

## Conclusions on Iceland

*(extract from the Communication from the Commission to the European Parliament and the Council "Enlargement Strategy and Main Challenges 2012-2013", COM(2012)600 final)*

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

The constitutional council's proposals on the reform of the Constitution are currently being reviewed by the parliament. Following the conclusions of the Special Investigation Committee (SIC), a number of measures were taken with a view to increasing the efficiency of the public administration. Presidential elections were held in June 2012, with the incumbent President reelected for a fifth term in office.

The Office of the Special Prosecutor continued working efficiently on cases relating to the 2008 banking crisis. In April 2012, the Court of Impeachment found the former Prime Minister at the time of the financial crisis guilty of one of four charges against him, namely that he had failed to hold dedicated Cabinet meetings ahead of the crisis. No sentence was passed.

Progress can be reported in further strengthening the anti-corruption framework. As regards conflicts of interest, a code of conduct for central government staff was established in spring 2012. Codes of conduct for civil servants in general and for political advisors still need to be established.

Iceland continued to safeguard fundamental rights, including economic and social rights. The UN Convention on the Rights of Persons with Disabilities, the Council of Europe Convention on preventing and combating violence against women and domestic violence and the Council of Europe Framework Convention for the Protection of National Minorities still need to be ratified.

Following a long and severe recession, the Icelandic **economy** started to recover in 2011 and grew by 2.6% in 2011, and expanded at a similar rate in the first half of 2012. The authorities proceeded with domestic debt restructuring, financial sector stabilisation and fiscal consolidation. A second post-crisis international bond of US\$ 1 billion was sold to foreign investors in May 2012 at a rate of 6%. Iceland regained investment grade by all three major rating agencies. Yet, weak financial and non-financial sectors' balance sheets still imply considerable risks to economic and financial stability. The removal of capital restrictions remains a key policy 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, fiscal consolidation, and domestic debt restructuring has been supportive in re-establishing a higher degree of macroeconomic stability. Monetary policy has been tightened in reaction to rising inflation

and exchange rate stability has been broadly preserved. Fiscal consolidation continued with additional revenue and spending measures in the 2011 and 2012 budgets. Measures were taken to reduce general government refinancing risks and to strengthen local government finances. A trade surplus and a roughly balanced underlying current account were maintained. A fall in the unemployment rate and recent growth of employment suggest that labour market conditions have improved somewhat. The country enjoys good basic infrastructure, abundant natural resources, and a flexible labour market with high participation rates.

However, macro-financial vulnerabilities remain significant. Annual inflation stayed above the target and inflation expectations are high. Preserving exchange rate stability remains challenging. Fiscal risks persist. Public and private debt levels remain high even after debt restructuring and private. Households and businesses are still faced with significant problems. Banks' asset quality is subject to large uncertainties and defaults continue to be widespread. Unemployment is still around 7%, which is close to unprecedented levels for the country. It particularly affects youth and includes a high share of long-term unemployed. Macroeconomic stabilisation occurs in a situation of temporary protection through capital account restrictions, which will have to be lifted. Growth, investment and development are hampered by high barriers to market entry in certain sectors. The industrial structure remains little diversified.

Iceland's **ability to take on the obligations of membership** continued to be assessed also taking into account Iceland's participation in the European Economic Area (EEA). The overall level of preparedness to meet *acquis* requirements remains good, in particular due to Iceland's participation in the European Economic Area.

The Icesave dispute remains unresolved, despite progress having been made. In December 2011 the EFTA Surveillance Authority (ESA) filed a case against Iceland with the EFTA Court, seeking a declaration that Iceland failed to comply with the Directive on deposit guarantee schemes and with Article 4 of the EEA Agreement regarding non-discrimination. Iceland rejected these claims and contended that they should be dismissed. A number of EU and EFTA member states sent written observations to the Court. The European Commission has intervened before the EFTA Court in support of the EFTA Surveillance Authority. Meanwhile, the first two partial payments from the commercial winding-up of *Landsbanki Íslands hf* to priority creditors were made in December 2011 and May 2012.

The accession negotiations have progressed further. During the reporting period, 14 chapters were opened, of which eight were provisionally closed. More than half of all negotiating chapters (i.e. 18) have now been opened, of which 10 have been provisionally closed.

Overall, preparations to take on the obligations of membership continued, in areas partly covered by the EEA as well as in chapters not covered by the EEA. Iceland remains largely in line with and applies a substantial part of the *acquis* in 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, public procurement, company law, intellectual property law, competition, and information society and media.

The progress report confirms a number of challenges in the following areas: financial services; agriculture and rural development; environment; fisheries; free movement of capital; food safety; veterinary and phytosanitary policy; taxation; and customs.

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

Iceland continues to be highly aligned with the *acquis* on *free movement of goods*. Further efforts are necessary as regards horizontal measures and product legislation under the ‘Old and New Approach’ as well as administrative capacity, including in the area of market surveillance.

Iceland maintains a high level of alignment with the *acquis* in the area of *free movement of workers*. Good progress can be reported on coordination of social security systems. Iceland will need to extend the social security coordination rules also to legally resident third-country nationals and continue preparations for setting up an electronic data exchange system.

Legislation on the *right of establishment and freedom to provide services* is highly aligned with the *acquis*. Alignment with the Third Postal Directive has yet to be achieved and existing restrictions in the fisheries sector need to be lifted.

Iceland applies parts of the *acquis* on *free movement of capital*. Exceptions remain, notably in connection with Iceland’s investment restrictions and extensive capital controls.

In the field of *public procurement* Iceland is well advanced. The level of alignment and implementation in this area remains satisfactory, with the exception of the Remedies and Defence Procurement Directives.

Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of *company law*. Full alignment with the *acquis* on company law and with accounting and auditing standards still needs 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. Full alignment with the Enforcement Directive has yet to be achieved.

Regarding *competition policy* Iceland has reached a high level of alignment with the *acquis*. Iceland’s State aid measures taken in response to the financial crisis have been in line the relevant *acquis*.

Alignment in the area of *financial services* is good. Despite progress being made, work needs to continue to align with the new *acquis* as well as to ensure effective enforcement and adequate supervision. The Icesave dispute remains unresolved. The ESA case against Iceland is pending before the EFTA court.

Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of *information society and media*. Several gaps in transposition in the field of audiovisual policy and information society services need to be addressed.

Preparations have commenced in the area of *agriculture and rural development*, where Iceland’s policy is overall not in line with the *acquis*. A strategy and planning schedule of measures to be taken to ensure compliance with the EU agriculture and rural development requirements has been adopted. The appropriate administrative structures to implement all aspects of the common agricultural policy needs to be set up.

Iceland’s legislation and administrative framework is partially in line with the *acquis* on *food safety, veterinary and phytosanitary policy*. Some progress was made in the areas of general food safety, and food safety rules. Gaps in legislation in the areas of animal and plant health, genetically modified organisms, novel foods and animal products that are not intended for human consumption need to be addressed.

Iceland continues to apply a *fisheries* management system which has similar objectives to those pursued in the EU, but some rules differ substantially. The existing restrictions in the

fisheries sector on freedom of establishment, services and capital movements are not in line with the *acquis*.

Iceland already has a good level of alignment in the *transport* field. Progress can be reported as regards road safety rules. Transposition of the relevant EU legislation on air and road transport needs to be completed.

Legislation on *energy* continues to be partly in line. Further efforts are needed to align with *acquis* on oil stocks, energy efficiency and the internal energy market as well as strengthen the independence and administrative capacity of the regulatory authority.

In the field of *taxation*, Iceland remains partially aligned with the *acquis* and continues to have a good level of administrative capacity. Further efforts for achieving IT interconnectivity and interoperability with EU IT systems for taxation are needed.

On *economic and monetary policy*, Iceland has a good level of alignment with the *acquis*. Existing gaps with the *acquis* on monetary policy remain to be addressed, including the strengthening of the independence of the Central Bank and the prohibition of monetary financing of the public sector.

Iceland partially applies the *acquis* on *statistics*. A large part of the register-based population and housing census was carried out. The allocation of sufficient resources to the Statistical Office needs to be further addressed.

Iceland continued to apply and implement a substantial part of the *acquis* on *social policy and employment*. Preparations for participation in the European Social Fund have commenced and a comprehensive employment strategy is being drafted. Legal alignment remains to be completed in the areas of anti-discrimination and equal opportunities.

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*.

A comprehensive action plan and related timetable has been adopted on how to meet the EU requirements in the area of *regional policy and coordination of structural instruments*. Iceland needs to identify the future Managing Authority and prepare the strategy and programming documents required by Cohesion Policy.

Iceland continues to have high standards in the area of *judiciary and fundamental rights* and its anti-corruption policy framework was further reinforced. Iceland also continues to strengthen its high level of protection on fundamental rights. 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 align with the *acquis* in areas including migration, asylum and judicial cooperation.

Iceland continued to participate actively in the EU Framework Programme in the field of *science and research*. Preparations for EU accession and integration into the European Research Area are well advanced.

Iceland has achieved a high level of alignment in the field of *education and culture* and continued to participate in several EU programmes on education and culture.

The legislative and administrative framework on *environment and climate change* remains to a large extent in line with the *acquis* and has been further strengthened. Full compliance with

the *acquis* on nature protection, water quality and climate change has not been achieved. Iceland needs to ratify the Espoo and Rotterdam Conventions.

Iceland has already achieved a high level of alignment and applies a substantial part of the *acquis* on *consumer and health protection*. Further progress can be reported in the field of public health. Additional efforts are necessary to close remaining gaps in aligning with the *acquis* on consumer protection.

Iceland applies to a large extent the *acquis* in the area of customs union. Preparations for effective implementation of the EU legislation upon accession have been initiated. The gaps regarding aligning with the EU Customs Union *acquis* have yet to be closed, including in the areas of customs tariff, general customs rules, rules of origin, procedures with economic impact, security rules and abolition of customs fees. Preparations to develop interconnectivity with the EU-related IT systems need to continue.

As regards *external relations*, Iceland is highly aligned with the *acquis*. Progress can be reported as Iceland and the EU have agreed to hold regular trade policy consultations.

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.

Iceland's *financial control* system is partly in line with international standards and EU best practices. Work needs to continue on preparing the Public Internal Financial Control policy paper, as well as on establishing internal audit, ensuring compliance with INTOSAI standards in the area of external audit and the protection of the EU's financial interests.

Iceland continues to have a good level of alignment with the underlying policy areas linked to *financial and budgetary provisions*. Administrative preparations need to be enhanced to set up the own resources system. A coordination structure still needs to be formally established.