

NAVIGATING BY THE STARS

**NORWAY, THE EUROPEAN ECONOMIC AREA
AND THE EUROPEAN UNION**

**MICHAEL EMERSON, MARIUS VAHL
AND STEPHEN WOOLCOCK**

WITH

**JOANNA APAP, DANIEL GROS, ALEXANDR HOBZA
AND MARC HOUBEN**

**CENTRE FOR EUROPEAN POLICY STUDIES
BRUSSELS**

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Centre for European Policy Studies
Place du Congrès 1, B-1000 Brussels
Tel: 32 (0) 2 229.39.11 Fax: 32 (0) 2 219.41.51
e-mail: info@ceps.be
internet: <http://www.ceps.be>

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EXECUTIVE SUMMARY

1. *The European Economic Area (EEA) works.* That the three EEA states* have taken on board some 2,904 legal acts of the EU's single market regime has largely assured the integrity and credibility of this enlarged single market. There are some mutually agreed areas of exclusion, such as agriculture and fisheries (although Norway's insistence on the latter exclusion seems to have turned to its disadvantage). The number of disputes and their resolution by means of agreed procedures, while raising some significant issues, has proven manageable so far. The extension of new EU legislation into the EEA is a continuous process. The specific institutional mechanisms of the EEA (a surveillance authority and court) function correctly.

2. *But it is a different EEA and a different EU.* The EEA turns out to be very different from what was initially envisaged. First came the defections of Austria, Finland, Sweden and Switzerland (in their different directions,) as well as the second negative outcome in Norway's latest referendum over EU accession. Secondly, the EU itself has changed with the start of monetary union, and the development of new competences in foreign, security and defence policy and justice and home affairs. Norway is accordingly extending its association relationships with the EU outside the EEA. Thirdly, there is now in prospect a huge enlargement of the EU into Central and Eastern Europe. Thus, the EEA is becoming a smaller part of the EU's wider European agenda, and a smaller part of Norway's relationship with the EU.

3. *Norway's perception of marginalisation.* This frequently heard refrain is objectively justified, but not because of any lack of affection towards Norway in the EU. On the contrary, Norway is seen as being completely in line with the highest standards of economic and social development, civil society and democracy, which are also the standards and values of the EU. Rather, the 'marginalisation' is attributable to the declining market share of the EEA in the widening and deepening affairs

* In a strictly legal and political sense, Iceland, Norway and Liechtenstein are the EFTA-EEA states, whereas the 15 EU member states are the EU-EEA states. All together, the 18 countries make up the EEA. As this would make for unduly heavy terminology throughout this document, however, we call the three the EEA states and the 15 the EU.

of the EU, alongside the huge complexities and pressures that weigh upon the EU in its non-stop struggle to maintain political control of the accelerating European integration process. This means that Norwegian ministers and officials visiting Brussels literally spend much of their time in the Council chambers' waiting room.

4. *Democratic transparency, legitimacy and accountability.* Norway has sought to keep up with the European integration process as far as is possible for a non-EU member, including new associate relationships (Schengen, Rapid Reaction Capability, etc.). This has become a highly complicated set of institutional relationships, because the EU itself is a multi-pillared institution, with different roles for the Commission, Parliament and Council according to the pillar. In every case, however, the EU is the policy-maker and Norway, the policy-taker. This creates an understandable unease also in Norway over questions of democratic legitimacy, transparency and accountability in its relations with the EU.

5. *Norway's options on the moving 'escalator' of European integration.* In view of these elements of unease, alongside the undoubted successes of the EEA and advances in the other newer forms of association with the EU, one may review what options are open to Norway (and its EEA partners). This report has deliberately considered an unconstrained range of options, not in order to take a position on their political desirability (which is not the task of the authors), but as a contribution to a fully informed debate. In order to try to connect with the terms of public debate, beyond the small circle of experts in the complexities of European affairs, three broad categories of options are set out: 'stop', 'reverse' or 'forward' movement in relation to the *moving escalator of European integration*.

6. *Stop, reverse and the risk of self-isolation.* An attempt is made below to specify what 'stop' and 'reverse' might mean in precise operational terms. The idea of 'stop' is much less simple than it sounds, and might be difficult to separate from 'reverse' in practice, since it would certainly mean a backward movement in relation to the general trend in Europe. It seems difficult to specify the 'reverse' scenario without the risk that it leads to an escalating process of marginalisation to the point of self-isolation.

7. *Moving forward with the escalator.* For these reasons more attention is devoted to variants of 'forward'. Norway is currently moving forward with the European escalator, given both the continuing dynamics of the EEA agenda and the new associations with the EU in other areas beyond the EEA. This can surely continue as the new EU policies mature

in practice. The difficult question is whether the perceptions of marginalisation, and lack of democratic transparency, legitimacy and accountability for Norway in relation to major EU political initiatives, could be significantly eased, short of going the whole way to EU membership.

8. *Limited scope for updating, upgrading or renegotiating the EEA Treaty.* The EU itself is set upon addressing these same issues of democratic legitimacy, transparency and accountability with its recently launched Convention on the Future of Europe, but this will not ease Norway's problem. While the outcome is uncertain, it is likely that the EU will become more of a genuine polity, and association arrangements will become further marginalised. In addition, the EU faces continuous and growing demands for deeper association by the transition states of Eastern and South-East Europe. In this situation, the EU will resist requests by EEA states for a greater role in policy-shaping or making within the EU, in order to avoid setting a precedent. The EU's forthcoming enlargement will require the new member states to also accede to the EEA, as for the existing 15, which will require a treaty revision and full ratification procedures. The idea of packaging into this enlargement act some wider revision of the EEA, ranging from technical-legal updating to upgrading of the policy-shaping possibilities, is unlikely to be attractive to the EU, which will give first priority to getting the EU's enlargement ratified without unnecessary complications.

9. *From the EEA to a Common European Economic Space?* On the other hand, a debate is developing over a wider 'Common European Economic Space', notably between the EU and Russia as a result of summit-level orientations. While the operational content of this new idea is unknown at this stage, if it were to be developed seriously it could head in the direction, amongst others, of the mechanisms of the EEA. One might even imagine a process whereby the EFTA-EEA structures gradually take on a progressive re-expansion by stages, starting perhaps with free trade for the new members, moving on into parts of the single market field, possibly drawing also on the Swiss-EU model of sector-specific agreements.

10. *Growing heterogeneity in the ante-chambers of the EU.* There will in any case be a greater heterogeneity in the ante-chambers of the EU, with a mix of the ultra-advanced EEA states that could become full members but prefer not to (e.g. Norway), and the weaker states to the east that would like to become full members but are not yet qualified (e.g. much of South-East Europe and Ukraine). This overlap of categories will

in some ways be quite unnatural and awkward for the EEA states, but it should not come as a surprise, since it would be their choice. Because the weaker states to the east represent security risks to the EU of different kinds, either because they are large but potentially unstable, or because they are small but very much 'weak states', the EU will have a serious interest in working out helpful methods for their maximum 'inclusion' in modern Europe, and in relation to actual EU policies.

11. An attractive idea seems to evaporate. Norway is associating selectively with the EU, joining in its activities where this suits, and keeping at a greater distance where it is less convenient. In this way, it secures its priority objectives, while retaining considerable autonomy and independence. That would seem to be the idea. However a hard-headed look at what is actually happening to Norway on the European landscape suggests a less comfortable pattern across five major blocks of policy:

- **Legally secure market access.** The EEA secures this, but at the price of intrusive legislation and regulation that goes deep into domestic economic policy-making. The EU decides the policy and the EEA associates have to apply it. The EEA has some institutional features of a club of equal members, but this has an element of political window-dressing since it does not touch policy-making. Even if Norwegian enterprises have secure legal access to the EU market, there is some evidence that the EEA regime leaves open a political uncertainty factor that may reduce the attractiveness of Norway as an investment location for mobile capital.
- **Monetary stability.** International monetary regimes are increasingly polarised between inclusion in one of the (two) continental and international currencies or total monetary independence as a floater. The EU has accepted this logic and has gone the whole way with the euro. Norway has accepted the same logic, and gone the other way, which at least for the time being is quite reasonable: euroisation without EU accession does not make sense economically or politically.
- **Freedom of access and security for people.** Norway secures freedom of movement and labour market access in Europe through the combination of the EEA and Schengen. This now leads on into the EU's expanding policies for internal security and justice and home affairs. The frontiers are not clear, however, between 'Schengen-related' measures that would involve Norway, and 'non-Schengen-related' measures that might not. In the latter case, Norway is tending to request ad hoc association agreements (asylum, arrest warrant,

EUROPOL, EUROJUST). In all these examples, the EU is the policy-maker, while the associated states are simply policy-takers.

- **Foreign policy.** The EU is gradually pooling its foreign policy, and its national diplomacies share out the top jobs ('special representatives', etc.). Norway's notable role in conflict-resolution diplomacy is beginning to suffer from some crowding out from the growing EU role, especially in the European periphery where the centripetal and systemic influences of the EU model are operative. (This is a pity because of Norway's finely tuned skills.)
- **Defence.** Old NATO is obsolete, or almost 'dead' to take a frank view. New NATO, which is in the security dialogue and crisis management business, finds it now has company in Brussels with the EU. The two are beginning to cooperate. Norway, as a non-EU NATO member, finds its position in the defence system becoming downgraded. It may associate with future ESDP actions, but again as a policy-taker, not a policy-maker.

12. The nature of sovereignty in contemporary Europe. In all these domains the EU member states have been, and still are hugely restructuring the nature of their sovereignty. Old national sovereignty is 'dead' in the new Europe. The EU member states go for greater sovereignty by getting synergetic value-added and power from putting the above five major functions together into a single political structure. These arguments may be even more important for the smaller EU member states than for the larger ones. Nonetheless, to make a success of the new sovereignty is very demanding. It means making the institutions and decision-making procedures work as a huge new polity (not as a collection of clubs), and to make it more democratically transparent, legitimate and accountable. For the EU this is the work-in-progress (in the Convention, etc.). For those on the periphery the choice becomes increasingly categorical, between being 'in' or 'out'. The 'half-in' option still exists, but its nature also changes. 'Half-in' means being a 'policy-taker', but not a 'policy-maker.' Such a system can work technically. Indeed, it may be a plausible 'half-way house' for the weaker states of Eastern Europe that aim at EU accession in the long-term. The economics of such a relationship may also be quite satisfactory. But from the viewpoint of Brussels, it looks increasingly like a systemic anachronism, and as a matter of politics for an ultra-advanced European democracy like Norway, it does not look sustainable.

CHAPTER 1

INTRODUCTION

The objective of this study is to assess the evolving relationship between Norway and the European Union (EU), the centrepiece of which is the European Economic Area (EEA). The underlying issue is that the role of the EEA in the overall relationship has been changing faster than was expected at the time the EEA Treaty was signed just ten years ago in 1992.

When negotiations on the EEA began in 1990, it had the appearance of a very sound political and economic deal between the European Union and the member states of the European Free Trade Area (EFTA), which at that time numbered six members: Austria, Finland, Iceland, Norway, Sweden and Switzerland.¹ The motivation behind the EEA was the EU's initiative to create its own single market. This was the main proposal of Jacques Delors at the beginning of his presidency of the European Commission in 1985. This became known as the '1992' project, since this was the date by which the EU set itself the task of passing a huge legislative programme (300 legal acts) to eliminate all internal borders for the movement of goods, services, capital and persons.

The EFTA states were concerned that their very open and highly advanced economies would be seriously disadvantaged and marginalised by their exclusion from the new single market. Jacques Delors saw that the EFTA states would have to be offered some special deal if they were not to be provoked into requesting full accession to the EU. While all the EFTA states were perfectly qualified by objective criteria to accede to the EU, the most integrationist leaders of the EU were not enthusiastic about the prospect of the accession of many more small member states. The EFTA states were perceived as being more interested in enhanced free trade than political integration, That many of them also were neutral provided an additional argument, as membership for these countries was seen as a potential impediment to the development of a common foreign and security policy.

Therefore Jacques Delors proposed the idea of the European Economic Area, which would give the EFTA states full access to the single market as long as they were prepared to accept the '1992' legislation, and called for the establishment of 'common decision-making and administrative structures'. The EFTA states would become virtual members of the EU

¹ Liechtenstein became the seventh member of EFTA in September 1991.

with respect to the single market, while remaining outside its political institutions and various other policies. However the EEA would be given a serious institutional structure of its own. This was for two reasons: first to ensure compliance with the rules of the single market, and secondly to provide as best as possible for political equality and legitimacy in what was necessarily – given the huge size differences between the parties – an asymmetric relationship.

In spite of the important content of the EEA Treaty in economic, legal and institutional terms, whose reasonably sound workings are analysed in this report, the EEA has never really settled down politically. On the one hand, the EEA lost much of its EFTA membership. On the other, the EU has developed much more rapidly and strongly in other policy domains outside the EEA Treaty jurisdiction than had been expected ten years ago.

On the side of the EFTA states, it became evident early on that the EEA would not be satisfactory, and their governments soon came to regard it as a stepping-stone to full EU membership, rather than as a permanent alternative. Austria had already applied for full membership in summer of 1989, whereas Sweden signalled its intention to apply in October 1990, just four months after negotiations on the EEA had started. Finland applied for full EU membership in March 1992, followed by Switzerland, which entered its application just days after the signing of the EEA agreement in May 1992, and Norway, in November 1992.

Switzerland's participation in the EEA, however, was then rejected in a referendum in December 1992, which also had the effect of freezing Switzerland's EU application. This Swiss upset further pushed back the entry into force of the EEA agreement from the beginning of 1993 to January 1994. By then, the accession negotiations with four other states, starting in February 1993 for Austria, Finland, and Sweden and in April 1993 for Norway, were almost completed. The four Treaties of Accession were signed in March 1994, but then Norway dropped out as the referendum for ratification of November 1994 failed to obtain a majority.

The Swiss 'no' to the EEA left Switzerland with the old free trade relationship with the EU, but it soon became apparent to the government that this was insufficient, and Switzerland has sought since then to resume a movement towards a deeper and wider relationship with the EU through a series of sector-specific agreements. More recently, Iceland has expressed concern over the growing obsolescence of the EEA Treaty, and has initiated a process aiming at some sort of revision of the EEA Agreement to take account of developments in the EU since 1992.

On the side of the EU, there has been a continuing cascade of developments outside the jurisdiction of the EEA. The EU has found itself with 13 more requests for accession from Central, Eastern and South-East Europe. After long negotiations it now seems possible that as many as ten new member states will accede in 2004 or 2005, including all of Central Europe and the three Baltic states. The process will continue even after that, with the remaining members of the 'waiting room' likely to be joined by other applicants for accession, such as Croatia, among others, in due course.

Also there have been major developments in policy and institutional arrangements on the side of the EU since the Single Market programme was decided. First, there was the move from 'One Market' to 'One Money', a long process that was finally crowned on 1 January 2002, with the introduction of euro coins and bank notes. Secondly, there has been a filling out of the economic agenda, first with the Monetary Union and more recently with the so-called Lisbon process, with some new elements belonging to the Single Market and therefore to the EEA process, but others lying outside the EEA domain.

Thirdly, there has been a slow but progressive development of the EU's foreign policy, now visibly in continuous action and personified in the role of its High Representative, Javier Solana. Norway frequently associates itself with EU foreign policy positions. Fourthly, there has been the rapid recent development of the Justice and Home Affairs pillar. This began with the Schengen regime for the movement of persons across the external frontier, to which Norway and Iceland have acceded in full. Norway is not included, however, in the wider development of the Justice and Home Affairs agenda of the EU, which has become increasingly important since 11 September. Fifthly, there has been the more recent development of EU defence policy, with preparations under way for a Rapid Reaction Capability of some 60,000 troops by 2003. Norway has offered to contribute significantly to this. Sixthly, the EU prepares for a new revision of its own treaties in 2004, which is being prepared by a Convention initiated at the Laeken summit of December 2001. The thirteen accession candidate states are formally represented in this process, but Norway, the other two EEA states and Switzerland are not.

The decision at Laeken to go ahead with the Convention reflects the current mood in the EU that this cascade of recent developments, with both its widening and deepening aspects, needs a more transparent and democratically legitimate constitutional foundation. The *ad hoc* accumulation of policy competencies under the several so-called pillars needs a simpler and more efficient political organisation. Decision-

making procedures need to be streamlined in view of the move from 15 to 25 or more member states. Achievement of these objectives is an extremely complex and intensely political process. It is not yet clear what the outcome will be, but the likely directions are more or less clear, and the political momentum behind the search for solutions is strong. This mood in the EU is captured in the name 'The Future of Europe,' which has been given to the Convention and the subsequent Intergovernmental Conference scheduled for 2004, and at which the member states will negotiate a reform of the Treaties and maybe an agreement on a constitutional document. To non-EU states it may sound pretentious on the part of the EU to be deciding 'The Future of Europe'. That may be, yet it fairly reflects the seriousness of the EU's current reflections and debate about what is now at stake. In the present context it invites a parallel reflection on *the place of Norway in the future of Europe*.

In view of all these developments it has at least to be observed that the EEA is becoming a smaller part of Norway's overall relationship with the EU, while the EEA becomes a smaller part of the EU's overall priorities and preoccupations. Norway's overall relationship with the EU comes to mirror in complexity the EU's own institutional and policy system. Both are *ad hoc* accumulations of functions and institutional arrangements. On the EU side, however, the pressures are towards greater unification and democratic transparency of its internal system. A reflection of these pressures is the perception among policy-makers in Oslo of a growing 'marginalisation' of Norway's position in relation to the EU. This is understandable, but should not be misunderstood. Norway is seen by the EU as the best of neighbours, and one that is absolutely in line on all essential matters of European values, in politics, economics and society. From Brussels' stand-point, however, the EEA relationship is looking more and more like a systemic anachronism, yet a revision of the EEA Treaty would be a complex task that would be extremely time-consuming for all its institutions. It would therefore not merit priority alongside the EU's huge agenda of other competing demands.

Such considerations form the background of our analysis of Norway's evolving relationship with the EU. The following chapters look successively at the four major blocks of policy: the single market (Chapter 2), the macroeconomic agenda (Chapter 3), justice and home affairs (Chapter 4), and foreign, security and defence policies (Chapter 5). Two final chapters deal with horizontal questions, namely Norway's position in relation to the 'future of Europe' debate (Chapter 6), and the range of hypothetical options that Norway may contemplate (Chapter 7). The conclusions are presented in the Executive Summary.

2.1 The core properties of the EEA system

The EEA has provided a functioning homogeneous market covering all 18 member states.² The credibility of the system has been ensured by the more or less full acceptance of the existing EU *acquis communautaire* (i.e. EU legislation in the single market area) by the EEA states and by the generally effective implementation of these provisions. There have been no cases to date of the EEA states failing to accept the EU *acquis*, due no doubt to their overriding commercial interest in having access to the single European market, and the damage that would be inflicted to the credibility of this guaranteed access by exemptions or exclusions.

2.1.1 The institutional framework of the EEA Agreement

As in the case of all association agreements between the EU and third countries, specific joint institutions have been established for the EEA Agreement [Phinnemore, 1999]. These include a high-level political body, *the EEA Council*, a committee of senior officials, *the EEA Joint Committee*, an advisory parliamentary committee, *the EEA Joint Parliamentary Committee*, and a consultative body for the social partners, *the EEA Consultative Committee* (see Box 1 below).

But whereas all other EU association agreements are bilateral, the EEA Agreement is multilateral. In addition, specific institutions with competencies limited to the EFTA (i.e. non-EU) members of the EEA Agreement were also established, creating a ‘two-pillar’ institutional structure that is unique among EU association agreements.³ This was necessary in order to reconcile the central aim of maintaining a homogeneous legal area with the constitutional and political requirements of the EEA states, which prevented them from accepting direct decisions from the EU institutions, as well as safeguarding the autonomy of EU decision-making.

² Consisting of the 15 EU-EEA member states and the 3 EFTA-EEA member states.

³ The institutions of the EFTA pillar are conspicuously absent in the brief description of the EEA on the EU’s website. See http://europa.eu.int/comm/external_relations/eea/index.htm

Box 1. The EEA institutions**Joint bodies**

The **EEA Council** is the main political body of the EEA. It consists of 'members of the Council of the European Communities and members of the European Commission, and of one member of the Government of each of the EFTA States' (Article 90), and meets twice per year. It provides political impetus to the Agreement and guidelines for the Joint Committee and evaluates the functioning of EEA Agreement. It also acts as a forum for general consultations on international affairs, although this is not mandated by the EEA Treaty as such, but through a Joint Statement added later to the Agreement.

The **EEA Joint Committee** is responsible for the day-to-day management of the EEA Agreement, and consists of the EU Ambassadors of the EFTA states and representatives of the European Commission. EU member states, the ESA and the EU Council Secretariat may also participate as observers. In monthly meetings the Joint Committee takes decisions by consensus on incorporation of European Community legislation into the EEA Agreement. The Joint Committee is assisted by five subcommittees: i) free movement of goods, ii) free movement of capital, iii) free movement of persons, iv) horizontal and flanking policies, and v) legal and institutional matters. Additional expert and working groups reinforce the subcommittees.

The **Joint Parliamentary Committee (JPC)** consists of 66 members, half from the European Parliament and half from the national parliaments of the EEA countries, and meets twice per year. The JPC plays a modest role in the EEA. Its contribution comes through 'dialogue and debate' and through reports and resolutions adopted by the JPC. It examines the annual report of the EEA Joint Committee, and has the right to call the President of the EEA Council to appear before them and be heard by the JPC.

The **EEA Consultative Committee** is composed of representatives of social partners/economic and social interest groups, and comprises an equal number of members of the EFTA Consultative Committee and the Economic and Social Committee of the EC (ECOSOC). It works to strengthen contacts between the social partners and provides input to the work of the EEA in the form of reports and resolutions.

EFTA bodies

The main task of the **EFTA Surveillance Authority (ESA)** is to ensure that the EEA states fulfil their obligations under the EEA agreement, i.e. to ensure that the provisions of the Agreement are properly implemented in the national legal orders of the EEA member states and correctly applied by the authorities. Cases are either initiated by the ESA itself or on the basis of complaints from individual legal persons or the Commission. In addition to general surveillance, the ESA also has wider powers in the fields of public procurement (the right to directly request that infringements are corrected), competition (the power to make on-the-spot inspections, issue Statements of Objection ordering eventual infringements of competition provisions to be brought to an end, and in case of non-compliance, to impose fines), and state aid (initiate and conduct investigations concerning state aid measures). Based in Brussels, the ESA is led by a college with one member from each of the three EEA members and has a staff of almost 50 officials, approximately two-thirds of whom are from the EEA countries.

The Luxembourg-based **EFTA Court** deals with infringement actions brought by the ESA against an EEA state with regard to EEA implementation, the settlement of disputes between EEA states, appeals concerning decisions taken by the ESA, as well as giving advisory opinions to national courts on the interpretation of EEA rules. In contrast to the European Court of Justice, the EFTA Court cannot impose fines on the EEA states. The Court, consisting of three judges appointed for six years, one from each of the EEA countries, only sits in plenary sessions and its decisions are taken by majority vote. The Court has a staff of 12 in addition to the three judges. In 2000, nine cases were brought before the EFTA Court, seven of which were requests for advisory opinions. The two infringement cases instigated by ESA brought the total number of such cases referred to the Court since its establishment to seven.

The **EFTA Standing Committee** was established to coordinate the positions of the three EEA states for the EEA Joint Committee. It consists of representatives from Iceland, Liechtenstein and Norway, and observers from Switzerland and the ESA. The Standing Committee has a structure of five subcommittees and a number of working groups mirroring that of the EEA Joint Committee, and is assisted by the Brussels office of the EFTA Secretariat, with a staff of approximately 40.

The *EFTA Surveillance Authority (ESA)* was established to ensure compliance of the EEA states of their obligations under the EEA Agreement, and has a similar role vis-à-vis the three EEA states as the European Commission has vis-à-vis the EU member states. The *EFTA Court* exercises similar competencies to the European Court of Justice with respect to the EEA states in the areas covered by the EEA Agreement. In order to prepare and coordinate their positions in the joint EEA bodies, the *Standing Committee of the EFTA States* was established, although this is not mandated by the EEA Agreement, as is the case of the ESA and the EFTA Court.

The EEA Agreement is thus by far the most complex and structured of all EU association agreements and as such, its functioning requires greater resources from the parties. There are for instance more frequent (monthly) meetings at the senior officials level than in any other EU association agreement. However, the burden of maintaining this complicated machinery is mainly borne by the EEA states. They are responsible for the running of the EFTA bodies specifically established for the EEA Agreement, leaving the Commission and the European Court of Justice (ECJ) to concentrate on the EU member states.

2.1.2 The scope of the EEA

The scope of the EEA is determined by the existing EU *acquis* when the EEA Treaty was signed plus the measures that have subsequently been adopted by the EU and to a very large extent also adopted by the EEA states. The EEA is therefore dynamic in the sense that procedures are in place to ensure the continuous updating of its coverage. At the end of the year 2000, the status of the EU *acquis* adopted by the EEA states consisted of 2,904 pieces of legislation (directives, regulations and decisions) that are binding on the EEA states [EFTA Surveillance Authority, 2000]. Of these, 1,424 were directives requiring implementation in the EEA states on or before 31 December 2000. The number of directives continues to grow. During 2000, the EEA Joint Council took decisions on the inclusion of 201 new acts in the EEA, and there were 118 directives requiring implementation in the EEA states. Table 1 provides an indication of the scope of the EEA.

Clearly the importance of these directives and other instruments varies. Some are largely technical modifications to existing pieces of legislation, while others have a more direct bearing on the EEA states. The following section on the evolution of the EEA discusses some of the more sensitive issues for the EEA states in the EU's growing agenda. This section aims to provide some idea of what the EU *acquis* consists of and thus the

scope of the EEA and how well this is being implemented in the EEA states.

Table 1. The scope of the European Economic Area

Policy area	Number of directives in the EEA <i>acquis</i>	Cases of non- or partial implementation		
		Norway	Iceland	Liechtenstein
Technical barriers to trade	486	20	16	4
Other trade in goods	13	0	0	0
Veterinary and related measures*	235	15	33	0
Free movement of persons	71	3	4	4
Free movement of capital	1	1	1	0
Financial services	53	2	1	4
Information technology and audio-visual	22	1	0	6
Transport (road, rail, maritime and air)	70	5	10	4
Social (health and safety, labour law and equal rights)	50	2	1	4
Consumer protection	12	3	2	2
Environment (air, water and waste)	43	1	0	0
Public procurement	9	0	4	0
Company law	12	0	0	0
State aid	3	0	0	0
Statistics	9	0	0	0
Total	1089	53	72	28

* Iceland and Liechtenstein are exempt from many of these measures.

Measures designed to remove *barriers to trade in goods* constitute about a third (486) of the directives that the EEA states have so far had to implement. Most of these are harmonisation or policy approximation measures designed to remove technical barriers to trade within the single European market. The directives cover a wide range of sectors but there is a preponderance of directives in those sectors in which the old approach (i.e. harmonisation) is important. These include motor vehicles, food stuffs and dangerous chemicals.

The level of implementation is reasonably high in the case of technical barriers to trade. The areas of difficulty are concentrated in specific sectors such as tractors, foodstuffs, and dangerous substances in Norway and medicinal products and dangerous substances in Iceland. One interesting aside is that notifications of draft technical regulations (under Directive 98/34/EC) averaged 711 each year from the EU states and 21 from the EEA states over the years 1996-2000. This is the provision that ensures that new national regulations that might represent potential barriers to trade are notified and discussed. Clearly, the flow of new technical regulations is coming from the EU.

Veterinary and related measures such as animal feedstuffs constitute the second largest part of the *acquis* in terms of directives and has accounted for a fairly large percentage of the cases of non-compliance. Indeed, regulations governing animal feedstuffs accounted for 26 cases of non-implementation in Norway.

Moving on to the *freedom of movement of persons*, there were 71 directives covered by the EEA at the end of 2000, most of which concerned mutual recognition of professionals or other services providers. The main area of non-implementation in all EEA states is free movement of doctors, with all of them failing, so far, to implement three directives. The one directive specifically directed at the free movement of capital, the directive on capital movements [European Commission, 1988] has only been partially implemented in Norway and Iceland.

Financial services account for a sizeable and growing share of the *acquis* with a total of 53 directives up to the end of 2000. Most are in banking, but insurance and securities also account for between 10 and 20 directives each. The EEA states have reasonably full implementation here, except for Liechtenstein, which has three cases of partial and one of non-implementation. This is one of the areas in which the EU *acquis* is evolving most rapidly, and one that includes several potential conflicts between Norway and the EU. A current example is the dispute concerning Norway's so-called 10% rule. Norwegian bank laws limit the

amount of shares owned by one entity to 10% unless it owns all the shares. ESA claims that this violates the principle of free movement of capital enshrined in the EEA Agreement and demands that this restriction be removed.

Transport is another area of policy that is coming to play a more central role in the *acquis*, with 68 directives included at the end of 2000 and new initiatives in all sectors of transport in the pipeline (see Section 2.2.2 below). Maritime transport is the area that has created most difficulties to date in terms of implementation, with Norway failing (as of the end of 2000) to implement five and only partially implementing one directive.

Health and safety at work, labour law and equal treatment account for 50 directives, mostly concerned with health and safety at work. Environmental regulation accounts for a growing part of the *acquis* with the 43 directives in this area more or less equally divided between air, water and waste. As one would expect, there are few cases where the EEA States have not fully complied with the directives covering the environment. The one notable exception is that of Norway not fully implementing the integrated pollution prevention control directive [European Commission, 1996]. The issue here, as with other directives, is that Norway considers its legislation already covers the aims set out in the EU directive. The directive therefore appears as not fully implemented because there is some doubt, in the opinion of the EFTA Surveillance Authority that Norway has fully complied.

Finally, *public procurement*, which accounts for up to 8% of the EEA GDP, is covered by just 9 directives. The 12 directives on *company law*, 3 (on transparency provisions) in *state aid* and 9 in *statistics* have all been fully implemented. There has been a dispute concerning the Norwegian employers' national insurance premium (*arbeidsgiveravgiften*) and the state aid provisions of the EEA. Norway operates a differentiated national insurance premium, with no premium in the northern regions, and regards this as regional policy. The ESA claims that this represents state aid and is incompatible with the EEA Agreement. In 1999, the EFTA Court determined that the scheme should be regarded as state aid. Norway and the EU agreed on a new practice until 2003, while keeping the scheme in place. The case is now reopened following a Commission decision not to accept a similar scheme in Sweden.

In addition to the implementation of directives in national legislation, there is the matter of whether the directives and original provisions of the EEA Treaty are being complied with. Enforcement of the EEA is the responsibility of the ESA. Cases of non- or only partial implementation –

are listed in Table 1 above. It is interesting to note that most cases of non-enforcement have been brought to light as a result of 'own initiative' actions by the ESA, with 713 cases over the life of the agreement, compared to only 263 in the form of complaints.⁴ Although few cases go as far as the EFTA Court, usually no more than a few each year, there is a growing number of open (unresolved) cases, totalling some 316 at the end of 2000.

2.1.3 EEA cooperation beyond the single market

The EEA Agreement also provides for the participation of the EEA states and their citizens in numerous European Community programmes in areas such as research, education, environment, consumer protection, SMEs, culture and public health, among others. As of January 2002, the EEA states participate in 32 such EC programmes (see Annex A for the complete list), with another seven programmes under consideration. The EEA states have full access to these programmes, including participation in their management committees, and their citizens and organisations can take part to the same extent as those of EU member states. Some of the programmes also entail the secondment of EEA national experts to the European Commission. The EEA states' financial contributions to these programmes are calculated on the basis of GDP figures, i.e. in the same way as it is done in the EU member states.

2.2 The expanding EU *acquis*

The EU's *acquis* for the single market and related processes has not stood still. It continues to evolve to include areas such as energy and transport that were not well developed at the time the EEA was signed, and electronic communications, in which market and technological developments necessitate an evolution of the EU regime. What then are the potential implications of a further expansion of the EU *acquis* over the coming years for the EEA states? Will the expanded EU *acquis* be extended to the EEA states and will these have difficulties adopting the EU approach? How effective have the EEA states been in influencing the evolving *acquis*, and are there any pointers to the types of disputes or areas of contention that will arise?

As with the existing *acquis*, the EEA states seem committed to adopting all new areas of the *acquis*. This appears to be because the move towards

⁴ Among the former, 220 concerned goods, 53 for persons, 202 for services and 26 for public procurement. Among the latter, 78 were for goods, 61 for persons, 38 for services and 60 for public procurement.

liberalisation represented by the EU *acquis* is generally in line with the national interests of the countries concerned. This is for example the case for Norway with regard to the provisions aimed at making a single European market in electricity and gas a reality. Norway has moved further and faster to liberalise electricity than many EU member states, although there has been considerable reluctance vis-à-vis the 1997 gas directive. In transport, Norway has generally moved further on unbundling the rail system than most other EEA countries, and in the telecommunications field, it, like other Nordic countries, is ahead in terms of both the use of the internet and new forms of communication, and is by no means a foot dragger in terms of liberalisation.

Such general support for the approach of the EU should not, however, disguise a number of quite important areas of tension between the EEA states and the EU when it comes to extending the EU *acquis*. The following sections discuss recent tensions in four key sectors.

2.2.1 Energy

Tensions over energy policies could be anticipated due to Norway's role as a major producer and net exporter of oil and gas, while the EU is an energy consumer and net importer. As a non-OPEC exporter of oil, Norway can have an important impact on oil supply and price. It is interested in securing reasonably good prices, while the EU will always be concerned to reduce energy dependence and ensure a reasonably low and stable price for oil. The tensions that can arise were readily illustrated when Norway decided to support OPEC efforts to reduce production in order to increase prices in autumn 2001. This led the European Commission to charge Norway with contravention of Article 12 of the EEA Agreement, which prohibits quantitative restrictions on exports, as well as competition provisions of the EEA. The European Commission is thus waving the EEA rulebook at Norway, in an area of central national interest to Norway. It seems that Norway's EEA negotiators avoided explicitly addressing this issue in negotiations on the EEA. In this case the dispute is unlikely to lead to a case before the EFTA Court, since the EU itself has an interest in oil price stability. Nevertheless, the Commission certainly wanted to make a point over Norway's failure to notify its action to the appropriate EEA forum. This tension in Norway's relations with the EU is not going to go away. Norway is acting as an informal associate member of OPEC, while it is very formally associated with the EU. There can be times when the two relationships do not ride well together.

*Table 2. Major oil exporters
(net exports in 2000, millions of barrels/day)*

Saudi Arabia	7.84
<i>Russia</i>	<i>4.31</i>
<i>Norway</i>	<i>3.11</i>
Venezuela	2.66
Iran	2.59
UA Emirates	2.18
Iraq	2.09
Kuwait	2.05
Nigeria	1.86
<i>Mexico</i>	<i>1.44</i>
Libya	1.29
Algeria	1.22
<i>UK</i>	<i>1.06</i>

Note: Non-OPEC states appear in italics.

The energy sector has produced other significant disputes. Norway's Gas Negotiating Committee (GFU) provides another case in point. The GFU was created to coordinate gas sales from all the producers operating on the Norwegian continental shelf. It was set up under the auspices of the Norwegian government as a means of sharing orders between the major producers. Orders were approved by the Committee, which then decided which producer would supply the gas. This procedure was challenged by the European Commission, which argued that all 21 participating companies were in breach of European competition law. Under the EEA, the European Commission is responsible for enforcing competition policy in cases where the alleged cartel influences intra-EU trade, which was the case with the GFU. It should be noted in this connection that Norway's two main competitors as suppliers of natural gas to the EU, Algeria and Russia, are of course not bound by these provisions. Norway argued that the GFU was set up by the government and that the issue should be dealt with by the ESA.

Whilst this defence of the two-pillar system may have helped to reassure those who saw this as an attack on Norwegian sovereignty, it did little to change the outcome of the case. Although Norway regards this as a matter of resource management, the GFU agreed in the summer of 2001 not to apply the supply allocation arrangements for supplies going to the

EU, and it was later decided to abolish the GFU. This does not mean, however, that the issue of Norwegian gas sales is off the agenda. The EU claims that Norwegian natural gas sales based on negotiations in the GFU have been illegal for years, as the EEA Agreement prohibits cartels. A process has been initiated by the EU that could in the end lead to the imposition of enormous fines – 5-6 billion euro is the figure most frequently quoted in the press⁵ – on energy companies active in Norway.

The nature of Norwegian producer interests also created difficulties with the application of competition to the gas distribution networks under the 1991 gas transit directive. In Norway a major part of the gas network is upstream (i.e. connecting the gas processing plants to the gas platforms in the North Sea). Norway resisted this application of competition on grounds that there was a need to plan the levels of delivery if the investment was to take place. Apart from this issue, however, there have been few major problems with either the old or new EU directives liberalising the energy sector. In the case of the new package of directives, the electricity provisions are in line with Norwegian policy, which has allowed cross-border competition since 1991 in the Nordic system [European Commission, 2001b]. These measures were identified in the ‘Lisbon process’ as priority measures to be adopted by the EU in the immediate future. They envisaged the liberalisation of gas and electricity markets for all users by 2005 and were recently endorsed by the European Parliament. The risk of excessive regulation of small Norwegian suppliers of hydro-electricity appears to have been removed by the exemption of such producers from the provisions of the directive.

Nevertheless, there have been some recent disputes concerning hydro-electricity. According to Norwegian law, power stations where private or foreign owners own more than one-third are automatically returned to the Norwegian state without compensation after 60 years (*hjemfallsrett*). This law is part of the so-called concession laws, adopted in the beginning of the 19th century, and an important economic corollary to Norway’s then recently achieved political independence. This specific rule does not apply to power stations owned by the Norwegian central or local government. The scheme keeps private owners out of the power sector in Norway and discriminates against foreigners and private capital according to ESA, which demands that the law be abolished. Secondly, there is the question of electricity fees. The EU has tightened up its rules on environmental support, with less leeway in exemptions from

⁵ The exact figure quoted in fact is 50 billion Norwegian krone; see *Dagens Næringsliv*, 13 December 2001.

environmental fees. Norway has accepted this through normal EEA procedures, although implementation has not begun. Norwegian industry does not pay electricity fees (at a savings of approximately 600 million euro), and ESA has signalled that this might be endangered [*Aftenposten*, 13 December 2001].

As a major supplier of gas to the EU market, Norway is keen to see the rapid introduction of liberal measures in the case of gas supply. The country has no domestic gas distribution market and therefore faces no vested interests seeking to retain monopolies, unlike most EU member states. If Norway were to make use of its natural gas, it would benefit from a ten-year exemption period for new networks. Norway is reaching the limits of hydro-electric generation, due to environmental protection of the remaining available water courses, but demand for power continues to grow. Gas-powered stations would however push up Norway's CO₂ emissions and make it very difficult to achieve its targets for CO₂ emissions under the Kyoto Protocol.

The link between energy and the environment illustrates how economic interests put pressure on the EEA states to adopt EU provisions even when the theoretical option of opting-out exists. In the face of growing import dependence on energy and the need to cut CO₂ emissions to meet its targets for Kyoto, the EU is introducing indicative targets for the use of renewable energy sources in electricity generation. Norway has a separate target for Kyoto and has an interest as a net energy exporter in the growth of energy exports to the EU. But Norway and the other EEA states are likely to adopt the same indicative guidelines because they are likely to become the standard requirement for obtaining 'green electricity' certification. Norway is likely to satisfy the green power requirements because most of its power is generated by renewable sources, and it therefore has an interest in being included in such a scheme.

2.2.2 Transport policy

EU transport policy has been relatively underdeveloped, but there are a number of areas in which the evolving *acquis* will have potential implications for the EEA members. In road transport there has been a focus on improving the qualifications of drivers in order to improve road safety [European Commission, 2001a]. The current proposals are awaiting a Council common position. This follows the driving time and other directives of the 1990s. Proposals for compulsory vocational training for drivers will increase costs in all EEA countries and will also require fundamental changes in the working conditions for drivers. There

do not, however, appear to be any particular difficulties for the EEA states.

In rail transportation one is only concerned with Norway. Iceland has no railway and in Liechtenstein the rail network is operated by Swiss Railways. The current proposals under discussion are aimed at unbundling rail services (separating train operators from network operators) to facilitate competition and providing for a separate safety authority. Norway is already ahead of most of the EU on these policies.

In air transportation the EU has introduced two previous liberalisation packages requiring the full liberalisation of the eight freedoms within the EU, since 1998. The current third package of directives on air transport includes provisions that will prepare the ground for the liberalisation of landing slot allocation, which limits competition *de facto* in the busier hubs [European Commission, 2001c]. This would for example require the establishment of an independent body to allocate slots. None of the EEA members has problems of congestion and therefore there are few limitations on landing slots. The Third Package also includes proposals to establish a supranational European Aviation Safety Agency that would replace the existing (intergovernmental) Joint Aviation Authority [European Commission, 2000h]. The aim of this proposal is to integrate the air safety regulations that currently contribute to the fragmentation of the air transportation sector in Europe. These proposals are making steady progress and could well be adopted in 2002. The adoption of such a body would extend the EU supranational model to another sector.

The third package of measures in air transport also includes proposals for a framework regulation on a single European sky aimed at creating a common European air space and to integrate air traffic control throughout Europe by 2004 [European Commission, 2001d]. These proposals resulted from the recommendations of a High Level Group that included Norwegian representatives. Here as with other elements of the Third Package, the issue for the EEA states is more one of the extension of the EU supranational model to a sector that had previously been dominated by intergovernmental regimes.

2.2.3 Electronic communications

The telecommunications sector in Europe has seen considerable liberalisation since the mid-1980s. The current EU programme of measures, which was put on the EU list of priorities at the Lisbon European Summit, envisages a new package of regulations governing electronic communications. This was given a high priority in the 'Lisbon

process' because of its potential impact on Europe's competitive position in the 'new economy' of services and other sectors that are communications-intensive. The package, which had its second reading in the European Parliament in December 2001, will have an impact in the coming years. It consists of a regulatory framework for all electronic communications (i.e. not separate regimes for telephony, mobile phones, data communication and television as is presently the case); provisions on access and interconnection; measures to protect universal services; measures on authorisation; and privacy and data protection.⁶

This sector is indicative of developments in EU approaches to regulation in the sense that it aims at 'light regulation (i.e. avoidance of excessive central regulation) whilst ensuring that dominant players do not abuse market power' [European Commission, 1999]. The oversight of market dominance is to be carried out by national regulators, rather than via some central Commission oversight, but the proposal envisages a so-called veto right for the Commission on national regulatory decisions. In other words, if the Commission feels that national regulators are not being tough enough on the abuse of market power by local/national suppliers, it would have the right to intervene. This is novel in the sense that determinations of market dominance would be made *ex ante* rather than *ex post* as is presently the case under EU competition provisions. This veto right is sensitive for some EU member states and so may not remain in the framework directive, but if it does, the ESA would assume responsibilities for regulatory oversight over the whole sector. The regulator would be a national government body in the EEA states and would therefore fall under the surveillance of the ESA.

Another potential difficulty with the electronic communications package is that the European Community envisages that it will be implemented at the same time, April 2003, in all countries, in order to avoid distortions to competition and the delayed implementation that has characterised previous directives. This raises the question of whether the EEA states would also have to implement its provisions at the same time, and if so whether they will be prepared to do so.

Another issue to watch from an EFTA point of view is the reform of the existing committee structure. Up to now, EEA states have participated in the major telecommunications committees and have therefore had an opportunity to play an active role in the consultation process shaping EU

⁶ See European Commission, 2001f, 2001b, 2001e, 2001d, 2001c, respectively.

communications policy. The composition of the new committees will therefore be of considerable interest to the EEA states.

In addition to the regulatory provisions for electronic communications as such, there are a series of initiatives aimed at promoting the use of electronic commerce (eCommerce programme), access to the internet for disadvantaged groups to prevent a digital divide within the European economy (eEurope) and the provision of public services via the internet (eGovernment). These initiatives are generally based on efforts to promote the use of best practice and therefore take the form of a more soft-law approach to the pursuit of EU policy objectives. In practice, this means that the respective actors in the EEA countries – whether service providers, regulators or governments – can participate.

2.2.4 Postal services

Postal services is a sector which is being indirectly affected by the technological and market changes shaping electronic communications [European Commission, 2000a]. It also represents a sector whose liberalisation in the EU has generally been very slow. In October 2001, however, there was a political agreement on proposals aimed at speeding up the implementation of a phased liberalisation package for postal services, starting with large letters in 2003, small letters in 2006 and full liberalisation in 2009. The final decision to undertake full liberalisation is to follow a review of universal service provision in 2006. Liberalisation of postal services is likely to touch some politically sensitive nerves in a number of EU member states and EEA states.

2.3 On the margins of the European Economic Area

The Common Fisheries Policy, the Common Agricultural Policy and the Common Commercial Policy are not part of the EEA agreement. There are however provisions in the agreement that cover various aspects of trade in fish and agricultural products, making it difficult to locate these sectors as being unambiguously either inside or outside the scope of the EEA Agreement. The limited significance of these sectors to Norway's overall economy is outweighed by their high political sensitivity, and thus their importance in Norway's relationship with the European Union. It is widely considered that agriculture and fisheries were among the main reasons why the two successive referenda over Norway's accession to the EU both failed. In addition the ambiguous location of these two sectors in relation to the EEA Agreement has been the main source of friction, both within Norway and between Norway and the EU, since the Agreement entered into force.

2.3.1 Fisheries

The fundamental issue posed by the fisheries sector is that, whereas Norway has large resources and is a net exporter of fish, the EU as a whole is a net importer and has a fishing fleet that is too large in relation to its own resources. Norway aims to obtain unhindered access to the EU market for its fishery products, while the EU seeks access for its fishery fleet to Norwegian territorial waters.

Fisheries exports amount to little more than 5% (almost 4 billion euro) of Norwegian exports, of which 60% goes to the EU (see Annex D). Although fish exports amounts to only 1.4% of Norway's GDP, this figure belies its political importance. Fishing is a prominent part of Norway's socio-economic and cultural identity, and the fisheries sector in Norway is well organised and is a more powerful political actor than its economic significance would imply.

A *bilateral framework agreement on fisheries cooperation* between Norway and the European Community entered into force in 1980, and forms the basis of annual negotiations on quotas in each other's territorial waters, as well as cooperation on management and control of fishery resources. In connection with the EEA negotiations the agreement was revised, increasing the EU's quotas in Norwegian waters. But since Norway's and the EU's shares of quotas are fixed, the annual quota negotiations are essentially mechanical exercises without significant disputes,⁷ and the principal issue is the total allowable catches. More importantly, the 1992 agreement widened the scope of cooperation on resource management. The ensuing enhanced cooperation has led to a certain convergence of resource management policies between the EU and Norway, and some of the strategies developed under the bilateral agreement seems likely to be introduced in the 2002 review of the EU's Common Fisheries Policy. Control and implementation constitute the weak point of the framework agreement [Stortingsmelding nr. 12, 2000/2001, p. 118], made more difficult by the different policies pursued by the EU and Norway in this field, and the fact that this is a member state competence in the EU. However, in recent years some progress has taken place also in this field through the close cooperation between the EU and Norway under the aegis of the framework agreement. There are

⁷ The exception to this concerns mackerel fishing, where Norway and the EU disagree on the required management regime. The two sides agree on ad hoc quotas each year and have not made an agreement on fixed quotas as for other species.

also signs that the 2002 review of the CFP might make the control function an EU competence, which would further facilitate cooperation.⁸

Fisheries and the EEA Agreement. The EEA agreement does not cover the EU's Common Fisheries Policy. The agreement does however cover trade in certain fishery products, categorised according to species and by degree of processing.⁹ For a number of unprocessed fishery products, the EEA gives Norway free access to the EU market. For other products there was a gradual reduction in tariffs during the late 1990s. It has been calculated that if the EEA Agreement was replaced with WTO rules, this would reduce exports by more than 100 million euro worth of fishery products, accounting for less than one-tenth of 1% of Norway's GDP.¹⁰ The EEA Agreement also stipulates higher tariffs for processed products. This stimulates the export of raw materials from Norway, which are then processed in the EU. The main value-added of Norway's exports of fish to European consumers thus takes place in the EU [Hoel, 1999, p. 218]. So-called 'sensitive products' (i.e. species in which the EU perceives itself to be potentially uncompetitive), are not however covered by the EEA Treaty and the EU has kept high tariffs.¹¹ This includes, among others, salmon, which constitutes almost half of Norway's fish exports to the EU. It must be noted, however, that these import limitations are balanced by restrictions on the part of the EEA states such as the restricted access of non-nationals to invest in the fishing industries in Iceland and Norway.

The Salmon Agreement. Production and export of salmon bred in fish farms have increased greatly in the last decade. The fish is by far the single most important Norwegian fisheries product exported to the EU. It has also become the main source of friction between the EU and Norway in the fisheries sector. Norway has frequently been forced to introduce voluntary export constraints following demands by EU fish farmers. In 1997 the Commission initiated anti-dumping procedures against Norwegian salmon exports. Norway then claimed that the EEA agreement prohibited anti-dumping procedures in this sector as well, an argument that was however rejected by the Commission. Negotiations

⁸ See <http://www.nrk.no/nyheter/okonomi/1582203.html>.

⁹ More accurately Protocol 9 of the EEA agreement, which covers fisheries.

¹⁰ 'EØS-oppsigelse ikke dramatisk', 13 November 2001, article available at <http://www.neitileu.no>.

¹¹ Up to 18% for raw fish and 25% for processed products; see Stortingsmelding nr.12 (2000/2001, p. 120).

were initiated, and culminated in the so-called Salmon Agreement of 1997.

The five-year Agreement stipulates an increase in Norwegian export duties, puts a ceiling on the growth of Norwegian salmon exports to the EU, introduces a minimum price and establishes a surveillance and implementation system. In addition, the Commission has entered into so-called 'undertakings' with each fish farmer, whereby the latter agrees to abide by the minimum price. In return, the EU agreed not to take further anti-dumping procedures, and not to introduce extra duties on salmon imports from Norway. The Agreement entails significant additional administrative costs, and there have been numerous attempts to circumvent the agreement. The Commission has retaliated with extra tariffs in these cases. A bigger problem though has been the minimum price, as it is higher than the current market price within the EU. As a consequence the growth in Norwegian exports have stalled and Norway is losing market shares in the fast-growing EU market [*Nettavisen*, 8 November 2001].

The Salmon Agreement expires in the summer of 2002. One expert [*Dagens Næringsliv*, 17 October 2001] recently suggested that Norway is faced with three alternatives: i) to prolong the agreement; ii) no new agreement under the assumption that EU threats of anti-dumping measures will be rejected as groundless; or iii) to undertake unilateral actions to reduce the growth in fish farming production. The last alternative is echoed by other experts, who propose that Norway should change the implementation of Norwegian fisheries policies in order to avoid renewed criticisms from EU fish farmers of concealed subsidies to the Norwegian aquaculture industry. It has also been proposed that ESA should be given the task of controlling compliance with the EEA rules in parts of the fisheries sector not covered by Protocol 9 of the EEA Agreement. It is suggested that this could be combined with guarantees that both Norwegian and EU companies are given equal opportunities to establish and run fish farms in Norway. However, the EU appears to be reluctant to change the regime for fisheries trade under the EEA Agreement [Stortingsmelding nr. 12, 2000/2001, p. 120].

In 1994, Norwegian fishermen were among the strongest opponents of Norway's bid for EU membership, whereas the fish-processing industry was among the most ardent supporters. Norway's status as a non-member of the EU appears to be causing increasing problems for Norway's fishery sector. Although still representing a minority view, important actors among Norwegian fishermen have recently argued that EU

membership would be better for the sector than the current arrangements [Dagens Næringsliv, 10 January 2002].

2.3.2 Agriculture

Although the EEA Agreement does not include the Common Agricultural Policy, and agricultural products are explicitly excluded from the general provision on the free movement of goods within the EEA, it does contain important provisions of relevance to Norway's agricultural sector. The key provisions are contained in Annex I, which brings EU *acquis* on veterinary standards into the EEA Agreement and also contains provisions on feedstuffs and phytosanitary legislation, Protocol 3 on trade in processed agricultural products, and Article 19, which stipulates the progressive liberalisation of bilateral trade (i.e. between Norway and the EU) in agricultural goods and which is to be reviewed every other year.¹² However, most of these provisions have for different reasons not yet, or only quite recently, entered into force, so that the EEA Agreement has not yet had its full impact on Norway's agricultural sector.

Veterinary and phytosanitary rules and standards. In the original EEA Agreement provisions abolishing veterinary border controls were excluded. As the EU's new phytosanitary rules were not yet in place, these were also excluded from the EEA Agreement [Veggeland, 1999, p. 232]. In 1995 Norway took the initiative to include veterinary issues in the EEA Agreement, and Annex I on veterinary and phytosanitary matters, colloquially known as the Veterinary Agreement, was approved in the EEA Joint Committee in 1998 and entered into force in January 1999. Through the Veterinary Agreement, border controls on agricultural products are removed between the EEA states and the EU, and the EEA states introduce EU veterinary standards. The ESA has surveillance powers in this area as under the EEA Agreement, and have used them actively. The Veterinary Agreement has so far been the most contentious issue concerning the EEA Agreement in the domestic political debate in Norway, and was even opposed by members of the Eurosceptic government at the time, which was however forced to introduce it by a pro-European majority in Parliament.

The EEA Agreement contains the possibility of abstaining from implementing the Agreement under certain conditions, known as the

¹² Chapter 2 of the EEA Agreement covers agricultural and fisheries products. In addition Annex II of the EEA Agreement on technical standards includes rules on food standards.

‘veto right’.¹³ This became relevant during the foot and mouth crisis in spring 2001, when Norway temporarily prohibited the import of certain animal products, and banned wholesale imports into Norway. Although the measures were allowed under the EEA Agreement, they were countered by complaints from the EU side, and were subsequently removed after only three weeks. Interestingly, EU member Denmark introduced restrictions on cross-border trade that had a similar effect as the Norwegian import ban and kept them in place for longer periods, without however being confronted by similarly strong complaints from their EU partners.

Another issue arising from recent food crises in Europe concerns the newly established European Food Safety Authority. At the EEA Council in October 2001, both sides agreed that the involvement of the EEA states with this Authority is ‘important for maintaining the homogeneity across the EEA’ [Council of the EU, 2001a], although there is not yet any agreement on what form this participation will take. Involvement by the EEA states in other EU autonomous agencies provides little guidance, as illustrated in Annex B, which shows that Norway’s participation in other agencies ranges from full membership, through associate or observer status to no participation at all.

Trade in agricultural products. Trade in processed agricultural products was the main unresolved issue when the EEA Agreement was signed in spring 1992, and the relevant protocol (Protocol 3) has only been in force since January 2002.¹⁴ Until then, trade in processed agricultural products was based on the 1973 bilateral EU-Norway free trade agreement.¹⁵ Protocol 3 of the EEA Agreement reduces the level of import tariffs further, 3% on average, and widens somewhat the range of products covered.

Article 19 of the EEA Agreement commits the parties to a gradual liberalisation of trade in non-processed agricultural products not covered by Protocol 3, a process that is to be reviewed every other year. However,

¹³ Often known as the ‘veto-right’; see Section 2.4.

¹⁴ The total value of trade covered by Protocol 3 was 500 million euro in 1999, approximately one-fifth of which were exports from Norway; see Stortingsmelding No. 12 (2000/2001, p. 124). Although Protocol 3 has entered into force, certain elements are not agreed upon, and further negotiations will take place during 2002. This concerns in particular the element of support categorised as ‘industry-support’ (as opposed to ‘agricultural support’), which in general is to be abolished, although with exceptions to be negotiated.

¹⁵ More accurately, on Protocol 2 of the agreement.

such a review has so far only taken place once in the eight years that the EEA Agreement has been in force, partially because such a review was linked by the Norwegian side to agreement on Protocol 3. The first and so far only agreement on Article 19-liberalisation measures was reached in late 1997, between the EEA states and the Commission. But according to some member states, the value of the concessions given by both sides, approximately worth 3 million euro, was not sufficient to warrant an agreement. A new review is expected in spring 2002.

Since key elements of the agricultural component of the EEA Agreement have only recently been ready, the Agreement has so far had less of an impact than could have been expected at the outset. Together with the exclusion of the Common Agricultural Policy from the EEA, this has made it possible for Norway to maintain a higher level of subsidies to the agricultural sector and higher prices on agricultural products than have the EU member states. There does not appear to be any significant convergence between Norway and the EU in terms of prices and levels of subsidies since the entry into force of the EEA Agreement in 1994, with Norwegian prices and subsidies considerably higher than in the EU.¹⁶ The consequences for Norway's agricultural sector are becoming increasingly apparent. The removal of border controls combined with lower EU prices have increased cross-border shopping, with Norwegians purchasing food in the EU (primarily in Sweden) worth hundreds of million euro.¹⁷ The price-reductions following implementation of the EU's Agenda 2000 further increase the price differentials and thus cross-border shopping. Partially in response to these developments, Norway recently took steps to reduce its agricultural prices through the elimination of VAT on food products.

The gradual reduction in tariffs and widening of the scope of the relevant agreement has led to a deteriorating balance of trade in processed agricultural products, with a steady reduction of Norwegian exports and increased imports. These trends are likely to continue, partially because of the commitment under Article 19 to progressively liberalise

¹⁶ Norwegian agricultural subsidies are approximately 50% higher than in the EU. Food prices in Norway are in general 12% higher than in Sweden; see OECD, 2001, pp. 65-66.

¹⁷ According to an officially commissioned report, this trade was worth approximately 400 million euro in 2000; see <http://odin.dep.no/archive/finvedlegg/01/04/rapp0064.htm>. Other sources estimate the cross-border trade with Sweden at more than 1 billion euro annually; see <http://www.hsh-org.no>.

agricultural trade, and in the medium-term through the next round of WTO negotiations.

The institutional provisions of the EEA Agreement make their mark also in the agricultural sector, with the ESA playing an increasingly pro-active role. The EFTA Court, on the other hand, has so far not handled any cases of relevance to the agricultural sector, in part due to the late and relatively recent entry into force of the provisions of relevance to the agricultural sector. The dynamism inherent in the EEA Agreement is also evident in the agricultural sector, through the provision (Article 19) stipulating regular negotiations on trade liberalisation and through the steady stream of new and often controversial directives.

2.3.3 Trade policy

The EEA is not a customs union and there is no formal linkages concerning trade policy with third parties. Norway and the other EEA states are therefore theoretically free to determine their own external trade policy. In practice, however, the scope for divergence from the EU policies is fairly limited. It is helpful to consider separately the three elements of trade policy (multilateral, regional/bilateral and commercial instruments (i.e. anti-dumping)).

In multilateral trade negotiations, Norway is free to set its own tariffs levels vis-à-vis other WTO members. The general reduction in tariffs has, however, brought about a significant reduction in the level of preference that tariffs can provide. In terms of trade relations between developed market economies, tariffs generally provide less protection than complex customs clearing provisions or the costs involved in completing the paperwork associated with customs clearance. Some tariff peaks and escalation remains, but proposals for the next phase of WTO negotiations following the Doha WTO meeting will lead to more or less tariff-free trade in the OECD countries.

Trade policy is therefore increasingly concerned with non-tariff barriers to trade, such as subsidies and government procurement or regulatory barriers to trade in goods (technical barriers to trade) and services. In this field of liberalisation, the WTO is lagging well behind the EU, so that by the time the WTO comes to discuss any given policy area, there is very often already an EU *acquis*. The EU's external trade policy is therefore shaped by the nature of the internal *acquis*. Changes to positions adopted within the EU are difficult, so the EU's policy in external trade negotiations is very much shaped by efforts to reconcile the emerging international regime with the existing European *acquis*. As Norway

adopts the European *acquis* in the EEA, it inevitably follows the EU external trade policy in everything covered by the *acquis*. Even in policy areas not covered by the EEA, such as agriculture, Norway follows the EU line, in this case because the EU provides Norway with some defence against what would otherwise be intense pressure to liberalise its agricultural sector. The only scope for independent policies is in those areas where there is no European Community competence in international trade or where there is mixed competence. This includes, for example, trade in services through right of establishment (i.e. investment), intellectual property and investment. Sectors such as maritime transport and air transport are also areas where Norway has some freedom to adopt differing positions, but most WTO members have explicitly excluded these sectors from most-favoured nation treatment under Article II of the General Agreement on Trade in Services (GATS), so the question of an independent Norwegian trade policy in these sectors is moot.

In the negotiating process Norway is not part of the EU delegation and can therefore play a role, along with Switzerland and countries such as Chile or Singapore, in mediating between the major players in multilateral trade negotiations. This role is one that Norway and Switzerland have traditionally played and it is one that is becoming more important as multilateral negotiations begin to assume the nature of negotiations between blocs.

In regional or bilateral trade relations, Norway has acted through EFTA to shadow agreements negotiated by the EU with third parties. The partners in free trade agreements between EFTA and third countries have generally followed agreements made with the EU partner. The first agreements were initiated in the 1990s with the Central and East European economies, and free trade agreements entered into force with the Czech and Slovak Republics in 1992, Hungary October 1993, Poland September 1994, Romania May 1993 and Bulgaria July 1993, Estonia, Latvia and Lithuania in 1996 and 1997 and Slovenia in 1998. The motivation behind these agreements was two-fold: to prevent or limit any trade diversion or discrimination resulting from the Europe Agreements between the EU and these countries, and to contribute to the economic and thus political development of the countries concerned. The latter was more important in the case of the agreements with the Balkan states (an FTA with Macedonia was signed in May 2001 and one with Croatia in June 2001).

EFTA bilateral trade diplomacy has also followed the EU into closer cooperation and free trade agreements with countries in the

Mediterranean, for example, the free trade agreement signed with Morocco in December 1999 and Jordan in 2001. In 1999 EFTA Ministers decided to extend bilateral negotiations outside of Europe, which has led rapidly to FTAs with Mexico and negotiations (like the EU) with MERCOSUR/Chile, and (unlike the EU) with Singapore. The scope of the EFTA FTAs is more or less the same as the coverage of the EU bilaterals with the countries concerned. Differences occur mainly in those sectors that are not fully covered, such as agriculture where there are bilateral protocols between each EFTA state and the FTA partner of EFTA.

With regard to the use of commercial policy instruments, such as anti-dumping, Norway is still free to use its national instruments against third countries, i.e. not against EU suppliers. Nevertheless, there are significant interactions between EU and Norwegian trade policies and interests, as a few cases have illustrated. In general anti-dumping duties cannot be used within the EU between the EU and EEA states, except in the case of products excluded from the EEA Agreement. As reported above, there was a contested application of anti-dumping duties imposed by the EU on Norwegian salmon exports to the EU.

In the case of magnesium there has been an interesting example of policy interaction. Until recently Norway and France were the world's leading magnesium suppliers. China then entered the market aggressively, and both Norway and the EU applied anti-dumping duties against China in independent but presumably coordinated moves (at least informally). This left Norway protected not only in its home market, but more significantly in its access to the EU market. Later, however, the French producer concluded that it could not sustain the competition with China and closed its production plant, the Norwegian producer soon decided also to follow suit. In this case, the EU and Norway moved together. In other cases, Norway might find itself exposed to EU decisions that it may not like, and that it might have been in a position to prevent as an EU insider.

Norway is a major producer of fertiliser products. In fact, Norsk Hydro is the world's largest producer, with important production plants within the EU. This is a product for which anti-dumping duties have been used in the last decade by the EU against several former Soviet Union states. In this case the Norwegian company has had a strong interest in EU anti-dumping policies towards third countries, in order to keep a privileged market access within the EU for both its Norwegian and EU-based production plants.

2.4 The functioning of the EEA institutions

2.4.1 Input of the EEA states into shaping the *acquis*

EEA input into the formulation of the *acquis* occurs mainly at the ‘pre-pipeline’ stage when the European Commission is considering proposals. The Commission, according to Article 99, includes experts from the EEA states in the consultation process. This is a challenging and resource-intensive process for the EEA states, since they must work quickly if they are to consult with domestic interests in order to represent national interests effectively. Although the EFTA Secretariat helps in the process of identifying issues, there is still a danger that EEA positions are not firmly established in time. Having said this, the Commission will often engage in a fairly lengthy consultation procedure, taking the form of green and white papers, which helps facilitate input from all interests, including the EEA states.

Liaison between the EFTA Secretariat and the Commission also helps to facilitate EFTA input, but there would appear to be a lack of consistency on the Commission’s side in the approach and effort made by different services. Each Commission Directorate General (DG) designates an office to deal with the EEA dimension of any proposed measure, but many of these officials have other extensive responsibilities and cannot always devote much time to monitoring everything that goes on in the DG and passing this information to the EFTA Secretariat.

Once a proposal enters the ‘pipeline’ phase, in other words the drafting of the legislative measure, EEA states are excluded from the process. Short of full membership of the EU, the EEA members cannot have a vote. But there are a range of indirect means whereby EEA views can be fed into the process. First of all there is not always a clear *de facto* distinction between the work of a Commission expert advisory committee and a drafting committee of the Council. Suggestions for possible approaches to drafting may well be discussed in the expert groups. During the Council discussions, the EFTA Secretariat can retain some contact with what is going on via the Commission, which may feed in EFTA views. The EFTA Secretariat can also maintain contact with the Council Secretariat in order to keep abreast of developments.

EFTA Working Groups also discuss developments in their respective areas on a regular basis and include Commission representatives. Moreover, there is usually a meeting of each EFTA Working Group attended by the appropriate representative of the Presidency. In addition, the EEA states can look to EU member states whose interests are similar

to theirs to act as proxies in the decision-making process. Given the diversity of interests represented among EU member states, there will generally be a number of governments whose views are compatible with those of the EEA states. By providing information and other support for the common cause, EEA states may be able to shape outcomes indirectly through this channel. A recent example can be found in the exemptions from the EU liberalisation provisions for small electricity generators under the latest cross-border supply directive [European Commission, 2001b]. In this case, Austria and Sweden had similar interests to the Norwegians, so the desire to avoid excessive regulation of small hydroelectric generators was adequately reflected in the debate, and thresholds for exemption were set at a level that excludes 90% of Norwegian power generators.

Adoption of any EU legislation or other provision into the EEA requires agreement in the Joint Committee of the EEA. There is therefore the option of opting-out of any EU legislation for the EEA states as a group – known colloquially as the ‘veto-right’ – but this has not been used to date.¹⁸ If such action were however to be taken by one of the three EEA states (which are obliged to speak on this as in other EEA matters with one voice) or the EU side, the ensuing dispute could take one of several courses. If agreement concerning the incorporation of secondary legislation into the EEA *acquis* is not found in the Joint Committee, the parties may request the European Court of Justice for an interpretation of the relevant rule (Article 111). If this fails to lead to a solution, the outcome takes one of the following three forms: a) the affected part of the treaty is suspended; b) ‘safeguard measures’ are introduced by one of the contracting parties, which could lead to counter-measures by other parties (see Articles 112-114 of the EEA Treaty); or, as a last resort, c) the dissenting EEA state withdraw from the EEA Agreement.

The record of the EEA states in implementing the *acquis* is also reasonably good, although there are a number of areas where countries have failed to comply with the implementation schedules. One problem has been that the national governments still appear to be ‘surprised’ by the need to modify national legislation even after the long process of debate on the proposed measure within the EU and EEA. One solution to this problem might be to ensure that government departments in the EEA states begin to work on implementation before the EU directive lands on their desk.

¹⁸ See Arnesen et al. [1997] for a more thorough treatment of the ‘veto-right’.

Guaranteed access to the European single market has come at the cost of reduced scope for national autonomy in the policy areas covered by the EU *acquis*. Several examples above have shown Norway's limited influence in the case of disputes. And although the EEA states can opt out, there has so far been no case in which this has actually happened, because of the perception that the homogeneity of the market depends on the credibility of the tie with the EU *acquis*. In practical terms therefore the EEA states have had to adopt the whole *acquis*.

It should be mentioned, however, that the EEA Agreement provides considerable scope for interaction between civil society in the EEA states and the EU through their participation, on an equal basis with their EU counterparts, in EC programmes. It should also be mentioned that the trade unions and industry confederations in the EEA states participate in the EU policy process. Their membership in the European-wide associations allows them to play a role equal to that of their EU counterparts in the social dialogue enshrined in the EU treaties. Thus although the EEA governments may play a very limited role in the EU policy network, this is somewhat compensated for by the participation of the EEA's private business sector and civil society in EU-centred networks, organisations and programmes.

2.4.2 The EEA Council and political dialogue

Initially, the EEA Council consisted of the 15 foreign ministers of the EU, the three foreign ministers of the EEA states and the European Commissioner for external relations. Over time, however, a practice developed whereby the EU side was represented not by the foreign ministers of the member states and the Commissioner, but by their deputies or senior officials. This model was increasingly seen as unsatisfactory, not just for the EEA but also in general for the EU's hugely expanding set of association agreements (see Annex C). The size of the association councils (in the case of the EEA consisting of 19 principals) was found to be too cumbersome, with most of the time consumed by formal statements. In mid-2000, the EU streamlined its participation in all association councils, including the EEA. Instead of the EU-15 model, the EU is now represented by a 'Troika', consisting of the foreign ministers of the current and incoming EU Presidencies, the relevant European Commissioner and the High Representative for the CFSP.

But even this level of consultation now appears to be too extensive for the crowded agenda of EU officials. At the last meeting of the EEA Council in October 2001, the Belgian EU Presidency and the incoming Spanish

EU Presidency were not represented by the Foreign Ministers, but by the Deputy Ministers from the Foreign Ministries. The European Commission was not represented by the External Relations Commissioner, but by the Director in charge of the EEA Agreement (among other things) in DG RELEX, a senior official. The High Representative was not present, and did not send anyone in his place. The three EEA states were as usual represented by their foreign ministers [*Aftenposten*, 9 October 2001].

The political dialogue accorded to countries with which the EU has association agreements is now not much different from the dialogue between the EU and countries with which it has ‘partnership and cooperation agreements’ and ‘trade and cooperation agreements’. Indeed, some major partner countries now have a more frequent and comprehensive political dialogue than associated countries. One example is Russia, which has a Partnership and Cooperation Agreement. The political dialogue between the EU and Russia has expanded rapidly, most recently with the decision at the EU-Russia summit in October 2001 to initiate monthly meetings between Russia and the ‘troika’ of the EU Political and Security Committee.

The regular meetings that take place between Norway and the EU outside of the EEA institutions are probably more important than the political dialogue conducted within the EEA institutions. These include the meetings between the Norwegian Prime Minister and the EU Presidency held at the beginning of each Presidency and the annual lunch meetings between EU and EEA finance ministers. The Norwegian Foreign Minister normally also meets bilaterally with EU colleagues and EU representatives in connection with meetings of the EEA Council. The most frequent meetings between Norway and the EU at a high political level are however those that take place on an *ad hoc* basis, between EU representatives and Norwegian ministers, bilaterally with EU member state governments or multilaterally, and increasingly consultations through Norway’s multiple association arrangements with the EU (CFSP, ESDP, Schengen, etc.).

2.4.3 Supranationality in the EEA: The ESA and the EFTA Court

The complex two-pillar institutional structure of the EEA agreement was established in order to respect the sovereignty of the EEA states and the decision-making autonomy of the EU, while at the same time allowing the EEA states to participate in the decision-shaping process of new EEA-relevant legislation. Both politically and in terms of their constitutional requirements, it was impossible for the EEA states to

accept direct decisions by the European Commission or the European Court of Justice. Accordingly, two supranational institutions, the EFTA Surveillance Authority and the EFTA Court, were established to perform the role of the European Commission or the European Court of Justice vis-à-vis the EEA states in the areas covered by the EEA Agreement.

The EFTA Surveillance Authority (ESA) has responsibility for ensuring the effective and timely implementation of the decisions of the Joint Committee. The ESA provides the second pillar of the EEA, which serves the purpose of avoiding a direct loss of sovereignty by the EEA states to the EU. Whilst this is the case from a legal point of view the practical outcome is that the EEA still adopts the EU *acquis*. In order to ensure the credibility of a single homogeneous market spanning across the whole of the EEA, the ESA has to follow the approach adopted by the Commission when it comes to interpreting any piece of legislation. Material circumstances can differ and so the ESA and Commission positions may diverge from time to time, but close cooperation between the Commission and the ESA has ensured that there is no different interpretation of the rules. On the rare occasion when the ESA might be in a position to set a precedent not yet covered by the EU *acquis*, the Commission has called for and obtained restraint from the ESA.

Complaints that the ESA is increasingly taking a legalistic view of the agreement and that it is less tolerant of special demands from the three EEA states are frequently heard among Norwegian politicians [*Aftenposten*, 20 August 2001]. It is often seen as playing a more pro-active role than initially envisaged and is criticised for its broad interpretations of the scope of the EEA Agreement. The steadily growing number of ESA 'own initiatives' supports the view that the ESA is becoming gradually more pro-active. Another explanation is that most cases so far have been concerned with less controversial issues related to the free movement of goods, whereas until quite recently there had been relatively few cases in more controversial fields such as financial services, competition and state aid, reflecting the gradual completion of the single market programme also in these areas.

The EFTA Court is available for the review of any ESA decision or for redress in the case of non-implementation by an EEA state. To date there have been relatively few cases brought before the EFTA Court, some 10-12 a year, although 2001 has seen more. Most of these cases are furthermore advisory opinions on the EEA rather than infringement cases. This compares with the more than 1,000 cases being brought to the ECJ and the EU Court of First Instance annually, most of which are

related to the single market. Thus, as in the case of technical regulations, the flow of case law affecting the EEA also comes predominantly from the EU.

In sum, the existence of a two-pillar system with the ESA and the EFTA Court seems to serve more of a political purpose in limiting the loss of formal sovereignty by EEA states, rather than to increase their national policy autonomy.

2.5 Preferences of Norway and its EEA partners

Eight years after the entry into force of the EEA Agreement, there is a consensus among the three EEA states that '[t]he EEA Agreement has worked well and in accordance with intentions' [EFTA Secretariat, 2001]. The three states also agree that the EEA Agreement has certain limitations, that developments within the EU since the Agreement was adopted has made these limitations more apparent, and that future developments of the EU such as enlargement might further complicate the functioning of the EEA. However, there are important difference between Iceland, Liechtenstein and Norway as to how severe these difficulties are, whether or not the EEA states should take an initiative to remedy this situation, and as to what should and indeed could be done more specifically to ensure that EEA Agreement can continue to function 'in accordance with intentions'.

More specifically, the issue of a possible 'update' or 'upgrade' or 'revision' of the EEA Agreement has risen to the top of the EEA agenda in the last year, mainly driven by the Icelandic Foreign Minister (see below). This issue has arrived in parallel with increasing scepticism in Norway about how the EEA is developing in practice, in particular concerns about a more pro-active ESA that is perceived as interpreting the Agreement too extensively [*Aftenposten*, 20 August 2001]. In spite of this, however, the Norwegian government has been reluctant to propose changing the status quo. According to then State Secretary Espen Barth Eide, the reason for this position was concern that Norway 'would have more to lose than to gain', from such a process [*Aftenposten*, 7 September 2001]. Instead, Norway has favoured enhanced efforts by the EEA states to take full advantage of the opportunities accorded to them by the EEA Agreement, such as broader participation in Commission committees. The Norwegian government has also supported, though somewhat reluctantly, the idea of a 'technical upgrade' of the Agreement to ensure that changes to the EU treaties since the EEA Agreement was signed in 1992 do not erode the homogeneity of the EEA.

2.5.1 Iceland

Among the three EEA states, Iceland appears to have become the most concerned about how the EEA Agreement has developed in practice. In legal terms, the problem is that the Maastricht and Amsterdam Treaties added new provisions of relevance to the EEA, for example in the social and environmental fields that have not been included in the EEA Agreement. This could threaten the homogeneity of the EEA, which is the principal aim of the EEA Agreement.¹⁹

Iceland also has concerns about the role played by the European Commission, the EFTA Surveillance Authority and the EFTA Court. A complaint frequently heard from the EFTA side is that the EU is taking a more legalistic and less flexible approach to the EEA Agreement. It is claimed that the Commission 'has sought to take decisions which belong to ESA in the [political] forum of the Joint Committee, where the Commission effectively has a veto,' which could threaten the 'special character' of the EEA Agreement [Iceland Ministry of Foreign Affairs, 2000, p. 22]. There is a widespread perception, shared to a large extent by the other EEA states, that the Commission has weakened in relation to the EU member states, and that this makes the management of the EEA Agreement less stable. In line with this, experience has shown that the European Commission is less of a committed advocate on behalf of the EEA states within the EU system than was the case in the early years of the EEA. The latter situation is to some extent due to the fact that there is less knowledge about the rights and obligations of the EFTA states arising from the EEA Agreement inside the European Commission. The officials originally working on the EEA have moved to other positions and, given the marginal importance of the EEA to the EU, the people who are familiar with the EEA and the particular concerns of the EFTA countries become fewer. This argument, however, could also be used against the EFTA side, as there has been a significant turnover in the EFTA Secretariat and ESA. There are also complaints against the ESA, whose surveillance is seen as 'more rigorous than the equivalent surveillance undertaken by the Commission in the EU Member States' [Iceland MFA, 2000, p. 8].

At a more general level, the problem according to Foreign Minister Halldór Ásgrímsson is that '[t]he EEA Agreement is leading to more integration far beyond what was envisaged.' This has created for Iceland 'a democratic deficit in decision shaping of EC *acquis*, and [...] a

¹⁹ Article 1 of the EEA Agreement.

sovereignty deficit. We are not pooling our sovereignty but are in danger of handing it over. If the Agreement is to survive, this trend will have to be reversed' [Ásgrímsson, 2001].

In light of this, Iceland has advocated the idea of updating the EEA Agreement. The initial response from the European Commission was negative, and there has been at most lukewarm support from the other EEA states,²⁰ and a more limited 'technical upgrade' is now under consideration (see Chapter 7).

It seems however that the update proposed by Foreign Minister Ásgrímsson would go much further than a just limited adjustment of the EEA Agreement. A more drastic overhaul of the EEA institutional set-up taking into account more fundamental changes to EU policy-making since the EEA Agreement was signed is envisaged. 'The clear changes in the balance of power between the EU institutions, giving the European Parliament and the Council stronger positions, means that the terms for decision shaping in the EEA Agreement need to be updated' [Ásgrímsson, 2001]. However, 'a considerable, but ultimately fruitless effort was made to get direct access to the EU Member States during the decision making process' in the EEA negotiations in the early 1990s, and the Icelandic government concedes that '[t]he chances of achieving this now in the present changed circumstances seem slim.' Such direct participation however does in fact takes place in the so-called Mixed Committee established for Iceland's and Norway's association with the Schengen co-operation in the EU (see Chapter 4). But '[a]lthough it would certainly be desirable to transfer to the EEA certain Schengen-type solutions for Iceland's and Norway's access to the EU institutions, it seems clear that the political preconditions for this is lacking in the EU' [Iceland MFA, 2000, p. 16]. As far as providing for the enhanced role of the European Parliament in EU legislation through improved mechanisms for consultation between the EP and the EEA states, 'it cannot be expected that such co-operation will be formalised' [Iceland MFA, 2000, p. 8]. Finally, it may be remarked that it is not clear what Iceland and the EEA states would be willing to concede, in the unlikely event that the EU accepted to negotiate an upgrade to the EEA Treaty.

There has also been some concern in Iceland about relations within the EFTA pillar of the EEA, more specifically concerning the dominant role of Norway, which could become a threat to the equal status of the much smaller Iceland and Liechtenstein in the EEA institutions. One expression

²⁰ See EFTA Secretariat [2001]; and *Aftenposten*, 7 September and 3 October 2001.

of this concern is the recent dispute about the next President of the three-member College of the EFTA Surveillance Authority. Iceland argued that the position should rotate among the three countries, and that since the President was a Norwegian for the first eight years, the position should now go to Iceland's member of the College. The Norwegians, on the other hand, argued that since Norway pays almost the entire budget of the EFTA EEA institutions, and since Iceland appointed the head of the EFTA Court and Switzerland the Secretary General of EFTA, it would be reasonable that a Norwegian should continue to be President of the College of the ESA. It was agreed in December 2001, that a Norwegian would continue as President of ESA for two years.

2.5.2 *Liechtenstein*

The latest official report on Liechtenstein's relationship with the EU and the EEA Agreement makes a 'positive assessment of the 5-year membership,'²¹ and claims that, 'on the whole, having joined the EEA can be depicted as mainly a correct step' [Liechtenstein Government, 2000, p. 60 and p. 62]. Although the government recognises that the Agreement has certain deficiencies and that these have become clearer over time, it does not push for a revision of the EEA Agreement. Its position is that pragmatic solutions can be found, and that no upgrading of the EEA Agreement is therefore required at present.

Although in relation to Liechtenstein's liberal tax regime, 'questions of fiscal harmonisation are not posed by the EC inside the EEA institutions,' [Liechtenstein Government, 2000, p. 60], the EEA Agreement has been helpful against 'accusations in relation to money laundering' intermittently levelled against Liechtenstein. The EEA Agreement allows these to be referred to the 'European standards of Liechtenstein's transposition procedures, as the EFTA Surveillance Authority remarks in its reports' [Liechtenstein Government, 2000, p. 61].

As far as the problems concerning the diverging legal basis of the EEA and the EU due to EU treaty changes, Liechtenstein's position seems to be in accordance with current practice in the EEA. As of today, 'the changed basis is referred to in the preamble to the decision [made by the

²¹ Liechtenstein joined EFTA on 1 September 1991. Following the Swiss 'no-vote' to participate in the EEA, Liechtenstein had to renegotiate its customs union with Switzerland in order to be part of the EEA, and also to renegotiate, though to a more limited extent, its terms of participation in the EEA. The entry into force of the EEA Agreement for Liechtenstein was therefore delayed until May 1995.

EEA Joint Committee] and, as far as possible, the substance of the change is taken into account' [Iceland MFA, 2000, p. 15]. Furthermore, an updated EEA Agreement taking the Maastricht and Amsterdam Treaty revisions into account would be quickly outdated after the entry into force of the Nice Treaty and then the perhaps more radically changed treaty emerging from the 2004 intergovernmental conference (IGC). Combined with the view that the problems of diverging legal bases are limited and manageable, Liechtenstein thus appears more reluctant concerning a comprehensive revision of the EEA Agreement.

There are other considerations that are relevant for Liechtenstein, however. The small size of Liechtenstein provides it with a different set of options than its EEA partners, as it is unlikely that a 'mini-state' like Liechtenstein would be accepted as a full-fledged member state of the EU. And because of its close relationship to Switzerland – Liechtenstein uses the Swiss franc and shares a customs union with Switzerland – the development of Swiss-EU relations provides an additional factor of divergence with its Nordic EEA partners.

2.6 EU enlargement

The overall assessment of the Norwegian government is that the forthcoming EU enlargement to Central and Eastern Europe will be beneficial to Norway,²² although the country's authorities have several concerns about EU enlargement. At the most general level, there is a fear that EU enlargement might further marginalise Norway in Europe. There is also some disquiet about how EU enlargement will affect the functioning EEA Agreement, in particular how and when the EEA will be enlarged. The most important specific concern is how enlargement will affect Norwegian fisheries exports to the new members in Central and Eastern Europe.

2.6.1 The EU-EEA balance

The imminent enlargement to Central and Eastern Europe will create a much larger and more heterogeneous European Union. The EEA Agreement was negotiated between the European Community of 12 member states and the seven members of EFTA, their most important trading partner, accounting for almost one-fourth of the EC's total

²² See Stortingsmelding nr. 12 [2000-2001], Part 11, and Utenriksdepartementet [2001].

external trade.²³ Today, the three EEA states combined account for less than 5% of the EU's external trade. EU enlargement will further reduce the economic significance of the three EEA states to the EU, while simultaneously increasing, albeit marginally, the role of the EU to the economies of the EEA countries.²⁴ With possibly ten new EU member states soon, the 25 EU member states will have a total population of 480 million, compared to 4.8 million for the three EEA states. By contrast, the originally conceived EEA of seven states would have had a total population of 34 million people compared to the EU-12 of 348 million.

To put these changes into a nutshell, the EEA reverts from being a 25% partner of the EU in terms of trade to a 5% partner; or in terms of population from being 10% partner of the EU to a 1% partner.

The future increased heterogeneity of an enlarged EU has already had an effect on Norway's relationship with the EU. The EEA states frequently complain that the EU is taking a more legalistic and less flexible approach to the EEA Agreement and it is assumed that this is because 'it is not acceptable to show the affluent EEA countries more flexibility than the much less well off candidate countries' [Iceland MFA, 2000, p. 6]. This change is likely to be much more pronounced once the candidates actually accede and become full members of the EU.

Northern Europe has received considerable attention within the EU in recent years, perhaps due to Sweden's and Finland's accession to the EU and the fact that four of the ten of the most advanced accession candidates are in Northern Europe (Poland and the three Baltic states). One example of this is the Northern Dimension initiative proposed by Finland and followed through by the Swedish Presidency in spring 2001 (see Chapter 5 below). But as the northern EU candidates become members, the EU's geographical focus is likely to shift to the south and east, where the next tier of candidates for EU accession, such as the current candidates Romania, Bulgaria and Turkey as well as the countries of the Western Balkans, are located. This southern and eastern shift will likely be accentuated by the accession of new members to the EU, for whom relations with the enlarged EU's poor and unstable eastern and

²³Imports from EFTA to the EC-12 accounted for 22.9% of total external trade of the EC in 1992, with exports accounting for 24.7% [Eurostat, 1993, pp. 32-33]. Trade with the EC accounted for approximately 58% of EFTA exports and 61% imports in 1990 [EFTA, 1992].

²⁴ EU-15 accounts for approximately 70% of Norway's trade, whereas the EU candidates account for less than 3%, see statistics in Annex C.

southern neighbours are infinitely more important than with the EU's prosperous and democratic neighbours to the north-west.

2.6.2 EEA enlargement²⁵

Enlargement of the EU necessitates the enlargement also of the EEA. Although any other outcome is politically inconceivable, the EEA Agreement contains specific yet somewhat unclear provisions for the enlargement of the EEA,²⁶ which could become a source of friction between the EU and the EEA states.

First, it is not clear from the EEA provisions when the states acceding to the EU should apply to become part of the EEA, what kind of negotiations are envisaged or when accession to the EEA should take place. Negotiations between the European Commission and the accession candidates are almost completed and since the EEA states have not been included in the process and have only been informed through the regular EEA dialogue, it seems clear that such EEA membership negotiations will take place after EU accession agreements are concluded. If the logical aim of simultaneous enlargement of the EU and the EEA is to be reached, there will be little time to prepare and conduct negotiations on EEA accession of new EU members, whatever the substance of the eventual EEA accession agreements.

Secondly, it is unclear what would happen if the agreement on accession to the EEA of a country already accepted to join the EU was not approved by all 18 parties to the EEA Agreement. It seems highly implausible that any of the EEA states would delay or even prevent the accession of new EU members to the EEA. However, it is certain that some sort of negotiations will take place on EEA enlargement, and the possibility that these could become entangled with other issues cannot be

²⁵ 'EEA enlargement' is meant here in the legally strict sense that the new EU member states will become 'EU-EEA states' and thus part of the EEA.

²⁶ Article 128 of the EEA Agreement stipulates the requirements for EEA enlargement:

'1. Any European State becoming a member of the Community shall, and the Swiss Confederation or any European State becoming a member of EFTA may, apply to become a party to this Agreement. It shall address its application to the EEA Council.

2. The terms and conditions for such participation shall be the subject of an agreement between the Contracting Parties and the applicant State. That agreement shall be submitted for ratification or approval by all Contracting Parties in accordance with their procedures.'

completely discarded. It has for example been suggested that the proposed 'technical update' of the EEA Agreement 'could be 'tagged on' to the [EEA] enlargement instrument and be ratified by EU member states along with the first accession wave' [EFTA Secretariat, 2001].

Another eventuality that may be contemplated in this connection is the possibility that some of the EU candidates fail to become full EU members, for example as a consequence of negative results in referenda on membership. The governments in question may choose to join Norway, Iceland and Liechtenstein in the EEA. It must first be noted that this is regarded as an extremely unlikely scenario because of the widespread (though somewhat declining) support for EU membership in these countries. Secondly, it would entail that the erstwhile candidate countries would not be able to reap the political and economic benefits of full membership (i.e. to participate in decision-making, receive increased net transfers and enjoy improved market access), while having already gone through the difficult process of preparing for accession. Joining the EEA club of net contributors without a voice in decision-making is unlikely to be regarded as a desirable alternative. From an EEA perspective, this unlikely scenario could perhaps better enable the EEA to continue in its present form even in case of defection by some of the current EEA states (for example an application from Iceland for full EU membership). On the other hand, an enlarged EFTA pillar in the EEA would also be much more heterogeneous, which would make it more difficult for the EEA states to speak with one voice vis-à-vis the EU [Bull, 2000].

2.6.3 Costs to Norway

Although the expansion of the EEA into Central and Eastern Europe will mean intensified competition for Norwegian business and industry, these are expected to be outweighed by the new opportunities provided by an enlarged single market. But beyond the general assessment that EU enlargement is beneficial to the Norwegian economy, there are however certain specific Norwegian economic concerns.

Fisheries. One of Norway's biggest problems with EU enlargement is the effect it will have on Norway's fast-growing fish exports to Central and Eastern Europe. Currently, Norway has free trade agreements with the candidate countries. Upon accession, Norwegian fish exports will be subject to the EEA Agreement, which entails the imposition of tariffs on Norwegian exports of certain species, salmon in particular. Furthermore, the duties that Norway's competitors in the EU today face when

exporting to Central and Eastern Europe will be removed with enlargement, thus placing Norwegian exporters at a double disadvantage.

Although fish exports to the EU accession candidates account for only about one-tenth of 1% of Norway's GDP, this figure belies its political significance. Several small and fragile coastal communities in Norway rely heavily on these exports for their continued existence. And although the current value of fish exports to Central and Eastern Europe is relatively modest, these markets are among the fastest growing markets for Norwegian fish exports in the last decade, and are regarded as the most promising for the expanding fish farming sector in Norway.

When Austria, Finland and Sweden acceded to the EU in 1995, Norway and the EU negotiated a compensation agreement giving Norway zero tariffs quotas for certain products [Stortingsmelding nr.12, 2000-2001, pp. 208-209]. Although this would provide some comfort for Norway, the same quotas are renewed every year, and would in effect prevent Norwegian fish exporters from profiting from the expanding market for fish products in Central and Eastern Europe.

Financial contributions. One of the key challenges for the EU is how to deal with the strain that EU enlargement to Central and Eastern Europe will put on the EU budget. The EEA states currently contribute modest amounts to the development of the poorer regions of the EU through the Financial Instrument of the EEA Agreement (see Annex E), in Norway's case 20-25 million euro annually, the equivalent of approximately 0.013% of GDP. An important issue for Norway is to what extent the EU will demand increased contributions from the EEA states in order to cover the costs of the next EU enlargement. There have already been signals from the EU that Norway will be expected to continue their contributions to the EU beyond the period covered by the Financial Instrument. Considering the consequences of enlargement to the EU budget, most people seem to expect significant pressure from the EU on the EEA states to increase their contributions. Recent speculation suggests that the EU may demand as much as a five-fold increase in the contributions from the EEA states [*Aftenposten*, 14 December 2001]. Increases of this magnitude are justified by comparing Norway's combined contribution to the development of the poorer regions of the EU and to the Central and Eastern European EU candidates, with those made by the EU. In 2002, Norway will spend approximately 0.02% of GDP on this through the EEA Financial Instrument and the Norwegian Foreign Ministry's Action Plan for the EU candidate countries. The EU by contrast has allocated 0.47% of GDP for 2002, or more than 20 times

the Norwegian contribution. The EU figure is set to rise to 0.52% of GDP by 2006 [Council of the EU, 1999a].

Norway's bargaining position on such financing issues has dramatically changed over the last decade, due to the performance of the Norwegian economy and the radical improvement in public finances. Due to high income from oil and gas exports, boosted in recent years by high oil prices, the current account surplus is expected to be 20% of GDP in 2001, with a government surplus of 15% of GDP. In addition, there is the rapidly growing Government Petroleum Fund (GPF) (see Box 2 below), currently valued at almost 75 billion euro, more than half of Norway's GDP.

This economic and financial situation makes it somewhat difficult for Norway to argue that it should be compensated for any loss in connection with enlargement. Any possible compensation requested from Norway would be dwarfed even by the interests earned from the GPF, not to mention in relation to the size of the fund, which will soon be larger than the entire EU budget. The timing of negotiations on a new EEA financial arrangement could become very important. If a new agreement comes much later than the expiry of the disbursement period of the current arrangement in 2003, which happened after the first five-year mechanism expired, EU enlargement may have already taken place. The new members are then likely to join forces with the poorer countries of the EU today in demanding larger contributions from the prosperous EFTA states. Increased contributions from Norway could be taken from Norway's Action Plan in support of the candidate countries (approximately 10 million euro annually) and would not in effect entail additional assistance. It is in any case difficult to imagine that an increase in Norway's contribution to the development of the poorer regions of the EU through the EEA Agreement can be avoided.

2.7 Assessing the alternatives to the EEA

Unease with the EEA, in the sense that it provides Norway and other EEA states with little alternative but to follow the EU *acquis* over which the EEA states have at best only limited influence, has raised suggestions that a more flexible alternative should be sought, as advocated by the 'No to EU' movement in Norway [*Nei til EUs motmelding*]. Does a flexible alternative exist that will allow EEA states more scope for national policy autonomy in sensitive sectors, whilst guaranteeing market access to the single European market?

Table 3. Summary comparison of the various options available to the EEA countries*

	European Union	EEA	EU-CH	OECD	WTO
Coverage	Comprehensive, <i>acquis</i> covering harmonised and new approach directives	Comprehensive, follows the EU <i>acquis</i>	Significant, but selective coverage, less than EU <i>acquis</i>	Selective coverage tends to be based on reciprocity and positive lists	Framework agreements and selective coverage based on positive lists
Degree of harmonisation	Approximation of regulatory norms, with mutual recognition and a move towards the use of framework regulations with flanking use of supra-national competition powers	As in EU <i>acquis</i> but EFTA two-pillar system	High degree of harmonisation required before mutual recognition, potential exposure to EU competition policy	Regulatory approximation, some ineffective bilateral MRAs, cooperation between sovereign regulatory authorities	National treatment, selective harmonisation of norms
Use of active competition policies parallel to regime	Extensive EU <i>acquis</i> pushed by activist competition authority	EFTA surveillance authority applying EU <i>acquis</i>	Partial application of EU competition regime	Common principles and cooperation between competition authorities	No WTO provisions but could potentially be included

* For more detail on the differences between the various regimes, see the annexes.

Scope for national policy discretion	Limited to exceptions provided under Art. 36 EEC	Formal scope but de facto little more than EU	Scope to opt out, but must adopt full <i>acquis</i> to guarantee market access	Sensitive sectors excluded from coverage (e.g. investment and public procurement)	Some scope but being selectively reduced or removed
Method of enforcement	EU law with direct effect	EU law through EFTA court	Bilateral committee effectiveness depends on trust and fairness	Generally peer pressure but some rights to national reviews	General WTO dispute settlement for non-compliance with national treatment
Scope to influence the 'rules of the game'	Full participation, but loss of 'veto rights' in all single market issues	Participation in Commission working groups and expert groups, other multilevel channels open	None with regard to EU but some scope via some multi-level channels	Limited rules increasing shaped by the European and American (NAFTA/ FTAA) <i>acquis</i>	Membership of WTO along with 143 others
Effectiveness in terms of market access	Good but still some difficulties with mutual recognition	Good, limited backlog implementation, EU <i>acquis</i>	Moderate access only assured when CH mirrors EU regulations	Moderate, access not assured	Moderate, access not assured

The alternatives to the EEA are a) full EU membership, b) an advanced free trade agreements with the EU along the lines of the Swiss sector agreements, c) multilateral agreements such as in the OECD, based in part on peer review and which are therefore generally less binding than in the case with the EU, and d) global multilateralism for trade and investment under the rules of the World Trade Organisation (WTO). The different regimes are summarised in Table 3 above (with a more thorough treatment of selected sectors in Annexes F-I).

Full membership of the EU would provide Norway with a seat at the table but would raise political issues domestically. The EEA is criticised because it is neither one thing nor the other; it provides Norway with very limited influence in decision-making, but at the same time obliges the country to follow what the EU does.

Can a FTA type of arrangement as with the Swiss model provide market access whilst retaining more policy autonomy? The short answer to this would appear to be no. Swiss suppliers are only guaranteed access to the EU market when Switzerland adopts the EU *acquis*. For example, in the mutual recognition agreement between the EU and Switzerland, mutual recognition only applies in the so-called harmonised sectors in which Switzerland has fully adopted the EU regulations. Outside of this there is no full mutual recognition. Thus Switzerland must *de facto* adopt the EU *acquis* if it wishes guaranteed access, but it has had *no* influence at all on the shape of the *acquis*. In terms of future legislation, Switzerland has the option of not following the EU *acquis*, but if it does so the EU can adopt safeguard measures to deny the Swiss access to the EU market in the areas concerned.

The Swiss model is also not comprehensive. This has the advantage of allowing Switzerland to be selective and to opt out of parts of the EU *acquis* it is not interested in. For example, there is no agreement on freedom of capital or right of establishment except in selected sectors. This is possibly not much of a drawback for Swiss investors since all the European OECD countries have largely liberalised their investment policies anyway. The only difficulty is likely to be in a sensitive sector such as energy, where EU member states can block Swiss investment. On the plus side, the Swiss can retain Swiss control over sensitive sectors, at least in so far as these are not covered by OECD or GATS provisions.

But the selective approach also represents a cost for the Swiss. Switzerland sought bilateral negotiations in 16 sectors, but the EU agreed to negotiations in only seven, with a further five currently under discussion. The EU has also linked the bilateral agreements through the

so-called ‘guillotine clause’ so that Switzerland cannot opt out of one without all seven being suspended. The EU could well also link future bilaterals in the same fashion. If Switzerland fails to fully comply with the EU *acquis* reflected in a bilateral agreement, it could face suspension of benefits. There is no formal dispute settlement procedure and no arbitration. Implementation is based on mutual agreement and trust between the members of the Joint Committee (European Commission and Swiss government). Finally, the absence of a common competition policy means that Swiss products are still potentially subject to trade remedies such as anti-dumping or the initiation of other WTO dispute settlement cases under the EU’s trade remedies regulation.

The Swiss FTA agreement(s) seems to confirm the view that any country seeking guaranteed market access to the EU market must ultimately adopt the EU *acquis*. A history of close links within Europe, combined with similar approaches to market regulation and a well developed regulatory infrastructure mean that European OECD countries are likely to get better access to the EU market than countries further afield that have divergent approaches to regulatory policy or are less developed. But as the EU seeks to rationalise its FTAs with third countries, there could well be efforts to harmonise the scope and provisions in any given ‘generation’ of FTA. Precedents set in one FTA will also shape later FTAs. Therefore the Swiss agreements are probably the most plausible model for any future FTA, if Norway were to opt for such an approach.

In terms of the option of multilateral agreements along the lines of what has been depicted in Table 3 as the ‘OECD’ type of agreement, there would be gains in terms of *de jure* policy autonomy. Coverage of the agreements is less comprehensive and not always binding. For example, OECD provisions on investment are not binding with regard to national treatment and there remains scope for exclusions based on negative listing (i.e. listing of sectors excluded). Much the same can be said for other multilateral agreements such as the government purchasing agreement. Framework agreements tend to require non-discrimination, with binding coverage determined by sector schedules based on reciprocity. This is also the case in effect for services under the GATS agreement. It means that if Norway were to negotiate such agreements, any exclusion sought (for example from liberalisation in investments in a few sensitive sectors) would attract reciprocal exclusions of Norwegian investment by its trading partners. Policy harmonisation in the OECD is limited although there is an expectation that countries move towards best practice. Competition policy is also covered only in terms of very general criteria and policy cooperation is only backed up by peer pressure. The

effectiveness of such agreements in terms of market access falls below a full guaranteed access. In reality the rules tend to be shaped by what the major actors are doing, i.e. the US and the EU. So in reality the ability of a relatively small country to shape the course of policy debate and the nature of the rules is fairly limited. National negotiators do however get to sit at the table.

The wider multilateral option generally means even greater scope for national policy autonomy, although the WTO is progressively encroaching on national autonomy in sectors such as food safety, intellectual property and some service sectors. Mutual recognition agreements at this level, as indeed at the OECD level (such as between the EU and US and EU and Canada) have not proved very successful. First, although framework agreements have been negotiated they cover only a few sectors. Second, there is a general lack of agreed international standards to provide the basis for common essential requirements. Third, the OECD/WTO type of mutual recognition agreements is mutual recognition of conformance assessment, not recognition that one country's regulations are equivalent to the others. Policy harmonisation is limited to a few sectors, which have tended to be dictated by the interests of the US (food safety and intellectual property) and increasingly the EU (i.e. competition and environment), so that the scope for national discretion in regulatory policy is also being eroded in sectors in which Norway might not wish to cede national policy autonomy. So the WTO offers a greater degree of national policy autonomy, but at the expense of a loss of guaranteed market access, and policy autonomy may still be threatened in sectors or policy areas that the US and the EU see as important for their interests. The use of anti-dumping actions, the safeguard instrument of choice in most countries, would also mean that access to major markets would be subject to uncertainty.

2.8 Conclusions of the functions of the EEA system

In line with other recent studies [EFTA Secretariat, 2001], this study finds that *the single European market extending across the whole European Economic Area (i.e. the 15 EU member states and the three EEA states) is functioning effectively*. This provides guaranteed market access for EFTA members of the EEA in what is for the most part a homogeneous market. This is true despite something of a backlog in the implementation of the EU *acquis* in the EEA states, especially in the case of veterinary provisions. But for the most part the EEA has satisfied the credibility test that any single market must meet in terms of effective implementation and as such has ensured effective access.

The EU *acquis* has not stayed still since 1992. The desire to complete the single European market in further sectors appears to be strong enough to provide forward momentum, but in addition to this there is the need for the EU to keep up with market developments and technology, such as in electronic communications. The EU *acquis* is therefore not static, so the EEA, if it is to maintain a homogeneous market must also continue to evolve. In response to this evolution of the EU, the EEA states have opted to accept the EU *acquis* into the new areas. There are no cases to date of the EEA states showing any sign of wishing to diverge. This is in line with the commercial interests of the countries concerned.

In terms of the instruments used and the approach adopted by the EU, there have been some changes in the EU's approach to regulation that will have implications for the operation of the EEA. There is a tendency to make greater use of horizontal provisions, in particular competition policies, both to drive home liberalisation and to ensure that the abuse of market dominance or cartels do not limit competition in the newly liberalised sectors. This is also consistent with a desire to limit the degree of detailed central regulation via directives and rely on framework directives, which will be implemented by independent regulatory authorities or competition authorities (for example, electronic communications, energy and transport). Within the EEA context it is noteworthy that most of the disputes have arisen as a result of the application of competition policy (GFU case, state aid cases, etc.)

There also appears to be a shift towards on-going or continuous regulatory reform through cooperation between national regulatory authorities rather than through central EU directives. The advantage of this approach is that regulatory policy can remain more flexible in order to respond to market developments or changes in the expectations of the electorate.

Finally, there is a greater use of 'soft' forms of regulatory change, such as benchmarking, or efforts to promote best regulatory practice, such as indicative targets for renewable energy sources. This reflects criticism of central regulation by the EU, but also means greater flexibility. Whilst there is some concern that this means a reduced role of directives and thus reduces the scope for EEA input into the early stages of legislation, regulators in EEA states and other interests can participate fully in the more open approximation of regulatory practice. It remains to be seen to what extent this softer approach is applied. It may prove to be a passing phase brought about by criticism of undue centralisation. It may prove to be ineffective and result in a resumed reliance on directives and other

'hard' instruments of regulation. But an approach based on framework directives backed up by competition policies is not necessarily a soft option, as the proposals for ultimate Commission veto rights over national regulation in the electronic communications sector show. Equally, European competition policy is being rigorously applied in other sectors, as some of the EEA states have already experienced.

The EEA states will have to adjust to the shift in emphasis in EU regulatory policies, but the reduced reliance of central EU directives does not necessarily mean a dilution of EEA states' involvement. The shift towards greater use of competition will, however, mean an enhanced role for the ESA.

With regard to EEA state influence over the development of the EU *acquis*, all actors in the EEA states will have to maintain continuous – and resource-intensive – efforts to monitor developments if they are to have much of a say. Influencing EU decision-making is a multi-level process today, in which advisory groups, coordination between national regulators, and public opinion in all member states shapes outcomes as well as Council and European Parliament deliberations. The only way the EEA states will have a vote in shaping the EU *acquis* is through membership of the EU. It is not evident whether much more can be done beyond the present level of competent and assiduous input from EEA experts. The bottom line is that negotiated EU positions in matters of importance are extremely difficult for the outsider to budge in the absence of a very strong bargaining position, which the EEA states do not have.

CHAPTER 3
THE BROADER ECONOMIC AGENDA

3.1 Norway's macroeconomic performance in the last decade

Over the last decade, Norway has performed better than the EU-15 or the eurozone in terms of most macroeconomic indicators. The average growth from 1990-2001 outpaced that of the EU countries by 1 full percentage point and the unemployment rate was on average lower by almost 5 percentage points. The average inflation rate remained under the EU-15 average by 0.7 percentage points, although Norway's performance on this account has been more variable as discussed below.

Another area in which Norway does very well is public finances, which are in much better shape in Norway than in the EU, as public debt accounts for less than 30% of GDP and the general government budget generates surpluses thanks to the oil-related revenues.

Table 4. Basic macroeconomic indicators (average 1990-2001)

	Norway	EU-15
Unemployment rate	5.0%	9.7%
GDP growth	3.2%	2.2%
Inflation rate	2.5%	3.2%
Public sector surplus/deficit (-)	4.9%	-3.0%

Source: Amexco, IMF.

Norway has not always outperformed the EU. At the end of the 1980s, the country went through a deep recession from which it recovered only at the beginning of the 1990s. The economy then experienced a long period of robust growth, but this boom came to an end when fiscal and monetary policy reacted, possibly too late. Furthermore, the completion of major offshore and public investment projects resulted in a contraction of investment. Combined with low oil prices in 1998 and early 1999, the result was that real growth dropped sharply to less than 1% in 1999. But the Norwegian economy recovered rather quickly, partly due to the sustained domestic consumption, and is now coming back to the path of a relatively strong growth.

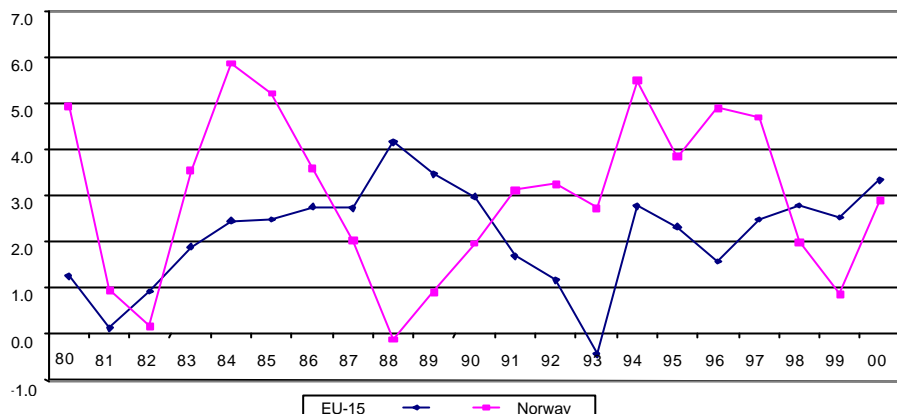
Looking ahead it seems that it will be difficult for Norway to outperform the EU to a similar extent in terms of growth over the next decade. The continuing decline in oil-related investment will somewhat reduce the

growth rates in the coming period. But despite the cooling of the economy, the labour and housing markets remained relatively tight. The economy is currently again operating close to capacity, limiting the scope for further growth.

Norway shares some of the structural problems of the Nordic EU member states, but the Norwegian non-oil private sector seems to be accumulating relatively more serious weaknesses. In part this is surely due to a rather acute case of ‘Dutch disease’, according to which the expansion of consumption financed by natural resource exports has to go hand in hand with a relatively high exchange rate and shrinking of the non-oil sector (unless the Government Petroleum Fund were to leave none of the profits of oil and gas sector for the Norwegian people to consume).

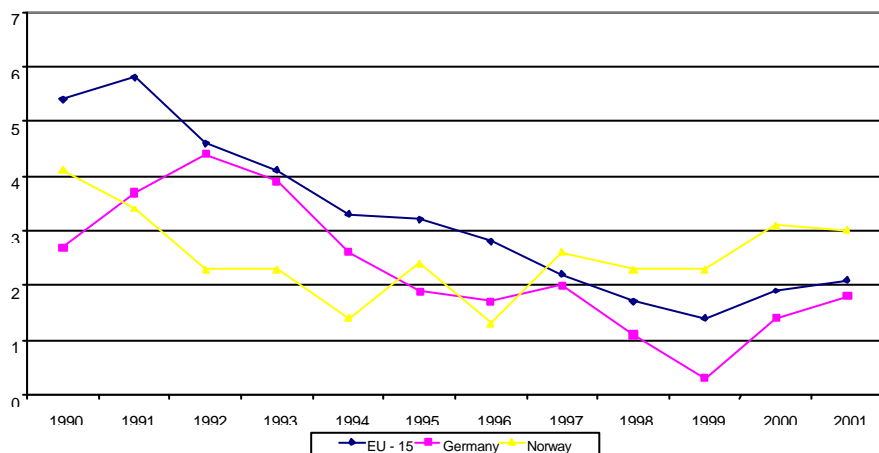
There seems also to be some evidence of other kinds of weakness in the Norwegian general business sector, which may be related to the difference between full EU membership versus EEA membership. Research conducted at the Norwegian School of Management [Benito et al., 2000 and 2001] has examined in some detail the relative qualities of the international business strategies of large Norwegian enterprises, and of foreign direct investment in Norway, compared to their Danish and Swedish counterparts. The thesis is that EEA membership, compared to full EU membership, leaves open some degree of uncertainty as to the medium and long-term future environment for business in Norway relative to the EU (indeed, the present report ends by presenting a range of scenario options for consideration – see Chapter 7). The thesis goes on to postulate that, while in strictly legal terms the EEA is closely equivalent to EU membership, the perception of political uncertainties for the future can be a significant and negative factor for long-term business strategies. In particular it seems to be the case that large Norwegian enterprises are now tending to locate more of their high-value functions abroad (such as headquarter facilities, R&D, etc.) than their Danish or Finnish counterparts. As regards foreign direct investment in Norway, it is found that such subsidiaries are tending to be assigned more limited tasks than their counterparts in Denmark or Finland. Finally, it is notable that the small open economies of the EU are now often doing very well in attracting concentrated clusters of related enterprises in given business sectors, such as the computer and software sectors in Ireland and Sweden. It may be feared that the highly internationally mobile enterprises of these typically very fast growing sectors may be hesitant to make large investments of this type in Norway, if they leave themselves open to the kind of politico-economic uncertainties discussed here.

Figure 1. Real GDP growth, 1980-2000 (in %)



The only area where Norwegian performance is somewhat less favourable concerns the inflation rate, which started to exceed that of the EU in 1997, and has since stayed at a higher level. The wage inflation induced by excessive wage increases that were not backed by an appropriate rise in productivity contributed to a large extent to the inflation growth. Combined with the exchange rate fluctuations, also starting in 1997, this led to a change in policy. The Norwegian central bank changed its monetary strategy, abandoning the loosely defined exchange rate stability target and setting a medium-term inflation target. From March 2001, Norway opted for an explicit inflation target, i.e. a

Figure 2. Rate of inflation



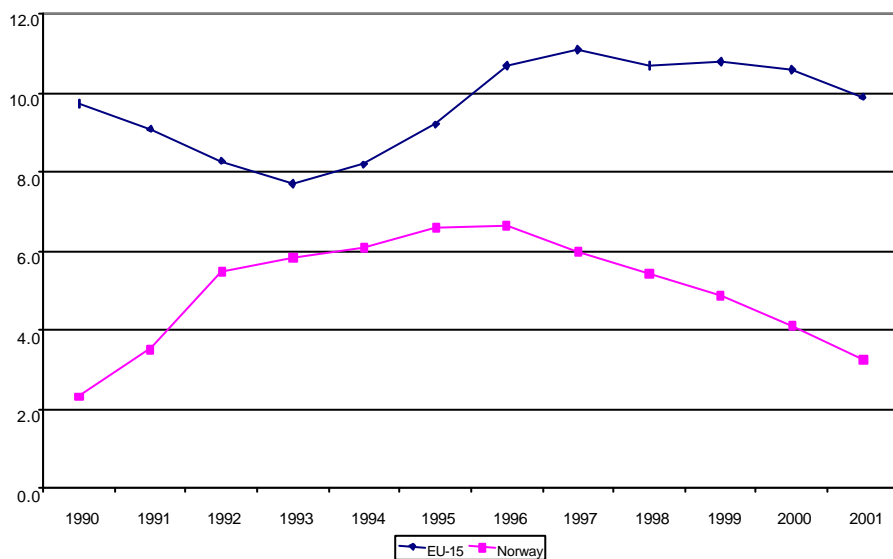
commitment of the central bank to keep inflation close to its medium-term target of 2.5%.

Since the inflation targeting policy was introduced only recently, it is too early to conclude whether it will be a success. A first evaluation [Andreassen et al., 2001] arrived at fairly positive conclusions. The most recent policy moves suggest that the new system still has some way to establish fully its credibility. Due to the sustained inflation pressures, the Norges Bank (Norway's central bank) had been reluctant to reduce the key interest rates from a high level of 7% despite the world-wide economic slowdown in the second half of 2001 and sharp reductions undertaken by the world's leading central banks. Under the increasing impact of an economic slowdown on the Norwegian economy, however, the Norges Bank decided on a 0.5 percentage point interest rate reduction on 12 December 2001. Nevertheless, present interest rates remain far higher in Norway than in the euro area.

The question that remains open is whether this policy of targeting inflation will assure longer-term stability of the Norwegian exchange rate vis-à-vis the euro. We come back to the issue of exchange rate stability below.

All in all, the performance of the Norwegian economy has been very favourable, consistently keeping unemployment well below that of the EU average. Norway is a Nordic-type welfare society, characterised by 'a

Figure 3. Rate of unemployment



large public sector, a high level of transfers to households and enterprises and high direct and indirect taxes.’ [Gjedrem, 2000]. It thus shares some of the structural problems of the Nordic EU members. But, as remarked above, Norway seems also to be accumulating some further weaknesses in its non-oil, non-government sector, which could be due in some degree to the politico-economic uncertainties of non-EU membership.

3.2 Energy in the Norwegian economy – How special?

When discussing the broader macroeconomic issues regarding the relationship between Norway and EU, one argument that keeps coming up insistently is that ‘Norway is different because it has energy’.

This is clearly true to some extent, but the question is to what degree. Over the last 20 years the Norwegian economy has become dominated by the extraction, processing and export of oil, natural gas and related products. In the second half of the 1990s, the offshore oil-related economy accounted for about 23% of the Norwegian GDP. Furthermore, a significant part of the mainland economy, especially engineering, also depends on the oil and natural gas activities. Thus, the other internationally exposed segments of the mainland economy have been rather ‘fragile and vulnerable’ [Gjedrem, 2000]. In the second half of the 1990s, oil and natural gas made up for about 36% of the overall exports. In terms of GDP the share of oil and natural gas exports reached 15%. According to most forecasts energy will remain important although the composition may change. The production of oil will peak in a few years and then gradually decrease, whereas the production of natural gas is expected to grow in the decades ahead.

The most visible benefit from the energy sector is that government income from oil and gas-related sources forms a significant part of the budget revenues which has a positive impact on the amount of resources available for public spending. In the past, however, most of the oil revenues were being spent quickly, thus increasing the vulnerability of the economy to the shocks to the oil industry. Therefore, in 1990 the Norwegian government decided to address this problem by establishing the Petroleum Fund in which the government’s oil-related revenues would be accumulated (see Box 2). The Fund started to accumulate reserves in 1996. One would thus expect that in future the Norwegian economy and public finances should be much more insulated from the short-term shocks to oil prices and the oil industry as such.

Box 2. The Government Petroleum Fund

In 1990, the Norwegian government established the Petroleum Fund in which the government's oil-related revenues are accumulated. The purpose of the Fund was two-fold. First it was intended to act as a buffer fiscal policy insulating the country from short-term variations in oil revenues. Secondly, it was supposed to accumulate the oil funds in order to be able to cope with the future long-term financial implications of the ageing population and the eventual decline in oil revenues.

Since 1996, when the first transfers to the Fund were executed, its size had reached NOK 386.4 billion in 2000, or about 28% of Norway's GDP. According to the projections, the size of the Petroleum Fund might reach as much as 125% of GDP in 2010. The Fund was set up by the Ministry of Finance, which delegated its management to the central bank. The revenues of the fund are the net cash flow from oil activities, the returns on the Fund's capital and net financial transactions related to oil activities. On the expenditure side, the Fund is used to finance the non-oil budget deficits.

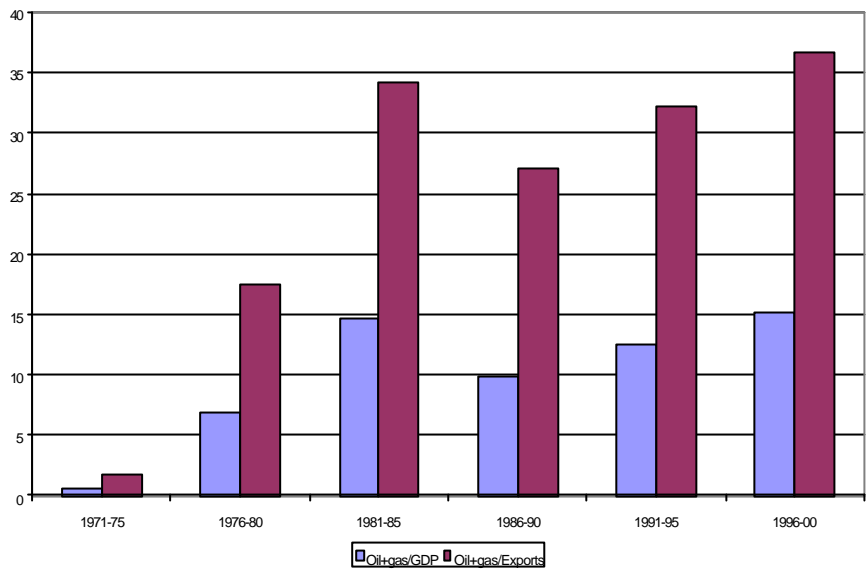
The Fund's stabilisation function is clearly defined in the new guidelines for fiscal policy according to which the structural, non-oil budget deficits²⁷ shall roughly correspond to the expected real return on the Petroleum Fund (currently estimated at 4%). Furthermore, spending of the oil revenues should be adjusted taking into account the capacity utilisation of the economy, allowing for somewhat increased spending in downturns and tightening of the fiscal policy in the case of overheating. In the event of extraordinarily high swings in the Fund's capital, or the budget's structural non-oil budget deficits, the change in spending should be spread over several years to smoothen the transition.

Source: Norges Bank website at <http://www.norges-bank.no>.

Even in the absence of a direct short-term impact of the oil prices, the mainland economy can still be rather strongly influenced in the medium run by the developments in the offshore oil sector through the level of oil-related investment, which accounts for a large part of the total Norwegian business investment. Furthermore, the offshore supply sector including maintenance of vessels and platforms, landing facilities, catering, etc., is another channel connecting the oil sector and the mainland economy.

²⁷ Structural, non-oil deficits are used as an indicator of the fiscal policy stance.

Figure 4: Oil and natural gas exports as a share of GDP and total exports, 1971-2000

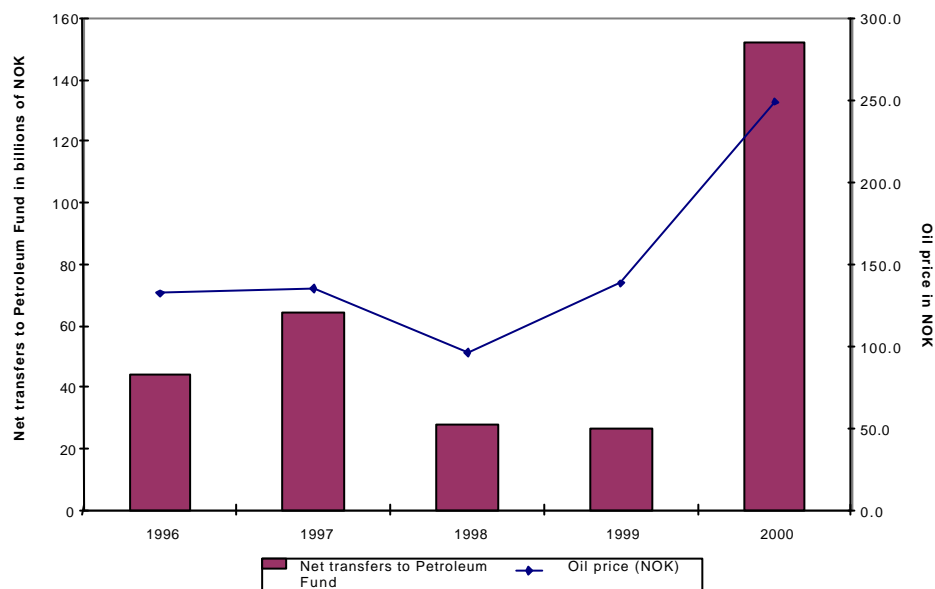


Given these factors, one would have expected that the business cycle in Norway should be driven essentially by the price of oil. This does not seem to have been the case, however, even if one restricts attention to the period before the stabilisation fund became operative. We did not find any impact of the oil prices on the economic growth, employment or other macroeconomic variables, which is surprising. (More details on this finding are provided below when we discuss the factors that influence labour markets in the short run). However there does appear to be a significant correlation between Norway’s real GDP growth and that of the US economy. At least over the last 20 years, the Norwegian economy has tended to follow the US, rather than the European, business cycle.

3.3 Is the Norwegian krone a petro-currency?

We now turn to one macroeconomic variable, the exchange rate, which is of particular importance, both because it might be thought to be more directly influenced by short-term fluctuations in the price of oil, and because it represents a key EU policy area.

Figure 5. Net transfers to the Government Petroleum Fund and oil



Norway has experimented over the last decades with several different exchange rate regimes. For some time it followed a (unilateral) commitment to a fixed exchange rate regime with a defined central parity and fluctuation margins. This practice was then abandoned in 1999, and Norway adopted inflation-targeting, which implies a fully flexible exchange regime, or rather a benign neglect of the exchange rate as long as price stability is guaranteed. We briefly analyse below what factors have driven the exchange rate of the Norwegian krone over the last decades, i.e. across different official exchange rate regimes (see Annex J). We do this also in preparation of a more detailed discussion below on whether Norway would benefit from reducing exchange rate variability, for example by linking the NOK to the euro, or even joining the euro area.

It is often assumed that a key factor driving the NOK should be the price of oil. Indeed the Norwegian krone is often considered to be a petro-currency as many would expect a significant impact of the world oil prices on the krone exchange rate. This does not seem to be the case in reality, however. We undertook a simple empirical analysis to document the link between the NOK exchange rate and the price of oil, but to our surprise we did not find any link between these two variables. This is not just a freak result; other studies have found similar results. For example, while the Norges Bank considered the oil price fluctuations to be one of several driving forces behind the increased daily and monthly volatility of the exchange rate during the late 1990s [Gjedrem, 2000], an analysis over a longer time horizon does not support this assumption. Thus there seems to be no evidence that oil price changes influenced the Norwegian exchange rate over the last two decades.

If the price of oil is irrelevant, what factors are important? Due to the country's geographical position and its traditionally strong ties with neighbours, one would expect that the krone exchange rate would be influenced by economic developments in the other Nordic countries, in particular its largest trading partner – Sweden. Another country with a traditionally strong connection with Norway is Great Britain, and one might therefore also expect some correlation between the pound and krone exchange rates.

Our simple empirical investigation of the causes of fluctuations in the NOK exchange rate partly confirm these assumptions. The fluctuations in NOK exchange rate have indeed been significantly correlated with the movements of both the Swedish krona and the British pound over the last two decades.²⁸ The ties between the Norwegian and Swedish currencies seem to be rather strong and stable over time, whereas the evidence concerning the pound is rather mixed. Over the whole period observed, the pound seems to play a part in explaining the fluctuations in the krone, but in some sub-periods (e.g. since 1992 until now), the two currencies have moved independently of each other. As already mentioned, fluctuations in the krone exchange rate seem to be independent of developments concerning world oil prices. Similarly, the movements of krone vis-à-vis the US dollar proved to be poor in explaining the fluctuations in the NOK-ECU/euro exchange rate.

²⁸ The time period was chosen to reflect the period of Norway's increasing dependence on oil and natural gas exports, which has changed significantly its economic structure and trade relations with its partners.

There is no obvious explanation as to why the correlation between the Norwegian and Swedish currencies is so strong, in light of the substantial differences in the economic structures of the two countries. It may be that Norway has followed similar policies as Sweden over the observed period, which then induce the co-movement of the exchange rates. If this were the case, one would have to consider whether/how the relationship is going to change if and when Sweden does decide to join the euro area, as now seems increasingly likely.

3.4 Norway and the euro: Costs and benefits of exchange rate stability

The euro, which is now legal tender in cash form in 12 EU countries constitutes a major step in the European integration process and is likely to bring about far-reaching economic consequences. For Norway, euro area membership remains out of the question as long as EU membership is still a remote prospect. While euro area membership thus remains off the table politically, it might nevertheless be useful to investigate the economic implications of Norway adopting the single currency. After all, the country joined the EEA in order to reap the benefits of the unified European market. It is often argued that the potential of the single market cannot be fully achieved without the single currency [Emerson et al., 1991].

We thus undertook a simple analysis of the factors that would determine the economic costs and benefits of Norway abandoning its monetary sovereignty (see Annex K). Outside the EU, this could take one of several forms:

- Norway could simply revert to a *unilateral peg to the euro*, but in a much tighter form, for example as currently practised by Denmark. The extreme form of such a peg would be a *currency board*.
- Norway could *unilaterally adopt the euro* as its national currency.
- Norway could ask to *be part of the euro area under special conditions*. For example, one could conceive of a European Monetary Area (EMA) agreement under which Norway would join the euro area, participate in the distribution of seigniorage and the governor of its central bank would participate as an observer in the Governing Board of the ECB.

The essence in all cases would be that Norway would lose its monetary sovereignty. We now discuss some of the economic costs and benefits that this would entail. We start with some indicators of the likely costs and then turn to an estimate of the gains.

3.4.1 The standard optimum currency area indicators

The costs and benefits of establishing a monetary union are often judged using the optimum currency area theory (OCA). We are not persuaded that such an approach can provide an unambiguous indication as to whether a country is 'ripe' to give up its currency and join a monetary union. As it is the most widely used methodology, however, we provide some evidence for the case on Norway. Although the OCA-based conclusions are at best indicative and subject to a number of reservations they might provide some useful insights into the core issues.

We use the following standard six indicators from the optimum currency area approach:

- 1) *Trade structure similarity*: The more similar the trade structure, the lower should be the likelihood that trade is affected by asymmetric shocks.²⁹
- 2) *Intra-industry trade*: An indicator of the extent to which two countries exchange similar goods. The higher this indicator the lower should be the likelihood that trade is affected by asymmetric shocks.³⁰
- 3) *Real GDP growth correlation*: Correlation coefficient between real GDP growth in EU-12 and single EU members from 1980-2000.
- 4) *Industrial growth correlation*: Same method as above.
- 5) *Unemployment rate correlation*: Correlation coefficient between the unemployment rate of EU-12 and individual EU members, 1980-2000.
- 6) *Exports to EU-15* as a percentage of GDP (average for period 1995-2000).

²⁹ The measure used is the correlation coefficient between the shares of about 100 products (at the 2-digit CN-level) in overall intra-European exports and in the exports of each EU member to other EU members (2000 data).

³⁰ Technically we use the Grubel-Lloyd index on the basis of the 2-digit CN-level of trade structures. This index is calculated as one minus the sum of the absolute value of net exports of each CN 2-digit sector over the sum of total exports and imports (2000 data).

The first two indicators capture the differences in economic structures that are supposed to measure the potential for asymmetric shocks. Indicators 3 to 5 measure the extent to which the economies of individual countries have tended to move together with the EU average over the last 20 years. The last indicator measures the importance of trade with the rest of the EU and is thus a measure of the expected benefits from EMU.

In Table 5, we present the values of the indicators for Norway and selected EU countries, including both EMU members and abstaining ones. It is important to stress that the absolute value of the indicators should not be taken at their face value in order to determine whether a country is suitable for joining a monetary union, as it is difficult to say what magnitudes are still acceptable. Rather, one should look at the relative ranking of the countries.

Table 5. Traditional Optimal Currency Area Indicators

	Trade structure similarity	Intra-industry trade	Real GDP growth correlation	Industrial growth correlation	Unemployment rate correlation	Exports to EU-15
Denmark	76	69	43	55	11	17
Germany	95	77	68	90	85	14
Finland	60	57	46	43	67	18
Greece	22	26	64	56	64	5
Sweden	91	77	71	77	69	19
UK	95	79	56	46	41	11
Norway	22	32	-7	25	32	23

Source: Own calculations based on AMECO data

Even at the first glance it is apparent that Norway does not rank highly in most of the indicators. The indicators of trade structure similarity and intra-industry trade in particular show a very low value both in absolute terms and in the comparison with the EU member states. The only exception is Greece, which is a member of the euro area, but whose trade structure is even further away from that of the EU average than that of Norway.

This indicates a relatively high exposure of Norway to asymmetric shocks, compared to most other economies. It is not too surprising as the Norwegian economy is to a large extent dependent on oil and natural gas production and exports. After excluding mineral fuels, the value of the

trade similarity indicator increases from 22% to 47% and the value of Grubel-Lloyd index from 32% to 49%. However, even these values are considerably lower than those of most EU members, which indicates that oil and natural gas are not the only sources of trade composition divergences between Norway and the EU. Norway is also an important exporter of fish and fish products, non-ferrous metals (above all aluminium), paper, paperboard and ships. These goods also account for a majority of Norwegian exports to the EU countries. If we exclude the three largest export articles (mineral fuels, fish products and aluminium), the trade structure indicator reaches a level of 79% which is a standard value comparable to the EU member states. Therefore, Norway might be predominantly vulnerable to the external shocks to these industries. The intra-industry trade index rises to 53%, which nevertheless still shows a considerable divergence in the export-import structure across the traded articles.

Another indicator often used is the degree to which business cycles have been correlated in the past. Here the message is clear: Norway's business cycle is not synchronised with the EU economies. There is virtually no correlation between the real GDP growth in Norway and the EU countries in the last two decades and the situation does not seem to have changed in the last 11 years. Interestingly, the correlation of the real GDP growth with Sweden and Great Britain is also extremely low (12% and 4%, respectively), despite the relatively high degree of correlation in the exchange rate. The other indicators depicting the movement of the Norwegian economy in relation to the other European countries also report relatively low values, further strengthening the argument that the Norwegian business cycle follows a different path than the European one.

On the other side, the relative importance of Norwegian exports to the EU countries might be considered as a proxy for estimating the benefits of joining the euro area. In terms of this indicator, Norway scores rather high. Its exports to the EU countries over the second half of the 1990s accounted on average for 23% of GDP, which is above the EU average of 18%. But roughly 40% of these exports at the time were made up of crude oil. The price of oil is determined in world oil markets and customarily quoted in US dollars. Therefore, even after the adoption of the euro the value of oil exports to the EU countries would strongly depend not only on the world-wide oil prices but also on the US dollar exchange rate. After deducting the share of oil exports to the EU, the picture becomes somewhat different as Norway then ranks towards the bottom of the list with a value of about 14%.

The standard optimum currency area indicators thus suggest that the Norwegian economy is more likely to be hit by asymmetric shocks than most EU member countries. This in turn would suggest that membership in EMU (or in general abandoning monetary sovereignty) could be relatively costly.

The low values of the indicators that are supposed to embody the costs of adoption of a common currency do not necessarily need to lead to a conclusion that Norway is at the present time an unsuitable candidate for euro area membership. As Frankel and Rose [1996] note, some of the OCA indicators are endogenous and are bound to change once the country joins the monetary union. It is thus possible that the indicators of co-movement in the macroeconomic variables, such as the GDP growth, industrial growth and unemployment rates, will adapt and become more synchronised with the EU average. Therefore, we can argue that a country like Norway may not satisfy the OCA criterion of a high correlation with the core countries as long as it stays outside, but that it could satisfy this criterion once it had been inside EMU for some time.

This point obviously concerns the relative development of business cycles, which can be to a certain extent considered as policy-induced, but the trade structures would not be much affected by EMU membership, as they depend on structural characteristics that change only very slowly over time. However, one needs to stress that the dependency on the oil exports which is the primary cause of the large divergence in the trade structure may not be such a great problem after all. As the Norwegian government set up the Petroleum Fund at the beginning of the 1990s, in which the proceeds from the oil sales are accumulated, the economy has become to a much larger extent insulated from the external shocks to oil prices. Moreover, given the fact that the krone exchange rate is not strongly influenced by developments in world-wide oil prices (at least when they are at reasonably high levels), a potential fixing of the exchange rate would not bring large adverse effects if the oil industry suffers from externally induced swings. Furthermore, Greece exhibits the same value of the trade structure similarity indicator and it has become a successful member of the EMU. In a more detailed analysis, which would exceed the scope of this report, one should also have a closer look at the development of the dominant export industries and assess their vulnerability to sector-specific shocks.³¹

³¹ As a simple test of the impact of the oil price fluctuations, we executed standard causality analysis of the determinants of the real economic growth (see below). The results persistently indicated no significant correlation between oil

The traditional OCA approach also emphasises, rightly, that a high degree of labour mobility can offset asymmetric shocks. A surprising (surprising, that is for an EU researcher) finding here is that there is considerable short and long-term international labour mobility in Norway. As shown in the table below, almost one half of the change in the Norwegian work force over the last decade was accounted for by an increase in foreign workers. Over such a long period one might argue that the increase in the employment of foreigners represents the result of a supply shock (i.e. an influx of migrants, who then found jobs in Norway), rather than the reaction to a shock to the demand for labour. But even over a shorter period, such as between 1999 and 2000, foreigner still accounted for about 18 % of the increase in employment. These values are much higher than what one finds for most EU member states. Could this be due to the freedom of movement of labour long established within the Nordic area? This does not seem to be the case as only a very small part of the increase in the foreign workforce came from intra-Nordic migration.

Table 6. Foreigners as % of total increase in employment in Norway

	1999-2000	1990-1999
All foreigners	18.2	45.5
Europe	9.7	17.9
Denmark	0.1	-0.2
Finland	0.6	1.1
Iceland	0.4	-0.3
Sweden	3.0	1.4

Source: Own calculations based on data from Statistisk Sentralbyrå.

There is thus some evidence that the Norwegian labour market is more open than that of many EU members. This much can be established with the limited data analysed here. However, it would take a much deeper analysis to establish whether this also implies that migration could constitute an efficient shock absorber for the Norwegian economy.

price developments and economic growth, which might be a sign of rather low vulnerability of the economy to shocks to oil prices.

3.4.2 Exchange-rate variability and Norwegian labour markets

This section provides some evidence that the elimination of the exchange rate variability might bring about considerable benefits. Traditionally, it was assumed that exchange rate variability makes trade more risky and thus the reduction in variability would increase the standard gains from trade through an increase in its volume. However, the possibility to hedge against the movements in exchange rates reduces somewhat the validity of such an argument. And indeed, the empirical literature does not find a strong influence of exchange-rate uncertainty on trade.

From a welfare point of view, however, what matters most at the macroeconomic level is essentially the level of (involuntary) unemployment. A common belief is that exchange rate variability should not have an impact on employment or unemployment. But a simple causality-type analysis performed on several EU countries [Gros, 1996] shows that the elimination of the exchange rate variability might have a significant positive effect on unemployment and job creation.

The analyses of the Norwegian case confirms the significant impact of the exchange-rate variability on the labour market. According to the results of simple statistical tests (for details see Annex K), the elimination of exchange rate variability could have a potentially significant effect on both the unemployment rate and the employment in Norway. The estimates imply that if Norway introduced a fixed exchange rate vis-à-vis the euro (or even joined the euro area), so that exchange-rate variability would drop to zero, the result could be a decrease in the unemployment rate of about 0.5 percentage point. This is a considerable amount given the already low level of Norwegian unemployment. Similarly, the removal of exchange rate uncertainty could lead to more than a one percentage-point increase in Norwegian employment creation, which under current circumstances means an additional 23,000 jobs.

We also checked whether similar results link real GDP growth and exchange-rate variability. The results reported in Annex K confirm that this is the case. Technically speaking one finds a significant effect of (lagged) exchange rate variability (of the NOK against the euro) on GDP growth. Hence the elimination of the exchange-rate fluctuations could have positive impact on the economic growth.

3.5 Conclusions on Norway and the euro

With the successful launch of the euro in January 2002, and watching the apparent warming of public opinion in Denmark and Sweden to joining the eurozone, one can discuss whether Norway has the option of joining

the eurozone without or before acceding to the EU. The argument can be made that this would be no more than following the logic of ‘one market, one money’ that the EU itself followed. Since Norway is already in the single market without being a member state of the EU, why not apply the same logic in the monetary domain?

For the time being, Norway has chosen a regime of inflation targeting, under which the exchange rate is neglected by the central bank in setting its policy unless an excessive swing in the exchange rate threatens price stability. It is too early to make a final judgement about this regime, but the first evaluations are encouraging and there is every reason to believe that the system will work as well as it has in some other countries.

The current framework for monetary policy seems able to guarantee price stability for Norway. But could the country do even better by joining the euro area, or linking the NOK tightly to the euro in some form? This should achieve the same result in terms of price stability, given the reputation the ECB has in this respect, and would deliver exchange rate stability at the same time. Our analysis of the standard criteria used to assess whether a country has an interest in joining a monetary union suggests that there are arguments on both sides. On the one hand, the data show that the structure of the Norwegian economy, and in particular its trade, is quite different from that of the EU (or the euro area). This would suggest that it might be preferable for Norway to retain its monetary sovereignty in order to be able to deal with asymmetric shocks. On the other hand, however, we note that the Government Petroleum Fund is now working as a major smoothing instrument of macroeconomic policy. We also find that the influx of foreign workers may have given the Norwegian labour market more flexibility, potentially providing an alternative shock-absorbing mechanism. Moreover, we find that eliminating exchange rate instability should lead to a (one-time) gain in employment and growth. At this point it is not possible to say what the net benefits might be for Norway of joining the euro area. Given these findings, however, it appears that there is certainly no imperative case for Norway to adopt the euro unilaterally.

Technically and legally, unilateral euroisation is possible without accession to the EU, as long as the state in question has sufficient financial means to buy euro in the market to replace the whole stock of its existing banknotes and coin in circulation, which would hardly be a problem for Norway. According to their present doctrine, however, the EU and ECB would not approve of this, but since the euro is an entirely convertible currency, no one could stop it. Alternatively one may discuss

the idea of a consensual approach, under which Norway might negotiate a special monetary association agreement with the EU, as outlined above (participation in the distribution of seigniorage, observer status on the Governing Council of the ECB, etc.). One could argue that this would be no more than the monetary analogue to EEA and Schengen associate membership.

Nevertheless, the uncertainty about the economic benefits would be compounded by the political cost in terms of not being able to participate in the setting of the policy for the euro area. This judgement confirms thus the finding of Buiter [2001] for the case of Iceland. We have already (above) assessed the economics of Norway acceding to the euro area and found it neither compellingly advantageous nor strikingly disadvantageous. However the balance of the cost-benefit analysis becomes much more negative when political considerations are brought into the balance in the event of unilateral euroisation without accession to the EU, rather than joining the euro area through the conventional route of prior EU accession. The arguments have been well summarised by Buiter for Iceland, and we can repeat them here, additionally for Norway:

Unilateral euroisation, where a small peripheral country simply adopts the currency of another ('centre') nation, without a fair share of the common seigniorage, without access to the discount window and other lender of last resort facilities, and without a voice in the decision-making processes of the centre's central bank should be of interest only to a chronically mismanaged economic basket case, whose only hope of achieving monetary stability is to unilaterally surrender monetary sovereignty. Iceland [*we add Norway*] does not belong to that category. The political arguments against unilateral euroisation are overwhelming. The absence of effective political institutions encompassing both Iceland [*we add Norway*] and Euroland would mean that there could be no effective political accountability of the ECB. The surrender of political sovereignty inherent in euroisation would therefore not be perceived as legitimate by a politically sophisticated citizenry.

In conclusion there is no case for adding to the democracy deficit already inherent in Norway's relationship with the EU by unilateral euroisation. To accede to the eurozone as a normal part of the accession process would, however, be a different matter. Though its petroleum fund and openness to immigration Norway has already developed ways of adjusting its economy to the fluctuations in the oil price. The importance

of the oil sector does not present itself as a strong reason why Norway should never join the eurozone, in the event of accession to the EU.

3.6 The Lisbon process

The so-called Lisbon process has attracted a lot of public attention. It started when, at its meeting of March 2000, the European Council recognised the challenges that are lying ahead of the EU – to combat effectively the unsatisfactorily high unemployment, underdeveloped sectors in services and ever more apparent skills shortages. Therefore, the so-called Lisbon strategy was devised, whose purpose is to bring together existing efforts at coordination of economic policies (structural, employment and macroeconomic) with new measures aimed at enhancing the technological capacity and ability of the European economy. Thus a complex process was launched with the aspiration to make the EU ‘the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion’ [Council of the EU, 2000a].

The Lisbon process has potentially large benefits. If its goals were achieved, global economic relations would change in favour of the European economies that have been lagging behind the US in terms of most economic indicators over the last decade. Therefore, it is relevant to explore whether/how Norway should participate in the process. In this context it is also essential to answer the prior question of how successful the process has been so far and what are its prospects over the medium run.

In judging the prospects of the Lisbon process, it will be useful to take a look at the experience of the EU with similar initiatives undertaken in the past. It is not widely appreciated that already on a number of previous occasions, notably the European Councils of Cardiff, Cologne and Luxembourg, the leaders of the EU undertook to ‘do something’ to improve the performance of what is widely seen as the Achilles heel of the EU economy, namely its labour markets.

An important milestone in this respect has been the coordination of employment policies agreed five years ago at the Luxembourg European Council of November 1997. Under the so-called ‘Luxembourg process’, countries are required to elaborate an annual National Action Plan (NAP) under guidelines that according to the Council should be the basis for employment policies in the EU. These policies put emphasis on the ‘employability’, ‘entrepreneurship’, ‘adaptability’ and ‘equal opportunities’ of the labour force. NAPs should spell out employment

and regulation policies that meet these guidelines, and submit them for evaluation by the European Commission. The granting of Cohesion Funds were recently made conditional on a country having received a positive evaluation.

At first sight, the approach embedded in the Luxembourg process to fighting structural unemployment seems sound. Who would be against 'employability', 'entrepreneurship' and 'adaptability'? The guidelines are general enough to accommodate the different traditions of employment policies followed across the EU countries. But the diagnosis of the problem is inadequate, as it does not really identify the still-pervasive protection of insiders in the labour market. In practice, the results so far have been disappointing. First, the only quantitative targets for employment policies refer to the proportion of unemployed to those covered by active labour market policies (Guideline 1 regarding 'employability'), whose effectiveness in reducing unemployment is not always rigorously assessed. Secondly, the supervision of NAPs by the Commission is not effective. Thus, while some countries take the process seriously and perform a thorough analysis of their employment policies and try to find new measures to improve the functioning of the labour market, others introduce only marginal reforms and keep the ineffective measures of the past. Admittedly, it may be still too early to judge a long-term process which is being updated from time to time. In particular, the introduction of quantitative targets for employment rates agreed by the European Council (in 2000 in Lisbon and in 2001 in Stockholm) may introduce some peer pressure on the countries with less employment-friendly policies. The problem with this approach, however, is that there will be a considerable time lag between the enactment of reforms and the payoff in terms of higher employment. Governments are thus constantly tempted to adopt the measures that promise the quickest results, even if they are only transitory.

The main innovation of the Lisbon process might turn out to have been a procedural one, namely the commitment to hold special bi-annual European Council meetings on the economy at the level of heads of state or government to take stock of progress. Thus political leaders at the top level are trying to work out economic policy doctrine themselves, rather than leaving it just to finance ministers where the processes of coordination can easily become just bureaucratized and time-consuming exercises. This top-level politicisation certainly has the quality that the leaders can range across all levels of economic policy-making with unquestioned legitimacy, be it legislation at the EU level, or softer EU coordination and concerted actions of the member states. It is certainly a

uniquely important forum for leaders to influence each other by peer pressure. As the current preparations for the forthcoming European Council meeting in Barcelona may show, the stock-taking might become a useful occasion to achieve modest progress in specific, well defined, areas (e.g. energy markets or telecommunications).

From Norway's point of view, the Lisbon process is another indicator of the limits to its model of multiple associations with the EU. The Lisbon process is manifestly open only for the leaders of the full member states. In this formation, however, EU leaders are quite free to choose policy orientations of all types, ranging from new legal acts by the EU, for example in the fields of information technology (which will become later part of the EU-EEA *acquis*) to softer coordination. The Lisbon process will place the EEA-relevant measures within the framework of comprehensive economic policy strategy. Norway will be a recipient of new legal obligations, without participating in the strategic dialogue. In all likelihood, such obligations may well be quite benign or even welcome for Norway, but they will come at the cost of zero political legitimacy at the level of Norwegian democracy. In other words, the Lisbon process is an illustration of what political scientists call the EU's 'intensive transgovernmentalism' model, which is somewhere between the execution of hard competences of the EU level (in federal mode) and soft coordination of the type seen at OECD meetings (which are very soft and rarely effective). It is arguable that the EU will see a growing weight of this mode of policy-making in the years to come. It is for all parties to decide whether they want to be policy-shapers or policy-takers at this main European level.

CHAPTER 4

JUSTICE AND HOME AFFAIRS

Cooperation in the domain of justice and home affairs (JHA) has been one of the most rapidly developing areas of European integration in the last decade. This cooperation increasingly takes place within the EU, after having earlier developed on an intergovernmental basis outside the formal EU institutions. The first major initiative was the Schengen system for eliminating internal border controls and establishing common external border policy. More recently, however, the wider field of justice and home affairs has been advancing very fast, even before 11 September, which has however given a fresh boost to this internal security agenda.

As in the economic domain, Norway has sought to associate itself as closely as possible with these developments. The cornerstone of Norway's relationship with the EU in the field of JHA is its associate membership of the Schengen Agreement. However, with the rapid development and increasing political significance of non-Schengen JHA cooperation, as well as the difficulties in distinguishing between these two fields, there have been further developments of importance for Norway. This is seen in the formulation of a new category of 'Schengen-related' JHA measures, such as the Dublin Convention on Asylum. Norway has also sought additional agreements to associate itself more closely with other 'not Schengen-related' JHA measures, including the European arrest warrant, EUROPOL and EUROJUST.

There is an important systemic issue here for Norway. The JHA programme (the 'Tampere agenda'), including Schengen but going way beyond it, becomes a political initiative of the EU on a scale comparable to the Single Market in terms of legislative action. Norway is partially involved in this process, perhaps in as much as 50% of it, by virtue of its Schengen membership. Moreover, it increasingly is party to much of the rest, which adds up to incremental integration on a significant scale.

4.1 Norway as Schengen associate member state

The Schengen system is a set of common rules and mechanisms of common action and cooperation governing the external frontier of the Schengen area, worked out to permit the completely free movement of persons across the internal frontiers of the Schengen states. These now comprise all of the continental EU member states as full members, and

Iceland and Norway as associates. The system is based on a common visa system and rules for longer visits by nationals of non-EU/EEA states, and extends into issues of cooperation between consular and border control services. The Schengen *acquis* now consists of 220 legal acts, amongst which one finds recurrent titles on the themes listed in the box below.

Box 3. The Schengen acquis – major themes of legal acts

- *Uniform visa, common visa policy*
- *Common consular instructions*
- *Schengen Information System*
- *Siren (co-operation over national security data bases)*
- *Harmonisation for declarations of invitation, responsibility*
- *Uniform model of residence permit*
- *Policy of transfer and readmission agreements*
- *Extradition*
- *Removal of obstacles at internal borders*
- *Computerised consultation of central authorities*
- *Schengen mode of organisation in airports*
- *Common stamps of entry and exit at external borders*
- *Narcotics – legal cooperation*
- *Public safety – police cooperation*
- *Clandestine immigration*
- *Illicit traffic in weapons*
- *Stolen vehicles*
- *Expulsion of minors*
- *Terrorism*
- *Transborder police cooperation*

Norway joined the Schengen system³² as an associate member in the first place as a continuation of the Nordic Passport Union. In this matter Norway's partners in the Passport Union also had a strong interest [Anderson and Bort, 2001]. The preamble to the Association Agreement refers back to the Agreement of Luxembourg of 1996, the purpose of which was to 'preserve the existing regime' of free movement within the

³² 'Agreement concluded by the Council of the European Union, the Kingdom of Norway and the Republic of Iceland and concerning the latter's association with the implementation, application and development of the Schengen acquis', *Official Journal*, L 176, 10.7.1999, pp. 36-40. The Schengen acquis as incorporated into the European Union is published in OJ L 239, 22.9.2000

Nordic Union following the accession to Schengen of Denmark, Finland and Sweden.

With the entry into force of the Amsterdam Treaty on 1 May 1999, the Schengen agreement was linked to formal EU cooperation, and parts of it (notably border control) became integrated in the EU's 'first pillar'. This also meant that the Council now became the decision-making body, with a diminished role for national parliaments of the EU to act as a legislative authority, following the transfer of the Schengen *acquis* to the first pillar of the treaties. One of the objectives of the EU in this incorporation process was to develop the *acquis*, or to 'build on it', in the language of the Schengen Protocol [Yli-Vakkuri, 2001, pp. 53-56]. Schengen association thus becomes more than preserving the *status quo ante*. The creation of an area of free movement of persons, which is also a 'secure' area, thus going beyond the economic freedoms enshrined in the Treaty of Rome and already duplicated in the EEA Agreement, is a dynamic process. Hence, from the perspective of Iceland and Norway, there was the need to regulate their involvement in this ongoing process. The implications for the Nordic Passport Union were that its preservation would have to go hand in hand with a new form of participation for the Schengen associates in the EU's policy process.

Under the Association Agreement with Norway and Iceland, in Articles 1 and 2, the parties are bound by the provisions of the Schengen *acquis*, although certain provisions are excluded, for example responsibility for processing applications for asylum. These exclusions do not detract from the fact that Norway and Iceland must now apply the vast bulk of *acquis*. These include a long list of measures adopted by the Executive Committee (of the EU's JHA domain), including matters associated with the abolition of internal frontier controls and countervailing measures for control of the external frontiers, notably those connected with police, security and the Schengen Information System (SIS).

The SIS and its huge data base is at the heart of Schengen security cooperation. Much attention was paid to the SIS in the preparations for the application of the Schengen *acquis* to the Nordic countries [Council of the EU, 2001d]. The national components of the SIS were required by this decision to become fully operational before the abolition of internal border controls. The SIS raises important issues of data protection. The Joint Supervisory Authority of Schengen, in its annual reports, gives accounts of the supervisory mechanisms available at European level to ensure that the central function of the SIS respects the relevant legal

provisions.³³ But the national authorities also have an important role to play – especially in ensuring that personal data is not abused.³⁴ The relevant provisions of the Convention regarding data protection in the framework of the SIS have found legal bases in Title VI of the Treaty on European Union (law of the ‘Third Pillar’). Legal protection must be secured first and foremost by the national data protection authorities. Recourse to national courts may be had if abuse should occur, though for EU member states the European Court of Justice may also have jurisdiction.³⁵ The European Court may refer to Article 8 of the Charter of Fundamental Rights of the European Union, as proclaimed at Nice, when interpreting Schengen-based provisions.³⁶

The obligation under the Schengen association agreement for Norway and Iceland to adopt acts by the EU that amend or build upon the Schengen *acquis* is similar to the situation with the EEA, but without even the (unused) opt-out clause that exists in the EEA. Refusals to adopt new Schengen acts would mean having to leave the system (see below). While at the legal and political level this is a hard system for the outsider, interviews with officials from the Nordic countries suggest that for frontier controls and security cooperation, Schengen will not lead to major changes compared to traditional Nordic cooperation [Anderson and

³³ See *Fourth Annual Report on the Activities of the Joint Supervisory Authority*, 18 July 2000.

³⁴ *Ibid.*, p. 6: ‘Police intelligence systems are evolving, including Schengen’s. The role of the independent supervisory authorities concerned must be enhanced in pace with these changes. The integration of Schengen into the European Union as ensuing from the Treaty of Amsterdam must afford greater transparency and guarantees with regard to the fundamental rights of the citizen. The national parliaments and the European authorities are now in a position to play a more active part in attaining these objectives.’

³⁵ Article 111 of the Schengen Convention: ‘Any person may in the territory of every Contracting Party, bring an action before the competent court or authority under national law for correction, erasure, information or compensation by reason of a report concerning him.’

³⁶ Protection of Personal Data: ‘Everyone has the right to the protection of personal data concerning him or her. Such data must be processed fairly for specified purposes and on the basis of the consent of the person concerned or some other legitimate basis laid down by law. Everyone has the right of access to data which has been collected concerning him or her, and the right to have it rectified. Compliance with these rules shall be subject to control by an independent authority.’ For a ‘human rights audit’ of the SIS, see the report with that title prepared by the NGO called Justice, 2000 (<http://www.justice.org.uk>).

Bort, 2001, p. 123]. On the other hand, the legally binding nature of Schengen association contrasts with the non-binding character of the previous Nordic cooperation, and Norway and Iceland have for instance had to considerably upgrade their airport and port facilities.

Institutional aspects at EU level. The preamble of the Schengen Association Agreement refers to the need to ‘involve all parties’ in discussions regarding its implementation. Such discussions should take place ‘at all levels’ and ‘in an appropriate fashion’. Thus the preamble recognises the legitimate interests of all parties applying the *acquis* to be involved in the whole of the process. The role of the Schengen ‘Mixed Committee’ (i.e. a mix of EU and non-EU states) is key. This committee from a legal point of view works ‘outside the institutional structure of the Union’ (see Preamble). Its function and powers are set out in considerable detail in the Association Agreement. The committee convenes in different guises: at the level of Ministers, senior officials or experts.

The essential function of the Mixed Committee is (Article 4) to address all matters relating to the development of the Schengen *acquis*, i.e. all new acts or measures to be adopted by the EU. The Mixed Committee is considered to be more than a discussion forum, and is involved in ‘decision-shaping’. Schengen-related proposals are first drafted by the Commission or the EU member states. Associated states have the right (Article 4 (4)) ‘to make suggestions in the Mixed Committee’ for initiatives or proposals. Decision-taking is reserved for the EU Council. Article 5 imposes an obligation on the Council to inform the Mixed Committee of ‘preparation within the Council of any acts or measures which may be relevant to this Agreement.’ Article 6 imposes an obligation on the Commission to ‘informally seek advice’ from experts of Norway and Iceland – who apparently need not be experts of the Mixed Committee – when drafting new legislation in fields covered by the Agreement. An obligation to do something informally is hardly a strong currency.

Whether purely consultative, or rather more of a decision-shaper, the Mixed Committee is clearly not a decision-taking body.³⁷ The decisions are for the EU Council to take, or, if co-decision should apply, the Council and the European Parliament. However the Council takes decisions in many cases more or less ‘automatically’ on the basis of the

³⁷ So says the first sentence of Article 8 of the Association Agreement: ‘The adoption of new acts or measures ... shall be reserved to the competent institutions of the European Union.’

recommendations of its committees and working parties, including the Schengen Mixed Committee.

Furthermore, these Schengen arrangements offer fuller opportunities for participation in the legislative process than under the EEA. Norway and Iceland at least have working sessions in the Mixed Committee with members of the corresponding Council bodies. This model of participation was also sought by Norway and its EFTA partners for the EEA, but was rejected by the EU. That the Schengen associates are able to participate so extensively is due to fortuitous historical circumstances, mainly the existence of the Nordic Passport Union and because the Schengen system began as an intergovernmental mechanism outside the EU. It would be highly unlikely that the EU would extend similar rights of participation to Norway had its Schengen association been negotiated today.

Institutional aspects at national level. Implementation of Schengen law is a national responsibility. Article 8 of the Schengen Association agreement provides that it is for national authorities to ‘decide independently whether to accept [the] content [of measures building on the Schengen *acquis*] and to implement [them] in their internal legal order.’ The article recognises that in order to become binding certain acts may have to be made subject to the fulfilment of constitutional procedures.

At face value, Norwegian and Icelandic sovereignty is thus protected in the sense of autonomous decision-making according to customary constitutional procedures. It is nevertheless clear that the intention of the Schengen Agreement is that, once measures building on the *acquis* have been adopted by the European institutions and after due discussions in the Mixed Committee, they will indeed be implemented and applied by Norway and Iceland (see paragraph 3 of Article 2). Norway and Iceland cannot in practice ‘opt out’ of individual Schengen measures at their discretion. Instead the option is for the whole Schengen Agreement to be terminated, under a process of ‘consensual termination’, or ‘non-consensual termination’.

The latter is possible in two cases. The first is where Norway or Iceland might fail to agree to or notify a particular measure, for constitutional or other reasons. The Agreement is in such circumstances deemed terminated with respect to the country concerned ‘unless the Mixed Committee, after a careful examination of ways to continue the Agreement, decides otherwise ...’. The second possibility relates to possible disputes about the implementation of measures in Norway or

Iceland. In order to avoid the possibility of non-consensual termination which can occur if a ‘substantial difference’ (undefined) in application or interpretation of Schengen measures persists between Norwegian and Icelandic courts or authorities and the authorities of the Member States or the European Court of Justice, certain procedures and dispute-resolution mechanisms, which involve the Mixed Committee, are provided for. It should be noted that there is no equivalent to the EFTA (EEA) Court for EEA for Schengen disputes.

4.2 The EU’s wider justice and home affairs agenda

The present agenda of the EU for developing its policies in the field of justice and home affairs was set at an EU summit meeting in Tampere in 1999. Box 4 sets out the chapter headings of this agenda. The point here is to compare this list with that of the Schengen system given earlier. The two overlap, especially in the area of ‘external borders’, where Schengen is the prime mechanism of JHA policy.

Box 4. Chapters of the EU’s justice and home affairs agenda

- *Asylum*
- *External borders*
- *Migration*
- *Organised crime, fraud and corruption*
- *Drugs*
- *Terrorism*
- *Police cooperation*
- *Customs cooperation*
- *Judicial cooperation in civil matters*
- *Judicial cooperation in criminal matters*
- *Funding of activities*
- *Human rights related issues*

The JHA agenda is very much wider, however, and extends deeply into internal security, with a mass of legislation and implementing actions. It becomes comparable to the Single Market ‘1992’ programme, which consisted of 300 legal acts by the EU. The institutional method is similar, indeed a copy. For example in October 2001, the Commission addressed to the Council and Parliament its *Biannual Update of the Scoreboard to review Progress on the Creation of an Area of ‘Freedom, Security and Justice’ in the European Union* [European Commission, 2001e]. This is reminiscent of the implementation procedures used for the ‘1992’ Single

Market programme. Studying this document one reads of no less than 165 identified actions for realisation within five years.

For Norway and Iceland, it is especially important to know where to draw the line between core Schengen *acquis*, ‘Schengen-related’ activities and other JHA activities. These categories are becoming effectively recognised in the work of the EU and Schengen bodies in order to identify where the legal and institutional base should be. One may argue as a matter of common sense that the whole of the JHA agenda is a continuous chain of inter-connections, and therefore all are ‘Schengen-related’. However, legal and institutional considerations require that the line be drawn with operational precision, so long as Schengen is a system that is not co-terminous with the EU itself.

The categories thus present themselves:

1. *Pure Schengen acquis*, i.e. measures implemented only by the 13 EU Schengen states and the 2 non-EU Schengen states, prepared by the Schengen Mixed Committee, but decided by the EU Council, e.g. deciding the ‘visa-list’ (the list of countries whose citizens require visas to enter the Schengen area).
2. *Solely EU JHA actions*, i.e. measures implemented by the EU-15 member states, without participation by non-EU Schengen states, e.g. anything to do with EU citizenship.
3. *Schengen-related EU JHA actions*, i.e. measures of the EU-15 member states that the non-EU Schengen states can associate with easily (via simple legal act, without a new Treaty), e.g. consular cooperation with third countries.
4. *EU JHA actions leading to new Treaties of Association*, i.e. where the non-EU Schengen states may request formal association, but this may be agreed by the EU-15 only through negotiation and treaty-level legislation (notably requiring ratification by all parties), e.g. Europol.

Norway and Iceland may themselves have difficulty at times in working out where their preferences lie, since there will be trade-offs to be made between different interests. On the one hand, there may be interests in limiting the extension of Schengen law into home affairs, if the proposed measures are regarded as intruding excessively on their national sovereignty. On the other hand the new areas may be of positive interest for Norway and Iceland, in which case they may want to associate with these measures as promptly and as fully as possible.

An agreement 'concerning the criteria and mechanisms for establishing the State responsible for examining a request for asylum' between the EC, Norway and Iceland entered into force in April 2001. This effectively entails the partial association of Norway with the Dublin Convention on asylum between the EU member states, which is now regarded as 'Schengen-relevant'.

Box 5. 'Schengen-relevant' measures

- Listing of third countries whose nationals are exempt from visas.
- Listing of third countries whose nationals must have visas.
- Procedure and conditions for issuing visas.
- Measures for implementing the common consular instruction.
- Rules on a secure uniform visa.
- Rules for the airport transit visa.
- Cooperation between EU consulates in third countries.
- Rules for free movement in the Schengen territory for up to three months.
- Conditions for entry for a maximum of six months.
- Minimum security standards for travel documents.
- Cooperation between the border control services.
- Common definitions for unauthorised entry, movement and residence.
- Penal framework to prevent unauthorised entry and residence.
- Mutual recognition of decisions on expulsion of third country nationals.
- Exchange of information and mutual assistance between police.
- Dublin Convention on Asylum.

Sources: European Commission [2001e], Council of the EU [1999b, 2001b, 2001c and 2001d].

Norway and Iceland have also taken an active role in the Schengen Mixed Committee on various 'Schengen-relevant' topics, such as harmonised penalties pertaining to cross-border smuggling of people and trafficking in human beings.

In practice there seems to be emerging some divergence of interests between the non-EU associates of Schengen (Norway and Iceland) and the non-Schengen members of the EU (Ireland and the UK). Norway and Iceland may wish some new initiatives in the JHA domain to be

considered Schengen-relevant, meaning that they will be included not only in the Schengen jurisdiction but also in the processes of decision-shaping consultations, such as in the Mixed Committee. Ireland and the UK on the other hand may take the opposite view.

The agreed field of ‘Schengen-relevant’ measures is already quite substantial, and involves the topics listed in Box 5. However it seems that the EU is indeed making a fairly restrictive interpretation of what is directly and closely ‘Schengen-relevant’, mainly recognising measures touching upon the movement of persons cross the external Schengen frontier.

There are currently three important examples of EU JHA initiatives, that have not been classified as ‘Schengen-relevant’, and with which Norway wants to associate: EUROPOL, EUROJUST and the European Arrest Warrant.

EUROPOL is a distinct EU agency, located in The Hague, with operational activity for coordinating cross-border police actions. Norway has concluded a special Treaty of Association with the EU in this case, which will become active when ratification is completed.

EUROJUST is being created as another quasi-agency for the judiciaries of the EU to organise their operational collaboration on matters of cross-border criminal proceedings. Norway is expected to also request association here.

The European Arrest Warrant is an initiative to do away with slow-moving extradition procedures within the EU, which is also of high significance in relation to traditional precepts of legal sovereignty. Norway sought to have this initiative, whose political priority has been greatly boosted by 11 September, treated as a ‘Schengen-relevant’ measure. The EU refused however on the grounds that it was far more central to the core JHA agenda than just a ‘Schengen-relevant’ measure. As a result, Norway has now requested further negotiation of the Treaty of Association.

These tensions over the border between Schengen and EU jurisdictions, however, will come as no surprise to Norway and Iceland, since Schengen cooperation is seen by the EU as part its integration process and in particular its ambition to establish an ‘Area of Freedom, Security and Justice’ (as in the Treaty of Amsterdam). The Schengen Protocol itself refers to the Schengen *acquis* as part of the process of ‘enhancing European integration and, in particular, enabling the European Union to develop more rapidly into an area of freedom, security and justice...’

5.1 Strategic security: Norway and the EU-US-Russia strategic triangle

Many analyses of Norwegian foreign and security policy take as their starting point the fact that Norway is a small power surrounded geographically by three great powers. The principal contention underlying this 'small-state perspective' is that Norwegian foreign policy and indeed Norway's security is to a very large extent determined by the relative weight of these major powers and the relationships among them. Historically, these big powers were Great Britain or the United States in the west, Prussia or Germany to the south and Russia or the Soviet Union to the east. A similar structure is evident today, with the United States as the power in the west, the EU in the south and (again) Russia, with which Norway shares a border, in the east.

5.1.1 Norway's fear of marginalisation

The eventuality of having to confront an aggressive neighbouring great power on its own has been a major preoccupation in Norway's strategic thinking. During the Cold War, this took the shape of a fear of abandonment by its NATO allies in a conflict with the Soviet Union. Norway sought to bolster its position vis-à-vis the Alliance by emphasising its especially vulnerable and strategically important location, through support of its major allies in other areas, and through an activist foreign policy going beyond traditional security policy (see below).

Although the end of the Cold War vastly improved Norway's security, the demise of the military might of its neighbour also undermined its claim to be regarded as a 'special case'. Norway became the security 'Cinderella' of the greater Europe as Foreign Minister Jan Petersen expressed it [Petersen, 2000]. While the public demanded a 'peace dividend', the elite feared the possibility of being left alone to face an uncertain and unstable Russia that no longer posed a strategic threat to Norway's NATO allies.³⁸ The end of the Cold War was therefore received as somewhat of a 'mixed blessing', and it has been argued that among the Nordic countries, Norway has had the greatest difficulty

³⁸ In the Norwegian debate on security policy, this has been referred to as the danger of 'political marginalisation', see Stortingsmelding (1992/1993, p. 11).

adjusting to the post-Cold War era [Dörfer, 1997]. The reduction in the American forces earmarked for Norway in case of emergency and the closing of NATO's Northern HQ outside Oslo in the early 1990s seemed to confirm these fears of abandonment. But as a cooperative relationship between Russia and the West gradually emerged, the fear of a large military confrontation abated and was consequently crowded out of the security agenda in Europe by other more diverse security concerns. The limited progress towards a credible EU common foreign and security policy for most of the 1990s assuaged the fears of marginalisation, and a generally positive relationship with Russia developed, facilitated by considerable amounts of economic support for the transition process.³⁹

However, that geopolitics is increasingly replaced by 'geo-economics' is not necessarily unequivocally beneficial for Norway. Norway has one of the world's largest economic zones – a vast maritime area containing large oil and gas reserves as well as some of the richest fisheries. For a sparsely populated country to manage those resources, as well as handling the concomitant borderline dispute with Russia in the strategically sensitive Barents Sea, requires not only cooperative relations with its other neighbours, but also their active engagement.

5.1.2 The United States and Europe

One of the principal objectives of Norwegian foreign policy is to ensure that the United States remains actively engaged in Europe and in NATO. As one of the few European NATO members for whom EU membership is not a short-term proposition, Norway arguably has a stronger interest in preserving a central role for NATO and of the US in the European security architecture than most of its European allies. And with the disappearance of a strategic threat to NATO, the value of the Alliance increasingly lies in its function as a broader forum for common security concerns as much as its mutual defence obligations.

As noted above, the strong and positive links developed between Western Europe and North America during the Cold War were maintained throughout the 1990s, in spite of a reduced US presence in Europe and in contrast to what many prominent analysts expected [Mearsheimer, 1990]. The numerous transatlantic disputes that did occur over such issues as

³⁹ Russia has been the recipient of ca. 200 million euro in 1992-99, more than half of Norway's total assistance to the transition process in former Communist countries; see Utenriksdepartementet [2001].

trade and the handling of the Balkan conflicts were not significant enough to seriously upset a cordial transatlantic relationship.

The US relationship with Russia also remained cooperative, despite intermittent upheavals and periods of discord, most notably following the Kosovo war. The same could be said about Western Europe's relationship with Russia, and with hindsight, the consistency of a combined US and Western European policy towards Russia throughout the 1990s has been quite remarkable. However, in the last few years there have been a number of contentious issues on the agenda on which the US has found itself in disagreement with both Russia and the EU, on missile defence and arms control treaties and the Kyoto Protocol on climate change. The new administration of George W. Bush is frequently cited as the main reason for this, although these general developments can be traced back before the presidential election in the US in the autumn of 2000.

There has also been a gradual divergence between US and EU relations with Russia. Whereas Russia plays an increasingly diminished role in a US foreign policy, Russia is becoming an increasingly important partner for the EU (see below). Indeed, the same divergence is evident when comparing US and Russian policy towards the EU. Europe is becoming less of a priority in US foreign policy, as the focus is gradually shifted towards Asia. In contrast, Europe and the EU are becoming a more important element of Putin's foreign policy, as spelled out in the new [2000] Russian foreign policy doctrine.

5.1.3 The EU-Russian 'strategic partnership'

The EU-Russian relationship is deepening.⁴⁰ The 1997 Partnership and Cooperation Agreement (PCA) provides an institutional framework for enhanced cooperation, and the strategy documents exchanged in 1999 provide the medium-term aim of establishing a 'strategic partnership'. Several recently proposed joint projects (profiled below) could move bilateral EU-Russian relations towards a real strategic partnership in the medium-term.

Common European Economic Area. The idea of more comprehensive economic integration of Russia with the EU was re-launched at the May 2001 EU-Russian summit, and a high-level group has been mandated to come up with a concept by autumn 2003. A sequential and progressive deepening of EU-Russian economic integration could be envisaged: i)

⁴⁰ See Emerson et al. [2001] for a more thorough treatment of the evolving EU-Russian strategic partnership.

Russian WTO-accession, ii) sectoral free trade moving towards iii) a comprehensive free trade area which could in the long-term lead towards the establishment of a European Economic Area, Mark II.

Energy cooperation. Russia and the EU agreed to establish a strategic energy partnership in October 2000. Limited progress has so far been achieved in terms of increasing European investments in Russian energy projects, but the two sides have agreed to designate specific infrastructure projects as being of ‘common European interest.’ This is likely to influence decisions on long-term investments in energy production and transport infrastructure to supply the EU’s growing energy demand in the next decades. The comprehensive energy dialogue has already shown its worth, with Russia consulting with Brussels before announcing its oil production cuts in autumn 2001. As seen in Chapter 2, the lack of such consultation between Norway and the EU on the same matter was a source of conflict at a recent meeting of the EEA Joint Committee. The EU-Russian strategic energy partnership combined with the completion of the EU internal energy market represent a major challenge for Norway in the coming years. The constraints on Norway’s freedom of action due to the EEA Agreement (see Section 2.2.1) are not applied to the other main external suppliers such as Russia and Norway’s main competitors for market shares in the EU. If the EU-Russian strategic energy partnership enhances the incentives for investments in Russian energy projects, this is likely to have a further negative impact on Norway’s competitiveness in the EU energy market.

The Northern Dimension. This was initially a Finnish EU initiative to enhance regional cooperation between the EU, Russia, Norway, Iceland and the enlargement candidates in Northern Europe. The result however has not been in accordance with the more ambitious ideas of transforming regional multilateral cooperation in the region, but has rather turned the Northern Dimension into a useful element of the evolving bilateral EU-Russian partnership, with a very limited role for non-EU countries like Norway. Among the more practical results of the initiative has been the opening up of European Investment Bank operations in Russia, initially for conventional environmental projects in Northwest Russia, and increased attention on the special situation of the Russian Kaliningrad region in the EU enlargement process.

Environmental cooperation. Environmental problems in Russia represent an area where the EU and Norway have strong common interests, ranging from conventional pollution to the nuclear hazards of the Kola Peninsula. Norway has been actively engaged concerning the latter, spending a large

share of its assistance to Russia on issues of nuclear safety. Implementation of the Kyoto Protocol on global warming provides a huge EU project with Russia, which has the world's largest credit of CO₂ emissions savings, and the largest potential for investments in energy savings.

Political and security dialogue. The PCA provides a political dialogue of biannual summits at the level of Heads of Government and State, ministerial meetings and a committee of senior officials. In light of the development of the ESDP, Russia and the EU have decided to strengthen their cooperation on political and security issues on an extensive agenda that includes 'thorough-going reform of the OSCE', cooperation on arms control and 'possible Russian participation in civilian and military crisis-management operations.'⁴¹

5.1.4 The effects of September 11

The terrorist attacks on September 11 appear to have reversed the trends of transatlantic divergence. For Norway, the principal question is whether the new cooperative spirit among the big three will last, or if the triangular relationship will revert to the evolving patterns seen before September 11.

The effects of September 11 on Norwegian foreign and security policy seem to be mixed. If the improved relations among the EU, Russia and the US can be sustained, this would immensely improve Norway's geopolitical situation. Russia's recent rapprochement with NATO is perceived in Norway as a positive development.

On the other hand, September 11 is likely to speed up the gradual withdrawal of the US presence in Europe, as well as leading to enhanced EU-Russia cooperation. As far as the latter is concerned, this development is already evident with the institutionalised dialogue on international security, with monthly consultation meetings between the Troika of ambassadors of the EU Political and Security Committee and Russia's ambassador to the EU. This is likely to affect Norway's relationship with Russia. Because of structural asymmetries, a principal aim of Norway's policy towards Russia has been to prevent a bilateralisation of the relationship. This is likely to become more difficult

⁴¹ *Joint Declaration on stepping up dialogue and cooperation on political and security matters*, Brussels, 3 October 2001.

as the EU increases its responsibilities in the wider Europe, and as the US presence is further reduced.⁴²

If the proposals for enhanced EU-Russian collaboration are followed through, they would transform not only their bilateral relationship, but European politics as a whole. A general improvement of EU-Russian relations might over time change the EU's views on relations between Norway and Russia. The latter relationship, though immensely improved by the end of the Cold War, has been quite cool in the last few years, a consequence both of Russia's worsened relationship with the West in the late 1990s, and more limited and specific bilateral disputes.⁴³

It seems increasingly likely that the events of September 11 might reduce the importance of NATO. Article 5 of the Atlantic Treaty was invoked for the first time, largely a European show of solidarity with the US, but the US has not responded to this in a manner satisfactory to its European allies. The negative experience of waging war by committee during the Kosovo campaign has led to US to avoid NATO structures in conducting the military aspects of the war on terrorism, preferring to include its European allies only to a limited extent. In the words of one prominent European expert, 'NATO is no longer a defence organisation, but a security and defence service institution' [Heisbourg, 2001b]. Furthermore, the transatlantic dialogue is increasingly conducted between the US and the EU, the latter through ESDP institutions like the Political and Security Committee. Apart from the fact that Norway is excluded from an increasingly important forum of transatlantic dialogue, the long-term effects could be to further diminish the role of NATO.

5.2 Humanitarian foreign policy

The idea that Norway has a 'special role in leading the world up the straight and narrow path towards peace based on international justice and humanitarian values' has been a motor force of Norwegian foreign policy since independence in 1905 [Riste, 2001, p. 255]. This humanistic activism is conceived in global terms, and has led to the claim that Norway has more foreign policy per capita than any other nation. To the

⁴² See for instance the recent speech by Norway's Ambassador in Moscow [Nordsletten, 2001].

⁴³ These include the lack of agreement over demarcation of an off-shore oil province (Grey Zone in the Barents Sea), and over the Treaty on Svalbard of 1920, and Russian complaints that a radar station in Northeast Norway could be used as part of US missile defence. See Laugen [2001].

extent that average Norwegians today think about Norway's international role, it is usually with a global, rather than a European perspective, and is something the general public seems quite proud of. A brief survey of recent and current Norwegian efforts give credence to the words of former Foreign Minister Frydenlund that 'Norway's influence in the world is much greater than could be expected given the resources and the size, but less than we [Norwegians] perceive it to be.'

5.2.1 Development aid

Norway currently spends 0.8% of GDP per capita on development aid, the highest share of any non-EU member state and more than double the figure for the EU as a whole. The biggest difference concerning the geographical distribution is that Norway spends less assistance in Europe and relatively more on sub-Saharan Africa (which receives more than half of Norway's development aid).⁴⁴ A recent World Bank report [World Bank, 2001] gave high marks for the effectiveness of Norwegian development assistance. The higher effectiveness of Norwegian assistance is attributed to its focus on very poor countries and the reasonably good policies of the countries to which it assigns priority.

Through its emphasis on global rather than on European challenges, the humanitarian or 'ethical' component of Norwegian foreign policy has different geographical priorities than that of the EU, which focuses more on its direct neighbourhood, in particular on those countries that are candidates for membership. This is however a difference of emphasis rather than of kind, and Norway's efforts are clearly complementary to the general aims of EU foreign policy.⁴⁵

5.2.2 Conflict prevention and management

Norway has achieved a niche role as a peace-broker, most famously through the so-called Oslo process leading up to the 1993 peace accord between Israel and Palestine. These activities have been stepped up since

⁴⁴ In 2000, Denmark and the Netherlands spent a higher share 1.07% and 0.84% of GDP/capita respectively, while Sweden spent 0.8% of GDP/capita. The EU as a whole spent 0.32% of GDP/capita. See OECD website: <http://www.oecd.org>. On Norway, see NORAD (2000). On the EU see the website of EuropeAid, the EU's aid co-ordination office at <http://europe.eu.int/comm/europeaid>.

⁴⁵ According to the Laeken Declaration on the Future of Europe [European Council, 2001e], the EU needs to be a 'power seeking to set globalisation within a moral framework, in other words to anchor it in solidarity and sustainable development.'

then, with Norwegian negotiators currently active in the civil wars in Colombia and Sri Lanka. Norway is also an active participant in UN peacekeeping operations, and has so far has contributed 60,000 troops to such operations.⁴⁶ Norway was the lead nation of KFOR last year. The Nobel Peace prize, although not awarded by the Norwegian government, has also become a symbol of Norway's international vocation and its 'ethical' foreign policy.

The Oslo process put Norway at the centre stage of international diplomacy. Was this just a glorious moment for Norwegian diplomacy, with an extraordinarily well-managed blend of official and unofficial diplomacy? Or did it represent an enduring niche role for Norwegian diplomacy and indeed foreign policy priorities? Through its continued global activism, the Norwegian government clearly aims for the latter. But the cumulative strengthening of EU foreign policy also includes efforts to enhance the Union's role in conflict prevention diplomacy, and increasingly brings it into Norway's niche role of mediation in conflict situations, and in deploying substantial financial resources in support of the efforts.

Recent years have seen the EU move into the field of international mediation even more extensively, and deploying its own special representatives to perform high-profile conflict prevention or resolution roles. The mere listing of such nominations points to a pattern. After the Bosnian war the EU appointed former Prime Minister Carl Bildt of Sweden to be special representative in execution of the Dayton Agreement. He was succeeded in this function by Wolfgang Petrisch, an Austrian diplomat. To clinch negotiations with Milosevic at the end of the Kosovo war, the EU fielded President Ahtisaari of Finland. To lead the Stability Pact for South East Europe, the EU nominated Bodo Hombach of Germany, who was followed in this position by Erhard Busek, a former Austrian Vice-Chancellor. To lead the UN administration of Kosovo the EU fielded Bernard Kouchner, a French minister, and he was succeeded by Hans Haekkerup, a Danish minister, who was recently replaced by a German diplomat, Michael Steiner. The EU's growing role in the Middle East peace process has been visible in the role of special representative Angel Moratinos, a Spanish diplomat, with EU High Representative Javier Solana, former Spanish foreign minister, having come into the process at top level more recently. In the recent crisis in Macedonia Javier Solana was actively in the lead with NATO Secretary General George Robertson. This work in Macedonia

⁴⁶ Website of Norway's Mission to the UN: <http://www.norway-un.org>.

was taken over on the ground for a while by François Leotard, former French Defence Minister, who was recently replaced by Allen Le Roy, another Frenchman.

The pattern is clear. The EU nowadays actively fields its own representatives for essential tasks in international peacekeeping or conflict resolution in the wider European area. The small EU member states fill a good number of these roles, deploying individuals who by background and professional skills are highly comparable to Norwegian counterparts. The EU provides more than half of all official development aid in the world and is able to use this to back its diplomatic efforts. Norway is being squeezed out of the market and increasingly marginalised in a field where it has excellent capabilities. This is in no way intended to be unsympathetic towards Norway; it is just that the EU wishes to mature its own role. This is particularly true in areas where Norway has been active in recent years, such as the Balkans and the Middle East. Here, Norway's services will be needed less, and it is likely to find that the places where there is a role for Norway to play are increasingly in areas of the world that are less important to the EU.

There are not many areas where Norway can play a role that the EU cannot. And in areas where Norway may provide added-value to EU policies, this is not often taken advantage of, and Norway is continuously in the situation of having to market its comparative advantage, from the Balkans to the Middle East, rather than being called upon to contribute. Although the exception that confirms the rule, there have been instances where Norway has contributed to EU foreign policy. Serbia provides a recent example, the Middle East/Oslo-process is the most known example, and Norwegian engagement in Sri Lanka and Colombia may become new examples. It is also notable that the Serbia case was considered a success because of good coordination between Norway and the EU.

5.3 Multilateralism

'Lilliputs and Gulliver: Small States in a Great Power Alliance' is the title of a telling article by former Norwegian Defence and Foreign Minister Johan Jørgen Holst [1983]. The Lilliputs of this world benefit if the Gullivers stick to the rules and solve their conflicts according to these rules. It is therefore only natural that small states seek part of their security in international law and it is in their legitimate interest to strive to make these international institutions as strong as possible.

This orientation on multilateral structures – liberal institutionalism – has been described as ‘very much a Nordic approach to an international security dilemma’ [Archer and Sogner, 1998, p. 127]. Norway has always been a strong supporter of, and played an active role in, international organisations, providing *inter alia* the world’s first High Commissioner for Refugees (for the League of Nations in the early 1920s) and the first Secretary General of the United Nations. Norway currently has a seat in UN Security Council, and through its chairmanship of committees in charge of sanctions on Iraq and the group coordinating the assistance to Afghanistan, the country plays an important role in current global diplomacy.

However this approach is also very much a Western European approach, as seen in the debates on European multilateralism versus American unilateralism.⁴⁷ Indeed, the European Union as such is often regarded as the principal embodiment of Western Europe’s preference for and indeed dependence on a rules-based international community.⁴⁸

Norwegian multilateralism is not limited to global institutions and it plays an active role in Euro-Atlantic structures, recently seen during its 1999 chairmanship of the OSCE during the difficult period of the Kosovo and Chechnya conflicts. It is also a proponent of regional cooperation in Northern Europe through its membership in the Nordic Council and the Council of Baltic Sea States, and Norway took the initiative in the early 1990s to establish the Barents Euro-Arctic Council of the five Nordic countries, the European Community and Russia. With the establishment of the Nordic-Polish peacekeeping brigade and NORDCAPS (Nordic Co-ordinated Arrangement for Military Peace Support), and the coordinated Nordic assistance to the armed forces of the three Baltic States, such regional cooperation has in the 1990s also acquired a security component.

However, most of these Euro-Atlantic, European and Northern European multilateral institutions are primarily fora for consultation with limited resources and operational responsibilities. This is likely now also to include NATO (see Section 5.1). And regardless of what role these organisations will be tasked with in the future, an enlarged European Union of 25 or more member states is likely to play an increasingly dominant role in these organisations, arriving in these fora with common position agreed within the EU institutions. In sum, all of these

⁴⁷ See for instance Everts [2001] on the multilateralism-unilateralism debate.

⁴⁸ See Emerson et al. [2001], in particular p. 6, on Western European multilateralism.

developments entail an increasingly marginal role for small non-EU member states such as Norway.

5.4 Associating with the CFSP

In addition to cooperating with EU member states on foreign and security policy multilaterally, Norway is also associated with the EU's Common Foreign and Security Policy (CFSP). The biannual EEA Council meetings include more general discussions on foreign and security policy. In addition, a dialogue on CFSP at senior officials and experts levels was initiated in the middle of the 1990s, and is conducted through regular meetings between Norwegian governmental representatives and selected Council working groups. This dialogue can be traced back to the informal contacts established between Norway and European Political Cooperation in 1980 [Tamnes, 1998, p. 224].

In contrast to the dialogue on the single market and the Schengen agreement, and similarly to the ESDP arrangements, the CFSP dialogue is not embedded in a formal bilateral agreement between Norway and the EU. The specific working groups with which Norway has such a dialogue and the number of meetings that takes place is decided by the incumbent EU Presidency. During the Belgian Presidency for example, Norwegian experts had meetings with six Council working groups, reflecting a mix of common values and interests as well as areas of particular Norwegian interest and expertise.⁴⁹

Through this dialogue Norway, together with the other EEA states and the candidate countries, is invited to associate itself with EU CFSP declarations. Among 199 CFSP declarations in 2000 there were 131 cases of such active association,⁵⁰ another sign of the significant similarities and overlap between the CFSP and Norwegian humanitarian foreign policy. Through the CFSP dialogue, the associated states are also frequently invited to associate themselves with EU contributions to international conferences and organisations.

This dialogue, while harmless, seems to provide limited added-value. Since their interests on the broader international matters discussed are perceived to be very similar, if not identical, at most it would be a question of coordination and obtaining synergies. The dialogue does not provide the associated states with the possibility of contributing to EU

⁴⁹ Working Groups on the Middle East; weapons exports; disarmament and non-proliferation; Western Balkans; the OSCE; and Eastern Europe.

⁵⁰ See Council of the EU [2000b, Annex p. 46, and Annex II].

policy, and takes the shape of an exchange of information, whereby the EU's position is determined beforehand and which the associated states are then invited to support.

5.5 Associating with the ESDP

Norway's foreign and security policy since the 1994 rejection of EU membership has been described by E. Barth Eide, State Secretary at the Norwegian Foreign Ministry from 2000-01, as one of 'eager adaptation' to the EU [Eide, 1996]. There is today a broad political consensus in Norway supporting the policy of adaptation by the government.

Norway's association with EU-centred (i.e. including the WEU) security cooperation preceded the 1994 referendum. Although the early European Community had no security competence, it contained the most important European allies of Norway and its members were gradually developing their foreign and security policy cooperation. 'It thus had much to offer in the non-defence aspects of security, just those areas that could, according to Norwegian thinking, bring a more solid and lasting peace than purely the resort to a military-based security policy' [Eide, 1996]. Following the reactivation of the WEU in 1984, Germany took the initiative to establish an informal consultation dialogue between Norway and the presidency of the WEU. In the early 1990s, the WEU invited European NATO countries that were not in the EU to become associate members, which Norway consequently became in November 1992 [Tamnes, 1998, pp. 225-227]. Norway's WEU association allowed it to participate fully in all WEU institutions (ministerial council, senior officials committee and expert working groups, military committee, parliamentary assembly, etc.), although without the right to vote.

The rationale behind this 'European turn' of associating with the embryonic EU security and defence institutions, according to a Norwegian independent commentator, was clear:

It is...far from improbable that the [NATO] forces earmarked for Norway will already be deployed elsewhere on the planet when they are most needed. Thus, the reduced operation capacity of a main ally to respond to Norway's security needs should worry Norway's policy-makers and make them look for structures that may complement the lingering NATO guarantee. Since the EU and the WEU are the only structures available that can strengthen Norway's position, the only option is to try to integrate more strongly with these structures and to support the expansion of their ties to NATO. If Norway is to compensate for the reduction of the

US production of forces for Norway, European forces will have to be involved [Eide, 1996, pp. 87-88].

The risks attached to being marginalised in Europe and European security are thus perceived to be quite considerable.

Norway has supported the European Security and Defence Policy (ESDP) since the idea was launched by Britain and France in late 1998, and has pledged 3,500 troops to the 60,000-strong Rapid Reaction Capability to be developed by 2003. This is a bigger contribution per capita than any of those pledged by EU member states. Although the EU is in favour of extensive cooperation with third countries on ESDP (see Box 6 below), this has to take into account the EU's own decision-making autonomy. Norway's aim has been to associate itself with the ESDP as closely as possible and to maintain the level of participation and consultation that it had in the Western European Union.⁵¹ A comparison of the Nice European Council Presidency Conclusions with Norway's WEU participation clearly shows that this objective has not been obtained.

Box 6. European Council on the role of third countries in ESDP

Helsinki Presidency Conclusions, Annex I of Annex IV
December 1999

The Union will ensure the necessary dialogue, consultation and co-operation with NATO and its non-EU members, other countries who are candidates for accession to the EU as well as other prospective partners in EU-led crisis management, with full respect for the decision-making autonomy of the EU and the single institutional framework of the Union.

With European NATO members who are not members of the EU and other countries who are candidates for accession to the EU, appropriate structures will be established for dialogue and information on issues related to security and defence policy and crisis management. In the event of a crisis, these structures will serve for consultation in the period leading up to a decision of the Council.

Upon a decision by the Council to launch an operation, the non-EU

⁵¹ The terms of participation by third countries in the ESDP are found in Annex VI of Annex VI of Nice European Council Presidency Conclusions of December 2000 (Council of the EU, 2000d). Norway's position was first presented in a policy memorandum in October 1999 (available at <http://www.atlanterhavskomiteen.no>), specified in more detail in a so-called non-paper circulated in autumn 2000; see *Aftenposten*, 14 November 2000.

European NATO members will participate if they so wish, in the event of an operation requiring recourse to NATO assets and capabilities. They will, on a decision by the Council, be invited to take part in operations where the EU does not use NATO assets. Other countries that are candidates for accession to the EU may also be invited by the Council to take part in EU-led operations once the Council has decided to launch such an operation. Russia Ukraine and other European States engaged in political dialogue with the Union and other interested States may be invited to take part in the EU-led operations.

All the States that have confirmed their participation in an EU-led operation by deploying significant military forces will have the same rights and obligations as the EU participating Member States in the day-to-day conduct of such an operation. In the case of an EU-led operation, an ad-hoc committee of contributors will be set up for the day-to-day conduct of the operation. All EU Member States are entitled to attend the ad-hoc committee, whether or not they are participating in the operation, while only contributing States will take part in the day-to-day conduct of the operation. The decision to end an operation will be taken by the Council after consultation between the participating states within the committee of contributors.'

Nice Presidency Conclusions, Annex VI, December 2000

The EU project is open. If there is to be efficient crisis management, the European Union wishes to receive contributions from the non-EU European NATO members and other countries which are candidates for accession to the EU, in particular those which have the determination and capability to commit considerable resources to participate in the Petersberg tasks. This openness must, of course, respect the principle of the European Union's decision-making autonomy.

Additional contributions from European non-EU members of NATO and other countries that are candidates for accession to the EU will be taken into consideration and welcomed as further valuable contributions towards the improvement of European military capabilities. These contributions will be examined, in conjunction with the nations concerned, on the basis of the same criteria as those applying to Member States' contributions.

At the political level, Norway had full participation rights in the biannual WEU Council of foreign and defence ministers. In the ESDP, Norway will not participate in the much more frequent meetings of EU foreign and defence ministers, but will instead have biannual meetings in which Norway and the other associates are informed of common EU positions concerning ESDP. Instead of the monthly meetings at senior officials

level between the Political and Security Committee and European NATO members requested by Norway (the 15+6 formula), the EU has offered two meetings per EU Presidency convening in two back-to-back sessions 'at 15+6' and 'at 15+15'.⁵²

The participation of the WEU associates has also been circumscribed through the transfer of WEU functions to the EU in other ways. The WEU Assembly has been re-named the interim European Security and Defence Assembly, but the fate of the parliamentary dimension of the ESDP is as of this writing (February 2002) uncertain, in particular concerning an eventual role for the European Parliament. The same could be said of the Western European Armaments Group (WEAG), which continues its work in its previous form.

So what does 'Annex VI of Annex VI' of the Nice European Council Conclusions mean for Norway's participation in the operational phase of EU-led crisis management efforts? The main conclusion is that Norway will be allowed to participate in decision-*shaping*, but not in decision-*making*. It may participate upstream (consultations at political, senior officials and military level) and downstream (membership and voting rights in the committee of troop contributing nations). However, the operational mandate of this committee is strictly limited. It may decide on things concerning the day-to-day running of the operation, but the major strategic decisions are prepared by EU ambassadors in the Political and Security Committee and made – ultimately – by Foreign Ministers in the General Affairs Council (GAC) of the EU.

But this is mainly about operations at the higher end of the Petersberg 'spectrum', such as peacemaking and peace-enforcement operations. The EU is most likely during the early years of ESDP to take up operations that are at the lower end of the spectrum, e.g. humanitarian disasters and traditional peacekeeping operations. The first ESDP operation, a police mission in Bosnia consisting of 500 police officers from early 2003, provides a good illustration of this. Norway has already pledged 80 police

⁵² The 'six' are the Czech Republic, Hungary, Iceland, Norway, Poland and Turkey. The '15' consists of the 'six' plus the other (nine) EU accession candidates that are not NATO members (Bulgaria, Cyprus, Estonia, Latvia, Lithuania, Malta, Romania, Slovakia and Slovenia). This dual format is unlikely to survive the next rounds of NATO and EU enlargement. If, as generally expected, the EU invites 10 new countries to become members and NATO five, the old formats will be transformed into '25+3' (the '3' being Iceland, Norway and Turkey) and '25+5' (the '3' plus Bulgaria and Romania).

officers to the civilian part of ESDP and has signalled its interest in participating in the Bosnian mission [*Aftenposten*, 24 January 2002].

ESDP associates like Norway have been invited to appoint liaison officers to the new EU Military Staff similar to the WEU arrangements, and there will be two meetings per EU Presidency with the EU Military Committee of national defence chiefs. (In addition the Norwegian chief of defence meets with most of his EU counterparts at the three annual meetings of the NATO Military Committee). But EU crisis management will principally be a comprehensive affair deploying a mixture of different (civilian, military, diplomatic, financial) policy tools. The institutional mechanisms for coordination and political guidance have not been decided or established. It is thus unclear what the position of third countries will be in this effort combining ESDP instruments, member states resources and non-military EU tools.

The limited and reduced (compared to the WEU) role of the ESDP associates has led to an acrimonious dispute between Turkey and the EU. Like Norway, Turkey is a NATO member without short-term prospects for EU membership. But in contrast to Norway, Turkey has not accepted the terms for their participation in the ESDP. More specifically, Turkey has resisted an agreement between the EU and NATO giving the EU 'assured access' to NATO assets under the terms of participation accorded to them by the EU, which the EU is unwilling to change with reference to their right of decision-making autonomy. Negotiations are still going on as of February 2002, and do not appear to have impeded Norway's participation in ESDP structures so far. But if no solution is found, the EU might decide to 'go it alone' and develop its own autonomous capabilities. Apart from the very negative impact this is likely to have on transatlantic relations, it would also remove part of the rationale for allowing non-EU NATO members to participate at all. It may in this context be noted that whereas Norway's participation in the WEU was based on an association treaty, its participation in the ESDP is based on a unilateral declaration by the EU, and is thus not formally guaranteed. As of today, this is mere speculation, but the story does point to a potential challenge for Norway. The 2004-05 EU enlargement is likely to be followed by a South-East European enlargement round. The EU is likely increasingly to lump Norway together with the 'rest of Europe'.

CHAPTER 6

NORWAY AND THE FUTURE OF EUROPE

6.1 The future of the European Union

While the place of the EEA in the European system has already in the last decade been drastically affected by new developments in the EU, these processes of transformation of European structures have not at all come to an end. On the contrary the scene is now set for a further five years of major changes in the EU. On 1 March 2002, the EU's *Convention on the Future of Europe* will begin its work. This will conclude one year later with a final document addressed to the European Council, destined to pave the way for the next Intergovernmental Conference scheduled for 2004, with options and recommendations for the future of the EU's system of governance, and possibly favouring the drawing up of a constitutional text. This process may in any case be expected to deliver by 2005 a major revision of the existing set of treaties (Treaties of Rome, Maastricht, Amsterdam, and Nice), to be ratified presumably in the course of 2006. By then the EU may be expected to have 25 member states.

As we have already seen in the preceding chapters, such changes in the EU's own internal treaties and structures tend to have inescapable knock-on effects for Norway and its EEA partners. It is therefore necessary to take a view on what is happening within the EU in order to form a view of Norway's future relationship with it. At this stage the simplest observation is that the future of the EU, as it may emerge in 2006, is definitely unknown. A huge list of basic questions has been drawn up by the European Council for the Convention to consider. To give some flavour of the likely content, the questions include the following:

The division of competences between EU, national and where appropriate regional levels; implementation of the principle of subsidiarity; how to give greater coherence to foreign and defence policies, how to step up economic policy coordination, how to intensify cooperation in the fields of social exclusion, environment, health and food safety; how to prevent a creeping expansion of EU competences, without halting its dynamic; how to simplify the EU set of legislative and executive instruments; how maybe to have more recourse to framework legislation, and open coordination and mutual recognition; how to enhance the authority and efficiency of the Commission; whether and how to strengthen the role of the

European parliament; how to give greater transparency to the work of the Council; how to involve national parliaments more effectively in the interests of democratic legitimacy; how to improve the efficiency of decision-making with up to thirty member states; what to do about the six-monthly rotating Council presidency; whether to retain the distinction between the three pillars for economics, foreign and security policy and justice and home affairs; whether to reshape the treaties into a basic treaty and other treaty provisions; how to integrate the Charter of Fundamental Rights; whether to foresee in the long-run the adoption of a constitutional text, and what its basic features should be.

The uneasiness of the Norwegian people about their relationship with the EU, as revealed in the unsuccessful referendum campaigns and the continuing concerns about the EEA relationship, seems to be basically about democratic control, legitimacy and accountability of policy-making. It also reflects an uneasy relationship between the people and their government. Such concerns are remarkably similar in nature to those perceived with the EU itself, with perhaps only some differences of degree. Of course specific points of friction between this and that policy are also in evidence. Yet fundamentally it is clear that both the EU and the EEA systems pose perceived problems of democratic legitimacy and accountability. For Norway and the EEA, however, these matters are more ambiguous (even contradictory) because of the nature of the EEA compromise: the EEA process is clearly less democratically legitimate than the EU, yet the EEA states retain a higher degree of formal independence.

Given these very fundamental issues for European democracy, it is at least worth noting the direction in which the EU seeks to move, in order to do something about the perceived problems. The Laeken Declaration, adopted by the European Council on 15 December 2001, in order to launch the Convention, gives one version of the EU's self-image as it embarks upon its own reform, as follows:

The expectations of European citizens

The image of a democratic and globally engaged Europe admirably matches citizens' wishes. There have been frequent public calls for a greater EU role in justice and security, action against cross-border crime, control of migration flows and reception of asylum seekers and refugees from far-flung war zones. Citizens also want results in the fields of employment

and combating poverty and social exclusion, as well as in the field of economic and social cohesion. They want a common approach on environmental pollution, climate change and food safety, in short all transnational issues that they instinctively sense can only be tackled by working together. Just as they also want to see Europe more involved in foreign affairs, security and defence, in other words, greater and better co-ordinated action to deal with trouble spots in and around Europe and in the rest of the world.

At the same time, citizens also feel that the Union is behaving too bureaucratically in numerous other areas. In co-ordinating the economic, financial and fiscal environment, the basic issue should continue to be the proper operation of the internal market and the single currency, without jeopardising Member States' individuality. National and regional differences frequently stem from history or tradition. They can be enriching. In other words, what citizens understand by 'good governance' is opening up fresh opportunities, not imposing further red tape. What they expect is more results, better response to practical issues and not a European superstate of European institutions inveigling their way into every nook and cranny of life.

In short, citizens are calling for a clear, open, effective, democratically controlled Community approach, developing a Europe that points the way ahead for the world. An approach that provides concrete results in terms of jobs, better quality of life, less crime, decent education and better health care. There can be no doubt that this will require Europe to undergo renewal and reform [European Council, 2001e].

A final point about the Convention is its composition. Responding to the calls for greater openness in the processes of shaping the future of Europe, compared to traditional inter-governmental negotiation behind closed doors, the Convention will hold its proceeding in the public domain. Its composition will include, beyond the 15 representatives of the member states, 30 members of national parliaments, 16 members of the European Parliament and similar representation for the 12 accession candidate states currently negotiating accession and from Turkey, and representatives of the Economic and Social Committee and the Committee of the Regions. Norway, the other EEA states and Switzerland have not been invited. It is interesting to note that Norwegian trade unions and business federations will be more closely associated

with the Convention than their governments, through their membership in the European-wide associations like UNICE and ETUC, which have observer status.

From the above it will be evident that the EU is attempting to go further in directions that are entirely consistent with fundamental values that are shared by Norway. In the words of one Norwegian political scientist interviewed by the authors: ‘both Norway and the EU have problems of democratic legitimacy and accountability over Europe. The difference is that the EU is doing something about it’.

Political scientists in the EU, not regarding the EU’s mere declarations as gospel, try to keep track analytically of what kind of system the EU becomes: ‘what is the nature of the beast?’ The EU has evolved into an increasingly complex system of collective governance, which is not captured by the traditional concepts of European integration or of orthodox federalism. Developments in key EU policy domains in the last decade, from EMU to JHA and CFSP/ESDP, are not easily categorised as either federal or intergovernmental governance. The ‘curious marriage of the supranational and intergovernmentalism’ [Ludlow, 2001, p. 3]. that has led to the present hybrid character of the EU has prompted analysts to identify several different models within the EU system of policy-making. A detailed analysis of these falls outside the scope of this report, but a taste of these efforts is provided in the Box 7 below.

Box 7. Six methods of EU policy-making

Community method

- European Commission plays key role in all stages of policy process.
- Empowering role of Council of Ministers through strategic bargaining and package deals.
- National agencies are engaged as subordinated implementing agency of common regime.
- Limited role of parliaments, both national and European.
- European Court of Justice (ECJ) supports legal authority of the Community regime.
- Typical policy: Common Agricultural Policy

Regulatory model

- The Commission as architect and defender of regulatory rules and objectives.
- The Council mix of minimum standards, harmonisation, and mutual recognition.

- ECJ to ensure application of rules, enabling individuals to have redress.
- Enhanced role for the European Parliament.
- Considerable opportunities for economic actors to influence policy decisions.
- Typical policies: Single market and competition policy.

Multi-level governance

- Enhanced role of sub-national and regional authorities, with Commission and Council.
- Cohesion policies through redistributive budget
- Typical policies: Structural and cohesion policies

Policy coordination and benchmarking

- Convening of high-level groups in the Council, brainstorming rather than negotiation.
- Involvement of networks of independent experts with Commission.
- Dialogue with specialist groups in the European Parliament.
- Typical policies: Environment, education, research

Intensive transgovernmentalism

- European Council leads in setting strategic guidelines and as ultimate negotiating body.
- Council consolidates with circles of national policy-makers.
- Limited involvement of the European Parliament and the ECJ.
- Special systems for managing co-operation, often outside formal EU structures initially.
- Lack of transparency in policy process, limited role of national parliaments and public.
- Typical policies: EMU Lisbon process, JHA, CFSP/ESDP.

Virtual federalism

- Exclusive competence devolved to independent EU institution.
- Federal structure of representation on governing council.
- Limited accountability to European Parliament or Council.
- Example: monetary union and the European Central Bank.

Source: Authors, drawing heavily on Wallace [2000, pp. 28-35].

One general observation is that policy-making in the EU has become ever more complex and opaque, as the new methods of policy-making have

not supplanted but supplemented previously dominant models. The lack of transparency has made it more difficult for national parliaments and the public within the EU (let alone Norway) to follow the process; hence the new Convention.

The balance among the EU institutions has also shifted, with a strengthening of the Council of Ministers and the European Council at the expense of the Commission and national parliaments. The European Parliament has gradually enhanced its role in certain sectors, although it has so far been excluded from the main new areas of EU cooperation, as has the European Court of Justice.

While the member states are still the major actors within the system, this does not mean the EU is intergovernmental in the sense of other international organisations. On the contrary, due to the intensity of cooperation and the extensive commitments made by member states to adhere to common policies, the EU's peculiar form of intergovernmentalism, sometimes called 'intensive transgovernmentalism', entails considerable constraints on the freedom of the EU member states.

Three features of 'intensive transgovernmentalism' need to be mentioned. First, co-operation among EU member states in the new policy domains tends to have been initiated outside the EU institutional framework, and only later brought formally inside the EU. Secondly, common policies are sought through a gradual convergence by way of benchmarking, peer review and 'soft law', as well as regulations and directives of the classic EU model. Thirdly, the development of 'hard' common EU policies in these domains were preceded by long periods of modest co-operation and at times with considerable setbacks along the way.

6.2 The future of the EU associated state

In conclusion, we may try to distil the nature of the deal for the associated state, of which Norway is the most advanced example. The deal may be described for the attractions it is meant to have, and then compared with emerging realities.

The attractive idea. Norway is associating selectively with the EU, joining in its activities where this suits well, and keeping at a greater distance where it suits less well. In that way, it secures its priority objectives, while retaining considerable autonomy and independence. This model is most plausible to the extent that the EU is in effect a collection of clubs, with considerable possibilities to shop around for the preferred associate member cocktail.

The emerging realities

1. *Guaranteed market access.* The EEA secures this, but at the price of intrusive legislation and regulation that goes deep into domestic economic policy-making. The growing EEA *acquis* is less and less trade policy, and more and more domestic regulatory policy. The EU decides the policy and the EEA associate has to apply it. The EEA has some institutional features of a club of equal members (for the 'EU-EEA states' and 'EFTA-EEA states'). But this is largely political tokenism and has an element of window dressing.
2. *Monetary stability.* International monetary regimes increasingly polarise between inclusion in one of the (two) continental and international currencies or total monetary independence as a floater. The compromise regimes of monetary coordination and semi-fixed exchange rates virtually disappears under the impact of globalised capital markets. The EU has accepted this logic, and has gone the whole way, delegating all monetary sovereignty to the independent ECB. Norway has accepted the same logic, and gone the other way.
3. *Freedom of access and security for people.* Norway secures freedom of movement and labour market access in Europe through the combination of EEA and Schengen. The EU decides policy and the associated states have to apply it. However the whole package now becomes increasingly tied up with internal security and justice and home affairs, with here also intrusive legislation in 'home' affairs, but quite uncertain frontiers between 'Schengen-related' measures that would involve Norway, and 'non-Schengen-related' measures that might not.
4. *Foreign policy.* The EU progressively pools its foreign policy, and its national diplomacies share out the top jobs ('special representatives', etc.). Strategic action is increasingly focused at the level of huge continental actors, whereas the multilateral agencies (UN, OSCE, Council of Europe) become more marginal. Norway's notable role in conflict-resolution diplomacy begins to suffer from some crowding out from the growing EU role, especially in the European periphery where the centripetal and systemic influences of the EU model are operative.

5. *Defence.* Old NATO is obsolete, or almost ‘dead’ to take a frank view.⁵³ New NATO, which is in the dialogue and peacekeeping business, finds it now has company in Brussels with the EU. The two begin to cooperate together. Here the EU is eyeing the opportunities for getting synergies out of its multiple functions (all 1 to 5 items here), while profiting also from economies of scale through using NATO assets. Norway, as a non-EU NATO member, finds its position in the defence system becoming downgraded. It may associate with ESDP actions, but again as a policy-taker, not policy-maker.

The nature of sovereignty in contemporary Europe. Questions have been raised concerning whether Norway’s association arrangements are in contradiction with the Norwegian constitution, be it the Schengen association agreement or ESDP participation.⁵⁴ In Iceland, there have been some concerns that the EEA Agreement may be in contradiction with the Icelandic Constitution [Asgrimsson, 2001]. These all emphasise formal sovereignty. However, ‘[t]here is a difference between theoretical, *de jure*, sovereignty, and practical, *de facto*, sovereignty. In my book, there is not much to be said for battling hard to preserve theoretical sovereignty while losing much of the real thing,’ as Commissioner Patten argued in a speech in Norway last year [Patten, 2001].

In all of the five domains mentioned above the EU member states have hugely restructured the nature of their sovereignty. Simply to lose sovereignty makes no sense. The deal therefore is to pool sovereignty in order to get more of it. The way to get more sovereignty is to go for the synergetic value-added and power of putting all of the above five functions together in a single political structure. Old national sovereignty is ‘dead’ in the new Europe. But the new collective sovereignty is alive and not doing badly at all. But to make a success of the new sovereignty is very demanding. It means giving up on the idea a loose collection of clubs. Having toyed with the idea of variable geometry and reinforced cooperation of sub-groups, the EU – especially noting the preferences of the next 10 acceding states that want to be in everything – seems now to

⁵³ Such is the view of some leading analysts of strategic security issues, for example Francois Heisbourg [2001b], and in more detail by the same author, Heisbourg [2001a].

⁵⁴ See for instance *Aftenposten* 16 November, 2001 and *Klassekampen*, 22 November, 2001.

be heading basically in the centripetal direction.⁵⁵ It means making the institutions and decision-making procedures work as a huge new polity (not as a collection of clubs), and to make it more legitimate, accountable and transparent. The time for fuzzy compromises runs out. The polarisation model is at work here again too, with the same logic that the evolution of monetary regimes has exemplified so clearly. The choice becomes increasingly categorical, between 'in' or 'out'. The 'half-in' option still exists, but its nature also changes. 'Half-in' means to be a policy-taker, but not a policy-maker. Such a system can work technically. It may be viable for the weak states of Eastern Europe that aim at EU accession in the long-term. But it does not look sustainable for an ultra-advanced European democracy like Norway.

⁵⁵ An interesting French perspective on this issue is found in Lamy and Pisani-Ferry [2002]. This draws the conclusion that the underlying trend in the EU is centripetal, and that the issue is to make the huge EU polity work. But it is also interesting to note that this is consistent with the British government's position, which recognises that one has to be in everything if one's voice is to count. The Swedish and Danish warming towards the euro upon the introduction of the currency in January of this year may also be seen as part of the centripetal tendency.

The analogue of an *escalator* may be used to represent the continuing movement of the European integration process, which in the EU is now of huge proportions in all of three dimensions: first, with the forthcoming enlargement, secondly, with new policy competences and, thirdly, with the institutional or constitutional reform of the EU's governance. It is not yet clear where all this is going to end up, but it is clear that the movement of the escalator is strong and sustained.

To work with the analogue of the escalator, one might imagine three theoretical options for Norway:

- '*Stop*'. This would follow from a view that the EEA and other EU relationships had proved more entangling than anticipated. Accordingly Norway would seek to put its relationship with the EU into a 'stand still' mode, and stop a process of creeping integration that was difficult to control democratically. There would be no wish to regress to a more isolationist position. But this would amount to trying to stand still on a moving escalator, which is not so easy.
- '*Reverse*'. This would reflect a more strongly negative view of the EEA and other relationships with the EU in terms of its encroachment on Norwegian sovereignty, coupled with a realisation that the 'stand still' idea would not be easy to implement. There would be a wish therefore to revert to a simpler and more independent situation. It would imply getting off the escalator, and then standing still or even take some steps backwards, in both cases backwards *relative* to the EU escalator.
- '*Forward*'. This would reflect a view that Norway should not at all disconnect itself from the profound trends of contemporary Europe, and that it was an illusion to suppose that Norway could have a satisfying future outside it. This would mean therefore moving with the escalator. Nevertheless, there is a spectrum of possibilities to consider under this heading. One could stay on the escalator, but stand still on it, thus keeping an even distance from the EU. One could advance on the escalator, gradually catching up with the EU. One could alternatively step off the escalator, but move in parallel with it. One could, of course, move sharply forward and join with the EU on the same step of the escalator, meaning full accession. Finally, many EU candidate states are running up the escalator, overtaking

Norway, and other states from Eastern and South-East Europe may also jump on the escalator and try to move up it too.

These options are so far expressed in terms of vague political sentiments, which are not operationally precise. To assess their technical and political feasibility, they have to be defined in policy-operational terms.

7.1 Stop

Definition: Get off the escalator. Freeze the EEA relationship, refusing extension of new EU single market legislation into EEA law, leaving open possibilities for non-legally binding and easily reversible 'cooperation'. In other areas, such as justice and home affairs, and foreign, security and defence policy, Norway would abstain from entering into new commitments where it did not have a full and equal role in policy-shaping and decision-taking.

Comment: While the idea of sticking to the status quo may sound appealing, on closer inspection it has drawbacks. First, by refusing to pass new EU single market laws into the EEA, there will be a break-up of the principle of integrity and homogeneity of the single market. Moreover the continuing flow of new EU legislation in single market and related fields is substantial, not trivial. Security of market access for the future would lose credibility, which is important in decisions by enterprises on long-term investments. Even the present EEA regime leaves open a political uncertainty factor, with some evidence that this reduces the attractiveness of Norway as an investment location.⁵⁶ Secondly, there would be problems with the other EEA states, to the point that the EEA itself might break up. Thirdly the political message communicated by such a policy would adversely affect the goodwill that Norway can profit from in negotiations with the EU. In an extreme case, the EU could exercise its right, which all EEA partners have under Article 127, to withdraw from the EEA giving one year's notice.

7.2 Reverse

7.2.1 Back to EFTA + WTO

Definition: Get off the escalator and take some steps backwards. Quit the EEA and revert to the free trade regime between EFTA and the EU as it was before the EEA, retaining WTO membership and the 'most favoured

⁵⁶ See Section 3.1 above.

nation' regime, or miscellaneous free trade arrangements with other WTO members.

Comment: This would be one possible reaction to the realisation that freezing the EEA relationship presented difficulties. It would be perceived in the rest of Europe as running against the trend, since all non-EU member states are seeking from the EU either full accession or deeper agreements of partnership or association. Such a choice would not be contested as Norway's legal, sovereign right. But it would mean withdrawing from a Treaty commitment of the highest international legal standing, and require negotiations with both the EU and the other EEA states. Norway could find itself with less advantageous arrangements. There would also remain the question of the stock of EEA legislation that has entered Norwegian law. Presumably such legislation would remain, except where there was an interest in reversing or amending it. Norway's wishes to associate with the EU in other ways, for example in the areas of foreign, security, defence and justice and home affairs policies, would be viewed with considerable scepticism and little enthusiasm.

7.2.2 Revert to the Swiss model

Definition: Get off the escalator, and take a few steps backwards, then forward again. Quit EEA and negotiate with the EU bilaterally the most convenient set of sector-specific agreements, following the model of Switzerland after its referendum had rejected the EEA Agreement.

Comment: This model may at first sight seem much more attractive than the preceding scenarios. It is advocated by the *Nei til EU* ('No to EU') movement in Norway. However this proposal also has drawbacks.

First, there may be some illusions over what the so-called Swiss model actually represents. The intention was to find the most advantageous relationship with the EU consistent with the referendum result, which was apparently a vote against an excessively fast or wide or deep integration with the EU. In fact; Switzerland has reverted to a dynamic process of building up its relationship with a growing number of sector-specific agreements. Three are in force, to be joined by seven more in a few months, and another ten for which talks have been initiated.⁵⁷

⁵⁷ The three bilateral agreements currently in force concern a *free trade agreement*, *scientific and technical cooperation*, and *transit*. The seven new sector agreements cover *free movement of persons*, *air transport*, *overland transport*, *agriculture*, *technical barriers to trade*, *public procurement markets* and *research*. In July 2001, Switzerland and the EU initiated preliminary talks on

Secondly, it would be an illusion to suppose that Norway could just negotiate the items it found attractive. The EU has developed a clear aversion to so-called ‘cherry picking’ tactics by its negotiation partners, and has insisted on matching a number of Switzerland’s favoured dossiers with a number of the EU’s favourites. The EU also insisted on a clause whereby default by either party on its obligations under one agreement will render the whole set legally dissolved. The EU’s reluctance to make ad hoc agreements of this kind is now being intensified by the current enlargement process, where the EU has to apply pressure on the candidate states to conform with the whole of EU law. The EU might well therefore not agree with Norway to a repeat of the so-called Swiss model, except maybe under more severe terms.

Thirdly, Switzerland has not withdrawn its request for accession; it has only suspended its active pursuit. Even so, from an institutional point of view, Switzerland now enjoys a *less strong sovereign position* than the EEA states, since it has no equivalent to the EFTA Surveillance Authority and Court. Instead it is more often required to take EU law and jurisdiction directly.

7.3 Forward

The variants here range widely from a relatively technical updating of the EEA in the light of experience and developments in EU policies, through to the extreme hypothesis of full accession to the EU.

7.3.1 Update EEA for new EU laws

Definition: Stand still on the moving escalator. Continue to accept new EU legislation in the single market field, adding to the EEA law and commitments, preventing an opening up of a gap between the EU and the EEA.

Comment: The EEA is now continuously adopting new EU legislation in the single market area. This process will go on indefinitely, and the institutions of the EEA (Joint Committee, EFTA Surveillance Authority, EFTA Court, etc.) are at work executing this.

opening new negotiations in ten additional areas, concerning services, pensions, processed agricultural products, environment, statistics, media and education, vocational training and young people, domestic security, fight against fraud and taxation on interests.

7.3.2 Associate with other new EU policies

Definition: Again, stand still on the moving escalator. Seek to associate bilaterally with new EU policy developments outside the EEA Treaty, including foreign, security and defence policies, and Schengen and justice and home affairs.

Comment: For Schengen and the fast-developing wider justice and home affairs pillar of the EU, an issue for Norway is how far new policy developments are determined by the EU to be ‘Schengen-related’ (and therefore easy for Norway to accede to), and how much are ‘not Schengen-related’. In practice, the EU seems to be taking a restrictive view of what is ‘Schengen-related’, because of its general interest in embodying this new field fully into EU legal and institutional structures. This means that Norway has to negotiate further ad hoc association agreements or treaties (as it does currently with Europol, Eurojust, asylum and the arrest warrant, etc.). For foreign policy Norway has major operational interests in common with the EU, the Balkans and the Middle East. With the EU becoming a more active player in these regions, there is every reason for Norway and the EU to work closely together. For the new European defence policy initiative, Norway is already part of the NATO Six (non-EU members), for whom association is being worked out. This process has recently been held up by the difficulty for the EU and NATO to reach agreement with Turkey over the use of NATO assets by the EU. This problem may be solved, but it does illustrate the risks and uncertainties of the associate relationship, compared to full membership.

7.3.3 Upgrade, revise or renegotiate EEA-EU relationships

Definition: Move up the escalator, getting closer to the EU. Theoretically there could be several possibilities, ranging from the minor to the very substantial, for example: 1) use existing mechanisms of consultation more actively; 2) revise the EEA Agreement for legal-technical updating; 3) seek an enhanced political dialogue between EU and Norway in all areas of common interest; 4) upgrade the EEA Agreement to give enhanced access to EU policy and decision-shaping; and 5) renegotiate the EEA Agreement, so as to integrate all the new association arrangements in a comprehensive new treaty.

Comment: These theoretical possibilities can be assessed one by one, but overall there seems to be little scope for something that would be both substantial for Norway and acceptable for the EU.

1) While there may be scope for activating some of the mechanisms more effectively, for example the joint EEA-EU Parliamentary Committee,⁵⁸ there is likely to be resistance on the EU side to a significantly expanded EEA participation in consultative committees, especially working groups of the EU Council. This is because the EU is under pressure internally to try and limit its '*comitologie*', in order to achieve a more efficient demarcation of roles between the institutions in the interests of democratic transparency and accountability.

2) The Maastricht and Amsterdam Treaties changed the legal bases of certain EU policy domains on the edge of the single market, such as culture, environment, consumer protection and public health, bringing them more fully into EU jurisdiction. This has led to some divergence between the EEA and EU legal bases, and therefore the risk of erosion of the homogeneity of the EEA economic environment. One noticeable example concerns environmental matters. Since the requirement in the Amsterdam Treaty to include an environmental dimension in all policy areas was introduced, the EU has made significant progress in ways not mirrored in the EEA states. But revision of the EEA Agreement would be a very onerous procedure, requiring ratification by all parties. One idea is to take the occasion of the next enlargement to accommodate a revision of the EEA Treaty, and to add on amendments resulting from the Maastricht and Amsterdam Treaties. Nevertheless, the EU will be reluctant to do anything that might complicate and delay the EU enlargement ratification procedures.

3) The idea of enhanced political dialogue with Norway, bilaterally rather than at EEA level, has an objective rationale, because of Norway's impressive set of special interests and strengths: third largest oil exporter in the world, significant aid donor on a world scale, respected contributor to international conflict prevention and resolution diplomacy, reliable NATO partner offering now a significant contribution to the EU Rapid Reaction Capability, and an important relationship with Russia. The EU and Norway could consult systematically on this range of foreign policy interests, for which the EEA formats are not well suited. Norway has some bilateral political dialogue sessions with the EU, but they are thin and few (compared to Russia for example).

⁵⁸ See for example the comments made by Norwegian parliamentarians to the Government's report on Europe, available at <http://www.stortinget.no>.

4) The Schengen system sees Norway and Iceland participating more deeply in the policy-shaping of the EU Council (seat and voice in meetings of officials and ministers) than in the EEA. The idea of upgrading the role of EEA states in EU policy-shaping has been advocated by Iceland, but is certain to raise serious reservations on the EU side. The only reason why the Schengen system is more favourable in this regard than the EEA is that Norway and Iceland joined Schengen before its integration into the EU system, and because of the prior passport union of the Nordic states. The EU will be wary of creating new precedents of this type. Active candidates for EU accession are first in line for getting positive responses to such requests, as seen in the decision to include not only the ten most advanced accession candidates, but also Bulgaria, Romania and Turkey, in the Convention initiated at Laeken in December 2001, to the exclusion of Norway and Switzerland.

5) The idea of seeking to renegotiate the EEA Agreement, in order to have a comprehensive new treaty embracing all the associations (EEA, Schengen, JHA, CFSP, ESDP), and to harmonise upwards institutional links on the Schengen model for ‘policy-shaping’, may have a certain logic to it, but is even more implausible. The EU reply to such ideas would probably be quite simple: ‘by all means, request accession to the EU if you like’. Taking an initiative to renegotiate the EEA Agreement runs the risk, in the words of former Norwegian State Secretary for Foreign Affairs, Espen Barth Eide, of ‘opening a dam of counter-demands from southern European EU countries that for a long time have been irritated by parts of the Agreement’ [*Aftenposten*, 9 September 2001]. For our part, we would not discount this observation.

7.3.4 Full EU membership

Definition: Self-evident – step up the escalator to join the EU.

Comment: This issue is sufficiently debated within Norway, such that it is not useful for the present report to evaluate this option, except with a few remarks. Clearly the option of full membership still exists, although the EU will itself be wary about taking in candidate states that may be deeply divided over the issue. Full EU accession would ease the problems of marginalisation, and lack of democratic legitimacy, transparency and accountability of the EEA relationship. As an EU member state, Norway would of course have a full and equal voice alongside all other member states, big and small, in many aspects of EU decision-making. Even where decision-making is by qualified majority vote in the Council, Norway’s vote would be about double its population weight, and coalitions of small states can easily form blocking minorities in the EU.

More generally it is observed that the small member states at work in the EU can often have a more than proportional influence in their domains of special interests (e.g. in Norway's case energy, fisheries, shipping ,etc.) It is still a matter for speculation what the EU's Convention and next Intergovernmental Conference in 2004 will do to the EU system. The pressure will certainly be in the direction of greater constitutional simplification and clarification of the EU system, with a view to improving its democratic legitimacy, transparency and accountability.

Traditional cost-benefit analyses over EU accession are often presented in economic terms, and it should not be forgotten that EU accession would indeed entail a substantial net contribution to the EU budget. However such calculations ignore some concerns for future generations of Norwegians, which may be rising in importance as the EU matures as a political and societal entity. The EU has now become a huge networking system, increasingly involving professional people from almost all sectors of the economy, political system and civil society. Even in the (non-EU) international organisations, one observes increasing tendencies for key positions to be subject to proposals for manning by EU candidates. Although Norwegians are able to participate extensively in these networks through the multiple association arrangements, it is likely to increasingly have the appearance of second-class participation, as they will find themselves excluded from the full range of opportunities now open to cosmopolitan young Europeans. This may at some stage come to have a disturbing effect on Norwegian society's sense of mission and identity, even while Norway manifestly retains the material possibilities to be rich and secure economically.

7.3.5 Expand the EEA into Eastern Europe

Definition: Others jump on the escalator. Increasingly there are demands from East European states to be progressively integrated with the EU, even without being accession candidates. For example new ideas for a 'Common European Economic Space' are already being explored by the EU and Russia. While the content of this initiative is not yet worked out, the similarity of the language to the EEA is striking, and the idea of re-expanding the EEA in this context may be considered.

Comment: The centripetal effects of the huge Economic and Monetary Union of the EU are likely to continue, and this will most importantly concern the three major states of Eastern and South-East Europe – Turkey, Russia and Ukraine. For Turkey, enlargement negotiations may begin even in 2003 (as Turkey requests). While full accession is unlikely for many years, a conceivable interim measure might be for Turkey to

integrate progressively into the single market, beyond its present customs union relationship. This would tend to make Turkey a 'virtual member' of the EEA. In the case of Russia, ideas for a 'Common European Economic Space' are already being explored with the EU, with a mandate from summit level. One possible approach might be to divide up the legal commitments under the EEA into several blocks, with a timetable for their progressive adoption by Russia. In addition Russia and the EU are already developing an 'energy dialogue', of obvious interest to Norway. Ukraine for its part seeks a new association agreement with the EU.

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Annex A. Participation by the EEA States in European Community Programmes

Research and technological development

- Fifth RTD Framework Programme (FP5)

Information services and security of information systems

- European digital content on the global networks and to promote linguistic diversity in the information society (eCONTENT)
- Promoting the information society in Europe (PROMISE)
- Promoting safer use of the Internet

Environment

- Accidental or intentional marine pollution
- Community framework for cooperation to promote sustainable urban development

Education, training and youth

- Cooperation in the area of education and youth policy (preparatory measures)
- Second phase of the Community action programme in the field of education 'Socrates'
- Community action programme for youth
- Promotion of European pathways for work-linked training, including apprenticeship
- Second phase of the Community vocational training action programme 'Leonardo da Vinci'

Social policy

- Preventative measures to fight violence against children, young persons and women (DAPHNE)
- Community framework strategy on gender equality

Consumer protection

- General framework for Community activities in favour of consumers

Small and medium-sized enterprises (SMEs)

- Multi-annual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises

Audio-visual sector

- Training programme for professionals in the European audio-visual programme industry (MEDIA-Training)
- Measures to encourage the development of the audio-visual industry (MEDIA Plus)

Civil protection

- Civil protection programme (II)

Culture

- Community framework programme in support of culture

Energy programmes and environmentally-related energy activities

- Multi-annual programme for the promotion of renewable energy sources in the Community (ALTENER II)
- Multi-annual programme for the promotion of energy efficiency in the European Union (SAVE II)
- Multi-annual programme of studies, analyses, forecasts and other related work in the energy sector (ETAP)

Public health

Rare diseases

Prevention of drug dependence

Action plan to combat cancer

The prevention of AIDS and certain other communicable diseases

Health monitoring

Health promotion, information, education and training

Injury prevention

- Pollution-related diseases

Telematic interchange of data between administrations

- Interoperability of and access to trans-European networks for the electronic interchange of data between administrations (IDA)

Statistics

- Policy on statistical information concerned with non-member countries

Source: EFTA Secretariat: <http://secretariat.efta.int>

Annex B. Norway and the EU Agencies

	Established	Norway's role
1. European Centre for the Development of Vocational Training	1975	Observer
2. European Foundation for the Improvement of Living and Working Conditions	1975	None
3. European Environmental Agency	1990	Full member
4. European Training Foundation	1990	None
5. European Monitoring Centre for Drugs and Drug Addiction	1993	Observer
6. European Agency for the Development of Medicinal Products	1993	Observer
7. Office for Harmonisation of the Internal Market	1993	None
8. European Agency for Safety and Health at Work	1993	None
9. Community Plant Variety Office	1994	None
10. Translation Centre for the Bodies of the European Union	1994	None
11. European Monitoring Centre on Racism and Xenophobia	1997	None
12. European Agency for Reconstruction (in the Balkans)	1999	None
13. Europol	1999	Associate
13. European Food Safety Authority	2002	Association requested
14. European Maritime Safety Authority	2002 ?	Association requested
15. European Aviation Safety Authority	2002 ?	Association requested
16. European Police College	2002 ?	?
17. Eurojust	?	?
18. European Railway Safety Authority	?	?

Sources: Europa website (http://europe.eu.int/agencies/carte_en.htm), *Financial Times*, 13 December 2001. Council of the EU [2001e].

Annex C. Status with the EU of 38 Non-Member States of the Wider European Area, 2002

Association agreement	Other agreement with EU	Short-term EU candidate	Longer-term EU candidate	Not candidates for EU membership	
		European Conference (including invited states)			
		Convention on the Future of the European Union			
European Economic Area	Schengen+ ESDP 6				Iceland Norway
					Liechtenstein
Europe Agreements	ESDP 6	Czech Republic Hungary Poland			
	ESDP 15	Estonia Latvia Lithuania Slovenia Slovakia			
	ESDP 15		Bulgaria Romania		
Association agreements	ESDP 6		Turkey		
	ESDP 15	Cyprus Malta			

Stability and Association Agreements				(Albania) (Macedonia) (Bosnia) (Croatia) (Yugoslavia)		
Euro-Med association agreements						Israel Morocco Palestinian A Tunisia (Jordan) (Algeria) (Egypt) (Lebanon) (Syria)
Multiple agreements				Switzerland*		
Partnership and Co-operation Agreements					Ukraine Moldova Russia	
						Belarus Armenia Azerbaijan Georgia

Notes: (): Agreement not yet in force. *ESDP 6*: European non-EU NATO members. *ESDP 15*: *ESDP 6* + EU accession candidates that are not members of NATO.

* Switzerland has 3 bilateral agreements with the EU currently in force. Another 7 agreements are expected to enter into force in spring 2002.

Annex D. Norwegian Trade Statistics, 2000

Norway's trading partners:	Exports		Imports	
	NOK billion	% total exports	NOK billion	% total imports
Total	528	100.0	302	100.0
EU-15	405	76.8	189	62.5
10 EU-candidates	7	1.5	7	2.5
EFTA	3	0.7	4	1.4
US and Canada	70	13.3	33	11.0
Japan	8	1.7	15	5.2
Russia	1	0.3	7	2.4
Developing world	25	4.9	42	14.0

Norway's trade by commodity	Exports		Imports	
	NOK billion	% total exports	NOK billion	% of imports
(GDP = 1 424 NOK billion)				
Total exports/imports	528	100	303	100
Petroleum	335	63.4	9	3.8
Crude oil	284	53.4		
Natural gas	52	9.8		
Other raw materials	8	1.5	21	7.1
Food stuffs	33	6.3	18	5.8
Fish	30	5.7		
Chemical products	25	4.7	27	9.0
Processed manufact.	59	11.2	43	14.3
Non-ferrous metals	31	5.9		
Machinery & transport	50	9.5	135	44.6
Industry			24	7.9
ICT			28	9.2
Road vehicles			25	8.3
Other processed goods	13	2,5	45	14.8

Source: Norway's Official Statistics, Statistisk Sentralbyrå: <http://www.ssb.no>.

Annex E. Contributions by EEA States to the EU Structural Funds

The EEA Agreement established a Financial Mechanism, initially for the five-year period 1994-1998, whereby financial assistance to poorer regions of the EU is provided by the EEA states (Part VII (Articles 115-117) of the EEA Agreement). The amounts to be provided and the regions in the EU eligible to receive funds are listed in Protocol 38.

The financial assistance initially took the form of interest rate rebates on loans by the European Investment Bank and direct grants, also disbursed through the EIB. The volume of loans eligible for interest rate rebates was set to 1.5 billion ECU for a five year period from the entry into force of the EEA Agreement, and the rebates were fixed at 2% per annum. Direct grants amounted to 500 million ECU, also for a five-year period. Greece, Portugal, Ireland, and certain regions in Spain are eligible for this assistance.

The bulk of the assistance under the Financial Mechanism was provided by the European Commission, as it took over the shares intended for the EFTA states (Austria, Finland and Sweden) becoming EU members. In the period 1994-98, Norway provided approximately 112 million euro through the Financial Mechanism, almost 20% of the total amount provided, or 95% of the contribution from the three EEA states.

The disbursement period of the Financial Mechanism ended at the end of 1998. After lengthy negotiations between the EU and the EEA states, it was decided in May 2000 to replace the 'Financial Mechanism' with a 'Financial Instrument' for the 1999-2003 period, to be financed in its entirety by the EEA states. There are no interest rate rebates included in the Financial Instrument, only direct grants. Approximately 120 million euros will be provided as direct grants during the 1999-2003 five-year period. At 20-25 million euro annually, or approximately 0.015% of GDP, Norway's contribution remains more or less the same as it was under the previous Financial Mechanism.

According to Article 108 of the EEA Treaty, the EEA states also finance the costs of the EFTA Surveillance Authority and the EFTA Court.

Annex F. Technical Barriers to Trade

The following table compares the treatment of technical barriers to trade in a range of different regional agreements and the WTO multilateral regime. There is a general trade-off between on the one hand effective market access, in which goods are not restricted unduly by mandatory technical regulations, voluntary standards or conformance assessment measures, and on the other hand national policy autonomy.

At the one end of the spectrum stands the EU *acquis*, based on harmonisation with the 'new approach' to technical barriers, including partial harmonisation and mutual recognition. This approach depends on the availability of harmonised voluntary standards, common conformance assessment procedures, common standards of accreditation of assessment bodies, effective regulatory cooperation between national bodies and last but not least confidence in the ability of the regulatory bodies in other countries. At the other end of the spectrum is the WTO system which provides for transparency, although not very effectively, and national treatment in the application of mandatory technical regulations and conformance assessment. Harmonisation is limited, although there are international voluntary standards (ISO, IEC) and national regulators have considerable policy autonomy. In between these two lies a range of other options, in particular mutual recognition of conformance assessment. This is not the same as mutual recognition, in the sense that products must still comply with the importing country's regulatory requirements. But the products can be tested in the exporting country and thus avoid the costs of double testing. This is for example broadly the approaches adopted by the United States in the Canada-US FTA, and to a lesser extent NAFTA.

The EU covers virtually all products, especially since the introduction of the 'new approach' directives, which cover whole categories of products. There is either harmonisation or mutual recognition. In the case of the latter, products sold in one market may be sold elsewhere in the Single Market without further testing or approval. National approvals are based on common minimum essential requirements and common conformance and assessment procedures. All conformance bodies must be attested as meeting these standards. Under Art. 36 EEC [new number], it is possible to deviate from these rules, for example, by setting higher standards, but such a move can be challenged under European law. The rules have direct effect. Member states decide on technical regulations (i.e. minimum requirements) and the national standards-making bodies participate in

technical bodies such as CEN and CENELEC in electrical sectors. While there are still some difficulties with the operation of mutual recognition, the approach has been generally recognised as the most effective means of maintaining standards whilst keeping markets open.

The EEA, which takes on the whole EU *acquis* is virtually the same as the EU. The EEA may jointly opt out of a new piece of EU legislation by not adopting a directive setting out technical regulations, but in practice the EEA has with some time-lag introduced all new measures. There is no direct effect under the EEA. The only major difference between the EEA and EU membership is that the EEA governments do not participate in decisions on legislation, although national experts participate in the consultation process. The national standards-making bodies are full members of CEN and CENELEC and vote on the adoption of voluntary European standards.

In summary, the EEA provides companies in the its jurisdiction with guaranteed access to the EU market on a par with all other EU producers.

The Swiss-EU bilateral agreement on technical barriers to trade is less comprehensive in coverage. The agreement covers all the key manufacturing sectors including in particular those covered by the ‘new approach’ directives (i.e. machines, toys, pressure vessels, personal safety equipment, etc.) and important sectors such as cars and telecommunications equipment. But other sectors, such as building products, some chemicals and fertilisers are not covered. Under the bilateral agreement Switzerland can choose whether to harmonise its technical regulations and standards with those of the *acquis*. But the benefits of mutual recognition of conformance assessment with the EU/EEA are only available where it adopts the EU *acquis*. In practice Switzerland has decided to harmonise its technical regulations with the EU (law of 1996 on *Technische Handelshemmnisse* laying down the aim of harmonising with its ‘major trading partners’). Swiss producers only benefit from mutual recognition of conformance assessment. This means that only in the harmonised sectors, where Swiss and EU regulations are the same, can producers dispense with double-testing. In the non-harmonised sectors, i.e. those in which the new approach applies, Swiss producers only benefit if Switzerland harmonises its regulations with those of the EU *acquis*. Enforcement differs from the EEA also in that this is overseen by a Joint Committee and is based on trust and cooperation between the parties. There is no legal redress should market access be denied by a technical barrier to trade. Switzerland has no access to EU decision-making on the *acquis*, although Swiss standards bodies

participate in CEN and CENELEC. Access is less assured than under the EEA. Coverage is determined by specific agreements, which take time to negotiate. In some sensitive sectors this means that access may be denied during critical phases of market development. Effective access can only be assured when Switzerland adopts the EU *acquis*, but the Swiss have no say in the shape of that *acquis*.

Moving further down the spectrum of effectiveness, but with greater scope for policy autonomy, there is the US-EU mutual recognition agreement. This is of the same type as the EU-Swiss agreement, in that it pursues the mutual recognition approach. But the US has no centralised system of accreditation of conformance assessment bodies, and makes much less use of international voluntary standards, than for example does Switzerland. So coverage has been limited to a few sectors such as pleasure crafts, medical equipment and telecommunications equipment. Compared to the intra-EU system, mutual recognition agreements outside Europe are likely to be less effective because of less trust and cooperation between national entities and fewer common approaches to non-tariff barriers.

Finally the WTO offers essentially national treatment for technical regulations and conformance assessment. Coverage is comprehensive but national treatment by itself has been shown to offer inferior market access accorded by mutual recognition of conformance assessment and especially full mutual recognition. There is encouragement for mutual recognition under the WTO and a non-binding code of conduct for national (voluntary) standards bodies. But as these are less binding constraints, there is much greater scope for national policy autonomy. Such autonomy will however tend to reduce market access.

Comparison of regimes for technical barriers to trade

	European Union	EEA	EU-CH	EU-US MRA	WTO
Coverage	Comprehensive, <i>acquis</i> covering harmonised and new approach directives	comprehensive follows the EU <i>acquis</i>	significant coverage but less than EU <i>acquis</i>	selective approach, at present only three sectors covered	Framework agreement
Degree of harmonisation	High degree of harmonisation of technical standards, conformity assessment and accreditation systems, but mutual recognition avoids full harmonisation	High degree of harmonisation of technical standards, CA and accreditation but mutual recognition	High degree of harmonisation required before mutual recognition of conformance assessment is applied/ no mutual recognition of regulatory policy	moderate to limited/ limited application of international standards, conformance assessment standards vary except in narrow field	Limited/ national treatment with regard to technical regulations and conformance assessment/ code of conduct for standards bodies
Scope for national policy discretion	very limited to exceptions provided under Art. 36 EEC	Limited to exceptions as per <i>acquis</i> / plus possibility of not adopting new EU directives	Limited in areas in which CH seeks mutual recognition/ option of not including sectors	Considerable	Considerable

Enforcement method	EU law with direct effect	EU law through EFTA court	Bilateral committee effectiveness depends on trust and fairness	Bilateral committee	General WTO dispute settlement for non-compliance with national treatment
Scope to influence the norms (tech standards/conformity assessment and technical regulations)	Full for EU technical / regulations/full in European standards bodies and conformance assessment	Consultation on EU technical regulations/full in European standards bodies and conformance assessment standards	None with regard to EU technical regulations/full in European standards bodies (must accept EU regulatory norms to gain effective access)	None in bilateral with the US which would insist on its national standards	Membership of ISO can shape international standards
Effectiveness in terms of market access	Good but still some difficulties with mutual recognition	Good, difficulties with MR as in EU, limited backlog implementing EU <i>acquis</i>	Moderate access only assured when CH mirrors EU regulations	Limited	Limited

Annex G. Public Procurement

The rules for public procurement are another key element of the Single Market system, accounting for some 8% of GDP. As for technical barriers to trade, general international framework agreements for public procurement, such as the Government Procurement Agreement (GPA) negotiated during the GATT in the 1970s and revised in 1994 during the Uruguay Round, have had little practical impact on market access. Even within the EU this is a sector in which national preferences have proved difficult to counter. All FTAs and integration agreements with any ambition to tackle regulatory or structural barriers to trade cover public procurement.

In public procurement the range of options between the EU and multilateral GPA is less pronounced, mainly because the GPA is based on agreement between the EU and the US. Where the EU differs is in its coverage, which is comprehensive, compared to the more select, reciprocal coverage of the GPA and other agreements on procurement in FTAs. The EEA follows the *acquis* and is therefore also comprehensive in its coverage.

The EU-CH agreement builds on the GPA by enhancing the coverage to include, for example, telecommunications equipment, rail and ski-lift equipment, all local government (cantonal purchasing above the set thresholds) and purchasing by companies that have concessions or benefit from special or exclusive rights granted by the state. The latter is important. The EU *acquis* includes such companies, because it is felt that if private companies depend on government grants or concessions or other rights, the government can make an extension of the concession or right dependent on the company purchasing from a national champion. The extensive of coverage in the EU-CH agreement brings it very close to the EU *acquis*. Monetary thresholds, procedures and disciplines are based on the EU *acquis*, which is the same as the GPA in all cases where coverage overlaps.

Compliance under the EU-CH agreement is essentially the same as under the EU *acquis*, in that it also contains a bid-challenge procedure for aggrieved companies. There is in addition monitoring at the national level in Switzerland by an independent agency, a task that mirrors the role of the Commission in promoting open competitive tendering in the EU.

Comparison of regimes for public procurement

	European Union	EEA	EU - CH	GPA	WTO
Coverage sectors	Comprehensive, central and local government as well as utilities whether public or private	<i>EU acquis</i>	GPA plus all local government covered as well as telecoms, rail and purchasing by companies with special and exclusive rights	Selective coverage by sector, most central government but less local and state govt.	Negotiations on agreement
Coverage thresholds	Essentially based on GPA of 1994	<i>EU acquis</i>	<i>EU acquis</i>	Set thresholds for coverage	
Transparency	High for procedures and tenders	<i>EU acquis</i>	High	High	Under discussion
Harmonisation of procedures	Something less than full harmonisation i.e. compliance procedures in utilities vary	<i>EU acquis</i>	GPA procedures, which are essentially the same as the EU	GPA procedures which were agreed between the US and EU	n/a
Harmonisation of standards	Requires use of European or international standards	<i>EU acquis</i>	<i>EU acquis</i>	Requires use of internatn standards if available	

Scope for policy discretion	Flexibility in procedures, i.e. scope for selective and negotiated contract awards	EU <i>acquis</i>	Equivalent to position in the EU, end to EU 3% price preference and 50% EU value added preference in telecoms	Less coverage means more scope for local preferences, but bid challenge exists
Enforcement	'Bid challenge' and monitoring by Commission, but no contract suspension	EU <i>acquis</i>	Bid challenge and monitoring by independent Swiss authority	Bid challenge but no contract suspension
Scope for influencing the regional or international norms	Full participation	Participation in expert working groups	Shape rules in the GPA	Shape GPA rules
Effectiveness	Moderate	Moderate	Moderate	Poor

Annex H. Investment Regimes

Right of establishment, or national treatment with respect to any regulatory provisions concerning foreign direct investment, is an important element in any integration agreement. In addition to the EU *acquis*, which provides for full right of establishment, and the EEA, which offers equivalent treatment, there are multilateral rules under the OECD, as well as some coverage of establishment under the GATS agreement.

There is no EU-CH bilateral on investment, which is probably one of the larger gaps in coverage of the seven bilateral agreements negotiated in 1995-96. It is not clear how much impact the absence of any such agreement has, however, since all EU and EEA countries are pursuing liberal policies with regard to investment. If one EU member state makes difficulties for a Swiss company seeking to establish itself in the EU market, all the Swiss company has to do is move to another more liberal EU member state. However Swiss investors lack the direct access to remedies that are available under EU law with direct effect. In sectors not covered by the OECD or GATS, such as energy, Swiss investors may also be discriminated against by EU member states. If the economic costs in terms of exclusion from EU markets for a few Swiss investors are likely to be small, so are the economic benefits from retaining national policy autonomy over sensitive sectors at home.

Within the OECD, most restrictions on foreign direct investment and review processes for inward investment have been removed. This has been in part due to efforts within the OECD (i.e. the OECD Codes and National Treatment Instrument, which though not binding has helped establish a de facto right of establishment in covered sectors) but also due to unilateral decisions of governments to remove restrictions in order to attract foreign investment.

The importance of the EU and the EEA rules in this area are therefore less than in some other policy areas, such as the cross-border provision of services. However, legally binding rules provide a guarantee against any reversal of liberal policies. The OECD provides such a ratchet mechanism and although this is less legally binding than the MAI would have been had it been negotiated, the OECD provides a reasonable guarantee that developed countries within Europe will not revert to controls on inward investment.

Comparison of regimes for investment

	EU	EEA	EU-CH	OECD	GATS/WTO
Coverage	Comprehensive	EU acquis, but a few exceptions e.g. fishing vessels in Norway	Not covered (but see under air transport in Annex I)	Selective coverage with sensitive sectors such as energy and air transport excluded	Selective, positive list coverage, with exemptions e.g. shipping and air transport
Scope for discretion/national prefs	Very limited	Very limited	Considerable	Some scope but pressure to reduce	Considerable scope but current negotiations will reduce
Enforcement	Direct effect	Remedies under EEA	n/a	Peer pressure among governments	WTO dispute settlement
Scope to influence regional/global norms	EU policy has tended to follow unilateral liberalisation	Limited	n/a	Reasonable	One of 144 WTO members
Effectiveness	Liberalisation likely even without EU rules	Full access to EU	De facto access to EU	Has prevented re-introduction of restrictions on investment	Impact in sectors such as telecoms and financial services

Annex I. Air Transport

Air transport liberalisation has lagged behind the creation of the Single Market because of the desire of member states of the EU to protect national carriers, the lack of coordinated policies governing the use of airspace and a patchwork of bilateral agreements between Member States and third countries. EU proposals now envisage the progressive liberalisation of air transport to include all eight freedoms.⁵⁹ To date progress has been slow towards achieving this aim. One of the main limitations on further liberalisation has been the lack of liberalisation of landing slots. Here the Commission has made proposals to prepare the way for liberalisation of slots by requiring that they be allocated by independent bodies (independent of national airline interests). It also proposed measures to promote the harmonisation of air traffic control and to create a single European sky. The aim of the EU is to liberalise air transportation not only within the EU, but also within the wider European area with neighbouring countries. Finally, the Commission seeks to apply competition rules to air transportation, especially in the field of 'near mergers' in the shape of alliances.

Air transport provides one example of where the EU-Swiss bilateral agreement has gone further than the EEA. The bilateral agreement applies the existing EU *acquis* in terms of legislation aimed at establishing a single European sky. There are also provisions to include Switzerland in any new legislation. It remains to be seen whether the distinction between the EEA and CH-EU agreements will make much of a substantive difference. The European Commission has already acted against mergers between EU airlines and airlines in third countries (British Airways and American Airlines), so it is difficult to believe that it will not act if anti-competitive practices develop in other countries neighbouring the EU. The Commission has in any case sought powers to apply EU competition policy in such instances.

⁵⁹ 1st freedom: overflight. 2^d landing rights for non-commercial reasons. 3^d freedom right to carry passengers from home airfield to an airport in another country. 4th freedom right to carry passengers on the return flight. 5th freedom right to carry passengers from home field to an airport in another country and then to a third country and pick up passengers in the second country. 6th freedom carry passengers from second country to home country and then to another third country. 7th freedom right to carry passengers from second to third country. 8th freedom right to carry passengers on an internal flight in another country (cabotage).

Comparison of regimes for air transport

	EU	EEA	EU- CH	Bilaterals	GATS
Coverage	Liberalisation of 8 freedoms, but landing slots still controlled	EU <i>acquis</i> ; with provision and expectation that the EEA will adopt new legislation	Adopts the existing EU <i>acquis</i> at the time of signature of the bilateral agreement: with Joint Committee to decide on new legislation. CH has right to introduce new national legislation	Open skies policies shaped by US	Some limited liberalisation possible in existing GATS negotiations covering air cargo
Investment	Right of establishment	Right of establishment	Right of establishment	Retention of national controls, e.g. in US	Investment in airlines excluded from GATS
Harmonisation	Moves to harmonise air-traffic control in EU	Follows EU <i>acquis</i>	Follows EU <i>acquis</i>		
Relations with third countries	Efforts to bring international air transportation under EC competence	EEA countries have freedom to negotiate bilaterals with third countries	CH has right to negotiate with third countries but must cooperate with EU		

Competition	Commission controls anti-competitive practices and state aid (although not fully effective)	Competition rules governing anti-trust, abuse of market dominance and state aid applied by the ESA	EU applies Arts. 85 and 86 to air transport for the EU and CH. CH law applies to purely CH travel and travel with third countries/ prohibition of state aid implemented by Commission and Swiss authority	EU competition policy will claim/have jurisdiction over international mergers affecting intra-EU air travel	
Enforcement	European Court of Justice	EFTA Court	Joint Committee, scope for suspension in cases of non-compliance	Retaliation	Not covered by WTO rules

Annex J. Determinants of the NOK Exchange Rate

In order to assess the determinants of the krone exchange rate, we undertook a simple OLS regression. As a dependent variable we considered monthly percentage changes in the krone-ECU/euro exchange rate defined as a difference between the logarithms of the average monthly exchange rates. As the independent variables we used the percentage changes in the krone-dollar exchange rate, the Swedish krona-euro exchange rate, the pound-euro exchange rate and the oil prices (UK Brent), defined in the same way as the dependent variable. The data cover the period from January 1980 to September 1999.

The NOK/EUR exchange rate seems to be highly correlated with the SVE/EUR exchange rate. There also appears to be a relatively significant correlation between the krone and pound sterling. By contrast, the developments of the krone exchange rate seem to be independent of the development of the oil prices. Also, the movements of the krone vis-à-vis the US dollar do not seem to explain the changes in the krone-ECU/euro exchange rate. The results of the regression are reported below.

Explanatory variable	Coefficient (t-Statistics)
Constant	$9.05 \cdot 10^{-5}$ (0.14)
NOK/USD changes	0.04 (1.40)
SVE/EUR changes	0.29 (7.70)
GBP/EUR changes	0.12 (3.31)
Crude oil price changes	$-9.85 \cdot 10^{-4}$ (-0.13)
Adjusted R	0.25
Standard Error	0.01

The regressions done on the sub-samples of the data confirm the relative stability of the results over time. The relationship between the Norwegian krone and Swedish krona remains highly significant over the whole observed period. The prices of crude oil persistently show no impact on the Norwegian exchange rate. The evidence concerning the NOK/USD exchange rate and GBP/EUR exchange rate is somewhat ambiguous. Over the whole period, the pound is statistically significant in explaining

the fluctuations in the Norwegian exchange rate with the exception of the mid- and late 1980s. Over the 1990s, the significance of the pound has increased. The US dollar played a role in certain time period, but overall its impact is insignificant.

T-statistics

	Overall	80- 83	84- 87	88- 91	92- 95	96- 99	92- 99	88- 99
NOK/USD			++	+		++		
SVE/EUR	++	+	++	++	++	++	++	++
GBP/EUR	+	+			+	++		
OIL								

Notes: + denotes a probability between 0.01 and 0.05 that one finds a statistically significant relationship; ++ denotes probability of less than 0.01 that one finds a statistically significant relationship; blank fields represent non-significant values.

Appendix K. Exchange Rate Instability and the Norwegian Unemployment Rate

The analysis was performed using the changes in the unemployment rate, with a simple OLS regression of this variable on its own past and the measure of exchange rate variability during the previous year (ER variability (-1)) over the period 1981-2000. The results reported below are standard causality tests on annual data. The exchange-rate variability of the Norwegian krone was measured by taking for each year the standard deviation of the 12 month-to-month changes in the logarithm of the nominal exchange rate of the NOK against the euro.

The analysis discovered an outlier for the year 1989, which was caused by a jump in Norwegian unemployment rate of 2 percentage points from the original 3.5% during the deep recession of late 1980s and early 1990s. After introducing a dummy variable for this period, the regression showed a relatively good fit.

Explanatory variable	Dependent variables	
	Change in unemployment rate	Percentage change in employment
Constant	-0.43 (-1.85)	1.18 (2.40)
Lagged dependent variable	0.40 (2.41)	0.73 (4.57)
ER variability (-1)	0.46 (2.06)	-1.15 (-2.33)
Dummy (1989)	1.42 (2.57)	
Adjusted R	0.54	0.51
Standard error	0.50	1.07

Exchange-rate variability has a significant impact on unemployment in Norway. Given that only one lag of exchange-rate variability turned out to be important, one can use the t-statistics directly, to check for the significance of the effect. The value 2.06 is marginally significant. The point estimate implies that a reduction in the exchange-rate variability measure by one percentage point reduces unemployment after one year

by 0.46 percentage points. Therefore, if Norway hypothetically eliminated all exchange-rate variability vis-à-vis the euro, one could argue that Norwegian unemployment could decrease by almost roughly 0.5 percentage point if the starting level is about 1.0% per month) for ER variability in 2000. Taking into consideration that the unemployment rate in Norway was 3.4% in 2000, this would mean a significant drop of about 15%. However, when comparing the regression results to those we obtained in the case of Germany (Gros and Thygesen, 1998), one has to stress that the level of significance of the exchange-rate variability is much lower. Also the point estimate is somewhat lower. This can be explained by relatively lower integration of Norway in the European economy (see Section 3.4.1 on OCA indicators).

A similar story emerges when one performs the same test on the rate of employment creation (defined as the percentage change in the number of employed persons). A simple OLS regression of this variable on its own past and on exchange-rate variability during the previous year (ER variability (-1)) has proved the significance of the exchange rate variability on the Norwegian labour market. The t-statistics on ER variability (-1) is marginally significant as it slightly exceeds -2. Again, compared to the results for Germany, the values are considerably lower. Also in this case one has to conclude that the elimination of exchange-rate fluctuations stemming from the adoption of the euro could have a potentially significant impact on the growth of employment in Norway.