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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT AND THE COUNCIL**

Commission Opinion on Iceland's application for membership of the European Union

{SEC(2010) 153}

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A. INTRODUCTION

a) Application for membership

Iceland presented its application for membership of the European Union on 17 July 2009. Subsequently, on 27 July, the Council of the European Union requested the Commission to submit its opinion on this application, in line with the procedure laid down in Article 49 of the Treaty on European Union, which currently states: *'Any European State which respects the values referred to in Article 2 and is committed to promoting them may apply to become a member of the Union. The European Parliament and national Parliaments shall be notified of this application. The applicant State shall address its application to the Council, which shall act unanimously after consulting the Commission and after receiving the consent of the European Parliament, which shall act by a majority of its component members. The conditions of eligibility agreed upon by the European Council shall be taken into account'*.

Article 2 states that *'the Union is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities. These values are common to the Member States in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail'*.

In Copenhagen in June 1993, the European Council concluded that:

Accession will take place as soon as a country is able to assume the obligations of membership by satisfying the economic and political conditions required.

Membership requires:

- that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- the existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union;
- the ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union.

The Union's capacity to absorb new members, while maintaining the momentum of European integration, is also an important consideration in the general interest of both the Union and the candidate countries.

In December 1995, the Madrid European Council referred to the need 'to create the conditions for the gradual, harmonious integration of [the applicant] countries, particularly through the

development of the market economy, the adjustment of their administrative structures and the creation of a stable economic and monetary environment’.

In December 2006, the European Council agreed that ‘the enlargement strategy based on consolidation, conditionality and communication, combined with the EU’s capacity to integrate new members, forms the basis for a renewed consensus on enlargement’.

In the present opinion, the Commission analyses Iceland’s application on the basis of the country’s capacity to meet the criteria set by the Copenhagen European Council of 1993. The method followed in preparing this opinion is the same as used in previous opinions, *mutatis mutandis*. The Commission has analysed both the present situation and the medium-term prospects. For the purpose of this opinion and without prejudging any future date of accession, the medium-term has been defined as a period of three years.

In line with the renewed consensus on enlargement, the present opinion also identifies key policy areas likely to require particular attention in the event of Iceland’s accession and provides initial impact estimates with regard to key policies and sectors. The Commission will provide more detailed impact assessments for these key policy areas at later stages of the pre-accession process. In addition, Iceland’s accession Treaty would involve a technical adaptation of the EU institutions in the light of the Lisbon Treaty, as well as the recognition of Icelandic as an official language of the EU.

The report containing the detailed analysis on which the opinion is based is made public as a separate document (*Analytical Report for the Opinion on the application from Iceland for EU membership*¹).

b) Recent developments

The last two years have been challenging for Iceland. In the context of the global financial crisis, its banking system collapsed in October 2008 with severe economic impact and social consequences. The crisis led to significant economic contraction, caused considerable hardship for the population and triggered a series of political developments.

In January 2009, the Prime Minister resigned and early parliamentary elections were called. General elections took place in April 2009, resulting in a coalition government of the Social Democratic Alliance and the Left-Green Movement. In July 2009, on a proposal by the government, the Icelandic parliament voted in favour of applying to join the EU. Public opinion and political parties in Iceland are divided on the question of EU membership.

On 5 January 2010, following a petition signed by 25% of the electorate, the Icelandic President withheld his signature on the law setting the arrangements for repayment of a €3.9 billion loan to the governments of the United Kingdom and the Netherlands, known as the Icesave bill², as approved by the parliament on 30 December 2009 after months of heated debate. In line with Article 26 of the constitution, a referendum has been called on that law for 6 March 2010.

¹ SEC(2010) 153.

² The ‘Icesave bill’ authorises the Icelandic Minister of Finance, on behalf of the State Treasury, to issue a state guarantee on the €3.9bn loans granted by the governments of the UK and the Netherlands to the Depositors’ and Investors’ Guarantee Fund of Iceland. The purpose of the loans is to reimburse the British and Dutch governments for the compensation already provided to their citizens holding savings accounts in the Icesave online wing of Landsbanki Íslands hf.

c) Relations between the EU and Iceland

Iceland became an independent republic on 17 June 1944.

Iceland and the European Union have been cooperating extensively across a broad range of areas over the last forty years.

Iceland joined the European Free Trade Association in 1970 and has been a party to the Agreement on the European Economic Area (EEA) since its entry into force in 1994. The EEA provides a framework for regular meetings between Iceland and the EU at political level, including the twice-yearly EEA Council meeting of Foreign Ministers.

Participating in the single market for over 15 years through the EEA Agreement, Iceland has adopted a significant part of European Union law. The EFTA Surveillance Authority (ESA) regularly monitors Iceland's performance under the EEA Agreement. Overall, Iceland has a satisfactory track record in implementing its EEA obligations. Some shortfalls that will have to be addressed at an early stage have been identified, notably in areas such as financial services, food safety and the free movement of capital and are described under the relevant chapters in Part 3 of the analytical report. Against the background of the financial crisis, Iceland invoked the exceptional balance of payments safeguards allowed for non-Eurozone countries. These temporary safeguards – some of which were lifted in November 2009 - restrict capital flows between Iceland and EU/EEA members.

Starting in 1981, regular meetings have taken place between the European Parliament and the Committee of Members of Parliament of EFTA Countries. Since the entry into force of the EEA Agreement, these relations have been institutionalised in the EEA Joint Parliamentary Committee. In addition, bilateral meetings between Icelandic parliamentarians and Members of the European Parliament take place on a regular basis.

Iceland has been associated with the development of the Schengen agreements since 1996³ and has applied its provisions since 2001. This means that Iceland has abolished border controls with other Schengen area countries. Common rules and procedures are applied with regard to visas for short stays and external border controls. Iceland participates in extensive cooperation and coordination among police services and judicial authorities within the Schengen area.

Iceland is associated to the Dublin Regulation, which establishes criteria and mechanisms for dealing with asylum requests⁴.

As regards trade relations, Iceland became a member of the GATT in 1968 and is a founding member of the World Trade Organisation. In addition to its membership of the European Free Trade Association (EFTA) and the Agreement on the European Economic Area (EEA), Iceland has free trade agreements - along with complementary bilateral agreements on basic agricultural products - in force with sixteen third countries within the framework of EFTA, as well as four additional ones, still to enter into force. In addition, a bilateral trade agreement

³ The Agreement on Iceland's association with the implementation, application and development of the Schengen *acquis*, as based on Council Decision 1999/439/EC of 17 May 1999, was signed between Iceland and the EU on 18 May 1999. Council Decision 2000/777/EC of 1 December 2000 provides for the application of the Schengen *acquis* arrangements to the five countries of the Nordic Passport Union, including Iceland, as from 25 March 2001.

⁴ Council Decision 2001/258/EC.

and a complementary agreement on basic agricultural products relating to the EEA-Agreement is in force with the EU.

In 2008, more than 54 % of Iceland's imports came from the EU and 76 % of its exports went to the EU.

Iceland contributes to reducing social and economic disparities in Europe through the EEA Grants⁵. For the period 2004-2009, Iceland provided approximately €29 million for project funding in a number of EU Member States through EEA Grants.

Following Iceland's membership application, the Commission proposed that Iceland be included as a beneficiary of pre-accession financial support under the Instrument for Pre-Accession Assistance (IPA). Such support would foster institution and capacity building to allow smooth implementation of the *acquis*, especially in areas not covered by the EEA, mainly through the Technical Assistance and Information Exchange Instrument (TAIEX) and twinning.

B. CRITERIA FOR MEMBERSHIP

1. POLITICAL CRITERIA

Iceland is a functioning democracy with strong institutions. It is a parliamentary republic with deeply rooted traditions of representative democracy and division of powers. Its constitutional and legal order and governing institutions are stable.

The separation of powers between the legislature, the executive and the judiciary is respected. The government is subject to effective parliamentary control; its ministers are accountable for their acts. Municipal authorities function efficiently.

Iceland's judiciary is of a high standard and the judicial system is well established. The effective independence of the judiciary, in particular the procedure for judicial appointments, is, however, a matter of concern.

Iceland's public administration is, in general, efficient and free from political interference. A public administration reform process was initiated in October 2009.

Following the financial crisis, certain questions have been raised concerning possible conflicts of interest in Iceland's public life, such as close links between the political class and the business community, especially in light of the country's small population and isolated location. Immediately following the crisis, a Special Investigation Commission and a Special Prosecutor were set up to investigate and prosecute alleged criminal acts in the context of the bank collapse. Investigations are under way. Against this background, mechanisms will, where appropriate, need to be strengthened to reduce the scope for conflict of interest.

Iceland has a comprehensive system for safeguarding fundamental rights and there is a high level of cooperation with international mechanisms for the protection of human rights.

⁵ The 'EEA and Norway Grants' are Iceland's, Liechtenstein's and Norway's contribution to the wider European cohesion efforts. The EEA Grants are contributions funded jointly by Iceland, Liechtenstein and Norway, while the Norway Grants are funded by Norway alone.

2. ECONOMIC CRITERIA

Iceland is a small open economy and a member of the EEA since 1994. As an EEA member, Iceland is well integrated into the EU economy. During the 1990s and for most of the past decade, it restructured its economy, mostly through deregulation and liberalisation. It moved from an economy based mainly on the fishing sector to being more diversified with a large and open financial sector. Given the degree of exposure of Icelandic banks and the lack of adequate financial sector supervision, in the context of global financial turmoil, Iceland's banking sector collapsed in 2008, pushing the economy into a monetary and financial crisis which led to deep recession. The government subsequently sought the assistance of the international community, including the IMF, to support the currency and re-establish sustainable macroeconomic stability. The IMF stand-by arrangement for €1.4 billion focuses on currency stability, fiscal consolidation and bank restructuring.

The gravity of the economic crisis and the resulting political situation in Iceland delayed the implementation of the IMF programme. However, since summer 2009, a broad consensus about the fundamentals for recovery has been reached. The authorities have taken important economic stabilisation measures, aimed at fiscal consolidation, exchange rate stabilisation and financial sector restructuring. The first positive results of these measures are starting to emerge. Iceland has a relatively flexible labour market with high participation rates, a relatively young working population and a well managed and robust resource base.

However, macroeconomic stabilisation is not yet complete. In response to the crisis and as a consequence of the public takeover of the failed banks, the government deficit rose to 14.4% of GDP in 2009. In the same year, the gross public debt reached 130% of GDP, a third of which is due to the Icesave debts. Fiscal consolidation remains a key challenge. Public and private debts require far-reaching and sustainable restructuring in order to enable recovery. The completion of financial sector restructuring as well as the substantial improvement of the regulatory and supervisory institutional framework and practices are among the key challenges to be addressed in the short term. Further diversification of the economy and the implementation of a number of structural reforms would improve the country's competitiveness.

3. ABILITY TO ASSUME THE OBLIGATIONS OF MEMBERSHIP

Iceland's ability to assume the detailed obligations of membership has been evaluated according to the following indicators:

- The obligations under the EEA Agreement;
- The level of alignment, implementation and enforcement of the *acquis* outside the EEA Agreement.

In general, Iceland has a satisfactory track record in implementing its EEA obligations.

According to the EFTA Surveillance Authority (ESA), the percentage of internal market legislation introduced into national legislation as required by July 2009 is at the same level as

the average for EU Member States. The total number of infringement proceedings⁶ against Iceland decreased significantly in recent months. ESA's investigation into the emergency legislation and actions taken by Iceland in the aftermath of the banking collapse, including its compatibility with EEA law, is ongoing.

Iceland is on the whole well prepared to assume the obligations of membership in most areas, in particular fields covered by the EEA.

In the following areas, Iceland will need to make serious efforts to align its legislation with the *acquis* and/or to implement and enforce it effectively in the medium term in order to meet in due course the accession criteria: fisheries; agriculture and rural development; the environment; free movement of capital; financial services; as well as customs union; taxation; statistics; food safety, veterinary and phytosanitary policy; regional policy and coordination of structural instruments; financial control.

C. CONCLUSION AND RECOMMENDATION

Iceland is a parliamentary republic with deeply rooted traditions of representative democracy. Its institutions are effective and respect the limits of their competences. Iceland's constitutional and legal order is stable. The rule of law and respect for human rights are guaranteed. The Icelandic authorities need to make further efforts to strengthen the independence of the judiciary, especially regarding the procedure for judicial appointments. Mechanisms to prevent conflicts of interest need to be strengthened. Overall the Commission considers that the country satisfies the political criteria set by the Copenhagen European Council in 1993.

As regards the economic criteria, Iceland can be considered a functioning market economy. The functioning of the markets has been seriously affected by macroeconomic imbalances and certain structural and regulatory weaknesses, exacerbated by the global economic and financial crisis. In order to address existing vulnerabilities, agreed reform measures and policy adjustments need to be strictly implemented. Before the crisis, the country proved able to withstand competitive pressures and market forces within the European Economic Area (EEA). Bearing this in mind, Iceland should be able to cope with competitive pressures and market forces within the Union in the medium term provided it swiftly implements the necessary policy measures and structural reforms.

The country has a generally satisfactory track record in implementing its obligations under the EEA, of which it has been a member since 1994. Iceland is well prepared to take on the obligations of membership in the medium term, particularly in the fields covered by the EEA, and, on the path towards accession, Iceland needs to continue to fulfil these obligations. Efforts to align legislation with the *acquis* and to ensure its implementation and enforcement need to continue. Serious efforts will be required particularly in the areas of fisheries, agriculture and rural development, environment, free movement of capital, and financial services in order to meet the accession criteria.

Iceland's accession would have a limited overall impact on the European Union and would not affect the Union's capacity to maintain and deepen its own development.

⁶ For cases concerning lack of conformity with or incorrect application of EEA provisions, as well as legislation not at all or not fully transposed.

In the light of these considerations, the Commission recommends that negotiations for accession to the European Union should be opened with Iceland.