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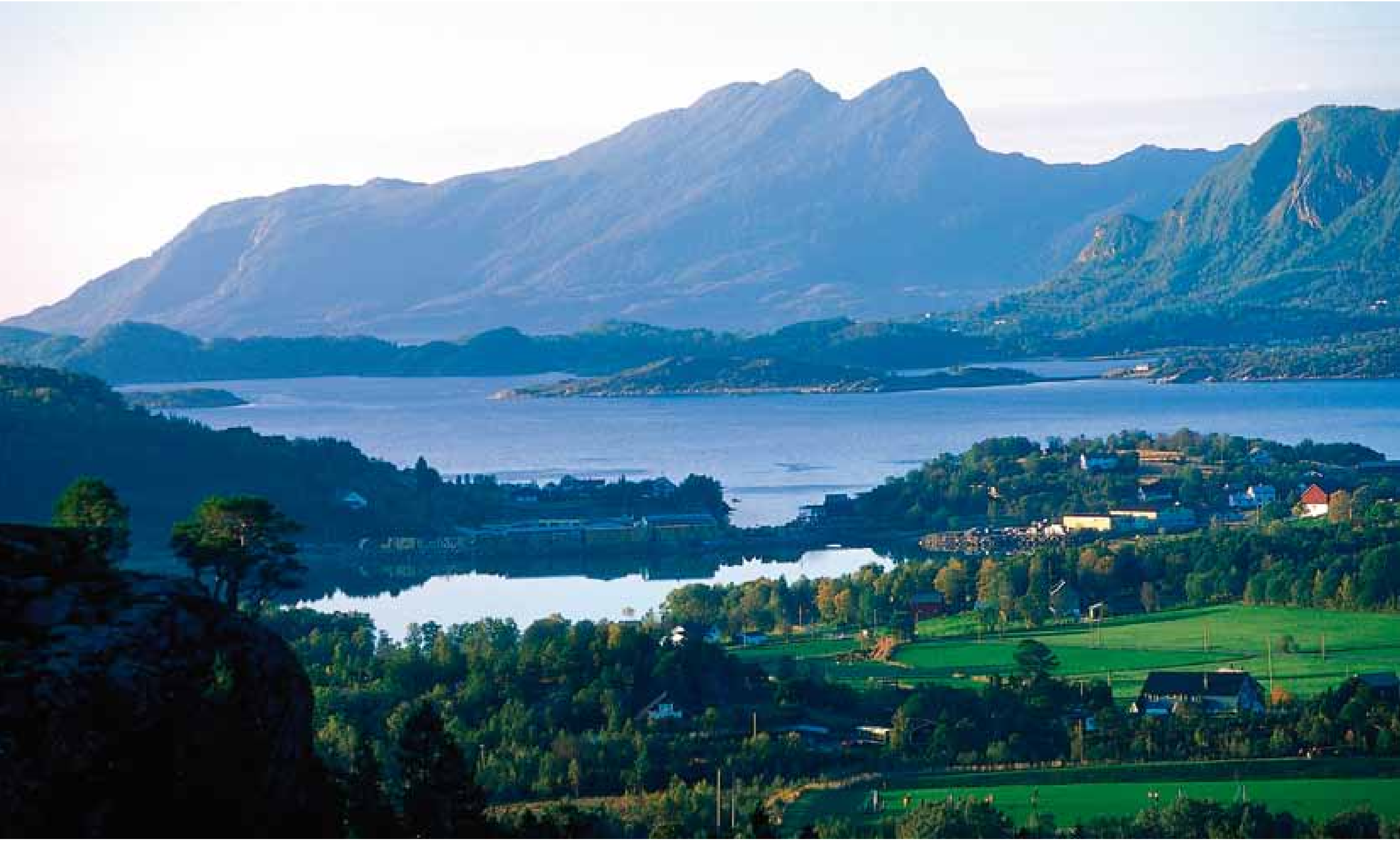
Swedish Board of Agriculture

Norway

A market hidden behind tariff peaks



- The EEA Agreement foresees a progressive liberalization of agricultural trade with regular reviews of trade conditions at two-year intervals. Since 1994 the agreement with Norway has only been reviewed twice.
- There is an imbalance in the EEA Agreement since there has been effective trade liberalization for fish and fish products but not for agricultural products.
- The agreement for processed agricultural products has been updated only once since 1994 and is in great need of renovation.

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Innehåll

1 Summary

EU export possibilities in agricultural products to Norway remain significantly constrained by high tariffs. The average applied agricultural tariff amounts to 57.8% in Norway (15 % in the EU). Article 19 of the EEA Agreement foresees progressive trade liberalization in agriculture between the Parties. To that purpose, the Parties shall carry out regular reviews of bilateral trade conditions at two-year intervals. However, since the entry into force of the EEA Agreement on 1 January 1994, bilateral trade preferences in agriculture have only been improved twice. The second agricultural agreement between the Parties will come into force in the beginning of 2012.

Norway enjoys preferential access to the EU market for fish products, owing to an effective trade liberalization schedule for fish implemented over a few years, and according to mandated timing, after the conclusion of the EEA Agreement. There was clearly a similar thought behind Article 19, even though implementation was left to bi-annual negotiations.

Trade in processed agricultural products (PAPs) is covered by Protocol 3 of the EEA Agreement, which entered into force in 1994 and was last updated in 2004. The Commission has been trying to enter into negotiations with Norway on further liberalization of trade in PAPs since 2005. The objective is to enter into talks on re-negotiation of the current Protocol 3 to the EEA Agreement, which lays down the trade regime for these products. Norway has a legal obligation and made a commitment in 2004 to review the Protocol, but has continuously refused to enter into review talks with the EU. According to this trade regime, import duties should only reflect the actual price differences (between domestic and world market prices) on agricultural raw materials used in the production of PAPs. There has only been one round of bilateral trade liberalization under Protocol 3 since the entry into force of the EEA Agreement in 1994. Processed agricultural products are a sector where European companies are particularly competitive.

Economic and market conditions have undergone significant changes since the entry into force of the agreement. The Protocol 3 regime, based on prices of agricultural raw materials in the mid-90s, must be considered obsolete since import duties are mainly based on historical differences in agricultural prices. Recent data and calculations indicate that the Norwegian import regime is characterized by overcompensation when it comes to several basic agricultural products. This means that EU producers, which use agricultural raw materials for their PAP production, have lost some of their preferential benefit in relation to Norway in recent years.

The EEA Agreement will most likely remain as the factor that determines rules on trade between the EU and Norway. This makes it very important for the EU that all commitments are complied with and that the arrangements are not eroded. It is in the interest of the entire EU to bring trade liberalization a step further.

2 Trade development

Norway is a very important trading partner for the EU. As regards EU third country exports, Norway is the fifth largest destination for agricultural products and food, receiving some 4 per cent of total exports.

Denmark is the largest exporter to Norway in the EU followed by the Netherlands, Sweden, Germany and France. The largest product groups, exported from the EU to Norway, are drinks (wine, beer, juice, mineral water etc.), cereal preparations and animal fodder.

Norway is also an important source for agri-food imports to the EU. Fish and fish products is the dominating product category, making up almost 90 per cent of the value of EU imports. The EU is by far Norway's largest trading partner. Trade with the EU accounted for 67 per cent of the Norwegian agri-food import value and 72 per cent of the Norwegian agri-food export value during 2010. Norway's largest agri-food trading partners in EU are presented in Table 1.

Table 1 Agri-food trade between Norway and EU countries 2010

EU exports to Norway, by country	Share (%)	EU imports from Norway, by country	Share (%)
Denmark	20	Sweden	48
Netherlands	17	Denmark	27
Sweden	16	Germany	6
Germany	13	United Kingdom	6
France	6	Other EU countries	13
Other EU countries	27		

Source: Eurostat

In recent years, trade in agricultural products (Article 19) and processed agricultural products (Protocol 3) has not developed as well as trade in fish and fish products (Protocol 9), see figure 1 and 2. The trade balance between exports of agricultural products and imports of fish and fish products has become very negative for the EU in relation to Norway.

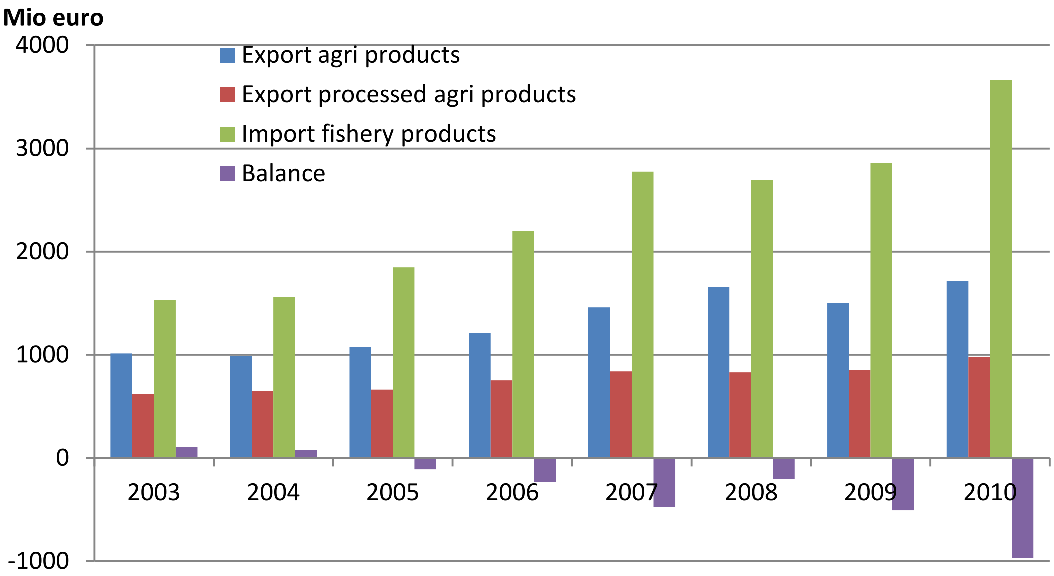

Figure 1 EU exports of agricultural products and PAPs to Norway and imports of fishery products from Norway 2003-2010 (mio euro)[1]

Source: EU Commission and Eurostat

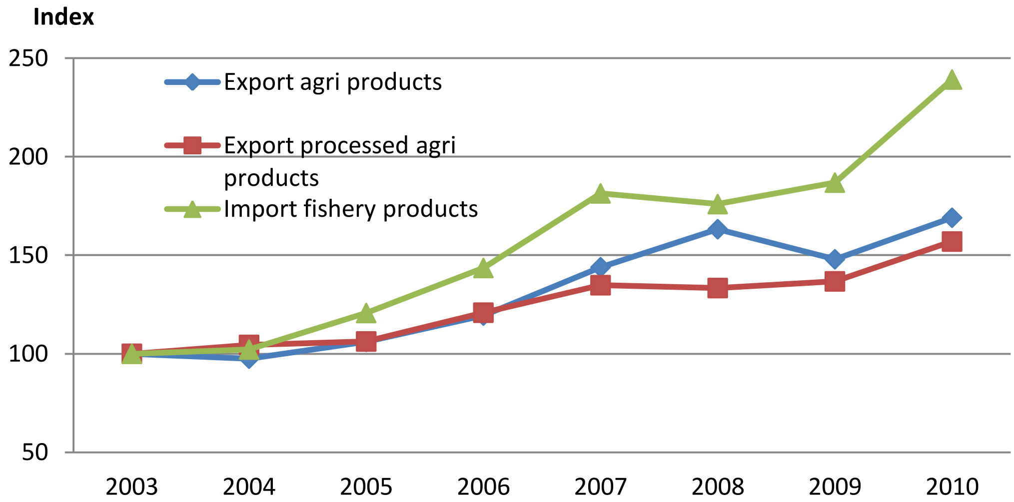

Figure 2 EU exports of agricultural products and PAPs to Norway and imports of fishery products from Norway 2003-2010 (Index 2003=100)

Source: EU Commission and Eurostat

[1] If also Norwegian export of agricultural products to the EU is included, the trade balance would be even more favorable for Norway.

3 Trade agreements between the EU and Norway

3.1 The EEA Agreement

Norway is very well integrated into EU cooperation, particularly via the EEA Agreement. This Agreement expands the Common Market (except for agriculture and fisheries) to also include Norway, Iceland, and Liechtenstein. In practice, this means free movement of goods, services, capital, and people. Through the EEA Agreement, Norway also takes part in several EU cooperation programmes, for instance in areas like business, environment, education, and research, but this participation does not include co-decision. The Agreement is dynamic in the sense that all EU Directives relevant to the EEA need to be adopted by the parliaments of those countries. A special authority, the EFTA Surveillance Authority, monitors implementation and application of EU Directives in Norway, Iceland, and Liechtenstein. The EEA Agreement calls for the fullest possible realisation of the free movement of goods, persons, services and capital within the whole EEA and the agri-food sector should progressively become part of the regional integration sought by the Agreement.

Norway and Iceland have reserved the right to have their own policies in the areas of agriculture and fisheries. The EEA negotiations therefore resulted in specific arrangements to regulate trade in agricultural products (Article 19), processed products (Protocol 3), and fish (Protocol 9). The construction of the EEA Agreement regarding these issues can be traced back to the EFTA convention and various bilateral agreements from the 1960s and 1970s.

Beside trade negotiations there is cooperation between the EU and Norway in various areas – within the framework of the EEA as well as in other contexts. Norway is also an important supplier of natural gas and oil to several EU countries and furthermore is a very important contributor within the framework of the EEA Financial Mechanism (support to development projects in certain EU countries).

3.2 Agricultural products – Article 19

The first agricultural agreement between the EU and Norway according to Article 19 was concluded in 2003 after several years of negotiations. A second agricultural agreement between the parties had to wait until 2010, this time after 2 years of negotiations. The agreement is expected to come into force in the beginning of 2012.

According to Article 19 (1) the parties shall examine difficulties that may occur in their agricultural trade and search for proper solutions. Furthermore, according to 19 (2) the parties shall take measures with a view to gradually liberalize agricultural trade. According to 19 (3) this shall be fulfilled by means of a review of the trade conditions for agricultural products every second year. In the light of these reviews the parties shall, with due consideration to their respective agricultural policies and the results of the Uruguay round, agree on a preferential, mutual basis beneficial to both parties, to decrease all kinds of trade barriers in the agricultural sector.

To sum up Article 19 gives clear support to the carrying out of trade reviews and to the continuation of mutual efforts to liberalize agricultural trade. However, Norway insists on the need to reach a “balanced” agreement. This mercantilist approach is questionable, particularly since it is matched by virtually no Norwegian interest in exploiting their export potential. With an absolute minimum of Norwegian negotiation requests, it is of course impossible to reach a “balanced” agreement within the agricultural sector. Furthermore, when fish is taken into account Norway enjoys a substantial trade surplus with the EU in the broader food sector.

The practical value of Article 19 is another issue. The wording of the article is very general and unspecific. The assumption is that the parties, which in this agreement are equal, agree on trade concessions in both directions. The concessions shall be beneficial to both parties. Considering that Norway and the EU in practice are not equal in the agricultural area it is not easy to agree on trade liberalizations in the way laid down in Article 19.

3.3 Processed agricultural products – Protocol 3

The rules on processed products (Protocol 3) were laid down in an arrangement in 2004. That is, implementation began 10 years after that EEA Agreement entered into force. Protocol 3 is based on historic and rather out-dated market conditions and prices. The product scope of the Protocol was laid down in the EEA negotiations in 1991 and may therefore need to be adapted to current circumstances. New negotiations on the scope of the Protocol would need to take into account factors like product development, changes in consumer preferences, trade development, and political reform in recent years. Tariffs are too much based on negotiation outcomes from the mid-1990s and the prices that prevailed at the time. This gives cause to review the parameters of the Protocol. On several occasions in recent years, the Commission has demanded new negotiations on the conditions for processed products in Protocol 3 of the EEA Agreement. In the EEA Council, Norway has been urged to participate in renegotiating Protocol 3. Norway has however rejected all such demands, referring to the current WTO negotiations, shortage of personnel, and by arguing a different interpretation of the follow-up/resumption clause of the Agreement.

One basic problem in this context is that Norway has not ratified the original Protocol 3 arrangement in the EEA Agreement, which means that the methods of follow-up and adaptation of the conditions in the Agreement are unclear in several aspects. When it comes to Protocol 3, Norway has sought to avoid the dynamic characteristic of the rest of the EEA Agreement. Norway’s position is linked to Norwegian internal policies in the agri-food sector, aiming at protection of Norwegian producers of PAPs.

According to the agreed Minutes of the Protocol 3 agreement of 2004, “the customs duties in Protocol 3 shall be subject to annual calendar reviews” and “may be adapted by the Joint Committee taking account of the evolution of costs among contracting parties of the basic agricultural products and/or mutual concessions”. Basic agricultural amounts of the agreement are based on price differences between the domestic markets and the global market. In the final text of the Protocol 3 agreement, there is no explicit wording on how to carry out the annual reviews. The text also does not require price notifications, i.e. mutual reports on price developments on domestic and world markets.

An exchange of price notifications would mean improved transparency and predictability compared to the present situation.

Economic and market conditions have undergone significant changes since 2004. The current regime, based on prices of agricultural raw materials in the mid-90s, must be considered obsolete since import duties are mainly based on historical differences in agricultural prices. The Norwegian market has been less affected by increasing world market prices. For several basic commodities, price gaps between the global market and the Norwegian market have been narrowing. This means that EU producers, which use agricultural raw materials for their PAP production, have lost some of their preferential benefit in recent years.

International price monitoring indicates that global prices remain high and volatile but significantly higher than in the mid-1990s, when the price situation latest was thoroughly reviewed. Domestic prices in the Norwegian market remain stable, compared to global prices.

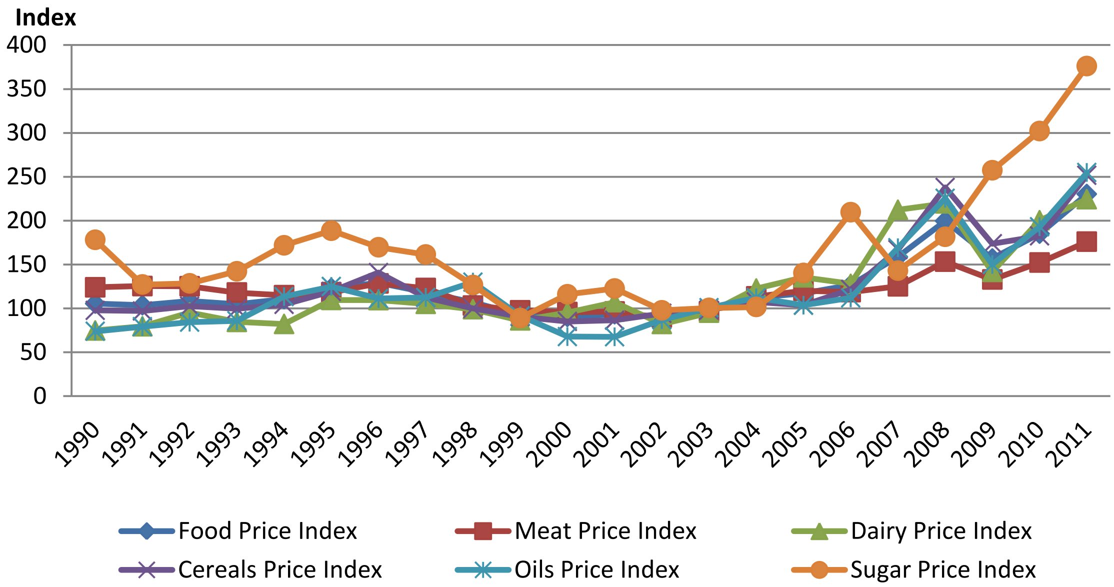

Figure 3 Annual food price indices (Index 2002-2004=100)

Source: FAO

When asked about the possibility to renegotiate the agreement, Norway has claimed at several occasions that such a renegotiation would result in increased custom duties since the cost of basic agricultural products have risen faster in Norway than on the international market. However, recent data and calculations indicate that the Norwegian import regime is characterized by overcompensation when it comes to several basic agricultural products. It must be an interest of the EU to thoroughly review Protocol 3 with the aim of resuming negotiations with Norway on developing Protocol 3. The calculations in Table 2 clearly shows that there is a large overcompensation for the raw materials included in the table. The situation is similar for several other raw materials, used in the production of PAPs.

Table 2 Examples of a large overcompensation in Norway beef and butter

Beef	
World Market Price (3875 USD/t)	22,09 NOK/kg
Protocol 3 duty (Norway)	26,69 NOK/kg
Total	48,78 NOK/kg
Domestic Market Price (Norway)	65,00 NOK/kg
Refunds in the form of an internal price rebate	23,00 NOK/kg
Net price paid by domestic enterprises	42,00 NOK/kg
DIFFERENCE (48,78-42,00)	***6,78 NOK/KG***

Butter	
World Market Price (4 200 USD/t)	23,94 NOK/kg
Protocol 3 duty (Norway)	13,13 NOK/kg
Total	37,07 NOK/kg
Domestic Market Price (Norway)	32,50 NOK/kg
No price rebates applied this year	
DIFFERENCE (37,07-32,50)	***4,57 NOK/KG***

Sources:
International Price Monitoring Newsletter, October 2011, European Commission
Domestic Agricultural Prices in Norway, Norwegian Agricultural Authority 2009-06-15
Domestic "price rebates" 2011: Norwegian Agricultural Authority, Forskrift om råvareprisutjevning for bearbeidede jordbruksvarer.
Conversion rate USD/NOK (2011-11-01): 5,697

3.3.1 Issues when Protocol 3 is renegotiated

Trade conditions in Protocol 3 are primarily determined by the coverage of finished products and tariff levels. Several products are potential candidates when renegotiating the product scope of the Protocol. Possible product groups are dairy products, meat and vegetable preparations and juice.

The agricultural element of the tariffs is calculated in accordance with the Protocol using parameters as: raw material contents; standard recipes and conversion factors, matrix construction, price gaps between domestic and World markets and price rebates.

Raw material contents
It may be necessary to review and reduce the number of agricultural raw materials comprised by the system, due to changes in markets and the political situation. Determining factors may include whether raw materials are mostly provided by imports or by domestic production. Outstanding issues concern i.a. Norway's price compensation measures on strawberries, raspberries, blackcurrants, wheat, cheese and meats.

Standard recipes and conversion factors
For product groups based on a homogenous mix of raw materials (like pasta and crisp bread), tariffs are based on standard recipes. The standard recipes in force, as well as the conversion factors used, reflect the situation in the mid-1990s and should be reviewed, due to changes in production methods and other factors.

Matrix construction
For products that consist of many different raw materials, tariffs are based on a so-called matrix. The Norwegian matrix was drawn up in the mid-1990s and needs to be updated to current economic conditions. Furthermore, WTO negotiations have brought up issues of tariff simplification, and in this context the matrix constructions of both Norway and the EU could be expected to be overhauled.

In addition to the agricultural element of the tariffs, Norway also applies an industrial element to some products. This element is often expressed as an *ad valorem* duty. The remaining industrial elements should be scrapped when the Protocol is renegotiated.

Price gaps between domestic and World markets
The Agreement still relies on price data from the 1990s, and one needs to draw the Commission's attention to the fact that parties need to notify each other about prices (see figure 3). Norway claims that the price gap between their domestic market and the World market has increased. However, there are indications that the price gaps probably have declined since 1995 for many of the agricultural raw materials of main importance in the Norwegian price compensation system (dairy products, meat, poultry, egg products, cereals).

Price rebates
In future negotiations, domestic budget-financed support in the form of so-called price rebates should be taken into account, in combination with price data. If production is protected by tariffs that allow high domestic prices for raw materials and processed products, there is good reason to question why Norway also compensates for the extra cost of using expensive domestic raw materials. This implies double protection.

3.4 Non-Tariff Measures (NTM)

Discrimination against imports

The extensive Norwegian use of the so-called price rebates system in favour of domestic producers of processed food products for the domestic market is a clear example of a non-tariff measure. These subsidies discriminate against imports of these processed products. The price rebates are only granted for the use of agricultural raw materials of Norwegian origin and thus discriminate against imported raw materials. Price rebates thereby fulfill the criteria for prohibited subsidies, according to Article 3.1(b) in the Agreement on Subsidies and Countervailing Measures. Furthermore, the Norwegian system can lead to cross subsidization in companies which are active both in domestic sales and in exports. Raw material subsidies to a company for processed products going to the domestic market can easily affect prices of products exported by the same company, in spite of the fact that raw materials in exported processed products are not granted this kind of price rebate.

The risks that the price rebate system for domestic sales is abused as indirect export subsidization is evident already today. This is due to the fact that these subsidies apply to most agricultural raw materials, are quite substantive, and are granted to a wide range of processed products. In the future, when export subsidies may have been eliminated in the WTO, the potential for Norwegian price rebates to create trade problems would appear even larger. There is an obvious risk that these price rebates, through cross subsidization or abuse, function as indirect export subsidies. Even though these subsidies are aimed at the domestic Norwegian market, there are neither guarantees that subsidized products are not exported, nor guarantees that price rebates to one company for domestic production are not used to facilitate competitive export prices in the same company. It seems likely that the risks of abuse increase when the benefits are big and the possibilities for control are limited.

The increase of the levels of internal price rebates can be seen, as well, when looking at total expenses for the system of internal price rebates, paid by the Norwegian Government. The budget for internal price rebates has increased since 1995 from NOK 30 to about NOK 179 Millions for 2010.

Table 3 Budgetary payments to Price rebates (prisnedskrivning) 1995-2010, Norway (mio NOK)

Year	1995	1998	2000	2004	2006	2007	2008	2009	2010
Budget	30	70	90	142	151	154	101	193	179

Source: Norwegian Agricultural Authority

The Common Agricultural Policy (CAP) used to comprise subsidies which could have been questioned in the WTO on the same grounds as those mentioned above, e.g. the unreformed EU production subsidies, in particular subsidies concerning discounted sales of butter, butteroil and cream. However, these production subsidies have been abolished. Accordingly, they should not constitute any obstacle to a more offensive EU approach in negotiations with Norway.

3.5 **Parallel trade agreements between the EU and Switzerland – a comparison**

A number of components in the 2005 Protocol 2 agreement result in a higher degree of trade liberalization and also mean improved transparency, simpler administration and lower budgetary costs for both parties. In the case of the EU all costs for price compensation of exports have disappeared.

The agreement is based on the principle of net compensation. Since prices most often are higher in Switzerland (not for sugar nor for milk recently) the EU has accepted that only Switzerland is allowed to use price compensation (tariffs on imports and refunds for exports). The parties have furthermore agreed not to grant any price compensation for price differences concerning sugar.

If Protocol 3 with Norway were to be adjusted in line with Protocol 2 with Switzerland this would mean that it would be possible to liberalize a number of products of interest for the EU in the trade with Norway. Protocol 2 can thus serve as a model when further liberalization of Protocol 3 with Norway will take place.

The wordings in Protocol 2 appear to be quite sufficient to avoid misuse of other kinds of price compensation e.g. price rebates. Any benefits of this kind should be included in the price notifications from both parties.

Protocol 2 has been designed in the same way as Protocol 3 of the EEA Agreement. Products have been divided into two tables. Table1 lists products for which Switzerland may apply price compensation for price differences in raw materials between Switzerland and the EU, and Table 2 lists products free of tariffs in trade between Switzerland and the EU. Table 2 i Protocol 2 with Switzerland has a larger product coverage than Table 2 of the EEA Agreement. The bilateral agreement with Switzerland thus means a higher degree of trade liberalization.

The agricultural agreement between the EU and Switzerland contains a number of trade preferences for the EU's agricultural exports.

Trade preferences for the EU i.a. include tariff-free quotas for salted, dried or smoked meat, sausages and preserved ham, free imports of game meat, no tariffs for cheese or for certain other dairy product imported from the EU, tariff preferences for tomatoes, iceberg lettuce, cucumber, preserved tomatoes, tomato paste, preserved mushrooms, processed potato products, oranges, mandarines, water melons, plums, apricots, strawberries and free imports of jams and marmelades. The agreement also lays down that no export refunds from the EU side are allowed for exports of cheese to Switzerland.

The agreement with Switzerland can serve as a model in future discussions with Norway concerning agricultural trade. Quite a few tariff preferences that Switzerland applies to imports from the EU have been granted without any quantitative restrictions. The preferences for cheese are perhaps the most far-reaching.

4 Norwegian agricultural policy

Norway has the highest GDP per capita in the OECD region. It has relatively low inflation and unemployment rates. Agriculture constitutes a small share of Gross Domestic Product (1.2 %) and employment (2.8%). The farm structure is based on relatively small family farms. Support to farmers as a share of income is very high, but has declined by 10 percentage points, from 70 % in 1986-1988 to 60 % in 2008-2010. Prices received by farmers were 1.9 times higher than those on the world market in 2008-2010. According to OECD, this is a significant reduction relative to 1986-1988[2]

Norwegian agriculture enjoys one of the highest support levels in the World. Reform ambitions are moderate compared to those of other OECD countries. Norway sticks to traditional agricultural policies based on market price support and high tariffs. Market price support in the form of wholesale target prices, is provided for most commodities. These target prices and most payments are negotiated annually between the government and producer organizations. Matters of regional policy are given much weight when agricultural policy is laid down. Norway has few interests in agricultural exports, a fact that slows the process down with the EU and makes negotiations difficult. The present Government's introductory declaration from 2009 does not signal any major changes in Norway's positions as regards the EEA or the WTO negotiations. One quote from the declaration says that "Any further development of our agreements with the EU should be done on a basis of mutual benefit within the framework of the agricultural policies of both parties".

Policy developments

Overall, there has been modest policy reform since 1986-1988 towards market orientation, and a modest reduction in the level of support. There has also been a move away from support based on commodity output, particularly with respect to payments based on output, but on the other hand payments based on current production factors have increased. While the share of the most distorting support has declined significantly, it continues to account for more than half of overall support. Agriculture in Norway remains among the most highly protected in the OECD area and according to OECD, greater efforts are required to reduce the share of production-linked support and increase market access.

4.1 Common Norweigan objections (and counter arguments) on liberalization of trade

Norwegian imports from the EU of agricultural products have doubled in eight years.

- Growth of food imports to Norway is not an effect of trade liberalization. Norwegian consumers have greater purchasing power and demand a greater variety of food products. This reality is reflected in a general increase of food

[2] OECD: Agricultural Policy Monitoring and Evaluation 2011: OECD Countries and Emerging Economies, page 176.

imports to Norway. Norway has, like several of its neighbours, seen a growing gap between domestic production and demand in key sectors. For example, Norway and Sweden were both self-sufficient in the beef sector 15 years ago. In 2008 Norway could supply only 86 % of its market; the corresponding figure for Sweden was 57 %. The gap is filled by imports, mostly from the EU area. Since the gap is expected to continue growing, there should be no problem for Norway to ease some of the draconian trade barriers. Tariffs for beef varieties often exceed AVE 400 %.

Norway insists on the need to reach a "balanced" agreement

- This mercantilist approach is questionable, particularly since it is matched by virtually no Norwegian interests to exploit the export potential. With an absolute minimum of Norwegian negotiation requests, it is of course impossible to reach a "balanced" agreement within the agricultural sector. We should reject the "balancing" argument as a basis for denying the EU improved market access in accordance with Article 19. Furthermore, when taking also fish into account Norway enjoys a substantial trade surplus with the EU in the broader food sector.

There are no linkages in the EEA Agreement between Agriculture and Fisheries and no requirement for Norway to offer additional preferences to the EU

- No explicit requirements in Article 19. However Norway enjoys preferential access to the EU market for fish products, owing to an effective trade liberalization schedule for fish implemented over a few years, and according to mandated timing, after the conclusion of the EEA Agreement. There was certainly a similar thought behind Article 19, even though the implementation was left to bi-annual negotiations.

Trade concessions on agriculture to the EU would jeopardize domestic Norwegian production

- Imports of domestically produced categories constitute a small part of total domestic consumption. As indicated above, imports are increasingly relied upon to meet growing demand. This is achieved through temporary tariff reductions. It is therefore unlikely that some tariff reductions on a permanent basis would undermine agriculture. Experience from the present EU cheese quota confirms that liberalization of trade is actually beneficial to operators on both sides. Increased imports lead to greater variety of supply and improved quality. The overall Norwegian cheese market has grown, to the benefit of both importers and domestic producers. This has been confirmed by Norwegian operators.

EU applies prohibitive customs tariffs to agricultural exports from Norway

- The EU has been forthcoming in further opening its markets to food products from Norway. However, tariff quota utilization has been low for a range of existing TRQs granted to Norway. There seems to be few incentives for Norwegian operators to invest in export promotion due to present agricultural policies.

5 Conclusions

- The EEA Agreement foresees a progressive liberalization of agricultural trade with regular reviews of trade conditions at two-year intervals. Since 1994 it has only been reviewed twice. The trade balance between exports of agricultural products and imports of fish and fish products has become very negative for the EU in relation to Norway

- There has only been one round of bilateral trade liberalization for PAPs since the entry into force of the EEA agreement. Norway has a legal obligation and made a commitment in 2004 to review the trade regime of PAPs. Price monitoring indicates that overcompensation is a common feature in the Norwegian import regime.

- According to the EEA agreement, regular bi-annual reviews of the bilateral conditions shall be carried out. However, bilateral trade preferences have only been improved twice since the entry into force of the agreement in 1994.

- There is much to suggest that the EEA Agreement will remain the factor that determines rules on trade between the EU and Norway. It is in the interest of the entire EU that all commitments are complied with and updated to current economic and market conditions.

This report can be ordered by contacting:

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