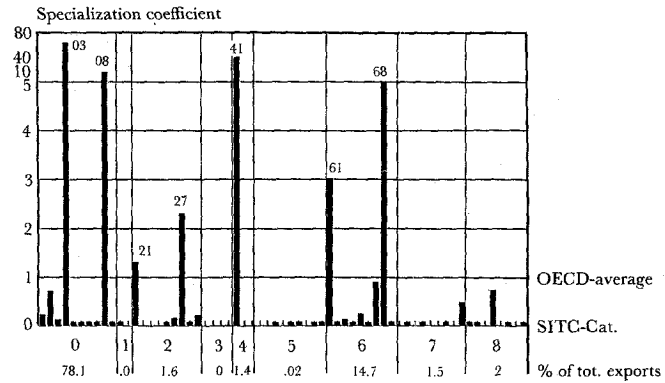
FINLAND



NORWAY



ICELAND



¹ The specialization coefficients have been calculated by dividing export shares (productwise, at 2-digit SITC level) of each country by the respective shares of total OECD exports to the whole world

Figure 3 (cont.)

Notes:

2. Product classification (SITC 1, 2)

0 Food and live animals

- 00 Live animals chiefly for food
- 01 Meat and meat prep.
- 02 Dairy products and birds' eggs
- 03 Fish, crustaceans, molluscs and prep.
- 04 Cereals and cereals prep.
- 05 Vegetables and fruits
- 06 Sugar, honey and prep.
- 07 Coffee, tea, cocoa and manuf.
- 08 Feeding stuff for animals
- 09 Miscellaneous edible prod. and prep.

1 Beverages and tobacco

- 11 Beverages
- 12 Tobacco and tobacco manuf.

2 Crude materials, inedible except fuels

- 21 Hides, skins and fur skins, undressed
- 22 Oil-seeds, oil nuts and oil kernels
- 23 Crude rubber including synthetic and reclaimed
- 24 Wood, lumber and cork
- 25 Pulp and waste paper
- 26 Textiles fibres, not manufactured, and waste
- 27 Crude fertilizers and crude minerals, nes
- 28 Metalliferous ores and metal scrap
- 29 Crude animal and vegetable materials, nes

3 Mineral fuels, lubricants and related materials

- 32 Coal, coke
- 33 Petroleum, petr. prod.
- 34 Gas, natural and manuf.
- 35 Electric current

4 Animal and vegetable oils and fats

- 41 Animal oils and fats
- 42 Fixed vegetable oils and fats
- 43 Animal and vegetable oils and fats, proces.

5 Chemicals

- 51 Chemicals elements and compounds
- 52 Crude chemicals from coal, petroleum and gas
- 53 Dyeing, tanning and colouring materials
- 54 Medicinal and pharmaceutical products

- 55 Perfume materials toilet and cleansing prep.

- 56 Fertilizers, manuf.

- 57 Explosives and pyrotechnic products

- 58 Plastic materials, etc.

- 59 Chemical materials and products, nes

6 Manufactured goods classified chiefly by material

- 61 Leather, lthr. manufs., nes & dressed fur skins

- 62 Rubber manufactures, nes

- 63 Wood and cork manufactures excluding furniture

- 64 Paper, paperboard and manufactures thereof

- 65 Textile yarn, fabrics, made-up articles, etc.

- 66 Non-metallic mineral manufactures, nes

- 67 Iron and steel

- 68 Nonferrous metals

- 69 Manufactures of metal, nes

7 Machinery and transport equipment

- 71 Power generating machinery and equip.

- 72 Machinery specialized for particular indust.

- 73 Metalworking machinery

- 74 General indust. machin. and parts. nes

- 75 Office mach. and automat. data proces. equip.

- 76 Telecom., sound recording equip.

- 77 Elect. machin., appliances and parts nes

- 78 Road vehicles

8 Miscellaneous manufactured articles

- 81 Sanitary, plumbing, heating and lighting fixt.

- 82 Furniture

- 83 Travel goods, handbags and similar articles

- 84 Clothing

- 85 Footwear

- 87 Scientific and control instrum.

- 88 Photogr. goods, optical goods, clocks, watches

- 89 Miscellaneous manufactured articles, nes

3. % in total exports may not add up to 100.

SITC 9 (commodities and transactions not classified elsewhere in the SITC) is not included

Source: data from *Foreign Trade by Commodities* (1987)
OECD, 1989

and steel industry, and paper products account for a large share of Finnish (25.8 per cent; coeff. 10) and Swedish (11 per cent; coeff. 4.3) exports. Textiles is relatively important for Austria (5.4 per cent; coeff. 1.8) and Switzerland (4.7 per cent; coeff. 1.6), and non-ferrous metals for Iceland (aluminium 9.6 per cent; coeff. 5.0) and Norway (9.1 per cent; coeff. 4.7).

(7) The share of machinery and transport equipment (SITC 7) in overall exports is large for Sweden (43 per cent), Austria and Switzerland (33 per cent) and Finland (27 per cent). Sweden, Finland and Austria have no specialization coefficients above 1.9 and do not display any significant comparative advantage in an area where intra-industry trade is very significant. Switzerland holds a stronger position with a higher specialization for machinery specialized for particular industries (9.6 per cent of exports; coeff. 2.5) and for metalworking industry (4.5 per cent of exports; coeff. 4.8) and Norway has very low specialization coefficients (under 1) except for shipbuilding (7.8 per cent of exports; coeff. 3.6)

(8) Specialization coefficients are also low for miscellaneous manufactured articles (SITC 8). Only Switzerland for SITC 88 (mainly watches, 7.4 per cent of exports; coeff. 5.4) and scientific instruments (4.8 per cent of exports; coeff. 2.4) and Austria for sanitary, plumbing, heating and lighting fixtures (8 per cent of exports; coeff. 2.6) have specialization coefficients above 2.

From this analysis the following points emerge:

(a) The share of low-technology products⁴ in EFTA countries exports is very high for Iceland (86.2 per cent), Norway (70.6 per cent) and Finland (55.8 per cent), somewhat lower for Austria (41.1 per cent) and Sweden (38.9 per cent) and much lower for Switzerland (21.2 per cent). It is in this type of products that the Nordic countries have most of their high specialization coefficients. Both Iceland (81.2 per cent of total exports) and Norway (52.7 per cent of total exports) are highly specialized in a few non-manufactured goods (SITC 0-4); these two countries are very vulnerable to fluctuations in world demand, world supply and world prices, to management of resource (e.g. fish) and market access. Further, these exports have a low income elasticity and limited growth prospects.

(b) More than half of Swiss, Swedish and Austrian exports and slightly more than a third of Finnish exports take place in the intermediate-technology field.⁵ For the Nordic countries and Austria, specialization

⁴Low-technology products include in descending order: stone, clay, glass (International Standard Industrial Classification (ISIC 361, 362), food, drink, tobacco (ISIC 311-14), shipbuilding (ISIC 3841), petroleum refineries (ISIC 353, 354), ferrous metals (ISIC 371), fabricated metal products (ISIC 381), paper and printing (ISIC 341, 342), wood, cork, furniture (ISIC 331, 332) and textiles, footwear, leather (ISIC 321-4) (OECD, 1986).

⁵Intermediate-technology products include in descending order: motor vehicles (ISIC 3843), chemicals (ISIC 351, 352; except 3522), other manufactured industries (ISIC 390), non-electrical machinery (ISIC 382; except 3825), rubber, plastic (ISIC 355, 356), non-ferrous metals (ISIC 372), other transports (ISIC 3842, 3844, 3849) (OECD, 1986).

coefficients are either lower or not much above the OECD average. Switzerland is the only EFTA country with a relatively strong comparative advantage in three different kinds of products, namely products with a high R&D component (chemicals), highly-differentiated consumer goods (watches) with large intra-industry trade flows and specialized-investment goods (machinery).

(c) EFTA countries' specialization in high-technology industries⁶ is weak; specialization coefficients are very low for the top three high-tech industries. Switzerland is the most high-tech oriented EFTA country with a degree of specialization much above the OECD average for drugs, medicine and scientific instruments.

EFTA Trade in Services and Foreign Direct Investments

Trade in services has expanded more rapidly than trade in goods and GDP in the recent past. Between 1975 and 1985, the average annual percentage increase in nominal exports (imports) of services was 8.4 per cent (10.2 per cent) for EFTA, 9.7 per cent (9.9 per cent) for the EC, 11.5 per cent (13.5 per cent) for the USA and 12.6 per cent (10.4 per cent) for Japan (EFTA, 1988b). EFTA's export performance was lowered by Sweden (5 per cent) and Norway, while Swiss (9.9 per cent) and Finnish (10.2 per cent) growth rates were above the EC average.

Between 1975 and 1985, the share of exports of services in total exports increased substantially for the USA (from 31.4 per cent to 41.3 per cent), significantly for the EC (30.5 per cent to 34.6 per cent) and much less for Japan (from 19.5 per cent to 20.6 per cent) and EFTA (from 30.8 per cent to 31.7 per cent). In the latter, Norway (from 40.4 per cent to 32.3 per cent), Iceland (from 35.1 per cent to 33.1 per cent) and Sweden (from 20.3 per cent to 19.3 per cent) registered a decline, while Switzerland had the largest increase (from 37.2 per cent to 42.0 per cent).

Within EFTA, Switzerland is the major exporter of services (39 per cent of EFTA); the Swiss trade surplus is colossal and was almost half that of the EC or the USA in 1985. Fields of specialization vary substantially in EFTA (see Table 1, Appendix 1). In 1985, 57 per cent of Swiss exports of services were attributed to investment income against 20–30 per cent for the other EFTA countries, except Iceland (3.5 per cent); Switzerland was the only EFTA country to run a surplus for investment income. Norway and Iceland realized more than 50 per cent of their exports of services with transport, Sweden and Finland close to 40 and 30 per cent respectively, while Switzerland (2 per cent) and Austria (7 per cent) had very low shares.

⁶High-technology products include in descending order: aerospace (ISIC 3845), office machinery and computer (ISIC 3825), electronic components (ISIC 3832), drugs and medicine (ISIC 3522), scientific and professional instruments (ISIC 385) and electrical machinery (ISIC 383; except 3832) (OECD, 1986).

Tourism was very important for Austria (48 per cent), less for Switzerland (21 per cent), and ranged between 8 and 16 per cent for the other countries. Exports in other services ranged between 10 and 27 per cent and consist mainly of insurance (Switzerland) and intellectual property rights (Switzerland and Sweden). On the import side, differences among EFTA countries were smaller, except for transport.

The specialization of EFTA countries in services is linked closely with the geographical location, natural resources endowment and international activities developed over a large number of years. As was observed earlier in the case of goods, EFTA is not at the forefront in trade for services. Travel and transport account for almost half of the Association's exports, against less than a fifth for the USA and less than a third for the EC. All EFTA countries except Switzerland register trade deficits in the two fastest growing categories of services, investment and other services (financial services, insurance, consulting, engineering, etc.).

As data on trade in services suggest, the importance of inward and outward foreign direct investments (FDI) varies greatly among EFTA countries. In 1987, EFTA countries' FDI stock amounted to US\$66.2 bn with Switzerland (55.3 per cent) and Sweden (27.2 per cent), the two largest investors and Austria the smallest one (3.7 per cent). Switzerland (55.9 per cent) had also more than half of EFTA countries' inward FDI of US\$37.4 bn, and had a significant net investment position (US\$16.1 bn). Owing to a dynamic development of foreign activities during the 1980s, both Sweden (US\$+12.9 bn) and Finland (US\$+2.6 bn) registered also a positive net position, while Norway (US\$-2.0 bn) and Austria (US\$-2.1 bn) had a negative net position (EFTA, 1989).

The linkages of the various EFTA countries with their EFTA partners and with the international economy come clearly into perspective with the regional share of inward FDIs during the 1982-8 period. EFTA countries were the largest investors in Finland (73.4 per cent) and Sweden (69.8 per cent) and had a major share in Norway (44.3 per cent); these flows originated mainly from the Nordic countries. EFTA accounted, on the other hand, for a much smaller share of Austrian (19.2 per cent) and Swiss (3.0 per cent) inward investments, more than 50 per cent of FDI originating from the EC. Switzerland was the only EFTA country with a fairly large amount of North American inward FDI (37.0 per cent). Finally, as expected, the share of the EC in EFTA countries' outward FDI has increased substantially since the beginning of the implementation of the EC Internal Market in 1985.

THE POTENTIAL AND LIMITATIONS OF EFTA COUNTRIES' TRADITIONAL INTEGRATION POLICY

The integration policy achievements of EFTA have been limited by a number of factors, including the differing interests of its members, most of

whom have given priority to their own integration policy with the EC. As long ago as 1961 the United Kingdom, followed by Norway, Denmark and Ireland (not an EFTA member) had filed an application for EC membership. The three neutral countries — Austria, Sweden and Switzerland — requested the opening of negotiations based on Art. 238 of the Rome Treaty for the status of association. General de Gaulle's veto on British membership delayed the decision to enlarge the EC until the EC Conference of Heads of States and of Governments of 1–2 December 1969 in La Haye; the role of the EFTA neutral countries in Europe was also recognized at that Conference.

During the ensuing exploratory talks, the EFTA countries presented views on strengthening their relations with the EC. Switzerland emphasized, for instance, that in order to ensure free competition and to avoid distortions, competition rules ought to be envisaged in several areas, including public procurement, government aid and dumping; Switzerland also expressed interest in eventual participation in the creation of European law, in particular in the areas of company law, execution of civil judgments, insurance and mutual recognition of diplomas and licences (Report to the Swiss Parliament, 1971). Sweden proposed a broad harmonization with a corresponding determination right. The EC faced a dilemma with, on the one hand, the objective of eliminating trade barriers and, on the other hand, the need to maintain the internal cohesion of the EC system and the normal functioning of EC institutions. The EC opted for free trade agreements (FTAs) strictly limited to commercial matters with very general principles for competition conditions. The evolutionary clause included in all the FTAs except Finland's foresee their extension to other fields of common interest.

With the elimination of the last remaining tariff barriers and quantitative restrictions affecting their bilateral trade in industrial products, the EC and EFTA countries decided in April 1984 to 'lay down orientations to continue, deepen and extend cooperation within the framework of, and beyond the FTAs' (Declaration of Luxembourg, 1984). The aim of strengthened multilateral relations was to create a dynamic European Economic Space.

The Multilateral Approach

Table 1 presents the outcome of EFTA–EC multilateral co-operation within the Follow-up of the Declaration of Luxembourg in six groups. By 1989, EFTA–EC co-operation spread over more than 20 fields ranging from origin rules to telecommunications.

Table 1

EFTA-EC Multilateral Co-operation under the Follow-up of the Declaration of Luxembourg, 1989

I.	Physical barriers to trade	Type of co-operation	Brief description
A.	<i>Administrative Barriers</i>		
	Single Administrative Document	AG, 1987	Adoption of one document for border formalities in the EES;
	Common transit procedures	AG, 1987	Adoption of common procedures for the transit of goods in the EES;
	Trade facilitation	AG, 1989	Participation in the EC programme for Trade Electronic Data Interchange System (TEDIS)
		INF	Harmonization and simplification of procedures related to the use of electronic customs messages;
	Border formalities for persons	—	EFTA group only; prepares a common position on controls for EFTA and EC nationals at 'internal' EES borders;
B.	<i>Policy-oriented Barriers</i>		
	Origin rules	AG, 1988	Simplification of origin rules (cumulation)
		—	EFTA group only; prepares a common position to extend the alternative percentage rules to the chemical sector;
	Export restrictions	AG, 1989	Abolition of existing and prohibition of new export restrictions;
	Price compensation for processed agricultural produce	EX	Exploration on the real raw material content of the processed products;
			Discussion on a reform of the reference price systems used for the calculation of the compensatory amounts;
	Counterfeit trade	INF	Discussion on planned and adopted measures for combating counterfeit trade;
	Indirect taxation	INF	Discussion on exemptions and allowances in cross-border trade and traffic;
	Anti-dumping practices	—	No common ground for further discussion;
II.	<i>Technical Barriers to Trade</i>		
	CEN, CENELEC, ETSI	JA, 1985-9	EFTA financial participation in most of the mandates given by the EC;
	Technical regulations	AG, 1989	Exchange of notifications on draft technical regulations;

Testing and certification	EX	EFTA-EC mutual recognition in 10 areas where EFTA prepares sectoral agreements under the Tampere Convention;
Chemicals	INF	Comparison of relevant EC Directives and existing national legislation in the EFTA countries;
Veterinary controls	INF	Comparison of EFTA legislation with existing and proposed EC legislation; future EFTA-EC harmonization in the meat hygiene sector to be discussed;
Phytosanitary controls	INF	Identification of EFTA-EC co-operation fields;
III. <i>Public Procurement and Services</i>		
Public procurement	AG, 1989 EX	Notification system for tenders; Conditions of a mutual opening for public supplies and works based upon EC Directives and adoption of legal remedies equivalent to the EC's;
Services		
Financial services	INF	Banking (licensing criteria, prudential supervision of banks, capital regulations), securities trading, insurance;
Telecommunications	INF	Mutual recognition of type approval for telecom terminal equipment and telecom services (opening up of the markets to international competition, EC Directive);
New technologies of services	INF	Information services market plan (IMPACT), new payment cards, recommendation for a European code of conduct relating to electronic payments;
Land transport	—	Intra-EFTA reports on bilateral negotiations (Switzerland-EC; Austria-EC) and contacts (Nordic countries-EC); national assessments of selected EC Directives;
Civil aviation	—	Intra-EFTA reports on contacts between Norway-Sweden and the other EFTA countries and the EC;
IV. <i>Legal Questions</i>		
Product liability	INF	Progress of the work on the implementation of the EC Directive and introduction of product liability legislation in EFTA countries;

Company law	INF	Comparison between the EFTA countries' legislation and the <i>acquis communautaire</i> ;
Intellectual property rights	INF	Discussion covers semi-conductor products, biotechnological inventions and Community Patent Convention;
V. <i>Flanking Policies</i>		
Education	AG, 1989	EFTA countries' participation in COMETT II, a programme for advanced training in new technologies to be set up between universities and firms;
	EX, 1990	EFTA countries participation in ERASMUS;
	INF	Vocational training (PETRA and EUROTECNET) and foreign language competence (LINGUA), mutual recognition of diplomas;
Research and Development	JA	EFTA countries participation in various EC R&D programmes;
	INF	On EFTA participation in the third EC R&D framework programme;
Environment	INF	EFTA countries participation in the planned European Environment Agency;
Consumer protection	INF	Future EFTA-EC co-operation to be envisaged <i>inter alia</i> for product safety, new methods of payment, consumer credits, etc.;
Social dimension	INF	Discussions between EFTA's Consultative Committee (social partners) and the Economic and Social Committee of the EC;
Tourism	JA	Joint preparation of the European Year of Tourism 1990;
Civil protection	JA	Experts from EFTA countries invited by the EC to a civil protection exercise 'Europe 1989';
VI. <i>Other Fields</i>		
State aid	AG, 1988	Notification of new state aids given to industry in the EES;
	INF	Strengthening of rules for surveillance and enforcement in EFTA to serve as a basis for a future agreement with the EC;
Small and medium-sized enterprises	EX	EFTA link-up to BC-NET, and other programmes such as Euro-Info Centres and the training programme for managers;

Statistical co-operation	INF	Aim: to ensure comparability and where necessary harmonize EFTA countries and EC statistics;
Exchange of information on the economic situation	INF	Analysis of the economic situation, major risks, short- and medium-term perspectives, and effects of the completion of the Internal Market of the EC on finance and industry;

Source: Various progress reports on EFTA-EC Co-operation published by EFTA Press and Information Service

Notes: AG: agreement

EX: exploratory talks leading, if successful, to negotiations for an agreement

INF: exchange of information

JA: joint action for a specific activity

Physical barriers to trade. Major results were realized in the administrative field with the adoption in 1987 of a Single Administrative Document harmonizing border formalities for goods and of common transit procedures for goods. In the same area, in 1989 EFTA countries joined the EC programme on Trade Electronic Data Interchange Systems (TEDIS) which aims to co-ordinate work pursued in this field in various countries, to develop the awareness of hardware and software producers for electronic exchange of trade data, and include in telecommunications and normalization policies the specific needs of trade data exchange.

Only two achievements were realized to reduce policy-oriented barriers. In 1988, origin rules which determine the criteria for products to be duty-free in EFTA-EC trade were simplified. The new rules increase the possibility of using parts or components originating in any country of the free trade area without having to pay duties. In 1989, an agreement was signed to abolish existing export restrictions which were mainly limited to non-ferrous metals, and to prohibit new ones. This agreement filled a gap in the FTAs.

Technical barriers to trade. In this area, EFTA countries have actively supported the work of the European Committee for Standardization (CEN), the European Committee for Electrotechnical Standardization (CENELEC) and the European Telecommunications Standards Institute (ETSI). By the third quarter of 1989, EFTA countries had supported 127 out of 130 projects or mandates for European norms with a financial participation of 14 per cent. One of the last contracts with CEN concerned a project to establish a database with the aim of supplying companies or other users with information on administrative and technical conditions relating to the certification of products, and to direct the user to the body responsible for certifying or in some other way approving the product.

To prevent technical barriers, EFTA countries concluded an agreement in 1989 on the exchange of notifications of draft technical regulations. The aim of this agreement is to give EES partners the opportunity within a period of six months to take a stand on drafts of technical regulations, so that new regulations would not depart from other countries' practices. This exchange of information will improve transparency and make it more difficult to pass regulations with an obviously protectionist character. In federal states, regional entities are covered by this agreement.

Under the Tampere Convention (1988), EFTA countries have established a framework for the mutual recognition of test results and proofs of conformity. The work of EFTA countries is based on existing EC Directives or projects. Sectoral agreements are first to be concluded among EFTA countries, then to be extended to the EES. Exploratory talks with the EC cover safety of toys, safety of machines, building materials, personnel protective equipment, electromagnetic compatibility, low voltage equipment, measuring instruments, simple pressure vessels and telecommunications terminals.

Public procurement and services. In the area of public procurement, in 1989 EFTA countries joined the EC notification system for tenders with the publication of tender notices and contracts awarded in the *EC Official Journal*, and participation in the EC tender electronic daily (TED) system. The latter provides various users, including firms and national associations, with direct on-line access to tender notices. EFTA countries publish notices and information as envisaged by the GATT Code on Public Procurement. They may also publish pre-information at the beginning of the year on future tenders. Local and regional entities are not covered by this procedure which was conceived as a transparency measure and as a first step towards the mutual opening of public procurement markets, a field where exploratory talks were conducted in 1989 for public supplies and works. EFTA countries have accepted in principle the *acquis communautaire*⁷ as a basis for the negotiations. EC and EFTA experts are also expected to exchange views in 1990 on the mutual opening of public procurement markets in the sectors excluded so far (telecommunications, water, energy, transport) and at a later stage in services acquired by the public sector.

In services, by contrast, EC-EFTA co-operation has remained at the level of exchange of information. The most advanced work has taken place in financial services. In banking, talks focused on banks' accounts, banks' own funds and solvency ratios. In securities trading, major topics were insider trading, admission of securities to official stock exchange listing, undertak-

⁷The *acquis communautaire* consists mainly of Directives 71/305/EEC, 89/440/EEC (public works), of Directives 77/62/EEC, 80/767/EEC, 88/295/EEC (public supplies) and of the Directive on legal remedies adopted by the EC Council in December 1989.

ings for collective investment in transferable securities and deposit guarantee schemes. The EC has shown particular interest in exchanging views on take-over bids, money laundering, withholding tax at source on interest income and tax on transactions in securities.

In land transport, contacts with the EC have so far been bilateral. In air transport, the EC Commission obtained a negotiating mandate in January 1990 from the EC Council to deal, on the one hand with Norway and Sweden who jointly own with Denmark an airline (SAS) and, on the other hand, with the other EFTA countries.

Legal questions. The major achievement in this area has taken place outside the Luxembourg process. In 1988 at a Diplomatic Conference in Lugano, the EC Member States and EFTA countries signed a Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters. This Convention marks an important step in strengthening the legal framework for EC-EFTA relations; it introduces a common system for the international competence of Courts and for the recognition of judgments in all EFTA and EC countries. This means that within the Convention, any judgment in one country can be recognized in another country without any special procedures. Legal conditions for the mutual recognition of national regulations should also be improved.

Flanking policies. Flanking policies cover the areas where co-operation or co-ordination is considered important, to ensure the success and the acceptance of the Internal Market programme. Major achievements at the EFTA-EC level were realized in research and development (R&D) and, very recently, in education. In the former, EFTA and EC experts have dealt mainly with the conditions of EFTA countries' participation in various EC R&D programmes which can either be full participation, based on projects, or limited to concertation. EFTA countries have also insisted on improved terms for their participation in the EC second framework programme for R&D (1987-91) and for full participation in the third programme. In education, EFTA countries joined COMETT II (1990-4) a programme which aims to promote training in new technologies, with close co-operation between universities and firms. In 1990, EFTA countries and the EC will negotiate the conditions under which EFTA will join ERASMUS, a programme linked to the exchange of students, researchers and professors.

Other fields. In 1988, EFTA countries and the EC signed an agreement to exchange information on new state aids given to industry in order to improve transparency on practices in the EES. Negotiations should begin in 1990 on EFTA countries' participation in the EC's Business Co-operation Network

(BC-Net) and concentrate on financial, legal and technical aspects. BC-Net was established in July 1988 and its objective is to help small and medium-sized enterprises to find commercial partners.

Overall assessment. The results achieved so far under the Follow-up of the Declaration of Luxembourg were hailed with much satisfaction at the official political level. Several agreements have been signed every year since 1987, and they have all undoubtedly contributed to strengthening the ties between EFTA countries and the EC, and to keep momentum going for the creation of the EES. Two major political constraints have impeded faster and broader-based progress. On the EFTA side, a common interest had first to emerge among the six members, who then had to agree on a common platform to approach the EC. In a large number of areas, economic interests based on economic specialization and domestic regimes diverged too much, thus excluding the multilateral approach or limiting its scope. On the EC side, policy towards EFTA was determined by three principles stated by Willy de Clercq, Commissioner for External Relations, in Interlaken (1987): first, priority to the EC integration process to realize the Internal Market by 1992; second, maintenance of EC autonomy of decision; and, third, balance between rights and obligations.

These framework conditions explain why the scope and depth of the agreements signed with the EC under the Luxembourg process have remained very limited. Out of nine agreements, three are related to administrative measures facilitating border controls or information on these; one covers export restrictions and has a very marginal impact on trade; one relates to origin rules and has yet to show any impact on trade; three concern exchange of information to increase transparency in governments' procedures and have no direct binding impact on policy; one, finally, relates to education.

Progress has been particularly difficult in several areas. In the mutual recognition of tests and certificates, no agreement covering the EES is expected to be signed in the foreseeable future. The issues at stake are horizontal and to be found in all sectors. Two issues are closely related with EC autonomy of decision and concern parallel modifications of EC Directives and EFTA sectoral agreements, and extension of the agreement to third countries. Four issues are more closely related to the balance between rights and obligations and concern surveillance, enforcement, dispute settlements and safeguard procedures. In addition, the mutual recognition of tests and certificates is not sufficient to ensure the free movement of goods between an EFTA country and the EC because the principle of the free movement of goods is based on all the Directives which may apply to a particular good.

The issues relating to the balance of rights and obligations are also the key problems in the public procurement field. In addition, difficulties are raised

by the free movement of workers and the extension of several EC schemes such as the mutual recognition of diplomas and of national standards and technical regulations in the absence of European norms (Cassis de Dijon principle). Furthermore, the vagueness of the EC Directives on key elements such as the definition of public works, or local working conditions, is a handicap in the analysis of the possible impact of liberalization domestically, and in gaining of local and regional government support. These are not regarded as problems by the EC because, once adopted, the Directives are directly applicable at all government levels in the Member States and the Court of Justice may give an opinion on points that might require further clarification.

In the field of state aid, EFTA experts have drafted a new system for surveillance and enforcement of Article 13 of the Stockholm Convention and its agreed interpretation. For further progress in EFTA-EC co-operation, EFTA's new procedures for surveillance and enforcement in this field must first be perceived as providing the same degree of control over state aid measures as the EC instruments, and actually result in the abolition or changing of aid measures that are perceived as distorting trade.

The difficulties pointed out above reflect essential differences between the EC and EFTA. The former is a customs union aiming at full economic and monetary union, and already possesses an important body of common law, common institutions and sovereignty transfers. The latter is a free trade group with only a small Secretariat managing the free trade association and multilateral relations, a Council that takes decisions by consensus and a membership opposed to a transfer of competences from the capitals to the association.

The Bilateral Approach

Most of the arrangements concluded under the bilateral approach deal exclusively with commercial matters, i.e. market access — GATT Rounds — before 1972 and, since then, EC enlargements and products not covered by the FTAs, agricultural goods in particular. The importance given by EFTA countries to the bilateral approach in order to deepen and expand co-operation beyond purely commercial matters varies considerably. By 1989, all EFTA countries had concluded a framework agreement for scientific and technical co-operation and had participated to various degrees in EC scientific and technological co-operation, Switzerland and Sweden being at the forefront. In addition to this, Finland and Norway had signed only one agreement on fisheries, in 1980 and 1983 respectively; Norway also had exchanges of letters on environment (1981); shipping (1981); coast, air and land transport (1981); development aid and North-South questions (1982); consumer protection (1983); and price compensation for primary products (1989). Sweden had concluded five agreements, namely on thermonuclear fusion and plasmaphysics (1976); distribution of specific

tariff-free British quotas (1980); transfer of information with Euronet (1981); and R&D for wood as a reusable primary product (1983). Exchanges of letters were made on environment (1977), consumer protection (1980), transport (1981), and the position of Sweden regarding the US-EC agreement on research in fusion (1986). Austria had concluded an agreement on train taxes for transit of coal and iron (1958, additional protocols, 1961, 1978, 1981, 1986, 1989), co-operation agreements on water management in the Donau area (1987) and on research for modern materials (1988), and an exchange of letters on environmental questions (1978). Switzerland had signed seven agreements covering the legal status of the European Investment Bank in Switzerland (1972), the protection of the Rhine river against chemical pollution (1976), thermonuclear fusion and plasmaphysics (1978), transfer of information with Euronet (1981), occasional international passengers travel services by road for buses (1982), terminology (1987) and freedom of establishment for non-life insurance (1989). Exchanges of letters mainly covered exchange of information on environmental protection (1975) and for management and stocking of radioactive waste (1982).

The most far-reaching agreement in EFTA-EC relations was realized under the bilateral approach by Switzerland for the freedom of establishment of non-life insurance companies. This agreement guarantees Swiss participation in a sector of the Internal Market and EC participation in the Swiss market on a basis of reciprocity and non-discrimination. Swiss and EC law are not harmonized, but equal treatment is given to Swiss and EC companies in their respective markets. For the first time in Swiss-EC and EC-third countries relations, a dispute settlements procedure, an evolutionary clause and a procedure applicable for the evolution of the internal law of any party are included. In this respect, the EC and Switzerland will not have to open consultations on legal developments, but must modify or withdraw any legal project incompatible with the agreement. The latter is a legal innovation which could be useful for the EES.

The bilateral approach has been particularly useful in dealing with commercial questions, in ensuring EFTA countries' participation in numerous EC R&D programmes, and in further co-operation according to each EFTA country's particular interests. Because of the EC's own interests and limited resources for dealing separately with the six EFTA countries, results were not always as forthcoming as EFTA countries might have wished. In addition, co-operation was not always on equal terms: in various scientific programmes, each EFTA participant must find two partners from two different EC countries, while an EC participant must find only one partner from another EC country. EFTA countries also have no say in the management of most of the programmes. In the past few years, it has become obvious that the EC Internal Market and the EES can only be brought closer together if EFTA countries are to take a common position on most outstanding issues.

THE NEED FOR A NEW POLICY ORIENTATION

EFTA was created with the aim, 'to facilitate the early establishment of a multilateral association for the removal of trade barriers and the promotion of closer economic co-operation between the Members of the Organisation for European Economic Cooperation including the Members of the EEC' (EFTA, 1960). The FTAs of 1972-3 did not meet all Switzerland's and Sweden's expectations expressed during the exploratory talks, not to speak of those of Norway. In that country, EC membership was narrowly rejected in a public referendum after the government had completed all the negotiations. The bilateral and multilateral approaches were satisfactory only until the EC launched its offensive for the abolition of internal borders, and thereby of all 'second-generation type' trade-related barriers. Within a short time, EFTA governments were forced to review their integration policy. Several factors led to a substantial reshaping of EFTA's policy stance.

Interdependence v. Integration

Figures 1 and 2 show how closely interdependent EC and EFTA economies are. Despite all the integration efforts of the past 30 years the relative share of the EES in EFTA overall exports has, however, increased only by about 10 per cent between 1959 and 1989. This moderate growth can be attributed partly to the low level of tariffs reached among industrial countries after successive GATT Rounds of multilateral trade negotiations, the growing role of non-tariff and technical barriers to trade, in particular for neighbouring countries with fairly similar consumer patterns and large potential for intra-industry trade, the economic difficulties of the 1970s — the breakdown of the Bretton Woods system of fixed exchange-rates parities, the oil crises and a deep-seated recession — felt strongly in Europe, and slower economic growth in Europe than Japan, the United States or the newly-industrializing countries of Asia in the 1980s.

While the notion of interdependence can be analysed using various statistical tools, the notion of integration is far more difficult to express diagrammatically. Significant qualitative steps separate a free trade area from a customs union embarked on economic and monetary union. The intensity of integration can be assessed by reference to price dispersion for similar goods: the higher price dispersion is, the looser the integration scheme. The ultimate aim of an integration process is the realization of the law of one price; this is possible only with the elimination of all trade-related barriers and full cross-border arbitrage by economic agents.

The qualitative gap between the EC and EFTA comes clearly into focus with a price comparison for a large number of food products, tradables and non-tradables. Data for 1985 show that the EC has a much lower price

dispersion than a group composed of its first nine members and four EFTA countries (Iceland and Switzerland are not included in the sample) (Wieser, 1989). This study also finds that price dispersion among the six founding countries of the EC is still significant for several products almost 30 years after the signing of the Rome Treaty. Price differences within the EC and between the EC and EFTA are so large, in particular in the latter case, that they cannot be attributed only to methodological problems (currency valuation, product identification) and special factors (transport costs). This price analysis tends to indicate that interdependence is not a good proxy for integration in the EES as numerous government schemes and private business practices distort prices and trade patterns.

Furthermore, EC membership for the United Kingdom, Ireland and Denmark led to a much lower price dispersion than the FTAs and therefore to a higher integration. The latter point is reinforced with a much stronger growth of the share of the EC six in the exports of the United Kingdom and Denmark (+12 per cent) than in those of EFTA countries (+4.6 per cent) between 1973 and 1985. These observations support the thesis of the existence of a substantial qualitative difference between the EC and EFTA; the common policies of the EC in several areas inevitably brought EC economies closer together. Most problematic for EFTA countries is that this large integration gap was already in existence before the EC initiated its Internal Market programme.

The Economic Specialization Factor

EFTA's economic specialization is concentrated in low- and intermediate-technology industries. In the Nordic countries, raw or processed natural resources represent the bulk of exports. Switzerland and to some extent Sweden are the only EFTA countries with a more specialized industrial sector including investment goods and world leaders.

EFTA is not specialized in the fastest growing activities and almost completely absent from the high-technology sector. With the on-going industrialization process in the Third World, EFTA countries, the Nordic ones in particular, must expect growing competition from low-cost countries for processed natural resources in particular. In addition, economic reforms presently sweeping Eastern European countries should lead progressively to a change in their export pattern from basically food products and natural resources to processed low-technology goods and at a later stage to intermediate-technology products. Over time, EFTA will face fiercer competition from these countries, in particular in the EC market.

The resources necessary to develop new industries and new technologies are so large that co-operation and European-wide research programmes are required to pull together the skills and experience of universities, research institutes and firms working in interdisciplinary areas. If EFTA countries

are not to be left behind in the large European co-operation effort, they must take an active part in EC research programmes. With the growing link between the sale of products and services, substantial efforts must also be made to move into the fastest growing services, and to realize an EES-wide market for services. For EFTA countries, this implies the removal of domestic barriers to competition which impair both the efficiency of the service sector and the competitiveness of the goods sector. The EES could therefore contribute to the development of new activities and a diversification of EFTA economies towards the high-tech information and product/services society of the twenty-first century.

Towards a New Integration Policy

By 1988, it had become obvious in all EFTA countries that the co-operation undertaken under the Follow-up of the Declaration of Luxembourg was not able to keep up with the Internal Market. EFTA countries faced both the risks of marginalization, that is, to be excluded from the integration momentum, and satellization, that is, to have to adjust their own regimes after the EC Directives and regulations have been adopted. EFTA countries felt less and less satisfied with their traditional integration policy,⁸ which gave priority to the internal development of their own legal system, their own treaty-making power and therefore their national sovereignties.

Over the years, the notion of national sovereignty has been eroded, in particular for small open economies with little or no influence on external factors to which they have to adapt to keep their competitiveness. Once the EC initiated the Internal Market programme, procedural and legal differences with EC regimes were perceived more and more as competitive disadvantages. As a result, several EFTA countries came to the point of very carefully comparing any new legislative proposal with existing EC law, and adapting their domestic projects to EC law to realize the greatest compatibility. Sweden even unilaterally adopted and implemented more than 20 EC Directives by the end of 1989. In such ways, EFTA countries have reacted against marginalization, but at the inevitable price of satellization. It became obvious for EFTA countries that their *de jure* national sovereignty had lost much of its *de facto* value.

Evidently they faced a difficult dilemma: on the one hand EC membership was not on the cards for the foreseeable future for several of them, and on the other hand they did not envisage turning EFTA into a fully-fledged integration scheme close to economic union. They therefore could not use the strategy of the 1960s to move within EFTA in parallel with the EC in order to conclude a bridging agreement with the EC at a later stage. They

⁸For an economic analysis of the issues involved, see Wijkman (1988), Krugman (1988) and Pintado *et al.* (1988).

were also confronted with the hard fact that the White Paper programme touches on a large number of aspects of economic, social, cultural and — last but not least — political life, where change is very difficult to bring about domestically without strong external pressure. In order to liberalize completely capital movements in the Nordic countries where the present regime is closely linked with very high personal taxes; or, in Austria, to open up the large state industrial sector to foreign competition; or, in Switzerland, to adapt banking practices, reform the stock-exchange market and open public procurement on a nation-wide basis, the forces of change had to come from abroad.

Austria acted first by announcing in mid-1988 that an application for EC membership would be filed in Brussels in 1989 (17.7.89). Lacking a strong foothold in the EC market and facing an important discrimination potential, the industrial sector in the Nordic countries urged their government either to join the EC or substantially to accelerate the integration process. If no satisfactory result could be reached, outward FDI would surge even more than today, and output would be transferred into the EC. The Swiss government submitted a report to its Parliament in autumn 1988, proposing to pursue its present strategy (i.e. the only one feasible under the three principles of Interlaken). The Swiss authorities were disposed to review their position if circumstances were to change. The Swiss situation differed from that of the other EFTA countries in the sense that both industry and major services already have a close network of EC subsidiaries and did not exercise any pressure on the government to speed up the integration process. The Internal Market was perceived more as an opportunity than a threat for internationally-minded Swiss business. The Swiss government also hoped to expand and deepen bilateral co-operation in areas of common interest and along the lines of the agreement on the free establishment of non-life insurance.

Aware of the limitations of the Declaration of Luxembourg process, and of the risks that Austria's example would be followed by other countries up to 1993, the President of the EC Commission, Jacques Delors, proposed to the EFTA countries in an important policy statement to the European Parliament on 17 January 1989, a more strengthened relationship with common decision-making and administrative institutions. Delors chose therefore to water down at least one of the three Interlaken principles — the priority given to the internal integration of the EC — and with a stroke of his pen changed the policy framework for EFTA. He made it clear that EFTA would have to become a single partner, speak with one voice and establish its own institutions to develop a partnership based on equal rights and obligations.

After only six months of informal talks, an exploratory phase leading to negotiations for an EES Treaty was launched on 19 December 1989 in Brussels at an EC-EFTA Ministerial meeting. As a starting point, during

the informal talks EFTA countries have accepted to integrate one way or another the relevant *acquis communautaire* in the EES Treaty as a common legal basis. This means that after careful examination with the EC, EFTA countries will have to incorporate into their domestic system, with primacy over domestic laws and practices, all the existing EC laws, rules and prescriptions which may have an impact on the free movement of goods, services, capital and persons and on the flanking policies.

The EES treaty negotiations will consider transitional periods in areas where adjustment will be particularly difficult, and also permanent exceptions. The latter will be so limited that they may cover only vital national interests, namely the quantitative aspect of the free movement of persons, transport policy (Switzerland and Austria, Switzerland, Liechtenstein and Iceland), transit questions, the purchase of land and buildings (most EFTA countries) and fishing rights for Nordic countries, Iceland in particular. Negotiations will also have to clarify how EES decisions will be shaped and taken. The EC will have to determine whether it is possible to distinguish EES and EC Internal Market decisions, the latter including also, for instance, agriculture, commercial policy towards third countries and common policies in specific sectors (shipbuilding, steel, the car industry, etc.). If EC internal decisions and EES decisions are so interlinked that they cannot be clearly separated, it will then be almost impossible for the EC to consider common decision-making institutions. On the EFTA side, Sweden has shown signs of flexibility. Switzerland has indicated that a system in which EES laws are not decided in a legally binding framework, will not be politically acceptable domestically. For Austria, co-decision is not to be expected and therefore EC membership must be pursued vigorously. Finland and Iceland are at the other end of the spectrum, with the requirement of parliamentary approval for all-important EES legislation; if these two countries were to impose their view, the end-product would only be a mere improvement of the Declaration of Luxembourg process at the very high cost of the incorporation of the relevant *acquis communautaire* in the domestic legal system.⁹

Another feature of a future EES is that EFTA will have to speak with one voice to the EC and develop a common position before submitting a project to the EC for new legislation (decision-shaping phase). During the decision-making phase, EFTA countries will also have to agree on a common stance throughout the process. This will be a major challenge for them, and is also a major weakness of the EES concept for two reasons. First, EFTA countries will display various degrees of sensitivity to new EES legislation because their interests differ as indicated by economic specialization, and some of them (the Nordic) have no common border with the EC except the sea, while Switzerland may become completely encircled by the EC if Austrian

⁹In Norway, a new coalition government came into office in autumn 1989. Its position was not clearly defined at the time this article was written.

membership goes ahead. Second, if the positions presented by the EC and EFTA to the EES Council differ, it might be difficult to reconcile them, both being the result of complex internal negotiations and hard-won compromises.

EFTA countries may as a result enter a completely new integration phase; some competences may be transferred from their respective Parliaments and regional governments (federal states) to their central governments who may adopt legislation for the EES within an EES Council. Although collaboration with the Parliaments will be sought, EFTA countries will have to accept the EC model, with its democratic deficit. The evolution of the common juridical basis of the EES may also take place with binding decisions of, for example, an EES Court of Justice and with proposals presented by the EC Commission, or EFTA, to an EES Council. The final decisions may not include all the wishes of each EFTA country, and may therefore differ from the end-product their respective national Parliaments might have reached. Economic interdependence will have become so intense, however, that it will be (and already is in many instances) in the interest of each EFTA country to adopt the EES solution. Refusing then to adopt new EES legislation would create a split between the EES and the EC Internal Market, and would represent a step backwards with respect to the main objective of the EES Treaty, namely to establish equal competition conditions throughout the EES. For the first time in their contemporary history, EFTA countries may become part of an integrated system which may be a quasi-economic union.

CONCLUSIONS

EFTA's new identity will be determined by the institutional framework of the EES. The major risk EFTA faces is that the EC will defend a very hard position regarding its autonomy of decision and that, in the final analysis, EFTA countries will face either of two options: join the EC or return to traditional integration policy. Membership motivated mainly by fears of satellization would miss the most important element of EC integration, that is political integration. No country should be forced to join a future economic and political superpower only through fear of economic discrimination. The failure to conclude a major EES treaty could seriously limit further integration progress for EFTA countries that are not able to join the EC, because all the institutional issues blocking progress today would remain. EFTA countries may then run the risk that they would simply be treated by the EC with the same priority as other neighbouring third countries.

In purely economic terms, EFTA countries have much to gain from the EES. Their economies need closer relations with the EC so as to be forced to undertake reforms leading to more competition domestically and to be part of the scientific and technological networks which will be at the source of tomorrow's economic specialization and growth. In political terms, the EC

sees an important role for EFTA in offering an alternative to the European economies for whom EC membership does not come into question. In the coming years, EFTA will establish closer ties with all Eastern European countries on a case-by-case basis. A co-operation declaration along the lines of that with Yugoslavia will be signed in 1990 with Hungary, Poland and Czechoslovakia. An FTA with EFTA or even membership later of EFTA and at a further stage of the EES will be a strong incentive for Eastern European countries to adopt reforms and, most importantly, implement them. The slow progress of EFTA–Yugoslavia co-operation shows, however, that without real economic and political reforms, the benefits to be obtained from close ties with free-market economies will not meet expectations.

EFTA will also be very active on several other fronts, *inter alia* with Turkey to conclude an FTA parallel to that of the EC; with the Countries of the Gulf Co-operation Council (Saudi Arabia, Kuwait, United Arab Emirates, Bahrain, Qatar, Oman) to develop co-operation as the EC itself engages in negotiations for an FTA; and with Israel to eliminate trade discrimination resulting from Israel's FTAs with the EC and the United States. EFTA will also establish a Development Fund of US\$100 million for Yugoslavia to promote investments and improve resource allocation.

The future of EFTA is important not only for its own members, but also for the EC and for several other European countries. EFTA countries and the EC will have to understand that conditions politically unacceptable to either party in a future EES treaty will lead to a failure of that concept. Both the EC and EFTA governments, their Parliaments and their constituencies will have to accept the need to go one step further in each other's direction in order not to force the course of history with a wave of EC candidacies on 1 January 1993, and not to deceive third countries who place high hopes on EFTA in their efforts to join the side of free-market economies.

Appendix 1: Table A

Trade in Services by Type of Transactions in the EFTA Countries in 1985 (in \$USm, current rate of exchange)

	Travel		Transport		Investment		Government		Other		Total	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
Austria												
Exports	5,085	48.2	707	6.7	3,184	30.1	541	5.1	1,043	9.9	10,559	100
Imports	2,723	33.3	—	—	3,442	42.1	383	4.7	1,638	20.0	8,186	100
Balance	2,362		707		-258		158		-595		2,373	
Finland												
Exports	501	15.2	914	27.8	938	28.5	51	1.6	889	27.0	3,293	100
Imports	777	16.1	922	19.1	1,949	40.4	86	1.8	1,090	22.6	4,824	100
Balance	-276		-8		-1,011		-35		-201		-1,511	
Iceland												
Exports	42	10.5	216	53.7	14	3.5	75	18.6	55	13.7	402	100
Imports	94	17.9	209	39.9	149	28.4	—		72	13.8	524	100
Balance	-52		7		-135		75		-17		-122	
Norway												
Exports	731	7.7	5,226	54.9	2,078	21.8	128	1.3	1,360	14.3	9,523	100
Imports	1,811	16.9	3,640	34.1	3,057	28.6	40	0.4	2,135	20.0	10,683	100
Balance	-1,080		1,586		-979		88		-775		-1,160	
Sweden												
Exports	1,146	15.8	2,704	37.2	1,917	26.4	124	1.7	1,369	18.9	7,260	100
Imports	1,916	19.8	1,249	12.9	4,337	44.9	60	0.6	2,101	21.8	9,663	100
Balance	-770		1,455		-2,420		64		-732		-2,403	
Switzerland												
Exports	4,120	20.9	378	1.9	11,242	57.0	n.a.	n.a.	3,988	20.2	19,728	100
Imports	2,964	29.0	33	0.3	4,367	42.8	n.a.	n.a.	2,854	27.9	10,218	100
Balance	1,156		345		6,875		n.a.	n.a.	1,134		9,510	
EFTA												
Exports	11,625	22.9	10,145	20.0	19,373	38.2	919	1.8	8,704	17.1	50,765	100
Imports	10,285	23.3	6,053	13.7	17,301	39.2	569	1.3	9,890	22.5	44,098	100
Balance	1,340		4,092		2,072		350		-1,186		6,667	

Source: OECD

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