

# The European Union's Newest State: Iceland?

Written by Peter Sherwood

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PETER SHERWOOD, APR 30 2012

The question of membership of the European Union (EU) has been a constant topic of discussion both in Reykjavik and Brussels. The issue has been on the agenda since the current Icelandic coalition government made its application for membership in July of 2009. Unlike some other potential members Iceland fulfils the EU's main criteria; it is already a member of the Schengen zone, European Economic Area (EEA), and has a long standing democracy whose parliament (the Alþingi) dates back to the year 930 (Chu, 2012).

The origins of the Icelandic bid for membership lie in a national crisis never before experienced and the logic and purpose of EU membership remains a hotly disputed topic in the nation of just over 300,000.

### Current Stage of the Process

The accession criteria of the EU (also known as the Copenhagen Criteria) state that to join the EU, a new member state must meet three criteria:

Political: Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for protection of minorities;

Economic: Existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union

Acceptance of the community *acquis* ability to take on the obligations of membership including adherence to the aims of political, economic, and monetary union. (Europa)

Clearly Iceland meets these criteria, the European Economic and Social Committee (EESC) has noted that "due to its high political and economic development and its participation in the European Economic Area (EEA), Iceland is generally well prepared to assume the obligations of EU membership (despite the breakdown of the Icelandic economy in the recent crisis) particularly in the fields of EEA agreement" (EESC, 2011).

Although Iceland is very close to Europe in terms of bilateral relations, and has in fact already implemented the substantial corpus of EU *acquis*, challenges remain in certain areas or chapters of negotiation, which are still open and it is as yet unclear which path these negotiations will take.

### Fishing

First and foremost among these areas is Iceland's fishing policy. Fishing in Iceland is not only culturally of massive importance to the Icelandic people, it is a key driver of the Icelandic economy, indeed fisheries account for nearly half of Iceland's merchandise exports (EESC, 2011, p. 10). In four steps from 1952 to 1975, Iceland managed to extend its fishing zone to 200 nautical miles despite heavy protests from Britain (which sparked the so called "cod wars") as well as other neighbours. Iceland was successful in this dispute which at times often saw dangerous clashes between the British navy and small Icelandic fishing and coastguard boats, although this success was in no small part down to its strategic position in the GIUK gap (Greenland, Iceland, UK) which was of particular importance

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during the cold war as well as the evolution of maritime law which was generally in favour of Iceland (Avery et al, 2011, p 2).

The main issues that surround Iceland's fishing policy are its restrictive rules on foreign investment in the industry which effectively bars all FDI in this area; this position is contrary to EU laws on the free movement of capital among others. There are also issues surrounding quota-hopping (the practice of registering one's ship in one jurisdiction and fishing in another). As well as Discarding, these and other issues have led Iceland to propose that its waters become a "specific management area" where Icelandic authorities would continue to be responsible for the management of their own fisheries industry. Furthermore Iceland's resumption of commercial whaling in 2006 could also prove a troubling hurdle for EU-Icelandic negotiations in this area. Hand in hand with this issue is the fact that Iceland would still like to represent itself at world fishing forums, this is contrary to the EU policy which maintains that the EU should present itself as having one joint policy in the world stage represented by one delegation (Avery et al, 2011, p 105-106, Willis, 2011). This kind of derogation could potentially lead to other nations attempting to undermine the EU in other areas of common negotiation, thereby undermining a fundamental pillar of the EU integration project. Indeed it is arguable that fishing being of such importance to the Icelandic people, the referendum on EU membership may depend on the pro-EU voices within Iceland being able to convince the public of the merits of the EU fishing plan. The view of many Icelandic people is well summarised by Baldur Thorhallsson who notes that membership will have "unbearable constraints" on Iceland's fishing interests and fishing community (Thorhallsson, 2007).

## **Agriculture**

Currently the Icelandic Farmer's Association strongly opposes EU membership arguing that it would create large scale loss of jobs in the sector and have a considerable negative impact on the food safety and security of the country. The main reasoning behind this is that Iceland would have to allow unlimited imports of agricultural products from the EU, which would lower the price of these goods to a level in which the Icelandic farmers could not compete (EESC, 2011, p 13). Indeed many countries feel it is vital to national security to maintain their own indigenous source of agricultural products and seek to protect their industries from imports by using direct or indirect tariffs such as subsidies. Prime example of this is the Swiss agricultural policy in which, according to the OECD, government support remains at 56% of farming income primarily in the form of direct payments (OECD, 2011).

One solution to this issue may be what is termed the "Finnish Solution" which provides regions situated north of the 62nd parallel with extra support to aid with farming in a region with difficult and unique climactic conditions (EESC, p 54). Although there is some confusion over this arrangement the EU seems to believe it is a temporary measure, although the receiving states seem to hold the view that it is a permanent measure. Iceland's capital restrictions on FDI in the agricultural sectors would require reforming as well as they are highly restrictive and this runs contrary to fundamental EU integration policy (Raunio, Tiilikainen, 2003, p 25-29).

The unique position of Iceland is one of interest for the EU, and indeed other potential applicant states are monitoring Iceland's application; the EU may want to be flexible with Iceland because of this "uniqueness". They may not want to be seen as being too flexible with Iceland, as this may lead to other member states and applicant states engaging in lengthy negotiations to obtain derogations based on an elusive concept of "uniqueness" in areas that go to the core of the European Union as an institution and could cause cracks in the European integration project as a whole.

Although it is worth mentioning that the EU may be willing to grant Iceland certain exceptions as Icelandic membership would be of considerable benefit to the EU. The EESC (2011, p 10) noted these benefits as, contributing to its geographical completeness, it would give the EU a foothold in the Arctic and the possibility of participation in the Arctic Council, as well as effective control over a prominent and important shipping passage, moreover Iceland would probably be a net contributor to the EU budget.

## **Attitude of Member States**

All questions of enlargement are decided in the EU by unanimity; an applicant must have the support of all the member states, but importantly have no serious disputes with any of whom could block a potential member's

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entrance.

The general response of member states seems to be positive the northernmost member states (Sweden, Finland, Estonia, Latvia, and Lithuania) are strong supporters, as is Spain who feel they may gain fishing benefits (Avery *et al*, 2011, p 102).

The only member states that may be in any way hostile are the British and the Dutch, Britain partly because of lingering tensions on both sides over the “cod wars”. Although the primary source of tensions between these nations arises from the manner in which the “Icesave” dispute has been handled which led to considerable losses of savings for Dutch and British citizens. According to the Deposit Guarantee Scheme Directive (94/19/EC) Iceland is responsible for reimbursing deposits of up to 20,000 euro per account. At the time of the collapse of the bank the British government made a controversial decision by invoking the *Anti-Terrorism, Crime and Security Bill 2001* to take control of the bank’s assets on the basis that the bank’s collapse would seriously harm the UK’s economy (Donaldson, Vina, 2008). Iceland has also agreed to repay a total of £2.3 billion to the British government with the Dutch government set to receive £1.2 billion, although the repayments will not start until 2016 and will be spread over 16 years (Mail Online, 2009). Iceland has agreed to honour these obligations however; both British and Dutch governments and MEPS have expressed their dissatisfaction with this resolution. More than 100 UK local councils and thousands of private UK investors had nearly £5 billion on deposit in Icesave accounts at the time of the collapse (Meade, 2012). Although the vast majority of MEPs support Iceland’s continued progress towards EU membership, London MEP Charles Tannock stated:

I understand around one third of the recognised priority claims have now been repaid. Given Iceland’s successful completion of the International Monetary Fund’s economic recovery programme last year and its return to positive economic growth, we have no doubt that the other outstanding claims will be repaid. (Meade, 2012)

Although some such as London MEP Marina Yannakoudakis feel that “[u]sing the enlargement negotiations are now the best way of securing a repayment from Iceland” (Yannakoudis, 2012). The wider EU and the EESC stress strongly that the Icesave dispute “should be resolved outside the accession negotiations and must not be made into an obstacle in the way of Iceland’s accession process” (EESC, 2011). Currently this matter is still under dispute and is before the EFTA court (Office of the Prime Minister, 2011), and this dispute appears to be taking a course of its own parallel to the accession negotiations and should not harm them, indeed should Iceland join the EU there may be a better chance of this money being repaid.

## Economy

The challenges that currently face Iceland’s economy must be given careful consideration by the EU as the nation must be able to stabilize before its entry, and to a certain extent it has done so already, but the EU may have great difficulty if investor confidence falls again leading to a run on the banks or the currency itself.

To combat the fiscal crisis the government of Iceland sought IMF assistance and received \$2.1 Billion in funding, this was partnered with economic restructuring as well as depreciation in the Icelandic Krona. Although macroeconomic stabilisation is not yet complete, and fiscal consolidation still remains a challenge; figures seem to indicate that Iceland is already showing signs of recovery, although Iceland’s debt to GDP remains stubbornly high at 87.8% (Trading Economics, 2012a), as does its structural deficit at 9.1% (Trading Economics, 2012b). Both of these will have to fall or show signs of a clear ability to fall in order for Iceland to not “rock the boat” when it enters the EU and to meet the requirements for the new fiscal compact treaty, which sets debt to GDP to a maximum allowable level of 60% and a general government deficit of not more than 0.5% of nominal GDP (European Council, 2012). Although positives can be taken from Iceland’s improving annual growth rate which in 2011 achieved 3.8% and look to report growth of 2.7% at the end of the first quarter (Trading Economics, 2012c).

The EESC believes that based on Iceland’s strong workforce, “robust resource base” and “rich fishing grounds and vast renewable energy sources” that it is likely that Iceland will recover fully from the current economic situation, furthermore, the European Commission believes that if Iceland aligns with the *acquis* in the area of economic and

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monetary policy its participation in the Economic and Monetary Union (EMU) should not pose any major problems (EESC, 2011, p 11). Indeed Iceland has already started to pay back some of the money loaned to it by the IMF, it announced on the 15 March 2012, that it would pay back ahead of schedule, obligations to the IMF amounting to some SDR[1] 288.8 million (US\$ 443.4 million). The payment was made on March 12.

The early repayment is about one fifth of the SDR 1.4 billion (US\$2.15 billion) that Iceland borrowed from the IMF under its Stand-By Arrangement. Together with a scheduled payment made in February 2012, this early repayment will reduce Iceland's outstanding obligation to the IMF to SDR 1.041 billion (about US\$1.60 billion). This outstanding balance is projected to be repaid during 2012-16 (IMF, 2012).

## **What Does Europe Get from Iceland**

Iceland joining the European Union would not boost its population greatly, nor would it would boost its economic clout, but it would generally be desirable from a European Union perspective for Iceland to join the EU for a number of reasons. It would add a sense of completeness, both politically and geographically, it would mark the end of EU expansion to the north. But vitally it would give the EU a more significant role in the Arctic – a region rich in untapped energy and mineral resources.

Iceland is a member of the Arctic Council a multinational organization made up of countries whose territory lies within the Arctic Circle[2] (Arctic Council, 2011). Currently the EU is present as an observer only, but undoubtedly if Iceland were to join the EU it would seek to increase its position in this area. Whether Iceland would be ready to be represented by a single EU delegation at these meetings is questionable. Iceland already has a parliamentary approved "Arctic Policy" which prioritizes "Icelandic interests with regard to the effects of climate change, environmental issues, natural resources, navigation and social development as well as strengthening relations and cooperation with other States and stakeholders on the issues facing the region" (MFA, 2011).

## **Canada – Iceland – EU**

Iceland joining the EU may also mark a shift in Canada – EU bilateral relations. Currently Canada and the EU have excellent bilateral relations dating back to the 1950's there is a Comprehensive Economic and Trade Agreement (CETA) in place, and they work closely in other areas such as agriculture, security and education, the EU and Canada also hold annual summits. (Gov't Canada, 2011).

Iceland too enjoys excellent relations with Canada, Canada is home to the largest population of Icelanders outside of their native country and this is reflected in bilateral trade between the nations which is quite high (Gov't Canada, 2011). Iceland and Canada support each other on many issues, primarily in Arctic and fishing matters. Some of these positions shared by Canada and Iceland are in direct conflict with EU common positions. Both Iceland and Canada have whaling industries which is in conflict with the EU. Furthermore Iceland has decided to support Canada and Norway in the case against the EU trade ban on seal products; these nations have lodged a formal complaint with the World Trade Organization (WTO) who have established a Panel which is as of yet to be composed (WTO, 2011). Canada also takes a very dim view on infringements on its Arctic sovereignty and may not take too kindly to increased large scale EU interest and presence in this area in the event that Iceland joins the EU, indeed Canada's Prime Minister Stephen Harper has stated numerous times that the protection and promotion of Canada's sovereignty in the Arctic a "non-negotiable priority" (CBC News, 2010).

## **Convincing Iceland**

Iceland's ascendancy to the EU is by far not a foregone conclusion, even if the negotiations prove successful there remains the issue of a referendum in which the Icelandic people will have to vote in favour of joining the EU. The current Icelandic government is split down the middle on the prospect of membership. The current Icelandic government is a coalition made up of the Left-Green alliance which are steadfast in their opposition to EU membership, and the Social Democrat party who are pro-EU (Avery *et al*, 2011). The cabinet positions are shared, with some such as the Ministry of Foreign affairs falling to a pro-EU member of the Social Democratic Alliance (SDA)

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Össur Skarphéðinsson[3], while the post of Minister of Fisheries and Agriculture has been given to a member of the Left-Green Movement (LGM) and EU sceptic Steingrímur J. Sigfússon[4] these divisions at the cabinet level are also reflected in the team[5] which is negotiating the terms of Iceland's potential EU membership package. Not only will the Icelandic government itself have to play a large role in convincing the public of the merits of EU membership the EU itself will have to play a role.

One of the main benefits of Iceland joining the EU would be the greater financial stability brought by being a member, as well as the reduced cost of products and services as well as other benefits such as increased tourism, access to structural funds as well as bailout mechanisms. Although since the application the EU's growth has stagnated and there still exist severe problems in the Eurozone, the question must be asked, is there still great economic benefit in joining the EU? This question is made even harder by the fact that Iceland is already a member of the EEA and therefore enjoys many trading rights and privileges with the EU. If there is no considerable economic benefit to be gained from joining the EU and eventually the Eurozone the sacrifices Iceland may make in other areas such as fisheries and agriculture may simply not be worth it. Iceland in search of greater economic stability has indicated that it is considering adopting the Canadian dollar, the Icelandic Prime Minister Johanna Sigurdardottir sounded the death knell for the Icelandic krona, saying her country faced a choice between "surrendering the sovereignty of Iceland in monetary policy by unilaterally adopting the currency of another country or becom[ing] a member of the EU" (Tencer, 2012). The Canadian Ambassador to Iceland Alan Bones has stated that Canada is open to discussions in regards to this matter (McKenna, 2012), according to a recent poll as many as 70% of the population of Iceland would support the adoption of the Canadian dollar (Berkow, 2012).

Iceland as the smallest population in the European Union would also have the fewest seats and therefore be the least represented country in terms of the European Parliament. Seats in the European Parliament are allocated on the basis of population with the total number of seats in the parliament not to exceed 750 members (Chalmers, 2010 p 81). Article 14(2) of the Treaty on the European Union (TEU) states that no country should have less than 6 MEP's this is undoubtedly the number Iceland would receive making them the least represented in terms of seats but the best represented on a per capita basis. This issue may enhance anti-EU groups in Iceland's position if they can make people feel as though their voice will not be heard on the European level.

## Conclusion

It goes without saying that the question of whether Iceland will join the EU is still vastly undecided considering negotiations are yet to draw to a close. Current polling data from a recent Capacent Gallup indicates that the population is not yet in favour of joining the EU. Support for joining fell to 26.3 percent from 37 percent, according to the poll, published on the pro-membership group's website. Opposition to joining the 27-nation bloc fell to 56.2 percent from 63 percent in a January 2012 survey (Valdimarsson, 2012). Although the accuracy and predictability these polls offer is very difficult to predict, Norway experienced 53% EU referendum approval ratings in 2002/2003, although subsequently voted to stay out of the Union (BBC News, 2002). Although without the support of influential groups such as the fisheries and agricultural groups it is hard to envisage a "yes" vote in the eventual referendum. The outcome of the referendum will fundamentally rest on the terms of membership the Icelandic people will be bound to. While Europe may want to be flexible in negotiations with Iceland as they will benefit from their membership, especially given Iceland's unique geo-political location, as an institution the EU may not want to be seen as being too flexible. Undoubtedly other candidate countries are watching this process carefully and the EU will not want to be seen to be in effect creating a two-tiered application system, where there are "more favoured applicants" who may be more likely to receive derogations and exceptions and "less favoured applicants" who are less likely to receive special exemptions from the EU

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[1] Special Drawing Rights

[2] These members include, Iceland, Canada, U.S.A., Denmark representing Greenland and the Faroe Islands, Sweden, Russia, Finland, and Norway, as well as six international organisations representing the interests of Indigenous people in the Arctic regions.

[3] <http://www.mfa.is/minister/about/>

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[4] <http://eng.sjavarutvegsraduneyti.is/minister/cv>

[5] <http://europe.mfa.is/sidemenu/negotiation-committee/>

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