



BULLETIN

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Iceland's Relations with the EU: A Partnership Needed

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Contrary to popular opinion, Iceland's August 2013 decision to suspend negotiations on EU membership is no blow to the credibility of enlargement policy. Iceland, like Norway and Switzerland, is already closely tied to the EU, and it opened negotiations in a bid to create economic stability. This has largely been achieved, with the negotiations permitting a recalibration of bilateral relations. Nevertheless, the episode does point to the EU's failure to secure its strategic interests. It should therefore "complete" the new relationship through political partnerships in fisheries and in the Arctic.

EU–Icelandic relations are today dominated by uncertainty and tension. The 22 August decision by the centre-right Icelandic government to dissolve the national Negotiation Committee put a halt to EU membership negotiations, *de facto* suspended since January 2013. Despite pre-election promises, the coalition government of the Progressive and Independence parties decided not to hold a national referendum on the subject, let alone wait for the results of the report evaluating the stage of the negotiations and internal EU situation, expected this autumn. This comes in response to the European Commission, which in July demanded that the new Icelandic government make its decision on negotiations without further delay.

Iceland's Interests in the Negotiations. As a member of the European Economic Area since 1994, Iceland has implemented the EU single market provisions and has been party to the Schengen Agreement since 2001, as well as been involved in both Northern Dimension partnerships and Baltic Sea Region cooperation. These close ties were not enough, however, to stabilise the Icelandic economy. During Iceland's 2008 insolvency and subsequent IMF negotiations, the Icelandic Central Bank contended that the adoption of the euro would help stabilise the currency through access to eurozone assistance mechanisms. The Social Democratic government elected in 2009 made accession a mainstay of its agenda.

Iceland's application for EU membership, motivated by economic necessity, met with strong opposition at home. Opinion polls revealed fears about a loss of sovereignty or identity. After all, Iceland has just one quarter of the population of the city of Brussels. Except for at the beginning of 2008, popular support for accession in Iceland has never crossed the 50% threshold, and fell to 25% in the August 2012 Eurobarometer. In the 2013 April elections, support for the pro-accession and pro-euro Bright Future party wallowed at 8.25%, a sign not just of its relative political immaturity.

A particular kernel of resistance consists of Icelandic fishing lobbies, which contend that EU membership would strip the country of control over its fish stocks. Iceland is crucially reliant upon its fisheries for economic output and exports. Fish and fish products alone comprised 40% of Icelandic exports in 2012. Sources of concern include recent EU measures to reduce overfishing, which would likely restrict catch sizes.

Iceland's Residual Fiscal Instability. Ironically perhaps, another reason for the hardening of attitudes towards the EU in Iceland is that the accession process itself has helped stabilise the economy. For instance, one of the purposes of the approximately €29 million for Transition Assistance and Institution Building thus far made available to Iceland has been to develop Icelandic financial services that strengthen the domestic financial system and minimise the risk of future financial crises and bank failures. This process of stabilisation is not, however, complete. Although Iceland has recently achieved marked rises in real wages, not to mention normalising inflation and slashing government deficits,

the future of the Icelandic economy is still largely dependent on the continued existence of capital controls, the successful write-off of part of private mortgages, and fishing quotas. This shows that it is not yet out of the woods.

The removal of capital controls would, in effect, mean lifting restrictions on investment that keeps money inside Iceland, as well as potentially decreasing the competitiveness of Icelandic exports. This will not be well-received by the markets. International attitudes toward the Icelandic economy have been marked as wary since the governing parties made electoral promises to break with austerity policies and relieve mortgage debt. The credit rating agency Standard & Poor's issued a warning in July about the government's plans to write off about 20% of Icelandic mortgages, downgrading its outlook from "stable" to "negative." If the new government proceeds to simultaneously write off debts and remove capital controls, this could trigger capital flight.

The fishing and fish-processing sectors have played a role in the economic recovery of Iceland—in 2012 they constituted 11.3% of GDP—an increase of more than 4% above pre-crisis levels. This effect largely comes down to the unilateral decision to increase fishing quotas, a response to the noticeable migration of key stocks northward, caused by rising temperatures, from the EU and Norwegian Exclusive Economic Zones to the Icelandic and Faroe Iceland EEZs. The brewing "mackerel dispute" between all of these parties has broader significance to the management of quotas of "migrating natural resources." If the fish are considered "tourists" and not "residents" of the Icelandic EEZ, Norway and the EU could claim compensation from Iceland.

Interests of the EU in Icelandic Negotiations. At the same time, a halt on membership negotiations makes it more difficult for the EU to influence developments in the north. In the last three years, the significance of the Arctic in terms of resources, trade, security and environmental protection has dramatically increased, as witnessed by the rising interest of a range of emerging powers in the region. In case of Iceland's accession, not only would the EU get expanded access to the country's resources but it would also mean the northern EU states would constitute half of the membership of the Arctic Council (AC)—an organisation that has recently positioned itself to become the governance platform for Arctic issues.

This matters. Chinese interest in Iceland is increasing: in April the countries signed a free trade agreement and large Chinese companies are pairing with Icelandic energy companies—for example, the China National Offshore Oil Corporation joined Eykon Energy in the second round of bids for the rights to Iceland's Dreki Area, and Sinopec cooperates with Orka Energy in geothermal energy, research and technology. Moreover, the new Chinese embassy building can host up to 500 staff members, and Chinese magnate Huang Nubo has shown an interest in acquiring land in the northern part of Iceland. Earlier this year, the AC granted permanent observer status to China, India, Japan and Singapore, but not to the EU.

An additional point of interest is fish stocks in general, which in recent years have become a growing concern within Europe. Although a July report found that Europe returned to sustainable fishing levels in 2011, the verifiability of this finding and the success of the EU's Common Fisheries Policy remain contentious. In 2011, the EU fishing industry sold 4.6 million tonnes of products whereas Iceland's figure in the same year totalled 672,000 tonnes. Although Iceland does participate as a third party in the European Fisheries Policy, it is partially integrated at best, and its full membership in the EU would add the cushion of Icelandic stocks to the European fishing industry, whose annual catches have steadily declined since the early 2000s.

Conclusions and Recommendations. Although these mutual interests have not culminated in Iceland's EU membership, the talks have permitted a recalibration of relations. Since 2009, 11 accession chapters have been concluded and a further 16 opened. These have principally been to the benefit of Iceland, which has seen its economy stabilise. The country has also joined the EU Common Defence and Security Policy (CSDP) as an observer country. Still, on the most controversial issues—fisheries, agriculture, free movement of capital, freedom of establishment, and on services—negotiating positions have not yet been established. This is partially reflective of points on which Icelandic interest in EU membership is the lowest.

As long as the economy is improving and the government delivers on its pre-election promise of decreasing household debt, Icelanders will see little incentive toward EU membership. Nevertheless, the governing centre-right coalition still needs to fully restore financial stability, the success of which is dependent on capital controls and the development of the fishing industry. Improvement of the economy through a strengthening of Icelandic-Chinese collaboration is a distant opportunity at best, due to the predominance of economic relations between Iceland and the EU as well as the internal opposition of the Icelandic society towards a greater Chinese presence in the country. With the EU's economy showing slight signs of growth and Iceland's still shaky, the recalibration of bilateral relations is not yet complete.

This provides the scope for the EU to pursue its interests in the Arctic dimension of the EU-Icelandic relationship and to create a more political dimension to the currently rather pragmatic basis of cooperation. To this end, Poland, as a permanent observer country in the Arctic Council, could act as a mediator. This may lead to deepening the current project-based channels of cooperation between the EU and Iceland, such as the Northern Dimension Partnerships or the EU Strategy for the Baltic Sea Region.