

# GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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## AGREEMENT BETWEEN FINLAND AND HUNGARY

### Second Report of the Working Party

1. At its meeting on 31 October 1975 the Council adopted a report of the Working Party on the Agreement between Finland and Hungary, covering the meeting held in September/October 1975 (L/4230), and agreed that the Chairman of the Working Party, in consultation with delegations and in the light of further experience, should fix an appropriate time for the further examination of the Agreement (C/M/109).
2. Following consultations with delegations the Working Party met on 9 and 11 May 1977 to continue its examination under the terms of reference agreed by the Council at its meeting in February 1975 (C/M/103), as follows:

To examine, in the light of the relevant provisions of the General Agreement, the provisions of the Agreement between Finland and Hungary signed on 2 May 1974; and to report to the Council.
3. The meeting was chaired by the secretariat.
4. The Working Party had before it the text of the Agreement, which had been circulated earlier with document L/4136/Add.1. The Working Party also had additional documentation including recent trade statistics supplied by the parties to the Agreement in documents L/4488 and Add.1 and L/4492.

#### I. GENERAL CONSIDERATIONS

5. In an introductory statement the representative of Hungary pointed out that thirty-nine questions concerning the Agreement were put to and answered by Hungary and Finland. This formed the basis of the meeting of the Working Party held on 29 September and 1-3 October 1975. At the meeting further questions were put to and answered by the two parties to the Agreement. As additional information to the data supplied earlier, the representative of Hungary gave the following statistical data as to the effect of the Agreement. Taking imports in 1974 as 100 per cent, Hungarian imports from Finland amounted to 141 per cent in 1975, and to 134 per cent in 1976.

During the same period, total Hungarian imports from contracting parties decreased to 95 per cent and 93 per cent respectively. As for Hungarian imports from Finland, the imports of commodities contained in List 2 of Protocol No. 2 of the Agreement, the duties of which were to be cut at a slower pace, amounted to 107 per cent in 1975 and 111 per cent in 1976. A much bigger increase, of 257 per cent and 204 per cent respectively, took place in the case of commodities, the duties of which were to be reduced according to the basic schedule of the Agreement. The share of agricultural commodities in Hungarian imports from Finland declined to 1 per cent in 1975, as against 10 per cent in 1974, but rose again in 1976 to 6 per cent of the total imports from Finland. The Agreement covered practically all agricultural imports: in 1974 it covered 98 per cent of agricultural imports, in 1975 and 1976 it covered 91 per cent. On the basis of the above figures, it could be stated that the trade coverage of the Agreement comprised almost 100 per cent of the total Hungarian imports from Finland. The figure for 1974 was 99.9 per cent, for 1975 99.9 per cent, and for 1976 99.5 per cent. In the opinion of the representative of Hungary, the Agreement was in this respect, too, in full conformity with the provisions of Article XXIV of the General Agreement.

6. In an introductory statement the representative of Finland stated that some experience now had been gained as to the operation of the Agreement. Judging from the latest trade figures which had been submitted to the members of the Working Party, the impact of the Agreement on the parties' trade had been positive. The Agreement had been in force more than two years, and thus there was a fairly good basis for drawing conclusions about its effect on the trade between Finland and Hungary, especially as during these two years the major part of the tariff reductions had taken place, and duty-free trade would be established, as a general rule, from 1 July 1977. The trade statistics for 1975 and 1976 showed a positive development. If one compared the growth rates of Finland's total foreign trade and Finland's trade with Hungary, the latter had grown more rapidly during the two years during which the free-trade Agreement had been in force. While total Finnish exports had diminished by 2 per cent in 1975 compared with the preceding year, Finnish exports to Hungary had grown by 22 per cent. In 1976 total exports had grown by 21 per cent, whereas exports to Hungary had increased by 24 per cent. On the import side one could see a similar, although less rapid development. In 1975 total Finnish imports had increased by 9 per cent and imports from Hungary by 6 per cent. In the next year total imports had grown only by 2 per cent, but from Hungary they had increased by 19 per cent. These growth rates were a clear indication of what was taking place in the parties' mutual trade since the Agreement had entered into force. He added that the trade balance, which had been slightly negative to Finland from 1970 to 1974, had turned into a surplus as from 1975. As to the structure of the trade, no significant changes had taken place in the past two years. In fact, the growth had occurred rather evenly in a variety of positions. The representative of Finland concluded by saying that the Agreement had begun and continued to function well, as any other free-trade agreement concluded by Finland and examined in the GATT.

7. One member of the Working Party noted that the statistics furnished to the Working Party by the delegation of Hungary gave a different figure for industrial imports from Finland in 1975 than that shown in the official statistical yearbook published by Hungary, and asked whether different exchange rates had been used in the two cases.
8. The representative of Hungary replied that this issue had been discussed in the Working Party on the Accession of Hungary and said that since 1976 all Hungarian statistics had been published in current forints.
9. One member of the Working Party expressed the view that on the basis of the statistics available it was not possible to evaluate the effects of implementation of the Agreement in Hungary, and in particular the consequences of tariff dismantlement to date. After mentioning some concrete examples in that connexion, he went on to explain why he could not yet form any conclusion as to the nature of the Agreement.
10. The representative of Hungary noted that an item-by-item examination would not be feasible to undertake, and questioned whether the authorities of the delegation which had raised the possibility would welcome a similar examination of free-trade agreements to which they were parties. He said that in any case the Agreement in question had to be examined in accordance with the mandate of the Working Party and should not be treated differently from other similar agreements that had been notified under Article XXIV. He furthermore added that he saw no reason why a free-trade agreement comprising a tenth of a per mille of world trade should be more thoroughly examined than free-trade agreements covering more than 25 per cent of world trade.
11. Another member of the Working Party stated that the present Agreement should not be treated as a special case and that it should be examined in GATT on the basis of the same rules and conditions as applied to other free-trade agreements involving contracting parties.
12. Some members of the Working Party considered that all agreements concluded under Article XXIV should be examined in the same manner, but with regard to agreements involving a centrally-planned economy State-trading country and a market economy or a mixed economy country, they considered that serious and novel questions were raised, which merited serious consideration, although this did not mean that they took the position that such agreements could not under any circumstances comply with the requirements of Article XXIV. Accordingly, they would be interested in determining whether the customs tariff alone influenced trade flows between the parties.

13. The representative of Hungary reiterated his opinion expressed during the previous session of the Working Party, namely, that Hungary, like any other contracting party, had the right to conclude agreements under Article XXIV.

14. Having regard to recent fluctuation in his country's trade with Hungary, which was probably due to conjunctural uncertainties, another member of the Working Party said that it might be necessary to examine the parties' mutual trade over a longer period to determine the effects of the Agreement. Furthermore, in his opinion, the Agreement was not entirely of the same nature as the free-trade agreements examined earlier in GATT. He expressed doubts as to whether the Working Party could, at this stage, arrive at a conclusion as to whether or not the Agreement was consistent with Article XXIV.

15. The representative of Finland stated that his Government was fairly satisfied with the development of the parties' bilateral trade, and that there had been rather little fluctuation in that trade since the Agreement had come into force.

16. Some members of the Working Party considered that agreements presented under Article XXIV involving centrally-planned economy State-trading countries were not entirely the same as earlier agreements examined in GATT. One of them said that the Agreement in question was qualitatively different from other agreements concluded by Finland with some other centrally-planned economy State-trading countries because it did not include an undertaking that Hungary would use the means provided by its economic system which, in addition to customs duties, had a bearing on the access of Finnish goods to the Hungarian market.

17. The representative of Hungary said that Hungary, like any other contracting party, had the right to conclude agreements under Article XXIV, and he added further that stipulations which were not included in the Agreement under consideration could not be examined.

18. The representative of Finland welcomed the keen interest shown by some members of the Working Party towards the Agreement because of certain novelties that it might have. His Government had broken a new path when entering into the Agreement, just as the CONTRACTING PARTIES had done when Hungary had acceded to GATT. He cautioned the Working Party, however, against drawing conclusions based solely on statistics, since trade flows were influenced by many factors, some of which could not always be reflected in the figures.

19. With regard to the statistics furnished by the parties, several members of the Working Party expressed the desire to receive in the future data that would permit a comparison between the parties' mutual trade and each party's total trade.

20. The representative of Hungary said that his authorities were prepared to submit to a biennial examination as provided by the CONTRACTING PARTIES at their twenty-seventh session (SR.27/12, page 167, paragraph 4(c)) for agreements concluded under Article XXIV. There was one single procedure that applied to such agreements; and all those presented to GATT should be treated in the same manner.

21. One member of the Working Party said that his delegation had not been able to determine the provisions of the General Agreement under which the present Agreement actually belonged. He agreed that the Working Party was presently conducting its examination under Article XXIV, but said that thus far no agreement had been reached as to whether that Article of the General Agreement was appropriate.

22. Several members of the Working Party pointed out that the decision mentioned in paragraph 20 did not establish any procedure, but merely a time-table. They considered that agreements between market economy countries and centrally-planned economy State-trading countries raised serious and novel questions which required thorough exploration and which did not exist at the time the referenced Decision was taken.

23. The representative of Hungary said that this statement had no relevance to the subject under consideration. Furthermore, he added that his authorities would not accept any procedures which would impair their full rights under the General Agreement or otherwise be of a discriminatory character.

## II. TRADE COVERAGE

24. Some members of the Working Party expressed reservations about the fact that the Agreement covered only a limited number of agricultural products, and noted the relatively small trade in this sector. They also called attention to a sharp drop in Hungarian agricultural imports from Finland in 1975.

25. The representative of Finland replied that the Finnish authorities recognized the necessity of maintaining the country's agricultural production, which required some protection in the light of geographical factors. He noted that agricultural items represented only about 3 to 4 per cent of Finnish exports, and that small fluctuations could produce notably greater changes in percentage terms. Moreover, Finnish exporters constantly sought the most favourable market, which might not be the same country in two successive years. The representative of Hungary pointed out that from 1974 to 1976 Hungarian agricultural imports from Finland had risen by 40 per cent.

26. A member of the Working Party drew attention to a number of agricultural products covered by the Agreement which might not under normal circumstances be expected to have originated in Hungary. He also noted that statistics supplied by the parties to the Agreement related to the items actually traded and did not shed light on whether imports of additional agricultural products would be liberalized. In this context he regretted that the parties had approached the issue from the standpoint of the products in which trade was permitted rather than from the products in which trade was not liberalized.

27. Another member of the Working Party agreed with this view and said that in order to be compatible with Article XXIV a free-trade agreement should allow for future expansion of the trade coverage. He asked whether there were any prospects for a future enlargement of the scope of the parties' trade in agricultural products.

28. The representative of Finland recalled that the difficulty in establishing free trade in the agricultural sector generally had been discussed earlier by the Working Party, and said that even with the small agricultural trade between the parties, the Agreement nevertheless covered substantially all their trade. He attached little importance to the particular agricultural products singled out by a member of the Working Party, and added that it was too early to judge the prospects for future enlargement of the scope of the parties' agricultural trade.

29. A member of the Working Party noted that between 1973 and 1974, prior to the entry into force of the Agreement, total Hungarian imports from Finland had nearly doubled, whereas in the next two years these imports had risen by 45 per cent and then fallen by 5 per cent. While not contesting the intention on the part of the Hungarian authorities to accord preferences to imports from Finland, he said that these figures made it difficult to establish a correlation between the Agreement and any increase in the parties' mutual trade.

30. The representative of Hungary did not agree that the effect of the Agreement could not be discerned from the statistics supplied by the parties. The representative of Finland expressed satisfaction with the operation of the Agreement.

31. A member of the Working Party drew attention to figures in the 1975 official statistical yearbook published by Hungary, where it was indicated that for a number of industrial products on which the Hungarian m.f.n. duty amounted to 40 per cent, Hungarian imports from third countries had increased noticeably, while imports at reduced rates of products in the same categories from Finland had increased only slightly. He attributed this to factors other than the customs tariff that influenced the selection of imports into Hungary, and said that the operation of the Agreement would have to be examined over a longer period.

32. The representative of Hungary stated that the effect of tariffs could be determined only when all other factors, such as prices, delivery terms, quality, etc. were equal. Only in such cases could the tariff be the only element of decision to choose among various potential suppliers. The representative of Finland said that in the context of another free-trade agreement to which his country was a party, it would be interesting to examine the view that a free-trade area could not be said to be functioning satisfactorily if one party's imports from third countries increased more than imports from the other party.

### III. CUSTOMS DUTIES

33. Some members of the Working Party stated that it was impossible for them to conclude at this stage whether the reduction of duties had affected the development of the parties' mutual trade.

### IV. QUANTITATIVE RESTRICTIONS

34. One member of the Working Party referred to Section C of the publication "Import System of Finland"<sup>1</sup> and asked whether goods from countries other than Hungary would be subject to discrimination in terms of quantitative restrictions.

35. The representative of Finland replied that his country maintained some quantitative restrictions vis-à-vis some Socialist countries but not against Hungary, since such restrictions had been abolished against that country in accordance with the Agreement.

### V. OTHER QUESTIONS

36. One member of the Working Party referred to an article recently published in Hungary stating that for some Hungarian firms export prices were not established by the costs of production but rather by a calculation based on the world market price, which was called a "limit" price. He said that judging from this, customs duties were not the only instrument in Hungarian foreign trade policy, and asked whether input prices were adjusted to meet the desired costs of production after the "limit" prices had been established. He questioned further whether a "limit" export price and a desired cost of production could not be contradictory. In particular, if a Hungarian producer used intermediate goods from Finland in the manufacturing stages, how was the "limit" price of the final goods determined when they were exported? How did the "limit" prices affect competition in external markets? Did they not constitute obstacles to trade? If one party to a free-trade agreement established selling prices without reference to production costs and the

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<sup>1</sup>Circulated to contracting parties with document L/4489.

other party was obliged to accept such goods without the payment of a duty, would this not constitute a discrimination to third-party attempts to trade with the importing country? He concluded by asking for explanation of how the Hungarian State reimbursement system operated, especially in view of Article X of the General Agreement which requires that foreign trade regulations of contracting parties be published and made available to other parties.

37. The representative of Hungary considered that these questions were not relevant to the Working Party's examination of the Agreement. He added that the price limits were not fixed by the Government. The bulk of the Hungarian foreign trade was conducted on a commission basis. In practice the producing companies concluded contracts freely, whereby limit prices were set at what the companies considered the real price to be on the world market. This price constituted the basis for the calculation of the commission. If the products were sold above the limit prices, the contract might provide that the difference between the limit price and the export price fell to the exporting company, i.e. the agent. As far as the State refund system was concerned, the representative of Hungary referred to the discussion on this point in the report of the first meeting of the Working Party (L/4230, paragraph 29). He added that all laws and regulations pertaining to the Hungarian foreign trade system were published in accordance with Article X of the General Agreement.

38. A member of the Working Party asked for references to those provisions in the Hungarian foreign trade régime that pertained to sub-paragraphs 3(a) and (b) of the Protocol for the Accession of Hungary. In his view there was a contradiction between these two sub-paragraphs and their application in the operation of this Agreement.

39. The representative of Hungary replied that this question had been clarified during the discussion in the Working Party for the Accession of Hungary and referred to paragraph 7 of its report<sup>1</sup> which contained a summary of this discussion.

40. One member of the Working Party referred to two Hungarian legal texts, Regulation No. 55/1975 of the Ministries of Finance and Foreign Trade concerning State refunds, and Notification No. 328/75 of the Ministries which allowed inter alia State allocations, reduction of taxes and State refunds. He asked for the amount of subsidies, in the form of tax reductions applied to exports to Finland, paid in accordance with these two decrees and which products were subsidized in this way.

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<sup>1</sup>20 BISD 35

41. The representative of Hungary replied that the State refund system was operated in a non-discriminatory way and was fully in conformity with Article XVI of the General Agreement. The Regulation concerned State subsidies; and the only change introduced since the Hungarian accession to GATT had been presented to the CONTRACTING PARTIES at their thirty-first session (SR. 31/2, page 20, Item 17). The Notification concerned a system of tender, permitting firms to seek taxation facilities. This system aimed at stimulating exports to the convertible currencies area and contained no specific preferences with regard to any particular country. He added that a discussion on these decrees fell outside the scope of this examination.

42. The representatives of Finland and Hungary stated that any question of subsidies should be dealt with as a general GATT matter rather than taken up in this particular context which concerned the correct application of Article XXIV, which contained no specific reference to subsidies.

43. Some members of the Working Party did not share the opinion that the question of subsidies would not be relevant to the examination of the conformity of the Agreement with Article XXIV.

#### CONCLUSIONS

44. Several members of the Working Party said that they still could not, on the basis of the available information, express a view on the question whether the Agreement was in conformity with the provisions of Article XXIV. They requested that the Working Party should continue the examination within eighteen months on the basis of additional information then available.

45. The parties to the Agreement, supported by two other members of the Working Party, were of the opinion that the Agreement was in full conformity with the provisions of Article XXIV. They furthermore considered that sufficient information had been given to enable the Working Party to assess the compatibility of the Agreement with Article XXIV and to report its views to the Council. They stated that any further action in respect of the Agreement should be identical with action in regard to other free-trade areas already examined in other working parties and in accordance with the Decision by the CONTRACTING PARTIES relating to free-trade areas concluded under Article XXIV.

46. Several members of the Working Party felt that agreements between market-economy countries and centrally-planned economy State-trading countries raised serious and novel questions which required thorough exploration and which did not exist at the time the referenced Decision was taken.

47. The representative of Hungary stated that the Agreement had been concluded between contracting parties having full rights, under Article XXIV.

48. As the Working Party could not reach any unanimous conclusion as to the compatibility of the Agreement with the provisions of the General Agreement and as to the continuation of its work, it considered that it should limit itself to reporting the opinions expressed to the Council.