



R. Schuman

Miami-Florida European Union Center of Excellence

**Will an Economic Crisis
Give Iceland the Final Push?**

Vilborg Asa Gudjonsdottir



Vol. 6, No. 8
August 2009

Published with the support of the EU Commission.

EUMA

European Union Miami Analysis (EUMA), Special Series, is a service of analytical essays on current, trend setting issues and developing news about the European Union.

These papers are produced by the Jean Monnet Chair, in cooperation with the Miami-Florida European Union Center of Excellence (a partnership of the University of Miami and Florida International University) as an outreach service for the academic, business and diplomatic communities.

Among the topics to be included in the series, the following are suggested:

- The collapse of the Constitution and its rescue
- Turkey: prospects of membership
- Immigration crisis and cultural challenges
- Security threats and responses
- The EU and Latin America
- The EU as a model and reference in the world
- The Common Agricultural Policy and other public subsidies
- The euro and the dollar
- EU image in the United States

These topics form part of the pressing agenda of the EU and represent the multifaceted and complex nature of the European integration process. These papers also seek to highlight the internal and external dynamics which influence the workings of the EU and its relationship with the rest of the world.

Miami - Florida European Union Center

University of Miami
1000 Memorial Drive
101 Ferré Building
Coral Gables, FL 33124-2231

Phone: 305-284-3266
Fax: (305) 284 4406
Web: www.miami.edu/eucenter

Jean Monnet Chair Staff

Joaquín Roy (Director)
Astrid Boening (Associate Director)
María Lorca (Associate Editor)
Maxime Larive (Research Assistant)

Florida International University
Elisabeth Prugl (FIU, Co-Director)

Inter-American Jean Monnet Chair Editorial Board:

Carlos Hakansson, Universidad de Piura, Perú
Finn Laursen, Dalhousie University, Halifax, Canada
Michel Levi-Coral, Universidad Andina Simón Bolívar, Quito, Ecuador
José Luis Martínez-Estay, Universidad de los Andes, Santiago de Chile, Chile
Félix Peña, Universidad Nacional de Tres de Febrero, Buenos Aires, Argentina
Stephan Sberro, Instituto Tecnológico Autónomo de México
Eric Tremolada, Universidad del Externado de Colombia, Bogotá, Colombia

International Jean Monnet Chair Editorial Advisors:

Francesc Granell, University of Barcelona, Spain
Ramūnas Vilpišauskas, Vilnius University, Lithuania

Will an Economic Crisis Give Iceland the Final Push?♦

Vilborg Asa Gudjonsdottir♣

1 Introduction

In the beginning of October last year (2008) the three biggest banks in Iceland were seized by the Icelandic government. By then, the banks (which had all been privatized in 2003) had financial reliabilities amounting to about ten times the size of Iceland's economy.¹ The country was left in a total economic crisis, which consequences have not yet been fully realized. The country's currency, the Icelandic Krona (ISK), which had been devaluating substantially towards the euro ever since January 2008, crashed as a consequence of the banking crisis, leaving the devaluation at 96% against the euro over a period of 18 months (from January 2008 until July 2009).² Iceland, before one of the most prosperous countries in the world, is now in a state of total economic, financial and currency crisis. The situation can be characterized by fast rising unemployment, bankruptcies of businesses and homes, extremely high interest rates (going up to 18% in January 2009, at 12% in July 2009)³, falling housing prices and skyrocketing commodities prices, amongst other things. In *Iceland in the European Union: Will it ever happen?*, written in May 2007, economic changes were noted as one of the factors that could possibly push Iceland towards full EU membership; whether it would simply become necessary for Iceland to replace the EEA Agreement with full EU membership, to be able to gradually give up the Icelandic krona and adopt the euro, for the purpose of economic stability. Today it is safe to say that these changes have come forth, and with substantial force. On July 16th, after a vigorous debate, the Icelandic Parliament (Althingi) voted for an EU membership application with a narrow margin of five votes.

How did the economic crisis change the view towards full EU membership in Iceland, both on the political front and amongst the public? What will the upcoming negotiations center on and what is the likely outcome? Will Iceland become EU's 29th member state? Or even its 28th member state?

2 The Political Front

Before the economic collapse last fall the Social Democratic Party (SDP), the second biggest political party in Iceland at the time, was the only party supporting EU membership. In May 2007 the SDP and the Independence Party (IP) (the biggest political party in Iceland at the time) formed a coalition government, making no plans to apply for EU membership. Last November, both the IP and the Progressive Party (PP) decided to speed up their national meetings in light of

♦ For background information, see: Gudjonsdottir, V.A. (September 2007). *Iceland in the European Union: Will it Ever Happen?* Florida: Miami-Florida European Union Center of Excellence, EUMA.
<http://www6.miami.edu/eucenter/GudjonsdottirIcelandEUMA2007.pdf>

♣ Vilborg Ása Guðjónsdóttir holds an MA in International Relations from the University of Iceland, studying at the University of Miami as an exchange student 2006-2007. She has her Bachelors of Science in Business Administration from Reykjavík University, Iceland. She is currently a Project Manager at the Institute of International Affairs and Centre for Small States Studies, at the University of Iceland.

¹ The Economist, "Britain's fallen star", February 12th, 2009.
http://www.economist.com/world/britain/displayStory.cfm?story_id=13110366 / Althingi (the Icelandic Parliament). "Frumvarp til laga: Þskj. 204 — 136. mál.". <http://www.althingi.is/altext/137/s/0204.html>

² Central Bank of Iceland, "Exchange rate". <http://sedlabanki.is/default.aspx?PageID=183>

³ Central Bank of Iceland, "Interest rates". <http://sedlabanki.is/?PageID=224>

the new views on EU membership that generated following the economic crisis. Subsequently, the chair of the SDP implied that if the IP would not come to the conclusion to apply for EU membership, there would have to be a reevaluation of the coalition.⁴ The question of EU membership had become an ultimatum issue in Iceland.

Around mid-January the PP held its national meeting and concluded to support an EU application, given that considerable preconditions were met, including that Iceland would keep full control over its fisheries resources and that the production and handling of agricultural products would be secured.⁵ The two other political parties represented in Parliament at the time which have not been mentioned before, the Left Green Movement (LGM) and the Liberal Party (LP), have always been and continue to be against EU membership.

Before the IP had the chance to hold its national meeting the government collapsed in the end of January, following what has been called the fiercest public demonstrations ever to take place in Iceland. At that time, the SDP and the LGM formed a temporary minority government, which was in charge until Parliamentary elections were held at the end of April. The SDP won a victory in the elections and became the country's largest political party, receiving 28% of the votes. Given that the SDP's political campaign had completely centered on applying for EU membership, as the solution out of the economic crisis, the election results were by many seen as a sign that a majority of the nation was in support of at least an EU application. Especially since the SDP, the PP and a new movement called the Citizen's Movement, which also supports an EU membership application, received 52% of all the votes.⁶ The SDP formed a majority government with the LGM following the elections, under the condition that the new government would put forth Parliament a bill towards an EU application. The LGM, although still strongly against EU membership, agreed on that condition. Last July the bill came to a vote, and won a majority of 5 votes. Members of all political parties voted for the bill, demonstrating how divided all the political parties (except the SDP) are on the issue.

3 Public Opinion

Numerous opinion polls have been taken in Iceland on EU membership and an EU membership application since last spring (2008). Before the crash in October Icelanders had been experiencing the consequences of a steadily weakening currency, with the Icelandic krona devaluating 26 % against the euro from January until May 2008.⁷ That development gave rise to increased support for EU membership, in the hope of being able to get rid of the Icelandic krona for the euro by joining the EU. Since then support has in general been steady at around 55-65%, although fluctuating somewhat. According to a poll taken in July 2008 60% of Icelanders favored an EU membership application and 50% supported EU membership at that time.⁸ The support for an EU application then went from 69% in October 2008⁹, down to 46% in March 2009¹⁰, to go up again

⁴ Gísladóttir, I.S., "Vikulokin", *Rás 1 (Radio 1)*, December 13th, 2008/ Morgunblaðið, "Ríkisstjórnin verður að svara kalli um breytingar", December 13th, 2008.

http://www.mbl.is/mm/frettir/innlent/2008/12/13/rikisstjornin_verdur_ad_svara_kalli_um_breytingar/

⁵ Fréttablaðið, "Framsókn styður aðildarviðræður", January 17th, 2009.

http://epaper.visir.is/media/200901170000/pdf_online/1_1.pdf

⁶ Alþingiskosningar 25. apríl 2009, "Úrslit alþingiskosninganna 25. apríl 2009".
<http://www.kosning.is/frettir/nr/6741/>

⁷ Central Bank of Iceland, "Exchange rates". <http://sedlabanki.is/default.aspx?PageID=183>

⁸ Capacent Gallup, "Samtök iðnaðarins: Viðhorf almennings til ESB aðildar", June/ July 2008.

<http://www.si.is/media/althjodlegt-samstarf/2008-06-ESB-almennigur.pdf>

⁹ Fréttablaðið, "70 prósent vilja ESB og evru", October 27th, 2008.

http://epaper.visir.is/media/200810270000/pdf_online/1_1.pdf

¹⁰ Morgunblaðið, "Meirihluti andvígur ESB-umsókn", March 1st, 2009.

http://mbl.is/mm/frettir/innlent/2009/03/01/meirihluti_andvigur_esb_umsokn/

to 58% in last June¹¹. In general the support for an EU application is substantially higher than EU membership support, understandably so, given that most Icelanders feel that they first need to see how negotiations, especially on fisheries, will go. In addition, the polls have showed that support for an EU membership application is in general stronger amongst those living in the capital area, the highest in the age group 35-44, and amongst women, the more educated and the wealthier.¹²

4 What will the negotiations center on?

Through the EEA agreement Iceland has already accepted 20 out of the 35 chapters to be negotiated during accession talks. The remaining chapters include the ones which will become the most difficult to negotiate, i.e. fisheries, agriculture and rural development, economic and monetary policy, regional policy, financial and budgetary provisions and institutions.¹³ Although it will be a challenge to reach an agreement on all of these chapters, it is safe to say that fisheries will be the most difficult one, in addition to being the one that will probably determine the result of the national referendum following accession negotiations.

Although the relative importance of fisheries for the Icelandic economy has decreased somewhat in the last decades it is still high and even more so now, following the collapse of the banking system. Around 50% of Iceland's export is fisheries products¹⁴, counting for one third of the country's foreign exchange in 2007.¹⁵ Fisheries account for 8% of GDP¹⁶ (expected to rise to 10% in 2009, due to the collapse of the banking system¹⁷) and 5% of the working force in Iceland¹⁸. The general view in Iceland is that the result of accession talks will depend on how willing EU negotiators will be to meet Iceland's demands regarding fisheries by really taking into account the high importance of the industry to Icelanders, and negotiate accordingly. Negotiations on agriculture might prove somewhat difficult as well, but it is not likely that the chapter will become a deciding factor like fisheries.

5 Iceland's Entry Number

Only ten days after the Icelandic government submitted its request to start accession talks with the EU, the Union's foreign ministers gave the green light and passed the bid to the European Commission for an evaluation. What followed were speculations on whether Iceland would be granted a speedy entry into the EU, and be favored at the expense of Balkan applicants, such as Bosnia-Herzegovina, Macedonia, Serbia, Montenegro, and Albania. EU officials have stated that there is no such thing as a speedy entry into the EU and that Iceland would get no special

¹¹ Morgunblaðið, "58% fylgjandi ESB viðræðum", June 13th, 2009.

http://mbl.is/mm/frettir/innlent/2009/06/13/58_prosent_fylgjandi_esb_vidraedum/

¹² Morgunblaðið, "61,2% vilja aðildarviðræður", May 6th, 2009.

http://mbl.is/mm/frettir/innlent/2009/05/06/61_2_prosent_vilja_adildarviadraedur/ /Fréttablaðið, "Meirihluti andvígur ESB", January 26th, 2009. http://epaper.visir.is/media/200901260000/pdf_online/1_2.pdf / Morgunblaðið, "58% fylgjandi ESB viðræðum", June 13th, 2009.

http://mbl.is/mm/frettir/innlent/2009/06/13/58_prosent_fylgjandi_esb_vidraedum/

¹³ Arnórsson, A., "Inni eða úti? Aðildarviðræður við Evrópusambandið", pp. 26-27. Reykjavík, Iceland: Institute of International Affairs and Centre for Small States Studies.

¹⁴ Icelandic Ministry for Foreign Affairs, "Iceland in figures 2007-2008, p. 23.

http://www.utanrikisraduneyti.is/media/PDF/Iceland_in_figures_2007_-_2008.pdf

¹⁵ Statistics Iceland, "Þjóðhagsreikningar". <http://www.hagstofa.is/Pages/983>

¹⁶ Ibid (2007 numbers) / Icelandic Ministry for Foreign Affairs, p. 21 (2006 numbers).

¹⁷ Arnórsson, A., p. 122.

¹⁸ Iceland Ministry for Foreign Affairs, p. 8.

treatment in that regard.¹⁹ They have, however, stated that since Iceland is already a member of the EEA and Schengen, the country's route to entry will consequently be shorter than for other candidate countries.²⁰ It is difficult to predict how these things will develop, it depends on the outcome of the negotiations and the referendum that follows. In addition, many European leaders have stated that in order for the Union to be able to absorb additional members the Lisbon treaty needs to be ratified. Ireland, which notably rejected the treaty last year, will vote on it again next October. All the same, EU's Commissioner for Enlargement, Olli Rehn, has implied that if negotiations go well and the agreement is accepted in a national referendum it is possible that Iceland would join at the same time as Croatia (which is already well on its way in the accession process). Iceland would thus become the EU's 29th member state, since entry is in alphabetical order.²¹ Rehn has even said that Iceland could end up competing with Croatia to become EU's next member state.²² Now it is safe to say only time can tell how these things will develop, and whether Iceland will indeed become an EU member state at all.

6 Conclusion

Ever since the economic crash last October discussions on EU membership have been growing gradually in Iceland, with numerous newspaper articles, news shows and public lectures all over the country focusing on the pros and cons of EU membership. The economic turmoil changed Iceland's position towards EU membership immensely in a very short period of time. Before, Icelanders were satisfied with the EEA Agreement and saw no reason to rock the boat; now the prospects of EU membership seem to many the only way to go, to ensure Iceland's future. At the same time there are many who think joining the EU would be the worst thing to do now, and want the Icelandic nation to dig their way out of this hole by themselves. Although the Icelandic Parliament has now agreed to apply for EU membership, it is still very unclear how negotiations and consequently the referendum will go, given the preconditions regarding the utilization of natural resources, first and foremost the fisheries resources. Icelanders are divided on the issue, but it is safe to say that unless an acceptable agreement on the control of fisheries can be reached (acceptable in the eyes of Icelanders), it will be difficult to convince Icelanders to vote yes to EU membership. In this regard it is important to note that Iceland received its independence only 65 years ago and hence have a very hard time imagining relinquishing the country's sovereignty and independence in the way EU membership entails. To many the idea of giving up the full control of the country's most important natural resource is unthinkable. Given all this it is safe to say that there are only two things certain; accession talks will be tough, and the result is impossible to predict.

¹⁹ Financial Times, "EU gives boost to Icelandic membership", July 27th, 2009.
<http://www.ft.com/cms/s/0/47b77600-7ac1-11de-8c34-00144feabdc0.dwp?uuiid=70662e7c-3027-11da-ba9f-00000e2511c8.html?ftcamp=rss>

²⁰ Fréttablaðið, "Engin hraðleið í ESB en samt styttri leið", July 28th, 2009.
http://epaper.visir.is/media/200907280000/pdf_online/1_8.pdf

²¹ The Guardian, "Iceland to be fast-tracked into the EU", January 30th, 2009.
<http://www.guardian.co.uk/world/2009/jan/30/iceland-join-eu>

²² Rehn, O., "Prospects for enlargement in the South-Eastern and North-Western corner of Europe", December 10th, 2008).
<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/693&format=HTML&aged=0&language=EN&guiLanguage=en>