EFTA Bulletin

60th Anniversary Papers

- Democracy Promotion and the European Free Trade Association (EFTA): Four Case Studies
- Settling Inter-State Trade Disputes: Lessons from the EFTA Complaints Procedure
- Subsidies and State aid in the Context of Free Trade – Roles and Obligations of EFTA and its Member States in WTO and European Subsidy Regimes
- EFTA as an actor in the transition towards a carbon-neutral economy

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Table of Contents

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Foreword

Henri Gétaz, Secretary-General

The year 2020 has been a turbulent year, unlike any other we have experienced. Yet, it has shown the importance of international cooperation and not least the value of the European Free Trade Association. EFTA was founded 60 years ago and has since developed into a resilient international organisation for the benefit of its Member States – and for economic cooperation globally.

In 2020, EFTA celebrates its 60th anniversary. To highlight this milestone, EFTA provided three grants for the purpose of researching EFTA's history, economic impact and politics from 1960 to 2020 and beyond. With these grants, EFTA specifically seeks to support young and early career researchers. The submissions were reviewed by EFTA's Scientific Committee:

- Youssef Cassis, European University Institute
- Dieter Schlenker, Historical Archives of the European Union
- Henri Gétaz, European Free Trade Association

The Scientific Committee selected three papers from young researchers which are presented in this issue of the EFTA Bulletin:

- Johannes Hendrik Fahner: *Settling Inter-State Trade Disputes: Lessons from the EFTA Complaints Procedure*
- Magdalena Friedrich: *Subsidies and State aid in the Context of Free Trade – Roles and Obligations of EFTA and its Member States in WTO and European Subsidy Regimes*
- Cristina Dans Iglesias: *EFTA as an actor in the transition towards a carbon-neutral economy*

In addition to these papers Matthew Broad from the University of Leiden submitted another paper for the EFTA Bulletin: *Democracy Promotion and the European Free Trade Association (EFTA): Four Case Studies.*

If the year 2020 – EFTA's anniversary year – has proven anything, then it would be that EFTA's mission and work has a considerable economic and political impact and value for its Member States and their partners. This solid fundament helped EFTA countries to navigate the recent Covid crisis, just as it served them in ensuring stability and prosperity throughout the turbulence and historical shifts of the last six decades.

All papers show the role and value of the European Free Trade Association in various fields and times. I wish to thank all those who contributed to this publication, especially the authors!

I hope you enjoy the reading.

Democracy Promotion and the European Free Trade Association (EFTA): Four Case Studies

Matthew Broad, Leiden University

One of the standout features of the Stockholm Convention was its brevity. The document, signed by the seven founder members of the European Free Trade Association (EFTA) on 4 January 1960, did, admittedly, stipulate the not unambitious objectives of achieving a 'sustained expansion of economic activity' and 'continuous improvement in living standards' by gradually abolishing industrial tariffs and quantitative restrictions.[1] So too did the Convention delineate in some detail a complaints and consultation procedure, as well as a number of provisions covering competition and origin rules and trade in raw materials, agriculture and fish. But as its authors were keenly aware, the environment into which EFTA was born – coming off the back of the failed Free Trade Area (FTA) talks and early successes of the nascent European Economic Community (EEC) – made the need for any treaty rapidly to be accepted by the governments involved very great indeed. As a result, it was only ever going to be possible to lay down a general framework specifying minimum rules and procedures. The Convention which materialised was thus little more than a set of guiding principles rather than a comprehensive blueprint for how the Association should operate and what tasks ought to be included within its scope.

It is perhaps because of this that many commentators have remarked on the flexibility and pragmatic nature not simply of the Convention but, subsequently, of EFTA itself.[2] Such a judgement is moreover borne out by the actual development of the Association, which progressed in ways scarcely foreseen in its founding text. Institutionally for instance it is well known that at various moments in EFTA's history the Secretariat – about which the Convention had nothing to say bar its responsibilities for providing 'services required' by member countries – sought to expand its limited advisory functions.[3] In terms of policy, meanwhile, it has likewise been shown that the range of areas in which the Association's members cooperated also broadened as time passed to include, among others, cooperation in non-trade items like research and development.[4] Against this backdrop and on the occasion of the sixtieth anniversary of its signing, the aim here is to examine another example of EFTA members acting in ways not necessarily anticipated by the Convention: namely, to promote and consolidate democracy in Europe via the very institution which enabled their own economic cooperation.

1 Article 2, *Convention Establishing the European Free Trade Association* (Geneva: EFTA Secretariat, 1967).

2 For instance Johnny Laursen and Mikael af Malmborg, 'The creation of EFTA', in Thorsten B. Olesen (ed.), *Interdependence Versus Integration: Denmark, Scandinavia and Western Europe 1945–60* (Odense: Odense University Press, 1995); 'Expansion paths for EFTA', in Hugh Corbet and David Robertson (eds.), *Europe's Free Trade Area Experiment: EFTA and Economic Integration* (Oxford: Pergamon Press, 1970).

3 Bjarne Lie, 'A Gulliver among Lilliputians: A history of the European Free Trade Association 1960-1972' (unpublished MA thesis, University of Oslo, 1995); Wolfram Kaiser, 'A better Europe? EFTA, the EFTA Secretariat and the European identities of the 'outer Seven', 1958–72', in Marie-Thérèse Bitsch, Wilfried Loth and Raymond Poidevin (eds.), *Institutions européennes et Identités européennes* (Brussels: Émile Bruylant, 1998).

4 Richard T. Griffiths, 'EFTA and European integration, 1973–1994: Vindication or marginalization?' in Kåre Bryn and Guðmundur Einarsson (eds.), *EFTA 1960–2010: Elements of 50 Years of European History* (Geneva: EFTA Secretariat, 2010); Bettina Hurni, 'EFTA-EC relations: Aftermath of the Luxembourg declaration', *Journal of World Trade Law* 20, no. 5 (1986), 497–506; Wolfram Kaiser, 'The successes and limits of industrial market integration: The European Free Trade Association, 1963–1969', in Wilfried Loth (ed.), *Crises and Compromises: The European Project 1963-1967* (Baden-Baden: Nomos, 2001), 371–90; Lise Rye, 'Slow train coming: EFTA's quest for free trade in Western Europe (1960-92)', *EFTA Bulletin* (July 2015), 4-17; Lise Rye, 'The European Free Trade Association: Formation, completion and expansion', in Gilles Grin, Françoise Nicod and Bernhard Altermatt (eds.), *Formes d'Europe: Union européenne et autres organisations* (Lausanne: Fondation Jean Monnet pour l'Europe, 2018).

Extant scholarship has relatively little to say about this component of the Association's history.[5] Part of the explanation for this might well be found in the tendency to characterise EFTA as a somewhat unsuccessful episode in the post-1945 European integration process when likened to the evolution of the EEC and its successor, today's European Union (EU).[6] The picture which consequently emerges is of an organisation whose mark on European politics was slight.[7] Yet not only have researchers started to reveal EFTA's agency in terms of how it was able to impact the internal policies and external behaviour of the EEC.[8] But it has also long been acknowledged that trade groupings more generally use economic links to encourage or consolidate democracy and human rights.[9] It is not impossible to imagine therefore that EFTA states combined the pursuit of free trade among themselves, and in (Western) Europe as a whole, with the objective of promoting democracy during the Cold War and in its aftermath.

If we understand democracy promotion to be the use of 'various instruments (technical, financial, political) through which to assist local processes of democratization', this chapter highlights at least four mechanisms deployed by EFTA states where they did precisely this.[10] These include first the offer of associate membership negotiated with Finland between 1959–60, second the supply of financial aid and practical support to shore up emerging democratic administrations as in the case of post-authoritarian Portugal of the 1970s, third the decision to extend formal economic and trade links just short of full membership during Eastern Europe's post-Cold War transition to the Western market system, and fourth a tendency in more recent years to adopt democratic conditionality as a cornerstone of joint declarations and trade agreements signed by the Association. Taken together, these examples should not only portray EFTA as an organisation progressively at ease with using its economic free trade mandate to facilitate democracy and stabilise its local neighbourhood, but should hopefully also reveal the Association as an actor that was – and today remains – rather more relevant on the European stage than sometimes appreciated.

A 'major step toward real independence': Finland

For a topic that would in some ways come to dominate EFTA's foundational year, Finland was curiously absent from the formative phase of the Association. It did not take part in the exploratory meeting, held in Oslo in February 1959, during which the Seven expressed interest in creating a small free trade area designed to counterbalance, and eventually somehow link up with, the six countries of the EEC. Nor were the Finnish among those who in June that same year met in Saltsjöbaden, near Stockholm, to first begin drafting what would become the Stockholm Convention. And even when in the following month the Finnish prime minister, V.J. Sukselainen, publicly announced his desire to join the talks then underway outside the Swedish capital, there was muted enthusiasm for its being included.[11]

5 Some exceptions do exist, for instance Mario Del Pero's 'A European solution for a European crisis: The international implications of Portugal's revolution', *Journal of European Integration History* 15, no. 1 (2009), 15–34. Commentators writing around the fall of the Berlin Wall were also liable to interrogate EFTA's democratising role, for instance Anders Åslund, 'Systematic change in Eastern Europe and East-West trade', *EFTA Occasional Paper* no. 31 (June 1990), 25; Richard E. Baldwin, 'An eastern enlargement of EFTA? Why the East Europeans should join and the EFTAns should want them', *CEPR Occasional Paper* no. 10 (1992); Kálmán Dezséri, 'Hungarian orientation toward Western Europe: Will it be to the EC and/or to the EFTA?', *Soviet and Eastern European Foreign Trade* 26, no. 4 (1990) 50-64; Wojciech J. Kostrzewa and Holger Schmieding, 'The EFTA option for Eastern Europe: Towards an economic reunification of the divided continent', *Kiel Working Papers* 397 (October 1989); Peter S. Rashish, 'East Europe could turn to EFTA', *International Herald Tribune* (22 February 1990).

6 Thorsten B. Olesen, 'EFTA 1959–72: An exercise in Nordic cooperation and conflict', in Norbert Götz and Heidi Haggrén (eds.), *Regional Cooperation and International Organizations: The Nordic Model in Transnational Alignment* (London: Routledge, 2009).

7 Andrew Marr, *A History of Modern Britain* (London: Pan Books, 2017), 204; Miriam Camps, *Britain and the European Community, 1955–1963* (Oxford: Oxford University Press, 1964), 194–5; Derek W. Urwin, *The Community of Europe: A History of European Integration since 1945* (London: Routledge, 1995), 118; Pascaline Winand, *Eisenhower, Kennedy, and the United States of Europe* (Basingstoke: Palgrave Macmillan, 1996), 119–21.

8 Lise Rye, 'Integration from the outside: The EC and EFTA from 1960 to the 1995 enlargement', in Haakon A. Ikonomou, Aurélie Andry and Rebekka Byberg (eds.), *European Enlargement across Rounds and Beyond Borders* (London: Routledge, 2017); Wolfram Kaiser, 'Challenge to the Community: The creation, crisis and consolidation of the European Free Trade Association 1958–1972', *Journal of European Integration History* 3, no. 1 (1997), 7–33.

9 See for instance Karolina Milewicz and others, 'Beyond trade: The expanding scope of the non-trade agenda in trade agreements', *Journal of Conflict Resolution* 62, no. 4 (2016), 743–73; Laurence Whitehead (ed.), *The International Dimensions of Democratization: Europe and the Americas* (Oxford: Oxford University Press, 2002); Jon C. Pevehouse, 'Democracy from the outside-in? International organisations and democratization', *International Organization* 56, no. 3 (2002), 515–49.

10 Taken from Giles Scott-Smith, 'US public diplomacy and democracy promotion in the Cold War, 1950s–1980s', in Nicolas Cull and Francisco Jiminez (eds.), *US Public Diplomacy and Democratisation in Spain: Selling Democracy?* (Basingstoke: Palgrave Macmillan, 2016), 15.

11 For Sukselainen's speech see Gunnar Lange, 'Welcome for a Nordic partner', *EFTA Bulletin* (April 1961), 3.

This disinclination to include the Finns had multiple roots. Part of the reason can be traced to Finland being something of an unknown quantity: Portugal, for instance, had yet to establish official diplomatic ties with Helsinki. What was more, Finland was neither a member of the Organisation for European Economic Cooperation (OEEC) nor had it been involved in the original FTA discussions. Its absence in fact implied that there was an arguably stronger basis for the likes of Greece or Turkey joining EFTA.[12] There was, moreover, a generalised belief that focus on enlargement so early in EFTA's history, be it to include Finland or any other European country, would simply divert the Seven from consolidating the Association within its current membership and tackling the arguably more complex task of reaching a new settlement with the EEC. And even if membership was on the cards, there were doubts as to Finland's economic suitability. After all, the country maintained a high tariff regime of around 30 per cent on goods such as rubber, silk, glass and wool. Given its still limited industrialisation and poor balance of payments position, however, it was uncertain whether it could remove or even reduce these tariffs according to the transition period envisioned by the Convention.[13]

Most immediately worrisome, though, was the status of Finland's relationship with the Soviet Union. This nexus was of concern economically since the two had granted one another most favoured nation (MFN) treatment back in the late 1940s. There was speculation as a result that Finland would inadvertently emerge as a conduit through which goods from the Eastern bloc could infiltrate EFTA markets tariff-free without reciprocal access for their own exports.[14] It was most obviously a problem politically, however. For while officially neutral with a mixed market economy and democratic government akin to the countries of the West, its geostrategic position unquestionably left Finland embedded in the Soviet security system and with Moscow afforded a not trivial degree of influence over its internal affairs. This fact was not lost on EFTA members. Swiss diplomats were reported to have warned that Finland might act as a 'Russian Trojan horse', and together with their Austrian equivalents even temporarily left the Saltsjöbaden talks following a spat over the nature of Finnish-Soviet ties.[15] The British too voiced concerns that the Finnish establishment was liable to 'Russian pressures', and consequently whether this could put in peril both EFTA's internal cohesion and also the likelihood of reaching an accommodation with the EEC.[16] Very quickly therefore Finland was denied formal observer status at Saltsjöbaden.

That on 18 November 1959 the Seven nevertheless sanctioned informal talks with Finland, and on 27 March 1961 Finland later became an associate member of EFTA, thus warrants some explanation. It doubtless helped that when talks with Helsinki were first authorised, the bulk of the Stockholm Convention had already been drafted. The Seven had thus found themselves with greater bandwidth to negotiate a deal. Probably more crucial was the energy with which Finland's Nordic counterparts – Denmark, Norway and, in particular, Sweden – vocally advocated for its association. This for sure was based partially on Nordic allegiance, but also because the signing of the Convention had all but sealed the fate of the Nordic customs union proposal which had been under discussion by the four countries since 1954. And in large part because of the failure of this last, some form of Finnish membership of EFTA came to be seen by the Nordics as a decision which, if

12 Minutes of 1st Ministerial Meeting at Saltsjöbaden, 21 July 1959, EFTA-499, Historical Archives of the European Union, Florence [henceforth HAEU].

13 'List of goods which Finland wishes to prolong periods of transition', EFTA 52/60, undated, EFTA-5, HAEU. Foreign Office, London, to Helsinki, tel. no. 161, 16 July 1959, T 236/6094, British National Archives, Kew [henceforth TNA].

14 'Finnish situation as explained by Munkki', Annex to SGN 5/60, 4 October 1960, EFTA-349, HAEU.

15 Helsinki to FO, tel. no. 197, 24 July 1959, T 236/6094, TNA.

16 FO to Stockholm, tel. no. 310, 17 July 1959, MAF 322/26, TNA.

handled unconstructively, could have much broader consequences for the region. A clue to this came in a meeting between British ministers and the Swedish trade minister, Gunnar Lange, in August 1959. As he explained to his hosts:

> *Sweden's whole attitude towards Finland depends on maintaining its economic and political viability [...] If Finland could not join or be associated with the Seven, her industry, especially timber, wood products and pulp, would be at a disadvantage compared with those of Sweden and some other Western countries. Finland would inevitably be drawn towards the Soviet bloc.*[17]

To better understand this point, it is worth reflecting for a moment on the broader position of Finland in the post-Second World War matrix. In the first decade or so after 1945, Finland's growing reliance on exports to Eastern Europe, a steep rise in unemployment, and the domestic strength of the Finnish communist party, had already led Western states to conclude that its standing as a neutral state was under threat.[18] Developments on the eve of the 1960s – including the so-called Night Frost Crisis of 1958, where the Soviet Union intervened to unseat the government of Sukselainen's predecessor, Karl-August Fagerholm, of which it disapproved – seemed only to accentuate this danger. The thrust of Lange's argument was consequently that to deny Finland a link to EFTA would be to force it to drift still closer to Moscow economically. For him, the potential fallout from this meant Finland's neutral status and its whole democratic future appeared to be at stake as well.

The Swedes were not alone in thinking along such lines. Even the United States (US) came to accept that 'Finland remains, in almost any conceivable circumstances, vulnerable to Soviet economic and political pressures'.[19] Where all this mattered for EFTA was perhaps best surmised by the US ambassador to Helsinki, John D. Hickerson, in a memorandum sent to the State Department in Washington in July 1959:

> *The importance of the Seven's plan to Finland, whether Finland joins or is forced to back away, can scarcely be overemphasized. If Finland moves forward [...] it will be a major step toward real independence and the establishment of further long-term and binding economic ties with the West; if Finland should back down in the face of Soviet pressure, it will be another major step toward greater dependence, political and economic, on the USSR.*[20]

So seemingly widespread was this vein of thought that later in October President Dwight Eisenhower himself approved a new policy document – NSC-5914 – the crux of which declared Finland's exclusion from the European integration process was 'of such far-reaching importance that it may ultimately be a major determinant of Finland's fate as an independent and Western-oriented country' to which only 'closer cooperation between Finland and other West European countries, particularly those of Scandinavia' could really help.[21] EFTA's ostensibly apolitical nature, and the fact that any link could be justified given that among its membership sat not only Finland's Nordic neighbours but also other neutral states like Austria and Switzerland, suggested it was the ideal body through which to build precisely this sort of cooperation.

17 Stockholm to FO, tel. no. 276, 14 August 1959, T 236/6094, TNA.

18 For more see among others Jussi M. Hanhimäki, *Scandinavia and the United States: An Insecure Friendship* (New York: Twayne Publishers, 1997).

19 Foreign Relations of the United States [henceforth FRUS] 1958–1960, volume X, part 2, document 207: 'Operations Coordinating Board Report on Finland' 1 July 1959.

20 FRUS 1958–1960, Volume X, Part 2, Document 208: Hickerson to State, 17 July 1959.

21 FRUS 1958–1960, Volume X, Part 2, Document 213: 'Statement of US Policy Toward Finland (NSC 5914)', 14 October 1959.

Given what was at stake, Lange spent much of the summer encouraging his colleagues in the Seven to reverse their reluctance to engage with the Finns. The Americans wasted no opportunity to convey much the same argument, raising the topic in meetings of the North Atlantic Treaty Organisation (NATO)'s North Atlantic Council and bilaterally with individual EFTA members.[22] The result was the decision by the delegations in Saltsjöbaden to undertake an intense exchange of preliminary views with Finnish officials over the remainder of 1959 before, early in the new year, the EFTA Preparatory Committee – charged with overseeing the creation of the new EFTA Council – eventually concluded that while 'several difficulties' required attention, Finland's entry to EFTA was both desirable and feasible.[23] Formal negotiations began in earnest on 22 March 1960.

Nothing about the ensuing talks between Finland and EFTA were to prove easy. Consensus, it is true, was relatively quick in converging around the idea that Finland ought to join EFTA under Article 41 (paragraph 2) of the Convention, which provided for associate rather than full membership. And yet Finland's association would nonetheless force EFTA members to devise a whole new institutional structure able sufficiently to integrate it into the Association while simultaneously addressing continuing doubts that the Soviet Union might use Finland's inclusion for pernicious ends. Were this not already challenging enough, the negotiations would in due course throw up fundamental questions about the pace and extent of tariff and quota reductions, the degree to which members should be allowed to deviate from the aims and timetable laid down in the Convention, and quite whether it was possible to square EFTA membership with the maintenance of third-country relations.[24] That in wrestling with these issues an agreement between EFTA and Finland was nevertheless to emerge in March 1961, is thus testament to the fact that, however technically or economically problematic, the desire to help uphold its democratic credentials mattered more. As Secretary-General Frank Figgures would put it, 'there are obvious and compelling advantages in Finland's association with EFTA on political grounds.'[25]

Stability through industrial development: Portugal

Whereas in the above case EFTA used the extension of its own free trade framework as a means of preventing Finland sliding further into the Soviet orbit, the second illustration of the Association promoting democracy relates to a country already firmly part of the organisation: Portugal. In retrospect, though, it might seem odd that the Portuguese were even among those drafting the Stockholm Convention. Its system of government certainly made it an outlier. The *Estado Novo* regime established in 1932 by António Oliveira Salazar was, after all, an 'archetypal Catholic nationalist right-wing dictatorship with certain affinities with fascism', and the regime's survival until 1974 marked it out as one of the longest-lived authoritarian governments in Europe.[26] In the years immediately following the end of the Second World War, moreover, it was never obvious that the Portuguese themselves actually wanted to develop such ties. Instead, Salazar tended to privilege the defence of Portugal's empire and its relations with Brazil and Spain over closer links with Western Europe or, for that matter, the United States. And yet the financial crisis of 1947–48 worked to convince the Portuguese leader that his country's economic interests would be ill served by isolating itself completely

22 See Matthew Broad, 'Transatlantic relations and Finland's application to the European Free Trade Association', *Faravid* 48 (2019), 65–87, here 77–8.

23 'Summary record of fifth meeting of Preparatory Committee', EFTA P.C. 5/60, 24 February 1960, Preparatory Committee Documents 1–13 1960, EFTA Archives, Geneva [henceforth EFTA-Geneva]; Holliday to Busk, 16 July 1960, FO 370/150307, TNA.

24 On the negotiations see Broad, 'Transatlantic relations'.

25 'Problems posed for the GATT by the possible association of Finland with EFTA', Annex to EFTA/SGN 13/61, 23 January 1961, Secretary General's Notes 1961, EFTA-350, HAEU.

26 Quoted from Nicolau Andresen Leitão, 'A flight of fantasy? Portugal and the first attempt to enlarge the European Economic Community, 1961–1963', *Contemporary European History* 16, no. 1 (2007), 71–87, here 72.

from the West.[27] In addition to seeking Marshall Aid and thus joining the OEEC, therefore, Portugal wound up negotiating its inclusion in the abortive FTA and subsequently of EFTA also.

On the whole this was a development with which the West was content. For however unseemly was the existence of an autocratic regime on Europe's southern flank, Salazar's vehement anticommunism and Portugal's strategic position in the militarily sensitive Mediterranean basin made it a good deal easier to live with. Within EFTA, though, relations were not always easy. Even at Saltsjöbaden a fierce battle had raged after the Portuguese, acutely conscious of their limited industrial development, requested a host of exceptions from the Stockholm Convention – a request initially and rather forcefully denied by its partners only later to be accepted in the form of the Annex G exemptions.[28] As would become obvious over the following years, this was not a fleeting moment of confrontation. Instead, it was a sign that some in EFTA found it difficult fully to countenance or accommodate Portugal so long as the *Estado Novo* administration remained in charge. In the mid-1960s, buoyed by the sluggish performance of the Portuguese economy, this expressed itself in the form of Sweden and Norway openly attacking Salazar for his unrelenting grip on Portugal's African colonies and apparent indifference to domestic freedoms.[29] Once Salazar's successor, Marcelo Caetano, assumed office in 1968, it again materialised in the form of the Swedes and Norwegians publicly questioning the enduring status of Portugal's authoritarian regime. And by the early 1970s criticisms of the administration in Lisbon from among the parliamentarians and trade unions of other EFTA states had become increasingly pronounced as well.[30]

It is little wonder, then, that EFTA governments were among the first to welcome the overthrow of *Estado Novo* in the Carnation Revolution of 25 April 1974. Nor should it shock that EFTA states very quickly agreed to assist with easing the turmoil which initially followed the coup by permitting temporary measures – including the re-imposition of some tariffs to restrict imports and steps taken in the field of invisible transactions to prevent abnormal capital movements – intended to help steady Portugal's economy.[31] Yet the transition to democracy was to prove arduous and at times highly uncertain. While there is little room here to describe in detail the sequence of events which would stretch from the Carnation Revolution of 1974 through to the first democratically elected government of Mário Soares taking office over two years later, it suffices to say that, throughout this period, EFTA members were among those in the West enormously troubled by the possible course of events in Portugal.[32] This apprehension was arguably at its most pronounced during the 'hot summer' of 1975 when a range of skirmishes made it seem quite feasible that Portugal would experience a Marxist-Leninist takeover, undermining its place in NATO. Such an outcome was considered plausible enough that it soon translated into a showering of practical assistance from West Europeans of which EFTA would play its full part.

27 For a useful introduction on the crisis a good place to start is the article by Pedro Lains and Jaime Reis, 'Portuguese economic growth, 1833-1985: some doubts', *Journal of European Economic History* 20 (1991), 441–53.

28 This about-turn only came after ministers in Lisbon threatened to abandon the talks. Annex G of the Convention offered a much slower pace for the lifting of import duties and quantitative export restrictions and exceptions for Portugal's infant industries like steel and electricity supplies.

29 Del Pero, 'A European solution', 16.

30 See for instance 'Eighteenth meeting of members of parliament from EFTA countries', 18 February 1970, EFTA/EXT 1/70, EFTA/EXT Documents 1969–72, EFTA-Geneva.

31 'Eleventh simultaneous meeting, at ministerial level', 8–9 May 1974, EFTA/CJC.SR 11/74, EFTA-388, HAEU.

32 In November 1974, for instance, the Norwegian delegation to the Council pondered 'about the use of EFTA as a framework for discussion on how best to help the new democratic regime in Portugal', see 'Twenty-fifth simultaneous meeting, at ministerial level', 31 October–1 November 1974, EFTA/CJC. SR 25/74, 17 January 1974, EFTA-388, HAEU.

The precise nature of this contribution took four main forms. First was the initial inclination to join broader efforts in flooding Portugal with visitors from European capitals and organisations, intended as a visible display of support for democratic elements within Portugal. Alongside stopovers by ministers from individual EFTA states hence came a much-publicised visit by Secretary-General Bengt Rabaeus in May 1975.[33] Second was further assistance on the commercial front. In part this simply meant agreeing to Portuguese requests to prolong the temporary measures sanctioned a year earlier as well as relaxing the Annex G timetable for Portuguese tariff reductions for a further five years from their original date of 1980. Aware no doubt that communist support was particularly strong among agricultural workers, however, these actions were complemented by the appeal that EFTA agree to introduce new concessions for Portuguese agricultural products such as wine and olive oil.[34] The third component consisted of offers of technical advice. On one level this involved connecting experts and businesses: the Norwegians thus invited specialists from Portugal to study the legal and organisational matters of its crude oil trade, while the Swiss government arranged for professionals from the tourist, agricultural and forestry sectors to counsel their Portuguese counterparts. But it also extended to the government level – normally in the form of visits of national experts – with the EFTA Secretariat playing a logistical role allowing members to exchange with the Portuguese information covering everything from how to arrange employment, tax, fiscal and regional policy to advising Lisbon on the nuances of financial planning, urban development and education and welfare reform.[35]

Most substantive, though, was the fourth aspect: a financial aid package for Portugal. The idea for this originated at the beginning of 1975, proposed by Norway and Sweden and modelled on a similar fund the Nordic states had set up to assist industrialisation in Iceland. It was not until 6 November that same year however, during the apogee of the 'hot summer', that EFTA ministers formally sanctioned the idea and began actively investigating the amount of aid they were prepared to offer.[36] Crucial to this decision was the bleak economic picture facing Portugal. By this stage its balance of payments deficit had deteriorated sharply, amounting to over 5 per cent of gross domestic product (GDP). And this was exacerbated further by a dramatic loss of reserves, which in the first four months of 1975 alone stood at around $440 million against $640 million for the entirety of 1974. So grave was this situation that it was decided the Association needed to act in unison, contributing more together – the working figure very swiftly became $100 million, with the possibility of expanding this further as needed – than any one EFTA country could underwrite individually. This would take the aim of long-term credits for selected projects aimed primarily at the modernisation of existing industries, in particular small and medium enterprises, as well as the formation of new ones and the financing of technical assistance.[37]

From the moment the Industrial Development Fund for Portugal (to give the package its formal name) was approved in November 1975, EFTA members made no bones of the fact that its primary aim was to foster democracy in the country. Official documentation at the Fund's launch later in February 1976 even made the bold claim that EFTA members would 'contribute to the strengthening of democracy in Portugal by helping to finance an expansion of the industrial sector of the Portuguese economy which would both provide a means for raising living

33 EFTA, *Seventeenth Annual Report of the European Free Trade Association 1975–1976* (EFTA: Geneva, 1976), 25.
34 'Twelfth simultaneous meeting, at ministerial level', 22 May 1975, EFTA/CJC.SR 12/75, 18 July 1975, EFTA-339, HAEU.
35 'New assistance to Portugal: Note by the Secretary-General', SGN 1/76, 10 April 1976, Secretary General's Notes 1976, EFTA-357, HAEU
36 Twenty-fifth simultaneous meeting, at ministerial level', 6 November 1975, EFTA/CJC.SR 26/75, 9 January 1976, EFTA-340, HAEU.
37 Ibid.

standards in the country and enable it to compete on better terms in international markets'.[38] Likewise true is that member states recognised full well that this marked a clear departure from the aims of the Convention. As a member of the Icelandic delegation to EFTA would remark, the Industrialisation Fund went 'beyond the scope of [EFTA's] normal activities' but he 'was convinced that more could and should be done in each and every one of the EFTA countries [...] to buy more from Portugal and to assist in its industrial development. By strengthening the Portuguese economy the EFTA countries were also strengthening democracy in Portugal and both were of great importance to all the EFTA countries'.[39] Democratisation through free trade was now seemingly very much part of the Association's thinking.

Quite whether EFTA's input alone helped Portugal to meet these rather lofty aims is of course doubtful. Nevertheless, the Association could with some justification look back and congratulate itself on having assisted in a meaningful sense. Assessing the impact of the Fund in 1984, the EFTA Secretariat reckoned that it had approved 249 loans to various Portuguese companies totalling some $67.8 million, further financed initiatives – including a substantial upgrade to the Lisbon metro – to the tune of $150 million, directly helped create 3,700 jobs, and through higher productivity and better quality of output secured the livelihoods of a further 54,000 workers.[40] That these figures were even being discussed by an organisation usually restricted to facilitating free trade among its members is, though, surely where the significance of this intervention lies. Admittedly, economic self-interest was at least partly responsible for the decision to support Portugal to begin with: a stable economy was only ever going to be positive for the exporters of other EFTA members. It was also true that the financial aid funnelled through the Association, while certainly not trivial, was neither unique nor particularly extensive in comparison (the EEC also provided financial aid to finance infrastructure, industrialisation and agricultural projects[41]). But when considering exactly how EFTA has functioned historically it matters greatly that the Association's members saw fit to adopt a strategy that brought making a small if quite overt contribution to the stability of Europe's southern flank together with the pursuit of its traditional free trade mandate.

'We accept our responsibility to support these reforms': Eastern Europe

One of the knock-on effects of having launched the Portuguese Fund was that EFTA of the late 1970s appeared to be a more confident and dynamic organisation than at any time since its creation. It was against this backdrop that in May 1977 prime ministers met in Vienna to consider 'the future role of the EFTA countries in the context of European and world economic co-operation and development'.[42] For sure, much of the meeting in the Austrian capital was concentrated on how to deepen relations with, and in turn develop a more united EFTA approach towards, the EEC. Caught up in this momentum, however, was also a commitment to expand trade and economic cooperation elsewhere, including to the socialist countries of Eastern Europe – even if, as a follow-up meeting to Vienna would hear, these activities 'fell outside the scope of the Convention'.[43]

38 'The EFTA Industrial Development Fund for Portugal: First annual report', FSC 1/78, 17 March 1978, Portugal Documents 1976, EFTA-323, HAEU.

39 'Eleventh simultaneous meeting, at ministerial level', 25–26 May 1978, EFTA/CJC.SR 12/78, 22 September 1978, EFTA-342, HAEU. In the end, the Portugal Fund would function until its liquidation in January 2002. By that stage the equivalent of €140 million had been paid to the government in Lisbon and various Portugal-based industrial enterprises.

40 'EFTA Development Fund for Portugal: Seventh annual report', FSC 8/84, 22 June 1984, Portugal Documents 1982–83, EFTA-327, HAEU.

41 For more on EEC-Portugal relations, Alice Cunha, 'A welcome incentive: Pre-accession aid to Portugal within the context of the Iberian enlargement', *Journal of European Integration History* 25, no. 2 (2019), 207–24.

42 EFTA, *Seventeenth Annual Report of the European Free Trade Association 1976–1977* (EFTA: Geneva, 1977), 9.

43 'Seventeenth simultaneous meeting', 22 September 1977, EFTA/CJC.SR 17/77, 15 November 1977, EFTA-341, HAEU.

Doing so obviously mattered at a time when the Western world was reeling from oil shocks and economic stagnation and when both unemployment and inflation were continuing to accelerate. In other words, EFTA states appeared ready to shield themselves from further economic damage by collectively seeking out untapped or underutilised markets. But it also mattered at a time when hopes for a negotiated East-West détente, symbolised by the signing of the Helsinki Accords in 1975, were beginning to fade, and when superpower tension was again a concern for governments across Western Europe. On this basis, Vienna marked a moment when EFTA states appeared more confident about taking decisions of 'political importance' if these were ultimately to help secure, strengthen and enlarge the broader free trade ecosystem in which they operated.[44] It was this rationale which led to the Association working variously with Belgrade to create a Joint EFTA-Yugoslav Committee in October 1978, itself later intensified further through the June 1983 Bergen Declaration; with post-Franco Spain where, as with Portugal, EFTA countries acted multilaterally to help foster democracy and stability via a free trade agreement signed on 26 June 1979; and, following the fall of the Berlin Wall in November 1989, eventually too with members of the Eastern bloc.

The origins of EFTA-level relations – to say nothing of bilateral links – with these last predated the toppling of the Wall by several years, of course.[45] Following the EEC's recognition of the Soviet Union in 1988, moreover, the Secretariat had already been tasked with considering ways EFTA states might cooperate more substantively with members of the Council of Mutual Economic Assistance (CMEA).[46] That EFTA would come jointly to play a role in supporting the broader reform efforts ongoing in the socialist world was, though, never guaranteed. For a start it was unclear whether the Association had within its scope the sort of instruments necessary to cooperate with third countries. It was one thing to offer associate entry to a Western market economy such as Finland and award financial aid to an existing member like Portugal, or even for that matter to sign a free trade agreement with an OEEC member like Spain and deepen ties with just one socialist country as with Yugoslavia. But the utter breadth and complexity of constructing ties with several Eastern Europeans far outweighed each of these and was expected severely to test both the boundaries of EFTA's free trade mandate and decision-making capacity of the organisation. Unlike the Community, it should be remembered, EFTA was not a customs union and did not maintain any sort of common external (trade) policy. In light of this fact, several EFTA members wondered whether the interests of Eastern Europe would not be better served by instead developing contacts within an alternative framework such as the United Nations Economic Commission for Europe.[47]

Another, closely related element that needs to be stressed is the basic lack of agreement about what any multilateral EFTA contribution would even look like. Opinions on this fell into two main camps. On the one side stood those – notably Austria, Norway and Sweden – who wished to devise a unique and rather ambitious set of commercial and diplomatic measures to aid East Europeans in restructuring their economies and building a new relationship with the West. As the Norwegian foreign minister, Jan Balstad, put it when speaking at a ministerial meeting in Kristiansand in June 1989, this meant that 'EFTA countries should be prepared to give support to the process and in doing so not act so that their reaction was simply a passive copy of the E[uropean] C[ommunity]', but rather 'act in anticipation of developments' by seeking out ways of 'accommodating

44 'Committee of Parliamentarians of the EFTA countries: First meeting in Geneva, 25 November 1977', MF 1/78, 18 January 1978, EFTA 145, HAEU.

45 Hungary had shown an interest in forging ties as early as 1982, see 'Minutes of EFTA Council and Joint Council on 4 June 1982', EFTA/CJC.SR 10/82 (Draft), 30 June 1982, misc. folder 'SG visit to Norway August 1982', EFTA-Geneva.

46 Reisch to Ceska, 14 July 1988, misc. folder 'USSR (1)', EFTA-Geneva; 'Secretariat report on a visit to the EFTA Secretariat by two Soviet officials, 26 October–3 November 1989', Annex to R 288/89, 14 November 1989, misc. folder 'USSR (2)', EFTA-Geneva.

47 'Aide-mémoire', Annex to EFTA/C.SR 22/88, 23 January 1989, Council Summary Records 1988, EFTA-Geneva.

those countries and collaborating with them'.[48] On the other side amassed the likes of Switzerland and Finland, neither of which thought it wise for EFTA to engage the socialist countries in too overtly political a fashion or adopt a distinct Eastern policy of its own. Knowing very well his country's economic and political relationship with the Soviet bloc, Olli Mennander, the head of the Finnish delegation to the Association, would for example emphasise as late as September 1989 that 'the basis for any relations, by virtue of the nature of EFTA, had to be the economic interests of both parties concerned and in that context he did not believe that EFTA could have a political role or act as a bridge-builder between East and West'.[49] Bar technical collaboration on things like tariffs, in other words, the belief among some was that EFTA's contribution would by default be restricted.

All this meant that while no doubt welcoming the reforms underway in Eastern Europe, well into 1989 it appeared unlikely there would be any EFTA contingent working to support or shape this process. In time, though, this reluctance would progressively shift towards a position whereby EFTA members more eagerly utilised the economic tools at their disposal for the purpose of easing the democratic transition of the region. That they did so can be explained by at least three interrelated motivations.

For one thing, EFTA states appear to have been taken aback by the magnitude of events in Eastern Europe. Testimony to how the sheer speed and energy with which socialism collapsed came to influence EFTA thinking was supplied by Jean-Pascal Delamuraz, the head of the Swiss Federal Department for Public Economy, who speaking in November 1990 called the previous year 'a sort of cataclysm for Europe' in which 'certain long-standing principles had suddenly been abandoned'. It had, he continued, 'become necessary to reconstruct Europe, to identify ways in which to do so and also the role to be played by the countries of Western Europe in that task' and within this environment, he concluded, the 'EFTA countries had to join in the efforts to form a new European architecture'.[50] The contrast with the more reserved Swiss position of a few months prior was startling.

Second, there was anxiety among EFTA countries that developments in Eastern Europe might disturb their dealings with the Community. To appreciate this argument, it is necessary briefly to remind ourselves that during this period EFTA members were preparing for discussions with the Commission in Brussels over the creation of the so-called European Economic Space (EES, later European Economic Area (EEA)), a structure intended somehow to absorb EFTA into the framework of the Community's internal market.[51] A few government officials had already resigned themselves to the fact that that progress on the EES would be slowed as Community officials began to prioritise contacts with Eastern Europe.[52] This apprehension then moulded into more specific concerns that concessions granted to East Europeans on issues such as origin rules might influence the conditions for the EES negotiations as a whole.[53] Even if this concern was somewhat unfounded, it was not inconceivable to think that a lack of a more coherent EFTA approach to the East might allow businesses from the EEC or the United States to gain prized market access in the region at the expense of EFTA operators. Increasingly therefore it was considered vital to maintain a certain parallelism of action in the talks between the EEC and

48 Twelfth meeting of Council, at ministerial level', 13–14 June 1989, EFTA/C.SR 12/89, 8 December 1989, Council Summary Records 1989, EFTA-Geneva.

49 'Note on the restricted meeting of EFTA Heads of Delegation', 20 September 1989, CS 59/89, 22 September 1989, misc. folder 'Restricted HoD Notes', EFTA-Geneva.

50 'Joint EFTA-Yugoslavia Committee: Fourteenth meeting', 13 November 1990, EFTA/YJC/W 1/90, 18 December 1990, EFTA/YJC/W Documents 1985–91, EFTA-Geneva.

51 For more on these negotiations see i.e. Rye, 'Slow train coming'; Juhana Aunesluoma, 'Less than membership but more than association: Establishing the European Economic Area, 1989–1993', in Matthew Broad and Suvi Kansikas (eds.), *European Integration Beyond Brussels; Unity in East and West Europe since 1945* (London: Palgrave Macmillan, 2020),

52 'Informal EFTA ministerial meeting, Geneva', 27 October 1989, CS 72/89, 15 November 1989, misc. folder 'CS Letters 1989–1990', EFTA-Geneva.

53 Ibid; 'Relations with Yugoslavia and other third countries', Annex to CS 41/89, 28 June 1989, misc. folders CS Letters 1989–1990, EFTA-Geneva; 'Meeting of EFTA Heads of Government', 14 June 1990, CS 52/90, 17 September 1990, misc. folder 'EFTA summit: Gothenburg, 14 June 1990', EFTA-Geneva.

EFTA vis-a-vis those with Central and Eastern Europe.[54] A more constructive and cohesive EFTA approach could be expected to follow as a result.

Third, from late 1989 several Eastern Europe countries began actively to enquire about building a new relationship with the Association. Hungary was first to request a high-level meeting in a proposal sent in late October 1989. This was followed by an almost identical document lodged by Poland on 23 January 1990. And there were indications too that the Czechs and Slovaks were among those likely soon to submit analogous requests. The actuality of these overtures, and acceptance that a cold shoulder would probably only dent EFTA's reputation and potentially damage trade links with the countries involved, began to become significant. In short, it obliged EFTA states conclusively to settle whether and how they ought to respond to changes in the socialist world.[55] When combined with the factors referenced above, this almost certainly helps explain why on 11–12 December 1989 ministers, gathered for their bi-annual Council meeting, opted not simply to 'warmly welcome the progress of economic and political change in Eastern Europe and the efforts in some of those countries orientated towards a market economy as well as the establishment of political pluralism and democratic freedoms' but also to 'accept our responsibility to support these reforms [...] with a view to assisting the current process of change'.[56] The search for how EFTA, collectively, would engage with Eastern Europe was thus set to begin in earnest.

Almost overnight ministers and officials hit upon the idea of using EFTA's links with Yugoslavia as a model. As briefly mentioned above, contacts with Belgrade stretched back to the 1960s before being revived in 1978 in the form of a new Joint Committee. This had met annually thereafter, and the Bergen Declaration of 1983 in turn underscored quite how valuable both sides regarded the Committee as a framework in which to discuss a range of economic questions like trade promotion, industrial cooperation, tourism and transport, technical barriers to trade, financial services and capital movements.[57] In the process, the Joint Committee became a unique component of the EFTA machine. It was flexible enough to offer technical assistance, afford Yugoslav exporters access to EFTA businesses and markets, and furnish officials from both sides with the opportunity to converse on any pressing economic matters that should arise. But it was structurally distinct enough to give recognition to the fact that, as a country with a state trading system, Yugoslavia was not yet capable of taking part in the full rigours of economic integration binding other members of the Association. For EFTA states, though, this system had the added benefit of drawing Yugoslavia – a country which during the Cold War was officially non-aligned but often thought of as vulnerable to Soviet interference – closer to Western Europe without impeding the workings of the organisation as a whole. To this end, the relationship with Belgrade, while always ostensibly economic, served an additional purpose: encouraging what one national EFTA delegate would call 'European solidarity' by fostering economic prosperity as a way of encouraging stability in Yugoslavia and the wider Mediterranean region.[58]

54 Twelfth meeting of Council, at ministerial level', 13–14 June 1989, EFTA/C.SR 12/89, 8 December 1989, Council Summary Records 1989, EFTA-Geneva.

55 'Informal EFTA ministerial meeting, Geneva', 27 October 1989, CS 72/89, 15 November 1989, misc. folder 'CS Letters 1989–1990', EFTA-Geneva; 'Items discussed by Deputies at their 23rd meeting', 20 December 1989, MISC 2461/90 (CS), misc. folder 'Items discussed by deputies', EFTA-Geneva.

56 EFTA, *Twenty-Ninth Annual Report of the European Free Trade Association 1989* (EFTA: Geneva, 1990), 53. For minutes of meeting, 'Twenty-fourth meeting of Council, at ministerial level', 11–12 December 1989, EFTA/C.SR 24/89, 6 April 1990, Council Summary Records 1989, EFTA-Geneva.

57 For more on the Bergen Declaration see EFTA, *Twenty-Third Annual Report of the European Free Trade Association 1982–1983* (EFTA: Geneva, 1984), 38–40.

58 'EFTA-Yugoslav Joint Working Group: Fifth meeting', 19–20 June 1978, EFTA/JWG/SR 1/78, 25 September 1978, Joint Working Group 1967–1978, EFTA-328, HAEU. For more on EFTA's links with Yugoslavia see Matthew Broad, 'An irrelevant relationship? The European Free Trade Association (EFTA) and Yugoslavia, c.1960–91' (working paper, 2020).

With the EFTA-Yugoslavia Joint Committee and Bergen Declaration acting as a ready-made template, the hope was that an identical format could for the likes of Hungary and Poland do precisely the same.

It was a mere six months after the December 1989 Council that, at a meeting in Gothenburg on 13–14 June 1990, the first tranche of joint committees was established with Hungary, Poland, and the Czechs and Slovaks (then as the Czechoslovak Republic). Over the course of the next eighteen months, similar structures would be put in place with Estonia, Latvia, Lithuania, Romania, Bulgaria and Slovenia.[59] The aim in doing so was discussed by EFTA ministers at Gothenburg. According to Wolfgang Schüssel, the Austrian foreign minister, their purpose at first was 'not very much more than a political signal' both of Western support for the democratic transitions underway and EFTA's ability to bring former socialist countries into the broader process of European integration.[60] But in time, according to Schüssel's Swedish counterpart, Anita Gradin, these joint committees would come to represent 'an effective and practical way with as little time-consuming bureaucracy as possible' to help in efforts for these countries to restructure and reorientate themselves towards a market economy.[61] As a result, the communique which emerged from the meeting in Gothenburg was unapologetic as to how EFTA members saw their input:

> *We welcome the commitments made by the emerging democracies of Eastern Europe to democracy, pluralism, the rule of law, respect for human rights and the principles of market economy. We pledge our willingness to contribute actively to the consolidation of these developments and to the restructuring of the economies concerned.*[62]

Democratisation beyond Europe

In some ways it is tempting to stop the analysis here and conclude that EFTA members, while by this stage discernibly committed to using the Association as a vehicle to assist in democratisation efforts, were unlikely to repeat such feats much beyond the early 1990s. It is true that the joint committees signed into existence in June 1990 with Hungary and Poland were quickly upgraded to full free trade agreements, as were similar agreements signed with Romania, Bulgaria, Slovenia and, in 1996–97, Estonia, Latvia and Lithuania. But there was also no doubting that by this stage EFTA was a shadow of its former self, the end of the Cold War having led the way for Austria, Sweden and Finland to leave in favour of European Union membership. What their departures had highlighted in contrast was the EU's growing power of attraction. In gravitating towards Brussels, they were but part of a more general trend which, gradually, would include most of Eastern Europe applying to join. And even with Switzerland's rejection of the EEA in December 1992, it was nevertheless accepted that going forward all those countries remaining in EFTA would themselves now operate within an environ heavily coloured by the EU ecosystem. This influence was likely only to loom larger since the Maastricht Treaty, signed in February that same year, had dramatically expanded both the range of policies dealt with at the EU level and the powers of its Brussels-based institutions to deal with them. The pull of its internal market, promises of substantial financial assistance, and a more coherent set of foreign policy functions reinforcing its capacity and willingness to intervene in its near abroad, indeed made it look as though the EU alone represented the best means to induce and support democratic transitions and reforms. Seen in this light, the four-member EFTA comprising Norway, Switzerland, Iceland and Liechtenstein appeared rather surplus to the task.

59 The series of negotiations for these can be found in misc. Folder 'Baltic States: Aug. 1991–Sept. 1992', EFTA-Geneva.

60 'Sixteenth meeting of Council, at ministerial level', 13 June 1990, EFTA/C.SR 16/90, 16 October 1990, Council Summary Records 1990, EFTA-Geneva.

61 'Seventeenth meeting of Council, at ministerial level', 13 June 1990, EFTA/C.SR 17/90, 16 October 1990, Council Summary Records 1990, EFTA-Geneva.

62 'Meetings of Heads of Government and ministers of the EFTA countries, Gothenburg, 13 and 14 June 1990: Communique', 26 May 1990, misc. folder 'EFTA Summit: Gothenburg 14 June 1990', EFTA-Geneva.

With the benefit of hindsight, however, it is possible to observe that far from being the end of EFTA's third country policy, this moment in fact ushered in a new phase of engagement – one which saw EFTA look towards countries outside of Europe as well as those within it. It would, admittedly, be unfair to credit EFTA members with too much strategic foresight or political wisdom for having chosen to embark on this path. On the contrary, the tendency to ramp up third country links seems to have been quite reactive, encouraged by the need to counter at least two trends already well underway by the time EFTA ministers met in Bergen in June 1995 and declared 'their determination to play a constructive role in contributing to political stability in Europe and beyond'.[63] One of these followed the logic that the decade marked a period of ever greater interconnectedness in global trade. As a collection of small states highly reliant on access to foreign markets, the new EFTA thus seemingly had little choice but to build a diverse network of trade connections if they were to stand any chance of flourishing economically. Another was the perceived need – common to the parallelism which had earlier induced EFTA to institutionalise links with Eastern Europe after 1989 – to maintain coherence with the EU as it went about more energetically developing its own trade relations in areas such as the Mediterranean, in the hope this would offset any potential discrimination for EFTA exporters. Where all this mattered for EFTA's democratising penchant was that as members sought to keep pace with the EU, and were themselves ever more impacted by the policies it pursued, so there was the tendency to replicate in their own external trade relations the very form and approach deployed by Brussels. At a technical level this morphed into greater focus being placed, for instance, on trade in services rather than simply on goods. Even more fundamentally, at a diplomatic level this translated into tying the pursuit of free trade ever more explicitly to the stimulation of market economy principles as a means to encourage economic growth and, with it, to consolidate democracy and stability among commercial partners.

Acceptance of this trend was confirmed in Bergen. The declaration on third countries issued at the summit spoke of free trade's 'increasingly important role in securing work, welfare, peace and democracy in Europe' and of the fact that the 'scope and substance of their free trade agreements will be extended as appropriate', to include 'trading partners outside the continent'.[64] Their willingness to do so was then immediately put to the test with EFTA's inclusion in the EU-led Barcelona process, a partnership formed in 1995 destined to establish a Euro-Mediterranean free trade zone. As EFTA ministers admitted, their hope was to have 'positive effects on stability and economic development in the entire region', out of which declarations of cooperation were signed with Egypt, Morocco and Tunisia.[65] Having long cooperated with Yugoslavia, meanwhile, it was perhaps natural for EFTA states to agree to 'making a substantial contribution to the common European effort to bring peace and stability to the Balkans' by, in addition to again signing joint declarations, providing scholarships and technical support for Albania, Macedonia and Croatia, the first of which were initialled in 1992 and the latter in 2000.[66] And as part of efforts to encourage democratic changes while pursuing economic cooperation, statements of non-trade related values have since also become far more common a sight in some trade agreements that the Association has drafted. Front and centre in those adopted with the Palestinian Authority, Jordan and Georgia for example has been the commitment to spreading 'democracy based on the rule of law, human rights, including rights of persons belonging to minorities, and fundamental freedoms'.[67]

63 Comments by EFTA Secretary-General Kjartan Jóhannsson in EFTA, *Thirty-Fifth Annual Report 1995* (Brussels: EFTA, 1996).

64 'Declaration of EFTA states' policy towards third countries', 14 June 1995, cited in ibid.

65 See comments by the then Norwegian foreign minister, Thorbjørn Jagland, in EFTA, *40th anniversary of EFTA 1960–2000* (EFTA: Geneva, 2000), 39, available at https://www.efta.int/publications/commemorative-publications/efta-40th-anniversary (last accessed 10 August 2020).

66 EFTA, 'EFTA's third-country relations', Fact Sheet of the European Free Trade Association (2004), 3, available at http://www.sice.oas.org/TPD/CAN_EFTA/Studies/EFTARels_e.pdf (last accessed 11 August 2020).

67 A comprehensive collection of declarations and trade agreements signed by is available on the Association's website, https://www.efta.int/free-trade/free-trade-agreements.

It is imperative once again to qualify these statements a little. EFTA of course could only ever achieve so much. Without the foreign, military or economic power to coerce partners to comply with these conditions, the Association has tended to promote what some scholars call 'soft' as opposed to 'hard' conditionality standards.[68] This, it is true, often makes it simpler to reach trade agreements in the first place. But it also potentially makes it harder to influence governmental and societal change and, alternatively, easier to cast aside these conditions altogether (as was the case of EFTA's agreement signed with Hong Kong).[69] And yet this has to be weighed against the toolbox that is used by, or at least available to, EFTA to achieve broader free trade goals. Today, for example, offers of technical assistance and help building state capacity and institutional resilience represent a commendable goal in itself as well as a potential precursor to forging closer economic ties between EFTA and the likes of Kosovo, Pakistan, Myanmar, and East Africa.[70]

Only the future historian, able to access the archival material crucial to identifying individual country positions and intra-EFTA dialogue, will be able to tell us how members regarded these issues and indeed what the impact was of their actions. When placed against the backdrop of EFTA's history, though, it seems safe to assume that there was a certain amount of debate and tussling. The Stockholm Convention as devised in 1959 never envisioned that the promotion of democracy would become a cornerstone of the Association's free trade remit. Nor did it have anything to say about the means by which EFTA countries could go about encouraging economic and, in due course, political stability or democratic government. From 1959, as a result, there has been a process of negotiation and evolution underway during which EFTA members have debated whether and how it should engage with such a value-driven non-trade issue and the degree to which it is compatible with, or an essential extension of, the Convention. This has meant EFTA, at times, has been slow or reluctant to act. That it has eventually done so is, however, surely beyond dispute from a reading of the analysis above. And while it has been reticent to admit it itself, the implication of this is that EFTA has played a notable part at crucial moments in European history. The pace and substance of EFTA's trade agreements of recent times suggests it will continue to do so in the future too.

68 Emile M. Hafner-Burton, 'Trading human rights: How preferential trade agreements influence government repression', *International Organization* 59 (2005), 593–629.

69 For a comparison of the conditionality principles in trade agreements signed by the EU and EFTA see Andreas Maurer, *Comparing EU and EFTA Trade Agreements: Drivers, Actors, Benefits and Costs* (Brussels: European Parliament Directorate-General for External Policies – Policy Department, 2016).

70 EFTA Consultative Committee, 'Work Programme 2020', Ref. 19-3652, 10 September 2020, available at https://www.efta.int/sites/default/files/documents/advisory-bodies/consultative-committee/19-3652%20EFTA%20CC%20Work%20Programme%202020.pdf (last accessed 6 October 2020).

Settling Inter-State Trade Disputes: Lessons from the EFTA Complaints Procedure

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Introduction

Sixty years ago, the EFTA Convention was signed between Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the United Kingdom. While a number of other European states established a customs union and a common market with supra-national decision making, the EFTA Member States aimed for an alternative form of economic integration at the intergovernmental level.[1] Accordingly, unlike the European Economic Community, EFTA was not endowed with a court. The idea was that the Member States would collectively interpret and enforce the Convention.[2] For that reason, the drafters of the EFTA Convention saw no need to establish a standing institution with the power to issue binding interpretations of the treaty.

Nevertheless, the original Stockholm Convention contained a 'complaints mechanism' in Article 31.[3] This Article authorised Member States to refer a matter to the Council, if they considered that a Convention benefit or an objective of the Association was being frustrated, and if no satisfactory settlement could be reached between the Member States concerned. Upon receiving such a referral, the Council would, by majority vote, make arrangements for examining the matter, which could include the appointment of an 'examining committee'. The Council would assess whether a Convention obligation had not been fulfilled and could, by majority vote, make appropriate recommendations to the member state concerned. If that member state refused to comply with the recommendations of the Council, the latter could authorise any member state to suspend the fulfilment of its obligations toward the member state in breach.[4]

In this article, I investigate the complaint procedure provided for in Article 31, on the basis of new information obtained through archival research.[5] I discuss the background of Article 31, demonstrating how its drafters sought to provide a form of international review of compliance with EFTA commitments without intruding too much upon State sovereignty. Next, I describe how the mechanism has been used in practice. I analyse the contents of the cases brought under Article 31 and the extent to which the procedure helped to solve the disputes. I also discuss internal documents of the organisation to see how

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1 EFTA provides an often overlooked strand of 'European' integration. See José Alvarez, 'The New Dispute Settlers: (Half) Truths and Consequences' (2003) 38 Texas Journal of International Law 405, 430: '[t]he integrative goals ... of those who established the Strasbourg and Luxembourg Courts are not necessarily shared in other regions and certainly not throughout the globe'. For a discussion of why most of the original EFTA members have since joined the EU, see e.g. Sieglinde Gstöhl, 'EFTA and the European Economic Area or the Politics of Frustration' (1994) 29 *Cooperation and Conflict* 333;

2 Frank Figgures, 'Legal Aspects of the European Free Trade Association' (1965) 14 International and Comparative Law Quarterly 1079, 1082.

3 The text of Articles 31 and 33 is annexed to this article.

4 Andreas Ziegler, 'Dispute Settlement in Bilateral Trade Agreements: the EFTA Experience' in Lorand Bartels and Federico Ortino (eds), *Regional Trade Agreements and the WTO Legal System* (OUP 2006) 408, noting that '[t]he EFTA solution of 1961 was thus very similar to the model enshrined in the GATT of 1947'. Unlike the GATT, however, the complaints mechanism of the Stockholm Convention provided for majority voting in dispute settlement.

5 The research is undertaken in February 2020 in the EFTA archives located in the Historical Archives of the European Union (HAEU) in Florence. I have studied the files related to specific disputes (HAEU EFTA-851-853, HAEU EFTA 915-927) as well as a general file on the complaints procedure (HAEU EFTA-854). In this article, the footnotes refer to the HAEU reference code of the file. In addition, I identify the specific document as precisely as possible. However, not every document cited contains details such as author and date. When these elements are absent from the footnote, this means they could not be derived from the original document.

the procedure was appreciated at the time.[6] I will then use the findings concerning the successes and failures of Article 31 in order to draw lessons for the design of dispute settlement mechanisms in international economic law. In this way, the analysis of an understudied chapter of European integration history provides insights into the strengths and weaknesses of particular forms of inter-state dispute settlement in regimes of economic integration.

"A Typical Compromise Solution": the Background of Article 31

Article 31 was among the most controversial articles of the Stockholm Convention. As explained in a Secretariat document of 1962, the final text was a 'typical compromise solution': 'it [was] more than a simple procedure of consultation and negotiation, but less than a strict legal procedure, leading up to a decision which is binding on the parties to the dispute'.[7] According to some observers, the procedure could 'yield excellent results if it [were] implemented in the right spirit'.[8] The strength of Article 31 was considered to lie in its combination of negotiation, examination, and coercion. If necessary, the procedure involved both moral pressure, in the form of a Council declaration finding a breach, and material pressure, in the form of countermeasures.[9]

However, doubts over the usefulness of Article 31 were also voiced at an early stage. In a Secretariat paper of September 1962, it was considered 'unlikely' that the procedure would be used in its entirety, 'on the basis of past experience of relations between the EFTA Member States'.[10] Accordingly, it was also questioned whether the consultation stage of the procedure had any added value: '[t]he Council has in fact in its routine meetings dealt with a number of questions which might have been dealt with under the procedure described in Article 31, and satisfactory results have nonetheless been achieved'.[11] The 'informal procedure' entailed a discussion within the Council, after which the opinion of the majority would be sufficiently clear to pressure the member state concerned into the desired direction.[12] It was considered that 'it may be psychologically easier to comply with an informal opinion of the Council than with an express recommendation under the Article 31 procedure, which implies that the Member State in question is put on record as having broken its obligations'.[13] Indeed, 'although the formal procedure in Article 31 is given very considerable prominence in being described at length and in detail, it is fact intended to be used as a last resort'.[14] Recourse to the procedure would imply 'that a problem is too difficult to solve in the normal way or that there has been a failure of understanding of co-operativeness on the part of one or more Member States'.[15]

6 This article seeks to contribute to the historiography of international economic law by providing new archival data rather than 'grand narratives' of the history of the field. See on the merits and risks of the latter the debate between Rafael Lima Sakr and Steve Charnovitz in the JIEL: Rafael Lima Sakr, 'Beyond History and Boundaries: Rethinking the Past in the Present of International Economic Law' (2019) 22 JIEL 57; Steve Charnovitz, 'The Historical Lens in International Economic Law' (2019) 22 JIEL 93. The article also seeks to contribute to the study of international judicial practices, see Jeffrey Dunoff and Mark Pollack, 'A Typology of International Judicial Practices' in Andreas Follesdal and Geir Ulfstein (eds), *The Judicialization of International Law: A Mixed Blessing?* (OUP 2018).

7 *The General Consultations and Complaints Procedure under Article 31*, 8 October 1962, HAEU EFTA-854, para 1. Cf Frank Figgures, 'Legal Aspects of the European Free Trade Association' (1965) 14 International and Comparative Law Quarterly 1079, 1084, speaking about 'a very delicately balanced compromise'. According to Figgures, the EFTA negotiators had a 'lazy style': 'We do not much like working out theoretical solutions and answering hypothetical questions. A treaty negotiated between the group of EFTA countries tends to be simpler because they are content with their capacity to solve problems when they arise tomorrow, and have more confidence in their ability to do that than work out a theoretically perfect solution in advance', at 1080. According to Figgures, the absence of a court in the EFTA Convention was due to this style: 'had we not at the time of the negotiation of the Stockholm Convention in 1959 been dominated by that desire for simplicity which I have already mentioned, it is very likely we should have had a court within EFTA', at 1082.

8 Idem, para 2.

9 Idem.

10 *The Complaints Procedure*, 14 September 1962, HAEU EFTA-854, para 9.

11 Ibid, para 2.

12 Ibid, para 3-4.

13 Ibid, para 10.

14 *Consultations and Complaints Procedure*, undated, HAEU EFTA-854, para 19.

15 Ibid.

According to Frank Figgures, the first secretary-general of EFTA, Article 31 suffered from several other weaknesses. In his view, Article 31 put too much emphasis on bilateral discussion as a precondition for the involvement of the Council. Figgures feared that this would foster divergent interpretations of the Convention, and potentially harm the rights of private citizens if governments would decide to strike a deal between themselves. Moreover, Figgures lamented that Article 31 did not provide a simple procedure for solving disputes concerning the interpretation of the Convention and for establishing the correct understanding. The adoption of a recommendation by the Council would have this effect, but the Council could do so only after passing through various preliminary stages of the procedure of Article 31. Finally, Figgures considered that Article 31 implied 'coercion when none may be intended'.[16] In his view, the procedure was geared towards an increasing degree of coercion, even if Member States only wished to make a firm recommendation.

When Figgures published these reflections in October 1965, Article 31 had been invoked in three cases: *Portugal – Fertilisers*, *Austria – Rockwool*, and *United Kingdom – Fish Fillets*. At the time, the first two cases had been settled, whereas the third was pending. The next section of this article will discuss these cases in some detail, investigating how and to what effect Article 31 had been applied.

The First Complaints: *Portugal – Fertilisers*, *Austria – Rockwool*, and *United Kingdom – Fish Fillets*

Portugal – Fertilisers

On 8 October 1962, Austria introduced a complaint against Portugal concerning the import of nitrogenous fertilisers. The complaint originated from an Austrian company that had requested a Portuguese import licence, which was issued only after a year and on the condition that the company would pay a security deposit pending an anti-dumping investigation. According to Austria, the delay constituted a breach of the Convention's provision on quantitative restrictions (Article 10).

In a letter of 10 October 1962, Sören Sommerfelt of the Norwegian Delegation expressed some thoughts on 'how to handle the Austrian complaint'. He advised the Council to establish the procedure for the examination of the matter 'as quickly as possible'.[17] According to Sommerfelt, '[t]here is always advantage in such cases in avoiding premature discussion of the substance. The existence of a clear procedure facilitates this'.[18] On 15 October 1962, the Council initiated proceedings and established a working group. Mr Figgures considered that this approach was preferable over the establishment of a formal 'examining committee' under Article 31(2): '[i]n the particular case before the Council, it seems to us that unless Austria or Portugal wishes to ask for an Examining Committee there would be an advantage in the Council adopting itself rather a more flexible procedure'.[19]

16 Frank Figgures, 'Legal Aspects of the European Free Trade Association' (1965) 14 International and Comparative Law Quarterly 1079, 1085.

17 Letter of S.E. Monsieur Sören Chr. Sommerfelt of 10 October 1962 [addressee unknown], HAEU EFTA-924.

18 Ibid.

19 Letter of Mr Figgures to the Heads of Delegation, 10 October 1962, cited in *Article 31*, Internal Memorandum by Mrs. Szokoloczy of 1 March 1965, HAEU EFTA-854.

As to the merits of the case, Portugal recognised 'that the license should not have been withheld' and it 'presented its excuses to Austria for this fact'.[20] Nevertheless, Portugal considered that the request for a security deposit was a legitimate temporary anti-dumping measure in accordance with Article 17 of the Convention. In December 1962, the working group presented its views. It proposed that the relevant Austrian company would receive its licence without any requirement to pay a deposit or anti-dumping duty. Moreover, the import of fertilisers from EFTA countries into Portugal would be completely liberalised over time, while Portugal would be allowed to increase basic duties on nitrogenous fertilisers in the meantime.[21] The Council concluded that this proposal was 'acceptable to all Member States'.[22]

According to one commentator, the working group 'sought and found a practical solution'. Even though 'an attempt was made to clarify the legal issues as well as the factual ones', 'the Committee realized rapidly that a proper legal interpretation of the situation would necessitate lengthy research, and it was considered preferable to seek a compromise which would permit a rapid settlement', because '[p]rolonged investigation could but increase the damage done to traders'.[23] In a memorandum of 1963, British official Ray Colegate reflected on *Portugal – Fertilisers* in the context of a discussion of whether EFTA should have a court: 'A court might have been called upon to decide some issues (for example, the Austrian complaint against Portugal) which, in the absence of a court, were settled perhaps no less satisfactorily by the Council. If there had been an EFTA Court, a number of points of interpretation might have been submitted to it, points which have in fact been settled pragmatically by the Council'.[24]

Austria – Rockwool

On 30 August 1963, Denmark introduced a complaint against Austria concerning the importation of the insulating material rockwool. Denmark complained of Austria's reclassification of the material, which produced a tariff increase and new quantitative restrictions. After almost two years of exchanges, Denmark considered that 'the possibilities of reaching a satisfactory settlement bilaterally [had] been exhausted'.[25] Austria, by contrast, 'would appreciate the opportunity of further bilateral discussion' and 'therefore hoped the Council might leave open the date of the first meeting of the working party'.[26]

On 24 September 1963, the Council established a 'Committee of Enquiry'.[27] In a first report, the Committee noted that 'it had no competence to decide whether or not the Austrian authorities were right to reclassify the product', as this was for the Nomenclature Committee in Brussels to decide. In the meantime, the Committee of Enquiry considered that 'Austria should consider sympathetically the possibility of raising a subheading, if not to restore the

20 *Austrian Complaint about Difficulties Concerning the Export of Fertilisers to Portugal*, Draft Report of the Working Group of 19 November 1962, HAEU EFTA-923, para 10.

21 *Proposed Solution for the Austro-Portuguese Dispute Concerning Imports of Nitrogenous Fertilisers into Portugal*, Note by the Working Group, 17 December 1962, HAEU EFTA-924.

22 *Increase of Portuguese Basic Duties on Nitrogenous Fertilisers, and Application of Annex G Timetable,* Draft paragraphs for a Council Summary Record [undated], HAEU EFTA-924.

23 A. Szokoloczy-Syllaba, 'EFTA. The Settlement of Disputes' (1971) 20 International and Comparative Law Quarterly 519, 520-521.

24 *The High Court of the European Communities*, Note by R. Colegate to F. Figgures, 4 April 1963, HAEU EFTA-854. Colegate further noted that the major functions of the EEC Court were 'the check on the abuse of power by the executive and the supervision of the application of community law within domestic jurisdictions'. Neither would apply in the context of EFTA, as the Association did not have a powerful executive like the EC Commission, nor did EFTA produce laws directly applicable within domestic jurisdictions.

25 *Danish Complaint Concerning the Importation of Danish "Rockwool" Insulating Material into Austria*, Memorandum by the Danish Delegation, 3 September 1963, HAEU EFTA-925, para 11.

26 Document EFTA/C.SR 30/63 (DRAFT), HAEU EFTA-925, para 7.

27 In a draft document of 24 September 1963, the term 'working group' was crossed out and replaced by 'Committee of Inquiry'. *Danish Complaint Concerning the Importation of Danish "Rockwool" Insulating Material Into Austria.* Draft Entry into the Council Summary Record, 24 September 1963, HAEU EFTA-925.

original lower duty, at least to restore some intermediate rate which would mitigate the adverse effects on Danish exports'.[28] With regard to the quantitative restrictions, the Committee found that, on grounds of Article 10 of the Convention, 'Austria should immediately restore complete freedom of EFTA imports for the product in question'.[29] In October 1963, the Nomenclature Committee resolved the dispute, determining that the original classification of the product was the correct one. Subsequently, the Committee of Enquiry 'assumed' that Austria would 'immediately revert to that classification' and eliminate the quantitative restrictions.[30]

United Kingdom – Fish Fillets

In April 1965, Norway initiated a complaint under Article 31 against the United Kingdom concerning the tariff treatment of certain goods made of fish fillets. At this point, the Council's experience with the two previous complaints had led to some established practice. In an internal memorandum of 9 July 1965, it was explained that the initiation phase of an Article 31 procedure consisted of three steps: a reference to the Council by the plaintiff; a statement of position by the defendant; and arrangements for an examination of the case. The memorandum noted that the second step was not formally required by the Convention, but the Council nonetheless wished to have at least an oral statement before the third step would be initiated.[31]

On 20 July 1965, the Council set up a 'Committee of Inquiry' to examine the Norwegian complaint. The case concerned the interpretation of the term 'quick frozen fillets', to which EFTA tariff treatment should be applied, and, more precisely, the question of whether fish 'grillets' and fish 'portions' fell under this term. These products were made from frozen slabs cut into pieces ('portions') and sometimes breaded with crumbs ('grillets'). According to Norway, portions and grillets required more processing than ordinary 'quick frozen fillets' and should, for that reason, be granted EFTA tariff treatment.[32] The United Kingdom argued that the cutting of the fillet blocks resulted in smaller units that could not be classified as fillets themselves, under the definition 'used by traders and housewives'.[33]

In a letter of 25 February 1966, a member of the Secretariat suggested to one of the Committee members 'that it might be desirable to come to one firm conclusion rather than a number of possible approaches to a solution', which 'would have the great advantage of ending the whole subject without the need for protracted discussion in the Council'. The proposed solution would be for the United Kingdom to apply, 'as an act of grace', EFTA tariff to grillets and portions, even if they could not be classified as 'quick frozen fillets'. This solution, it was suggested, would be acceptable to the United Kingdom, 'since it would not destroy the United Kingdom argument' and also give the United Kingdom authorities 'a reason for explaining the tariff change to the United Kingdom fish interests'.[34]

28 *Danish Complaint Concerning Importation of Danish "Rockwool" Insulating Material into Austria*, Report of a Committee of Enquiry [draft], HAEU EFTA-925, para 16.

29 Ibid, para 17.

30 *Danish Complaint Concerning Importation of Danish "Rockwool" Insulating Material into Austria*, Report of a Committee of Enquiry [draft], HAEU EFTA-925, para 7.

31 *Norwegian Complaint Concerning Fish Fillets: Council Action to Initiate Examination*, Internal Memorandum, 9 July 1965, HAEU EFTA-926.

32 During one of the Committee meetings, the Norwegians gave a demonstration of how fish slabs, fish portions and fish grillets were produced. 'Miss Artiss has made the Conference Room at 35 Budé available and is ensuring that the Norwegian corner has waterproof covers on the table. Mr. Berg will let me know whether any containers such as buckets and any hot water or ice are required'. *Committee of Enquiry into Certain Fish Products*, Internal Memorandum of 10 January 1966, HAEU EFTA-926.

33 *Report of the Committee of Enquiry on Frozen Fish Products*, 8 March 1966, HAEU EFTA-926, para 11.

34 Letter of F.T. Hallett to O. Long of 25 February 1966, HAEU EFTA-926.

In its report of 8 March 1966, the Committee reasoned that '[a]s EFTA is a multilateral trading arrangement, … the Council will wish to arrive at a uniform interpretation valid for the EFTA relations of all Member States'.[35] On the merits of the case, the Committee noted that the term 'fillets' did not appear in the Brussels Nomenclature, which was not, in any case, 'a complete guide for the interpretation of the description of goods contained in the EFTA Convention'.[36] Rather, '[a]s the Convention is a commercial treaty, the commercial practices prevailing between the parties at the time of its signature, in the absence of contrary indication, should be used as a guide where necessary, to discover the intentions of the parties'.[37] After a brief survey of the treatment of the products by other EFTA Member States, the Committee concluded with some 'directions in which a solution might be found', noting, in particular, that most EFTA States gave EFTA treatment to the products concerned even if they did not consider this to be an obligation under the EFTA Convention.[38]

The Council ultimately agreed that 'quick frozen fish fillets' included portions of at least one ounce, whether breaded or not. The United Kingdom agreed to adapt its duties accordingly as of 1 July 1966. At a later stage, the governments of Denmark, Norway, Sweden and the United Kingdom agreed that if imports of quick frozen fillets into the United Kingdom would exceed a certain amount, the latter would be free 'to modify the tariff reductions already made …, so far as may be necessary to avoid serious disturbance in the United Kingdom market, without reference to the Council'.[39]

"This Is Not An Easy Task". The First Examining Committee: *United Kingdom – Cattle*

On 8 February 1966, the Council established for the first time a formal Examining Committee under Articles 31 and 33 of the Convention.[40] The case concerned a Danish complaint alleging that United Kingdom subsidies on cattle had resulted in increased exports to West Germany, to the detriment of Danish traders. On 22 and 23 February, the parties pleaded the case before the Committee.[41]

Early drafts of the Committee's report show that there was some controversy as to whether an Examining Committee had the authority to establish a breach of the Convention.[42] The Council had asked the Committee to 'assist it in establishing whether an obligation under the Convention [had]

35 *Report of the Committee of Enquiry on Frozen Fish Products*, 8 March 1966, HAEU EFTA-926, para 16.

36 Ibid, para 17, 19.

37 Ibid, para 20. The Committee would do so having 'regard to the spirit of the Convention as well as its strict letter'.

38 Ibid, para 25-28.

39 *Text of Copenhagen Proposal*, 7 October 1968, HAEU EFTA-926, para 1(c).

40 See also *Norwegian Complaint Concerning Fish Fillets: Council Action to Initiate Examination*, Internal Memorandum, 9 July 1965, HAEU EFTA-926, where it is noted that neither the 'working party' set up in *Portugal – Fertilisers* nor the 'Committee of Enquiry' established in *Austria – Rockwool* was an 'examining committee' in the sense of Article 33 paragraph 2.

41 A. Szokoloczy-Syllaba, 'EFTA. The Settlement of Disputes' (1971) 20 International and Comparative Law Quarterly 519, 521: '[t]he fact that the complaint bore on the very delicate subject of agricultural subsidization and that it was not a purely internal EFTA matter, but concerned exports to West Germany, where the common agricultural policy of the EEC was in force, and where Denmark faced other non-EFTA competitors, obviously made the case very difficult'.

42 This question was touched upon also by the Committee in *United Kingdom – Fish Fillets*: 'the Committee feels that those questions are part of the matter in dispute, since the matter has been referred to the Committee by the Council expressly under Article 31, and not under, for example, Article 32, paragraphs 1(b) and 3. *Report of the Committee of Enquiry on Frozen Fish Products*, 8 March 1966, HAEU EFTA-926, para 15.

not been fulfilled'.[43] However, Article 31 paragraph 3 left ambiguous whether this determination fell not within the exclusive competence of the Council itself, stipulating that '[w]hen considering the matter, the Council shall have regard to whether it has been established that an obligation under the Convention has not been fulfilled'. The Committee ultimately concluded: 'we noted that paragraph 3 of Article 31 does not expressly say (as it so easily could have done) that it is for the Council alone to establish the existence of a breach and we concluded that, provided the existence of a breach were established objectively, the Convention left open how and by what body such breach was to be established'.[44] According to the Committee, a breach could be established even by the complainant alone, as long as the requirement of objectivity would be respected. While '[p]olitical or trade policy questions of the moment could be reflected in any remedy decided upon by the Council', the purely legal assessment was not left to the Council:

> *Considering ... that the Convention did not appear to authorise the Council to establish the existence of a breach ... but merely to have regard to whether it had been established that an obligation had not been fulfilled, we concluded that while an Examining Committee constituted the only full examination provided by the Association for a particular matter, that it was for such a committee to establish the existence of any breach, otherwise the Council in its normal legislative, administrative or policy making capacities, would not be able to have regard to whether the existence of a breach had been established.*[45]

According to the Committee, there was a distinction between 'the administrative or policy making or "considering" function of the Council and the examining function of any body set up by the Council as part of its arrangements for examining the matter'.[46] Accordingly, the Committee considered that the Convention obliged it, as part of the examining arrangements, to establish whether an obligation had not been fulfilled.[47]

The Committee also noted that the Convention put an emphasis on 'the practical matters of frustration of a benefit', which demonstrated 'the spirit' in which the matter should be approached, 'both in interpreting the Convention and (in the absence of Council instructions) in adopting a procedure and standards of proof'.[48] The Committee felt that 'a judicial approach' was appropriate, 'but free from the intricacies of usual Court room procedures and standards'.[49] The Committee was not entirely satisfied by the performance of the disputing parties, but did not want to criticise 'the agents concerned since they, like ourselves, found the proceedings novel'.[50] The Committee also noted that it would have been helpful if other Member States had intervened in the procedure, in accordance with their positive duty under the last sentence of Article 31, paragraph 2.[51]

43 *Export of Cattle from the United Kingdom to the Federal Republic of Germany*, Draft Report by the Examining Committee to the Council of the European Free Trade Association, 27 February 1966, HAEU EFTA-851, para 1.

44 *Export of Cattle from the United Kingdom to the Federal Republic of Germany*, Report by the Examining Committee to the Council of the European Free Trade Association, 2 March 1966, para 5.

45 Ibid, para 6.

46 Ibid, para 7.

47 Ibid, para 8. The Committee also noted: 'as Article 31 can only be amended by the ratification procedure of Article 44, we considered that the Council could not by terms of reference, cut down the duty incumbent upon us under the Convention, even though the Council might, by means of its own full and objective examination, exercise parallel functions.

48 Ibid, para 9.

49 Ibid. 'We did not consider that procedures, before or during the examination, should allow tactical advantages to be gained at the expense of a reasonable, fair and fundamental examination'.

50 Ibid, para 14.

51 Ibid, para 15.

None of these considerations, however, appeared in the final version of the report, which was issued on 25 March 1966.[52] In this report, the Committee focused more exclusively on the merits of the case, primarily in light of Article 24, the Convention's provision on export subsidies on agricultural goods. The Committee noted that a violation of Article 24 required a 'causal connection between subsidies and increased exports'.[53] Given the complexity of the diverse factors that can cause an increase in exports, the Committee agreed with Denmark that Article 24 provided 'a difficult rule to base a complaint on'.[54] However, the Committee was 'bound to deal with the Convention as it is, not as it possibly could have been'.[55] It concluded that neither the United Kingdom's subsidies system for cattle nor its export rebate scheme could be considered as the cause of the increase in exports to Germany.[56]

For the sake of completeness, the Committee also considered whether Denmark had suffered any damage caused by the increased British exports, and concluded that this was not the case.[57] Nevertheless, the Committee noted the potential relevance of Article 22, which stipulated that 'Member States shall have due regard to the interests of other Member States in the export of agricultural goods and shall take into consideration traditional channels of trade'. The Committee noted that these obligations were 'vague' 'standards' that should be filled with concrete content 'as the Council goes from case to case and takes decisions and actions'.[58] It would be a difficult task, however, to build a 'case law' defining the scope of Article 22, in particular in light of the narrow obligations of Article 24.[59]

The Committee concluded:

> *We have been asked to pronounce upon whether an obligation … under the Convention has not been fulfilled and whether and to what extent any benefit conferred by the Convention or any objective of the Association is being or may be frustrated. This is not an easy task.*[60]

The Committee struggled with two issues in particular. First, the Convention was not 'a very clear legal instrument', bearing 'every mark of being something hammered out between different and conflicting interests – a compromise where colliding points of view were, if not bridged, at any rate somewhat disguised and perhaps left to the future development'.[61]

52 *Complaint by Denmark against the United Kingdom with Regard to United Kingdom Cattle Exports to the German Federal Republic. Report by the Examining Committee to the Council*, 25 March 1966, HAEU EFTA-852.

53 Ibid, para 46.

54 Ibid.

55 Ibid.

56 Ibid, para 47. In an earlier draft, the Committee noted 'so many uncertainties about the effect of the United Kingdom support measures on the increase' of the export to Germany, that it hesitated 'to advise the Council to rule that even an indirect link between subsidization and the actual increase' could be found. *Export of Cattle from the United Kingdom to the Federal Republic of Germany*, Draft Report by the Examining Committee to the Council of the European Free Trade Association, 27 February 1966, HAEU EFTA-851, para 18.

57 *Complaint by Denmark against the United Kingdom with Regard to United Kingdom Cattle Exports to the German Federal Republic. Report by the Examining Committee to the Council*, 25 March 1966, HAEU EFTA-852, para 53.

58 Ibid, para 58. An earlier draft had read: 'The Committee studied the wording of the last sentence of sub-paragraph 1 of Article 22 and found that although the wording was mandatory, the obligation contained therein was vague. However, like any international treaty, the EFTA Convention must be considered as a frame which should be elaborated in order to create a worthwhile and valid instrument. The rulings of the Council is the way prescribed in the Convention for developing the relationship between the partners. Under these circumstances, also a vague obligation and a declaration of intent can be considered as relevant and operative parts of the Convention.' *Export of Cattle from the United Kingdom to the Federal Republic of Germany*, Draft Report by the Examining Committee to the Council of the European Free Trade Association, 27 February 1966, HAEU EFTA-851, para 25.

59 *Complaint by Denmark against the United Kingdom with Regard to United Kingdom Cattle Exports to the German Federal Republic. Report by the Examining Committee to the Council*, 25 March 1966, HAEU EFTA-852, para 59.

60 Ibid, para 66.

61 Ibid.

The second difficulty was that the interests involved on both sides did 'not easily lend themselves to an exact evaluation'.[62] The Committee was 'in some doubt' as to what finding it should reach: 'we feel that we ought not to be categorical – we should leave the matter to a thorough discussion in the Council'. Nevertheless, on the basis of the information before it, the Committee had 'not been able to establish' a breach of the Convention.[63]

In a letter to the Secretary-General, one of the Committee members reflected on his experience with the Article 31 procedure. He expressed his conviction that 'EFTA should make much more use of the complaints procedure and of Examining Committees' and that 'a more certain procedure for future Examining Committees would greatly enhance the quality and speed of their work'.[64] In an internal memorandum of 12 April 1966, the Secretariat also reflected on the procedure. It noted that '[m]any difficulties which the Examining Committee had to face … could have been avoided if some procedural rules had already existed before the Examining Committee was set up by the Council'.[65] On the other hand, 'going into too much detail by setting up procedural rules might make the whole procedure too rigid and not appropriate for every possible case'.[66] As a sort of procedural framework, the memorandum proposed that both the claimant and the defendant would provide factual and legal information in a 'basic paper', to be sent to the Examining Committee and the Member States. After this exchange, hearings should be organised, primarily for the purpose of answering questions from the Examining Committee.[67]

The report issued by the Examining Committee in *United Kingdom – Cattle* was repeatedly discussed in the Council. On 22 April 1966, the Swiss delegate observed that there was 'a moral rather than a legal responsibility on all Member States of EFTA to alleviate the difficulties the Danish Government was facing'.[68] Likewise, the Portuguese delegate argued that 'the strict letter of the law should not be the only consideration'.[69] Rather, 'it was necessary to think of the future and to try to act in a spirit of friendship which went beyond the limitations of the law'. The Portuguese delegate requested the United Kingdom 'not to consider the matter closed nor to press for a decision on the narrow basis of the Examining Committee's report but to try to work out a solution in the true EFTA spirit'.[70] The United Kingdom delegate found these statements 'disappointing'. He recalled that the matter had not been 'an appeal to equity' but 'a formal complaint under the provisions of the Convention that the United Kingdom was in breach'.[71] Therefore, '[i]t was imperative that his authorities should know whether or not the Council agreed with the Examining Committee that the Danish case had not been substantiated'.[72] Since the Committee had found that the difficulties experienced by the Danish

62 Ibid.

63 Ibid, para 67. In its accompanying letter sent with the draft report of 2 March, the Committee noted that 'under the Convention the final decisions and the setting in motion of remedies or measures of execution were within the province of the Council, not the Committee'. Letter of O.C. Gundersen, A. França e Silva and H.P. Keller to Kare Willoch, 2 March 1966, HAEU EFTA-851.

64 Letter from O.C. Gundersen to Sir John Coulson of [no date] March 1966, HAEU EFTA-852. Mr Gundersen also recommended that 'the chairman is allocated a room on the premises with a private secretary at his disposal' and that 'the Chairman might be asked to bring his own secretary with him'. Furthermore, 'the other members should either have one room each or a common room to work in with proper desks and cupboards. A typist should also be at their disposal when required'. Moreover, since Mr Gundersen's Portuguese colleague 'understood and, especially, spoke, very little English', '[s]imultaneous translations during future meetings of a Committee might have to be envisaged, if the language problem is not taken care of when choosing the members of the Committee'.

65 *Internal Memorandum*, 12 April 1966, HAEU EFTA-852.

66 Ibid.

67 Ibid.

68 EFTA/C.SR 17/66, 22 April 1966, HAEU EFTA-852, para 19.

69 Ibid, para 20.

70 Ibid.

71 Ibid, para 23.

72 Ibid.

exporters of cattle to Germany were due to a considerable number of factors and not only by the exports from the United Kingdom, 'he found it hard to see how any useful purpose could be served by bilateral discussions'.[73]

On 6 May 1966, the Council adopted a decision under paragraph 3 of Article 31, with the Danish delegate abstaining.[74] According to the decision, it had not been established that a Convention obligation had been breached. Consequently, there was no need for a formal recommendation, although the members of the Council not party to the dispute considered that given the potential damage to Danish interests, the two governments should 'pursue the matter with a view to finding a solution acceptable to both of them'.[75]

Later that month, the head of EFTA's General and Legal Department complained of the outcome chosen by the Council: 'we had certainly hoped that they would feel their responsibility to act under Article 31, but they never left their normal attitude of acting as negotiators and trade policy experts'.[76] The letter concluded: '[p]erhaps it would be too much to ask them to act as judges of a legal problem, but I think that they had been put in a very good position by the report to do so, and this is of course what Article 31 implies'.[77]

The Strengths and Weaknesses of Article 31

In spite of the hopes of some observers, *United Kingdom – Cattle* would be the last case in which Article 31 was used.[78] A high-profile dispute between Norway and the United Kingdom concerning the construction of aluminium smelters by the latter was dealt with by the Council through the ordinary means of Article 32. On the request of Norway, the Council established an ad hoc working party under Article 32 paragraph 3 of the Convention.[79] The absence of a reference to Article 31 suggests that already in the late 1960s, the complaints procedure had become obsolete.[80] In July 1964, the Secretary-General observed that 'differences of opinion between governments about what the Convention meant seemed not to be aired'.[81] He nonetheless expressed his hope that 'governments would not be afraid of using the complaints procedure provided

73 Ibid, para 24.

74 The Danish delegate explained that 'the only way that might offer possibilities for a rapid solution was bilateral talks with the United Kingdom Government, and since the United Kingdom position was that a condition for the resumption of bilateral talks was that the Council had expressed its views, the Danish Government could not oppose the decision taken'. EFTA/C.SR 19/66, HAEU EFTA-852, para 11.

75 *Danish Complaint on United Kingdom Cattle Exports*, EFTA press release of 6 May 1966, HAEU EFTA-852.

76 Letter of Mrs. B. Selldén-Beer to O.C. Gundersen of 26 May 1966, HAEU EFTA-852.

77 Ibid.

78 PJG Kapteyn *et al* (eds), *International Organization and Integration. Annotated Basic Documents and Descriptive Directory of International Organizations and Arrangements* (1983) II.B.6.a, 17-18.

79 *Ad Hoc Working Party on United Kingdom Aluminium Smelters*, Report to the Council, EFTA 17/68, 12 March 1968, HAEU EFTA-915. See Victoria Curzon, *The Essentials of Economic Integration: Lessons of EFTA Experience* (Palgrave Macmillan 1974) 53-55.

80 Another controversy involving the United Kingdom, concerning the introduction of a 15% surcharge on imports from any source in October 1964, did not lead to an Article 31 procedure either. A. Szokoloczy-Syllaba, 'EFTA. The Settlement of Disputes' (1971) 20 International and Comparative Law Quarterly 519, 524-525. In her internal memorandum about 'conflicts in EFTA', Szokoloczy noted: 'I have not dealt with the two major conflicts we have had – the United Kingdom decision to negotiate bilaterally with the Common Market and the surcharge – as these were not handled "legally" but "politically"'. *Conflicts in EFTA*, Internal Memorandum of 9 August 1965, by Mrs. Szokoloczy, HAEU EFTA-854. In a dispute between Denmark and Finland concerning the tariff classification of foam plastic materials, a compromise was reached on the basis of a proposed solution by the Secretariat, before Article 31 was invoked. *Finnish Basic Duty on Foam Plastics*, T.36.3, 26 May 1964, HAEU EFTA-927. The archival file contains several indications that a reference to Article 31 should be avoided. On the front page of an internal memorandum of 17 February 1964, handwritten apostrophes were added to the word 'complaint'. In a note from the Secretariat of the same date the word 'complaint' was crossed out and replaced by 'representation'. *Finnish Basic Duty on Foam Plastics*, T.36.3, 26 May 1964, HAEU EFTA-927: 'Disputes of this sort, as to the proper EFTA duty on a particular product, are normally dealt with bilaterally by the authorities concerned and it is only exceptionally, if agreement cannot be reached bilaterally that recourse is had to the complaints procedure of Article 31. In the present case agreement could not be reached bilaterally but before bringing the matter to the Council under Article 31 the parties concerned agreed to seek the opinion of the Secretariat on the matter under dispute. As a result a compromise solution was reached that was acceptable to both parties.'

81 EFTA/C.SR 23/64, Edinburgh, 9 July 1964, HAEU EFTA-854, para 15.

in the Convention: it had proved generally quite expeditious and had given a sense of justice to those who had used it'.[82]

Formally, the Article 31 procedure differed from an ordinary discussion in the Council in several ways. The activation of a 'complaints procedure' must have had stronger rhetorical effects than the tabling of a concern in an ordinary Council setting.[83] Moreover, Article 31 provided for the possibility of majority voting during several stages of the procedure, empowering the Council to issue binding interpretations of the Convention when two or more Member States disagreed.[84] Nonetheless, in practice, proceedings under Article 31 evolved quite similarly to 'ordinary' disputes within the Council. In none of the four cases did the Council resort to majority voting. In the first three cases, it did not even establish a formal Examining Committee, but only a working group or committee that operated similarly to the ones established under Article 32.[85] This suggests that the Council tried to keep disputes within the diplomatic sphere, even when Article 31 was invoked.[86]

The committees themselves also favoured relatively non-judicial approaches. For instance, the committee established in *United Kingdom – Fish Fillets* acknowledged that a determination as to whether the Convention was breached was 'part of the matter in dispute', precisely because the proceedings were based on Article 31 and not Article 32.[87] Accordingly, the committee considered it 'essential to define the meaning of "fillets" as used in the Convention', and 'desirable to discover' what the relevant trading communities understood by the relevant terms in 1960 and how EFTA States treated 'grillets' and 'portions' during the first years of EFTA.[88] Nonetheless, 'the Committee was of the opinion that amassing this evidence ... would take a considerable time and greatly delay the presentation of a report to the Council'.[89] Instead, the committee proposed several 'directions in which a solution might be found', some of which were actually conflicting.[90] Ultimately, the committee cautiously advanced a more assertive view, according to which the United Kingdom should confirm to its own initial practice and to that of other EFTA States,[91] but the report did not respond to the question of whether the United Kingdom was in breach.

The first and last formal Examining Committee, established in the case of *United Kingdom – Cattle*, was convinced of its duty to establish whether a breach of the Convention had occurred.[92] In its report, it dismissed the Danish case based on Article 24, but its findings on Article 22 were less categorical: 'the problems for Danish cattle exports to the German Federal Republic are real and growing problems and the matter

82 Ibid. cf Haruko Fukuda, 'First Decade of EFTA's Realization' in Corbet H and Robertson D (eds), *Europe's Free Trade Area Agreement. E.F.T.A. and Economic Integration* (Pergamon 1970) 43, 58: 'the few complaints EFTA has received have been solved during consultations in the ad hoc examining committees', demonstrating a 'successful operation of the complaints procedure'.

83 cf Marc Busch and Eric Reinhardt, 'Testing International Trade Law: Empirical Studies of GATT/WTO Dispute Settlement' in Daniel Kennedy and James Southwick (eds), *The Politics of International Trade Law: Essays in Honor of Robert E. Hudec* (CUP 2002) 468-469, discussing and validating the hypothesis that consultations held on the basis of Article XXIII:1 GATT are more likely to evolve into panel proceedings than consultations held on the basis of Article XXII because of the more explicit language in the former provision, referring to 'nullification and impairment'.

84 *Institutional Arrangements*, by Frank Figgures, 13 October 1965, HAEU EFTA-854. According to Figgures, the serious consequences of this procedure justified the condition that it could only be activated on the request of a Member State.

85 Cf A. Szokoloczy-Syllaba, 'EFTA. The Settlement of Disputes' (1971) 20 International and Comparative Law Quarterly 519, 522: 'though the Committees of Enquiry were quite comparable with the Examining Committee, the refusal to baptize them officially "Examining Commitees" is symptomatic of the desire to treat even formal complaints informally.

86 Cf A. Szokoloczy-Syllaba, 'EFTA. The Settlement of Disputes' (1971) 20 International and Comparative Law Quarterly 519, 522: 'all four cases reveal strikingly the reluctance of the Council to use Article 31 for more than consultation, and to implement its procedures as specified in the Article'.

87 *Report of the Committee of Enquiry on Frozen Fish Products*, 8 March 1966, HAEU EFTA-926, para 15.

88 Ibid, para 17, 22.

89 Ibid, para 23.

90 Ibid, para 24-25. For instance, point (a) proposed that '[t]he United Kingdom Customs Criterion for defining fillets is too strict', whereas point (f) proposed that '[t]he United Kingdom definition of fillets is accepted for want of contrary evidence'.

91 Ibid, para 27-28.

92 *Export of Cattle from the United Kingdom to the Federal Republic of Germany*, Report by the Examining Committee to the Council of the European Free Trade Association, 2 March 1966, para 8.

ought certainly to be taken up again by the parties with a view to finding a solution acceptable to both of them'.[93] Still, the Committee considered that it had not been able to establish a breach.[94] In this way, the Committee expressed a more straightforward opinion than previous working groups and committees had done.

In an internal memorandum of 1965, Adrienne Szokoloczy noted a strong preference for political compromises in EFTA: the association 'is so bent on finding a satisfactory solution to Member States' problems … that it has even gone so far as to agree to a temporary illegal solution when the provisions of the Convention were insufficient to provide a legal solution'.[95] She also noted that in the first two Article 31 cases, 'it was not found possible or rather desirable to clarify the legal issue', as 'a considerable amount of time would have been needed to discover what the correct legal interpretation was'.[96] Instead, 'a compromise was sought where both sides had to give up something'.[97] These solutions were not so much illegal, but rather 'alegal; outside the law'.[98] This corresponded to the nature of the Council, which was a political and not a judicial body, and also to that of the Secretariat, which was 'mainly composed of seconded Government officials', 'more likely to be diplomats than lawyers'.[99]

In her internal memorandum, Szokoloczy wondered why 'Article 31 has been used so little'.[100] She suspected that 'Member States find it unnecessary to complain against one another', which would go 'against traditional intergovernmental usage'.[101] Instead, states preferred to raise cases informally and multilaterally, avoiding 'a legalistic approach'.[102] Secretary-General Figgures shared this impression, noting 'a feeling in Member States that it is in some ways offensive to bring a matter before the Council under this Article'.[103] Figgures also considered that some might consider the application of Article 31 as having 'a bad effect on the image of EFTA', since it would bring public attention to the dispute.[104] This was not necessarily bad, however, as it could also 'create the impression that EFTA really means business and does not shy away from tackling difficult problems'.[105] Figgures suggested that paragraphs 1-3 should be named the 'consultation procedure', while the term 'complaints procedure' should be reserved for paragraph 4.[106]

93 *Complaint by Denmark against the United Kingdom with regard to United Kingdom Cattle Exports to the German Federal Republic. Report by the Examining Committee to the Council*, 25 March 1966, HAEU EFTA-852, para 65.

94 Ibid, para 67.

95 *Conflicts in EFTA*, Internal Memorandum of 9 August 1965, by Mrs. Szokoloczy, HAEU EFTA-854, para 3.

96 Ibid, para 5.

97 Ibid. cf A. Szokoloczy-Syllaba, 'EFTA. The Settlement of Disputes' (1971) 20 International and Comparative Law Quarterly 519, 528: the Council 'awarded more importance to the search for a compromise which would avoid embarrassment to member States … than to the establishment of legal truth in the matter'. See also 530, noting a 'preference to the maintenance of amicable relations over the rigid adherence to legality'.

98 *Conflicts in EFTA*, Internal Memorandum of 9 August 1965, by Mrs. Szokoloczy, HAEU EFTA-854, para 3.

99 Ibid, para 7. In her 1971 article, Szokoloczy further noted that non-disputing Member States had little interest in a proper legal analysis, as this might impact their own policies in the future. She also emphasised that the formal equality of EFTA members could not negate factual inequalities that made it unlikely that some Member States, in particular the United Kingdom, would be explicitly penalised. She concluded: 'EFTA implicitly recognises the sovereignty of Member States and … in the interest of survival she must accommodate all standpoints and seek solutions which can be unanimously accepted even at the expense of a strict interpretation of the Convention' A. Szokoloczy-Syllaba, 'EFTA. The Settlement of Disputes' (1971) 20 International and Comparative Law Quarterly 519, 532-533.

100 *Conflicts in EFTA*, Internal Memorandum of 9 August 1965, by Mrs. Szokoloczy, HAEU EFTA-854, para 6.

101 Ibid.

102 Ibid.

103 *Institutional Arrangements*, by Frank Figgures, 13 October 1965, HAEU EFTA-854. Figgures considered this feeling wrong, since it facilitated bilateral interpretations of the Convention instead of majority interpretations in the common interest under the authority of the Council.

104 cf A. Szokoloczy-Syllaba, 'EFTA. The Settlement of Disputes' (1971) 20 International and Comparative Law Quarterly 519, 523: 'a formal complaint has the political disadvantage of publicizing a controversy, which may, in turn, lead to an undesirable hardening of positions'.

105 *Institutional Arrangements*, Note by the Secretary-General, 29 April 1966, HAEU EFTA-854, para 22.

106 Ibid, para 24.

In order to allow a gradual judicialization of disputes, Article 31 contained several elements that enabled a more judicial treatment than ordinary Council discussions: investigation by an independent body and the possibility of retaliation. Such judicialization could potentially facilitate finality and provide clarity with regard to the interpretation and application of the Convention.[107] In practice, however, the Association attached more weight to the benefits of diplomatic settlement. Working groups and committees considered that legal assessments were time-consuming and backward-looking, whereas actual disputes required quick and forward-looking solutions. Moreover, the Council seemed not particularly interested in judicial finality and the construction of precedent. On the contrary, leaving legal questions more or less unsettled would preserve the members' freedom of action and leave them room to respond to changing circumstances in pragmatic ways. It would also avoid an overt condemnation of a Member State for breaching the Convention. Accordingly, the Council's responses to invocations of Article 31 sought to keep the dispute within the diplomatic sphere and to avoid the use of the more judicial tools provided by the complaints procedure. Whatever the perceived or actual merits of this approach, it explains why Member States lost interest in Article 31. Initially, there was a willingness to bring cases, even against the United Kingdom. Yet the Council's handling of the first four cases demonstrated that it was unlikely to treat disputes brought under Article 31 much differently from ordinary ones.

Political and judicial mechanisms of dispute settlement each have certain advantages and disadvantages.[108] Article 31 sought to combine them by introducing judicial elements in a procedure ultimately under the control of a political institution. EFTA's experience with the mechanism suggests that it might be preferable to have a fully independent judicial mechanism available to Member States that opt for a legal confrontation.[109] This enables Member States to resolve disputes in a purely judicial manner if so desired, obtaining a legal answer relatively unaffected by political considerations. Whether to make use of such a procedure would remain a discretionary choice by the States themselves, who might still prefer diplomatic means of dispute settlement, for reasons of comity, expedience or opportunism.[110] Yet once the choice for a legal complaint has been made, States should have the possibility to obtain a final, binding ruling.

107 Although the findings of an Examining Committee would not be binding upon the Council, which possibly also explains some hesitance to use the procedure. cf Victoria Curzon, *The Essentials of Economic Integration: Lessons of EFTA Experience* (Palgrave Macmillan 1974) 52: 'however disagreeable it may have been for countries to have to settle their differences bilaterally, they would have found it infinitely worse to have to submit to arbitration by majority rule'.

108 Karen Alter, Emilie Hafner-Burton and Laurence Helfer, 'Theorizing the Judicialization of International Relations' (2019) 63 International Studies Quarterly 449, 450, noting that '[w]hile judicialization can, under certain conditions, reduce state control over political processes and outcomes, this result may or may not be normatively desirable'. cf Moonhawk Kim, 'Costly Procedures: Divergent Effects of Legalization in the GATT/WTO Dispute Settlement Procedures' (2008) 52 International Studies Quarterly 657, noting the increased costs of legalised procedures that cause a benefit for bigger players. See also William Davey, 'The Limits of Judicial Processes' in Daniel Bethlehem et al (eds), *The Oxford Handbook of International Trade Law* (OUP 2009) 465, noting that in the WTO, 'the consultation requirement in the DSU is a fine example of melding non-judicial and judicial processes in a way that resolves many disputes'.

109 The dispute settlement procedure of the GATT was controlled by the GATT Council and, unlike the EFTA complaints procedure, even entirely voluntary. Nevertheless, the GATT dispute settlement system developed 'into a quite powerful legal instrument'. This success has been attributed to the GATT member's common political will to support a system of 'neutral and objective adjudication'. Robert Hudec, 'The New WTO Dispute Settlement Procedure: An Overview of the First Three Years' (1999) 8 *Minnesota Journal of International Law* 1, 8-10. See also Joost Pauwelyn, 'The Transformation of World Trade' (2005) 104 Michigan Law Review 1, 47, noting 'the gradual independence of the [GATT] dispute resolution mechanism'. In the WTO, the Member's veto power was removed and the establishment of panels and the adoption of their reports became virtually automatic. Moreover, the panel and AB procedure have a distinctly judicial character. Bernhard Zangl, 'Judicialization Matters! A Comparison of Dispute Settlement Under GATT and the WTO' (2008) 52 International Studies Quarterly 825, 830-831.

110 Lucy Reed, 'Observations on the Relationship between Diplomatic and Judicial Means of Dispute Settlement' in Laurence Boisson de Chazournes, Marcelo Kohen and Jorge Viñuales (eds), *Diplomatic and Judicial Means of Dispute Settlement* (Brill 2013) 293: '[i]t could be well within the first State's larger interests – political, economic and diplomatic interests extending beyond a particular legal dispute – not to institute formal proceedings'.

Conclusions

The design of dispute settlement mechanisms in international economic regimes is a delicate matter, as contracting States seek to strike a balance between the aims of strengthening treaty compliance and preserving policy discretion. The outcome of this balancing exercise depends on a range of contextual factors, such as the degree of equality among the contracting States and the intensity of the prospective integration.[111] Article 31 of the EFTA Convention contained a complaints mechanism that sought to provide a middle ground between diplomatic dispute settlement and a judicial procedure. This compromise seemed to fit well with EFTA's structure and objectives, aimed at intergovernmental cooperation on the basis of unanimity. Nevertheless, EFTA's experience with Article 31 suggests that although both diplomatic and judicial mechanisms have their advantages, a conflation of both is unhelpful. If a judicialized procedure is ultimately controlled by a political institution, the added value of the mechanism in comparison to ordinary diplomatic means is doubtful.[112]

When the EFTA Convention was revised in Vaduz in 2001, the complaints procedure was replaced by a new chapter on 'Consultations and dispute settlement'. Article 47 of the Vaduz Convention provides for the possibility to raise complaints within the Council, not unlike the previous Article 31, although without a reference to majority voting. By contrast, the new Article 48 of the Vaduz Convention establishes a right to initiate arbitration proceedings against another Member State, resulting in a final and binding award. To date, this procedure has not been used; nor has the EFTA Court, which has jurisdiction over three of the four current EFTA Member States, been seized in inter-state disputes. This suggests that EFTA Member States are still not inclined to litigate against one another and prefer to solve disputes through diplomatic means.[113] Possibly, the early experience with the complaints mechanisms of Article 31 convinced Member States that political dispute settlement works equally well as quasi-judicial proceedings. If that were the case, then Article 31 left a lasting legacy, committing EFTA Member States to the diplomatic rather than the judicial settlement of disputes.

111 James McCall Smith, 'The Politics of Dispute Settlement Design: Explaining Legalism in Regional Trade Pacts' (2000) 54 *International Organization* 137. See for a comparison across different fields of international law, Aletta Mondré et al, 'Uneven Judicialization: Comparing International Dispute Settlement in Security, Trade, and the Environment' (2010) 4 New Global Studies 1.

112 cf Robert Keohane, Andrew Moravcsik and Anne-Marie Slaughter, 'Legalized Dispute Resolution: Interstate and Transnational' (2000) 54 International Organization 457, comparing 'interstate' and 'transnational' systems of 'legalized dispute resolution', concluding that when dispute resolution is insulated from the immediate political demands of states, they are more likely to constrain state conduct.

113 Inter-State cases are not common in the European Union either. See Graham Butler, 'The Court of Justice as an Inter-State Court' (2017) 36 *Yearbook of European Law* 179. Both the EU and the EEA, however, have active institutions empowered to bring infringements proceedings against Member States. See also Geraldo Vidigal, 'Why Is There So Little Litigation under Free Trade Agreements? Retaliation and Adjudication in International Dispute Settlement' (2017) 20 JIEL 927, arguing that the role of community pressure explains why WTO adjudication is vibrant whereas FTA adjudication is not.

Annex – Convention Establishing the European Free Trade Association (Stockholm Convention)

Article 31 – General consultations and complaints procedure

1. If any Member State considers that any benefit conferred upon it by this Convention or any objective of the Association is being or may be frustrated and if no satisfactory settlement is reached between the Member States concerned, any of those Member States may refer the matter to the Council.

2. The Council shall promptly, by majority vote, make arrangements for examining the matter. Such arrangements may include a reference to an examining committee constituted in accordance with Article 33. Before taking action under paragraph 3 of this Article, the Council shall so refer the matter at the request of any Member State concerned. Member States shall furnish all information which they can make available and shall lend their assistance to establish the facts.

3. When considering the matter, the Council shall have regard to whether it has been established that an obligation under the Convention has not been fulfilled, and whether and to what extent any benefit conferred by the Convention or any objective of the Association is being or may be frustrated. In the light of this consideration and of the report of any examining committee which may have been appointed, the Council may, by majority vote, make to any Member State such recommendations as it considers appropriate.

4. If a Member State does not or is unable to comply with a recommendation made in accordance with paragraph 3 of this Article and the Council finds, by majority vote, that an obligation under this Convention has not been fulfilled, the Council may, by majority decision, authorise any Member State to suspend to the Member State which has not complied with the recommendation the application of such obligations under this Convention as the Council considers appropriate.

5. Any Member State may, at any time while the matter is under consideration, request the Council to authorise, as a matter of urgency, interim measures to safeguard its position. If it appears to the Council that the circumstances are sufficiently serious to justify interim action, and without prejudice to any action which it may subsequently take in accordance with the preceding paragraphs of this Article, the Council may, by majority decision, authorise a Member State to suspend its obligation under this Convention to such an extent and for such a period as the Council considers appropriate.

Article 33 – Examining Committees

The Examining Committees referred to in Article 31 shall consist of persons selected for their competence and integrity, who, in the performance of their duties, shall neither seek nor receive instructions from any State, or from any authority or organisation other than the Association. They shall be appointed by the Council on such terms and conditions as it shall decide.

Subsidies and State aid in the Context of Free Trade – Roles and Obligations of EFTA and its Member States in WTO and European Subsidy Regimes

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Abstract: Since its founding, EFTA has proved to be a solid platform pursuing free trade between its Member States and third countries. Pursuing the aim of establishing the best possible trade relations, one of EFTA's main tasks is to conclude free trade agreements, which has also increased the number of rules on State Aid. Concluding these agreements, it is not only necessary to take WTO law into account, but also considering the embedding of the various EFTA states into the European integration process. The aim of this article is to identify the influence of EU/EEA State Aid and WTO subsidy law on EFTA, its Member States and their relations with third countries. In comparing European and WTO subsidy regimes, conclusions for EFTA's future contract negotiations shall be drawn.

Introduction

The European Free Trade Association[1] has celebrated great success liberalising international trade in the last 60 years of its existence. In doing so, EFTA not only deepened economic ties between its Member States, but fostered economic integration in general. Based on its original purpose to remove customs duties on industrial products amongst its Member States – EFTA continuously evolved its economic policy towards acting as a platform for negotiations of Free Trade Agreements[2]. The focus has shifted towards the conclusion of (formal) bilateral relations since the early 1990s, now granting EFTA States access to "one of the world's largest networks of preferential trade relations."[3]

However, removal of tariffs and non-tariff trade bans is only one side of the coin: Increasing global liberalisation not only fosters economic prosperity but can also raise pressure on a country's economic system. Protecting their national economies, States tend to circumvent trade-restrictive bans by means of other economic *stimuli* such as subsidies[4] to domestic enterprises. In order to break this cycle, EFTA rules, the WTO system and the European Internal Market regime contain accompanying provisions on subsidy control.

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1 Hereinafter referred to as "EFTA" or "the EFTA".

2 Hereinafter referred to as "FTAs".

3 EFTA, 'Global trade relations' <https://www.efta.int/free-trade> accessed 3 September 2020.

4 When using the term "subsidies", reference is made to State granting in general, *e.g.* including both "State aid" as defined in Art 107 TFEU or Art 61 EEA Agreement as well as "subsidy" in WTO context. When explicitly referring to subsidies in the WTO legal order, this will be clarified.

These subsidy control systems affect their international trade and economic policies, as EFTA States are not only members of the WTO but are also connected to the European legal order[5] in different ways. However, little to no attention is paid to European subsidy policies outside the Union in contrast to some EU State aid procedures.[6]

The purpose of this paper is therefore to identify the roles and obligations of member states within the respective State aid regimes[7] as well as to show their main characteristics. Even though the interface between the European and WTO subsidy control systems shall not be underestimated, both systems show relevant differences, too. After a general introduction on the importance of subsidy control (II.), a comparison between European and WTO law (III.) will function as a basis for further reflections on EFTA's role in the regulation of subsidies (IV). As will be argued in the last section of this paper, EFTA must bear in mind the differences between European regulation and WTO law when concluding further FTAs or renegotiating existing ones. With a comprehensive understanding of the frictions the different systems cause, but also the possibilities that result from this, the next 60 years in forming global free trade will again be a story of success.

Preliminary Considerations: Why Subsidy Control?

Subsidy control systems clearly did not evolve out of a vacuum or "regulatory boredom". As the liberalisation of international trade gained momentum after the Second-World War, States decided on the removal of restrictions and distortions on global trade. The primary focus has been on the removal of tariffs and non-tariff trade bans to enhance economic prosperity through promotion of free trade.[8] Yet, this development towards more open trade borders also increased pressure on domestic economic systems. The possibility of waiving the protection of one's own economic system through tariffs, local production can run into the danger of being non-competitive on a global scale. In order to protect their domestic economies, States could use subsidies to help their national companies.

Advantages of liberalisation can, however, be offset by subsidies. Same as tariffs and non-tariff trade bans, subsidies can pose an obstacle to free trade and global competition and also undo the benefits of liberalisation.[9] This risk then forms the conceptual starting point of subsidy controls. Furthermore, granting subsidies by one State can lead to a negative "subsidy race". Subsidies granted by a State may trigger another State to grant public monies, which it would otherwise not have spent. This is not only to the detriment of national budgets but also disadvantages less prosperous States that cannot keep up with their wealthier counterparts.[10]

5 When speaking of "European legal order" or "European legal system" all rules regarding the Internal Market are included. In the context of this article, when referring to the "European system", notably not only European law in the narrower sense, *e.g.* the European Treaties and Secondary Legislation are analysed, but also EEA law, notable the EEA Agreement and incorporated legislature.

6 As for example the judgement of the European General Court T-365/15 *Austria v European Commission* (2018) ECLI:EU:T:2018:439 concerning aid planned by the United Kingdom in favour of Hinkley Point C nuclear power station which is, inter alia, appealed by Austria and pending before the European Court of Justice (ECJ) C-594/18 P.

7 Both the EU's subsidy system and the WTO Agreements include specific rules applicable to agricultural subsidies. Nonetheless these rules are left aside. As the EFTA system explicitly excludes the field of agriculture, my study is limited on the general rules affecting industrial goods and/or services.

8 Free trade, to put it simply, aims at the removal of trade barriers and hence not only leads to an increase of international trade but also prosperity: As the "Ricardian model of "comparative advantage" suggests, the best way to an efficient allocation of resources can be reached, when and if each (national) economy focuses on the production of goods, which it can produce at a less expense than other countries. In this regard, free trade is not only necessary to supply goods to production locations, but also to cover other demands for goods by producers as well as consumers. Due to enhancing specialisation of economies, the importation of goods to cover needs becomes more important, even indispensable. The call for reduction of trade barriers is only a logical consequence. Gustavo E. Luengo Hernández de Madrid, *Regulation of Subsidies and State aids in WTO and EC Law: Conflicts in International Trade Law* (Kluwer Law International 2007), 15ff; Fabian Böhm, *Strukturen Internationalen Subventionsrechts: EG Beihilferecht und WTO Subventionsrecht aus rechtsvergleichender Perspektive* (Peter Lang. Internationaler Verlag der Wissenschaften 2007), 24; for remarks on the extended approach of the classical free trade theory Feds based on Ricardo's considerations *Cf.* Christian Tietje,'Grundlagen und Perspektiven der WTO-Rechtsordnung' in Prieß/Berrisch, *WTO-Handbuch: World Trade Organisation* (C.H. Beck 2003), 20ff.

9 Böhm, (n 8), 24.

10 OECD, 'Policy Roundtables: Competition, State aid and Subsidies 2010' DAF/COMP/GF(2010) <http://www.oecd.org/daf/competition/sectors/48070736.pdf> accessed 3 September 2020, 105.

As important as the regulation of subsidies on an international level may be, it is a complex and delicate issue. Conceptually, subsidies have been closely linked to State sovereignty.[11] In granting subsidies States can strongly influence their economy and thus they achieve certain policy goals. Consequently, subsidy control can directly undermine a government's political autonomy by regulating national policies.[12]

Additionally – outside of textbook examples – the real market suffers from deficiencies,[13] which not only justify subsidies but require States to act in some way "in the name of a free market". Government measures are then used to "fix" market failures. Thus, subsidies may not be negative *per se* but depend on their effect on the market.[14] Attempts to direct these State investments into the right channels can be found in the provisions in the Treaty on the Functioning of the European Union[15] and to a lower extent also in WTO law. Despite the big efforts to liberalise trade, these provisions are a clear sign that supranational and international legislature recognises the bigger picture of free trade endeavours requiring subsidies. The functioning and assessment of subsidies is complex and exceeds pure economic considerations. Subsidy control systems must accommodate these contradictions as well as be sensitive when limiting State sovereignty.

The EFTA States in the Context of the different Subsidy Regimes

In order to be able to discuss the implications of the different subsidy control models for EFTA, it is necessary to identify the roles and obligations of EFTA and its Member States in the different legal contexts in which subsidy regimes are established and implemented.

First, all four EFTA States are members of the WTO.[16] At the heart of WTO's legal framework are the rules on non-discrimination, the so-called most-favoured-nation-principle and "national treatment". Pursuant to the "national-treatment-principle", imported and domestic produced products and foreign and domestic services must be treated equally. The most-favoured-nation-principle basically stipulates the prohibition of discrimination between trading partners; special treatment (*e.g.* lower customs duty rate) granted to one WTO member must be granted to all WTO members.[17] Yet, there are exceptions to that principle, one being the exemptions for free trade areas: According to Art XXIV GATT[18] and Art V GATS,[19] Member States may grant the participating State(s) more favourable conditions than other WTO members by entering into a free trade agreement. EFTA itself forms such a free trade area and FTAs concluded by EFTA also qualify as such.[20]

11 Herwig C. H. Hofmann, 'State aid Review in a Multi-level System. Motivations for Aid, Why Control It, and the Evolution of State aid Law in the EU' in Hofmann/Michaeu (eds), *State aid Law of the European Union* (Oxford University Press 2016), 5f; Annette Kliemann, 'Art. 107 AEUV' in Schröter and others (eds), *Europäisches Wettbewerbsrecht* (2nd edn, Nomos 2014) 2033, para 4.

12 Kliemann (n 11), 2033 para 4; Luca Rubini, *The Definition of Subsidy and State aid: WTO and EC Law in Comparative Perspective* (Oxford University Press 2009), 99ff.

13 Restriction to the free market may be some operators enjoying significant market power (which in extreme cases can even be a monopoly), not all undertakings having the same degree on information which is important for efficient allocation of goods, or inter alia external effects can lead to a misrepresentation of the true costs of a product. For a detailed analysis see Peter Behrens, 'Einleitung' in Birnstiel/Bungenberg/Heinrich (eds), *Europäisches Beihilfenrecht* (Nomos 2013), 89ff.

14 Luengo Hernández de Madrid (n 8), 20.

15 Consolidated Version of the Treaty on the Functioning of the European Union (2012) OJ C 326/47, hereinafter referred to as "TFEU".

16 Whereas Iceland, Norway and Switzerland joined the WTO directly on its date of establishment, 1 January 1995, Liechtenstein followed their step in the same year, on 1 September 1995. <https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm > accessed 3 September 2020.

17 Art 1 GATT 1994, Art 2 GATS, Art 4 TRIPS; for a comprehensive analysis of GATT's main legal principles see Georg M. Berrisch, 'Die Regelungsstruktur des GATT', in Prieß/Berrisch, *WTO-Handbuch: World Trade Organisation* (C.H. Beck 2003), 79ff.

18 Uruguay Round of Multilateral Trade Negotiations (1986-1994) – Annex 1 – Annex 1A – General Agreement on Tariffs and Trade 1994 – Protocol of Marrakesh (1994) OJ L 336/20.

19 Uruguay Round of Multilateral Trade Negotiations (1986-1994) – Annex 1 – Annex 1B – General Agreement on Trade in Services (1994) OJ L 336/191.

20 Georges Baur, *The European Free Trade Association. An Intergovernmental Platform for Trade Relations* (Intersentia 2020), 6f.

Second, apart from the fact that the EU is EFTA's most important trading partner[21], all EFTA States are linked to the EU, its Single Market and competition rules in some way or another.

To start with, most EFTA States soon fostered not only a closer economic cooperation with the (then) European Economic Community, but also economic and even political integration – even if the founding aims of EFTA are somewhat opposed. As the integration of the European Internal Market deepened, access to the European Communities became increasingly attractive. This change of opinion led to the "*Delors* Initiative" with the "Agreement on the European Economic Area"[22]. This agreement links the (remaining) three EFTA members Iceland, Liechtenstein and Norway and the EU into an Internal Market.[23] In providing an alternative rather than a preparation for EU membership, the EEA aligns the three EFTA/EEA-States very closely to the EU *acquis*.[24] Thus, the EU's competition rules, of which State aid rules are an integral part, have found entry in the EEA Agreement. Art 61 – 64 of the Agreement basically copy EU provisions on State aid and thus place three EFTA States under European State aid control.[25]

In contrast, Switzerland, although a signatory State, is not part of the EEA as its voters refused to ratify the EEA Agreement in 1992. Instead, Switzerland and the EU have concluded a vast number of bilateral agreements.[26] One of these Bilaterals is the FTA concluded in 1972, which also contains a prohibition on State aid, mainly copying the EU's provisions.[27] These provisions are not subject to a common juridical body; they are interpreted in pursuance of the principles of international law, which obviously can lead to different results.[28] Nevertheless, they apply the EU's State aid provisions and early jurisdiction to part of the Swiss-EU trade. The fact that the EU and Switzerland intend to renew the Bilaterals into a new "Institutional Framework Agreement", should not be ignored. At least as far as the EU is concerned, this new Agreement shall include more comprehensive State aid provisions. Probably this new set of bilateral rules would be very similar to the provisions in the TFEU and EEA Agreement and future Swiss – EU Free Trade Agreements then shall be interpreted in accordance with European State aid law.[29]

Definition of Subsidy in the different legal regimes

Before gaining a deeper understanding of State aid and subsidy under the legal systems in question, a preliminary remark must be made. At first sight, the remark may appear proper, but is nevertheless of crucial importance when comparing such different systems. Legal definitions depend strongly on the context as legal, political and economic deliberations frame the definition of subsidy in each specific

21 Ivo Kaufmann, 'Going Global – Overview of EFTA's Free Trade Relations' (2013) EFTA Bulletin, 9, 15; for a detailed breakdown of EFTA's trade statistics visit <http://trade.efta.int/#/overview/EFTA/WORLD/2018/HS2 > accessed 3 February 2020.

22 OJ L 1/3; hereinafter referred to as "EEA Agreement" or "the Agreement".

23 Finn Arnesen and others, 'The EFTA States, the EEA and the different views on the legal integration of Europe' in Arnesen and other (eds), *Agreement on the European Economic Area: A commentary*, 3f.

24 Ignacio Garcia Bercero, 'Dispute Settlement in European Union Free Trade Agreements: Lessons Learned?' in Bartels/Ortino (eds), *Regional Trade Agreements and the WTO Legal System* (Oxford University Press 2006), 385.

25 For this reason, in the proceeding conduction, when referring to the "European system", State aid law according to Art 107ff TFEU as well as Art 61ff EEA Agreement shall be meant and bore in mind.

26 Since 1950 more than 100 of these bilateral agreements (hereinafter referred to as "Bilaterals") were concluded between the European Communities, respectively now the EU and Switzerland, concerning economic as well as other materials such as Bilaterals on insurances, research, air transports but also the Schengen or Dublin agreements, <https://www.dfae.admin.ch/dam/dea/en/documents/folien/Folien-Abkommen_en.pdf> accessed 3 September 2020). For an overall analysis on Swiss EU relations see Matthias Oesch, *Switzerland and the European Union: General Framework, Bilateral Agreements, Autonomous Adaptation* (Dike 2018).

27 However, different to Art 107 TFEU or Art 61 EEA Agreement, the FTA 1972 does not define permissible State aid; see Matthias Oesch/Nina Burghartz, 'Die fehlende Disziplinierung staatlicher Beihilfen in der Schweiz' (2018) [5] Die Volkswirtschaft, 26, 27.

28 Oesch/Burghartz (n 27), 27.

29 Christa Tobler, 'Beihilferecht: Rahmenabkommen und staatliche Beihilfen' *Recht im Spiegel der NZZ* [61], (Zürich, 14 March 2019) 10.

legal system. Thus they represent different legal concepts and notions. Despite the very different genesis of these two different legal regimes, comparison can enhance the understanding of each system, its strengths and weaknesses and ideally reveals the methods for improvement.

EFTA as well as its Member States are embedded in different legal structures in terms of subsidies which cannot be strictly isolated from one another. Sometimes, the different legal systems – namely WTO law, EU/EEA law but also the provisions of different FTAs – can be applied to the same problem. Thus, the comparison of the systems is a necessary step to better understand and improve occurring deficiencies. Nonetheless, for this comparison to be fruitful, it has to focus on general features of the systems; analysing differences at the micro level (*e.g.* specific schemes) would be too varied to provide useful insights.[30]

General Traits

As an integral part of the European competition policy, European State aid law's purpose is to preserve the effectiveness of competition and free trade within the Single Market. Basically, it shall hinder favouritism towards national companies. Furthermore, domestic location policy based on financial initiatives shall be prevented.[31] Thus, Art 107 (1) TFEU, respectively Art 61 (1) EEA Agreement, establish a prohibition of State aid which "distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods in so far as it affects trade between Member States". On a closer examination, what is expressed as a general prohibition must be seen as a prohibition with possibilities to authorise certain kinds of State aid. The prohibition in Art 107 TFEU or Art 61 EEA Agreement is therefore not absolute– Art 107 (2) and (3) as well as Art 106 (2) TFEU and alternatively Art 61 (2) and (3) as well as Art 59 (2) EEA Agreement stipulate provisions under which State aid is compatible with the Internal Market.[32]

Looking at the characteristics of subsidy regulation in the WTO and comparing it with the provisions laid down in the TFEU, two differences stand out. First and foremost, the WTO subsidy system is only applicable to subsidies related to the production of goods. Subsidies granted in the service sector are not covered. Art XVI GATT and especially the Agreement on Subsidies and Countervailing Measures[33] lay down relevant aspects concerning subsidies in relation to exports of products or reduction of import of products in the granting State's territory.[34] Furthermore, its approach is – by contrast to the fairly open definition in EU law – rather of "taxonomic" nature.[35] Art 1 SCMA introduces a definition of subsidy under WTO law for the first time.

Which criteria a measure must fulfil in order to be covered by the WTO subsidy provisions and/or the provision of Art 107 TFEU or Art 61 EEA Agreement (and the possible exemptions to the general provision) will be examined below.

30 Rubini (n 12), 7.

31 Marc Bungenberg/Stefan Schelhaas, 'Beihilfenrechtliche Regelungen in (Freihandels-)Abkommen der EU' in Haslinger/Jäger (eds), *Jahrbuch Beihilferecht* (NWV 2017), 594; Hofman (n 11), 9.

32 Ramona Ianus/Tim Maxian Rusche/Massimo Francesco Orzan, 'Rules for the Compatibility of State aid' in Hofman/Micheau (eds) *State aid Law and the European Union* (Oxford University Press (2016) passim; for the EEA *Cf.* Jordal/Mathisen, 'Article 61 [Prohibition of State aid, exemptions] in Arnesen and others (eds) *Agreement on the European Economic Area* (C.H. Beck Hart Nomos Universitetsforlaget 2018), 594ff; Bertold Bär-Bouyssière, 'Artikel 107 AEUV', in Schwarze and others (eds) *EU-Kommentar* (4th edn, Nomos 2019), 1506f; see also Kliemann (n 11), 2032.

33 Uruguay Round of Multilateral Trade Negotiations (1986- 1994) – Annex 1 – Annex 1A – Agreement on Subsidies and Countervailing Measures (1994) OJ L 336/156; hereinafter referred to as "SCMA".

34 The provision of Art XVI GATT has first been specified and extended by the Tokyo Round Subsidies Code, dating back to 1979, and has been developed further in the Uruguay Round. The result was the SCMA, which brought detailed regulatory innovations in the matter. Its key aspects are still in force today; see Michael Sanchez Rydelski, *EG und WTO Antisubventionsrecht: Ein konzeptioneller Vergleich der EG Antisubventions-Verordnung mit den Beihilfevorschriften des EG-Vertrages unter Berücksichtigung des Subventionsübereinkommens der WTO* (Nomos 2001), 278.

35 Rubini (n 12), 70.

State Origin

European Law

Underlying the logic of the EU's State aid regime, the prohibition established in Art 107 (1) TFEU, respectively Art 61 (1) EEA Agreement, are first and foremost addressed to the Member States. As a consequence Art 107 TFEU does not apply to financial benefits granted by the EU itself (so-called "Community, respectively Union subsidies"[36]).[37] Since its objective is to prevent Member States from favouring national companies in such a way that they become so large that they would pose a threat to internal competition, the first step in assessing whether a measure falls within the scope of Article 107 TFEU or Article 61 of the EEA Agreement is to examine whether the grant is imputable to a Member State.

According to ECJ Case law, the criterion of State origin is fulfilled, when two requirements are met: Firstly, the advantage must be granted directly or indirectly through State resources, and secondly, the financial contribution must be imputable to the State.[38]

State resources in the meaning of the first requirement shall be all financing of the public sector, whether regional or otherwise as well as public undertakings – and as the case may be also financing from private bodies.[39] The decisive factor is not the public or private origin of the resources but rather if the State can exercise control over the transferred money.[40] This is based on the prerequisite that at a certain point in time, the funds in question are available to the State or its authorities. The funds do not have to be integrated in the State budget; the legal possibility of transferring them to the State budget is considered sufficient to speak of a public control, albeit being only a hypothetical one.[41] In that sense, the granted advantage results in a negative effect on the State budget.[42] Although some scholars argue, that a burden on the State budget is necessary when assessing the state-funding of a measure (and thereby falsely conclude a broader scope of the definition under WTO law),[43] it rather is only a logical reflex to potential public control. Consequently, it is not an autonomous characteristic of State origin.

Secondly, measure must be imputable to the State. This is the case, when the State can decide the financing mechanism and the distribution of the funds to the actual beneficiaries.

To speak of "State origin" in European law, both the initiative for a measure as well as the financial resources must have their origin in the State sector. According to the European Commission and the ESA, the transfer of State resources may take many forms, such as direct grants, loans, guarantees, and direct investment.[44]

36 Despite, this term is nowhere to be found in the European Treaties, it is used by the ECJ *Cf.* ECJ, C-298/96 *Oelmühle Hamburg and Schmidt Söhne v Bundesanstalt für Landwirtschaft und Ernährung* (1998), ECLI:EU:C:1998:372, para 37f.

37 *E.g.* through the establishment of the European Agricultural Guidance and Guarantee Fund based on Art 40 TFEU, or in order to strengthen its economic, social and territorial cohesion in respect to Art 174 TFEU but also in other policy areas such research and development (*eg* the "Horizon 2020 programme, Regulation (EU) No 1291/2013 of the European Parliament and of the Council of 11 December 2013 establishing Horizon 2020 – the Framework Programme for Research and Innovation (2014-2020) and repealing Decision No 1982/2006/EC (2013) OJ L 347/104.

38 ECJ, C-482/99 *France v Commission* (2002) ECLI:EU:C:2002:294, para 24 and case-law cited.

39 Bär-Bouyssière (n 32), 1530f, para 12.

40 ECJ, C-379/98 *PreussenElektra* (2001) ECLI:EU:C:2001:160, para 58; Dominik Eisenhut, 'Article 107 TFEU', in Geiger/Khan/Kotzur (eds), *European Union Treaties. A Commentary* (C. H. Beck, Hart Publishing 2015), 528ff; Bär-Bouyssière (n 32), 1530f, para 12. Thus, the negative impact on State budget must not necessarily have occurred yet. To fulfill this criterion, it is sufficient that the State aid can lead to such losses; Maria Jesus Segura Catalán, 'Art. 107 AEUV: Die einzelnen Beihilfekriterien' in Schröter and others (eds), *Europäisches Wettbewerbsrecht* (2nd edn, Nomos 2014), 2043, para 27.

41 ECJ, C-258-08 *Ladbrokes Betting & Gaming und Ladbrokes International* (2010), ECLI:EU:C:2010:308, para 50.

42 Andreas Bartosch, '*EU-Beihilfenrecht*, Art. 107 AEUV' (C.H. Beck 2016) para 149.

43 Eg Wolfgang Weiß, 'Der Subventionsbegriff im EG- und WTO-Recht – ein Vergleich, in Ehlers/Wolffgang/Schröder (eds), *Subventionen im WTO- und EG-Recht* (Verlag Recht und Wirtschaft 2007), 37.

44 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016) OJ C 262/1, para 51; EFTA Surveillance Authority Decision No 3/17/COL of 18 January 2017 amending, for the one-hundred and second time, the procedural and substantive rules in the field of State aid by introducing new Guidelines on the notion of State aid as referred to in Article 61(1) of the Agreement on the European Economic Area (2017), OJ L 342/35, para 51.

WTO Law

Pursuant to Art 1 SCMA a subsidy is deemed to exist, if either a financial contribution is made by a government or a public body or any income or price support, which also confers a benefit. According to Art 1.1.(a) (1) SCMA "financial contribution" occurs where

i. a government practice involves a direct transfer of funds,[45] potential direct transfers of funds or liabilities;

ii. government revenue that is otherwise due is foregone or not collected;[46]

iii. a government provides goods or services other than general infrastructure, or purchases goods;

iv. a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments.

As stated in the report of the *US- Exports Restraints Panel*[47] this listing should be considered exhaustive. Nevertheless, the wordings in Art 1 SCMA are rather broad and therefore the scope of "financial contributions" is quite extensive.

The term "government" in this context is, same as in European law, not limited to central governments but includes "any public body within the territory of a Member" as laid down in Art 1.1. (a) (1) SCMA. Art 1.1.(a) (iv) SCMA supplements the notion of governmental funding to constellations, where the government "entrusts or directs a private body to carry out" the financial contribution. In this way, the circumvention by a government, acting simply through a private body, is to be curbed, so to say "doing indirectly what it cannot do directly" shall also be prohibited.[48] Pursuant to the findings of the Panel in the Case *US – Export Restraints* government delegation or instruction "refers to situations in which the government executes a particular policy by operation through a private body"[49] implementing a governmental delegation or command.[50]

Therefore, the crucial criterion is the nature of governmental action. The WTO provision also does not ask for a negative impact on State budget.[51] This view, so the Appellate Body in *Canada – Measures Affecting the Export of Civilian Aircraft* stems from the understanding, that the underlying objective of the SCMA is not governmental cost saving[52] but the prohibition of unfair trade distortions.[53]

45 *e.g.* grants, loans, and equity infusion.

46 *e.g.* fiscal incentives such as tax credits.

47 WTO Panel Report, *United States – Measures Treating Export Restraints as Subsidies* (2001), WT/DS194/4, para 8.69.

48 Claus-Dieter Ehlermann/Martin Goyette, 'The Interface between EU State aid Control and the WTO Disciplines on Subsidies' (2006) EStAL, 695, 697; Rubini (n 12), 111.

49 See *United States – Measures Treating Export Restraints as Subsidies* (n 47), Para 8.28.

50 *United States – Measures Treating Export Restraints as Subsidies* (n 47), para 8.28, 8.29; see also WTO Appellate Body Report, *United States – Countervailing Duty Investigation on dynamic random access memory Semiconductors (DRAMS) from Korea* (2005), WT/DS296/AB/R, para 110; see also Ehlermann/Goyette (n 48), 698.

51 *Cf.* WTO Appellate Body report, *Canada – Measures Affecting the Export of Civilian Aircraft* (1999), WT/DS70/AB/R, para 155; see also Michael Hahn, 'Internationales Subventionsrecht' in Birnstiel/Bungenberg/Heinrich (eds), *Europäisches Beihilfenrecht* (Nomos 2013), 1413f, para 45.

52 The EU's State aid provisions subordinately also bear the idea of reducing Member States' costs. In the aftermath of the 2007 financial crisis, the European Commission highlights the necessity of the better usage of scarce State resources. Better State aid control can also contribute to better budgetary consolidation in the Member States. European Commission, 'EU State aid Modernisation (SAM)' COM (2012) 209 final, para 4f; *Cf.* also Gracia Marín Durán, 'Sheltering Government Support to 'Green' Electricity: The European Union and the World Trade Organization' (2018) ICLQ, 129, 159.

53 Hahn (n 51), 1413f, para 45.

To put it in a nutshell, the criterion of State origin shows big similarities between European law and WTO law. Compared to the EU/EEA's subsidy regime and especially the ECJ's and EFTA Courts, interpretation of the State criterion, the WTO's system appears quite formalistic and only takes a certain degree of State control into account. As a consequence complex forms of regulatory measures are not always captured by the WTO legal provisions.[54] Even though the European Courts chose a functional approach to address the problem as close as possible, the ECJ's double criterion "does not yield significantly better results than the WTO's formal approach when dealing with complex regulatory measures."[55]

Financial Advantage

An advantage within the meaning of Art 107 (1) TFEU/ Art 61 (1) EEA Agreement is any economic benefit which an undertaking could not have obtained under normal market conditions.[56] This can take the form of positive State action such as direct granting but also of defaulting State actions, like collecting taxes or other duties.[57] The criterion of the "*market economy operator test*" was installed in order to assess, if the undertaking would have received the benefit under normal market conditions,. If – under similar circumstances – a private investor of comparable size had made the same investment, *e.g.* capital injections, under normal market conditions, this financial transaction would not constitute State aid. This test is based on the following idea: if – under normal market conditions – public bodies act like private economic operators; they will not put a certain undertaking in a more favourable position than others and hence will not distort competition between them.

Additionally, aid granted by a Member State is not contrary to the European Internal Market if the Member State grants it to provide "services of the general economic interest."[58]

Frequently, also including in WTO law, it is quite easy to establish that the government's financial contribution also creates a benefit for the recipient. This is the case, for example, when as in Art 1 (a) (1) (i) SCMA, grants are transferred directly. Yet, sometimes the situation is not that obvious, especially when governments take measures which normal, private investors would also make.[59] In this respect, the criterion of "benefit" must also be seen in relation to normal market conditions. Similar to the "market operator principle" in European law, the SCMA introduces a comparable aspect when assessing the meaning of the term "benefit".[60] To make a long story short: As in EEA/EU law, if the government's financial contribution is in line with regular market processes, the financial contributions do not confer a benefit within the meaning of Art 1.1 (b) SCMA.[61]

54 Thomas Jaeger, 'Goodbye Old Friend: Article 107's Double Criterion' (2012) EStAL, 535, 535. Nonetheless, Jaeger and also Andrea Biondi, 'State aid is falling down, falling down: An Analysis of the Case Law on the Notion of Aid' (2013) CMLR, 1719, 1724ff criticise that the EU/EEA's functional approach in practice does not really achieve better results. Due to the jurisprudence of the ECJ and its double criterion to assess the State character (imputability to the State and State and State resources) sometimes falls short in going to the core of a measure. For criticism on the inconsistency of ECJ's Case law on the "State criterion" *Cf.* also Rubini (n 12), 149ff.

55 Jaeger (n 54), 535.

56 ECJ Case C-39/94 *Syndicat français de l'Express international (SFEI) and others v La Poste and others* (1996) ECLI:EU:C:1996:285, para 60; see also ECJ Case C-342/96 *Kingdom of Spain v Commission of the European Communities* (1999) ECLI:EU:C:1999:210, para 41.

57 Bär-Bouyssiere (n 32), 1523 ff.

58 ECJ Case C-280/00 *Altmark Trans und Regierungspräsidium Magdeburg* (2003) ECLI:EU:C:2003:415.

59 Anna-Alexandra Marhold, 'WTO Subsidy Rules: Implications for Energy' in Hancher/de Hauteclocque/Salerno (eds), *State aid and the Energy Sector* (Hart Publishing 2018), 95.

60 In *Canada – Measures Affecting the Export of Civilian Aircraft* (n 51; para 158), the Appellate Body made clear, that there is no "benefit" unless the financial contribution "makes the recipient better off than it would otherwise have been." In the same finding, the Appellate Body points to Art 14 SCMA for the interpretation, which lays down the relevant method for the calculation of the subsidy in term of benefit. By that Art 14 SCMA refers to the behaviour of private investors (Art 14 (a) or normal market conditions (Art (b), (c), (d)) and so the provision's wording emphasises the Appellate Body's approach in taking the marketplace as a benchmark.

61 Katerina Mandulová, 'Public Investment vs. State aid in the Context of EU Law: A Comparison of the EU and WTO Regimes of State aid Control' (2008) Common L. Rev., 43, 46.

Selectivity/ Specificity

Art 107 (1) TFEU and Art 61 (1) EEA Agreement imply that State aid must benefit a "certain undertaking or the production of certain goods". By including the requirement of selectivity, an important distinction is drawn between acts of general public policy and more targeted State interventions.[62] As long as a State measure benefits all undertakings established in a Member State, it is not considered selective. However, apart from the selectivity resulting from legal criteria, measures which at first sight appear to be of a general nature may also be considered selective, if they de facto favour certain undertakings.[63] This *de facto* selectivity can be either the result of legislation or it can stem from discretionary administrative practices. The key factor here is whether, a certain undertaking is favoured compared with undertakings in a comparable factual or legal situation.[64]

In this context the strong link between the assessment of benefit and selectivity in European law shall be pointed out. Unlike the WTO's Appellate Body,[65] the European Court of Justice (ECJ) states, that these two aspects cannot be examined independently of each other but a measure can only be considered selective, if it also confers an advantage on the beneficiary undertaking.[66]

Strictly speaking, specificity is not a prerequisite for a subsidy to be covered by provisions of WTO law; nonetheless only specific subsidies are actionable,[67] which ultimately, leads to similar results as the selectivity criterion in European law.[68]

Similar to the European definition of State aid,[69] the SCMA differentiates between generally applicable measures to promote the overall economy on the one side, and subsidies which are limited to a certain enterprise, group of enterprises or industry on the other. Art 2 SCMA defines principles according to which a subsidy is considered "specific" and hence distorts competition. Accordingly, "specificity" is assumed when the legislation itself or the granting authority limits access to a subsidy to certain enterprises (Art 2.1 (a), industry (Art 2.1 (b) or certain regions (Art 2.2). In addition to subsidies based on legal specificity, WTO law also recognises *de facto* subsidies. Pursuant to Art 2.1 (c) SCMA, measures are *de facto* specific if, *e.g.* a limited number of enterprises make use of the granting scheme or claim disproportionately large amounts and/or the discretionary scope in which the authority grants is somehow conspicuous.

Moreover, Art 2.3 SCMA implies that all subsidies falling under the provision of Art 3 SCMA, namely prohibited subsidies with regard to export and local content requirements, are *ex lege* qualified as specific.

62 This distinction is particularly important in relation to tax measures, see Kliemann (n 11), 2037, para 11; see also Mandulová (n 61), 44.

63 Commission Notice on the notion of State aid (n 44), para 121; EFTA Surveillance Authority Decision (n 44), para 121.

64 Eisenhut (n 40) 531; Kliemann (n 1112), 2052, para 44f.

65 According to Art 17 WTO's Dispute Settlement Understanding (Annex 2 to the WTO Agreement (1994) OJ L 336/3, the Appellate Body is installed as the second instance from Panel cases.

66 ECJ Case C-403/10 P *Mediaset v Commission* (2011) ECLI:EU:C:2011:533, para 62; see also Kliemann (n 11), 2053, para 45.

67 Ehlermann/Goyette (n 48), 701.

68 Ehlermann/Goyette (n 48), 703.

69 Hahn (n 51), 1414, para 46.

Effect on Trade and Competition

Another precondition for a measure to be qualified as State aid is that it "distorts or threatens to distort competition"[70]. As the wording (and rationale) of Art 107 TFEU or Art 61 EEA Agreement suggests, this criterion must be interpreted widely; a serious threat and causal link to distortion of competition are sufficient.[71] However, as small amounts of Aid are unlikely to distort or threaten to distort competition[72], it is considered that the so called *de minimis* aid[73] does not fulfil all the criteria of Art 107 (1)TFEU/Art 61 (1) EEA Agreement, and thus the presumption of compatibility with the internal market applies.

There is a strong tie between the requirement of distortion of competition and the affection of trade between the Member States. Unlike the WTO system, which focuses on the negative effect of subsidies on international trade, the European system slightly emphasises the competitive aspect. However, the ECJ calls for a combined evaluation. Any influence on intra-community trade, whatever its nature, is considered to be an interference with the Internal Market.[74]

By contrast, WTO law does not provide for a full competition analysis. Nonetheless, the influence of competition of foreign products on a domestic industry can be deduced from the different categories formulated in the SCMA.

Different categories of subsidies defined in the SCMA

The WTO system and especially Part II and Part III SCMA contain the idea that some subsidies are more harmful than others. This idea was newly introduced in the Uruguay Round in form of a so-called traffic-light approach. Based on the well-known colour scheme and the meaning attributed to it, the SCMA classified subsidies in prohibited (red), actionable (yellow) and non-actionable (green) categories.[75] Depending on the type of category under which a subsidy is subsumed, different procedural aspects are involved. Since most of these are procedural issues, the next section (V.) contains an analysis of these aspects. Nevertheless, the following subsection is intended to provide some remarks – on material issues.

Part III SCMA introduces the fallback category of subsidies. Even if only a small number of cases concerned the category of "actionable subsidies", it might still serve as a basis for analysis. Part III SCMA applies to these so-called actionable subsidies. Actionable subsidies are not defined by their nature but by their results – a subsidy is actionable under WTO law, if it is specific according to Art 2 SCMA and has negative effects[76] on the economic interests of another Member State.[77]

70 Art 107 TFEU or Art 61 EEA Agreement.

71 Annette Kliemann/Wolfgang Mederer, 'Art.107 AEUV: Die einzelnen Beihilfekriterien' in Schröter and others (eds), *Europäisches Wettbewerbsrecht* (2nd edn, Nomos 2014), 2058ff, recitals 56ff.

72 Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid (2013) OJ L 352/1, recital 3; EEA Joint Committee Decision (JCD) No 152/2014.

73 According to Art 3 De-minimis-Regulation (n 72) the total amount of *de minimis* aid granted to a single undertaking shall not exceed EUR 200 000.- over a period of three years.

74 Segura (n 40), 2064, recital 68.

75 Sánchez Rydelski (n 34), 287. For more details on the categories of subsidies provided by the SCMA and the possibilities to challenge them see Roberto Rios Herran/Pietro Poretti, 'Article 7 SCMA', 'Art 8 SCMA' and 'Article 9 SCMA' in Wolfrum/Stoll/Koebele (eds), *WTO: Trade remedies* (Brill Academic Publishers 2008).

76 The SCMA defines three types of adverse effects. According to Art 5 SCMA adverse effects can be injuries to the domestic industry of another member (a), nullification of benefits accruing to other Member States through the GATT (b), or serious prejudice to the interests of another Member State. What constituted a "serious prejudice" on the other hand, is again defined in the SCMA. Art 6.3 lists four situations: Firstly, a serious prejudice in the sense of Art 5 (c) SCMA may exist when the subsidy has the effect to displace or impede the imports of a product alike produced in another Member State into the market of the subsidizing Member. Secondly, when the effect of the subsidy is to displace or impede the export from one Member not in the domestic market, but from a third market. Third, when the subsidy results in a significant price undercutting or price suppression, depression or lost sales in the same market, and fourth, when the effect of the subsidy is an increase in world market share.

77 Ehlermann/Goyette (n 48), 710.

Whereas actionable subsidies are analysed on a case-by-case basis,[78] Art 3 SCMA prohibits subsidies which are either tied to exportation or which are granted *per se* when domestic goods are used as opposed to imported goods. Due to the distortion created in the economies of the other countries,[79] these kinds of subsidies are forbidden without further examination of specific or distorting aspects (Art 2 or 5 SCMA).[80] Since the aim of export subsidies is to directly favour the export of domestically produced goods, their distorting effect on international trade is evident. Similarly, domestic content subsidies directly benefit domestic goods, which in turn discriminate foreign products. They are therefore prohibited in all cases and no proof of actual adverse effects is required.[81]

Contrary to prohibited subsidies, Art 8 SCMA even stipulated the idea of "non-actionable subsidies", which, however, became obsolete due to objections from some developing States.[82] Art 8 SCMA laid down that subsidies which either are non-specific[83] or specific, but which target research activities (a), help disadvantaged regions (b), or promote adaption to new environmental requirements (c) are not actionable under WTO law. Consequently, these "green subsidies" were *de facto* allowed. This provision might remind the reader of State aid which is justified by considerations of efficiency and equity under Art 107 (3) TFEU/Art 61 EEA Agreement. This was certainly no coincidence, but a – limited – success in the EU negotiation.[84]

Aid exempted from the prohibition of Art 107 TFEU/ Art 61 EEA Agreement

In addition to the legal exceptions defined in para 2 Art cit – namely aid having a social character granted to consumers or aid to make good the damage caused by natural disasters or exceptional occurrences – Art 107 (3) and Art 61 (3) EEA Agreement permit different cases in which State aid may be considered compatible with the Common Market. The idea that some State investments can be made although they fulfil the criteria set down in Art 107 (1) TFEU, respectively Art 61 (1) EEA Agreement, stems mainly from the conclusion that free market competition is not sufficient to achieve the desired outcome in some areas.[85] EEA States actively use subsidies[86] to reach certain policy objectives, such as regional cohesion, research and development and environmental progress. In the light of the above, it can be concluded that the European State aid system is not only based on the concept of preventing distortion of competition and barriers to trade, but also acknowledges that State intervention in the economy can be in the wider interest and can thus be justified.[87]

78 Andrew B. Linter, 'Subsidizing Large Civil Aircraft: Airbus and Boeing's Newest Dispute before the World Trade Organization' (2017), Supra 41, 53.

79 Luengo Hernández de Madrid (n 8), 8.

80 Subsidies, which obviously benefit export are somewhat proscribed. Nevertheless, most cases dealt with by the Appellate Body concern subsidies falling under this category. The main question is, to what extent a connection between – on the first sight – export neutral subsidies and the expectation that "the granting of the subsidy […] is tied to […] actual or anticipated exportation" can be made. see Hahn (n 51), 1415, recital 51.

81 Linter (n 78), 51f.

82 Bungenberg/Schelhaas (n 31), 604.

83 Within the meaning of Art 2 of the SCMA.

84 For a detailed description of the "birth" of the category of "non-actionable subsidies" *Cf.* Sadeq Z. Bigdeli, 'Resurrecting the Dead? The Expired Non-Actionable Subsidies and the Lingering Question of 'Green Space'' (2011) Manchester J. Int'l Econ. L., 2, 4-8.

85 Wolfgang Mederer, 'Vorbemerkungen zu den Art. 107 bis 109 AEUV' in Schröter and others (eds), *Europäisches Wettbewerbsrecht* (2nd edn, Nomos 2014) 2022; Kliemann (n 11), 2034f, para 6.

86 For example in the year 2017 EU Member States spent EUR 116.2 billion on State aid; European Commission, 'State aid Scoreboard 2018: Results, trends and observations regarding EU 28 State aid expenditure reports for 2017' (2019) <https://ec.europa.eu/competition/state_aid/scoreboard/state_aid_scoreboard_2018.pdf> accessed 4 February 2020), 9.
EFTA States granted approximately EUR 3.3 billion in 2017; EFTA Surveillance Authority, 'State aid Scoreboard 2018: State aid Scoreboard for 2017 for the EEA EFTA States' (2019), <http://www.eftasurv.int/media/uncategorized/State-aid-scoreboard-2018-March-.pdf> accessed 4 February 2020, 5.

87 Rubini (n 12), 40.

From this point of view, strict supervision by the European Commission[88] or the EFTA Surveillance Authority[89] is essential to ensure that the exceptions defined in Art 107 TFEU or Art 61 EEA Agreement do not undermine the logic of the provision. To that effect, the term "State aid" must be interpreted in a broader sense, while exceptions must be applied restrictively.[90] In doing so, State aid declared compatible with the Internal Market must have an incentive effect and must be proportionate to the distortive effect on competition and trade.[91] Despite the general prohibition of State aid in the EEA, a great amount of State aid is still declared compatible with the Internal Market.[92]

Additionally, the EU itself grants large amounts of funding in the form of "Union subsidies". For example, the EU's "Horizon 2020" research and innovation program's budget alone is 70 billion Euros.[93] This sometimes is a blind spot in the EU's free trade negotiations.[94] The fact, that the Union is calling for stronger subsidy control on the one side and allowing large sums of subsidies within its territorial scope on the other side, makes potential free trading partners rigid.

Subsidy Supervision and Procedural Aspects

Need for notification

As the previous comparison between substantive provisions showed, there is a very high degree of overlap between the definitions of subsidy and State aid. Thus, most of the subsidies that can be subsumed under one regime also fall under the other.[95] In contrast to the definitions, the procedures on EU/EEA and WTO level differ widely. This is only logical with regard to the different willingness of States to surrender their sovereignty in this matter.[96] Apart from this and the resulting differences in legal nature, the objectives of the systems also differ – European law emphasises the need to safeguard competition, while WTO law emphasises the impacts of subsidies on trade. These different objectives are strongly reflected in the supervisory structure and procedural aspects of subsidy control.[97] As a result of these differences, an in-depth comparison seems rather fruitless. However, with regard to the contextual legal embedment of EFTA and in particular a further analysis of the provisions in the EFTA FTAs, a presentation of the main procedural aspects of the two systems in question shall not be omitted.

88 Hereinafter referred to as "EC".

89 Hereinafter referred to as "ESA".

90 Mederer (n 85), 2034, recital 5.

91 Mederer (n 85), 2034, recital 5.

92 See for example the numbers in (n 86).

93 European Commission, 'Factsheet: Horizon 2020 budget' <https://ec.europa.eu/research/horizon2020/pdf/press/fact_sheet_on_horizon2020_budget.pdf> accessed 3 September 2020.

94 For a deepened look on the global control of Union aid in the context of WTO subsidy law *Cf.* Patrick Cichy, *Wettbewerbsverfälschungen durch Gemeinschaftsbeihilfen* (Nomos 2002), 135ff.

95 Ben Slocock, 'EC and WTO Subsidy Control Systems – Some Reflections' (2007) EStAL, 249, 249.

96 Slocock (n 96), 249.

97 Marín Durán (n 52), 131, 159.

The procedural starting points in the WTO and the European system are similar in their consistency: Both include a notification requirement, which obliges States to register all specific subsidies. In the European system, this requirement stems from the provision laid down in Art 108 (3) TFEU/Chapter I Section II of the Protocol nr 3 to the Surveillance and Court Agreement[98], both of which contain a stand-still clause – pending a final decision, the granting Member State must not put the proposed measures into effect.[99] According to Art 25 SCMA, Member States undertake to report all subsidies granted on their territories by 30 June each year.[100] These notifications shall include information on the form of the subsidy, the amount of subsidy per unit, its purpose and duration and statistical data permitting a further assessment of the related trade effects.[101]

In European law, the notification procedure is a fundamental premise without which the strict *ex-ante* assessment would become a toothless tiger; usually installed for transparency reasons, the notification requirement in the ASCM has no legal consequences.[102] This means that under WTO law, in the moment of notification, a subsidy scheme may already be in force and subsidies may have been transferred to the companies at the time of notification, whereas under European law the waiting period until the EC/EFTA green light is given is just beginning.[103]

Further proceedings

European Law

In the European system, subsidy control is submitted to the EC or ESA and thus centralised within these institutions.[104] According to Art 108 (2) TFEU and Art 62 (2) EEA Agreement they then have the task of determining whether or not the requirements of Art 107 TFEU/Art 61 EEA Agreement are fulfilled; if so, the aid is in any case compatible with the Internal Market, *e.g.* it does not distort competition disproportionately. The proceeding itself is divided into a preliminary examination procedure[105] (with a timeframe of two months) and a formal investigation procedure.[106]

98 Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (2012) OJ L 344,3.

99 Yet, as the exception confirms the rule, most State aid measures are exempted from this obligation. Based on Art 108 TFEU the European Council can except certain categories of aid from the notification requirement. The Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (2014) OJ L 187/1; EEA JCD 152/2014 – as its name already implies – excludes measures from the formal requirement of prior notification and Commission/ESA approval. By fulfilling the conditions laid down in the regulation, the State aid granted is *ex lege* compatible with the Internal Market. In lieu of the formal notification and Commission/ESA approval States shall only ensure the publication of relevant information, the full text of each aid measure on a comprehensive State aid website.

100 Art 24 SCMA establishes the so-called Committee on Subsidies and Countervailing Measures, which is composed of representatives of the Member States. Member States notify their domestic subsidies to this Committee. *Rubini* (n 12), 70) notes the increase in the quality of enforcement which came through the establishment of this organ. In his view, in providing information for the Member States the Committee works as a "clearing house" in subsidy control. Nevertheless, he does not attest this system great efficiency.

101 Art 25.3 SCMA.

102 Sánchez Rydelski (n 34), 313.

103 Aid already existing, *e.g.* aid which was granted before joining the Internal Market or already authorised, must not be notified. Nevertheless, if they are not only individual grants but aid schemes, they are subject to constant review by the EC/ESA (Art 108 para 1 TFEU). This constant review can result in a call for adaption or even revocation of an existing scheme, if, in the meantime, conditions for compatibility with the Internal Market have changed. Bertold Bär-Bouyssière, 'Artikel 108 AEUV', in Schwarze and others (eds), *EU-Kommentar* (4th edn, Nomos 2019), 1706ff, recital 3.

104 In the case of EC, the control of State aid is a supranational competence; with regard to EEA Agreement (and the competences conferred to ESA by it) the EFTA Court attributes the EEA Agreement to be a legal matter "*sui generis*"; see Frank J. Büchel/Michael Sánchez Rydelski, 'Reformen aus der Außenperspektive: Die EWR-Perspektive' (2019) EuR Beiheft 2/2019, 173, 175. See also EFTA-Court Advisory Opinion Case E-9/97 *Sveinbjörnsdóttir v Iceland* (1997), para 59.

105 According to Art 4 Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (2015 OJ L248/9) preliminary examination is terminated by either a decision declaring the measure no aid, aid but compatible with the market or, in case of doubt, by the decision to open the actual proceeding. The Regulation (EU) on the Application of Article 108 TFEU is not yet incorporated in the EEA Agreement as the Draft of the JCD is still under consideration. However, as laid down in Protocol 27 to the EEA Agreement, the EC and ESA ensure uniform application, implementation and interpretation on the rules of State aid, the comments on EU procedure – unless otherwise stated – also apply for the EEA.

106 Art 6 Regulation (EU) on the Application of Article 108 TFEU.

The latter is opened by a formal EC/ESA decision and shall not take longer than 18 months.[107] The EC's/ESA decision itself may be positive, *e.g.* by declaring the Aid compatible with the Internal Market,[108] negative, *e.g.* incompatible and thereby prohibited from being implemented[109], or positive, but subject to conditions under which the aid may be considered compatible with the Internal Market.[110] In the event of a negative decision, the Commission/ESA also decides that the Member State concerned must recover the aid already granted from the beneficiary.[111] It is important to stress that under no circumstance shall this recovery decision include any form of penalty fee, as its sole purpose is to restore the real situation prior to the unlawful granting.[112]

As will be shown in the next paragraphs, although the proceedings themselves differ widely in European and WTO law, the results of granting prohibited subsidies may be more similar than expected. As will be shown in the following paragraphs for WTO law (in particular in the context of Track II proceedings), both systems strongly avoid the imposition of fines for unlawful investments because of their underlying motives – safeguarding free trade and competition rather than deterrence of states from unlawful behaviour.

WTO Law

In contrast to the unified approach under European law, the SCMA offers two broad sets of procedural rules, usually referred to as "Track I" and "Track II" proceedings.[113] The Track I proceeding is predetermined by Article VI GATT,[114] whereas Track II is governed exclusively by the SCMA.

Track I describes a decentralised proceeding which is implemented by the Member States themselves.[115] This procedure allows a Member State to apply countervailing measures to subsidised imported goods and thereby neutralising the unlawful disadvantage to its domestic economy. Before countervailing measures are imposed, the SCMA in conjunction with the GATT foresee a formal investigation by national authorities. This investigation aims to determine whether the investigated products have been subsidised and, if so, whether this subsidy has caused injury to the domestic industry of the investigating State. Interestingly, as in European law, the SCMA also mentions subsidies which are considered to be *de minimis* – if the subsidy in question is less than 1 cent ad valorem, the injury is negligible and thus, investigation shall be terminated immediately. The proceeding itself shall not exceed 12 months.[116] All in all, countervailing measures act as "unfair trade remedies" so their function is to correct unfair market practices, *e.g.* the benefit conferred by a subsidy. Similar to European law, the decision to impose countervailing duties is in any case less than the total amount of the subsidy.

107 This is, however, not binding and has no real practical implications. Nevertheless, if the EC exceeds the 18 months-period, a Member State can request that the Commission must take a decision within two months, based on the information available at point (Art 9 para 7 Regulation (EU) on the Application of Article 108 TFEU). This, however, might be a hazardous endeavour, as Member States have no right to access the records in State aid proceedings und thus cannot profoundly estimate, if the information available is in their favour or not.

108 Art 9 para 3 Regulation (EU) on the Application of Article 108 TFEU.

109 Art 9 para 5 Regulation (EU) on the Application of Article 108 TFEU.

110 Art 9 para 4 Regulation (EU) on the Application of Article 108 TFEU.

111 Art 16 Regulation (EU) on the Application of Article 108 TFEU.

112 Bär-Bouyssière (n 104), 1723 ff, recital 10; see also Bungenberg/Schelhaas (n 31), 72.

113 See for example Ehlermann/Goyette (n 48), 696.

114 Art 10 SCMA directly refers to the application of Art VI of GATT 1994 concerning anti-dumping and countervailing duties.

115 In the case of the EU, the proceeding is established at Union level. See Hahn (n 51), 1416f, recital 56.

116 According to Art 11.11 SCMA under special circumstances the investigations can be extended to a maximum of 18 months.

Track II describes the multilateral approach governed by Part II and Part III SCMA. If a State has reason to believe another WTO Member State is granting prohibited subsidies, it may request a proceeding before the quasi-judicial instances of the WTO.[117] In the first place, consultations with the suspected WTO Member shall be sought. However, if no mutually agreed solution can be found within a maximum of 60 days,[118] any Member party involved in the consultation, *i.e.* both, the accusing Member State as well as the accused one, may bring the matter before the Dispute Settlement Body (DSB) of the WTO.[119] If the DSB decides to establish a panel, this panel will also determine whether the measure constitutes a prohibited subsidy or whether it is a specific (actionable) subsidy with adverse effects on the complaining of the WTO member. If the ruling of the WTO Dispute Settlement panel (called "report") is in favour of the complainant, the subsidy in question shall be withdrawn or, in case of an actionable subsidy, only the adverse effects shall be eliminated within a recommended period of time, which in any case shall be without undue delay. However, there is also no obligation of repayment of subsidies violating the SCMA.[120]

Basically, member States are free to choose which procedure to follow; they can even choose a twin-tracked strategy. WTO members more often turn to Track I proceeding; mainly because imposing countervailing measures is a fast remedy, usually sufficient to deal with negative impact on the domestic economy.[121]

Nevertheless, when the negative effects occur on the market of a third country or the granting Member State, autonomously adopted countervailing measures do not really work as a satisfactory remedy. What is more, the imposition of a countervailing measure is only successful in deterring subsidization if it is likely to reduce a country's economic welfare. Thus, the logic of countervailing measures is in favour of larger economies such as the European Union or the US.[122] As a consequence, EFTA States do not use countervailing measures in their trade relations. For small economies Track II offers a more suitable way to oppose illicit subsidies.

Interim Conclusion: Possibility of Conflicts between the Systems

As regards the similarities between two systems, it can be concluded that the SCMA is a result of multilateral negotiations. However, the European signature is clearly visible. There is a profound congruence as regards the material components – both systems are based on the presence of the State benefiting an undertaking, which must be specific, *e.g.* not a general economic policy. Moreover, the necessary negative impacts on free trade and competition, are interpreted very broadly in both systems and are therefore almost similar. Even so, a closer look at the details reveals divergences.

117 Ehlermann/Goyette (n 48), 696.

118 Art 4.4. SCMA.

119 Hereinafter referred to as "DSB" or "the DSB". The DSB deals with arising disputes between WTO members.

120 Only in one Case, WTO Panel report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather* (2000) WT/DS126/RW), a WTO quasi-judicial body decided, that subsidies must be repaid to the granting State; *Cf.* also Hahn (n 51), 1419f, recital 66.

121 Besides this, Ehlermann/Goyette draw attention to a "procedural advantage" of the Track I proceeding: It may be easier for a Member State to impose measures and either achieve the desired outcome, or await the challenge by the Member State whose exports have been countervailed. By returning the metaphorical ball, the burden of proof then lays by the countervailed Member State and thus favour of time is at the Member imposing the countervailing duty. See Ehlermann/Goyette (n 48), 712.

122 So it comes with no surprise, that these two economies are the biggest users of this kind of remedy. See the tables published by the WTO <https://www.wto.org/english/tratop_e/scm_e/scm_e.htm> accessed 3 September 2020; *Cf.* Alan O. Sykes, 'Countervailing Duty Law: An Economic Perspective' (1989) Columbia Law Rev, 199, 260.

It is easy to notice, that the SCMA unlike Art 107 TFEU or Art 61 EEA Agreement is not applicable to trade in services and its scope is therefore much more limited. A negotiation mandate on this aspect has been included in Art XV GATS, but this has not led to any legal outcome. Beyond that, State aid can be declared compatible with the European market under the exemption clauses of Art 107 (3) (a)-(b) TFEU, alternatively Art 61 (3)(a)-(c); which may mean that some State aid measures granted under the EEA/EU system risk being countervailed or challenged before a WTO panel.[123] Since there is no longer any exemption from WTO disciplines with regard to the objectives of a subsidy, in principle all measures meeting the definition in Art 1 SCMA are actionable and countervailable, if they cause adverse effects on other Member States.

In terms of the enforcement of subsidy systems, European law offers a more progressive and comprehensive approach than WTO law. At the same time, it leaves no room for unilateral measures, such as countervailing duties. As discussed, this only comes with the different requirements and structures of the underlying organisations and thus is hardly comparable.[124] Nonetheless, there is a clear European influence with respect to increasing transparency which goes hand in hand with the need to report subsidies.[125]

From a European perspective, WTO law therefore has some shortcomings that should not be underestimated. Realistically, these deficits will not be remedied in the near future due to the stagnation in the reform of WTO law. Consequently, not only the focus of the EU but also of EFTA can now shift to bilateral solutions. Closing these – in the eyes of EFTA States – loopholes may offer some opportunities. This will be highlighted in the final section of this paper.

Subsidies in EFTA FTAs

Following the somewhat unsatisfactory conclusion of the Doha Round, it is realistic to expect no genuine progress in WTO law. The further development of WTO subsidy law is stagnating at the global level. This multilateral standstill may cause problems for the EU, the EEA and EFTA. For this reason, the EU has focused its trade policy on the conclusion of bilateral agreements; EFTA has been following this example.

Regardless of the different ways in which the EFTA States are associated with the idea of European integration, EFTA's primary objective has always been to promote free trade – also on a global scale.[126] Since EFTA pursues closer economic ties with third countries, one of its main concerns is the negotiation and conclusion of trade deals and FTAs.[127] It is no exaggeration to say that EFTA is highly successful in this respect – up to date, EFTA has negotiated [128] 29 FTAs with 37 countries.[129] EFTA's global trade policy is strongly influenced by the multilateral trading disciplines laid down in the WTO system, with FTAs "not as an alternative, so

123 See also Ehlermann/Goyette (n 48), 714.

124 Slocock (n 96), 249. In combination with the freedom of establishment a decentralised and less strict monitoring of State aid would easily lead to subsidy races between the Member States. See Bungenberg, 'Artikel 108 AEUV (ex-Artikel 88 EGV)' in Birnstiel/Bungenberg/Heinrich (eds), *Europäisches Beihilfenrecht* (Nomos 2013), 850, para 3; see also Ehlermann/Goyette (n 48), 714.

125 Thomas Weck/Philipp Reinhold, 'Europäische Beihilfepolitik und völkerrechtliche Verträge' (2015) EuZW, 376, 379.

126 Arnesen and others (n 23), 5.

127 Art 56 (2) EFTA Convention provides the legal basis for negotiating third-country relations.

128 Even though speaking of "EFTA FTAs", EFTA itself is not a party to the FTAs; contracting parties are the EFTA States and the respective partner country. See Niels Fenger/Michael Sánchez Rydelski/Titus van Stiphout, *European Free Trade Association (EFTA) and European Economic Area (EEA)* (Kluwer Law International 2012), 38.

129 Additionally, EFTA States signed an Interim Agreement with the Palestinian Authority which entered into force in 1999. See <https://www.efta.int/free-trade/free-trade-agreements> accessed 3 September 2020.

much as a compliment to that system."[130] This explains why most of the FTAs concluded as well as the EFTA Convention[131] itself are based on the subsidy rules of the WTO are and formulated in very similar terms.

The EFTA Convention, governing trade between its Member States,[132] bases its subsidy provision on Art XVI GATT and the SCMA, with the exemptions in the field of air transport laid down in Annex Q to the Convention. Art 6 of Annex Q to the EFTA Convention is basically a copy of Art 107 TFEU or Art 61 EEA Agreement extending the definition of State aid to the field of air transport between EFTA States. This is only consistent, since all four EFTA States – including Switzerland via the Bilateral on Air Transport[133] – are bound to EU law in that area and the Convention was updated in 2001 to avoid frictions that could arise from the changed relations between Switzerland and the EU.[134] In accordance with their special relationship and commitment to one another, Art 16 (2) also provides for the non-application of countervailing measures in respect of another EFTA Member State in accordance with Art 36 EFTA Convention. Accordingly, unilateral measures shall not be applied in relation to conflicts between the EFTA members.

With regard to EFTA's relations with third countries, especially the so-called second-generation FTAs[135] have widened the scope of application and started to include State aid/subsidy rules.[136] However, the subsidy provisions in FTAs are still largely based on the WTO subsidy regime, essentially taken over from or referred to by the SCMA. In view of the deepened trade relationship reflected by the conclusion of an FTA, some changes, especially procedural ones, are introduced.

Sometimes FTAs foresee an additional step before the parties might apply countervailing measures under Part V SCMA, by laying down the requirement to notify the other party in writing and allowing a period – usually between 25 and 60 days, in the case of Mexico[137] only 2 days – to find a mutually acceptable solution.[138] Moreover, the transparency of subsidy information has been enhanced in some FTAs. As for example provided for in Art 81 of the Agreement with Chile[139], for example, each party to the Agreement may request information on individual cases or State aid and the requested party "will make its best efforts" to provide such information. Finally, the China/Hong Kong FTA[140], similar to the

130 European Parliament, 'Briefing: free trade agreements between EFTA and third countries: An overview' (2016) <http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/580918/EPRS_BRI(2016)580918_EN.pdf> accessed 3 September 2020, 3.

131 Convention Establishing the European Free Trade Association, 4 January 1960, revised 21 June 2001 <https://www.efta.int/sites/default/files/documents/legal-texts/efta-convention/Vaduz%20Convention%20Agreement.pdf> accessed 3 September 2020; hereinafter referred to as "EFTA Convention".

132 To be more precise the EFTA Convention governs trade between Switzerland on the one side and the three EEA/EFTA-States on the other. Trade between the latter is governed by the EEA Agreement.

133 Agreement between the European Community and the Swiss Confederation on Air Transport, OJ L 114, 30.4.2002, 73–90.

134 Fenger/Sánchez Rydelski/van Stiphout (n 129), 18f.

135 First-generation FTAs were concluded in the early 1990s with central and east European countries after they entered democratic, liberal transitions. Most of these FTAs are no longer valid as most contracting parties now joined the EU and trade matters are thereby governed by the EEA Agreement and the Bilaterals. See European Parliament, 'Briefing: free trade agreements between EFTA and third countries: An overview' (2016) <http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/580918/EPRS_BRI(2016)580918_EN.pdf> accessed 5 September 2020, 9.

136 European Parliament Briefing (n 136), 7; *Cf.* for the EU Garcia Bercero (n 24), 384.

137 Art 11 Free Trade Agreement between the EFTA States and the United Mexican States, 27 November 2000 <https://www.efta.int/media/documents/legal-texts/free-trade-relations/mexico/EFTA-Mexico%20Free%20Trade%20Agreement.pdf.> accessed 5 February 2020.

138 For example, Art 16 Free Trade Agreement between the Republik of Albania and the EFTA States, 17 December 2009, amended 18 September 2015 <https://www.efta.int/sites/default/files/documents/legal-texts/free-trade-relations/Albania/EFTA-Albania-Free-Trade-Agreement.pdf> accessed 5 February 2020; Art 19 Free Trade Agreement between the EFTA States and Bosnia and Herzegovina, 24 June 2013 <https://www.efta.int/media/documents/legal-texts/free-trade-relations/bosnia-and-herzegovina/bosnia-and-herzegovina-fta.pdf>, accessed 5 February 2020; Art 18 Agreement between the EFTA States and Turkey, 10 December 1991, <https://www.efta.int/sites/default/files/documents/legal-texts/free-trade-relations/turkey/EFTA-Turkey%20Free%20Trade%20Agreement.pdf> accessed 5 February 2020.

139 Free Trade Agreement between the EFTA States and the Republik of Chile, 26 June 2003 <https://www.efta.int/media/documents/legal-texts/free-trade-relations/chile/EFTA-Chile%20Free%20Trade%20Agreement.pdf> accessed 11 February 2020.

140 Free Trade Agreement between the EFTA States and Hong Kong, China, 21 June 2011 <https://www.efta.int/media/documents/legal-texts/free-trade-relations/hong-kong-china/EFTA-Hong%20Kong%20China%20Free%20Trade%20Agreement.pdf> accessed 11 February 2020.

EFTA Convention itself – excludes the possibility to apply countervailing measures between Hong Kong, China and Norway.

Also common to the FTAs are additional dispute settlement rules applicable to disputes over State granting.[141] The provisions on dispute settlement generally provide for consultations between the parties as a starting point. They shall take place before the so-called Joint Committees, which are established in each FTA and are composed of members from each party. In case of further discrepancy, arbitration may be requested by written notification.[142] In terms of procedures, most FTAs contain shorter deadlines than WTO dispute settlement rules. The aim is to speed up the settlement of disputes by saving procedural time combined with the absence of an appeal body.[143]

To sum up, the WTO subsidy provisions in the EFTA FTAs will not be substantially changed. Neither a strong enforcement mechanism nor subsidisation of the service sector is included in EFTA's third-country relationships. However, from an optimistic perspective, this may mean that there is still "untapped potential" in terms of a comprehensive regulation on subsidies. This room for improvement now leads directly to the last chapter, dealing with recommendations in accordance to future subsidy policy.

Impacts for EFTA and its Member States – Lessons for the Future?

So what can be concluded from the above in relation to the future free trade efforts of EFTA and its Member States?

First and foremost, the close relationship with the EU and the impact of EU/EEA State aid characteristics may sometimes complicate the conclusion of FTAs.[144] As the EFTA States are linked to the European competition rules in various ways, their State aid policy is restricted. Whereas the strict application of State aid rules may be reasonable in order to ensure competition and equal opportunities in the Internal Market, their rigorous application might also harm European undertakings vis-à-vis others operating under less strict conditions or with no subsidy control at all.[145] The EC is already seeking to remedy this shortcoming and is seeking to incorporate State aid provisions in its multilateral and bilateral agreements.[146] This is an ambitious undertaking, but by no means hopeless, as demonstrated *e.g.* by the temporary inclusion of incontestable "green" subsidies in the WTO system.

The fact that the EU itself grants huge amounts of aid ("Union aid") clearly does not make negotiations on this (already sensitive) topic any easier.[147] Since EFTA States mostly do not share the EU's funding system, EFTA is not in the same dilemma as the EU in negotiating comprehensive subsidy provisions in its FTAs. This could be a good window of opportunity for EFTA to become a pioneer in exporting tighter subsidy control. In particular, the inclusion of subsidy rules which

141 The Dispute Settlement procedures resemble the WTO system, whereas the details can differ from FTA to FTA. As noted by Davey, dispute settlement in FTAs is used much less often than in the WTO system. Cf.. William J. Davey, 'Dispute Settlement in the WTO and RTAs' in Bartels/Ortino (eds), *Regional Trade Agreements and the WTO Legal System* (Oxford University Press 2006), 349.

142 Baur (n 20), 101f.

143 *Cf.* for the EU, Garcia Bercero (n 24), 396; but – as EFTA mostly pursues similar external trade policy goals as the EU – this finding can be transferred to EFTA related matters too.

144 *Cf.* for the EU Bungenberg/Schelhaas (n 31), 596.

145 Bungenberg/Schelhaas (n 31), 569; European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: trade, growth and World Affairs, trade Policy as a core component of the EU's 2020 strategy' COM (2010) 612 final, 17.

146 European Commission (n 146), 17.

147 Bungenberg/Schelhaas (n 31), 598.

also apply to services, would be in EFTA's interest. For example, as financial services account for a large part of the economies of Liechtenstein and Switzerland, these countries could make a strong effort to achieve a level playing field with financial institutions of third countries.

Second, the (global) revival of incontestable subsidies is another important aspect. The fact that "green subsidies" can be (re)contested under WTO law might be very problematic. As mentioned above, the granting of subsidies can also have positive outcomes by pursuing legitimate policy objectives.[148] For example, 38% of all EEA/EFTA States aid measures are granted in the field of environmental protection and energy-saving.[149] Limiting this important "policy area" can lead to a diametrically different result: Countries might lapse into a hostile attitude; consequently, stricter subsidy disciplines risk making "countries more redundant to relinquish their capacity to use tariffs as a policy tool."[150] Without doubt, the main problem is buried in the WTO law itself, but as already mentioned, a change in WTO's legal order is unforeseeable.[151] Even if this represents a dilemma in the global free trade order, the disagreement between WTO members, for example between the EU and the USA [152] but also between so called developing countries and others,[153] can offer an opportunity for EFTA. As all EFTA members are to some extent embedded in or at least strongly linked to the European State aid regime, they could also be a pioneer in promoting a revival of "green subsidies". The reintroduction of a non-actionable category of subsidies in FTAs would benefit the EFTA States in two ways. Together with the consolidation of a country's general willingness to reduce trade barriers by giving back some of its political competences, this can prevent friction between the European system and WTO law.[154] As EU/EEA rules allow for the authorisation of State aids under Art 107 (3) TFEU/ Art 61 EEA Agreement, they are particularly vulnerable to proceed or countervail against.[155] The European legislator will not (and shall not) abandon the exemptions to the general prohibition on State aid defined in Art 107 (3) TFEU respectively Art 61 (3) EEA Agreement, and as long as these exemptions exist, the European States will make use of them while living with the risk of infringing the WTO subsidy disciplines at the same time. Eliminating friction by creating a level playing field, including some policy space for granting subsidies *e.g.* development, research or environmental issues, should be a negotiation objective for the future.

To make the existing WTO rules – on which most FTA subsidy provisions are based – more effective, transparency and enforcement shall be improved.[156] Realistically, neither WTO provisions nor FTAs will, in short or middle term introduce *ex-ante*, (*de facto*[157]) binding subsidy control; EFTA could use the opportunity of FTA negotiations to create incentives for trading partners to "notify their measures [and] to do so in a comprehensive way."[158] Obligations – such

148 Rubini (n 12), 40.

149 EFTA Surveillance Authority (n 86), 10.

150 *Cf.* Rubini (n 12), 40, whose assumptions are based on a study by Kyle Bagwell/Robert W. Staiger, 'Will International Rules on Subsidies Disrupt the World Trading System?' (2006), The American Economic review, 877.

151 Vgl Oesch/Burghhartz (n 27), 26.

152 *Cf.* Bigdeli (n 84), 4-8.

153 The provisional inclusion of "green", non-actionable subsidies has not been prolonged partly because of interventions by developing countries, claiming that for example environmental subsidies would benefit more industrialised countries. Nicole Ruge, *Die Zulässigkeit staatlicher Umweltschutzsubventionen nach dem EG-Vertrag und dem GATT 1994/WTO-Regelwerk* (Universitätsverlag Rasch 2002), 143f.

154 See Chapter VI.

155 See also Ehlermann/Goyette (n 48), 714.

156 As former EU Commissioner for Competition, Joaquín Almunia put it in a keynote speech at a OECD roundtable (n 11), 232: "No rule can be applied properly without transparency. [...] Transparency helps contain protectionist measures by opening them up to public scrutiny – and helps ensure a level playing field for business in markets across the world."; *Cf.* also Marín Durán (n 52), 163.

157 As the EEA Agreement is not supranational, ESA's decisions are not "binding" *sensu stricto* for the Member States. As the result of non-compliance would be the termination of the benefits of the EEA Agreement, however, the EEA Members fully comply with ESA's findings.

158 Rubini (n 12), 83.

as those implemented in the Chile FTA – to provide information on a legal basis, form and amount of the subsidy, whereby "best efforts" may be a first step. Additionally, *Rubini* suggests that actionable subsidies as defined in the SCMA shall be prohibited or suspended if they are not duly notified.[159] The assessment as to whether the subsidy is forbidden will still be made according to the WTO scheme, but the notification step, and thus transparency, would be emphasised by making notification a precondition to State intervention.[160]

Bearing all this in mind, EFTA – together with the EU – must fight more actively for subsidy regimes similar to EU/EEA law. All in all, the conflicting negotiating objectives must be balanced and EFTA must not only negotiate well to implement more detailed subsidy provisions, but also recognise their importance for its domestic industries, which are subject to a tight corset of European regulations.

According to *Weck/Reinhold*, the combination of European State aid policy and international free trade efforts resemble "a political tightrope act"[161] but is certainly not an impossible mission.

Conclusion

As an integral part of multilateral trade organisations, such as the WTO but also the EEA, and by concluding nearly 30 FTAs, the prosperity of the EFTA Member States has increased considerably in the last decades. This has been accompanied not only by the sole reduction of tariffs and other non-tariff trade barriers to trade, but also by the associated control of subsidies.

Despite the very different institutional background, WTO rules and EU/EEA rules are not as different as one would expect. Especially, the two systems show great similarities in the definition of a "subsidy". The discrepancy becomes apparent once a measure has been defined as a subsidy. The possibility of exceptions in a common European interest as well as conceptually different procedures for dealing with an undue advantage might lead to unwanted frictions and diplomatic resentments. As far as EFTA is concerned, a possible way out of this situation can be found in the instrument of FTAs. By bringing third countries to a more comprehensive subsidy regime, the pressure on EFTA States and their economies, which goes hand in hand with the strong relationship with the EU, can be reduced.

To sum up, States will never restrict themselves to the possibility of granting subsidies. Consequently, the objective can only be to establish a strong subsidy regulation which, on the one hand, negotiates and defines acceptable types and classifications of subsidies and, on the other hand, effectively prohibits all subsidies apart from these. In *Rubini's* case, this can only work if there is an awareness that a comprehensive subsidy system is in the common (global) interest. He calls for "an underlying stronger sense of community."[162] Building stronger economic ties with third countries by concluding modern FTAs can be a very good step towards this objective. So let us toast another 60 years of EFTA taking steps to build a stronger sense of global free trade community!

159 Rubini (n 12), 84.
160 Rubini (n 12), 84.
161 Weck/Reinhold (n 126), 376.
162 Rubini (n 12), 83.

EFTA as an actor in the transition towards a carbon-neutral economy

Cristina Dans Iglesias

Introduction

The Intergovernmental Panel on Climate Change (IPCC) special report published in 2018 proved the urgency for limiting global warming to 1.5ºC with no or limited overshoot. This requires a reduction of about 45% of global net anthropogenic CO_2 emissions from 2010 levels by 2030 and achieving net-zero emissions around the year 2050.

While the Paris Agreement requires parties to achieve carbon neutrality during the second half of this century[1], at the COP 25, which took place in Madrid in 2019, more than 70 countries committed to submit a 2050 net-zero emissions strategy by 2020[2]. In the case of the European Free Trade Association (EFTA) Member States, Norway and Switzerland have already committed to carbon neutrality by 2050 and Iceland aims at reaching net zero emissions by 2040.

This paper analyses the contribution of EFTA to the transition towards a carbon-neutral economy both at the European Economic Area (EEA) and the international level. The EEA Agreement is at the centre of the climate action cooperation between the EU and the EEA EFTA States. While the EU Emissions Trading System (ETS) has been, since 2008, the cornerstone of this cooperation, Iceland and Norway recently decided to enlarge it by adopting the Effort Sharing Regulation and the Regulation on Land, Land-Use Change and Forestry (LULUCF). Within the international sphere, this paper addresses the environmental approach in free trade agreements and the progressive integration of climate-related provisions in EFTA Free Trade Agreements.

Climate change cooperation at the EEA level

The Kyoto Protocol to the UN Framework Convention for Climate Change (UNFCCC) was adopted in 1997 and entered into force in 2005. The inclusion of greenhouse gas emissions reduction targets in the Protocol, which covered the period 2008-2012, led to the search for new climate policy instruments that could help signatories reduce their emissions[3]. In December 2012, at the Doha Climate Conference, all parties to the Kyoto Protocol agreed on the Doha Amendment, which added the commitments for the period 2013-2020 to the Annex B of the Kyoto Protocol[4].

Article 4 of the Kyoto Protocol allows signatories to fulfil their commitments jointly. On the basis of this provision, the Member States of the European Union committed to reducing its greenhouse gas emissions by 8% against 1990 levels for the period 2008-2012[5]. Following a request made by Iceland in 2009, an agreement was concluded between Iceland

1 Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC), Paris Agreement, United Nations, 2015, article 4.1.

2 Climate Action Summit 2019, *Report of the Secretary-General on the 2019 Climate Action Summit and the way forward in 2020*, New York, United Nations, https://www.un.org/en/climatechange/assets/pdf/cas_report_11_dec.pdf

3 European Commission B, "EU ETS Handbook", retrieved on 10 February 2020, https://ec.europa.eu/clima/sites/clima/files/docs/ets_handbook_en.pdf

4 Council of the European Union A, Council Decision (EU) 2015/1339 of 13 July 2015 on the conclusion, on behalf of the European Union, of the Doha Amendment to the Kyoto Protocol to the United Nations Framework Convention on Climate Change and the joint fulfilment of commitments thereunder, *Official Journal of the European Union,* L 207/1, 4 August 2015.

5 Taking 1990 levels as a reference; Commission of the European Communities A, *Green Paper on greenhouse gas emissions trading within the European Union*, COM (2000) 87 final, Brussels, 8 March 2000, p.4.

and the European Union on the participation of the former during the second commitment period of the Kyoto Protocol[6]. In its request, Iceland expresses its interest both in adhering to the EU Climate and Energy Package and in being part of the joint emissions reduction commitments in the context of the Kyoto Protocol[7]. Following the aforementioned article 4 of the Kyoto Protocol, the Member States of the European Union and Iceland committed together to limit their average annual greenhouse gas emissions to 20% of their base year emissions for the second commitment period (2013-2020)[8].

Overall, the climate policy of the EEA EFTA Members States has evolved together with the EU climate policy. In 2007, the European Union took the lead at the international level with the publication of its Communication "20 20 by 2020 Europe's climate change opportunity"[9]. The Communication, which is considered as a turning point in the climate and energy policy of the European Union, builds on the targets previously agreed by the Council[10].

In April 2009 the European Union adopted the so-called Climate and Energy Package. Delivered ahead of the Fifteenth session of the Conference of the Parties (COP 15), which took place in Copenhagen in December of the same year[11]. Five of the six pieces of legislation that formed the package were EEA relevant, including a Directive on the use of energy from renewable sources, the Fuel Quality Directive, and the Regulations setting emission performance standards for new passenger cars and light commercial vehicles. The exception was the Effort Sharing Decision, which set greenhouse gas emission targets for those industry sectors that fall outside the Emissions Trading Scheme of the European Union, such as transport, building, agriculture and waste. While EFTA Member States did not take part in the first period 2013–2020, covered by the Decision, Norway and Iceland will be participating in the period 2021-2030 on a voluntary basis, as both countries agreed in 2019 to enhance their climate cooperation with the EU by adopting the Effort Sharing Regulation and the LULUCF.

The EU Emissions Trading System

The EU Emissions Trading Scheme has been, since the beginning, a key pillar of the Climate Policy of the European Union. In its Communication "Climate change-towards an EU Post-Kyoto Strategy", published in 1998, the European Commission reflects for the first time on the potential content of its post-Kyoto strategy and announces that the European Union would set up its "own internal trading regime". The main driver for the creation of an emissions trading scheme was to achieve the Kyoto Protocol greenhouse gas emissions reduction targets in a cost-effective manner[12].

The EU ETS was launched in 2005 and quickly became the world's leading "cap-and-trade" system[13]. An Emissions Trading System at the EU level implies having a single price for allowances, which would not have been possible in the case of multiple schemes at the national level[14]. In the context of emissions trading schemes, targeted entities receive a certain amount of emissions allowances, so that, if their final emissions are below their cap, they can sell their "surplus" to entities whose final emissions exceeded their allowances[15]. Emissions trading schemes are

6 Council of the European Union A, op. cit.

7 Council of the European Union, Council Conclusions on the Joint Fulfilment Agreement with Iceland with regard to a future international climate agreement, 2986th Agriculture and Fisheries Council meeting Brussels, 15 December 2009.

8 In most cases,1990; Council of the European Union, Council Decision (EU) 2015/1339 of 13 July 2015 on the conclusion, on behalf of the European Union, of the Doha Amendment to the Kyoto Protocol to the United Nations Framework Convention on Climate Change and the joint fulfilment of commitments thereunder, *Official Journal of the European Union,* L 207/1, 4 August 2015.

9 Commission of the European communities, Communication on the 20 20 by 2020 Europe's climate change opportunity, COM(2008) 30 final, Brussels, 23 January 2008

10 A reduction of at least 20% in greenhouse gases (GHG) by 2020 and a 20% share of renewable energies in EU energy consumption by 2020.

11 J. Delbeke and P. Vis (eds.), EU Climate Policy Explained, European Union, Brussels, 2016, p.17.

12 Commission of the European Communities, *Communication from the Commission to the Council and the European Parliament:* climate change-towards an EU post-Kyoto Strategy, COM(1998) 353 final, Brussels, 3 June 1998, p.20.

13 European Commission A, "EU action against climate change. EU emissions trading: an open system promoting global innovation", Brussels, 26 November 2007, retrieved on 10 February 2020, https://ec.europa.eu/environment/pdfs/2007/pub-2007-015-en.pdf, p.7.

14 Commission of the European Communities A, op.cit., pp.1-11.

15 Ibid.

assumed to have lower compliance cost if compared to a regulatory approach which does not include the possibility of trading emissions. They are also assumed to boost the investment in climate-friendly technology, as companies are incentivised to find a cost-effective way to reduce their emissions[16]. In this sense, while the performance of the EU ETS has varied across its different periods, it is assumed to have led to a reduction in CO_2 emissions without having a negative impact in the competitiveness of the European industry[17].

The EU Emissions Trading System Directive, adopted in 2003, is the legal cornerstone of the EU emissions trading system. The Directive set up the scheme, defined the concept of "allowance"[18] and provided for the penalties applicable in case of infringement[19]. The percentage reductions set out in the Directive are later converted into a cap expressed in tonnes of CO_2 by the European Commission at the start of each trading phase[20].

The evolution of the EU Emissions Trading System took place in various periods: the first period, which lasted from 2005 to 2007, covered around 10.500 installations. It accounted for about 50% of the total CO_2 emissions and 40% of greenhouse gas emissions[21]. In this first period, which was conceived as a pilot phase, the Commission acknowledged that, while the Emissions Trading System could include a wider scope of sectors and greenhouse gases, it was limited to those that could be measured, reported and verified with a high level of accuracy. The sectors chosen were the power and heat generation industry, combustion plants, oil refineries, coke ovens, iron and steel plants, as well as the cement, glass, lime, brick, ceramic, pulp and paper industries[22]. The second phase took place from 2008 to 2012, which corresponds with the initial period for the commitments made under the Kyoto Protocol. In the same line, the third phase, from 2013 to 2020, corresponds to the second phase of the Kyoto Protocol, whose commitments were included in the Doha Amendment[23]. However, while the EU Emissions Trading System´s phases and the commitment periods under the Kyoto Protocol correspond to the same timeframe, it must be noted that the EU Emissions Trading System is independent and is ruled at the EU level[24].

Norway, Iceland and Liechtenstein joined the EU Emissions Trading System at the start of the second trading period, on 1 January 2008, by incorporating the EU ETS Directive into the EEA Agreement[25]. This was the first international agreement signed by the European Union in the context of emissions trading[26].

Norway, which in 1991 established a CO_2 tax as its main climate policy tool, started exploring the possibility of setting up an emissions trading system by 1998. Coinciding with the start of the pilot phase at the EU level, in 2005, its own national emissions trading system was also launched. The scheme designed by Norway was similar to the one applied by the European Union, but excluded those sectors

16 Ibid.

17 A. Dechezleprêtre et al., "The joint impact of the European Union emissions trading system on carbon emissions and economic performance", *OECD Working Papers*, nº 1555, 2018, pp.1-57, p.52.

18 "Allowance to emit one tonne of carbon dioxide during a specific period".

19 European Union, Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, *Official Journal of the European Union,* L 275/32, 25 October 2003.

20 European Commission B, op.cit., p.7.

21 European Commission A, op.cit., p.7.

22 Ibid.

23 European Commission B, op. cit., p.7.

24 Ibid.

25 Ibid.

26 European Commission, Press release: Emissions trading: Commission announces linkage EU ETS with Norway, Iceland and Liechtenstein, Brussels, 26 October 2007.

already covered by the CO_2 tax[27]. Liechtenstein and Iceland introduced a carbon tax in 2008 and 2010 respectively[28]. Currently, around 50% of Norwegian emissions are covered by the EU ETS[29]. In the case of Iceland, this percentage is below 40% of the total annual emissions excluding LULUCF activities[30] and, in the case of Liechtenstein, only two firms are included in the ETS.

Given that Switzerland is not part of the EEA, the linkage between the Swiss and the European systems is considered the first between a national emissions trading scheme and the EU ETS. An agreement was reached between the two Parties on 23 November 2017 in Berne and entered into force on 1 January 2020[31]. The EU established the minimum criteria that should be met by national emission trading schemes prior to a potential linking: be mandatory, set absolute limits on emissions, count with robust registry systems and include monitoring and compliance provisions[32].

For Switzerland, where a CO_2 tax and a national emissions trading scheme was already in place, the main incentive for linking its system with the EU was economic, as the number of emitters in Switzerland is relatively low. According to an economic modelling study made by Switzerland, in a no linkage scenario companies would not have cost-efficient abatement options, forcing business to introduce major changes in their production system. The EU emissions market, larger and more liquid, offers lower abatement costs.

Typical motivations for linking emissions trading systems are the search for economic efficiency, liquidity and price stability. In addition, according to the current state of the research, linking emissions trading schemes could also entail environmental benefits, being a driver for a higher degree of ambition in climate policy[33]. With regards to the foreseen environmental policy implications of the linkage, in Switzerland only 10% of the emissions are subject to the ETS. Thus, the impact of the linkage is not expected to be enough to raise the ambition of its climate policy per se.

The Climate and Energy Policy Framework 2030

The European Council, in its conclusions from 24 October 2014, set the ground for the 2030 climate and energy policy framework of the European Union, which defines how the European Union will achieve its greenhouse gas emissions target for 2030. This target, a reduction of at least 40% of greenhouse gas emissions compared to 1990, is shared between those sectors covered by the EU ETS and non-ETS sectors[34]. However, in the context of the European Green Deal, the Commission announced its willingness to raise the level of ambition of the EU 2030 greenhouse gas emission targets from the initial 40% to, at least, 50% and towards a 55% compared to 1990 levels. The new targets will be accompanied by a revision of climate policy instruments, including the

27 Nordic Council of Ministers, Emissions trading outside the European Union, Copenhagen, 2007. p.40.

28 M. Hofbauer Pérez and C. Rhode, "Carbon Pricing: International Comparison", *ifo DICE Report I*, vol. 18, 2020, pp. 49-57, p.53.

29 Norwegian Ministry of Climate and Environment, Norway's National Plan related to the Decision of the EEA Joint Committee No. 269/2019 of 25 October 2019, December 2019, p.4.

30 Environment Agency of Iceland, Soil Conservation Service of Iceland and Icelandic Forest Service, Report on policies, measures and projections. Projections of Greenhouse Gas emissions in Iceland till 2035, Environment Agency of Iceland, 2019,p. 14.

31 Council of the European Union, Press release: Linking of Switzerland to the EU emissions trading system – entry into force on 1 January 2020, Brussels, 9 December 2019.

32 Ibid.

33 International Carbon Action Partnership, A Guide to Linking Emissions Trading Systems, Berlin, 2018, p.26.

34 Emissions reductions coming from EU ETS sectors will amount to 43% compared to 2005 levels, while in the case of non-ETS sectors, the reduction will amount to 30% compared to 2005; European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions: A policy framework for climate and energy in the period from 2020 to 2030, COM(2014) 15 final, Brussels, 22 January 2014, p.5.

Emissions Trading System, which might be extended to new sectors, the Effort Sharing Regulation and the LULUCF Regulation[35].

While the EU ETS is considered a key policy instrument for achieving the greenhouse gas emissions of the European Union, the Conclusions of the European Council also highlight the relevance of non-ETS sectors, which are covered by the Effort Sharing Regulation and the LULUCF Regulation[36]. As previously mentioned, the Effort Sharing Regulation set national greenhouse gas emission targets for those industry sectors that are not covered by the ETS, such as transport, building, agriculture and waste[37]. For the period 2021-2030, they range from 0% to 40% compared to 2005 levels. For complying with the LULUCF Regulation, states must ensure that emissions do not exceed removals[38] for two periods: 2021 to 2025 and 2026 to 2030[39]. Known as the "no debit" rule, states can balance emissions and removals coming from different land categories and accumulate net removals during the period 2021 to 2030[40]. Nevertheless, the Regulation provides for some flexibilities, including the possibility of buying and selling net removals.

There is a two-way interaction between global warming and land use. While climate change impacts the functioning and state of the land, changes in land and land use modulate climate. Land ecosystems are both sinks and sources of greenhouse gases. For instance, forests gather more carbon than agricultural land and, as a consequence, the deforestation of land for agricultural results in an increase of CO_2 emissions[41]. In this regard, the text of the LULUCF Regulation acknowledges that sustainably-managed forests are a sink for greenhouse gases. Therefore, Member States should not only ensure that they are conserved but also enhance them, as they have the potential to contribute to the achievement of the long-term goals of the Paris Agreement[42].

In October 2019, Iceland and Norway agreed with the EU to extend the climate cooperation for the period 2021 to 2030 and also enhance it by adopting the Effort Sharing Regulation[43] and the Regulation on Land, Land-Use Change and Forestry (LULUCF)[44]. The Decision JCD 269/2019 of the EEA Joint Committee included both pieces of regulation in the EEA Agreement. This Decision was accompanied by a Declaration by Iceland and Norway which specifies that both countries will, on a voluntary basis, draft national plans describing how they will comply with the commitments made in the context of both the Effort Sharing Regulation and the LULUCF

35 European Commission, Communication on The European Green Deal, COM(2019) 640 final, Brussels, 11 December 2019, p.4.

36 The LULUCF Regulation was drafted and approved after the release of the Council conclusions on the 2030 climate and energy policy framework. However, the text indicates that policy on LULUCF will be drafted and integrated into the framework before 2020; European Council A, op.cit., pp. 1-5.

37 European Parliament and Council, Regulation of 30 May 2018 on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement and amending Regulation (EU) No 525/2013, *OfficialJournal of the European Union, OJ L 156, 19 June 2018, pp. 26–42.*

38 Calculated as the sum of total emissions and total removals on its territory.

39 European Union, Regulation (EU) 2018/841 of the European Parliament and of the Council of 30 May 2018 on the inclusion of greenhouse gas emissions and removals from land use, land use change and forestry in the 2030 climate and energy framework, and amending Regulation (EU) No 525/2013 and Decision No 529/2013/EU, *Official Journal of the European Union,* L 156/1, 30 May 2018.

40 Ibid.

41 E. Shevliakova et al., "Land-climate interactions", in C. P.R. Shukla et al. (eds), *an IPCC special report on climate change, desertification, land degradation, sustainable land management, food security, and greenhouse gas fluxes in terrestrial ecosystems.* In press., p. 205.

42 European Union, Regulation (EU) 2018/841 of the European Parliament and of the Council of 30 May 2018 on the inclusion of greenhouse gas emissions and removals from land use, land use change and forestry in the 2030 climate and energy framework, and amending Regulation (EU) No 525/2013 and Decision No 529/2013/EU, *Official Journal of the European Union,* L 156/1, 30 May 2018.

43 European Union, Regulation (EU) 2018/842 of the European Parliament and of the Council of 30 May 2018 on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement and amending Regulation (EU) No 525/2013, *Official Journal of the European Union,* L 156/26, 19 June 2018.

44 Ibid.

Regulation[45]. Norway submitted its National Plan in 2019 and Iceland has recently drafted a new plan that updates its initial Climate Action Plan for 2030, published in 2018.

Norway indicates in its National Plan, submitted that the Government aims at reducing those emissions that fall outside the Emissions Trading System by 45 per cent in 2030 against 2005 levels. This commitment goes beyond the 40 per cent reduction that corresponds to Norway in the context of the Effort Sharing Regulation. The Government of Norway intends to achieve this goal by applying domestic policy tools and foresees to use the flexibility mechanisms provided by the Regulation only if strictly necessary. These flexibilities include buying and selling to other countries and using a certain number of ETS allowances for offsetting emissions from those sectors covered by the Effort Sharing Regulation[46].

With regard to the LULUCF Regulation, following the estimations of the Norwegian government, complying with the "no debit" rule will not be possible without additional measures or the use of the flexibility mechanisms provided by the Regulation[47]. An example of these additional measures, not included in the current projections, are the restrictions to the cultivation of peatlands. In Norway peatland CO2 emissions account for 15% of total CO2 emissions[48], the restrictions to be introduced by the Norwegian government are expected to prevent the cultivation of 200 hectares of peatlands per year, which could generate 450. 000 tonnes of CO2 equivalent during the period 2021-2030[49].

Iceland's new National Plan includes 48 measures. With regards to the emissions of those sectors covered by the Effort Sharing Regulation, the estimations of the Icelandic government show that, while a business as usual scenario would result in a 20% reduction in the period 2005 to 2030, by implementing these measures a 35% reduction is expected. In addition, further measures that are currently being drafted are expected to result in an additional reduction ranging from 5% to 11%. In conclusion, according to the projections made by the Icelandic government, the decrease in emissions is expected to exceed the 29% reduction target that corresponds to Iceland under the Effort Sharing Regulation[50].

On the LULUCF activities, the Climate Action Plan published in 2018 by Iceland already addressed them, notably by including measures aimed at increasing carbon capture and storage through afforestation. Those measures also included the protection and restoration of wetlands[51], as in Iceland peatland CO_2 emissions double the total of emissions from all other sources[52].

45 "Declaration by Iceland and Norway on national plans related to Decision of the EEA Joint Committee No 269/2019 of 25 October 2019", EFTA, retrieved on 15 January, https://www.efta.int/sites/default/files/documents/legal-texts/eea/other-legal-documents/adopted-joint-committee-decisions/2019%20-%20English/269-2019%20-declaration.pdf

46 Norwegian Ministry of Climate and Environment, Norway's National Plan related to the Decision of the EEA Joint Committee No. 269/2019 of 25 October 2019, 2019, p. 29.

47 Norwegian Ministry of Climate and Environment, op.cit., p.28.

48 Excluding land use; Barthelmes et al., *Peatlands and Climate in a Ramsar context. A Nordic-Baltic Perspective*, Denmark, 2015, Nordic Council of Ministers, p.8.

49 Norwegian Ministry of Climate and Environment, op.cit., p.28.

50 "New Climate Action Plan – Iceland will fulfil its commitments and more", Government of Iceland, 23 June 2020, retrieved on 30 June 2020, https://www.government.is/diplomatic-missions/embassy-article/2020/06/23/New-Climate-Action-Plan-Iceland-will-fulfil-its-commitments-and-more/

51 Ministry for the Environment and Natural Resources of Iceland, Climate Action Plan for 2018-2030, 2018, p.7.

52 Excluding land use; Peatland and climate, p.8.

The integration of the climate approach in EFTA´s free trade agreements

Environmental provisions in free trade agreements

The concept "sustainable development" was defined for the first time in the Report of the World Commission on Environment and Development, Our Common Future, published in 1987 and known as the Brundtland Commission. In the report, sustainable development was conceived as "a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are made consistent with future as well as present needs"[53]. Later, in 2002, the Plan for the Implementation of the World Summit on Sustainable Development of Johannesburg mentioned for the first time the "three dimensions of sustainable development": economic, social and environmental[54]. Finally, the document "The future we want", the outcome of the Rio+20 United Nations Conference on Sustainable Development, which took place in 2012, refers again to these three dimensions, and highlights the importance of the "environmental pillar", affirming "the need to strengthen international environmental governance within the context of the institutional framework for sustainable development in order to promote a balanced integration of the economic, social and environmental dimensions of sustainable development"[55].

Since 1990, the number of regional trade agreements which include environmental provisions has been growing, going from 20% in 2000 to 50% in 2014[56]. Key environmental-related provisions in Regional Trade Agreements include commitments on the enforcement of national environmental laws or environmental standards, and co-operation and capacity building mechanisms[57]. In the case of climate change, it has been approached in various ways, for instance, by removing barriers to the trade of "climate-friendly" goods and services or including climate provisions aimed at encouraging cooperation between parties[58].

Four main policy drivers for the inclusion of environment-related provisions in Regional Trade Agreements were identified in the report "Environment and Regional Trade Agreements: Emerging Trends and Policy Drivers", published by the OECD in 2007: to contribute to the overarching goal of sustainable development; to ensure a level playing field among parties to the agreement; to enhance cooperation in environmental matters of shared interest and to pursue an international environmental agenda[59].

Since the beginning of the XXI century, there has been an increasing trend to include the so-called "behind-the-border" provisions, including environmental ones, in free trade agreements[60]. At EFTA, the debate around the introduction of environment and labour standards provisions took place simultaneously. On

53 World Commission on Environment and Development, *the Report of the World Commission on Environment and Development: Our Common Future*, United Nations, New York, 1983, p.7.

54 The World Summit on Sustainable Development, *Plan of Implementation of the World Summit on Sustainable Development*, United Nations, Johannesburg, 2012, p. 60.

55 Río+20, United Nations Conference on Sustainable Development, *The future we want, outcome document of the United Nations Conference on Sustainable Development*, United Nations, Río de Janeiro, 2012, p. 23.

56 I. Martínez-Zarzoso, "Assessing the Effectiveness of Environmental Provisions in Regional Trade Agreements: An Empirical Analysis", *OECD Trade and Environment Working Papers 2018/02*, p. 10.

57 OECD, Environment and Regional Trade Agreements, Paris, OECD, 2007, p.27.

58 H. van Asselt, "Climate change and trade policy interaction: Implications of regionalism", *OECD Trade and Environment Working Papers 2017/03*, p. 29.

59 C. George, "Environment and Regional Trade Agreements: Emerging Trends and Policy Drivers", *OECD Trade and Environment Working Papers 2014/02*, p.6.

60 Committee of Members of Parliament of the EFTA Countries, CMP Report Environmental Policies and Labour Standards in FTAs, Brussels, 18 March 2009, p.1.

November 2008, two ad hoc working groups both on environment and labour standards were created[61]. In a context in which EFTA Ministers were "looking at new aspects" concerning their trade relations with third-country partners, in 2009, EFTA´s Consultative Committee stated the importance of encouraging economic growth that is also sustainable and socially just through free trade agreements[62].

At the EFTA Parliamentary Committee meeting that took place on 25 November 2008, the Committee agreed to adopt a report on environmental policies and labour standards in free trade agreements with the aim of reporting on its current status and exploring the incorporation of these provisions in future free trade agreements. The report, published in 2009, concluded that, while there was a consensus on the need for strengthening and upholding environmental protection, one of the main questions was whether or not free trade agreements were the adequate context for them. Other questions raised included the extent to which EFTA could ensure the enforceability of such provisions and the risk of foregoing trade opportunities due to its inclusion. The report concluded, however, that it would not be desirable for EFTA to have lower environmental and labour standard provisions than the EU, the US or Canada, which were already addressing both topics in their free trade agreements. This report contributed to the work that was being done by the EFTA´s Working Group on Trade and Environment and the Working Group on Labour Standards in Free Trade Agreements[63], which had the mandate to consolidate the provisions related to trade, environment and labour standards in EFTA´s Free Trade Agreements and to elaborate a set of new model provisions to be proposed to EFTA partners[64].

In June 2010 the conclusions of the work carried out by both Working Groups were presented to the EFTA Ministers at the EFTA Ministerial Conference that took place in Reykjavik. The result was several model provisions aimed at addressing both labour and the environment. They included a new chapter on "Trade and Sustainable Development". Among its provisions were the "commitment to observe multilateral environmental agreements" and "the promotion of trade in goods and services as well as investment favouring the environment and sustainable development[65].

Climate-related provisions in EFTA´s free trade agreements

Since 2010 all free trade agreements subscribed by EFTA include a chapter on sustainable development. As shown in the table annexed, the exception is the EFTA-Hong Kong Free Trade Agreement, signed in 2011, which replaced it by a chapter on trade and environment that included similar provisions. With a view to future free trade agreements and the revision of the existing ones, they are all expected to include a provision on trade and climate change. However, its inclusion requires the approval of both Parties.

Along these lines, the EFTA-Turkey Free Trade Agreement, initially signed in 1991, the EFTA-Serbia Free Trade Agreement, signed in 2009, and the EFTA-Albania Free Trade Agreement, also signed in 2009, have been revised and include now a chapter on sustainable development. In the case of Turkey, the inclusion of this chapter took place in the context of the modernisation and expansion of the agreement, which took place in 2018, while in the case of Serbia and Albania the chapter on sustainable development was added, respectively, through a protocol amending the free trade agreement that was signed

61 EFTA Consultative Committee, The need for increased dialogue with regard to EFTA's free trade agreements, Brussels, 11 March 2009.

62 Ibid.

63 Committee of Members of Parliament of the EFTA Countries, op.cit., pp. 19-20.

64 "Background information on the conclusions of EFTA work on trade, environment and labour standards", State Secretariat for Economic Affairs of the Government of Switzerland, retrieved on 8 January 2020, https://www.newsd.admin.ch/newsd/message/attachments/19675.pdf.

65 Ibid.

between both parties in 2015. In total, there are currently 16 free trade agreements that include environmental-related provisions out of the total 29 free trade agreements signed by EFTA.

The content of the sustainable development chapter has evolved since 2010. From the climate perspective, three provisions are particularly relevant: the provision on the promotion of "Trade and Investment Favouring Sustainable Development", the provision on "Trade in Forest-Based Products" and the provision on "Trade and Climate Change".

The provision on the promotion of "Trade and Investment Favouring Sustainable Development" states in its first paragraph that "Parties shall strive to facilitate and promote foreign investment, trade in and dissemination of goods and services beneficial to the environment, including environmental technologies, sustainable renewable energy, energy efficient and eco-labelled goods and services. Related non-tariff barriers will be addressed as part of these efforts". This article has been present since the introduction of the chapter. In line with the Doha Ministerial Declaration, adopted in 2001, it addresses the need for facilitating the trade of environmental goods and technologies[66]. The application of this provision depends on the national context and includes the promotion of voluntary standards and schemes, such as ecolabels.

The provision on "Trade in Forest-Based Products", later referred to as "Sustainable Forest Management and Associated Trade" is present in those free trade agreements signed by EFTA after 2013. It is aimed at contributing to the "reduction of greenhouse gas emissions and biodiversity loss resulting from deforestation and degradation of natural forests and peatlands, including from land-use change"[67]. Through this article, both Parties commit to working together at the bilateral and multilateral level, notably in the context of the United Nations collaborative initiative on Reducing Emissions from Deforestation and Forest Degradation. In particular, the provision specifies that the instruments for achieving this objective include "the promotion of the effective use of the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)", the promotion of the "development and use of certification schemes for forest-related products from sustainably managed forests" and the promotion of "the effective implementation and use of legality assurance system for timber as required in Forest Law Enforcement Governance and Trade Voluntary Partnership Agreement and corresponding schemes", aimed at combating illegal logging and eliminating trade of illegal timber products as well as the "exchange information on trade-related initiatives on forest governance, including measures to combat illegal logging and measures to exclude illegally harvested timber and timber products from trade flows"[68]. In the case of Indonesia, this provision on sustainable forest management is accompanied by another one on the "Sustainable Management of the Vegetable Oils Sector and Associated Trade" aimed at "ensuring economically, environmentally and socially beneficial and sound management and operation of the vegetable oils sector"[69]. This is particularly relevant as the oil sector has been traditionally associated with deforestation in Indonesia.

66 World Trade Organisation, Fourth Session of the Ministerial Conference, Doha, 9-14 November 2001.

67 EFTA States and The Republic of Indonesia, Comprehensive Economic Partnership Agreement between the Republic of Indonesia and the EFTA States, Jakarta, 16 December 2018, art. 8.8.

68 EFTA States and The Republic of Indonesia, Comprehensive Economic Partnership Agreement between the Republic of Indonesia and the EFTA States, Jakarta, 16 December 2018, art. 8.8.

69 EFTA States and The Republic of Indonesia, op. cit., art. 8.10.

The inclusion of a forest-related provision shows that sustainable forest management is high on the trade agenda of the EFTA member states. An example of this is Norway's International Climate and Forest Initiative (NIFI), launched in 2007 at the COP 13, which took place in Bali. Since its creation by Parties to the United Nations Framework Convention on Climate Change (UNFCCC), Norway has been the bigger contributor for Reducing Emissions from Deforestation and forest Degradation (REDD+) scheme. In the context of the NIFI, Norway has signed bilateral agreements with Brazil, Indonesia, Mexico and Vietnam, among others[70].

Lastly, a provision on "Trade and Climate Change" was firstly introduced in the EFTA-Ecuador Free Trade Agreement, signed in 2018, and is also expected to be included in the EFTA-Mercosur Free Trade Agreement. It recognises that trade plays an essential role in the achievement of the objectives of the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement and, ultimately, in the transition to a "low-carbon, sustainable and climate-resilient economy". It also indicates that both parties shall implement both the UNFCCC and the Paris Agreement accordingly and cooperate at the bilateral and multilateral level[71].

Overall, the above-mentioned provisions show that the transition towards a low-carbon economy has gained increased importance on EFTA´s trade agenda. Regarding the monitoring of its implementation, the inclusion of climate-related provisions in the sustainable development chapter guarantees the possibility of bringing up any of the issues covered by them at the Joint Committee when one of the parties is not delivering. The progress made with regard to the content of these articles is also assessed at the Joint Committee, that should review periodically the action being taken towards the objectives set in them[72].

70 A. Angelsen, "REDD+ as Result□based Aid: General Lessons and Bilateral Agreements of Norway", Review of Development Economics, vol. 21, nº 2, 2016, pp. 237-264.

71 EFTA States and The Republic of Ecuador, Comprehensive Economic Partnership Agreement between the Republic of Ecuador and the EFTA States, Sauðárkrókur, 25 June 2018, art. 8.11.

72 See, for example, Comprehensive Economic Partnership Agreement between the Republic of Ecuador and the EFTA States, 25 June 2018, art. 8. 14.

Conclusions

The climate policy of the EEA EFTA Members States has evolved, to a great extent, in parallel with the EU climate policy. Its cooperation has notably increased over the past ten years with the EEA Agreement at its centre. Since 2008, EEA EFTA States are part of the EU ETS and, more recently, Norway and Iceland decided to extend their cooperation to the Effort Sharing and the LULUCF Regulations. However, in the context of the Effort Sharing Regulation, both countries have committed to go beyond their corresponding targets. While at present it is not possible to determine what will be the outcome of the measures contained in Iceland´s and Norway´s national plans, according to their estimations, the greenhouse emissions reduction will be higher than required by the Regulation within those sectors that fall outside the ETS.

Driven by the need for cost-efficient abatement options, the linkage between the Swiss and the European emissions trading schemes is considered the first between a national emissions trading scheme and the EU ETS, as the previous took place in the context of the EEA Agreement. After the addition of Switzerland, all EFTA Member States are "linked" to the EU ETS. The performance of the EU ETS has varied over time and the proportion of emissions covered by it vary across EFTA member states. The integration of the EU ETS in the EEA and the subsequent linkage of the Swiss emissions trading scheme is expected to help EFTA Member States to achieve their targets more efficiently. However, there is no sufficient evidence regarding its potential as a driver for a higher degree of ambition in climate policy.

Since 2010 EFTA has been integrating a chapter dedicated to sustainable development in all its free trade agreements. From the climate perspective, three provisions are particularly relevant: the provision on the promotion of "Trade and Investment Favouring Sustainable Development", the provision on "Trade in Forest-Based Products" and the provision on "Trade and Climate Change". In total, there are currently 16 free trade agreements that include climate-related provisions out of the total 29 free trade agreements signed by EFTA. Its integration in the sustainable development chapter guarantees the possibility of bringing up any of the issues covered by them at the Joint Committee when one of the parties is not delivering. It also involves the periodic review of the progress made by the parties towards the objectives set in the relevant articles.

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Annex A. Climate-related provisions in EFTA´s Free Trade Agreements

YEAR	COUNTRY	SUSTAINABLE DEVELOPMENT	SUSTAINABLE FOREST MANAGEMENT	CLIMATE	SUSTAINABLE OIL MANAGEMENT
1992	ISRAEL				
1997	MOROCCO				
1998	PALESTINIAN AUTHORITY				
2000	NORTH MACEDONIA				
2000	MEXICO				
2001	JORDAN				
2002	SINGAPORE				
2003	CHILE				
2004	LEBANON				
2004	TUNISIA				
2005	KOREA, REPUBLIC OF				
2006	SOUTHERN AFRICAN CUSTOMS UNION (SACU)				
2007	EGYPT				
2008	CANADA				
2008	COLOMBIA				
2009	GULF COOPERATION COUNCIL (GCC)				
2010	UKRAINE	X			
2010	PERU				
2011	MONTENEGRO	X			
2011	HONG KONG, CHINA	X*			
2013	BOSNIA	X			
2013	CENTRAL AMERICAN STATES (COSTA RICA, GUATEMALA AND PANAMA)	X	X		
2016	GEORGIA	X	X		
2016	PHILIPPINES	X	X		
2018	ECUADOR	X	X	X	
2018	INDONESIA	X	X		X

Source: Prepared by the author based on the content of EFTA´s free trade agreements.
* The EFTA-Hong Kong FTA included a similar provision on trade and environment.

YEAR	COUNTRY	SUSTAINABLE DEVELOPMENT	SUSTAINABLE FOREST MANAGEMENT	CLIMATE	SUSTAINABLE OIL MANAGEMENT
1991, revised in 2018	TURKEY	X			
2009, revised in 2015	SERBIA	X			
2009, revised in 2015	ALBANIA	X	X		

Source: Prepared by the author based on the content of EFTA´s free Trade agreements.

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