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TRADE POLICY REVIEW

Report by

ICELAND

Pursuant to the Agreement Establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), the policy statement by Iceland is attached.

Note: This report is subject to restricted circulation and press embargo until the end of the first session of the meeting of the Trade Policy Review Body on Iceland.

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I. INTRODUCTION

1. International trade plays a key role in the Icelandic economy, accounting for a substantial proportion of the country's GDP[1]. Iceland imports a wide range of manufactured goods and commodities, reflecting both the small size of the economy and the limited range of natural resources. Although the mainstay of Iceland's exports still remains fish and other marine products, the diversity of exports has increased significantly in recent years with a rapid growth in the importance of manufactured products and services. The Icelandic government attaches great importance to the openness of markets for goods and services and the further liberalisation of trade at the multilateral, regional and bilateral levels.

2. The objective of Iceland's economic policy has been to maintain economic stability and raise living standards. The strategy of fiscal policy has been to create a counter-cyclical impact on demand through automatic stabilisers and discretionary measures. While growth rates of economic activity have been high in past years, fiscal policy has had an impact to restrain demand. As a result of the restrictive fiscal policy stance, budget surpluses have been generated which have been used to reduce the public debt. The monetary policy strategy, which was reformed in 2001, aims to achieve an inflation target of 2,5% with a floating exchange rate. In recent years, the interest rate has been raised sharply to counter the rapidly rising demand, partly due to large-scale investment projects. The monetary policy stance has resulted in an appreciation of the króna, which has helped contain price pressure in the economy.

3. Significant structural policy reforms have been implemented in recent years. These have contributed to increasing economic growth, while also helping to reduce demand pressures in the economy. The tax system has been simplified and made more efficient and neutral, notably through a significant reduction in tax rates. Publicly owned firms in the financial and communication sectors have been privatised, which has served to increase competition and activity in the economy and the proceeds have been used to further reduce the public debt, which is now low by international standards. In addition markets in electricity and telecommunications have been liberalised and the regulatory framework concerning competition and government procurement has been strengthened. These reforms have contributed to making the business environment more favourable for domestic and foreign investors.

4. The main challenge to policy makers in recent years has been to manage the high economic growth. Importantly, the inflow of foreign workers and low and stable prices on international markets have helped to reduce the pressures in the economy. Economic and structural policy reforms have thus combined to ensure a stable and flexible operating environment for Icelandic goods and services producers. Importantly, the scope for flexible adjustment in an ever changing and globalising economic environment has ensured the viability of firms and their ability to manage a temporary deterioration of their international competitiveness due to a high exchange rate in recent years.

5. Iceland's trade policy is pursued along three main tracks: multilateral trade liberalisation through the WTO, regional liberalisation through the European Economic Area (EEA) with its EFTA/EEA partners and the European Union and finally, bilateral free trade agreements in cooperation with its EFTA partners Norway, Liechtenstein and Switzerland. Iceland sees regional and bilateral trade agreements as complementary to the multilateral regime. They are essential for the expansion of trade and economic cooperation as well as an important foundation on which to build Icelandic business opportunities. However, regional and bilateral agreements cannot replace the need for a strong, rules based, multilateral trade regime which is of particular importance to smaller

[1] Exports and imports of goods and services amounted to 41% and 36% of GDP respectively in 2004.

members like Iceland. Iceland is furthermore strongly committed to the Doha Development Agenda and a fair and equitable outcome that will benefit the entire membership.

6. This report starts by describing the economic environment in which Icelandic trade has developed since Iceland's last review. It then sets out the main structural reforms that have taken place. Finally the report describes Iceland's trade policy objectives and key developments during the review period.

II. THE ECONOMIC ENVIRONMENT

(1) ECONOMIC DEVELOPMENTS AND PROSPECTS

7. Policies of market liberalisation, fiscal consolidation, privatisation and other structural reforms have led to a turn around of the Icelandic economy since the early 1990s. After a period of slow or negative output growth in the late 1980s and early 1990s, economic growth started to gain momentum. During the second half of the 1990s, the liberalisation process continued, competition increased, the Icelandic financial markets and financial institutions were restructured and the exchange rate policy became more flexible. With the additional effects of increased foreign direct investment, notably in aluminium production capacity, Iceland experienced one of the highest GDP growth rates among OECD countries. By 1999, however, signs of overheating became increasingly visible. Inflation took off in the wake of a change in the monetary policy strategy. The fixed exchange rate policy was abandoned and a flexible exchange rate with an inflation target was adopted. This led to a sharp decline in the value of the exchange rate with an associated inflation spike that reached a peak in January 2002. The economy then underwent rapid adjustment and the current account deficit disappeared in the space of two years. Due to increasing slack in the economy, the inflation rate came down relatively quickly to the 2,5 per cent inflation target. In 2003 an economic recovery began which gained momentum in 2004 when GDP growth reached 8.2%. Economic growth continued at 5.5% in 2005.

8. Private consumption and large scale investment in energy intensive projects has been an important source of this recent growth. Relative to the size of Iceland's economy, investments in the aluminium and power sectors in recent years have been very large, totalling a little over a quarter of Iceland's 2005 GDP. A second driver has been the sweeping change that took place in the mortgage market in 2004 when the banks raised their profile in the mortgage market by engaging in head-on competition with the state-run Housing Financing Fund (HFF).

9. The Icelandic labour market has one of the highest participation rates among OECD countries. Over the past 10 years it has consistently been well above 80%. This is explained partly by the fact that the rate of unemployment has normally been one of the lowest in the OECD. In 2004 the unemployment rate was 3.1%, considerably lower than unemployment levels in the early 1990s and in 2005 unemployment declined somewhat. The participation rate of women has also been very high by international standards. In 2004, female participation was one of the highest in the OECD countries, with women accounting for 47% of the labour force. Participation rates among the young and the elderly have also been quite high. Furthermore, Icelanders tend to work long hours. The participation rate and number of hours worked are positively correlated with economic growth, dampening cyclical movements in unemployment.

10. Recent developments in the labour market have to some extent been contradictory. Wage drift has been rather muted in historical terms, even in sectors that have experienced labour shortages. Stronger competition in the product markets seems to have added a new dimension to the flexibility of the Icelandic labour market, as employers have chosen to import labour on a large scale rather than

bid up wages as in previous periods of labour shortages. In 2004 approximately 4.7% of the Icelandic labour force was foreign, a modest figure, but representing a considerable increase in the number of foreign workers in recent years.

11. A new monetary policy framework, granting the Central Bank of Iceland full independence to implement monetary policy in accordance with an inflation target, came into effect in 2001. The target was defined as a twelve-month rate of change in the CPI of 2.5%. After a spike in inflation caused by a substantial depreciation of the króna, as imbalances built up during the preceding fixed exchange-rate regime were corrected, the inflation target was reached in November 2003. Subsequently, inflation was at or below the target until spring 2004. Since then inflation has been above the target and was in 2005 on average 1,5% above target. The recent rise in inflation has been the result of rapid expansion of domestic demand brought about by the combined effect of the investment projects and enhanced access of households and firms to credit at lower interest rates. Inflation has stemmed mostly from the rise in the price of housing. Excluding housing, inflation was in fact scant in 2005. The demand-driven nature of inflation is most evident in rising prices of non-traded goods and services and housing, while other goods prices, with the exception of fuel prices, have fallen year-on-year, mainly due to a appreciation of the Icelandic króna.

12. Although the current imbalances in the economy have posed challenges, the new monetary policy framework has enabled the Central Bank to react more promptly than in previous episodes of imbalances. In light of rising demand and the inflation outlook, the Central Bank began to raise its policy interest rate as early as May 2004. In September 2005 the Central Bank reiterated its ongoing commitment to bring inflation back to target, by pursuing a tight monetary policy and maintaining it for longer than previously has been expected. By January 2006 it had been raised by over 5 percentage points to 10.75%.

13. Compared to its neighbours, Iceland has a relatively small public sector, with expenditures of around 47% of GDP in 2004. This is lower than in the Nordic countries (53%) and the mainland countries of the European Union (49%), but higher than for the US, Japan or South Korea.

14. General government expenditure as a share of GDP has risen in the last few years, from 42,3% in 1998 to 45,7% in 2005, due mostly to increased outlays on health, education and social protection. Nevertheless, the budget balance has been mostly in surplus as general government revenues as share of GDP have over the same time risen from 42,8% to 49%. In the past decade or so, the fiscal balance has been counter cyclical. A thirteen-year string of general government deficits came to an end in 1997 after economic growth picked up. During the upswing from 1997 to 2001 there was a return to surplus. As the economy cooled down in 2002-2003 the surplus turned into deficit. Renewed growth brought back a surplus in 2004 and 2005. The Government's restrictive fiscal policy led to a budget deficit in 2003 being turned into surpluses in 2004 and 2005. The impact of the policy amounted to 5.5% of GDP over the period. This achievement rests on the medium term target of the government to restrain expenditure growth while allowing revenues in the upswing to deliver a sizable surplus. The outcome was realised despite a 1 percentage point cut in the personal income tax rate in 2005.

15. If the intentions of the 2005 budget are realised, the financial surplus from 1998 to 2005 will amount to 38 billion ISK. This surplus is being used to strengthen the Government Employees Pension Fund and to further reduce Treasury debt, which has been reduced by nearly half since 1995. Total Treasury debt has declined from 52.3 per cent of GDP in 1995 to 20.2 per cent according to the 2005 budget. Net Treasury debt declined from 35.0 per cent of GDP in 1995 to an expected 7.7 per cent in 2005, due also to the use of proceeds from the sale of Iceland Telecom to reduce the debt still further. A lower debt leads to lower interest payments. If debt had remained at 1998-levels,

interest payments would be more than 11 billion ISK higher than estimated in the budget, not a trifling sum. Total supplementary contributions of the Treasury to the Government Employees Pension Fund - made to reduce future commitments to the Fund – amount to close to 80 billion ISK including interest for the period 1995-2005. The position of the Fund has thus been strengthened accordingly and the need for direct payments of the Fund's pensions out of the Treasury has thus been postponed for many years.

16. In 2006, GDP growth is expected to continue to be robust, or 5 per cent. Growth in domestic demand is expected to slow down but increased exports of aluminium products will begin to be felt. In 2007, economic activities are projected to slow down and continuing improvement in foreign trade will drive the growth of GDP, which is expected to be 2.7 per cent. The deficit on the current account reached a peak last year when it amounted to 15 per cent of GDP. The current account deficit is expected to decrease this year and be 13 per cent of GDP and then decline sharply in 2007 when it is projected to be about 6 per cent of GDP. Unemployment has declined sharply and is expected to be 1.7 per cent of the labour force in 2006, but to increase to 2.6 per cent in 2007, when activity is projected to slow down. Some pressure is expected to be felt in the economy this year but it is expected it will unwind quickly next year as major investment projects are completed. The rapid rise in housing prices has led to the consumer price index increasing 4% in 2005, which is beyond the 2.5 per cent inflation target of the Central Bank. According to the projections inflation will be 3.9 per cent in 2006. There is an expectation that housing prices may now have peaked and that the exchange rate of the króna will decline throughout the year. Inflation is expected to reach 4 per cent in 2007 due to the continued weakening of the króna.

(2) FOREIGN TRADE

17. In 2004, imports and exports of goods and services amounted to 41% and 36% of GDP respectively. Although Iceland can be seen as a fairly open economy, reflecting the small size of GDP, many larger economies have a considerably higher ratio. To some extent Iceland's lower ratio than that of many larger economies can be explained by geographic distance from major population centres, but other factors may also be at work, including currency volatility and labour costs that are relatively high when compared in a common currency. The diversity of Iceland's exports has, however, increased significantly in recent years, due to structural reforms and privatisation of state owned entities in finance and other sectors. While fish and other marine products are still the largest part of merchandise exports their share has been declining over the past 12 years. In 2004, fish and other marine products accounted for 60% of merchandise exports and 39% of total exports, down from 82% and 60% respectively in 1991. Exports of manufactured products have been growing rapidly in importance, and accounted for 35% of merchandise exports in 2004. Services now account for 36% of total export revenues while in 1990 the share was 26%.

18. Iceland imports a wide range of manufactured goods and commodities, reflecting both the small size of the economy and the limited range of natural resources. Imports of capital goods accounted for 28% of total merchandise imports in 2004. Industrial supplies and consumer goods are each around one-third of imports. Free trade arrangements with Europe have stimulated Iceland's trade with the region, causing the share of trade with North America to fall. In 2004, four-fifths of merchandise exports went to the member countries of the EEA, which also were the source of almost three-quarters of imports. Currently, the largest trading partner countries are Germany, the UK, the Netherlands and the Nordic countries. In terms of currency, the euro area constitutes the largest trading area, accounting for 40% of imports and 48% of exports. Iceland has in recent years generally had a trade surplus with the UK, Germany, the Netherlands and the Iberian countries, but a deficit with the USA, Japan and its Nordic neighbours.

19. Iceland's ratio of services to total trade is one of the highest among OECD countries. In 2003, Iceland ranked third with a share of services to total trade of one-third. Data on the direction of services trade are not as reliable as merchandise trade data. However, just over 1/5 of Iceland's services exports in 2004 used the euro and 2/5 used the USD as the vehicle currency.

20. Since 1995, the only restrictions on investment by non-residents in Iceland apply to foreign direct investment in fisheries and fish processing, energy production and distribution, and aviation companies. Restrictions on investment in the fisheries sector apply equally to EEA residents and Non-EEA residents and have the purpose of protecting the nation's exclusive rights to the fishing grounds around Iceland. Energy harnessing rights and production and distribution of energy are restricted to EEA entities and entities domiciled outside the EEA may not own more than 49% of the shares in Icelandic aviation companies. Liberalisation of cross-border capital movements has led to a profound change in the composition of residents' financial asset portfolios. Before full liberalisation in 1995 residents owned only approximately €145 million (13 billion ISK) in foreign securities. Over the ten years to the end of 2004, foreign asset portfolios rose twenty-seven-fold to €3.9 billion (344 billion ISK), the equivalent of 39% of GDP. This trend is expected to have continued in 2005.

21. The economy began to respond to the large projects in 2003 and the exchange rate appreciated by almost 20% from the end of 2003 to the end of October 2005. The strong Icelandic króna, buoyant private consumption and growing pace of aluminium-related investments have been reflected in substantial growth in imports. Exports, however, after remaining virtually unchanged in 2003, rallied in 2004, declined slightly in 2005 and are expected to increase by around 10% in 2006. The current account deficit has increased and reached a peak of 15% of GDP in 2005. However, the deficit is expected to decrease somewhat in 2006 and then decline sharply to 6% in 2007. Imports in connection with investments in the aluminium and power sectors are estimated to account for half of the deficit in 2005 and 2006, and are then expected to subside once the investment period is over and plants come on stream.

(3) STRUCTURAL REFORMS

22. A number of structural reforms have been implemented in Iceland during the review period. The main objective of these reforms has been to increase the efficiency and competitiveness of the economy. An extensive programme of privatisation has been carried out. Competition has been enhanced through liberalisation of the electricity and telecommunications markets, structural adjustments in the agricultural sector as well as the restructuring and strengthening of the regulatory framework. Wide ranging tax reforms have been carried out benefiting both individuals and businesses. Generally, cooperation within the context of the EEA Agreement has led to reviews and reforms of a number of regulations.

(i) Privatisation

23. Over the last 15 years the Icelandic government has pursued an extensive programme of privatisation, contributing to the transformation of the economy towards a more liberal and competitive environment. After the most recent sales, which include Iceland Telecom, the two state owned banks and several sectoral loan funds, the state's most important business holdings are in the production and distribution of electricity, as well as the Housing Financing Fund, the Student Loan Fund and a few smaller financial institutions, altogether responsible for just under 20% of credit in the economy. Additionally, the State owns a 100% of the shares in Iceland Post, which is the largest letter, parcel and product distribution service for consumers and businesses. The government's monopoly both on telecommunications and broadcasting has been abolished and its competitive advantage diluted with new entrants.

24. Local governments own more than half of all the electricity production capacity in Iceland, notably through holdings in the national power company, Landsvirkjun and Reykjavik Energy as well as numerous small heating distributors, mainly geothermal power companies responsible for the central heating of most homes. As of the beginning of 2006 no decision has been made on privatising the state's holdings in energy companies. Many municipalities own their local distributor of heat and electricity and they generally own operating companies for the harbours.

(ii) Competition Policy

25. A new Competition Act came into force in 2005 implementing a 2003 EEA regulation. The Act strengthens the structure of the Competition Authority (CA) which replaces the previous Competition and Fair Trade Authority (CFTA). The CA's function is to monitor competition restricting practices. The new Act allocates increased resources to the policy area as well as giving the Authority stronger and clearer powers of intervention. The new Act also removes consumer affairs from the CA's portfolio so as to focus its resources on competition issues. A separate authority, the Consumer Agency, is to carry out surveillance of unfair trade practices.

(iii) Deregulating Markets

26. Considerable deregulation has taken place in the energy sector. Iceland's phasing in of deregulation under an EU directive, relating to the separation of electricity transmission and distribution from electricity production and sale, is now complete. The current legal framework, adopted in 2003, designates generation and sales as competitive activities and imposes accounting separation between transmission and other activities for the monopoly provider of transmission services. Landsnet hf. (IceGrid) was launched in 2005 with the main role of transmitting electricity from producers to consumers (municipal distribution utilities and end-users such as the aluminium smelters). Under the principal ownership of Landsvirkjun and Rarik (Iceland State Electricity), IceGrid is also responsible for network administration, supervision and operation. In addition, since the beginning of 2005 all large electricity consumers (over 100 kW) have been able to choose their supplier. From 1 January 2006, this freedom has been extended to all consumers. In 2005 a new Act was passed by Parliament which removed the tax exemptions previously granted to energy companies.

27. The telecommunications sector has expanded fast, following important legal reforms. The Telecommunications Act, introduced in 1999, reflected the government's aim to strengthen competition in the telecommunications market while ensuring efficiency and reliability. The law ensures that all Iceland's inhabitants have equal access to telephone and data transmission services. The law stipulates that all operators are obliged to provide their competitors with access to communications networks and services under their control, thereby easing the access of new entrants. No specific restrictions apply to foreign ownership or activities in the telecommunications market. A new Act introduced in 2003 takes further steps towards increased competition and openness. The new law makes provisions that facilitate the entry of new operators into the Icelandic market, abolishing the need for operating licences. The Government's policy on telecommunications was further strengthened in 2005 by a long term telecommunications plan that stipulates the continued expansion of the GSM system as well as the improved access of all Icelanders to the high speed network.

28. The 1999 the monitoring role of The Post and Telecom Administration was considerably strengthened. The Administration works together with the Competition Authority to ensure active competition and fair business practices within the new open telecommunications market.

29. The agricultural sector has continued along the path of structural adjustment over the review period. Government support to agricultural producers has *inter alia* aimed to promote rationalization, efficiency and improved competitiveness. The number of farms engaged in production has dropped markedly in recent years, while those which remain have tended to increase in size and output. Nowhere is this more apparent than in dairy production, where the number of farms has declined by over 40% over the last 15 years. The production of each remaining dairy farm has on average risen by 74% over the same period. Production of poultry and pig meat has concentrated significantly and only a handful of large producers remains.

30. Quality control and environmental considerations feature more prominently in governmental policy, e.g. in support schemes in favour of sheep meat production. Administered prices and production quotas have been phased out in all but the dairy sector, where legislation has been amended to allow for the abolition of the former at any time by decision by the competent authorities. A new support scheme in favour of producers of tomatoes, cucumbers and peppers was launched in 2002 following the abolition of applied tariffs on these and a number of other vegetable products.

31. A number of institutional reforms have taken place over the review period, the most significant of which involve the creation of the Agricultural Authority in 2006 and the Agricultural University of Iceland in 2005. The Agricultural Authority supersedes the Chief Veterinary Office, the Directorate of Freshwater Fisheries, the Feed, Seed and Fertiliser Inspectorate, the Plant Protection Service and the Meat Classification Board, in addition to taking on a number of administrative duties formerly carried out by the Farmers Association. The Agricultural University of Iceland was formed as a result of a merger between the Agricultural University of Hvanneyri, the Horticultural College of Reykir and the Agricultural Research Institute.

(iv) Tax Reform

32. In accordance with the 2003 Policy Statement of the Coalition Government the first phase of personal income tax cuts took place in 2005 when the tax rate was reduced from 25.75 per cent to 24.75 per cent. The personal and company net wealth tax was abolished in 2005 and will take effect at the time of the tax assessment in 2006. The second phase of income tax cuts will become effective in 2006 when the tax rate will be cut again by 1 per cent, to 23.75 per cent. The final and largest phase will be implemented in 2007 when the tax rate will be reduced by 2 per cent, to 21.75 per cent. With these changes, personal income tax will have been reduced by 8 per cent from 1997, from 29.75 per cent to 21.75 per cent, or by more than one-fourth. Furthermore, value added tax will be reviewed in accordance with the Government's Policy Statement.

33. Wide-ranging tax reforms for businesses have also been implemented during the review period. In 2002 corporate income tax was reduced from 30 per cent to 18 per cent and corporate net wealth tax was reduced from 1.2 per cent to 0.6 and then abolished in 2006. In 2003 stamp duty was reduced, both for corporations and individuals.

(v) Other Reforms in Review Period

34. In 2001 a full revision of the legislative environment concerning public procurement was carried out, creating for the first time a concise legal framework in one text. The revision was based on the eight existing EU directives concerning public procurement in force at that time. The Act contains provisions on scope, both as regards conformity with the EU-directives, other domestic acts and threshold amounts. Tender and purchasing procedures were improved and a common definition was established concerning contracting authorities and contractors, especially in the area of new emerging methods, such as the negotiated procedures and public private partnerships. Furthermore,

framework contracts were improved in order to maintain a common trust in the system, between future tender participants, contractors and contracting authorities. The selection procedures on bids were also revised and clarified. The new legislation stipulated an independent Complaints Committee on public contracts. In addition, a new Act on Public Projects Procedures came into force in 2001, setting provisions on planning, tendering, supervision and construction of public projects.

35. Iceland became a party to the WTO’s Government Procurement Agreement (GPA) in 2001. Neither the existing Act on Public Procurement from 2001 nor affiliated regulations limit participation of foreign suppliers in the public procurement market. This applies to goods, services and works contracts within the European Economic Area (EEA) but also applies to countries parties to the GPA. The legislation specifically stipulates that rights according to the present Act are enjoyed by both individuals and legal entities domiciled in any of the states in the EEA as well as those who have such rights on the basis of international treaties to which Iceland is a party.

36. In 2002 the Government issued a Policy on Public Procurement, in conformity with the new Act, incorporating features such as “best-buy”, e-procurement, life cycle cost, green-procurement, and a revision of tender procedures. In 2006 it is foreseen that Iceland will make a new revision of the existing domestic law on public procurement, based on new EU directives that were issued in 2004.

37. In January 2006 a new Customs Act came into force which further simplifies customs procedures. With the introduction of EDI-customs clearance, the role of operators who specialise in transmitting electronic data to Customs on behalf of importers and exporters has become more important. The Act introduces new provisions regarding the operation of customs brokers and their operation is subject to authorisation by the Minister of Finance. In addition procedures for complaints have been simplified. All rulings made by Directors of Customs can now be appealed to the State Customs Board. The Act also introduces amendments to the existing penal provisions and rules procedures. Among other amendments are new provisions regarding increased responsibility of Customs authorities for investigations of infringements and violations of the Customs Law.

III. TRADE POLICY OBJECTIVES AND DEVELOPMENT

(1) THE WORLD TRADE ORGANIZATION

WTO and the Doha Development Agenda

38. Iceland is strongly committed to the multilateral trade framework under the auspices of the WTO. A strong rules based trading system is of particular importance for smaller members like Iceland. Iceland is furthermore strongly committed to the Doha Development Agenda and is convinced that a fair and equitable outcome will benefit the entire membership.

39. Development cooperation is an important aspect of Icelandic foreign policy and it has been decided that the coming years will see a significant increase in Iceland's official development assistance. As a reflection of this a policy on Iceland's development cooperation for the years 2005-2009 has been formulated. The policy takes the Millennium Development Goals as a point of departure and identifies areas where Iceland will contribute to global development. An important part of the policy outlines Iceland's commitment to assisting developing countries in benefiting from increased trade liberalization.

40. Iceland supports the Doha Development Agenda Global Trust Fund, which is intended to assist developing countries in taking advantage of the opportunities created by increased trade liberalization. In 2005 Iceland substantially raised its contribution to the fund, to 60 thousand CHF a year for the years 2005-2007. In addition, Iceland contributed 20 thousand CHF to support the

participation of developing country delegates in the 2005 Hong Kong ministerial. Iceland is also one of the initiators of the Nordic-Africa Initiative (NAI), which aims to increase understanding of how trade, and trade policy, can benefit Africa. As a part of NAI, a ministerial conference was convened in Dar-es-Salaam in 2005. Participating, along with the Nordic countries, were twenty African countries, NGOs, as well as representatives from international institutions.

Non Agricultural Market Access

41. Having witnessed firsthand the positive effects of market liberalisation, Iceland is strongly committed to increasing market access for non-agricultural goods. It is crucial for the interests of developed and developing countries alike. The sector of fisheries products continues to be of particular importance to Iceland but other sectors are constantly gaining in importance, like machinery, weighs and scales, plastic containers, medicine and medical devices, to name only a few.

Trade in agricultural products

42. As a net food importer, Iceland is very dependent on international trade in agricultural products. Iceland is thus fully committed to the objectives of the ongoing reform process in the WTO and the establishment of a fair and market-oriented agricultural trading system, in accordance with the provisions and principles of the WTO Agreement on Agriculture. Government policy has in recent years placed considerable emphasis on structural adjustment and rationalization in agricultural production and processing in reaction to and preparation for multilateral commitments towards the liberalization of agricultural trade. It is the Government's stated objective to provide Icelandic agriculture with a realistic opportunity to adapt to changes in its operating environment, to the benefit of farmers and consumers alike.

43. As a high-cost, low-potential activity, agricultural production in Iceland has been largely dependent on direct and indirect government support. This is *inter alia* dictated by factors such as the harsh climate, difficult topography and low population density. The viability of agriculture is closely interlinked with rural development policy and plays a key role in the provision and preservation of a number of non-trade concerns such as food security, environment and cultural heritage. Iceland has as a result placed firm emphasis on the development of multilateral rules to govern agricultural trade which take due account of such non-trade concerns.

Trade in Services

44. Iceland is strongly committed to real liberalisation in trade in services over a broad range of sectors including air and maritime transport, telecommunications and various other sectors. Iceland has a very open and liberal regulatory environment for trade in services and is currently participating in the plurilateral request and offer process in accordance with the Hong Kong ministerial declaration.

Rules

45. In the rules part of the negotiations Iceland puts particular emphasis on strengthening disciplines on subsidies in the fisheries sector. This objective is of fundamental importance, not only because subsidies distort free trade and competition, but also for the direct relationship between such obstacles in the fishing sector and excess fishing capacity and overexploitation of fish stocks.

TRIPS

46. Iceland supports measures aimed at ensuring that the TRIPS Agreement is supportive of measures to protect public health. Iceland supported the decision by the General Council of

30 August 2003 waiving restrictions on exports on the basis of compulsory licences for pharmaceutical products. The necessary provisions have been implemented in Iceland through Act No.127/2005, amending the Act on Patents No. 17/1991. A regulation on the basis of this law is expected in the spring of 2006.

(2) THE EUROPEAN ECONOMIC AREA (EEA)

47. The Agreement on the European Economic Area (EEA) extends the internal market of the 25 EU Member States to three European Free Trade Association (EFTA) countries: Iceland, Norway and Liechtenstein. The EEA Agreement covers the free movement of goods, persons, capital and services (the four “freedoms”). As it is one of the primary obligations of the Agreement to ensure equal conditions of competition, the substantive competition rules of the Agreement correspond to the relevant *acquis communautaire*. This covers the rules concerning cartels, abuse of dominant positions, merger control, state monopolies and state aid, as well as public procurement. The Agreement also includes areas that have an impact on the competitive position of enterprises, such as consumer protection, environment, social policy (including health and safety at work, labour law and equal treatment of men and women), statistics and certain elements of company law. Other fields of co-operation include culture, education, information services, and small and medium-sized enterprises.

48. The scope of the EEA Agreement does not include the EU’s Common Agricultural Policy or the Common Fisheries Policy, but it contains provisions on various aspects of trade in agricultural and fish products. The EEA Agreement calls on the parties to "continue their efforts with a view to achieving progressive liberalization of agricultural trade".[2] To this end, the Agreement requires that the parties undertake biannual reviews of the conditions of trade in agricultural products.[3] The last such review was concluded in February 2006 and is expected to come into effect on 1 January 2007. After that date tariffs on certain agricultural products mentioned in Annex I of the EEA Agreement will be abolished. As the EEA Agreement is not a customs union, trade policy towards third countries is also outside its scope.

49. A key feature of the EEA Agreement, which distinguishes it from most other free trade agreements, is its dynamic character. Its common rules are continuously updated by adding new EU legislation. This aspect is essential, given the large output of Community legislation on the internal market. Each month, a number of EEA-relevant pieces of legislation are incorporated into the Agreement by decisions of the EEA Joint Committee. The Agreement provides for information and consultation procedures at all stages of the Community’s decision-making process. The EFTA-EEA states may ask for consultations on matters of concern, and may also seek adaptations to Community legislation in its application to the EFTA countries when special circumstances call for this. Since the Agreement entered into force, more than 5000 EC legal acts have been incorporated into it.

(3) FREE TRADE AGREEMENTS

50. Since the early 1990s, Iceland and its other partners in the European Free Trade Association (EFTA) – Liechtenstein, Norway and Switzerland – have established an extensive network of contractual free trade relations in Central and Eastern Europe, the Mediterranean region and with countries in other parts of the world.[4] Free trade agreements with Mexico and Chile have extended

[2] Article 19(2), EEA Agreement.

[3] Article 19(3), EEA Agreement.

[4] From 1 May 2004, the enlarged EEA Agreement replaced the FTAs with Estonia, the Czech Republic, Latvia, Lithuania, Poland, Slovakia, Slovenia, and Hungary following these countries’ accession to the EU.

this network across the Atlantic, and the free trade agreement with Singapore was the first between European countries and an Asian country. Since 2000, Iceland with its EFTA partners has signed free trade agreements with Chile, Croatia, Jordan, Lebanon, Macedonia, Mexico, Singapore, Tunisia and South Korea and an agreement with the South African Customs Union[5] is awaiting signature. At present, the EFTA network consists of fifteen free trade agreements and six declarations on co-operation. Several agreements are currently under negotiation, including some with countries in America, Asia and Africa.

51. It is the goal of EFTA third-country policy to safeguard the economic interests of the EFTA States by complementing interregional European trade co-operation and the WTO regimes and negotiations.

52. EFTA's free trade agreements cover free trade in industrial products, fish and marine products and processed agricultural products. In addition, each EFTA country has concluded bilateral agricultural protocols with each of the third country partners. The bilateral agricultural protocols are an integral part of EFTA's multilateral agreements. The free trade agreements incorporate provisions on a number of new trade issues, including rules of competition, state aid and protection of intellectual property. The scope of the agreements has been expanded during the last years to include services, investments and public procurement[6], as the parties recognise the growing importance of these areas. Other agreements contain evolutionary provisions on these areas with the aim of achieving gradual liberalisation and mutual opening of markets for investments and trade in services, taking into account developments in European integration and the WTO.

53. Many of the EFTA free trade agreements have been drawn up in a way that takes into account the different level of economic development in the partner countries by providing for an asymmetrical approach. The EFTA States are required to abolish barriers to trade at the outset, while the partner countries can, for certain sensitive products, phase them out during a transitional period, leaving them the necessary time to adapt their economy to free trade conditions.

54. In 2005, Iceland and the Faeroe Islands signed a Free Trade Agreement which is scheduled to be ratified by all parties in the first half of 2006. The Iceland-Faeroes FTA applies to trade in all goods, including agricultural goods. It also extends to trade in services with full market access and national treatment in all four modes. Furthermore, the Agreement also extends to investment and the Free Movement of Persons between the Contracting Parties.

55. In February 2006 Iceland and China launched a study into the feasibility of establishing a free trade area between Iceland and China. The study is scheduled to be concluded in the summer of 2006. Should the study conclude that a free trade agreement between Iceland and China is feasible, negotiations on such an agreement could be launched later in the year 2006.

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[5] Comprising Botswana, Lesotho, Namibia, South Africa and Swaziland.

[6] This has been done for the EFTA free trade agreements with Singapore, signed on 26 June 2002, and Chile, signed on 26 June 2003.