

GENERAL AGREEMENT ON TARIFFS AND TRADE

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ACCESSION OF ICELAND TO EFTA AND FINEFTA

Questions and Replies

In GATT/AIR/801 of 22 May 1970, contracting parties were invited to submit questions with regard to the accession of Iceland to EFTA and FINEFTA.

In reply to the invitation, a number of questions were received and transmitted to the members of EFTA and Finland. The questions and the replies prepared by the members of EFTA and Finland are reproduced hereunder.

I. GENERAL

Question 1: What proportion of Iceland's overall external trade will be covered by the Iceland EFTA Agreement?

Reply: About 40 per cent of Iceland's external trade is trade with the EFTA countries and Finland, and consequently is covered by the arrangements agreed for Iceland's accession to EFTA and FINEFTA.

Question 2: What contemplated effect will the Agreement have on the development and diversification of the economy of Iceland?

Reply: As is well known, the Icelandic economy is heavily dependent on fishing and fish processing. In other sectors, industry concentrates almost exclusively on the home market and in most branches companies are small. Given that the population of Iceland is only a little over 200,000, it is obviously essential for the future development of the economy that industrial operation be concentrated to an even greater extent in those branches where Iceland possesses (or can develop) a comparative competitive advantage.

As long as the economy operated behind relatively important tariff walls, the incentive towards specialization was of course greatly reduced. At the same time, unilateral tariff reductions would have been disastrous, since they would have turned the terms of trade against Iceland, something which the country could ill afford.

Accession to EFTA, therefore, provides Iceland with a double opportunity. On the one hand, the greater competition from other EFTA members will stimulate industry to specialize in those branches where a clear advantage exists, while on the other hand

easier access to the markets of Iceland's EFTA partners provides the most efficient branches of industry with the sales possibilities needed to make this specialization profitable.

Without detailed investigation of comparative costs of each industry in Iceland and in other countries both inside and outside EFTA, it is of course quite impossible to assess exactly how this process towards greater specialization and efficiency will develop. But there is every reason to believe that the opportunities given to the Icelandic economy through its accession to EFTA will enable it to diversify away from excessive reliance on fish and fish products and to do this in those sectors which offer the greatest chances of long run success.

Question 3: Is the effect of this Agreement anticipated to be trade creating or trade diverting? Why?

Reply: The extent to which trade creation or trade diversion occur cannot, of course, be judged ex ante, but only some time after the tariff reductions have taken place. However, it is the belief of the EFTA Member States and Finland that the net result of Iceland's accession to EFTA will be trade creation. The elimination of tariffs between the present members and Iceland will reduce prices for products traded within the Area concerned so that trade will be created by the increasing competitiveness of Area products as against domestic products.

There are also other advantages which a member of a regional free-trade area obtains. Indeed, the possible disadvantageous effects of trade diversion are balanced by a number of advantageous effects which could not be obtained if trade diversion were not present. These advantages in turn, by promoting a better allocation of resources and a better economic growth would also benefit third countries who trade with the free-trade area. Three further favourable elements could be mentioned:

- (a) The potential improvement in the Member countries' economies arising out of the rationalization of industrial production which the free-trade area is designed to create will increase prospects for a higher standard of living which will in turn lead to demand for more goods from outside the free-trade area.
- (b) The creation of a free-trade area also provides an opportunity for moving towards greater equality in marginal rates of transformation in production for the countries in the free-trade area; this provides a further increase in welfare.
- (c) Finally, and this applies especially to a small country like Iceland, freer trade has important dynamic implications. A country joining a free-trade area becomes increasingly more outward looking and individual industries develop a more dynamic attitude, even if only because of the need to adapt themselves to the new circumstances, including to opportunities offered by a wider market.

Furthermore, the possibilities of importing raw materials and semi-manufactured products (and perhaps also certain investment goods) may help to overcome, through greater imports, some of the restraints on growth resulting from a given country's particular problem of scarce resources.

II. TARIFFS

Question 4: On what percentage of Iceland's external trade with EFTA Members will duties be eliminated?

Reply: Slightly below 95 per cent of Iceland's imports from EFTA countries and Finland consist of industrial products and, therefore, are subject to the provisions of either Article 3 or Article 6 of the Convention, as applied to Iceland, concerning the elimination of import duties or of the effective protective elements in revenue duties on products originating in the Area. Statistics regarding the respective proportions of Icelandic imports, which at the time of accession fell under one or the other of these two Articles are not available. Since the elimination of Icelandic duties shall be completed only by 1980, i.e. at the end of the transitional period, during which a significant change is expected to occur in these proportions as a result of the industrialization and diversification of the Icelandic economy, it would not be possible, even if statistics relating to the present time were available, to give a reasonably sound estimate regarding the size of the respective proportions in 1980.

About 55 per cent of Iceland's exports to EFTA countries and Finland consist of industrialized products, which, on the conditions set out in the Convention, as from 1 March 1970, benefit from the elimination of import duties or from the elimination of the effective protective elements in revenue duties in the other Member countries. As a result of the industrialization and diversification of the Icelandic economy, which Iceland's membership of EFTA will contribute to bring about, this percentage is expected to increase considerably in the course of the transitional period.

Question 5: Iceland reduced its duties on certain categories of goods entering from all countries with which it has most-favoured-nation relations at the time it acceded to EFTA.

We understand that duties (on raw materials) were reduced by 50 per cent while duties on machinery were reduced to 7 per cent. How is the category raw materials defined for this purpose? With respect to the general reduction on machinery, does it apply to all types or only to selected items?

Reply: For the purposes of Iceland's entry into EFTA, customs duties were divided into three categories:

1. protective duties;
2. duties on raw materials and machinery;
3. fiscal duties.

With respect to the second category reductions were made on a most-favoured-nation basis and raw materials were defined so as to mean materials used in productive processes in Icelandic industry at the time of the classification. As a general rule, those duties were reduced by 50 per cent. Duties on special machinery used in Icelandic industry were generally reduced to 7 per cent. The reduction was selective in the sense that it applied to machinery in use by Icelandic industrial branches at the time of classification.

Question 6: What will be the consequence for third countries if Iceland increases its duties for development purposes?

Reply: In deciding whether to avail itself of paragraph 3 of the Accession Decision, Iceland will be governed by the international obligations which she has undertaken at the time such decisions are to be made. As far as third countries are concerned, these obligations are not affected by the said provision of the Accession Decision, as explicitly follows from Article 37 of the Convention, and the consequences for third countries, therefore, will depend upon the content of Iceland's obligations towards these countries. As a consequence of the ceiling imposed by sub-paragraph 3(a)(ii) of the Accession Decision, such increases of most-favoured-nation duty rates in Iceland will, however, not be higher, on an ad valorem basis, than the normal level of import duties applied in the most-favoured-nation tariff of Iceland at that time to similar products produced in Iceland. The EFTA Member States and Finland do not consider that Article XXIV:5(b) limits their freedom subject to Article XXVIII to increase duties subsequent to the formation of the free-trade area. But it is certainly not Iceland's intention to pursue a high tariff policy, on the contrary.

III. FISCAL

Question 7(a): Is the same meaning to be given to the term "effective protective element" in Article 6, paragraph 3, of the Agreement as was given to the term in 1960?

Reply: Yes.

Question 7(b): when the "effective protective element" in internal taxes or other charges is eliminated is it intended that similar taxes or charges will be eliminated at the same time for imports from non-member countries?

Reply: Iceland has informed her partners that so far no Icelandic internal taxes have been found to contain an "effective protective element". As for revenue duties, Iceland, like the other EFTA Member States and Finland, recognizes no obligation to remove the protective element in such duties, except in the case of imports from Member States.

Question 8: Is it envisioned that certain revenue duties on imports from other Member States will be in effect? Is it intended that goods from Member States and from third countries will be accorded equal treatment with respect to revenue duties?

Reply: Yes, it is envisaged that certain revenue duties on imports from other Member States will be in effect, as is the case in most of the original Member States. It is intended that goods from Member States and from third countries will be accorded equal treatment, except insofar as any effective protective element is removed only in respect of imports from Member States.

IV. QUANTITATIVE RESTRICTIONS

Question 9: On which products has Iceland as of the date of accession abolished quantitative import restrictions? What is the schedule for the removal of other remaining quantitative restrictions?

Reply: As from the date of its accession to EFTA, Iceland, on a GATT-wide basis, abolished quantitative import restrictions on whale meat etc., roasted chicory etc., lemonade etc., coal, coke etc., gas carbon, reconstituted wood etc., casks and barrels etc., certain building board, paper boxes and cases, certain boxes of paperboard, certain ladies' stockings, certain drums, certain used cars, arms and ammunition etc., works of art etc. The full details of this list are set out at Annex III to BOP/102.

As stated by the Icelandic representative in the Committee on Balance of Payments Restrictions (see BOP/R/38), Iceland will remove globally the remaining quantitative restrictions on industrial imports, except some petroleum products, and brushes made by the blind, by the end of 1974. In the intervening years, Iceland will gradually enlarge existing import quotas for these products. These liberalization measures will be implemented on a GATT-wide basis.

Question 10: How are the discriminatory quantitative restrictions granted to Iceland for lamb and mutton, by Denmark, Sweden, Finland and Norway consistent with Article XXIV:2?

Reply: The concessions for lamb and mutton given to Iceland by the four Scandinavian countries are an integral part of the free-trade arrangements agreed with Iceland for her accession to EFTA and FINETFA. According to paragraph 4 of Article XXIV the purpose of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories. In the opinion of the EFTA countries and Finland, the lamb and mutton arrangements are in conformity with this provision. According to sub-paragraph (b) of paragraph 5 of Article XXIV "the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of a free-trade area to the trade of contracting parties not included in such area, shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area". The EFTA countries and Finland consider the arrangements agreed for

Iceland's accession to EFTA and FINEFTA, including the agricultural arrangements, to be in conformity with this provision, as well as with sub-paragraph (b) of paragraph 8 of Article XXIV.

Question 10 (cont'd): Are other EFTA countries contemplating extending discriminatory quantitative restrictions to Iceland?

Reply: No.

Question 10 (cont'd): What effect will these discriminatory quantitative restrictions have on imports from third countries?

Reply: In the Nordic markets as a whole, consumption of mutton and lamb traditionally has been relatively modest, consumer preferences for other types of meat having been very pronounced. Over recent years, however, an increase in consumption of mutton and lamb has been recorded on the Nordic markets. Thus, on the Swedish market, consumption of these meats increased by 50 per cent in the course of the nine months' period 1 July 1969 to 31 March 1970. Although it is of course impossible to foresee with any precision what will be the future development in the individual markets, it seems reasonable to assume that the quotas granted to Iceland will not in the medium term lead to a reduction of imports from third countries, who will in all probability get a share in the growing consumption of mutton and lamb in these markets taken as a whole.