

Conclusions on Iceland

(extract from the Communication from the Commission to the European Parliament and the Council "Enlargement Strategy and Main Challenges 2011-2012", COM(2011)666 final)

Iceland continues to meet the **political criteria**. Iceland is a functioning democracy with strong institutions and deeply rooted traditions of representative democracy. The country's judicial system continues to be of a high standard, and Iceland is ensuring the continuous strengthening of its already high level of protection on fundamental rights.

The unity of the coalition government was tested on several occasions, but remained stable. The domestic scene is characterised by diverging views among the political forces and the population on the prospect of EU accession. Communication activities promoting an informed debate about Iceland's accession process have started.

Both government and parliament have continued to function well. A constitutional council was set up in April 2011 to review the Constitution and propose constitutional changes. Legislation was also drafted to further strengthen the efficiency of the parliament and the public administration.

Good progress can be reported in the further implementation of the recommendations of the Special Investigation Committee on the political and administrative consequences of the financial crisis. In accordance with these recommendations, the Court of Impeachment was convened in March 2011 to rule on a case against the former Prime Minister. This led to his indictment for gross negligence in May 2011. In parallel, the Office of the Special Prosecutor continued its work efficiently. It investigated numerous cases for alleged fraudulent business practices in the banking sector, which led to some arrests.

Progress can be reported in further strengthening of the efficiency of the judiciary and the anti-corruption framework. A number of judges were appointed in accordance with the rules of the amended Judiciary Act, and the UN Convention against corruption was ratified in February 2011. As regards conflict of interests, Iceland has begun to frame specialised codes of conduct for ministers and for a number of categories of employees.

Iceland continued to safeguard fundamental rights, including economic and social rights. The Council of Europe Framework Convention for the Protection of National Minorities remains to be ratified.

The **economy** of Iceland is slowly recovering from the fallout of its financial crisis and the deep and long recession that followed, but growth prospects remain weak as households and firms continue to suffer from a high level of indebtedness. Economic policies continued to be oriented towards stabilisation, firmly anchored by the successful completion of an IMF programme. Recently rising inflation prompted the central bank to increase interest rates whereas fiscal policy was somewhat relaxed. Expenditure-led fiscal adjustment to reduce public debt to sustainable levels remains a challenge. Unemployment is high, particularly among youth and long-term unemployed. Despite progress in banking sector restructuring, the economy still suffers from a dysfunctional financial sector and the removal of capital controls represents a key challenge.

As regards the **economic criteria**, Iceland can be considered a functioning market economy. However, financial sector weaknesses and capital movement restrictions still impede an

efficient allocation of resources. Iceland should be able to cope with competitive pressures and market forces within the Union over the medium term, provided that it continues to address current structural weaknesses through appropriate macroeconomic policies and structural reforms.

The policy mix with a strong focus on exchange rate stabilisation and fiscal consolidation has been supportive in re-establishing a higher degree of macroeconomic stability. In response to trade surpluses and an appreciating exchange rate the central bank continued to reduce its policy rate in the second half of 2010, but reacted with a modest tightening of monetary policy as of August 2011 in reaction to a weaker currency and significantly rising annual inflation. Efforts to strengthen public revenues and implement spending cuts have continued. In view of the high level of public debt, measures were taken to reduce refinancing risks and to strengthen local government finances. Foreign exchange reserves continued to increase and recent central bank estimates point to a more manageable external debt position. New measures were taken to accelerate private sector debt restructuring. A revised strategy for capital account liberalisation was adopted and its implementation remains a challenge. The labour market remained flexible and participation rates relatively high. The country enjoys good basic infrastructure, abundant natural resources, and overall a well-educated population.

However, macro-financial risks remain elevated. Domestic demand has picked up, but the recovery is largely based on temporary measures which supported private consumption. Risks and uncertainties with respect to future sources of growth and its sustainability remain. The financial sector is still suffering from weak asset quality and an efficient financial intermediation remains hampered by the incomplete private sector debt restructuring process. Public debt has risen above 90% of GDP. The fiscal consolidation path has been somewhat relaxed and public finances remain confronted with the challenge to implement severe spending cuts to enhance long-term sustainability. Fiscal risks arise from sizeable contingent liabilities and the unresolved Icesave issue. The labour market continues to be seriously affected by the deep post-crisis recession with unemployment unprecedentedly high for the country, particularly among the youth and with the large share of long-term unemployed. Growth, investment and development are hampered by weaknesses in the business environment, such as high barriers to market entry in certain sectors. The industrial structure remained little diversified.

In line with the methodology of the first progress report, Iceland's ability to **assume the obligations of membership** continued to be assessed in the light of its participation in the European Economic Area (EEA) and taking into account the exemptions granted under the EEA, as well as the EU legislation falling outside the scope of the EEA. The overall level of preparedness to meet EU *acquis* requirements remains good, in particular due to Iceland's participation in the European Economic Area.

The Icesave dispute remains unresolved. In spite of negotiating efforts, the new bill on the terms and conditions for the loan repayment to the UK and the Netherlands in a referendum was rejected in April 2011. The government confirmed that the outcome of the referendum would not affect the commencement of the payments to the UK and the Netherlands, which are due to start in late 2011. In May 2011, the government sent its reply to the letter of formal notice of May 2010 of the EFTA Surveillance Authority (ESA). In June 2011, ESA proceeded with the second stage of the infringement procedure, namely the issuance of the reasoned opinion. This opinion reiterates in full the findings of the previous letter of formal notice, namely that Iceland acted in breach of the deposit guarantee scheme directive. The European Commission shares the legal analysis of ESA. Iceland's government provided the answer to

the EFTA Surveillance Authority's reasoned opinion at the end of September. The Authority is now examining the response in detail before deciding on further action in this case. At this stage, the Icesave dispute remains unresolved.

Preparations to take on the obligations of membership continued, albeit relatively slowly, in areas partly covered by the EEA as well as in chapters not covered by the EEA. Iceland remains largely in line and applies a substantial part of the *acquis* in the fields covered by the EEA, such as free movement of goods, freedom of movement of workers, the right of establishment and freedom to provide services, free movement of capital, public procurement, company law, intellectual property law, competition, financial services and information society and media.

The progress report confirms that the following areas are likely to present challenges in the accession process: financial services, agriculture and rural development, environment, fisheries, free movement of capital as well as food safety, veterinary and phytosanitary policy, taxation and customs.

From the point of view of administrative capacity, attention should be paid to ensuring that human and financial resources are made available and remain available for the necessary preparations associated with the process of EU accession.

Iceland continues to be closely in line with the *acquis* on *free movement of goods*. However, there are no new legislative developments in Iceland to report as far as horizontal measures and product legislation under the 'Old Approach' are concerned. Transposition still needs to be completed in a number of areas where new EU *acquis* was adopted.

Iceland maintains a high level of alignment with the *acquis* in the area of *free movement of workers*.

Legislation on the *right of establishment and freedom to provide services* remains broadly in line, with the exception of the postal services directive. The implementation of the services directive was notified in July 2011.

Iceland largely applies the *acquis* on *free movement of capital*, with some exceptions. However, in the aftermath of the financial crisis, Iceland continues to apply capital controls which will need to be removed by the time of EU accession. .

In the field of *public procurement* Iceland remains broadly aligned with the *acquis*. Alignment with remedies and defence procurement remains outstanding.

Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of *company law*. However, full alignment with accounting standards and international audit standards remains to be achieved.

Iceland maintains a high level of alignment with the *acquis* on *intellectual property law* and has the administrative capacity necessary to implement it. There is a need to implement a comprehensive enforcement policy.

Iceland maintains a high level of alignment in the field of *competition policy*. Monitoring of the State aid measures taken in response to the financial crisis is proceeding satisfactorily.

Further efforts are needed in order to implement the *acquis* on *financial services* and in particular to ensure its effective enforcement and the adequate supervision of the sector. The Icesave dispute remains unresolved.

Some gaps in transposition remain in the field of *information society and media*.

Iceland's policy on *agriculture and rural development* is overall not in line with the *acquis*, and the appropriate administrative framework for implementation needs to be set up.

Parts of Iceland's legislation and administrative framework are not in line with the *acquis* on *food safety, veterinary and phytosanitary policy*. Particular attention is needed in order to close the remaining gaps with EU legislation on live animals, plant protection products and novel food.

In the area of *fisheries*, Iceland has not begun to align with the EU *acquis* or to set up the mechanisms for implementing and monitoring EU support measures. The existing restrictions on foreign investment in fisheries, which remain in place, are not in line with the *acquis*.

Some progress has been made in the *transport* field, in particular on road and maritime transport. However, there are still several areas where Iceland needs to transpose relevant EU legislation.

Legislation on *energy* continues to be broadly in line, except for oil stocks, the independence of the regulatory authority and energy efficiency.

Iceland's *tax legislation* remains partially aligned with the *acquis*. A strategy for achieving IT interconnectivity and interoperability with EU IT systems for taxation needs to be defined.

On *economic and monetary union*, alignment with the *acquis* on monetary policy remains incomplete and the relevant administrative structures require further strengthening.

Availability of *statistics* in line with EU methods, in particular in business, labour market and agriculture statistics, remains to be further improved.

Iceland continues to apply and implement a substantial part of the *acquis* on *social policy and employment*. A comprehensive employment strategy has yet to be drafted.

Iceland's state of preparation in the area of *enterprise and industrial policy* remains at a high level. Access to SME finance is still affected by the financial crisis.

Iceland maintains a good level of alignment with the EU standards on *trans-European networks*.

On *regional policy and coordination of structural instruments* Iceland needs to identify the institutions responsible for the implementation of the cohesion policy.

Preparations in the area of *judiciary and fundamental rights* continue to be well on track. Progress was made in further reinforcing the independence of the judiciary and the anti-corruption policy framework. Further monitoring of the implementation of these measures is needed. The legislation on citizen's rights and data protection is not yet in line with the *acquis*.

Iceland continues to apply the Schengen Agreement and is well advanced in aligning with the *acquis* in the area of *justice, freedom and security*. Further efforts are still needed to ratify and implement international instruments.

Iceland continues to be well advanced in terms of preparation for EU accession and integration into the *European Research Area*.

Iceland maintains its already high level of alignment in the field of *education and culture*.

Some progress has been made in strengthening the legislative and administrative framework on *environment and climate change*. Full compliance with the *acquis* on nature protection and water quality has yet to be achieved. Iceland needs to gradually align with the EU positions in the international environmental fora, as well as to ratify the outstanding multilateral agreements.

Iceland maintains a good level of alignment with the *acquis* on *health and consumer protection*. However, further efforts are necessary in the field of consumer protection.

The *customs legislation* continues to be partially in line with the *acquis*. Significant efforts are needed in order to address the discrepancies in the legislation, in particular in the fields of customs rules, procedures with economic impact, duty free and security aspects. Preparations for effective implementation of the *acquis* upon accession still have to be initiated, in particular as regards the development of interconnectivity with the EU IT customs systems.

Further progress has been made in *external relations*, in particular in the field of development cooperation and humanitarian aid. Iceland still needs to become member of the Kimberly process.

Iceland maintains a high level of alignment in the area of *foreign, security and defence policy*. Iceland's emphasis on Arctic policy underlines its commitment to play an active role in regional organisations in Northern Europe.

There has been limited progress in legislating on *financial control*. Further efforts are needed in order to prepare a public internal financial control policy paper and to ensure the separation between internal and external audit. Preparations for the protection of the EU's financial interests still have to be enhanced.

With regard to *financial and budgetary provisions*, Iceland has reached a good level of alignment in the policy areas underlying and affecting this chapter. It has continued to identify the required alignment with the *acquis*. Administrative preparations and concepts for setting up the own resources system are needed. A coordination structure remains to be formally established.