

A European Free Trade Area - United Kingdom Memorandum to the Organisation for European Economic Co-operation (February 1957)

Part I

United Kingdom views on a European Free Trade Area

1. Her Majesty's Government earnestly desire a successful outcome of the continued efforts in the post-war world to strengthen the cohesion and promote the prosperity of Western Europe. They have therefore given careful thought in recent months to the widely held view that our principal economic need in Europe is to remove existing barriers to trade and develop a single market for manufactured goods. With a population of 250 million, there is clearly a great opportunity which Europe can seize provided that the free circulation of goods is not impeded by tariffs and quantitative restrictions throughout Europe. The need to take large and constructive measures to remove these barriers to trade is the more urgent in view of the pace of technical development which increasingly demands larger markets in order that its full benefits may be obtained. During the past decade a great deal has been done in the Organisation for European Economic Co-operation and elsewhere to lower trade barriers in Europe, but Her Majesty's Government believe that what is needed now is a much bolder approach.

2. With these considerations in mind Her Majesty's Government are glad that the negotiations which were set in train in June 1955 for the establishment of a Customs and Economic Union consisting of France, Germany, Italy, Belgium, Holland and Luxembourg are now approaching a successful conclusion. There are, however, substantial reasons why the United Kingdom could not become a member of such a Union. These arise in particular from the United Kingdom's interests and responsibilities in the Commonwealth. If the United Kingdom were to join the Customs and Economic Union, the United Kingdom tariff would be replaced by a single common tariff with the other member countries against the rest of the world. This would mean that goods entering the United Kingdom from the Commonwealth would have to pay duty at the same rate as goods coming from any other third country not a member of the Customs and Economic Union, while goods from the Union would be admitted free of duty. Her Majesty's Government could not contemplate entering arrangements which would in principle make it impossible for the United Kingdom to treat imports from the Commonwealth at least as favourably as those from Europe.

3. At the same time it is of great importance in the view of Her Majesty's Government to establish free trade over as wide an area as possible within Western Europe. It was for this reason that Her Majesty's Government strongly supported the decision taken by the Council of O.E.E.C. in July 1956 that a study should be made urgently to discover whether other member countries of the Organisation could be associated with the Customs and Economic Union.

4. The possibility of such an association has now been examined by Working Party No. 17 of the Council. Her Majesty's Government believe, with the members of that Working Party, that it is fully practicable for the United Kingdom and many other O.E.E.C. countries, including the countries which are proposing to create a Customs and Economic Union, to enter a Free Trade Area. The members of this Free Trade Area would undertake to eliminate, in respect of each other's products, protective duties and other restrictive regulations of commerce, including quantitative restrictions. They would be free to keep their own separate and

different tariffs on imports from outside the Area, except that the countries which were also members of the Customs and Economic Union would in due course establish a common external tariff; they would also be able to vary these tariffs, subject to any international agreements by which they are bound from time to time.

5. Her Majesty's Government's own examination of this problem had led to the conclusion that, provided foodstuffs were excluded from its scope, a Free Trade Area in Europe could be established. On 26th November 1956 the Government informed the House of Commons of their intention to enter into negotiations in O.E.E.C. with this in view. Now that the practicability of a European Free Trade Area has been confirmed by the Working Party, Her Majesty's Government hope that other countries will also declare, either before or in the course of the forthcoming meeting of O.E.E.C., their willingness to negotiate on these lines.

6. Her Majesty's Government recognise the desirability of associating with the development of the Free Trade Area as many countries in Europe as possible. At the same time it is of the essence of the Free Trade Area that the obligations undertaken by its members progressively to remove tariffs over the whole field of trade which it includes should be reciprocal. Accordingly it is the view of Her Majesty's Government that the Free Trade Area should be open to all the member countries of O.E.E.C. who were prepared to accept its obligations. The position of any such countries which felt unable to accept the obligations of a Free Trade Area would need to be examined.

7. Her Majesty's Government believe that the establishment of a Free Trade Area would in no way prejudice the high level of employment which Europe generally has enjoyed, and that it should be an objective of member countries to maintain a high and stable level of employment. This would be an essential condition for the effective working of the Free Trade Area.

8. Her Majesty's Government advocate the establishment of a Free Trade Area in the belief that it will raise industrial efficiency by the encouragement it will afford to increased specialisation, large-scale production, and new technical and industrial developments. It should therefore strengthen the economy of Western Europe as a whole; and as a result of its formation the members of the Area should be in a stronger position progressively to remove restrictions on imports from countries outside the Area. The proposal aims at the total removal of barriers to trade over a significant proportion of world trade. It does not involve the creation of any new barriers against trade with the rest of the world. On the contrary Her Majesty's Government consider it indispensable that the Free Trade Area should be formed in such a way as to be wholly consistent with the existing objective of a collective approach to the widest possible system of multilateral trade and payments. It should also be fully consistent with the obligations of member countries as contracting parties to the G.A.T.T., the provisions of which would continue to govern the relations of the G.A.T.T. members of the Area with other G.A.T.T. countries.

## Part II

### Problems of a Free Trade Area

9. In the light of the considerations set out above, Her Majesty's Government have studied with the greatest interest the Report of Working Party No. 17. They regard this Report as a valuable study of the issues involved in the project for the formation of a Free Trade Area.

10. Though they have not yet formed a detailed view on a number of the questions analysed in the Report, Her Majesty's Government believe that it would be useful to indicate their general attitude on some of these questions, on which broad decisions of principle need to be taken at the Ministerial Council in order that negotiations may proceed.

#### General Economic Problems

11. Her Majesty's Government's concept of the Free Trade Area differs in some important respects from that of the Customs and Economic Union now contemplated by the Messina Powers. The arrangements proposed for the Customs and Economic Union involve far-reaching provisions for economic integration and harmonisation of financial and social policies, and for mutual assistance in the financing of investment. These arrangements are to be effected within an appropriate institutional framework. Her Majesty's Government envisage the Free Trade Area, on the other hand, as a concept related primarily to the removal of restrictions on trade such as tariffs and quotas. Nevertheless, Her Majesty's Government recognise that co-operation in the field of economic policy is of great and continuing importance. In practice an appreciable movement towards closer economic co-operation may be expected to take place among the members of a Free Trade Area over a period of years, either as a matter of deliberate policy or as a spontaneous development.

12. This co-operation will include such questions as the maintenance of satisfactory multilateral payments arrangements, consultation on questions of economic and financial policy of common interest and the avoidance of marked divergences between the policies pursued by member countries, co-operation in the furtherance of constructive social policies and arrangements about invisible exports and services, in which there must be no discrimination amongst members of the European Free Trade Area, and movements of capital and labour. In all these matters the nature of the trading and financial arrangements which exist among them make the members of O.E.E.C. already conscious of the need to maintain and enlarge close contact and consultation; and this need may become greater as the Free Trade Area develops. Her Majesty's Government believe that the existing procedures which have been developed successfully over many years within O.E.E.C. for dealing with this range of problems have proved their worth and should be continued subject to such modifications and improvements as may from time to time be found desirable.

13. It has been suggested that there are certain disparities between the social regulations in different countries which are likely to distort the free play of competition, and that these disparities should be corrected by harmonising these regulations at the beginning of the transitional period during which the Free Trade Area would be established. Her Majesty's Government's view is that this is only one of a very great number of factors of varying degrees of importance, some transitory, some permanent, some man-made, such as taxation and social legislation, others natural such as climate and terrain, which influence the pattern of international trade. Some of these differences cannot be removed by any legislative act, and Her Majesty's Government do not consider it essential, in order to achieve the degree of effective competition necessary for the functioning of the Free Trade Area, that agreement to remove any one of them should precede or be a necessary condition of the creation of such an Area.

#### Foodstuffs

14. There are special considerations which are of great concern to the United Kingdom in the matter of agriculture: the United Kingdom must be free to continue the preferential arrangements which apply to imports of foodstuffs from the Commonwealth; this is necessary in the interests both of the independent members of the Commonwealth and of the Colonial territories, many of which rely to an important extent on the preferential treatment which their exports of foodstuffs receive in the United Kingdom. It is essential that the United Kingdom should be able to continue the preferential arrangements which have been built up over the last twenty-five years.

15. Quite apart from these considerations which are of particular significance to Her Majesty's Government, there are other compelling reasons for the exclusion of foodstuffs from the Free Trade Area. The United Kingdom and most other European countries protect their home agriculture by one means or another for well-known reasons, and will wish to continue to do so. The United Kingdom would not in the foreseeable future be prepared to remove protection in this field and to admit the free entry of foodstuffs as is intended for other products; nor would Her Majesty's Government expect other countries to take such action. Indeed it appears to be the intention of the Messina Powers to institute a regulated market for agricultural produce, rather than a free market as is proposed for industrial products. Any special arrangements for agricultural produce, if restrictive in character, might clearly give rise to difficulty in securing international agreement.

16. For these reasons Her Majesty's Government have throughout made clear their view that the products in question (broadly the items enumerated in Chapters 1 to 24 of the Brussels Nomenclature\*) must be excluded from the provisions of the Free Trade Area. Her Majesty's Government's proposal is accordingly for a European Industrial Free Trade Area defined in this sense. It is of course the intention of Her Majesty's Government to continue to play a full part in the work of the Ministerial Food and Agriculture Committee and other organs of O.E.E.C. concerned with trade in agricultural products.

#### Method of Reduction of Tariffs

17. In the view of Her Majesty's Government the method of reduction of tariffs during the transitional period is a question of outstanding importance. They strongly endorse the Working Party's conclusion that this is a field where identical or closely similar arrangements within the Free Trade Area and the Customs and Economic Union would appear to be highly desirable. The objective appears to Her Majesty's Government to be the establishment of clear and unambiguous rules so that industry in each country can plan its production and its investment in advance knowledge of how it is likely to stand in relation to the tariffs of other countries and of what the position of imports from other countries into its own market will be. The system should also enable public opinion in all countries to recognise that there is reciprocity in the rate of reduction, and that no discriminations are being created between members of the Area. The method of reduction to be adopted should contain a large element of certainty and automatic procedures defined in advance.

#### Revenue Duties

18. Her Majesty's Government are of the opinion that the right to levy duties for revenue purposes should not be impaired by the rules of the Free Trade Area. They agree that any protective element in existing duties (whether import, export or excise duties) will need to be eliminated during the transitional period for goods to which the provisions of the Free Trade

Area apply. The precise definition of protection in this context will need to be settled in negotiation.

#### Quantitative Import Restrictions

19. Her Majesty's Government agree with the Working Party that quantitative restrictions within the Area will have to be removed and that it is of paramount importance to adopt the same methods within the Free Trade Area and the Customs and Economic Union if discrimination is to be avoided and the results of past work within O.E.E.C. are to be maintained. Her Majesty's Government think that the principle should be progressive annual increases, coupled with a programme for the complete abolition of quantitative restrictions within the Free Trade Area well within the transitional period contemplated for the reduction of tariffs. Such a programme would, of course, be subject to the escape clause for the imposition of quotas in acute balance of payments difficulties which is referred to in paragraph 20 below.

#### Escape Clauses

20. Her Majesty's Government welcome the general approach of the Working Party to this important subject. They agree that the invocation of escape clauses involves so serious a breach of the obligations undertaken by members in joining a Free Trade Area that it should rarely occur and probably only on the occasion of extremely serious balance of payments difficulties. In this field, too, they believe that there must be similar rules within the Free Trade Area and the Customs and Economic Union if full reciprocity and non-discrimination are to be maintained. In the event of acute balance of payments difficulties, it is clear that the imposition of quotas must be permitted and this without prior consultation, though it should be made subject to frequent and stringent examination. Apart from this, it seems unlikely that there will be circumstances in which unilateral action would be justified. In cases, if any, other than of acute balance of payments difficulties it appears that prior consultation and frequent subsequent examination should be the rule.

#### Rules of Competition

21. There are a number of other forms of Government intervention in the operation of commerce which are capable, to a greater or lesser degree, of frustrating the objectives of the Free Trade Area. These include the use of subsidies; artificial aids to exports; export controls; certain types of State trading; and discrimination in freight rates. In regard to practices of this kind, provisions of the G.A.T.T. or rules worked out in the O.E.E.C. already apply wholly or in part. These provisions will have to be applied in the Free Trade Area and in some cases they may need to be strengthened.

22. It will also in Her Majesty's Government's view be desirable to consider the possibility of frustration of the objectives of the Free Trade Area through the operation of private monopolies or restrictive business practices in private commerce; means would have to be provided by which specific practices likely to create major difficulties for the Free Trade Area could be dealt with. In considering this question it will be necessary to bear in mind that in most if not all countries legislative powers are far from being developed to the point where they are yet in a position to take decisive action. It may therefore be found that the formulation of general principles would be premature since countries are unlikely to be well

placed to implement such principles. Consideration of these aspects will, however, be necessary.

#### Definition of Origin

23. On the problem of the definition of origin analysed in detail in Annex I of the Working Party's Report, Her Majesty's Government agree with the conclusion of the Working Party that a combination of the percentage system and the system based on types of processes performed in the Free Trade Area offers the best chance of workable arrangement. The precise scope of each element of such a combined scheme would need to be negotiated.

#### Institutions

24. Her Majesty's Government recognize that, as the Working Party have pointed out, the precise nature of the institutions of the Free Trade Area cannot be determined in advance of the definition of the form and substance of the Area itself. In the view of Her Majesty's Government the Free Trade Area should be established within O.E.E.C. Some departure from the unanimity rule will be necessary in certain carefully defined matters, for example, where a country seeks a release from one of the original obligations; or in procedures of a fact-finding or judicial nature concerned with verifying that a country is carrying out its obligations and with remedying any failure to do so. It is clear that there should be close co-ordination between the institutions of the Free Trade Area and those of the Customs and Economic Union, so as to simplify administration and to facilitate the observance of their dual obligations by those countries which are members of both organisations.

#### Conclusions

25. Her Majesty's Government, believing that the establishment of a European Industrial Free Trade Area on the general lines suggested above would be greatly in the interests of the member countries of O.E.E.C., propose that at the meeting on 12th and 13th February the Council should give general approval to the creation of a European Industrial Free Trade Area, and should establish machinery for negotiating the detailed arrangements and preparing as soon as possible an agreed draft of the Convention which would be required.

\* The scope of Chapters 1 to 24 of the Brussels Nomenclature is virtually the same as the scope of Category I of Annex A to the O.E.E.C. Code of Liberalisation. It seems appropriate to use the internationally agreed tariff nomenclature for this purpose rather than the O.E.E.C. classification which was devised by the Organisation primarily for use in connexion with liberalisation of trade by the removal of quotas.