

Aline Müller  
**The Future of EFTA from a Swiss point of View**

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## 1. Introduction

The global financial crisis hit Iceland's economy hard. The only recently emerged banking system practically failed in late September 2008. The three largest banks were nationalized, the national currency, the Krona, declined significantly in value, the stock market was frozen for a few days and almost collapsed in October 2008. The entire country was thereafter faced with a massive budget deficit and a possible national bankruptcy. The International Monetary Fund (IMF) and several European neighbours had to rescue Iceland's economy with loans and currency swaps (ICELAND - MINISTRY FOR FOREIGN AFFAIRS, 2010). This severe economic crisis and the related extensive protests within Iceland's population led to the resignation of the government and new elections, bringing the pro-EU Social Democrats into power. The new government applied formally for EU membership in July 2009 (CNN, 2009) and therewith started discussions about the future of the European Free Trade Association (EFTA), of whom Iceland is one of the four remaining members.

For EFTA and its other three members, Switzerland, Norway and Lichtenstein, a realistic assessment of the likelihood of Iceland's EU-accession is imperative in order to conclude possible scenarios for the future of EFTA. Nevertheless, even irrespective of Iceland's possible EU-accession, it is unquestionably in the interest of Switzerland, to compile such scenarios, in order to be aware of essential challenges for its foreign relations and foreign trade. In order to be able to continue competing in international trade, Switzerland must weigh its options for international cooperation, taking into account its economic as well as political restrictions.

This thesis first examines the current situation of the EFTA, including Iceland's position within Europe. In the following, several possible sce-

narios for EFTA are being defined and analysed with respect to their likelihood of being implemented. A special focus is set on Switzerland's position within EFTA and also within Europe, and scenarios are analysed for Switzerland's future irrespective of EFTA.

In order to be able to fully assess EFTA's future, this paper also touches upon the future of the European Economic Area (EEA). EFTA and the EEA are inevitably linked, as all members of the EEA, apart from the EU, are also EFTA member states. Therefore it follows that EFTA's future will directly affect the EFTA/EEA institutions, equally EEA's future as a result also influences EFTA's future. Furthermore it is essential to additionally contemplate the view of the EU towards the developments within EFTA and the EEA, as the EU is the crucial counterparty in the EEA agreement, able to influence the EEA's, as well as EFTA's future to a considerable extent.

## **2. The European Free Trade Association (EFTA)**

### **2.1 Historical Background of EFTA**

EFTA and its institutions were founded with the signing of the so-called Stockholm Convention (EFTA convention) as an intergovernmental organisation in 1960 by Denmark, Norway, Austria, Portugal, Sweden, Switzerland and the United Kingdom (UK). While Germany, France, Italy, Belgium, the Netherlands and Luxembourg had decided to take further integration steps by signing the Rome Treaty only three years prior, thereby creating a customs union with the European Economic Community (EEC), the more liberal and the neutral states in Europe saw their opportunity to secure economic prosperity through certain free trade possibilities within EFTA. This was seen as especially



important for economic growth and reconstruction in Europe in the light of a failing Organisation for European Economic Co-operation (OECE). With the creation of EFTA, its member states tried to refrain from supranational institutions, from losing sovereignty in trade and foreign policy, by not having a customs union, and with this opting for a slim organisation, leaving the political power to each of the member countries (NZZ, 2010).

Under the terms of Article XXIV of the General Agreement on Tariffs and Trade (GATT), the EFTA member states hence established a free trade area for movement of goods with the Stockholm Convention. At first, the convention only included liberalisation of trade in industrial goods, by a progressive elimination of all tariffs in that sector. Free trade amongst EFTA member states in this sector was fully achieved by 1966. In 1972, after Denmark and the UK left EFTA to join the EU, the remaining EFTA states signed individual FTAs with the EU, leading to a full elimination of tariffs on industrial goods between EU and EFTA states by 1977. Eventually liberalisation efforts were also expanded to include integration for the services sector, as Article V of the General Agreement on Trade in Services (GATS) provides for. In 2001 in Liechtenstein, the EFTA convention was revised, whereby the sectorial agreement that Switzerland had only a few years prior, in the context of the Bilaterals I, established, served as a reference point for the new EFTA “Vaduz Convention”. From that time on, the completely revised convention was more comprehensive, as it now also includes free movement of persons between all EFTA member states and also includes certain provision regarding trade in services, movement of capital and the protection of intellectual property (SECO, 2011a).

Since its creation, the EFTA membership has changed several times, as certain countries joined the EFTA convention, Iceland in 1970, Finland in 1986 and Liechtenstein in 1991, but others decided to become members of the EU and left EFTA in the process (UK, Denmark, Portugal,

Austria, Finland and Sweden). Today, Switzerland, Norway, Iceland and Liechtenstein remain as the sole members of EFTA (BRYN, 2010).

## **2.2 EFTA Today**

Following its original objective of providing its members with an optimal framework to promote liberalisation of trade in goods, the EFTA administration on behalf of its member states focuses today on establishing new trade relationships with various partners around the globe. On one side the EFTA administration accordingly ensures and manages the trade relations amongst its member states. On the other side it supports its member states in their attempts to negotiate free trade agreements (FTA) with non-EU countries. For the three EEA/EFTA states, it also provides support within the EEA agreement.

The main task of the EFTA member states is negotiating and managing FTAs. These FTAs are mainly conducted in order to provide free trade in goods, by abolishing customs duties and other trade barriers. All EFTA FTAs consequently cover trade in industrial goods (incl. fish) and in most cases processed agricultural products. They also contain rules on competition, protection of intellectual property and payments and transfers. Unprocessed, basic, agricultural goods are also part of FTAs, as annexes, but they are being negotiated bilaterally between the individual EFTA member states and the respective negotiation partners. As a result of the customs union between Switzerland and Liechtenstein, regarding trade in goods, Liechtenstein can be considered as part of Switzerland. Since 2000, certain EFTA FTAs, also-called second generation agreements, also include substantive rules that allow for liberalising trade in services, investments and public procurement. In order for EFTA member states to be regarded as fair trade partners, especially as the circle of trade partners increased to less developed countries, it was necessary to take the different levels of development of the partner countries' into account, when negotiating FTAs. This

leads to asymmetrical approaches in certain agreements, with EFTA member states abolishing all tariffs and restrictions, while the partner country was granted a transitional period, allowing it to only gradually remove trade restrictions (EFTA, 2011b).

It is EFTA's goal to protect the economic interest of its member states and to strengthen the European and interregional integration. Moreover, EFTA wants to contribute to the global efforts in liberalising worldwide trade. To do so, EFTA member states today also extend their geographical scope of FTAs beyond the European continent. As of 2010 EFTA had already established 23 contractual FTAs with 31 partners (EFTA, 2011e):

<ul style="list-style-type: none"> <li>• Albania</li> <li>• Canada</li> <li>• Chile</li> <li>• Colombia</li> <li>• Croatia</li> <li>• Egypt</li> <li>• Gulf Co-operation Council (GCC)</li> <li>• Hong Kong (China)</li> <li>• Israel</li> <li>• Jordan</li> <li>• Lebanon</li> <li>• Macedonia</li> </ul>	<ul style="list-style-type: none"> <li>• Mexico</li> <li>• Montenegro</li> <li>• Morocco</li> <li>• Palestinian Authority</li> <li>• Peru</li> <li>• Serbia</li> <li>• Singapore</li> <li>• Southern African Customs Union (SACU)</li> <li>• The Republic of Korea</li> <li>• Tunisia</li> <li>• Turkey</li> <li>• Ukraine</li> </ul>
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*Table 1: Overview of the EFTA's FTA Partners (source: EFTA, 2011e)*

The EFTA member states are currently engaged in negotiations on respective FTAs with Algeria; Bosnia and Herzegovina; India; Indonesia; Russia, Belarus and Kazakhstan; and Thailand. Additionally, dialogues

in view of possible future FTA negotiations are undertaken with Central America and Vietnam (EFTA, 2011d).

It is important to mention that Switzerland also engages in negotiating bilateral FTAs<sup>1</sup>, without EFTA. The agreements Switzerland signed with the EU, with the Faeroe Islands and with Japan for example are purely bilateral. Furthermore, after a feasibility study, which analysed thoroughly the consequences of a possible free trade cooperation between China and Switzerland, Switzerland is currently in the midst of FTA negotiations with China, which are set to have a high significance for the Swiss economy as a whole. Norway and Iceland on their part are also negotiating with China on a bilateral basis (CHINA FTA NETWORK, 2011).

EFTA, as an international organisation, also faces other global and therefore increasingly important challenges, some of them brought up by various different interest groups and NGOs. For example, questions concerning environmental sustainability of worldwide trade are raised, pressuring the EFTA member states to take position on environmental issues and to eventually incorporate certain guidelines in future FTAs. Additionally, fighting against social inequalities (e.g. labour rights) also proves to be an important aspect for trade relations that the EFTA member states would want to address in the near future.

### **2.3 EFTA and the European Economic Area (EEA)**

Inextricably tied to EFTA is the European Economic Area (EEA). From its early days on, one of EFTA's main goals was the regulation of its relations with the EU, leading to those economically essential bilateral FTAs of its remaining member states with the EU in 1972.

<sup>1</sup> For a list of all the bilateral Swiss FTA, ratified as well as currently negotiated, see appendix 8.2

With the implementation of the internal market and its four freedoms (free movement of persons, goods, services and capital), the EU increased the level of integration within the EU considerably during the 1980s. In order to be able to take part in the internal market, the EFTA member states decided to negotiate a more comprehensive agreement with the EU, in order to secure their trade relationship with the growing number of EU members. These negotiations led to the agreement on the EEA. All EFTA member states apart from Switzerland, thereafter ratified the EEA and it came into force in January 1994. Although Switzerland was very involved in the negotiations and the elaboration of the EEA agreement, this same agreement was rejected by the Swiss population in a referendum in December 1992, after an intensive battle of the different political parties and interest groups. This rejection led to intense bilateral negotiations between Switzerland and the EU on a sectorial basis. The resulting agreements of these negotiations are now known as the Bilaterals I and the Bilaterals II (SECO, 2011a).

Currently, the EEA agreement counts 30 members, the 27 EU member states plus the so-called EEA-EFTA states, Norway, Iceland and Liechtenstein. As mentioned above, it allows all members to be included in the EU legislation that covers the four freedoms and also provides opportunities for co-operation in important areas, in the so-called “flanking and horizontal” policies, namely research and development, education, social policy, environment, consumer protection, tourism and culture. Other important policy areas such as the common agriculture and fisheries policies, the common trade policy and the common foreign and security policy are explicitly not covered by the EEA agreement, as the EEA-EFTA states want to remain independent in those areas (EFTA, 2011f).

The EEA agreement exists in a rather complex two-pillar structure, as displayed in Figure 1. On one side there are the so-called joint bodies that are mutually operated together with the EU, wherein substantive decisions are taken. As the EEA-EFTA countries have not transferred

any legislative power to those EEA bodies and are also not bound to decisions by the European Court of Justice or the European Commission, they set up corresponding EEA-EFTA bodies. Nevertheless, the EU and the EEA-EFTA states revise the EEA agreement on a regular basis, in order to ensure its unidirectional development with the relevant EU law with respect to the covered sectors, in order to continually comply with the EU's so-called "acquis communautaire" (EFTA, 2011g).

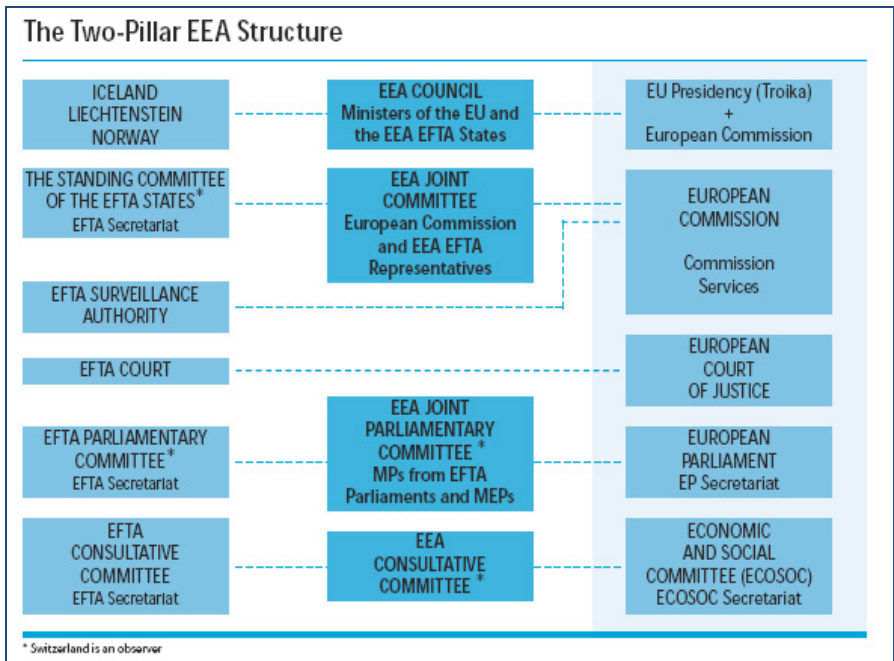


Figure 1: The Two-Pillar EEA Structure (Source: EFTA, 2009g)

Because Switzerland is a member of EFTA, it does enjoy observer status in the EFTA pillar of the EEA, which allows for a close monitoring of the current progress of the essential EEA- as well as the EU-acquis (SECO, 2011a).

## **2.4 Iceland applying for EU-Membership**

In order to analyse EFTA's situation and its outlook for the years to come, it is essential to know the current state of its members. Of particular interest in that matter is evidently the ongoing discussion regarding Iceland possibly joining the EU and the beginning of negotiations with the EU (EUROPA - PRESS RELEASES RAPID, 2010).

An early public opinion poll from 2010 in Iceland revealed that only a continuously low percentage of people, namely 26 percent of Iceland's population, were in favour of a membership in the EU, whereas 60 percent did not want to join EU (EU News from Iceland, 2010). A more current poll reveals that a slight majority of Icelanders (51 percent) would actually like to withdraw the application to join the EU, whereas only 38.5 percent would like to carry on with it (EU News from Iceland, 2011). This current sentiment of the Icelandic population is relevant, as even after possibly receiving an invitation by the EU and its member states to join, Iceland would hold a referendum on this question, leaving the last word regarding an accession to its population (Europa - European Commission, 2010a). Judging from this current state of affairs, it appears likely that Iceland will, at least for several more years, remain an EFTA member state and the question about EFTA's future should therefore not solely depend on Iceland's potential future EU accession. It should moreover be discussed on the basis that EFTA and its members want to remain successful players in international relations and trade matters.

## **3. Possible Scenarios for EFTA's Future**

### **3.1 Analysis of Possible Scenarios for EFTA's Future**

It is imperative to mention again that the following scenarios for the future of EFTA analysed in this thesis can be considered independently from the question of Iceland's EU-accession negotiations. However, because of the now more imminent possibility of Iceland leaving EFTA, a broad interest in the question about EFTA's future arose. While this thesis also emerges out of this imminent situation, the laying out of the scenarios below can just as well be seen as a general outlook for EFTA's future, with a special focus on Switzerland's role in it.

### **3.2 Continuation as Hitherto**

#### **3.2.1 Consequences for EFTA**

In the case of Iceland actually joining the EU, a simultaneous demission from the EFTA convention as well as from the EEA agreement would have to follow. From a purely legal point of view, if Iceland decided to leave EFTA due to an EU-membership, EFTA could continue to exist as it does up to now, only with now three members. EFTA is an international organisation that is based on a contract that follows international law. This implies that as long as there are at least two parties to this contract, it remains in force (TOBLER, 2009).

From a pragmatic point of view, for the EFTA institutions themselves, the above-mentioned legal argument that EFTA, as well as the EFTA convention, will prevail, still holds. As long as there are at least two members to EFTA, these remaining members will continue their work as of yet until given further notice by the relevant political actors. On an institutional level a withdrawal would nevertheless lead to certain



changes within the different EFTA's bodies, such as the EFTA Council, the Chairmanship and the different EFTA committees. For one, the rotational system of the EFTA presidency would be impacted. Additionally the decision taking process would also be impacted. Although most decisions and recommendations taken by the EFTA Council are usually based on consensus, the fact that every member state has one vote would remain and decrease the majority voting threshold from 3 to 2 yes votes, which represents a significant change in voting power for the individual member states (EFTA, 2011c).

As of the day of its withdrawal from the EFTA convention, Iceland would no longer be a contracting party to the existing EFTA FTAs. Iceland would then have to be crossed out of the existing FTAs, but the FTAs as such would remain in force for the lasting three EFTA countries<sup>2</sup>. The necessary amendments would have to be made by Joint Committee decisions, and it remained to be seen, if certain technicalities would have to be changed in the respective agreements. Judging from the clauses in the contracts, where this is not as such mentioned and appears therefore as not imperative. However, due to Iceland's small size in economic as well as in political terms, it is not very likely that this aspect would create actual difficulties.

### **3.2.2 Special Consequences for Switzerland**

The key questions arising with the possibility of Iceland leaving EFTA are of political nature. For Switzerland an important aspect of a continuation of EFTA without Iceland are the financial consequences. Iceland's share of the EFTA Budget 2011 runs at 4.33 percent (CHF 1'025'000). Should

<sup>2</sup> As an example see EFTA FTA with Albania, Article 41 (3): „Any EFTA State which withdraws from the Convention establishing the European Free Trade Association shall, ipso facto on the same day as the withdrawal takes effect, cease to be a Party to this Agreement.“

Iceland no longer pay the contributions to the EFTA budget, the other three countries would have to make up for its share. A new calculation of contributions would have to be made. On the expenditure side, significant savings cannot be expected, as the incurring managerial costs of the EFTA secretariat, the costs of ensuring the trade relations and the expenses for EU-EFTA and EFTA cooperation programs will not decrease significantly due to Iceland's parting. Compared with its current share of 37.68 percent (CHF 8'914'000), Switzerland would most like have to make up for some of the lost contribution of Iceland. Norway is already contributing the biggest amount with 57.12 percent of the overall sum of CHF 23'654'000 of EFTA's 2011 budget and would also bear some of the no longer covered budget. Liechtenstein's share amounts to less than 1 percent and probably wouldn't be increased significantly (EFTA, 2011a).

Another issue that has to be considered for the scenario of having an EFTA without Iceland, is the possible change in negotiation power for future FTA agreements. In general it can be assumed that Iceland has not played a very dominant role in negotiations, although - for obvious reasons - by and large sharing Norway's interest concerning fisheries. Altogether it can be assumed that Iceland seems to play a mediatory role within EFTA negotiations, alternatively supporting either big member in areas they respectively feel most strongly about.

Therefore, without Iceland, the different ideals and interests of Switzerland and Norway might become more apparent and eventually cause more problems. As can be strongly assumed today, these differences have already caused delays in negotiations.

The evident delay in the FTA negotiations with Canada is most likely related to these different focal points the individual contracting parties had, Canada and Norway both being active in the shipbuilding industry

might have been a reason for delay<sup>3</sup>. Such conflicts of interest might have eventually prevented the signing of letters of intent and agreements and led Switzerland and Norway to conduct FTA negotiations on a bilateral basis. The bilateral FTAs Switzerland has already signed and the ongoing negotiations with China<sup>4</sup> also support this assumption.

The relationship between the current EFTA member states would not change as such. The current state of integration between Switzerland, Norway and Liechtenstein would remain the same, and Switzerland's trade relations with Iceland would also not change significantly, due to the already profound integration Switzerland already enjoys with the EU, by means of its comprehensive bilateral agreements. Additionally, EFTA has already experienced members leaving to join the EU, and the whole process is known from recent EU enlargements and is not likely to cause major difficulties.

As the possibility of a stand still within an EFTA of three could increase, Switzerland would have to focus more on the bilateral way to extend the ring of its FTAs and pressing trade issues. For Switzerland, EFTA would then in turn become an apparatus that mainly provides support within the existing FTAs, but would no longer be the primary institution that promotes Switzerland's future interests regarding trade and other foreign relations issues.

### **3.2.3 Consequences for EFTA/EU-relations and the EEA**

The EEA agreement shows vast parallels to the EFTA convention regarding its continuity. From a legal perspective, the EEA is also an international organisation based on international law, where the number

<sup>3</sup> As an illustration of the prolonged FTA negotiations between EFTA and Canada see EFTA Trade Chronology: EFTA (2009i).

<sup>4</sup> For a complete list of the ongoing negotiations as well as the signed and ratified FTA see appendix 8.2.

of signature members as such is irrelevant. Legally its continuance is a given as long as there are at least two parties to the agreement (Tobler, 2009).

On a political level, on the other hand, the state of affairs following a possible withdrawal from the EEA agreement of Iceland presents itself very differently. With only Norway and Liechtenstein remaining in the EEA, the EU could possibly reconsider the continuance of the EEA altogether or at least rethink its current structure. For the EU the EEA, though being the preferred way of integrating non-EU-members into the common market, represents a considerable amount of expenditures, namely due to the time-consuming and costly administrative processes and the administration of the agreement as such. Additionally, the automatic adoption of the EU-acquis has not always worked as expected, having led to several delays in the ratification process causing disgruntlement within the different institutions of the EU. On the other hand, a possibility to increase efficiency within the EEA administration might be accomplished by inviting new members to join the EEA, though this would also involve some restructuring work (Generaldirektion Interne Politikbereiche, 2010, pp. 42)

Possible new EEA member states could be the three small European states of Monaco, Andorra and San Marino. Additionally, the EU might find it more efficient and therefore more desirable, to administer and develop further its bilateral relations with Switzerland on the basis of the EEA structures, instead of the unusually distinctive bilateral agreements that are in force as of today. This idea that has raised a lot of attention especially mid 2010 in the Swiss media. This was mainly due to talks in Brussels between the then Swiss President Doris Leuthard with the president of the European Council, Herman van Rompuy and the President of the European Commission, José Manuel Barroso about the state and the future of the Swiss-EU bilateral agreements (Van Rompuy, 2010).

However, it is also possible to assume that, confronted with only two remaining EFTA/EEA members, the EU would prefer to integrate Norway and Liechtenstein on a bilateral basis, should this approach turn out to be less expensive, more efficient and more effective in order to conclude the common market.

In any case, the constitution of the EFTA/EEA institutions would have to be reconsidered and changed respectively, should Iceland withdraw from the EEA agreement.

### **3.3 Accession of New EFTA Members**

#### **3.3.1 Consequences for EFTA**

A possible scenario for EFTA's future could also be found in its acquiring new members. According to the relevant Article 56 (1) of the EFTA convention, "Any state may accede to this convention [...]" (EFTA, 2001), as long as the EFTA council approves this accession and the set out terms and conditions are being followed. As much as these excerpts of the convention are straight forward and the acquisition of new members therefore legally uncomplicated, the practical question of which possible member countries the existing EFTA member states would approve of, is far more difficult to answer.

In practice, meaning in order for EFTA to continue negotiating useful FTAs, the circle of potential candidates is very limited. In a first consideration, the Mediterranean countries might seem to be possible candidates. These countries are though already connected with EFTA through far reaching FTAs, which lessens the need for further integration remarkably. Another consideration might focus on the remaining European non-EU-member states. Most of these countries however already enjoy EU-accession-candidate status, or applied for it. This implies on one hand that they would not want to be EFTA member

states in the long run, but also that they obviously do not fulfil all the relevant criteria (yet) to become EU-member states. In order for the EFTA administration to be able to continue its efficient work, possible candidates would have to be equally developed as the current EFTA member states and also show similar economic as well as political interest.

As a result, the existing EFTA member states would most likely not consider countries that do not yet live up to their economic and political status. Countries that would be eligible would mainly be the ones, that can – like the current members of EFTA - afford not to join the EU, but actually fulfilling all the mandatory requirements for an EU-accession. Hence, the only possible candidate that, within a reasonable timeframe, might be considered for an EFTA-accession would be the Faeroe Islands (NZZ, 2010).

Independently from the question of membership-candidates, EFTA would have to consider several institutional and legal consequences in case new member states were to join. The existing FTAs would not automatically incorporate all new EFTA member states. As set out in Article 56 (3) of the EFTA convention, every entrant to the convention would have to apply to become a member of the existing FTAs between the existing EFTA member states and the relevant third parties, such as states, unions of states and international organisations (EFTA, 2001). In practice this would most likely lead to renegotiations between EFTA, the new member state and the third parties. This is especially likely as the FTAs allow for purely bilateral negotiations of each member state concerning non-processed agricultural goods, due to the absence of a common agricultural policy among EFTA members (EFTA, 2011b). Additionally, each FTA grants the EFTA members several reservations, special commitments and exemptions in regard to certain trade aspects<sup>5</sup>.

5 See i.e.: Annexes and Protocols of the FTA EFTA-Ukraine.

The concept of renegotiation might put EFTA in a weaker position as the petitioner, which might lead to increased claims on behalf of the counterparty; sacrifices might have to be made. Altogether, it is apparent that renegotiations of existing FTAs would cause vast additional costs and absorb valuable resources on behalf of the EFTA administration as well as for the concerned Swiss government agencies. It can be expected that especially the accession of a big country, or the simultaneous accession of several smaller countries would increase the administrative cost within the EFTA secretariat, followed by an increase in the overall EFTA expenditures.

These additional expenditures would either have to be absorbed by an increase in the EFTA budget, or they would have to be compensated to the disadvantage of future FTAs. The EFTA budget would at the same time be influenced in a positive way, as the new member(s) would also make contributions to the budget, which should eventually lead to lower expenses of the current EFTA member states. The exact effect that new members would have on the EFTA budget depends on several aspects, as the EFTA budget distribution key heavily depends on the member states individual economic performance (GDP), but also on its EEA membership<sup>6</sup>. The exact effect on each of the existing EFTA member states can yet only be determined on a case-by-case basis.

The accession of new EFTA member states would certainly have institutional consequences. The new members would have to contribute to the EFTA-staff and would also want to be represented in the different EFTA-committees, which in turn would change the decision taking powers among the rest of the EFTA members (EFTA, 2011c).

6 At the time of the reorganisation of EFTA in 1994, Switzerland, as the only EFTA member state that is not at the same time an EEA member, was granted a 25 percent discount on the whole EFTA budget distribution, due to the fact that a big amount of the total EFTA expenses incur on the administration of the EEA in Brussels (LEUENBERGER, D. 2010).

On the basis of the EFTA convention, an accession of new members would lead to a sudden economic integration of those countries within the EFTA framework. Generally, free trade in goods would apply, as well as the liberalisation in movement of persons, of trade in services and investments, opening up public procurement markets and protection of intellectual property rights<sup>7</sup>.

### **3.3.2 Special Consequences For Switzerland**

Having new members join EFTA would as such not be problematic for Switzerland. As mentioned above the possible list of candidates is expected to be rather short. The additional costs and expenditures of time related to renegotiations however would be imperative for Switzerland. On a political basis, an accurate estimate of the candidate's economic concerns would be important to know, as these individual interests heavily influence future negotiations. The actual effect on Switzerland's share of the EFTA budget cannot be determined without further knowledge of the possible candidate(s) size and economic performance, as discussed above in chapter 3.3.1.

From a Swiss point of view the Faeroe Islands would probably not be an ideal partner, as their main economic interests concern the area of fisheries, which has already proved to be a major difficulty during past EFTA FTA negotiations. For Switzerland this is a rather secondary issue, but Norway and Iceland have not been willing to compromise on this matter, complicating negotiations with certain partners. Politically, an EFTA accession of the Faeroe Islands would also impact Denmark and the EU indirectly, as the Faeroe Islands are a self-governing part of the Kingdom of Denmark, which in turn is a member of the EU. When Denmark joined the EU, the Faeroe Islands opted not to join due to its resistance towards the common fisheries policy, but decided together with the Danish Government to integrate via preferential trade agree-

<sup>7</sup> See Article 2 of the EFTA Convention.



ments with the EU and other European countries. Denmark nonetheless would most likely be supportive of an EFTA membership of the Faeroe Islands (MINISTRY OF FOREIGN AFFAIRS OF DENMARK, 2009).

### **3.3.3 Consequences for EFTA/EU-relations and the EEA**

The accession of a new member state into the EFTA convention would most likely be accompanied by discussions about a simultaneous EEA accession of that country. Following Article 128 EEA<sup>8</sup> each new EFTA member state can apply to the EEA council to become party of the agreement. However this is not a mandatory requirement, though it would be for a future EU member state. The exact conditions related to such a voluntary participation in the EEA would have to be negotiated between the applicant state and the other contracting partners, and eventually have to be approved by the latter<sup>9</sup> (EEA, 1992).

For the EFTA/EEA framework, having an additional member that participates in both agreements would shift the current balance towards the EU-pillar, which would not be in favour of non-EEA EFTA member states, and would therefore not be in Switzerland's best interest.

## **3.4 EFTA Acquiring new Tasks**

When analysing possible scenarios for EFTA's future, it is important to also touch upon the idea of a complete reorientation on EFTA's behalf. Because EFTA as an international organisation might be faced with the loss a one of its few member states, its right to exist might be questioned<sup>10</sup> altogether. In order to push back this possible loss of

8 See EEA. (1992). Agreement on the European Economic Area.

9 See Article 128 (2) EEA (1992).

10 This could already be witnessed in different media articles, see for example: NZZ. (2010).

political importance, it could be an option for the EFTA to provide itself with new tasks, just as several other institutions, that were faced with a loss of cause did in the past<sup>11</sup>.

An option for EFTA could be to create an integral foreign relations instrument, similar to the EU neighbourhood policy. This would most likely require the EFTA member states to institutionalise, stabilize and also intensify their foreign relations with their neighbouring countries within Europe, as well as in the Mediterranean region. It is though questionable whether actual demand for such increased involvement exists. Pursuant to their respective reports on Switzerland's foreign (especially European) relation, Swiss government agencies seem not to support this thesis, stating that it would not be necessary for Switzerland to intensify its neighbourhood policy (Schweizerischer Bundesrat, 2009).

Switzerland appears to already conduct a very proactive foreign trade policy with its FTAs (with and without EFTA) that already guarantees good and intense foreign relations with the neighbouring countries. Additionally, Switzerland also directly profits from the EU neighbourhood Policy that supports EU neighbours economically and politically. It tries to prevent further gaps between the EU and its neighbours by supporting their economic welfare, as well as improving political stability and security within the whole EU neighbourhood area (Europa - European Commission, 2010b). So without being actively involved or providing its own similar framework, Switzerland as well as the other EFTA member states already gain from the EU's intense involvement in neighbourhood policy, lessening the need for own EFTA actions in this political field.

11 International organisations such as the BIS or the OEEC/OECD reorganised themselves and acquired new tasks to continue existing (BIS. (2010) and OECD. (2010)).

Concluding, it is important to add that the EFTA administration appears to be a very efficient, slim organisation that is nonetheless providing its members with very good outcomes. Imposing more, not essentially necessary tasks on the EFTA institutions would most likely have negative impacts on their existing tasks, which is not at all a desirable prospect.

## **3.5 Switzerland Withdrawing from the EFTA Convention**

### **3.5.1 Consequences for EFTA**

Pursuant to Article 57 of the EFTA convention, any EFTA member state can withdraw from that same convention subject to 12-month term of notice. As has already been mentioned above in chapter 3.2.1, the continuation of the EFTA convention would therefore not be affected, should Switzerland decide to withdraw from it, as long as two contracting parties remain within the convention.

Institutionally, several changes would follow Switzerland's withdrawal from the EFTA convention. First of all, without Switzerland as a member of EFTA, the current seat of the EFTA headquarters in Geneva would have to be reconsidered. The distribution key of the EFTA budget would have to be renegotiated amongst the residual members, most likely resulting in an increase of their respective shares. Additionally, all other resources would have to be reorganised, possibly causing an overall contraction of the EFTA staff, as the decrease in contribution to the EFTA budget, tied together with a drawback of Swiss deputies in the respective EFTA bodies, might be too expensive to counter.

From a more pragmatic viewpoint, it is altogether questionable whether EFTA would in fact persist, should Switzerland, and possibly also Iceland, decide to withdraw. Under such a scenario it appears to be likely

that Norway and Liechtenstein would also try to find other integration forms, and EFTA could be suspended on the whole.

### **3.5.2 Consequences for Switzerland**

Pursuant to the relevant provisions in the current EFTA FTAs, with a withdrawal from the EFTA convention Switzerland would as of the time of the exit, cease to be a contracting party to these EFTA FTAs. So as to be able to continue with the numerous, for Switzerland imperative free trade relations, new bilateral FTAs would have to be negotiated with those particular partner countries. Such renegotiations would be an extremely time-consuming and expensive undertaking, likely leading to interim gaps in the respective relations. They might possibly be causing recurring tariff quotas or other barriers of trade with certain partners, until all the applicable new bilateral agreements would come into force. Substantial personnel resources would be required to conduct these negotiations. Without the administrative and logistic support of the EFTA secretariat, and faced with an intense time pressure, the Swiss government agencies dealing with trade related issues and negotiating FTAs would be in dire need for adequate capabilities.

The abolition of the contribution to the EFTA budget and the withdrawal of the Swiss EFTA personnel would in contrast have a positive effect on Switzerland's budget. The savings of Switzerland's yearly share in the EFTA budget of about CHF 8.9 million (EFTA, 2011a) would on the other hand be upset considerably by the above mentioned increase in needed resources within the Swiss government. It would have to be expected, that the necessary extension of the current teams involved in FTA negotiations, within the Federal Customs Administration, the Federal Office for Agriculture, the State Secretariat for Economic Affairs (SECO) and the Swiss Federal Institute of Intellectual Property, would lead to a noticeable increase in budget spending. The exact increase in expenditures would have to be calculated, in respect to past cost

experiences related to the already signed bilateral FTAs and the ongoing negotiations. This could potentially cause an increase in expenditures of a few million Swiss Francs each year, as many agencies and experts would have to be involved, and it remains questionable whether the Swiss parliament would actually approve of such an increase in spending. Without this increase in personnel and logistic spending, fast renegotiations of the by then expiring EFTA FTAs with all current partners could not be conducted. This in turn would hurt Switzerland's economy substantially, as it would suddenly be faced with trade barriers of undetermined magnitude.

Regarding the at present deep integration level with the other EFTA member states, after a withdrawal from, or after the suspension of the EFTA convention, Switzerland would consequently also have to bilaterally negotiate new agreements with Liechtenstein and Norway (and Iceland, should they not become an EU member state) in order to sustain its current level of integration.

A withdrawal from the EFTA convention and the sole continuation of purely bilateral FTAs would however also offer opportunities for Switzerland. Although the bargaining power in FTA negotiations that EFTA imposed is missing in bilateral negotiations, Switzerland would on the other hand enjoy more flexibilities in choosing new negotiation partners and also when actually negotiating contents of FTA. Recently the different economic and political interests of Switzerland and Norway have started to cause problems, as these two EFTA member states seem to have diverging ambitions concerning future FTAs, their contents and also in respect to EFTA procedures, as already mentioned in the case of the FTA negotiations with Canada<sup>12</sup>. With bilateral FTA negotiations, as Switzerland has already started to engage in more and more, individual interests can be pursued more constructively and the tedious EFTA-procedures could be avoided. The gathered experience

<sup>12</sup> See chapter 3.2.2.

from the signed FTA with a challenging negotiation partner Japan, that has been reported about in positive tones, may indicate that negotiating FTAs on a bilateral basis, instead of within the EFTA framework, is a rather interesting option for Switzerland.

For the EEA, a withdrawal from the EFTA convention by Switzerland would mainly mean, that Switzerland would lose its EEA observer status, and therefore would not have access to certain important information concerning the EU and related matters.

## **4 Switzerland and its European Options without EFTA**

### **4.1 Switzerland's important Role within EFTA**

After considering the different scenarios EFTA might face in the future, it becomes more and more evident that Switzerland plays an important role within EFTA. Merely by looking at EFTA's trade statistics, the impressive proportion Swiss trade plays within all EFTA trade becomes apparent<sup>13</sup>. It is therefore appropriate to assume, that wherever Switzerland decides to do take its European policy, has a great impact on EFTA's future as such. Consequently, the following sub-chapters will in brief contemplate three additional scenarios Switzerland might consider for its future European and trade policy, though not directly involving EFTA, but eventually influencing its future.

A 2010 visit of Doris Leuthard, then President of the Swiss confederation, with Herman Van Rompuy, President of the European Council, led to an intense discussion in the Swiss media and amongst Swiss politicians about the future of the Swiss-EU relations, often elaborating the possibility of Switzerland joining the EEA or the EU. Although referring

<sup>13</sup> See EFTA. (2009j).

to the very close and friendly partnership Switzerland and the EU have enjoyed over the last years, a remark of Van Rompuy also addressed a few of the issues, that most likely led to the more current discussion about a Swiss EEA membership (Van Rompuy, 2010).

These addressed issues have however been known for quite some time, namely that the EU would rather prefer for Switzerland to adopt EU-legislation on a more formal basis, with less exceptions and less time lags. The Council of the European Union has though stated this desire in 2008 in a concluding note, following a debate between EFTA and EU on the matter of their relations. The Council would prefer for Switzerland to incorporate the EU “acquis communautaire” more directly and to a full extent in the indicated policy areas, where the two partners have agreements. The EU would like to deepen its partnership with Switzerland and would therefore encourage any Swiss initiative in such a direction, be it becoming an EEA member or with a new so-called framework agreement that would incorporate the “acquis communautaire” for all the bilateral agreements and provide for regular updating and uniform interpretation of them (Council of the European Union, 2008).

With the Lisbon treaty, which increases the EU’s capacity to act and its enforcement power, in order to further strengthen the EU institution, Switzerland’s negotiating power and ability to act as the EU counterparty might be cut short. It cannot be ignored that with the changes of the Lisbon Treaty, the European Parliament now enjoys more competences, also concerning future bilateral agreements, which will most certainly influence future bilateral negotiations.

## **4.2 Switzerland Joining the EU**

Switzerland formally applied to commence membership negotiations with the EU in 1992, but never actually entered into those negotiations, deciding to put them on hold after the negative outcome of the EEA referendum in December 1992. No formal withdrawal of this letter of intent to commence membership negotiations has taken place until today, as this is regarded as a politically delicate act (IB, 2011).

Albeit its recurring popularity in the media and in certain political circles, the scenario of Switzerland joining the EU, is, at least for the near future, not a realistic one. Past outcome referenda, as well as rather recent polls, illustrate clearly, that the majority of the Swiss population continues to reject a EU accession<sup>14</sup>. Additionally the institutional differences between Switzerland's direct democracy and the EU's increasing supranational character are making this scenario a politically very unlikely option, that is not needed to be elaborated more thoroughly in the context of this thesis.

## **4.3 Switzerland Joining the EEA**

According to Article 128 (1) of the agreement on the EEA, Switzerland is explicitly mentioned as being able to apply to become a party to the agreement, subject to the approval by all contracting parties. From a legal point of view therefore hardly any obstacles would prevent Switzerland from becoming a contracting party in the EEA agreement, obstacles though would have to be found on a political basis.

Politically, an important question that arises in the context of becoming a party to the EEA agreement is namely, whether it would altogether even be a possible option for Switzerland for sovereignty reasons. It

<sup>14</sup> See for example the Isopublic Europa-Index: 63 percent of the Swiss Population reject an EU membership of Switzerland, only 25 percent approve it (ISOPUBLIC, 2010).



would have to be considered to what extent Switzerland could actually automatically take over the “acquis communautaire”, and when it would impair Swiss sovereignty. As this argument seems to be mentioned often in this context, it is hereby nevertheless necessary to realize that Switzerland has already negotiated agreements with the EU that go beyond the EEA agreement, in order to realistically assess the Swiss willingness to integrate.

Additionally to the automatic adoption of European law, the main problem of a membership in the EEA for Switzerland would most likely be the free trade in services. For the EU on the other hand, it would be very desirable to finally have a defined set of rules for its relations with Switzerland. For Switzerland, the better integration in the relevant decision shaping processes, within the relevant committees, where it only enjoys observer status today, would be a positive aspect.

Nevertheless the key question remains, whether an EEA accession would actually be supported by a majority of the Swiss population. After the negative outcome of the first referendum about becoming a party in the EEA agreement in 1992, this is a delicate question, especially as the EU “acquis communautaire” that would have to be adopted, has since been enlarged. An ISOPUBLIC-poll, conducted in 2010, amongst the Swiss population however found that a referendum about an EEA accession these days might actually have a chance (44 percent would vote for an accession, while 42 percent would not want to join) (ISOPUBLIC, 2010).

Conclusively another uncertainty also remains, that is to say whether the EEA agreement as such will actually be able to persist on a longer-term basis. Certain comments from the EU are already being interpreted in a way that is supposed to prove a diminishing EU interest in the EEA agreement (Kündig, 2010). Furthermore, should Iceland leave the EEA, due to becoming a member of the EU, its continuation as such might truly have to be reconsidered.

#### **4.4 Switzerland on its own – Continuing with Bilateral FTAs**

An interesting scenario for Switzerland's future in trade related issues is to continue and even accelerate negotiating FTAs single-handedly. This could either happen alongside Switzerland's EFTA membership, or even after a withdrawal from EFTA, though as already mentioned in chapter 3.5.2, this might be a very costly and therefore unfavourable option. With the former option Switzerland would still be able to continue all its trade relations based on its EFTA FTAs, benefit from those free trade partnerships, but focus more on particular Swiss interests in the future.

Switzerland has already negotiated several FTAs on an entirely bilateral basis and has therefore already acquired important knowledge and experience in that field. An interesting aspect in accelerating bilateral FTAs presents itself with the possible future negotiation partners. Certain problematic issues that prevented the entering into, or the conclusion of FTA negotiations within the EFTA framework in the past, due to different interests among the EFTA member states or the respective counterparties, might now be possible. This might be especially important, as future FTA partnerships will most likely be negotiated with overseas countries, as almost all European and Mediterranean Countries are already part of the Swiss FTA-network. Many of those possible future negotiation parties are heavily involved in the fishing or shipbuilding industry, industries that are also important for Norway and Iceland, and that could cause delays and halts of negotiations when negotiating together within the EFTA-framework. Switzerland's negotiation power in bilateral negotiations with such countries would therefore increase, as Switzerland could allow for much more favourable terms and conditions in these areas. This might not only increase the speed of such negotiations, it might eventually lead to the launch of negotiations that would never be possible together with the other EFTA member states. The negotiations and the signing of the bilateral

FTA with Japan can be seen as proof of this increased flexibility in negotiations due to the fewer restrictions.

As already mentioned above in chapter 3.5.2, other important aspects for Switzerland's continuation on a bilateral basis are the related costs, due to an increased demand for qualified resources within the relevant government agencies. Under the assumption that Switzerland would remain an EFTA member states, the related increase in costs of an acceleration of bilateral FTA negotiations would most likely not be as great, as after a complete withdrawal from the EFTA convention. Another important question that would have to be considered is whether EFTA as such enjoys a certain "brand" value for FTA negotiations, and whether waiving this brand would have to be accounted for as unavoidable costs of the bilateral FTA negotiations.

## **5. The Way Forward for EFTA and Switzerland**

After considering the possible scenarios for the future of EFTA, with regard to the relevant political, economic and financial aspects, it becomes apparent that certain scenarios are more practicable than others, and also more positive. Nevertheless it is very difficult to determine the exact likelihood or the benefit of either of these scenarios, as they all involve several political aspects and other unknown variables, which are impossible to completely cover.

In a first concluding remark, it is important to indicate again that it is not at all likely that Iceland will become an EU member state, at least not in the near future. This puts the worrisome question about EFTA's future into perspective, making it less imminent as expected maybe some few months ago, therefore implying, that it would be advisable

for EFTA as it stands now, to continue its work as it is currently done. This all the more as EFTA is not in a position to decide about its future independently, as it is politically linked with all its partners. Thus, as long as the EFTA member states esteem EFTA and everything it represents and everything its institutions have worked out for them, they will refrain from disintegrating.

From an EFTA member state point of view, even after a closer analysis of the costs and benefits EFTA means to them, EFTA and its administration are very likely to prove to be beneficial. For Switzerland and the other EFTA member states a withdrawal from the EFTA convention, without any other form of integration into a free trade zone, would most likely have to be considered as too costly. The necessary additional resources needed to keep the current FTA-network Switzerland enjoys today, by (re-)negotiating bilateral FTAs, would most likely be immense. It would be questionable whether the savings due to the omission of the EFTA budget expenses, could offset these newly incurring costs.

Therefore, the appropriate option for Switzerland with regard to EFTA, would be to remain an EFTA member state, and as a result, continue to enjoy all the related benefits, such as the combined negotiation power, the EFTA reputation and the work of the EFTA administration. Additionally, in order to remain a competitive global trading partner, Switzerland should accelerate its ambitions in conducting bilateral FTAs, whenever the circumstances can be considered to be benefiting. After all Switzerland has already proven to be successful in bilateral FTA negotiations. Nonetheless, and to put Switzerland's negotiation power into perspective, it is important not to forget, that all such FTAs are based on the will of all involved negotiation partners, not only on EFTA's or Switzerland's desires. From a Swiss perspective, the status quo therefore appears to be the most pertinent. However this should not hide the fact that it remains to be a necessity to be open and alert to new developments concerning Switzerland's international relations.

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## 8 Appendices

### 8.1 FTAs between EFTA and Third Countries

Partners with whom EFTA has signed (EFTA, 2011e):

- Albania (signed, but not yet into force)
- Canada
- Chile
- Colombia
- Croatia
- Egypt
- Gulf Co-operation Council (GCC) (signed, but not yet into force)
- Hong Kong, China (signed, but not yet into force)
- Israel
- Jordan
- Korea, Republic of
- Lebanon
- Macedonia
- Mexico
- Montenegro (signed, but not yet into force)
- Morocco
- Palestinian Authority
- Peru
- Serbia
- Singapore
- Southern African Customs Union (SACU)
- Tunisia

- Turkey
- Ukraine (signed, but not yet into force)

Partners with whom EFTA is currently engaged in negotiations on a FTA (EFTA, 2011d):

- Algeria
- Bosnia and Herzegovina
- Central American States
- India
- Indonesia
- Russia, Belarus and Kazakhstan (Customs Union)
- Thailand

Partners with whom EFTA is conducting dialogues in view of possible FTA negotiations (EFTA, 2011d):

- Vietnam

## **8.2 FTAs between Switzerland and Third Countries**

Partners with whom Switzerland has bilaterally signed FTAs (SECO, 2011b):

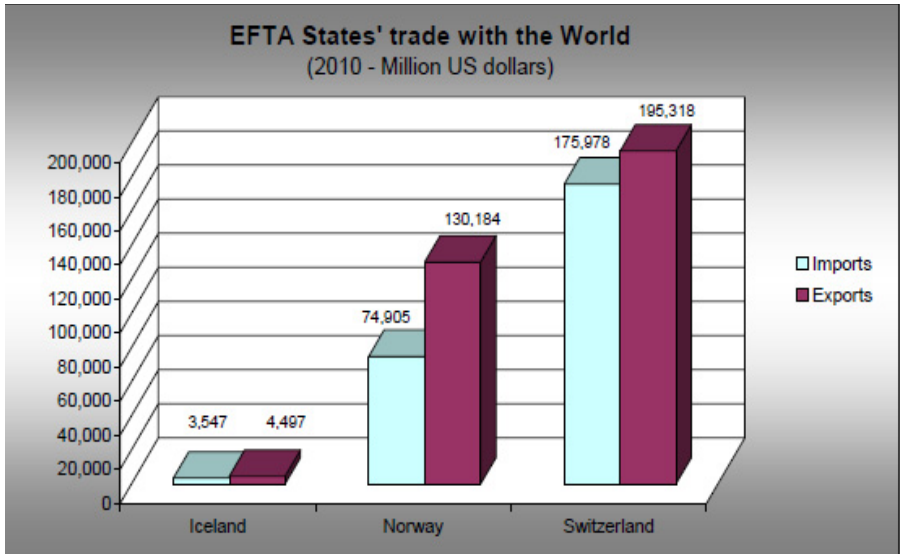
- EU
- Japan
- Faroe Islands

Additionally Switzerland has bilateral agreements with all of EFTA's FTA-partners on unprocessed agricultural goods.

Partners with whom Switzerland is currently bilaterally engaged in negotiations on a FTA (SECO, 2011b):

- China

### 8.3 EFTA States' Merchandise Trade with the World 2010



Source: GTI, Global Trade Atlas (last update: March 2011)

Figure 2: EFTA States' Merchandise trade with the World 2010 (Source: EFTA, 2011h, p. 1).

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- Nr. 1 Subsidiarität - Schlagwort oder Kurskorrektur (mit Beiträgen von Flavio Cotti, Jean-Paul Heider, Jakob Kellenberger und Erwin Teufel) (Doppelnummer).
- Nr. 2 Ein schweizerisches Börsengesetz im europäischen Kontext (Tagungsband/ Doppelnummer).
- Nr. 3 Martin Holland, The European Union's Common Foreign and Security Policy: The Joint Action Towards South Africa.\*
- Nr. 4 Brigid Gavin, The Implications of the Uruguay Round for the Common Agricultural Policy.
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