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**EMBARGO:**

**NOT TO BE PUBLISHED BEFORE 1300 HOURS GMT 10 FEBRUARY 1994**

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GATT/1610  
31 January 1994

**MANUFACTURING PLAYS CINDERELLA TO AGRICULTURE AND FISHERIES  
IN ICELAND'S SECTORAL ECONOMIC POLICIES**

"Marked differences exist in Iceland's trade and related policies towards agriculture, fisheries and manufacturing," says the GATT Secretariat's report on Iceland's trade policies and practices. "Agriculture has been supported both by subsidies and import restrictions; fishing has benefited from free access without payment to marine resources and other indirect aids; whereas manufacturing has had negligible protection, suffering indirectly from the support to other sectors."

The report points out that Iceland's agricultural policy has been designed to help provide an income level for farmers commensurate with other sectors of the economy and keep rural areas inhabited. "The budgetary cost to the Government and the direct costs to Icelandic consumers, who pay some of the world's highest food prices, are recognized as being considerable. As that cost has become more difficult to bear under weaker economic conditions, efforts have been made to implement policies which will be less costly for the State finances, but which will do little to reduce the direct burden on consumers."

A major agricultural reform programme, started in 1991, has replaced the price support system for agricultural products with direct income support to farmers. In the 1993 budget, aggregate farm support amounted to about 5 per cent of the total. This was a substantial reduction in support, and further cuts are set for 1994. Pressure for change will also increase as a result of growing links with the EEA. "Given that Icelandic agriculture is internationally uncompetitive," says the report, "it would be difficult for a sizeable agricultural sector to survive foreign competition without support."

Support to the fisheries sector is also significant, though less visible. Iceland has a policy of almost total exclusion of foreigners from its fishing grounds, fishing industry and fish-processing activities. The benefits of free-of-charge access to marine resources and governmental support measures have contributed to over-investment in the fisheries industry; overfishing has been common, the actual fish catch often being larger than the official allowed quota, which is frequently higher than the quotas recommended by scientists. As a result, not only has the natural wealth of the country's marine resources been dissipated through over-expansion and overfishing, but non-fisheries industries have been placed at a disadvantage in competing for resources.

Rationalization and structural adjustment programmes have been implemented to try to reduce the capacity of the fishing fleet, estimated to be 30 per cent too large. The EEA Agreement may help improve profitability by eventually eliminating almost 90 per cent of present tariffs. Given Iceland's natural competitiveness in fisheries, the elimination of subsidies and other measures distorting world markets would also be highly beneficial.

Food processing industries have been protected from foreign competition through the same restrictive licensing system protecting agriculture. However, other manufacturing industries, unlike agriculture and fisheries, seem to enjoy no special assistance; the level of support is modest and has declined over time. "Only by freeing the redundant capital and labour now tied up in agriculture and fisheries may manufacturing attain its real potential," stresses the report. "This would be important, as the sector has a valuable stabilizing effect in the economy."

Great hopes are pinned by Icelandic authorities on energy-intensive industries as the basis for the country's future economic development. New projects should eventually add significantly to exports. "However," notes the report, "energy-intensive exports make a much smaller contribution to net foreign exchange earnings and national value-added than fisheries."

According to the report, the EEA should have far-reaching effects on liberalizing Iceland's economy. Although the Agreement applies in principle only to manufactures, a limited number of agricultural products are to be progressively covered. Over time, Iceland's exports may shift even more towards Europe. "It also appears unavoidable that the Agreement will increase the competitiveness in Iceland of products from the EEA vis-à-vis those from other areas, as the latter will face tariffs not encountered by EEA goods."

Unlike most other EFTA countries, Iceland is not planning to apply for membership in the European Communities in the near future, as the EC Common Fisheries Policy is considered incompatible with Iceland's national interest. Moreover, the EEA Agreement is seen as already ensuring the position of Icelandic companies on the European market.

The report emphasizes that Iceland does not see the EEA as a substitute for the GATT multilateral trading system. "As a small country, highly dependent on trade for its well-being, Iceland has a major stake in the successful implementation of the Uruguay Round agreements. Iceland's drive for regional integration should be placed firmly within this framework."

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Notes to Editors

1. The GATT Secretariat's report, together with a report prepared by the Icelandic Government, will be discussed by the GATT Council on 9-10 February 1994. The TPRM enables the Council to conduct a collective evaluation of the full range of trade policies and practices of each GATT member at regular periodic intervals, to monitor significant trends and developments that may have an impact on the global trading system.
2. The two reports, together with a record of the Council's discussion and of the Chairman's summing up, will be published in 1994 as the complete trade policy review of Iceland and will be available from the GATT Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21.
3. The reports cover developments in all aspects of Iceland's trade policies, including domestic laws and regulations, the institutional framework, trade-related developments in the monetary and financial sphere, trade practices by measure and trade policies by sector. Attached are the summary extracts from these reports. Full reports will be available for journalists from the GATT Secretariat on request.
4. Since December 1989, the following reviews have been completed:  
Argentina (1992), Australia (1989 and 1994), Austria (1992), Bangladesh (1992), Bolivia (1993), Brazil (1992), Canada (1990 and 1992), Chile (1991), Colombia (1990), Egypt (1992), the European Communities (1991 and 1993), Finland (1992), Ghana (1992), Hong Kong (1990), Hungary (1991), India (1993), Indonesia (1991), Japan (1990 and 1992), Kenya (1993), Korea, Rep. of (1992), Malaysia (1993), Mexico (1993), Morocco (1989), New Zealand (1990), Nigeria (1991), Norway (1991), Peru (1994), the Philippines (1993), Poland (1993), Romania (1992), Singapore (1992), South Africa (1993), Sweden (1990), Switzerland (1991), Thailand (1991), Turkey (1994), the United States (1989 and 1992), and Uruguay (1992).

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## TRADE POLICY REVIEW MECHANISM

### ICELAND

#### Report by the Secretariat - Summary Observations

During the 1970s and most of the 1980s, Iceland experienced rapid economic growth based on a considerable expansion of the export-oriented fishing sector. Underlying this expansion was an extension of fishing limits, and practices and policies which led to over-investment in the fishing industry at the expense of other activities. Economic growth was also accompanied by high inflation, rising foreign indebtedness and pronounced cycles (dependent on variations in fish stocks) which, however, did not impair full employment. As economic relations became increasingly focused on the EFTA and EC areas, trade with those two areas became dominant.

Iceland is now undergoing difficult macro- and micro-economic adjustments. The Government has introduced restrictive domestic demand management policies and restructured its finances to reduce inflation and service the substantial foreign debt. However, policy options are limited because of the failure to exploit past favourable supply-side and terms-of-trade movements, and the over-exploitation of marine resources. Iceland, like other countries in the north Atlantic, suffers now from the general depletion of fish stocks. Demand for its other exports is weak.

While no major improvement is expected in the short-term, the foundations are being laid for what is hoped to be more sustainable long-term growth. Wide-ranging and overdue structural changes are being made in the financial and taxation systems. A new charter for the Central Bank is undergoing parliamentary scrutiny and exchange rates are now determined in an interbank market, while capital and exchange controls are in the process of being abolished. Privatization of state-owned enterprises and intensified competition policy are being pursued as priority areas. These reforms should help prepare Iceland for membership of the European Economic Area.

Membership in the EEA and implementation of the results of the Uruguay Round are not only likely to require further adjustments, but also to produce fresh opportunities. Conditions appear favourable for a new aluminium smelter to go ahead in due course and there is also the possibility of electricity exports via cable. Such projects have long lead-times and are capital-intensive, but should eventually add significantly to Iceland's exports. Further diversification may come from other manufacturing and service industries. Yet the challenges of managing an economy extremely reliant on variable, limited marine resources, in a sustainable manner, are not likely to disappear.

#### Iceland in World Trade

Iceland's ability to trade rests principally on the exploitation of its rich fishing grounds. Abundant supplies of hydroelectric and geothermal energy support a few energy-intensive plants, notably in processing of (imported) minerals. The exploitation and export of these resources constitute the principal source of foreign exchange.

In 1992, merchandise trade was the equivalent of almost 40 per cent of GDP. Nevertheless, significant segments of the Icelandic economy remain relatively unaffected by foreign trade. This results not only from the natural protection provided by Iceland's location, but also from non-tariff barriers to trade, particularly in agriculture, and limited competitive pressures stemming in part from

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the small size of the market. This situation is, however, changing as the country becomes more integrated in the European economy.

Iceland is in general a low tariff country; indeed, most imports enter the country duty-free, even discounting the preferential access for goods from EC and EFTA sources. Iceland has traditionally followed a Europe-oriented foreign economic policy; its largest partners in foreign trade and investment are the EC and the EFTA group. In 1992, the EC (mainly the United Kingdom, Germany, Denmark and France) accounted for some 77 per cent of Iceland's exports and 49 per cent of its imports; exports to the EFTA group amounted to about 7 per cent of the total and imports from EFTA countries, mostly Norway and Sweden, to 25 per cent. Outside Europe, the United States is Iceland's single most important trading partner, followed by Japan. Trade with other partners is small and highly variable. This regional composition of trade provides the rationale for determining the exchange value of the Icelandic Krona in terms of a basket of currencies in which the ECU weighs 76 per cent, the U.S. dollar 18 per cent and the Japanese yen 6 per cent.

The regional pattern of Iceland's exports has changed significantly over the last two decades. The EC's share of exports rose from just over 40 per cent in 1975 to almost 70 per cent in 1992, principally due to a surge in exports of fresh fish. Significant growth also occurred in exports to Japan. On the other hand, the relative importance of central and eastern European countries (particularly the former Soviet Union) and of the United States as export markets has diminished significantly over recent years. In general, the regional pattern of imports has remained relatively stable during the last two decades, although the former Soviet Union's share has fallen sharply and Japan's has risen steadily.

Although Iceland accounts for a very small share of world trade, it has been for the past 25 years a leader in the export of fish products. In 1992, fish products represented slightly more than 80 per cent of exports and mineral products (mainly aluminium) some 10 per cent. As a result, the balance of payments continues to be vulnerable to changes in fish catches and fish prices.

The import structure shows a predominance of manufactures, with a slight increase in their share over the last 25 years to almost 80 per cent of the total in 1992. Passenger cars are the most significant import followed by machinery, clothing, and ships. The remainder is made up roughly by equal shares of agricultural products (mainly cereals and fruit) and liquid fuels (of which there is no domestic production).

Most foreign direct investment in Iceland is concentrated in the manufacturing sector; an aluminium smelter and a ferro-silicon plant are the two largest foreign investments. Foreigners are barred from investing in the fishing and primary fish processing industries; in contrast, most Icelandic investment abroad has occurred in those two industries. Iceland has until recently maintained restrictive policies on foreign investment, with special agreements made for major foreign direct investment projects. The Government is presently attempting to expand the rôle of foreign investment; with this purpose, the Parliament enacted in 1991 new legislation – the first comprehensive foreign investment legislation in Iceland – to simplify and liberalize investment rules.

#### Institutional Framework

The Republic of Iceland is a parliamentary democracy, with the President and members of the Parliament elected at four year intervals. The Parliament is a unicameral legislature made up of 63 members, elected by proportional representation.

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All laws and agreements must be enacted by the Parliament and submitted to the President for confirmation. National laws prevail over international agreements unless the latter are incorporated by Acts of Parliament into domestic law. The General Agreement on Tariffs and Trade has not so been incorporated; however, GATT provisions are the basis for related Icelandic legislation and Icelandic customary law requires courts to seek to interpret internal law in accordance with international agreements of which Iceland is a member.

The Parliament has 12 permanent committees, whose jurisdictions correspond approximately to the functions of Government ministries. Trade bills are normally considered in the Economic and Trade Committee and, in some cases, the Foreign Affairs Committee.

The Ministry of Foreign Affairs and External Trade is responsible for most aspects of external trade, including trade agreements, and Iceland's relations with international organizations. The Ministry of Industries and Commerce has responsibility over domestic trade and the service sector, including banking. The Ministry of Finance leads in formulating customs and taxation policies. Reporting directly to this Ministry, the Directorate of Customs handles the general implementation of customs law and regulations (including the collection of import duties and various indirect taxes) and advises on tariff and trade-related changes to laws or regulations.

The Ministry of Fisheries oversees all activities in the fisheries sector, including those related to fish exports and imports. The Ministry of Agriculture, with responsibility for Iceland's farm policy and the administration of support to the sector, has considerable freedom to regulate the production, domestic trade, import and export of agricultural products. By law, the Ministry may allow the importation of agricultural products only if approved by the Agricultural Production Board.

Legislation and regulations affecting Iceland's external economic relations have recently come under intensive review, in preparation for participation in the European Economic Area (EEA). One recent, far-reaching outcome of policy reform has been the strengthening of competition policy, which should lead to reduced regulatory barriers to domestic and foreign commerce.

No official independent body exists to advise the Government on trade policy issues and there are no formal procedures for the private sector to influence trade policy, although its views are often considered during the legislative process. Iceland has no independent, statutory review bodies to assess policy developments; however, academic researchers, non-governmental and semi-independent official organizations, such as the National Economic Institute, occasionally review aspects of trade policy.

#### Trade Policy Features and Trends

Given Iceland's considerable dependence on foreign trade, access to foreign markets has been a major foreign policy priority since the establishment of the Republic. The main foci of trade policies in 1993 were integration in Europe and the Uruguay Round; however, importance is attached to maintaining and developing trade links with countries outside EFTA and the EC, particularly the United States, Japan and countries in central and eastern Europe and south-east Asia.

Iceland joined GATT on a provisional basis in 1964, in order to take part in the Kennedy Round. It acceded formally to the General Agreement on 21 April 1968. Iceland has not adhered to any of the MTN Agreements and Arrangements, largely due to constraints on administrative resources, although it will be bound by the "single undertaking" of the Uruguay Round. Iceland

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participated fully in the Round, advocating strengthened disciplines as well as liberalizing and improving conditions for world trade. Given the overriding importance of fish and fish products for Iceland, the authorities supported a sectoral solution based on a zero-for-zero or harmonizing approach

#### Recent evolution

Iceland's tariff schedule was simplified, and certain very high tariffs eliminated, on the introduction of the CCC Nomenclature in 1963. Accession to the European Free Trade Association in 1970 resulted in the gradual reduction, and elimination in 1980, of duties on most manufactured goods imported from EFTA countries. Intra-EFTA trade in fish and fish products was liberalized in 1990. Like other EFTA members, Iceland negotiated a free trade agreement with the EEC, which came into effect in 1973 and extended duty-free treatment status to manufactured goods from the EEC. Iceland adopted the Harmonized Commodity Description and Coding System in 1988, and simultaneously again lowered or abolished many duties.

Iceland accords m.f.n. treatment to GATT contracting parties and non-GATT members. However, m.f.n. treatment for imports has become the exception, rather than the rule, with an increasing share of trade conducted under free-trade-area rules. Major changes in the trading environment will occur with the advent of the EEA, ratified by the Icelandic Parliament in April 1993. The EEA, expected to enter into force on 1 January 1994, should expand free trade provisions to include movement of persons, services and capital. The flow of goods is to be improved through harmonization or elimination of technical barriers to trade, simplification of border formalities and rules of origin, wider access to government procurement and tighter control of unfair trade practices and various types of State aid. Under the Agreement, Iceland accepts all existing and future EC directives and regulations of the Single Market Programme, except those pertaining to the Common Agricultural and Fisheries Policies.

#### Type and incidence of trade policy instruments

Overall, the incidence of m.f.n. tariffs is low, with a simple average of 3.7 per cent. However, across a wide range of agricultural products, tariffs are supplemented by other charges and a variety of non-tariff measures, notably import licences and the operation of trading monopolies. As a result, tariff averages are not representative of the total level of protection granted to agriculture.

Eight positive m.f.n. tariff rates, are applied to manufactured products; five to agricultural products. The highest rate is 50 per cent, applying to only four tariff lines but to one-quarter of all manufactured imports, due to the importance of gasoline imports in overall trade. Although almost three-fourths of all m.f.n. tariff lines are duty free, the spread of tariffs is wide, and higher for agricultural products than for manufactured goods.

Three-quarters of dutiable tariff lines are granted duty-free preferences under the Stockholm Convention and two-thirds under the free trade agreement with the EC. Tariffs on trade in manufactured goods with EFTA and the EC have been practically eliminated; exceptions include gasoline, passenger motor vehicles, and radio and television receivers. Although agricultural products have by and large been excluded from those agreements, a significant proportion of tariff lines are granted a zero preferential rate. As a result, only between 6 and 7 per cent of all tariff lines are not subject to a zero tariff rate. Exceptions are mostly limited to vegetables, some types of gasoline,

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photographic film, tyres, motor vehicles and parts, electric and electronic household goods, and cranes.

About 80 per cent of m.f.n. duties are fully bound at existing levels. The incidence of bindings is considerably lower for agricultural products than for manufactured goods. The discipline of bindings may, however, be undermined by a recent amendment to the Customs Law authorizing the imposition of equalization taxes on imported goods which are processed from agricultural raw materials. These taxes apply to all imports, including those covered by the Stockholm Convention and the EEA Agreement.

M.f.n. tariff protection accorded to finished manufactures in general exceeds the incidence on raw materials, particularly in clothing, rubber and food products. However, the potentially higher effective protection granted through tariff escalation is eroded by the preferential arrangements applying to trade with the EC and EFTA countries. No duties apply to manufactured imports from the EEA under those arrangements, provisions to refund or waive charges on raw materials, components or parts for the production of domestic manufactured goods have become largely redundant. These arrangements, which give protection to EC and EFTA producers against other suppliers, are likely to have contributed to trade diversion away from m.f.n. suppliers.

In addition to a value added tax of 24.5 per cent almost all goods, about 13 per cent of tariff lines, or some 21 per cent of imports, bear non-tariff charges and levies. Excise duties on gasoline and motor vehicles are the most significant non-tariff charges. The excise system has been recently extended to maintain tax revenue after the abolition of tariffs on manufactured goods required under the EEA Agreement. At the same time, m.f.n. tariffs on the goods affected have been reduced. Excise duties do not discriminate among import sources.

In accordance with United Nations resolutions, trade with Iraq, Serbia and Montenegro is embargoed.

Imports of agricultural products are heavily restricted through licences. Generally, such imports are prohibited unless the Agricultural Production Board determines that domestic production does not meet demand. This scheme almost completely insulates locally-grown products from international price signals although, under special provisions concluded under the EEA Agreement, licences on some competing products are suspended during parts of the year. Imports of processed food products are similarly restricted. However, a debate is underway on re-classifying processed food from "agricultural" to "manufactured", which would have the effect of lifting the current restrictions.

Icelandic zoo-sanitary standards appear very strict. The importation of raw meat, unpasteurized milk and eggs is prohibited on zoo-sanitary and public health grounds. In other areas, there is no evidence of technical regulations or national standards being used, in general, to discriminate against imported products. Technical regulations, standards and testing procedures are generally based on internationally accepted norms and recommendations. Most rules on labelling and marking also follow international practices; there is no evidence of differentiation between imports and domestic products, although imports are required to signal their foreign origin. New regulations are being prepared to comply with EEC standards.

State trading is fairly widespread. Fertilizers are imported only by the State Fertilizer Plant under the supervision of the Ministry of Agriculture; alcoholic beverages, industrial alcohol, tobacco,

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and matches are imported by the Liquor and Wine Authority under the Ministry of Finance; electrical line, telephonic, and telegraphic apparatus by the Post and Telecommunications Administration; tree seedlings by the State Forestry Agency; and fresh vegetables by the Agricultural Production Board.

As a result of the EEA Agreement, the Government Purchasing Department has been given responsibility for the procurement of goods and services in domestic and foreign markets for all state institutions and enterprises; exceptions can be made, however, for individual organizations to arrange their own procurement. As a rule, all purchases of goods and services are subject to tenders; no registration requirements other than those stipulated in the EEA Agreement are in place for foreign suppliers bidding on public contracts. Of the purchases by the Government Purchasing Department, about half involved foreign suppliers and some 70 per cent were made through public tenders.

Minimum export prices have been used at times to prevent sharp falls in the price of certain fish types. Export controls ("export planning") apply to fresh fish, to avoid prices falling below the minimum levels fixed by the EC. Herring exports are controlled by a board which, however, appears not to have restricted sales in the recent past. Exports of fresh fish are also monitored for conservation purposes; certain conservation-related provisions seem to favour fish processing in Iceland over processing abroad. Licences are needed for the export of a limited number of fish as well as for some agricultural and manufactured products. Automatic export licences, used for surveillance, are required for the export of certain fish types.

The Government ceased to guarantee minimum prices for exported agricultural products on 1 January 1993. Although two export credit guarantee schemes are in force, neither fund is particularly active. Export promotion is carried out by the Export Council of Iceland, an autonomous Government-financed institution, and by a special levy on turnover. Other export promotion efforts have been minimal and ad hoc (most fish production is marketed through a few, large export organizations).

Cartels as such are not prohibited under Icelandic legislation. However, the law generally prohibits cartels whose effect or aim is to fix prices or other trading conditions, divide markets, or distort the making of offers. Following the acceptance of the EEA Agreement, a new Act on competition has been adopted. The Act is based on the abuse principle and has wide application, covering both goods and services as well as individuals, private companies and public enterprises. The Act does not apply to agreements, terms or actions which are only intended to have an effect outside Iceland; thus, export cartels fall outside the Act's scope. No specific restrictions exist with respect to import cartels either. The Competition Council is the highest administrative organ under the new legislation.

General price or wage controls no longer exist, the main exceptions relating to the prices of primary and agricultural products, cement, the maximum resale price of drugs and medicines, and charges by various public utilities. Price controls in Iceland do not distinguish between imported and domestically produced goods nor between goods intended for domestic consumption and for export.

Those parts of the country where fishing and agricultural activities are predominant are now the focus of regional assistance proposals. The cost of such proposals is modest, but the total resources committed to regional assistance are probably significantly larger as support to both fishing and agriculture has a strong regional element. Other non-sectoral support programmes also aim to promote adjustment and dealing with labour market problems, for example, by encouraging industrial

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research and development or vocational activities. Most credit in Iceland is still channelled through government-controlled institutions and includes a concessional component in the form of government guarantees.

### Sectoral policies

Marked differences exist in Iceland's trade and related policies towards agriculture, fisheries and manufacturing. Agriculture has been supported both by subsidies and import restrictions; fishing has benefited from free access without payment to marine resources and other indirect aids; whereas manufacturing has had negligible protection, suffering indirectly from the support to other sectors.

Agricultural policy has been designed to help provide an income level for farmers commensurate with other sectors of the economy and keep rural areas inhabited. Import licences are generally only granted when shortfalls occur in domestic production. The budgetary cost to the Government and the direct costs to Icelandic consumers, who pay some of the world's highest food prices, are recognized as being considerable. As that cost has become more difficult to bear under weaker economic conditions, efforts have been made to implement policies which will be less costly for the State finances, but which will do little to reduce the direct burden on consumers. However, it is recognized that there will need to be some longer term market opening as a consequence of the implementation of the results of the Uruguay Round.

A major agricultural reform programme put into law in 1991, has replaced the price support system for agricultural products with direct income support to farmers. Most affected are cattle and sheep farming, the traditional and largest agricultural activities in Iceland. The new programme establishes a quota system to adjust annual overall production levels to domestic demand; farmers receive income support proportional to their share in the total quota. The Government is helping adjust production to domestic demand by financing farm buy-outs and paying compensation to sheep farmers whose quotas are phased out. Other assistance to the agricultural sector is provided through various funds channelling subsidies and loans from the Government, as well as levies collected on agricultural products, into various projects in the farm sector.

In the 1993 Budget, aggregate farm support amounted to about 5 per cent of the total, mostly in the form of direct payments to dairy and sheep activities. This was a substantial reduction in support; further cuts are set for 1994. Pressure for change will also increase as a result of growing links with EFTA and the EEA. Although the new income support system brings Iceland closer to the type of farm support pattern envisaged in the Uruguay Round, some opening of the market through substitution (and eventual reduction) of tariffs for the present, almost comprehensive prohibitions would seem inevitable.

Given that Icelandic agriculture is internationally uncompetitive, it would be difficult for a sizeable agricultural sector to survive foreign competition without support. Farmers will, at best, have to live within the constraints of a small domestic market; in all likelihood, the number of farms will fall. Diversification into new farming activities does not offer a comprehensive solution, as first efforts to expand fur and fish farming seem to demonstrate. The Icelandic authorities thus face difficult decisions about the appropriate balance between acceptable levels of long-term income support for farmers and further inter-sectoral adjustment towards a more productive use of the country's resources.

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Although less visible, support to the fisheries sector is also important, Iceland has a policy of almost total exclusion of foreigners from its fishing grounds, fishing industry and fish processing activities. The fisheries sector has benefited from general policies aimed at maintaining the competitiveness of exports (including currency devaluations, privileged access to credit finance, favourable taxation and restructuring assistance. Moreover, free-of-charge access to marine resources has diverted the wealth generated by those resources from the community at large to the fisheries sector.

The benefits conferred through access without payment to marine resources and governmental support measures have contributed to over-investment in the fisheries industry; overfishing has been common, the actual fish catch being often larger than the official allowed quota, which is also frequently higher than the quotas recommended by scientists (especially for cod) As a result, not only has the natural wealth of the country's marine resources been dissipated through over-expansion and over-fishing but non-fisheries industries have been placed at a disadvantage in competing for resources. These distortions might have been prevented through a better management of marine resources, including a system to allow the community as a whole to retain the windfall profits arising from the exploitation of such resources. This could be realized, for example, through a resource rent royalty, or the allocation of fishing rights by auction instead of simply giving them away.

Rationalization and structural adjustment programmes have been implemented to try to reduce the capacity of the fishing fleet, estimated to be 30 per cent too large. A quota system was introduced in 1991 intended to establish property rights and a well-functioning market in which quotas can be traded. Initial results appear promising. A fund has also been established to buy and scrap redundant vessels. The EEA Agreement may provide a respite to Icelandic fishing by eventually eliminating almost 90 per cent of present tariffs. Given the sector's natural competitiveness, the elimination of subsidies and other market distorting measures would be highly beneficial. Nevertheless, rationalization must still take place and reallocating labour and capital resources to other sectors will not be painless.

Unlike agriculture and fisheries, there seems to be no special assistance to manufacturing; the level of support is modest and has declined over time. Food processing industries are major exceptions as, so far, they have been protected from foreign competition through the same restrictive licensing system protecting agriculture. The combination of low assistance to manufacturing with considerable support to fisheries and agriculture has had the ultimate effect of diverting resources away from manufacturing. Only by freeing the redundant capital and labour now tied up in agriculture and fisheries may manufacturing attain its real potential. This would be important, as the sector has a valuable stabilizing effect in the economy.

Great hopes are pinned on energy-intensive industries, which are seen as providing the basis for Iceland's future economic development. However, energy-intensive exports make a much smaller contribution to net foreign exchange earnings and national value-added than fisheries because most raw materials and equipment are imported.

#### Temporary measures

Iceland has taken no safeguard action under Article XIX of the GATT against imports and measures have been taken in only one case against allegedly dumped or subsidized imports. Iceland has not made use of, nor has it been subject to, dispute settlement procedures under GATT or the Tokyo Round Agreements.

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There are no remedies or retaliatory measures, in Icelandic legislation that allow recourse to measures not covered by the GATT. The Anti-dumping Code has not been adopted by Iceland, although Icelandic law on anti-dumping and countervailing measures reflects Article VI of GATT and Iceland would accept Uruguay Round disciplines on their adoption. No regulations have yet been promulgated, but guidelines are now being formulated.

#### New initiatives

Since Iceland's acceptance of the EEA Agreement, the alignment of the country's trade-related regulations with those of the EC has intensified. Partly as a result, the Government is implementing a number of reforms aiming to improve the functioning of the economy. An ambitious privatization programme begun in 1991 is intended, inter alia, to widen share ownership, encourage the development of a domestic stock market, and raise revenue. Privatization is, however, being approached cautiously, as it is believed that there is little to be gained by replacing a State monopoly with a private one.

A Bill has been submitted to Parliament to amend the Act on foreign direct investment by the immediate abolition of restrictions on investment by non-residents in domestic airlines, of authorization requirements on investments in excess of ISK 250 million per annum and of reciprocity requirements. The limit of 25 per cent on investment by non-residents in domestic commercial banks will be lifted on 1 January 1996, when the energy sector will also be opened up for investment from the EEA area. Restrictions on foreign ownership of agricultural land will be relaxed under the terms of the EEA Agreement.

The authorities are also introducing new legislation to make the single main objective of the Central Bank of Iceland to maintain the value of the Icelandic krona and promote price stability. The Bill proposes to increase the independence of the Central Bank by eliminating most provisions for ministerial consent to its decisions, and by strengthening the Board of Directors and the Board of Governors. The Bill, which did not complete its parliamentary process in the 1992 session, is to be reintroduced in autumn 1993.

Since May 1993, the exchange rate of the krona has been determined in an organized inter-bank market. A new Act and regulations on foreign exchange have liberalized foreign exchange procedures, although some financial transactions, mostly short-term capital flows, remain strictly regulated.

Widespread reforms of the financial sector are underway, including liberalization of interest rates, elimination of automatic access to Central Bank facilities by commercial banks, establishment of a securities exchange and leasing operations, and the development of secondary markets for public and private bonds. Banking activities are being rationalized and proposals are under consideration to reduce the widespread use of Treasury guarantees, a practice which has, inter alia, seriously distorted the structure of interest rates.

Changes have been recently made to harmonize the tax system with those in the EC, as Iceland's tax structure was seen as unbalanced and not well suited to increased competition with Europe. The corporate tax burden has been reduced and personal tax rates risen to European levels.

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### Trade Policies and Foreign Trading Partners

Iceland became a member of EFTA in 1970. On its accession, Iceland gained immediate duty-free access to markets in the EFTA for all products covered by the Convention, including aluminium and certain fish products. In return, Iceland agreed to abolish its protective duties on the import from EFTA countries of practically all manufactured products. Full liberalization of intra-EFTA trade in fish occurred in 1990. Like other EFTA countries, Iceland negotiated a free trade agreement with the European Economic Community, which came into effect in 1973. The agreement covers only trade in manufactured products but it also provides, through a special protocol, for tariff reductions on certain fish products.

Iceland and the other EFTA countries have concluded bilateral agreements with Bulgaria, the Czech and Slovak Republics, Hungary, Israel, Poland, Romania and Turkey. Iceland has also signed a free trade agreement with the Faroe Islands and Denmark.

The EEA Agreement should have far-reaching effects on liberalizing Iceland's economy, but may cause greater trade diversion. Although the Agreement applies in principle only to manufactures, a limited number of agricultural goods are to be progressively covered. Protocol 9 of the Agreement secured Iceland's interest in fish exports by reducing EC tariffs on fish and fish products. Returns to the fishing industry should increase as a result (if stocks are permitted to recover) and, over time, Iceland's exports may shift even more towards Europe. It also appears unavoidable that the EEA Agreement will increase the competitiveness in Iceland of products from the EEA vis-a-vis those from other areas, as the latter will face tariffs not encountered by EEA goods.

More generally, the Agreement should give Iceland access to a much greater pool of capital and reduce interest rates. Icelanders may also be able to take greater advantage of foreign labour markets to adjust to domestic fluctuations. Benefits will also flow from the removal of technical barriers, from cheaper intermediate services, from efficiency gains in the distributive trades sector, and from the opening up of air and other transport services.

Iceland, unlike most other EFTA countries, is not planning to apply for membership in the European Communities in the near future, as the EC Common Fisheries Policy is considered as fundamentally incompatible with Iceland's national interest. Moreover, the EEA Agreement is seen as already ensuring the position of Icelandic companies on the European market.

On the other hand, the Icelandic Government does not see the EEA as a substitute for negotiations in the GATT to improve the multilateral trading system. Iceland participated actively in the Uruguay Round and as a small country, highly dependent on trade for its well being, it has a major stake in the successful implementation of the Uruguay Round agreements. Iceland's drive for regional integration should be placed firmly within this framework.

**TRADE POLICY REVIEW MECHANISM  
ICELAND**

**Report by the Government - Summary Extracts**

**TRADE POLICIES AND PRACTICES**

**Introduction**

Iceland is at 103,100 km<sup>2</sup> the second largest island in Europe, with a small population of about 260,000. It thus represents the most sparsely populated country in Europe, the present average density being 2.5 inhabitants per square kilometre. A high standard of living has been achieved in the post-war period, with per capita GDP standing at about US \$25,000 (1991).

The move away from subsistence towards a modern and diversified high-income society was led by the fishing industry. The rich fishing grounds around the country, the Icelanders' nautical skills, investment in modern technology and favourable world markets all helped to make fishing a high-productivity industry in Iceland.

The fishing industry, including both fisheries and fish-processing, has throughout this century been the driving force of economic development. It presently provides for about 17 per cent of GDP, occupies 12-13 per cent of the work force, and generates 75-80 per cent of merchandise exports.

This is a comparatively recent development. As late as the 1870s agriculture employed about 75 per cent of the labour force. By the turn of the century the figure was down to about 50 per cent, and in 1991 accounted for only 4.9 per cent of total employment. Agriculture accounts for 2.8 per cent of GDP.

Iceland is endowed with valuable energy resources. Only a small fraction of these vast hydro electric and geothermal resources has been exploited so far. The potential for largescale development of power-intensive industry is therefore substantial. Industrial expansion has to a considerable extent relied on abundant energy resources and their attractiveness for power-intensive industries, aided by tariff-free access to the European market. The first major step in this direction was taken in the 1960s when an aluminium smelter was built a ferro-silicon plant and a diatomite plant. After fishing and fish processing, manufacturing has become the second most important sector in the economy. It contributed 13,6 per cent of GDP, in 1989 and approximately 12 per cent of the labour force works in manufacturing. Manufactured products accounted for some 17.4 per cent of total merchandise exports in 1991, with aluminium accounting for 8.8 per cent of the total.

There has been a rapid growth of various high-technology industries in recent years, particularly in the production of heavy equipment and electronic appliances for fishing and fish processing.

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Occupational distribution in 1991 (Per cent)	
Agriculture .....	4.9
Fishing and processing .....	11.7
Other manufacturing .....	11.6
Construction .....	9.7
Trade, restaurants, hotels .....	14.7
Other services .....	47.4
	100.0

In the period 1970-1990, the average annual growth rate of GDP was 4.5 per cent, while in the OECD area as a whole the comparable growth rate was just over 3 per cent. Since 1988, however, Iceland has experienced economic setbacks. This is due to the overall economic recession in Europe, as well as cutbacks in the cod catch. GDP rose by 1.0 per cent in 1991, which was slightly above the OECD average. In 1992, the Icelandic economy went into a deep recession after four years of near-stagnation. GDP fell by 3.7 per cent due to the combined effects of a decreased fish catch and a 20 per cent fall in prices of marine products. In 1993 GDP has grown slightly, but is expected to contract by 2.6 per cent between this year and the next (1993-1994). The reason for this decline is that it is necessary to reduce the cod catch temporarily in order to allow the over-exploited cod stock to recover. Beyond 1994, economic growth is expected to begin a recovery, the forecast level being 1-2 per cent for 1995 and 1996.

Conditions for a liberal trade policy have not always been favourable. Markets for the country's main exports, fish and fish products, have often been restrictive and unstable for long periods. Bilateral trade and payment agreements have therefore proved to be necessary to facilitate exports of fish products. Considering also the fluctuations in fish catches and foreign trade, it is not surprising that Iceland had to maintain a restrictive trade policy longer than most other Western European countries.

From the world depression in the thirties, through World War II. and until 1960, Iceland maintained import controls to a varying degree, depending on fluctuations in foreign exchange reserves. During the thirties and forties, this was a common policy followed by many of Iceland's trading partners. However, a move towards liberalization of international trade became extensive in the fifties as a result of European economic recovery, cooperation in the OEEC and the establishment of the European Payments Union in 1950. Iceland issued its first list of liberalized products in 1950, and during the next two years, more than half of the imports were exempt from import control. This policy suffered a setback, however, in the second half of 1952 because of excessive internal demand and the difficulty of marketing frozen fish fillets in Western European countries.

In the early post-war years, Iceland entered into many trade agreements on a clearing basis with countries that made barter a condition for the purchase of such products as frozen fish, salted herring and salted cod. In the fifties Iceland thus had bilateral trade and payment agreements with eleven countries: Seven in Eastern Europe, Brazil, Finland, Israel and Spain. During this period, Iceland's bilateral trade agreements governed more than one-third of its total foreign trade. Consequently, import controls were required to channel purchases to the bilateral trading countries, and at the same time restrict imports from other countries.

The 1960s were a turning point with the introduction of an overall stabilization programme, which included measures to liberalize imports. Trade liberalization was facilitated by the adoption

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of similar economic reform programmes in Finland, Spain and Israel. In 1960 and 1961, the bilateral trade and payment agreements with these three countries were replaced by new trade agreements based on convertible payments. In 1966 a similar change took place in the trade arrangements with Czechoslovakia and Poland and in 1970 with Hungary. Trade with Romania was also put on a convertible basis, and in 1973 a private compensation agreement with the German Democratic Republic was replaced by an official trade agreement based on convertible payments. Finally, convertible payments were introduced in the trade and payment agreement with the Soviet Union, effective from 1 January 1976. That marked the end of "clearing" arrangements, and trade has since been conducted solely in convertible currencies.

With its reduced dependence on bilateralism, Iceland was able to participate more actively in international and regional co-operation with the aim of liberalizing trade.

Iceland became a Contracting Party to the GATT in 1968, a member of EFTA in 1970 and in 1973 it concluded a free trade agreement with the EC. These developments carried with them very dramatic changes for Iceland's economy and society. In addition to the above-mentioned agreements, the EFTA countries and the EC concluded an agreement creating the so-called European Economic Area (EEA) in 1992, due to take effect on 1 January 1994. This last agreement covers not only free trade in goods but the freedom of capital, services and persons as well. It also provides substantial liberalization in trade with fishery products.

### Objectives of Trade Policies

Iceland is highly dependent on foreign trade. The relatively large share of foreign trade is due to the high productivity of the main export industry, fisheries, and to the narrow base of the economy, which means that most manufactured goods, raw materials, grains and fuel have to be imported. Imports amounted to 40 per cent and exports to 35 per cent of GNP in 1991. Because of the importance of foreign trade, a liberal trade policy is naturally in Iceland's interest. This applies especially to fishery products as well as industrial products.

Icelandic exports in 1991 and 1992 by commodities (Per cent)		
	1991	1992
Marine products	80.0	79.6
Agricultural products	1.8	1.9
Industrial products	17.4	17.2
Other commodities	0.8	1.3
Total exports	100.0	100.0
Icelandic imports in 1991 and 1992 by commodities (Per cent)		
	1991	1992
Food and beverages	8.7	9.4
Crude materials	5.1	4.8
Fuels and lubricants	8.1	8.3
Chemicals and rel. products	8.1	8.3
Manufactured goods	17.1	16.6
Machinery and transport equipment	35.7	34.4
Miscellaneous manufactured articles	16.8	17.7
Other	0.4	0.5
Total imports	100.0	100.0

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A natural starting point in the general orientation towards liberalization has been close and far-reaching economic co-operation with neighbouring countries.

A large proportion of Iceland's foreign trade is conducted with Western European countries. In 1992 they accounted for 75 per cent of its exports and 70 per cent of its imports. An important element of Icelandic trade policy is therefore the liberalization of trade at the regional level.

Iceland became a member of EFTA on 1 March, 1970. According to the agreement, Iceland obtained immediate duty-free access to the EFTA markets for all products covered by the EFTA Convention, and in return it abolished its protective duties on imports from EFTA countries. The EFTA Convention covers nearly all industrial products, as well as all fish and other marine products.

No sooner had Iceland joined EFTA than the European Community opened the door for membership negotiations with three EFTA countries (Britain, Denmark and Norway). At the same time, the EC invited the remaining six EFTA countries to participate in exploratory talks on ways of solving their problems arising from the enlargement of the EC. Following exploratory talks, Iceland negotiated a free-trade agreement with the European Community, containing the same general provisions as the EC's agreements with the other EFTA countries. This trade agreement differed in one respect as it included special provision for tariff reductions for certain fish products in a separate document, Protocol No. 6.

Despite the elimination or reduction of tariffs through these relatively far-reaching agreements, commerce in Western Europe still faces various barriers in the form of tariffs on some important fish and fish products in the EC markets, border formalities, differing technical regulations, and so forth.

Given the volume of Icelandic trade with Western Europe, the freest possible access to this market is an important objective of Icelandic trade policy. But it is not the intention of the Government of Iceland to apply for EC membership, despite the fact that Iceland does not have the foreign and security policy inhibitions that long hindered the neutral countries of EFTA from even considering membership, or the fact that its trade and economic relations are overwhelmingly with the EC. The reason for this caution is the limited size of the population and the nation's dependence on fisheries. New constitutional ideas in Europe on sharing sovereignty and exercising joint control have less appeal in a country that has relatively recently achieved full independence (1944). Iceland will nevertheless continue to follow closely the negotiations of the other EFTA countries, as well as the evolution of the EC.

Nordic cooperation is extensive and far-reaching in various fields, including trade and economy. A passport union, a common labour market and harmonization of various legislations are but a few examples.

Although close commercial cooperation with EFTA and EC members is both natural and advantageous, Iceland continues to show great interest in developing its trade with other countries, not least the United States, Japan, the states of the former Soviet Union and the Central- and East European countries.

A new dimension has recently been added to European cooperation through the developments in the Eastern European countries. Iceland supports the reform processes in these countries and welcomes their increased participation in regional economic cooperation based on principles of a market economy.

The EFTA Countries have already seized this new opportunity and concluded free trade agreements with Poland, Hungary, the Czech Republic and the Slovak Republic, Bulgaria and Romania. These agreements are based mainly on the free-trade agreements between each EFTA country and the EC but cover fish and other marine products as well. Iceland has also abolished tariffs on some agricultural goods, based on bilateral agreements with each of these countries. These free-trade agreements will in future give Iceland new opportunities in the export of fish and fish products.

Iceland has also concluded similar free trade agreements with Turkey and Israel.

Iceland joined GATT on a provisional basis in 1964 to take part in the Kennedy Round, and then acceded formally in 1968.

Iceland welcomes the successful conclusion of the Uruguay Round. Along with other Nordic countries it has been a strong advocate of the strengthening of GATT disciplines, as well as improved conditions for and liberalization of world trade.

Iceland is one of the founding members of the OECD and takes active part in its work.