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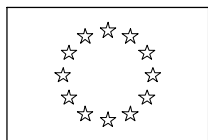
COVER NOTE

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EUROPEAN COMMISSION

Brussels, 24.2.2010
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COMMISSION STAFF WORKING DOCUMENT

ANALYTICAL REPORT

accompanying the

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

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

{COM(2010) 62}

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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.’*

This is the legal framework within which the Commission submits its opinion and the present analytical report. In line with the Treaty requirements, the current assessment is made in terms of the conditions of eligibility laid down by the European Council. 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 Madrid, in December 1995, the 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 opinion¹, 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. 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 perspective 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 Icelandic accession and provides initial impact estimates with regard to the policies and sectors concerned. 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.

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 by a narrow majority in favour of applying to join the EU. Public opinion and political parties are divided in Iceland 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 COM(2010) 62.

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 had a bilateral Free Trade Agreement with the EEC since 1972. Iceland 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.

As an EEA state, Iceland has effectively participated in the single market for over 15 years. This required it to adopt a considerable 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 have been identified, as described under the relevant chapters in Part 3 of this report.

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 contributes to reducing social and economic disparities in Europe through the EEA Grants³. For the period 2004-2009, Iceland provided approximately €29 million for project funding in a number of EU Member States through EEA Grants.

Iceland has been associated with the development of the Schengen agreements since 1996⁴ and has applied its provisions since 2001. This means that Iceland has abolished internal border controls with other Schengen area countries. Common rules and procedures are applied with regard to visas for short stays and border controls. Within the Schengen area, Iceland participates in extensive cooperation and coordination between police services and judicial authorities⁵.

Iceland is associated to the Dublin Regulation, which establishes criteria and mechanisms for dealing with asylum requests⁶, as well as to Eurodac, the EU database for fingerprints of asylum seekers.

³ 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.

⁴ 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.

⁵ Assessment of Iceland's participation in Schengen can be found under Chapter 24 (Justice, freedom and security) in Part 3 of this opinion.

⁶ Council Decision 2001/258/EC.

As regards trade relations, Iceland became a member of the GATT in 1968 and is a founding member of the World Trade Organisation (WTO). 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, along with 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. The main export items are fish and other marine products although, as a share of total exports, this category declined to 40 % in 2007. Exports of manufactured goods have been growing rapidly, led by aluminium and medical and pharmaceutical products. Exports of services increased significantly in the years before the crisis. Services account for almost 35 % of total export revenues.

Following Iceland's membership application, the Commission proposed that Iceland be included as an eligible beneficiary of pre-accession financial support under the Instrument for Pre-Accession Assistance (IPA). Such support would aim to foster institution and capacity building of the Icelandic administration mainly through the Technical Assistance and Information Exchange Instrument (TAIEX) and twinning.

d) Contents of the Analytical Report

The analytical report takes account of the conclusions of the European Council in Copenhagen in 1993 and subsequent European Council conclusions.

The report:

- Describes the relations between Iceland and the Union, particularly in the framework of the European Economic Area Agreement;
- Analyses the situation in respect of the political conditions established by the European Council (democracy, rule of law, human rights, protection of minorities);
- Assesses the country's situation and prospects in respect of the economic conditions established by the European Council (functioning market economy, capacity to cope with competitive pressure);
- Addresses the question of the capacity of the country to adopt the obligations of membership, i.e. the total body of EU legislation as expressed in the Treaty, the secondary legislation, as well as the policies of the Union (*acquis* of the European Union);
- In line with the December 2006 European Council conclusions, provides initial impact estimates in the fields of financial services, agriculture, fisheries, regional policy and financial and budgetary provisions. These have been identified as the main policy areas likely to require particular attention in case of Icelandic accession.

In assessing Iceland's situation in respect of the economic criteria and its capacity to assume the obligations of the *acquis*, the Commission has also estimated the progress which could reasonably be expected in the years ahead, before possible accession, taking account of the fact that the *acquis* itself will continue to develop.

The Commission has drawn on a number of information sources: answers given by the Icelandic authorities to a detailed questionnaire and additional follow-up questions, consultations with the EU Delegations accredited to Iceland, reporting by the Member States' Ambassadors in Reykjavik, assessments by international organisations (including the Council of Europe, IMF, OECD, OSCE, International Labour Organisation, EFTA Surveillance Authority), as well as local and international non-governmental organisations.

B. CRITERIA FOR MEMBERSHIP

1. POLITICAL CRITERIA

The European Council in Copenhagen in 1993 set a number of political criteria for accession to be met by applicant countries. A country must have achieved 'stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities'.

The political criteria established in Copenhagen derive from the fundamental values on which the EU is founded, as set out in Article 2 of the Treaty on European Union. These principles are emphasised in the Charter of Fundamental Rights of the European Union. Article 6(1) of the Treaty states that: *'The Union recognises the rights, freedoms and principles set out in the Charter of Fundamental Rights of the European Union of 7 December 2000, as adapted at Strasbourg, on 12 December 2007, which shall have the same legal value as the Treaties'*.

The assessment set out below examines the main ways in which the public authorities are organised and operate, and the state of fundamental rights protection. It does not confine itself to a formal description but seeks to ascertain the way in which democracy and the rule of law actually function in practice. The present report concentrates on the areas of most relevance for assessing Iceland's membership application.

1.1. Democracy and the rule of law

The Republic of Iceland is a representative democracy and a parliamentary republic. Its constitution was adopted in 1944, when the Republic was established.

The constitution provides that state power is exercised by the parliament (Althingi), the President of Iceland, the government and the judiciary. The parliament and the President exercise legislative power jointly, while the President and 'other governmental authorities' exercise executive power. Judges are vested with the exercise of judicial power.

The constitution provides for the direct **election** of the President and the parliament by secret ballot. All Icelandic citizens aged 18 and above who are permanent residents of Iceland are eligible to vote in parliamentary and presidential elections. Non-resident citizens remain on the voter register for eight years after declaring residency overseas. They may subsequently apply for four-year extensions. The right to vote in local elections is extended to foreign citizens with at least five years legal residency in Iceland before the day of election; this period of residency is reduced to only three years for Danish, Finnish, Norwegian and Swedish nationals. This differentiation is not in line with the provisions of the *acquis*.

The constitution guarantees the **freedom of assembly and association**.

The constitution codifies the basic principles of the rule of law in Iceland. Legislation provides, inter alia, for elections, the accountability of ministers, the appointment of public officials, the audit of the financial accounts of the state, its institutions and administrative bodies, and the functioning of municipalities.

The parliament adopts acts in accordance with the constitution and its rules of procedure. The President's signature validates a legislative act or a government measure signed by a minister. In cases where the President withholds his signature options are either the withdrawal by the government of the draft law adopted by the parliament or the holding of a referendum. Since 1944 the President has only twice refused to sign adopted acts. All laws are published.

The 1994 Parliamentary Procedure Rules on European Economic Area (EEA) matters provide that all EEA-related work is overseen by the parliament's Foreign Affairs Committee. The adoption of acts related to the *acquis* follows the ordinary parliamentary procedure.

Iceland 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.

1.1.1. The parliament

Althingi was first established in 930, and today comprises 63 members, 27 of whom are women (42%). All members are elected by secret ballot on the basis of proportional representation for a term of four years.

Parliamentary elections, for which Iceland is divided into six multi-member constituencies, are regulated by the constitution and the Parliamentary Election Act. Members are elected through a proportional list system: 54 seats are distributed on the basis of results at constituency level and 9 seats are allocated on the basis of a compensatory system, the aim of which is to ensure full proportionality at national level. Members of parliament have immunity on criminal proceedings, which can only be lifted with the consent of the parliament.

The **electoral administration** consists of three layers: the National Election Commission, six Senior Election Commissions (one in each constituency) and Local Election Commissions.

According to the constitution, **general elections** take place every four years. Following the last elections of April 2009, five parties currently sit in the parliament: the Social Democratic Alliance (20), the Independence Party (16), the Left Green Movement (14), the Progressive Party (9) and the Movement (3). One member has no party affiliation.

The President, based on a request from the Prime Minister, can dissolve the parliament; new elections must take place within 45 days from the announcement of the dissolution.

The election process is open and pluralistic. Elections in Iceland fully meet international standards.

Parliamentary procedure is set by the constitution and by the parliament's Standing Orders. The latter regulate committee work, the conduct of business, procedural rules for meetings, and the activities of party groups.

The Speaker oversees the work of the parliament, determines the agenda of meetings and draws up the schedule for parliamentary business and meetings. The Speaker also supervises the work of committees and international delegations.

Bills are introduced by one or more members of parliament or by the government at the initiative of the minister concerned. According to the constitution, the President may also submit bills and draft resolutions to Althingi but in practice does not exercise this right. The parliament also exercises parliamentary **control over the executive**. The Ombudsman and the National Audit Office play a role in this regard.

The legislative process incorporates effective consultation procedures, organised by the relevant parliamentary committees.

The parliament functions well. Its powers are respected by the other institutions and the rights of opposition parties are ensured.

1.1.2. The executive

The **President** of Iceland is elected by universal suffrage. The current President, first elected in 1996, was re-elected in 2000, 2004 and 2008; there is no term limit for the President. The constitution grants the President executive powers; nevertheless, most of these powers are *de facto* delegated to ministers.

In the absence of the President, presidential powers are exercised collectively by the Prime Minister, the Speaker of the parliament and the President of the Supreme Court.

The government of Iceland is established after elections, and is constitutionally responsible to the parliament. Following parliamentary elections, the President, after consulting with all political parties, mandates a party leader to form a government. The new government is then formally appointed by the President. The parliament may censure the government, or compel it to resign through a motion of no confidence. Ministers are accountable for all executive acts and may be impeached by the parliament.

The previous coalition government (Independence Party and Social Democratic Alliance) announced its resignation in January 2009 following the financial crisis. Early elections took place in April 2009 and a new coalition government consisting of the Social Democratic Alliance and the Left-Green Movement took office. It is composed of 6 men and 6 women.

There are 77 **municipalities** in Iceland of varying size. Their remit is wide and includes town planning and primary education. Municipalities play an important role in local democracy and benefit from a considerable degree of discretion in fulfilling their responsibilities.

The Association of Local Authorities in Iceland was established in 1945 by 52 local authorities. Since 1973, all local authorities in the country are members of this Association. Under the Local Government Act, the government is required to consult the Association when adopting decisions relating to local communities.

The **Ombudsman**'s role is to monitor the administration of the state and local authorities and safeguard the rights of the citizens vis-à-vis the authorities. Any person or association may lodge a complaint with the Ombudsman. The Ombudsman is fully independent in his/her work and does not answer to any other authority. The Ombudsman reports annually to parliament on his/her work, including details about concluded cases and subsequent actions

taken by authorities. The **Ombudsman for Children** endeavours to ensure that the rights, needs and interests of children are fully taken into account in all areas of society and to respond appropriately where necessary.

Iceland does not have **armed forces** of its own or an intelligence service as a separate entity; the National Security Unit of the National Commissioner of the Icelandic Police carries out security projects such as investigation of cases, risk assessment or strategic assessment.

Overall, division of power between the executive and parliament in Iceland is ensured. The government is subject to effective parliamentary control; its ministers are accountable for their acts. Municipal authorities function efficiently.

1.1.3. The judiciary

The judicial system is composed of a Supreme Court, eight district courts, a labour court and a court of impeachment. There is no administrative court in Iceland.

Eight **district courts** act as courts of first instance and have jurisdiction over criminal as well as civil and administrative cases. Judges are appointed for an indefinite period by the Minister of Justice and Human Rights after the Minister has consulted the Evaluation Committee. The Evaluation Committee, also appointed by the Minister for a term of three years, consists of three members nominated respectively by the Supreme Court, the Icelandic Judges' Association and the Icelandic Bar Association. The Committee is responsible for assessing the qualifications of candidate judges and ranking them by merit. However, the Committee's advice is non-binding.

The **Supreme Court** is the highest judicial authority in Iceland and reviews appeals against decisions of the district courts. It is composed of nine judges, appointed by the President for an indefinite period of time upon nomination by the Minister of Justice and Human Rights. The Supreme Court delivers an opinion as regards the competency and qualifications of the applicants prior to their nomination. The Supreme Court has jurisdiction in all cases except for cases heard by the Labour Court and the Court of Impeachment.

There is no **constitutional court** in Iceland. Icelandic courts are empowered to review the constitutionality of all laws. District courts and the Supreme Court may decide that legislation that they find incompatible with the constitution cannot be applied. Since 1995, the Supreme Court has on eight occasions declared an act or a legislative provision unconstitutional on the basis of substance. The legislature has reacted by amending the respective legislation. The Supreme Court and district courts are also competent to review decisions taken by the executive, although they cannot replace the repealed decision with another one.

The **Labour Court** is responsible for adjudicating disputes between employers and employees on the labour market. Its judgments may not be appealed to the Supreme Court apart from those related to criminal sanctions. Iceland should review limitations to the right to appeal in this area, with a view to reinforcing the guarantees for fair trial.

The **Court of Impeachment** has jurisdiction in cases where the parliament moves to impeach Ministers on account of their official acts. The court has, however, never been convened in practice; the actual act of impeaching a Minister would be taken by the parliament.

Under the Criminal Procedure Code, the **power of prosecution** is split into two administrative levels: 15 chiefs of police, including the Office of the National Commissioner,

and the Office of the Director of Public Prosecutions. The Minister of Justice and Human Rights appoints prosecutors following an evaluation of the applicants by the Ministry of Justice. The **Director of Public Prosecutions** supervises the conduct of investigations and the prosecutorial authority of the police. He/she is responsible to the Minister of Justice and Human Rights even though his/her prosecution powers are in principle independent from the Minister and the Ministry. The entry into force of the Criminal Procedure Code in January 2009 increases the independence of the prosecutor; the Code limits the types of decisions where the Minister of Justice and Human rights can review decisions taken by the Director of Public Prosecutions.

Following the financial crisis, two new bodies were set up to investigate and prosecute alleged criminal acts in the context of the bank collapse: the Special Investigation Commission and the Special Prosecutor. The **Special Investigation Commission**, consisting of three members nominated by the parliament, is tasked with collecting information on the main events leading to the collapse of the Icelandic banks and with identifying its causes. This Commission is requested to present a report to parliament in early 2010. The **Special Prosecutor**, established in December 2008 as a temporary body, conducts investigations into the matter and is responsible for issuing indictments. The Special Prosecutor cooperates with the UK's Serious Fraud Office, Interpol, Luxembourg's financial regulators and Norwegian and French counterparts. In March 2009, the Icelandic government nominated a renowned non-Icelandic anti-corruption investigator as 'special advisor' to the Special Prosecutor.

The **independence of the judiciary** is guaranteed by the constitution, which stipulates that judges shall be guided solely by the law in the performance of their official duties. Judges cannot be discharged from office except by a judicial decision. This complies with Article 6 of the European Convention on Human Rights. A special wage committee determines their salaries in order to guarantee independence from the executive. The Act on the Judiciary provides that judges shall discharge their judicial functions independently and that they shall, in resolving a case, not be subject to the authority of any other person. A judicial decision cannot be revised, except by appeal to a higher court. Under the Government Employees Act, a judge cannot be appointed to a second official position. A judge cannot accept a second occupation or become a share-owner in a company if this is not compatible with his/her office or carries a risk that the judge will not be able to discharge his/her official duties. However, the predominance given to the Minister of Justice and Human Rights in judicial appointments, given the consultative role of the Evaluation Committee and Supreme Court, raises questions in terms of the effective independence of judges.

In October 2009, an expert panel nominated by the Minister of Justice and Human Rights made recommendations relating to the process of judicial appointments. The findings of the panel were subject to public consultation and are currently under review in the Ministry of Justice and Human Rights with a view to amending relevant legislation.

Overall, Iceland's standards as regards the functioning of the judiciary are high. The judicial system is well established. However, the strong role of the Minister of Justice and Human Rights vis à vis the judiciary and the prosecutor is of concern. There is scope for improvement in the process for judicial appointments in order to better guarantee the independence of the judiciary. Following the financial 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. (*See also Chapter 23 — Judiciary and fundamental rights*)

1.1.4. Public Administration

The central government is composed of 12 ministries, each with authority over a number of agencies. The agencies are governed by special legislative acts setting out their roles and functions. Unless otherwise provided for by law, decisions taken by the agencies may be referred to the relevant ministry for revision.

In the absence of administrative courts, district courts are competent to review decisions taken by municipalities or by the state administration. They are not limited to ruling on the procedure for taking the decision, but may also review the reasoning of the issuing authority.

There is a high degree of decentralisation in recruiting personnel. The Government Employees Act sets out the minimum selection criteria, which are then used by the ministries and the agencies in a decentralised, merit-based recruitment process.

Senior civil servants are hired on five-year, fixed-term, renewable contracts, unless otherwise provided by the law. Employees of the state administration are recruited via open competitions, based on the principles of transparency and equal opportunities.

Complaints relating to the recruitment process must be addressed to the relevant ministry in the first instance. The Ombudsman is competent to review the ministry's decision on the complaint, without explicit powers of reversing it. The Gender Equality Complaints Committee is competent to review cases of alleged discrimination based on gender.

The EU accession process is coordinated by the chief negotiator mandated by the Minister for Foreign Affairs to lead accession negotiations on behalf of Iceland; he/she is assisted by the chairpersons of individual negotiation teams and other representatives on Iceland's negotiation committee. Assessing the compatibility of new legislation with EU/EEA *acquis* remains the responsibility of each ministry. The Ministry of Foreign Affairs may intervene in an advisory capacity, but its opinion is not binding for the ministry concerned.

Overall administrative capacity is satisfactory. Support from the Instrument for Pre-Accession would foster institution and capacity building to allow smooth implementation of the *acquis*, especially in areas not covered by the EEA, mainly through tools such as the Technical Assistance and Information Exchange Instrument (TAIEX) and twinning.

There is no central institution for the training of public servants. As part of a collective agreement, each employer (ministry, agency, municipality) contributes to an education fund, which is then used for training.

Overall, the core elements of a merit-based and efficient public administration free from political interference, as embedded in the principles of the European Administrative Space, are generally in place in Iceland.

1.1.5. Anti-corruption policy

Several laws are in place that criminalise corruption in relation to other activities, including active and passive bribery in the public and the private sector, trading in influence and money laundering.

There are a number of institutions with responsibilities for addressing corruption. The prosecution can instigate investigations and oversee their conduct. The Economic Crime

Division of the National Commissioner of the Police deals with various aspects of organised crime, including money laundering. The Ombudsman launches investigations following a complaint in cases of breach of duty. The Competition Authority has substantial authority with regard to the search for and seizure of evidence. The Government Procurement Agency manages procurement for public construction projects. The Financial Supervisory Authority carries out checks on commercial and savings banks, insurance companies and pension funds and is required to notify the police or the prosecution in case of any suspicion of money laundering.

The **National Audit Office** plays a watchdog role. It is responsible for monitoring party financing. In March 2007 it issued a set of Rules on the Financial Accounts of Political Parties, which lists the minimum reporting standards for political parties and electoral candidates. The Office is required to report all detected irregularities to the police. Rules governing **party financing** were introduced in 2007 by the Act on financial affairs of political organisations and candidates and their duty to provide information. It aims to reduce the risk of conflicts of interest and ensure transparency in the financial affairs of political parties.

Iceland has undertaken various international obligations to fight corruption in two main fora: the Organisation for Economic Cooperation and Development (OECD) and the Council of Europe's Group of States against Corruption (GRECO). Iceland has been a member of GRECO since May 1999. It has ratified the Council of Europe Criminal Law Convention on Corruption, the Convention on Laundering, Search, Seizure and Confiscation of Proceeds from Crime and the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Iceland has not yet ratified the UN Convention against Corruption and the Council of Europe Civil Law Convention on corruption.

As part of this cooperation, a number of independent evaluation committees have assessed the Icelandic system. The conclusions of these evaluations have generally been that corruption is at a low level in Iceland. Further efforts are, however, needed to implement GRECO recommendations. 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.

Overall, the financial crisis highlighted the existence of some structural weaknesses which will have to be addressed in the short term. (*See also Chapter 23 — Judiciary and fundamental rights.*)

1.2. Human rights and the protection of minorities

Human rights are enshrined in the constitution. The 1995 constitutional amendments reflect the provisions of the European Convention on Human Rights (ECHR), the UN International Covenant on Civil and Political Rights (ICCPR), the European Social Charter, the UN International Covenant on Economic, Social and Cultural Rights (ICESCR) and ILO conventions. Iceland incorporated the Rome Statute of the International Criminal Court (ICC) into its legal order in July 2002; Iceland has not concluded any bilateral immunity agreements granting exemptions from ICC jurisdiction.

Access to justice is guaranteed by the constitution. **Legal aid** is available in both criminal and civil cases. Persons charged with a criminal offence have access to legal counsel of their own choosing, with sufficient time to prepare their defence. Free legal aid is available to any individual involved in a court action in civil cases.

The constitution prohibits capital punishment and provides that no one may be subjected to **torture** or inhuman or any other degrading treatment or punishment. Slavery, servitude, and forced or compulsory labour are prohibited under the constitution.

Iceland has been a member of the Council of Europe (CoE) since 1950. It has signed and ratified almost all relevant conventions of the Council of Europe, including the European Convention on Human Rights (ECHR), which entered into force in September 1953. It recognised the jurisdiction of the European Court of Human Rights (ECtHR) in September 1994. The ECHR and its protocols were incorporated into Icelandic law in 1994. The CoE Framework Convention for the Protection of National Minorities was signed in February 1995 but has not been ratified.

Iceland is a member of several agreements within the Council of Europe, including the Venice Commission.

In the past decade, the ECtHR has received few applications against Iceland per year and has heard eight cases against the state. In most of these judgments, breaches of the procedural guarantees of Articles 5 (right to liberty) and 6 (right to a fair trial) of the Convention were at stake. The Icelandic authorities have executed all judgments against the country, and amended laws and regulations where necessary.

Iceland has signed and ratified most of the International Conventions of the UN, including the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights. It has also signed and ratified the European Social Charter and its Protocols.

Iceland is an active member of the **International Labour Organisation** (ILO). It has ratified the ILO conventions concerning human rights at work, as well as the conventions concerning labour inspection, employment policy and tripartite consultation, the social security convention and the health and safety at work framework convention.

Court rulings in Iceland commonly refer to **international human rights conventions**, such as the European Social Charter, the International Covenant on Economic, Social and Cultural Rights and ILO Conventions, when interpreting the human rights provisions of the constitution. Executive and legislative actions have also been compatible with these provisions.

Civil and political rights

Equality before the law is constitutionally guaranteed and further enriched by the 1994 Administrative Procedure Act. The basic elements of a fair trial in criminal cases as developed in the case-law of the European Court of Human Rights have been incorporated in the Criminal Procedure Code regarding the right to liberty.

The right to privacy is protected in the General Penal Code, the Data Protection Act and legal remedies granting the right to damages from the person violating another person's privacy.

The 1996 Act on registered partnerships stipulates that two persons of the same sex can enter into a registered partnership. Such partnerships have the same legal effect as marriage.

Provisions of the Information Act grant the public extensive access to data on cases being processed in the state and municipal administrative system. The Act on patients' rights guarantees various rights of patients such as the right to obtain information regarding their state of health, the proposed treatment and the possibility of seeking a second opinion.

The right of ownership is guaranteed to all citizens of Iceland. (See also 'Economic criteria')

Freedom of thought, conscience and religion is guaranteed by the constitution. The law on registered religious communities authorises the registration of religious communities with legally stipulated rights. There are no reported cases of limitations to the freedom of religion in Iceland.

In Iceland, **discrimination** is prohibited and **equality** is guaranteed by the constitution.

Iceland is party to several international instruments which set out the principle of non-discrimination. These include the ICCPR, the ICESCR, the Convention on the Elimination of All Discrimination against Women, and the International Convention on the Elimination of All Forms of Racial Discrimination.

As member of the Council of Europe, Iceland is subject to monitoring by the European Commission against Racism and Intolerance (ECRI), whose recommendations have been used by the Icelandic authorities as guidelines for amendments to the relevant legislation or improvements in practice.

The definition, status and rights of **refugees** are, according to Icelandic law, based on the 1951 UN Convention and the 1967 Protocol, implemented by the 2002 Act on Foreigners, which introduced clearer provisions on the legal status of foreigners and asylum seekers. In the period 2006-2008, Iceland received 154 applications for asylum. Four applicants were granted refugee status, 11 were granted a residence permit on humanitarian grounds, 61 were sent to other European states on the basis of the Dublin Regulation and other agreements and 41 applications were denied. Furthermore, as of 2007, Iceland resettles 25-30 'quota refugees' per year with the assistance of the UNHCR.

Given the rarity of persons belonging to **minorities**, Iceland has not passed specific acts on matters of discrimination based on racial or ethnic origin, religion or belief. Steadily increasing immigration in recent years has, however, led to calls for specific measures and legislation to combat discrimination on these grounds. In March 2009, there were some 24 000 foreigners — mainly from Poland, Lithuania and Germany — residing in Iceland. There have been individual cases of discrimination against foreigners, including asylum seekers. For the year 2008, Iceland reported only three cases recorded by the police, none of which were prosecuted or sentenced.

The 2008 OSCE-ODIHR report on hate crime made a number of recommendations, regarding, inter alia, amendments to the General Penal Code, more rigorous recording of hate crime and improving awareness among police officers and employees in the judicial system. Those recommendations should be followed up.

Freedom of assembly and freedom of opinion and expression are guaranteed by the constitution and no problems can be reported.

The media are regulated through the Right of Publication Act. All of Iceland's media are private, with the exception of the Icelandic National Broadcasting Service (RÚV). As a result of the financial crisis, the print media market has contracted significantly. At the same time, the number of on-line media outlets has increased. These provide access to a wide range of information.

Ownership of the media is highly concentrated with substantial links between media outlets and large corporations.

Overall, Iceland has established a high degree of media freedom. The Icelandic media are sufficiently diversified; ownership, however, is highly concentrated.

Economic and social rights

As regards **labour rights and trade unions**, the Act on Trade Unions and Industrial Disputes sets out the rules on trade unions operation and the framework of their relations with employers with regard to strikes and lock-outs and the solution of disputes arising from violations of law or the interpretation of wage agreements. There are no reports on infringement of the right to establish trade unions or the right to strike.

Since 1976, Iceland has had a special statute which ensures equality between women and men in all respects. These rights are regulated by the Gender Equality Act and the Act on equal status and equal rights of women and men. In 1996, the parliament added provisions to the General Penal Code, including penalties prohibiting discrimination on grounds of sexual orientation.

The principal equality bodies in Iceland are the Ombudsman, the Ombudsman for Children, the Centre for Gender Equality and the Gender Equality Council, and other specialised complaints committees such as the Complaints Committee on Equal Status and the Information Committee.

The percentage of women in parliament and government is 42% and 50% respectively. Income and labour force gender gaps are narrow. Overall, in the field of gender equality, Iceland has reached very high standards.

Children's rights are guaranteed in Iceland (Child Protection Act 2002); the country has ratified the UN Convention on the Rights of the Child.

The right of education is guaranteed in the constitution; the ECHR, incorporated into Icelandic law, protects this right.

In summary, regarding the acquis on fundamental rights, no major problems can be identified. In this area Iceland has achieved high standards; fundamental rights are respected and Icelandic society possesses a high degree of human rights awareness. (see also chapter 19— Social policy and employment and chapter 23- Judiciary and fundamental rights)

1.3. General Evaluation

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.

2. ECONOMIC CRITERIA

In 1993, the European Council in Copenhagen set the following economic criteria for accession to the EU:

- the existence of a functioning market economy;
- the capacity to cope with competitive pressure and market forces within the Union.

This section gives a brief overview of economic developments and policies in recent years. It then examines the impact of the financial and economic crisis. Against this background, it goes on to consider the extent to which Iceland fulfils the two economic criteria established by the Copenhagen European Council.

2.1. Economic developments

Iceland is a small open economy with a population of over 300,000 and a nominal GDP of €10.2 billion in 2008. This equals about 0.06% of the EU-27 population and about 0.08% of EU-27 GDP. During the 1990s and for most of the past decade, it restructured its economy mainly by deregulation and liberalisation. It moved from an economy mainly based on the fishing industry to a more diversified one with a large and open financial sector. It experienced growing economic prosperity and became one of the wealthiest countries in the world, with a GDP per capita in purchasing power standards at around 120% of the EU-27 average in 2008.

Economic activity

Iceland's economy grew considerably over the 10 years up to 2007. GDP growth rates were particularly high towards the end of this period, averaging 6.3% from 2004 onwards. The

fastest growth took place in the financial intermediation and real estate sectors, whose share of GDP rose from 17% in 1998 to 26% in 2007. Non-tradable services formed the bulk of economic activity, accounting for 67% of GDP in 2008. Private consumption contributed on average about 58% of GDP in 2002-2007 and public consumption and gross fixed investment 25% and 24% respectively. Although growth was accompanied by increasing social differences, the lowest income class increased its purchasing power by 60% in the last decade. The level of poverty is one of the lowest in the world.

Iceland's export base is relatively narrow and largely based on natural resources, namely fisheries products and industries powered by renewable energy sources. Marine products account for approximately 40% of Iceland's total exports and around 30% of its foreign currency earnings. However, this share declined considerably over time; in 2000, the share of marine products still accounted for around 75% of total exports. The economy became more diversified, not least with the development of aluminium production, pharmaceuticals, information technologies, tourism and the financial sector. As an example, metals produced by power-intensive industries accounted for over 20% of exports in 2008, compared to an average of 12% in the period 1980-2002.

Iceland's strong growth performance in the period 2003-2007 was largely driven by major energy investments and substantial foreign investments in aluminium production. These investments were equivalent to more than one third of annual GDP over the period 2003-2008. Imports of capital equipment and increased domestic demand resulted in considerable widening of the current account deficit. Driven by a growing trade deficit and a worsening income balance (increased expenditure on interest and dividend payments on foreign debt and investments), the current account deficit reached 26% of GDP in 2006 and peaked at 36% of GDP in 2008. The current account deficit was largely financed by FDI inflows and the issuing of króna-denominated bonds by foreign banks (glacier bonds).

In 2007, completion of large-scale investment projects, which resulted in a large external imbalance, pushed Iceland into first attempts to tighten fiscal and monetary policy. Investment contracted by around 12% in 2007 and by around 20% in 2008. At the same time, Iceland experienced a tightening of its economic policy. A decline in share prices and reduced access to cheap foreign financing led to a reduction in domestic growth and the imbalances in the economy started to unwind. Consumer consumption growth decreased due to increased interest rates and mortgages since the second half of 2007. Private consumption decreased by almost 8% in 2008.

Overall, Iceland's economy grew at a rapid pace from the mid-1990s. However, growth was volatile and accompanied by large external and internal imbalances that reflected in part major investments in the energy and aluminium smelting sectors but also buoyant foreign credit-funded domestic demand. Macroeconomic adjustments measures taken before the crisis had already slowed down the economy.

Structural change and reforms

Since the 1990s, Iceland pursued a significant number of reforms, many linked to EEA membership. Liberalisation, improved competition, internationalisation and privatisation were key processes which transformed the economy and supported high growth.

Both central and local governments were traditionally heavily involved in the business sector, for instance in the operation of utilities and banking institutions. Over the last two decades

Iceland has pursued an extensive programme of **privatisation**. The most important privatisations from 1992 to 2005 were the travel bureau, printing house, publishing house and fish processing plant. Icelandic Telephone was privatised in 2005. However, in the same period, the state consolidated its hold on the national power company.

In the financial sector, the three larger banks were progressively privatised from the late 1990s to 2003. The process of **bank privatisation** was marred by claims of favouritism as the initial plan to spread ownership among numerous investors was abandoned. This was considered largely a political decision. The Financial Supervisory Authority (FME) was originally dissatisfied with the result and gave its approval only after lengthy deliberations. Local business conglomerates took over the banks and subsequently started expansion into foreign markets with little previous experience in such operations.

Iceland adopted a **Competition** Act in 1993 in line with EEA requirements. A new Competition Act was adopted in 2005, based on the EU competition law principles. It is enforced by the Competition Authority, whose powers have been strengthened.

The **labour market** is flexible and the participation rate is very high, notably among women and the elderly. The unemployment rate was low throughout the boom years, averaging 2.7% over the period 1999-2007. The workforce is highly unionised and is known for wage flexibility, as salaries often do not follow inflation. Iceland's labour regulation offers a level of protection comparable with EU Nordic countries. The non-salary cost of employing a worker is moderate. There is no legal right to severance pay and employment contracts can be generally terminated without specific reasons. But notification requirements are strict and thus constraining for employers, as are the rules on collective dismissals and regulations regarding the number of working hours.

Demand for a **skilled workforce** increased with Iceland's diversification towards a knowledge-based economy. A clear shift was notable from resource-based industries and traditional manufacturing to sectors such as information technologies, pharmaceuticals and financial services. Iceland became an importer of skilled and unskilled labour. On average, one third of new jobs created during 2003-2007 were filled by foreign labour.

Icelandic per capita expenditure on **education** (around 7% of GDP prior to 2008) is among the highest in the world; however, the achievements of pupils at the end of compulsory schooling are below the EU average. Upper-secondary graduation rates are improving but remain comparatively low. The length of secondary education and easy access to the labour market postpone students' entrance into universities up to the age of around 20. Traditionally, Icelanders pursued university studies abroad. The recent expansion of the higher education sector and improved lifelong learning opportunities are changing this.

The Icelandic **innovation system** has gained considerable ground in recent years. Iceland's R&D intensity was at 2.8% of GDP in 2007. Almost 50% of R&D efforts were financed by the business sector and more than 10% were funded from abroad. However, according to the European Innovation Scoreboard 2008, Iceland only rates among moderate innovators.

Overall, Iceland's economic transformation was based on the implementation of widespread structural reforms, which opened the economy and enhanced competition. Financial market liberalisation and privatisation across a number of sectors unleashed growth. Competitiveness increased and enterprises expanded abroad. The country invested a large portion of the newly

created wealth in education and its society remained very cohesive. The skills and innovation profile of the economy has not kept pace with the high growth rates.

Financial sector and the financial crisis

The privatisation and gradual deregulation of financial institutions at the beginning of the past decade led to particularly rapid expansion of the Icelandic banking sector. Banks started tapping international capital markets to finance growth that, over the course of four years, pushed their consolidated assets to the equivalent of 880% of GDP by year-end 2007, while in the same year their borrowing in foreign capital markets increased Iceland's gross external debt to 566% of GDP. Iceland's financial system and the banking sector were among the largest in the world in relation to GDP, but the country's economic future became increasingly intertwined with the banking sector's health and its growth increasingly dependent on institutional and individual investors' risk appetites.

As a member of the EEA, Iceland is subject to European banking regulation, although supervision was left to the national authorities, the Central Bank of Iceland (CBI) and the Financial Supervisory Authority (FME). The two institutions were in turn supported by the Prime Minister's Office, the Ministry of Business Affairs and other ministries with access to relevant information on the financial sector. The Depositors' and Investors' Guarantee Fund was the institution responsible for providing liquidity during financial crisis situations. However, as the crisis revealed, the large number of institutions involved in Iceland's regulatory framework hampered the smooth flow of information and generated detrimental delays in the decision-making process. The regulators were neither sufficiently staffed nor equipped to cope with the rapidly changing situation. In consequence, they failed to develop a clear strategy for mitigating the banks' risk taking or controlling their rapid expansion. As bank deposits grew at such a rapid pace, the assets of the Deposit Guarantee Fund were nowhere near the levels required to pay back depositors.

In 2006, cross-border deposit accounts, such as Landsbanki's *Icesave*, increased rapidly. The FME endorsed the marketing of internet accounts abroad, despite indications of the banks' overexposure.

In October 2008, the three main banks, totalling 85% of the banking sector, collapsed as foreign finance dried up and confidence waned. Unable to obtain short-term loans, they were nationalised by the government. Their international exposure severely affected national macroeconomic stability and the economy moved into recession.

The restructuring of the banking sector started immediately after the collapse. The three banks have been recapitalised and established under new names. The government has also committed itself to a review of the bank regulatory framework and supervisory practices to strengthen safeguards against potential new crises.

The crisis originated in an over-eager expansion of the newly liberalised commercial banking sector. This was aggravated by the lack of adequate supervision which created substantial vulnerabilities. The macro-prudential framework showed itself unable to put a stop to the banks' unsustainable developments in credit, leverage and risk.

Impact of the financial and economic crisis

Against the backdrop of global financial turmoil, the collapse of Iceland's vulnerable banking sector pushed the economy into a deep recession. The national currency fell sharply in value,

considerably pushing up import prices, thereby causing a potentially alarming situation for a country highly dependent on international trade. Furthermore, the weakening currency strongly increased foreign debt burdens. The government sought the assistance of the international community to stabilise the foreign exchange market and restore currency credibility.

On 19 November 2008, the International Monetary Fund (IMF) approved a two-year **IMF stand-by arrangement** (SBA) for an amount of €1.4 billion, €560 million of which was made available immediately and the remainder to be disbursed in instalments of €105 million, following the conclusion of IMF programme reviews. The Nordic countries and Poland have agreed to fill the financing gaps under the programme.

The IMF programme focuses on three main areas. First, the main priority in the short run is to stabilise the króna. As an emergency measure, the policy interest rate was raised to 18%, and capital and current account restrictions on foreign exchange transactions were introduced temporarily. Secondly, a fiscal consolidation plan is to be put in place from 2010 onwards, to lower public debt to a sustainable level in the medium term. Finally, the programme focuses on restructuring the banking sector. On this basis, Iceland started implementing a recovery programme to restore credibility and economic growth.

As a result of the crisis, **GDP** decreased significantly in the first half of 2009, with a contraction of 5.5% year-on-year. The sharp drop in domestic demand has fallen largely on imports. The decline in domestic consumption was somewhat cushioned by automatic stabilisers.

The **unemployment** rate increased sharply from 2.5%, in the third quarter of 2008, to 9.0% in April 2009. It stood at 8.2% in December 2009, but is expected to rise again in 2010. Both youth and long-term unemployment have soared, with the low-skilled labour force mostly affected. The share of long-term unemployed (over 12 months) among all unemployed has reached 21%. The highest employment losses were in the construction industry. Migration out of Iceland has emerged as an issue.

Wages did not follow soaring inflation and fell by over 6 per cent in real terms in the first half of 2009. The fall was much more marked in the private sector than in the public sector.

The **current account deficit** shrank to about 2% of GDP during the first half of 2009. The trade balance has shifted into surplus, reflecting weak domestic demand. Strongly negative net interest receipts — a reflection of Iceland's external debt burden — have offset the trade surplus and kept the overall current account in deficit.

After peaking in January 2009 at 21.9%, **inflation** rates (Harmonized Index of Consumer Prices HICP) declined and stood at 11.3% in December 2009, in response to the gradual stabilisation of the króna, the drop in demand and falling house prices. However, until December 2009 the króna did continue to depreciate, providing the main impetus for inflation in 2009.

Credit conditions have become very tight and enterprises have little access to bank loans or other sources of financing. Investment has halved, reflecting severe credit constraints.

To sum up, after the collapse of the Icelandic banking sector and the ensuing economic crisis, the implementation of the IMF SBA is starting to produce first signs of stabilisation.

2.2. Assessment in terms of the Copenhagen Criteria

2.2.1. *The existence of a functioning market economy*

The existence of a functioning market economy requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy. Macroeconomic stability and a general convergence on economic policy enhance the performance of a market economy.

Iceland is a member of the EEA Agreement, which is designed to contribute, on the basis of market economy principles, to trade liberalisation. The EEA Agreement promotes the continuous and balanced strengthening of trade and economic relations between the Contracting Parties. Since 1 January 1994, the EEA has united the EU Member States and the EFTA States in an internal market governed by the same basic rules as in the EU.

In order to ensure equal conditions for businesses across the whole internal market, the EEA Agreement encompasses competition and state aid rules. It also includes provisions relevant to the four freedoms, as well as cooperation in "flanking areas", such as social policy, consumer protection, and environment policy.

Prices are determined by market forces in almost all sectors of the economy. As a member of the EEA, Iceland has **liberalised most economic sectors** and removed special government protection for state-controlled companies in all but a few instances, i.e. energy, postal services, broadcasting, alcohol and tobacco. In terms of compliance with EEA law as regards free movement of goods, services, capital, and persons, Iceland's track record can be considered satisfactory, despite some shortfalls as referred to in Section 3 of this opinion.

Legal system and barriers to entry / exit

The Icelandic **legal system** provides sufficient clarity and guarantees enforcement of **property rights**. Starting a business is facilitated by low administrative hurdles and a supportive legal framework. Bankruptcy proceedings are straightforward and take less time than the OECD average; in 2009, their number increased by around 20%. Given the current economic climate, the proper functioning of the bankruptcy system is essential to facilitate recovery, in particular to determine the order of creditors in the liquidation of firms, thus containing the burden of debt.

High **barriers to entry** exist, however, in the fishing, agriculture and energy sectors, which are not covered by the EEA. Icelandic legislation contains prohibitions on foreign ownership in the fisheries, energy, air transport and real estate sectors. Of these, restrictions on investment in fisheries are the only ones that apply to EEA residents.

Overall, Iceland retains open markets conducive to growth and has effectively operated within the EEA internal market, despite the existence of some barriers to entry in strategic sectors and additional measures following the current economic crisis. It has established a legal environment which offers good protection of property rights. This should support the country's recovery once macroeconomic stability is re-established and investors regain confidence in the Icelandic financial markets.

Financial sector

The financial regulatory and supervisory system can be considered as a key institutional weakness of the Icelandic economy, as it failed to prevent the accumulation of imbalances in the banking sector leading to the crisis. Consequently, the government has started to reorganise the supervisory framework, first by changing the law on the Central Bank and appointing new boards to the Central Bank of Iceland and Financial Supervisory Authority. The government also appointed a special prosecutor, who is leading an enquiry into banking wrongdoings. The enquiry might last several years. Forty cases of suspected criminal acts are currently under investigation. The first cases are expected to be opened by the prosecution in 2010. In parallel, the parliament set up a Special Investigation Commission that is expected to report in early 2010.

The banking sector is currently undergoing major restructuring. Through significant government intervention and some foreign private capital, the new banks have been re-capitalised with capital adequacy ratios well above international standards in order to compensate for credit, liquidity and foreign exchange risk, partly caused by lack of access to international capital markets. In addition, risk management and governance issues are being addressed as well as the banks' capacity to undertake the required large-scale loans restructuring operations. At the moment, foreign exchange risk is still significant and loan restructuring will remain the principal focus of the new banks' operation in the near future.

While stability of the financial sector is slowly improving, financial intermediation remains low and access to capital limited. Non-performing loans have risen to 17% of total outstanding loans in the banking sector. The interest rates on non-indexed loans are on average 9% and the spread between borrowing and lending interest rates is 2%. The financial system is expected to remain weak for some time due to high debt. Although the perceived risk of contagion from distressed to healthy companies has subsided, credit flows have remained low since 2008, as corporations remain highly leveraged. Numerous companies, including some outside the financial sector, are still undergoing reconstruction and are in negotiations with creditors. Creditworthiness of both corporate and household customers continues to be difficult to assess, holding back new lending by banks.

The share of the non-banking financial sector remains small and firms are largely dependent on bank recovery to regain normal access to capital. Financial services accounted for 82% of market capitalisation of listed companies at the end of 2007. Bank failures wiped out approximately 80% of overall equity holdings, hurting many in the non-banking sector as well as private individuals. At the same time, Iceland has a relatively large insurance market which is transparent, offers largely homogenous products across companies, and is closely monitored by a competition authority.

Overall, financial markets were highly developed, but have suffered due to the financial crisis. They have now somewhat stabilised. However, the functioning of the financial market and the financial intermediary roles are not yet restored. Enterprises face limited or no access to bank loans or capital market financing and will continue to face multiple challenges for some time.

Macroeconomic stability

Since the introduction of the IMF Stand-By Arrangement, Iceland has been implementing an economic programme focusing on stabilising the foreign exchange market and currency, in line with reserve targets. In November 2009, it started partially lifting capital controls

introduced as emergency measures in November 2008. It also developed a medium-term fiscal consolidation plan.

There is a broad consensus about economic policy fundamentals. However, the economic crisis and necessary response measures have also resulted in a heated political debate. The search for political consensus on reforms and limited administrative capacities caused a six-month delay in implementing the IMF programme, finally resolved by late autumn 2009. The remainder of the programme will be extended to account for the delays.

Monetary policy and capital controls

Up to 2001, Icelandic monetary policy targeted the exchange rate. After this time, the Central Bank of Iceland (CBI) started targeting inflation. The exchange rate of the króna became market-determined, normally without interventions by the central bank.

The CBI set the official target for inflation at 2.5%. However, in practice, inflation was volatile and systematically above target, averaging 4.7% during the period 2004-2007. The significant foreign investment boom in 2004-2005 stimulated domestic demand and inflation. Increases in the policy rate were required to anchor inflationary expectations.

Efforts to tighten the monetary stance via higher policy rates led to additional foreign capital inflows that strengthened the króna. The private sector's net wealth increased, offsetting to some degree the tighter monetary policy stance. Borrowing in low-interest currencies to invest in the higher-yielding Icelandic króna added to exchange rate volatility and stimulated domestic demand. Before the crisis, the Icelandic króna had already experienced wide fluctuations. In 2005, the króna appreciated strongly against the euro, only to drop again by 20% in value in 2006.

Credibility and effectiveness of monetary policy was further hindered by the lack of institutionally guaranteed independence of the Central Bank (*see Chapter 17*).

The crisis has changed the monetary policy objective in practice from inflation targeting to the stabilisation of the exchange rate. The króna has lost roughly half of its value against the euro, compared with the early 2008 rate. To cope with exchange rate pressures, the CBI raised policy rates, introduced capital controls and intervened in the foreign exchange market. In the context of the IMF SBA, capital controls were imposed to prevent potentially disturbing outflows initiated by non-residents possessing assets in krónas. The government also refused some investment abroad by resident creditors in the hope of increasing domestic lending and reducing risk premiums.

After signs of exchange rate stabilisation, the government in November 2009 adopted a plan to phase out capital controls. As a first step, the Icelandic authorities authorised investors to convert, without restrictions, asset sale proceeds into foreign currency. The second step will target foreign-exchange outflows. The speed of future removal of restrictions on capital outflows will depend on the success of these earlier steps, their effect on the exchange rate and the progress made under the IMF programme.

The relative stabilisation of the foreign exchange market has enabled the central bank to start a gradual reduction of policy interest rates. As a next step, the Icelandic authorities will need to reconsider their current ad hoc approach to monetary policy and establish a consistent medium-term monetary strategy and exchange rate regime.

Overall, the measures taken so far in the monetary area go in the right direction to restore stability. The focus on stabilising the exchange rate is an integral part of Iceland's immediate crisis-related measures and remains appropriate at the current juncture. Capital controls have been a necessary temporary restriction to the principle of free capital movement in order to stabilise the currency and foreign exchange markets.

Fiscal policy and debt

The booming economy resulted in a long period of government budget surplus. The privatisation of government assets allowed the repayment of debt and an increase of government deposits in the Central Bank. Higher tax revenues were collected despite substantial cuts in income and consumption taxes. Spending rose considerably as very substantial public investments were made in a power station and aluminium smelter.

Iceland's fiscal policy was *de facto* pro-cyclical with insufficient fiscal restraint, thus contributing to macroeconomic instability. Expansionary fiscal policy limited its potential stabilisation role. The country neither built up reserves during the boom nor introduced medium-term plans for expenditure cuts. At the same time, signals that the economy was overheating were ignored.

Since early 2009, tax revenues have decreased significantly due to a contracting tax base, whilst the government has prioritised expenditure in basic public services — education, health, social affairs and law enforcement. Expenditures on unemployment benefits and interest on inflation-indexed debt have increased. To counteract this the government increased excise duties and social contributions, and introduced surtaxes on high incomes. Tax increases have been combined with discretionary expenditure cuts, better means-testing of social benefits, and cuts in public investment. The net effect of new taxes and saving measures amounts to 2.5 % of GDP in 2009.

The budget deficit reached 14.4 % of GDP in 2009. It is expected to be financed domestically given the pool of capital locked in by capital controls, the capital available through the pension system, and government current account deposits in the Central Bank (at more than 10 % of GDP in September 2009).

The authorities are targeting an improvement of the structural primary balance of 3.5 % of GDP in 2010, and 3 % of GDP per annum in 2011–12. According to the fiscal consolidation plan, spending cuts will be similarly spread over all budget categories.

Following the banking sector collapse, government gross debt increased from 29.3 % of GDP in 2007 to 57.5 % by the end of 2008 and to around 125 % in 2009. Total external debt levels are currently estimated at 300 % of GDP, with the public share reaching levels in excess of 125 % of GDP. Debt levels of Iceland's private sector are exceptionally high.

Overall, the government is implementing fiscal measures aimed at reducing the deficit, setting up expenditure controls and increasing revenues. The measures announced and implemented will contribute to reducing public debt but pursuing fiscal consolidation and achieving sustainable public finances remain a particular challenge.

Unemployment

Unemployment increased sharply from the long-time average of 2-3 % to current rates of more than 8 % (8.2 % in December 2009). Long-term unemployment has become a policy

issue, and it remains to be seen whether the new emphasis on active labour market policies can prevent structural unemployment. It represents also a serious challenge for social cohesion in Iceland.

The rise in unemployment has put the unemployment benefit scheme under significant pressure. The system of financing the scheme via a payroll tax of 0.65% was found unsustainable when the financing requirements for 2009 and 2010 were calculated at 1.5% of annual GDP. Therefore, a new law on taxation to fund the scheme was adopted in June. In addition, new resources have been invested in a special scheme to discourage lay-offs.

The viability of the upgraded scheme is supported by a restrictive system of payments. 70% of the last salary is paid in the first three months of unemployment and a reduced fixed amount in the three years to follow. Individuals receiving the benefit are required to participate in active labour market programmes and are not allowed to refuse job offers. If they do, their payments are suspended for forty days.

Overall, unemployment rose sharply as a consequence of the crisis. The restoring of macroeconomic stability and revived growth should eventually bring it back to pre-crisis levels. The fair sharing of the social costs of the crisis will play an import role in reaching domestic consensus on further anti-crisis measures.

In conclusion, despite its current difficult economic situation following the financial and economic crisis, Iceland can be considered a functioning market economy. As a member of the EEA, Iceland has liberalised most economic sectors and removed special government protection for state-controlled companies in all but a few instances. Prices are determined by market forces in almost all sectors of the economy. Although there are some shortfalls, Iceland's track record in the implementation of the four freedoms stemming from the EEA Agreement can be considered satisfactory. The Icelandic legal system provides sufficient clarity and guarantees enforcement of property rights. Overall, Iceland retains open markets in all but a few protected sectors. Under the IMF programme, the government has been taking necessary measures with a view to reducing a large fiscal deficit and establishing a stable economic and monetary environment. However, fiscal consolidation and the firm implementation of a credible fiscal strategy remain key challenges. As a basis for recovery, a domestic agreement on necessary reform exists. The debt restructuring of the private sector and the reestablishment of financial intermediation will determine how fast markets can return to normal functioning.

2.2.2. Capacity to cope with competitive pressure and market forces within the Union

The ability to fulfil this criterion requires the existence of a functioning market economy with a sufficient degree of macroeconomic stability for economic agents to make decisions in a climate of stability and predictability. It also requires sufficient stocks of human capital with a strong education base, and physical capital including infrastructures in energy, telecommunications and transportation networks. Government influences the competitiveness of the economy through policy and legislation, among others trade policy and competition policy. Competitiveness is also affected by the structure of the economy, including the weight of the SME sector. The degree and pace of trade integration with the EU before accession demonstrates an ability to compete in EU markets.

Endowment with human and physical capital

Iceland has developed a **knowledge-based economy** with a relatively young labour force and high participation rates, particularly among women and the elderly. The crisis has affected new employment from the pool of students and pupils and reduced the participation rate among elders. The employment policy is currently being transformed into a system of active labour market measures. The authorities have started a series of projects for activating and retraining unemployed people. However, Iceland has not yet developed a comprehensive strategy. Recent reforms in the vocational education system should help the country to cope with some human capital issues.

So far, the crisis has had a limited effect on the **education system**. The authorities have, however, announced measures in the education sector that should reduce spending and increase efficiency and diversification. In addition, the crisis has led to outflows of educated professionals and workers to neighbouring countries, particularly those previously working in the financial sector. There is a risk that emigration will have a negative effect on the labour market in the medium term.

The quality of **basic infrastructure** is in line with the high income level of the economy. National transport is mainly by road. Iceland has 11 airports with scheduled flight of which two provide international connections.

Fish and geothermal energy are the most important **natural resources**. Fishing and fish processing secure 30% of foreign currency income. Renewable energy sources provide practically all of Iceland's electricity and around 80% of the nation's primary energy supply. The remaining 20% of its energy supply comes from imports of coal and oil.

Investment ratios over the past decade were systematically very high, above 20% of GDP. Investments have halved since the outbreak of the crisis, also due to completion of large projects started earlier. In 2009, they contributed to around 13.5% of GDP, with public investments slightly less than 2% of GDP.

Overall, Iceland has strong human and physical capital endowments. Infrastructures are well developed and can support economic recovery. However, the current drop in investment risks negatively impacting productivity of the economy in the medium term.

Reform and liberalisation of industries

Since the 1990s, Iceland has reformed and liberalised its economy through an extensive programme of privatisations in all but a few strategic sectors, which are presented below.

The fishing industry, which remains of crucial importance, is heavily protected, in particular against competition coming from foreign investment (*see Chapter 13*). To protect Iceland's resource base, the volume of annual catch is managed through a system of individual transferable quotas. Since 2004, a fee has been collected on holders of harvesting rights. Ownership of fishing operations and primary fish processing is limited to Icelandic nationals. In the spring of 2002 the Icelandic parliament decided to levy a resource tax on Icelandic fishing companies. The tax is levied on allotted quotas based on the performance of the fishing operations as a whole.

The agricultural sector remains heavily subsidised and protected. Support to the agriculture sector is provided through both internal and border measures. Before the currency crisis, food prices were on average 60% higher than in the EU.

The energy sector is dominated by state and municipality-owned companies. Only Icelandic, EEA or EFTA residents and legal entities may own energy exploitation rights or enterprises involved in producing or distributing energy, although agreements may be reached to extend these benefits to other parties. No plans have been announced by the Icelandic authorities to further liberalise the market in the short term. Energy prices are among the lowest in Europe and attractive wholesale contracts are being offered to industry.

The legal framework governing the telecommunications sector has been in place since 2000 and aims to promote competition. It is designed to ensure conformity of Icelandic law with European directives. The telecommunications sector was privatised in 2005. Since 2006 the government has maintained a Telecommunications Fund, financed by the proceeds from the sale of the government's stake in Iceland Telecom, for projects aimed at developing the country's telecoms infrastructure, principally in areas where investment from the private sector was considered unlikely to be undertaken on market terms.

Overall, Iceland has a liberal, market-oriented economy, except in a few sectors considered strategic, where the government retains or restricts ownership. It will have to align with the EU *acquis*, method of governance and rules upon entry into the Union.

Structural shifts in the economy

Fishing, fish processing and agriculture generated approximately 8% of GDP in 2008. Traditional manufacturing industry operates on a small scale and its contribution to GDP has not significantly grown over the last ten years. It generated around 16% of GDP in 2008. The construction sector was responsible for 12% of GDP in the same year, while services contributed the rest. Financial services represented 26% of the economy in 2008.

The importance of small firms in the Icelandic economy is high. SMEs account for around 70% of all jobs in Iceland. The private sector employed 71% of all employed persons in 2008.

Overall, Iceland continues to reduce its dependence on fishing. The aluminium industry and financial services have contributed to the diversification of the economy. Since the collapse of the financial sector, production in the aluminium industry has held steady.

Government interventions in the economy

State aid policy in Iceland is governed by the EEA Agreement, in line with EU legislation. The legal framework for state aid is also partly determined by the country's international obligations stemming from its membership of the WTO. State aid in Iceland amounted to 0.12% of GDP in 2007 and was mostly directed to R&D.

Publicly owned enterprises account for a sizable share of GDP — around 30% in 2005, declining to around 27% in 2008. Currently, the most important business holdings in **public ownership** are in the production and distribution of electricity and postal services, as well as in the Housing Financing Fund, the Student Loan Fund and a few smaller financial institutions. Local governments own almost all the geothermal power companies, which

supply heating for most homes and, on an increasing scale, electricity to the aluminium industry.

The crisis has further increased the role of the government in the economy, particularly through the restructuring of the three main banks.

Trade integration

Iceland is an open economy, with imports and exports of goods and services amounting to 57% and 49% of GDP respectively in 2008. Trade integration with the EU is high. 54% of Iceland's imports came from the EU and 76% of its exports went to the EU in 2008. However, certain factors restrict Iceland's openness, such as geographic distance from major population centres, limited intra-industry and transit trade, a natural resource-based export sector and extensive protection of domestic agriculture and fisheries.

Trade involves a large share of primary products and commodities. Exports of services have also soared as the economy becomes increasingly service-oriented. The share of services in total exports of goods and services was 28% in 2008.

Currently the real exchange rate is at historical lows, because of corrections in the nominal exchange rate and wage cuts. The weakening of the króna's real exchange rate has shifted demand from imported goods to domestic products, contributing to a surplus on the external trade balance.

In conclusion, as a member of the EEA Iceland has proved able to withstand competitive pressures and market forces within the Union. The crisis and macroeconomic shocks have seriously affected the investment capability of the private sector and have temporarily increased the role of the state. However, Iceland is well endowed with human and physical capital. It could regain the capacity to sustain the competitive pressures of the single market in the medium term, provided that it addresses current weaknesses by swiftly implementing the appropriate macroeconomic policies and pursuing structural reforms.

2.3. General evaluation

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, mainly 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 the 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 125% of GDP, a third of which is due to the Icesave debts. Fiscal consolidation remains a key challenge. The restructuring of both public and private debt will have an impact on the pace of 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

This part of the analytical report analyses Iceland's ability to assume the detailed obligations of membership — that is, the *acquis communautaire*, as expressed in the Treaties, the secondary legislation and the policies of the Union. This section follows the structure of the 33 negotiating chapters into which the *acquis* has been divided for the purpose of conducting accession negotiations. Each chapter examines the current situation and prospects in Iceland. The negotiating chapters have been divided into three groups: the 10 chapters covered by the EEA, the 11 chapters partly covered by the EEA, and the 12 not covered by the EEA. For the purpose of this analytical report, and without prejudging any future date of accession, the medium-term perspective in the assessments has been defined as a period of three years.

3.1. Chapters of the acquis

3.1.1. Chapters covered by the EEA

Chapter 1: Free movement of goods

The principle of the free movement of goods means that products must be traded freely from one part of the Union to another. In a number of sectors this general principle is supplemented by a harmonised regulatory framework, following either the 'old approach' (imposing precise product specifications) or the 'new approach' (imposing general product requirements). The transposition of harmonised European product legislation represents the bulk of the obligations under this chapter. For the smooth implementation of the *acquis* it is essential to have sufficient administrative capacity to notify restrictions on trade and to apply horizontal and procedural measures in areas such as standardisation, conformity assessment, accreditation, metrology and market surveillance.

All main elements of the *acquis* on free movement of goods are covered by the EEA. All new relevant Community legislation is incorporated into the Agreement and thus applies throughout the EEA.

Regarding **general principles**, Icelandic legislation is generally in line with Articles 34 to 36 of the Treaty on the Functioning of the European Union and the related case-law of the European Court of Justice. However, some questions remain in the fields of alcoholic beverages and distance selling of medicines.

In the area of **horizontal measures**, Iceland is implementing EU legislation related to the principles of the new and global approach, standards, conformity assessment, accreditation, metrology and market surveillance.

In the field of **standardisation** the national standards body of Iceland is Icelandic Standards (ÍST). ÍST is already a full member of CEN and CENELEC and an associate member of ETSI. ÍST is also active in international standardisation organisations. The administrative capacity of ÍST should be sufficient to ensure proper transposition of harmonised European standards into national standards.

Conformity assessment is organised in Iceland on the basis of both horizontal and sector-specific EU legislation. CE marking is already used, recognised and accepted for those products falling within the scope of new approach directives. However, Iceland needs to ensure that the latest changes in the field of conformity assessment are duly implemented, not least Decision 768/2008/EC on the establishment of a common framework for the marketing of products. A small network of laboratories, certification and inspection authorities is in charge of implementing the requirements for accreditation and market surveillance relating to the marketing of products.

As for **accreditation**, the Icelandic Board for Technical Accreditation (ISAC) is the national accreditation body in Iceland and is a full member of European cooperation for Accreditation (EA). The Icelandic accreditation policy principles are in line with those of the European Union, including as regards professional and financial independence. However, full alignment with EU legislation will have to be ensured. ISAC has not yet been peer evaluated.

Concerning **metrology**, the tasks of legal metrology are entrusted to the Consumer Agency, which is in line with EU practice.

With regard to **market surveillance**, a system in line with EU practice is in place. The Consumer Agency coordinates other market surveillance authorities. However, Iceland needs to improve both internal and external coordination.

In the areas of **new and global approach product legislation**, Iceland has transposed the sector-specific legislation.

As regards **old approach product legislation**, Iceland is well aligned with EU legislation. However, in the automotive sector, Iceland also currently accepts vehicles produced and marketed according to technical requirements and standards other than the international ones on which EU legislation is based.

Regarding **procedural measures**, Iceland is implementing the Directive on notification procedures. External border checks on imported products are performed by the Directorate of Customs of Iceland. As regards **firearms**, Icelandic legislation is largely harmonised with the *acquis*. Icelandic transposition of the Directive on return of **cultural objects** unlawfully removed from the territory of an EU Member State is aligned with EU legislation.

Conclusion

As a member of the EEA, Iceland applies, with a few exceptions, the *acquis* on free movement of goods. Some further efforts are needed to align with the general principles and the old approach legislation and also to ensure full compliance with the *acquis* in the fields of conformity assessment, accreditation and market surveillance. Relevant structures are in

place, including a quality infrastructure with sufficient administrative capacity. Overall, Iceland should be able to assume the obligations of membership in this area.

Chapter 2: Freedom of movement for workers

The *acquis* under this chapter provides that EU citizens of one Member State have the right to work in another EU Member State, to reside there for that purpose with their family members and to be treated in the same way as national workers in relation to working conditions and social and tax advantages. Furthermore, the *acquis* includes the Community instruments on coordination of different national social security systems. The EEA Agreement covers the *acquis* under this chapter with some adaptations in the area of coordination of social security systems.

Iceland applies the *acquis* on **access to the labour market**. EU workers enjoy the same rights of access to the labour market and equal treatment as Icelandic nationals⁷. Iceland has notified that it has implemented its obligations under the EEA Agreement as regards the corollary right to reside, which includes the right to reside of workers and their family members. Iceland has also implemented the *acquis* on safeguarding of supplementary pension rights.

Iceland is fully participating in the European Employment Services network (**EURES**). EURES Iceland is an efficient service and has been able to remain a committed partner, despite challenging circumstances as a result of the impact of the global recession on the country's economy. Sufficient administrative capacity is in place, with a manager for EURES, two EURES advisers and two administrative staff. Furthermore, there are eight EURES contact persons/placement officers in regional offices around the country. EURES provides services to newcomers on unemployment benefits in English and Polish.

As regards **coordination of social security systems**, Iceland applies the Regulations on coordination of social security, and has shown that it has adequate administrative capacity. However, as required by the new *acquis* scheduled to enter into force in May 2010, Iceland will have to take the necessary steps to prepare for electronic data exchange within the Electronic Exchange of Social Security Information (EESSI) system. It will also have to extend its rules on the coordination of social security to third country nationals. Iceland has introduced the **European Health Insurance Card** to which Icelandic citizens and other residents who are EEA citizens and have National Health Insurance in Iceland are entitled.

Conclusion

With a few exceptions linked to derogations granted under the EEA, Iceland applies the *acquis* under this chapter. Adequate administrative structures are in place and Iceland should be able to assume the obligations of membership in the area of freedom of movement of workers.

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A temporary exception until December 2013 at the latest applies for Bulgarian and Romanian nationals in accordance with the transitional arrangements following the accession of the two countries and the extension of the EEA Agreement: they are currently still subject to restrictions on labour market access and need a work permit.

Chapter 3: Right of establishment and freedom to provide services

Member States must ensure that the right of establishment of EU nationals and legal persons in any Member State and the freedom to provide cross-border services as laid down in Articles 49 and 56 of the Treaty on the Functioning of the European Union (TFEU) is not hampered by national legislation, subject to the exceptions set out in the Treaty. The core piece of *acquis* in this area is the Services Directive. The *acquis* also harmonises the rules concerning regulated professions to ensure the mutual recognition of qualifications and diplomas between Member States. For certain regulated professions a common minimum training curriculum must be followed in order to have the qualification automatically recognised in an EU Member State. The EU postal reform aims to ensure the provision of a universal postal service, the establishment of an internal market for postal services and a high quality postal service for end users.

The entire *acquis* in this chapter is covered by the EEA Agreement. Articles 49 and 56 TFEU correspond to Articles 31 and 36 of the EEA Agreement. The postal services *acquis* and the *acquis* in the field of professional qualifications are incorporated into the EEA Agreement.

In the field of the **right of establishment and freedom to provide cross-border services**, the decision to incorporate the Services Directive into the EEA Agreement has not yet entered into force. Icelandic authorities are nevertheless already working on the implementation of the Services Directive in the Icelandic legal order. The Ministry of Economic Affairs is in charge of the implementation of the Services Directive and coordinates cooperation with other ministries, agencies and local authorities. Iceland will need to ensure that the Services Directive is fully transposed and that adequate administrative capacities are set up. Iceland has some restrictions in place as regards the right of establishment and the freedom to provide services in the fisheries sector. (*See Chapter 13 – Fisheries*).

In the area of **postal services**, Iceland has implemented the main corpus of the *acquis*. However, the Third Postal Directive is not yet incorporated into the EEA Agreement. Particular attention will need to be paid to a number of specific issues including the scope of the universal service obligation, the authorisation procedure, the financing of the national regulatory authority and the compensation of net costs of the universal service obligation. The administrative structure is similar to that of most EU Member States. The Ministry of Communications is in charge of postal policy and legislation, whereas the national regulatory authority, the Post and Telecom Administration, oversees the implementation of postal policies and legislation, and monitors the market. Particular attention has to be paid to the strengthening of administrative capacity and the separation of regulatory and management tasks.

In the field of **mutual recognition of professional qualifications**, Iceland has implemented a number of different directives on regulated professions, whereas the main Directive on the recognition of professional qualifications of September 2005 is not yet implemented. This non-implementation has been noted by the EFTA Surveillance Authority. The competent authority for this Directive is the Ministry of Education, Science and Culture. A number of other line ministries are in charge of sector-specific legislation on other regulated professions. Full transposition of the *acquis* in this sector, as well as an adequate institutional framework, still have to be achieved.

Conclusion

With some exceptions, Iceland applies the *acquis* on the right of establishment and freedom to provide services. However, in the fisheries sector Iceland has some restrictions in place which it will have to align with the *acquis*. Iceland will in particular need to undertake further efforts to align with the Services Directive and the Third Postal Directive, as well as complete the framework for mutual recognition of professional qualifications. Further efforts are also needed to strengthen its administrative capacity for effective implementation and enforcement of the EU rules and policies. Overall, Iceland should be able to take on the obligations of membership in this area.

Chapter 4: Free movement of capital

Member States are expected to remove all restrictions on capital movements and payments, both within the EU and between Member States and third countries. The *acquis* also includes rules concerning cross-border payments and the execution of transfer orders concerning securities. The Directive on the fight against money laundering and terrorist financing requires banks and other economic operators to identify customers and report certain transactions, particularly when dealing with high value items and large cash transactions. A key requirement to combat financial crime is the creation of effective administrative and enforcement capacity, including cooperation between supervisory, law enforcement and prosecutorial authorities.

All main elements of the *acquis* on free movement of capital are covered by the EEA Agreement. New *acquis* is regularly incorporated into the Agreement. However, Iceland has a temporary exemption which restricts foreign investments (see below).

With regard to **capital movements and payments** the rules applied within the EEA are almost identical to those of the *acquis* requiring the liberalisation of capital. However, countries not belonging to the Euro area can still make use of exceptional balance of payments safeguards. In November 2008, against the background of the financial crisis, Iceland took protective measures under Article 43 of the EEA Agreement which restrict capital flows between Iceland and EEA Member States. Currently very comprehensive exchange controls exist on operations between Iceland and abroad. Certain controls were further tightened in April 2009. These remain to be liberalised in order for Iceland to comply fully with the freedoms of capital. The Icelandic authorities have approved a plan for the gradual liberalisation of capital controls. Implementation of the plan started in November 2009 and some relaxation measures were introduced allowing the conversion of asset sale proceeds into foreign currency. The IMF, in its first review of its Stand-By Arrangement, noted that a faster pace of fiscal adjustment and ‘*a more gradual pace of capital account liberalisation*’ would be key towards preserving stability and sustainability. Removal of important controls is, however, not expected imminently. All measures on the basis of the current enabling legislation can remain in force until November 2010. This does not preclude their extension under future legislation depending on developments.

Under the EEA Iceland has a permanent exception which restricts foreign investments in fishing vessels and fish processing (*see also Chapter 13 — Fisheries*). There are also restrictions in other areas, such as energy, air transport or real estate, which apply only to third country nationals, and not to EEA nationals.

As regards **payment systems**, secondary legislation on payments has fully liberalised capital movements within the internal market. In November 2009, the EU legislation changed significantly, with an expanded Directive on payment systems becoming applicable as well as a new, more detailed Regulation on cross-border payments in the Community. All such legislation is covered by the EEA Agreement. As of the end of October 2009, all the *acquis* relevant to payment systems had been fully implemented. No derogations or areas of difficulties were indicated or detected.

With regard to the **anti-money laundering** *acquis*, the third Anti-Money Laundering (AML) Directive, the Directive laying down implementing measures for the third AML Directive and the Regulation on information on the payer accompanying transfers of funds are all covered by the EEA. Iceland has already transposed the third AML Directive and the Regulation on information on the payer accompanying transfers of funds. The Directive laying down implementing measures is partially implemented. In some cases Iceland has gone beyond the requirements of the *acquis* in order to establish a sound and effective supervisory regime. However, the implementing capacity of the Financial Intelligence Unit (FIU) in terms of staffing and independence is questionable as the FIU is currently a one-person entity. (See also chapter 24 Justice, Freedom and Security).

Conclusion

With some exceptions Iceland applies the *acquis* on free movement of capital and should be able to assume the obligations of membership in this area. However, Iceland has a permanent exception regarding foreign investment in fisheries. The restrictions on foreign investment and foreign ownership will have to be aligned with the principles of the *acquis*. Significant and sustained efforts will be needed to remove the restrictions on capital outflows. Administrative capacity will need to be strengthened, in particular in the area of anti-money laundering.

Chapter 5: Public procurement

The *acquis* on public procurement includes general principles of transparency, equal treatment, free competition and non-discrimination. In addition, specific EU rules apply to the coordination of the award of public contracts for works, services and supplies, for the classical sector and for the utility sector. The scope of application is defined according to contracting authorities/entities, contracts covered and application thresholds and specific exclusions. The *acquis* also specifies rules on review procedures and the availability of remedies.

The *acquis* on public procurement is included in the EEA Agreement, except for two technical Directives (2006/97/EC and 2007/24/EC) and the new Remedies Directive (2007/66/EC).

Iceland has implemented the main corpus of the *acquis* on public procurement in line with its EEA obligations but it will need to ensure full implementation of the new Remedies Directive and the above-mentioned technical Directives. Some further fine-tuning is also needed as regards the implementing provisions of directives covering the award of public contracts, i.e. the Directive for utilities and the Directive on public sector contracts.

As regards administrative capacity, the Ministry of Finance is in charge of general supervision and implementation of public procurement rules and policy. It has wide powers to intervene in contracting authorities' decisions, if needed. Even if the Ministry is currently managing to

discharge its duties, having only two members of staff working on public procurement policy might prove insufficient should any major problem arise.

There is a need to enhance the appropriate administrative structures at central level to ensure the key functions of policy-making, drafting of primary and secondary legislation, provision of operational tools, help-desk, monitoring and statistical reporting, as well as consistent controls in all areas related to public procurement. Moreover, main purchasers at all levels have to possess the necessary administrative capacities to allow effective implementation of the procurement rules.

Conclusion

Iceland applies the main provisions of the public procurement directives in line with its EEA obligations. However, some further efforts will be needed to ensure final alignment of the legislation with that of the *acquis* as regards the new Remedies Directive and certain implementing provisions for the award of public contracts. Overall, the central administration seems able to meet the requirements of membership. However, the administrative capacity needs to be further enhanced to ensure proper implementation of the public procurement policy in Iceland.

Chapter 6: Company Law

The *acquis* in company law includes rules on disclosure requirements, formation, maintenance and alteration of capital, merger and division, takeover bids and transparency requirements of companies, as well as corporate governance principles. In the area of financial reporting, the *acquis* specifies rules for the presentation of annual and consolidated accounts, including simplified rules for small and medium-sized enterprises. Particular accounting rules apply to the banking and insurance sectors. The application of International Accounting Standards is mandatory for some public interest entities. In addition, the *acquis* specifies rules for the approval, professional integrity and independence of statutory auditors.

All main elements of the company law *acquis* apply to the EEA countries. New *acquis* is regularly incorporated into the EEA Agreement.

As a consequence, Icelandic company law is generally harmonised with the **company law** *acquis*. However, the 2007 Directive on shareholders' rights has not yet been implemented. Measures have been taken to promote the application of Commission Recommendations in the area of corporate governance and further measures are planned with regard to the Commission Recommendations of April 2009 on remuneration.

As regards administrative structures, the Business Department within the Ministry of Economic Affairs is responsible for company law. The Department has a staff of five people. Registration of companies is the responsibility of the Director of Internal Revenue, which is an Agency under the Ministry of Finance. The Business and Company Register has fourteen employees and receives technical support from other divisions of the Director of Internal Revenue. The Register has regular contacts with Nordic and European registers.

In the area of **corporate accounting**, Iceland has implemented most of the relevant *acquis*. However, parts of the Directive amending certain provisions on annual and consolidated accounts and the Regulations on equivalence of accounting standards remain to be implemented.

Regarding administrative capacity, the Business Department of the Ministry of Economic Affairs is also responsible for corporate accounting and audit. The Registry of Annual Accounts (Ársreikningaskrá) is responsible for receiving and publishing companies' annual accounts, as well as monitoring companies that follow the international accounting standards.

As regards **auditing**, the 2008 Act on auditors, which came into effect in January 2009, transposes the Statutory Audit Directive and also takes into account recommendations on external quality assurance and the limitation of the civil liability of statutory auditors and audit firms.

The Public Auditors' Oversight Board (Endurskoðendaráð) is the public oversight body for auditors in Iceland. The Board is responsible for the external quality assurance system and publishes information on the result of the external quality assurance annually. The Board can also investigate auditors, auditing firms or issues on its own initiative if it has reason to believe that the relevant legislation has been violated.

Conclusion

Iceland largely applies the *acquis* in the area of company law and should be able to take on the obligations of EU membership in this area. Some further efforts are needed to align with the rules on shareholders' rights and corporate accounting.

Chapter 7: Intellectual property law

The primary objective of the EU *acquis* in the area of intellectual property is to ensure the proper functioning of the internal market while striking the right balance between right-holders' rights and users' interests, as well as adapting the legal framework to the changing technological environment. As regards copyright, the *acquis* harmonises rules for the legal protection of copyright and related rights. Specific provisions apply to the protection of databases, computer programs, semiconductor topographies, satellite broadcasting and cable retransmission. In the field of industrial property rights, the *acquis* sets out harmonised rules for the legal protection of trademarks and designs. Specific provisions apply to biotechnological inventions, pharmaceuticals and plant protection products. The *acquis* also establishes a Community trademark and Community design.

Intellectual property is covered by the EEA Agreement, which contains provisions on protection of intellectual property, exhaustion of rights, adherence to or participation in European Community measures and international conventions and relations with third countries. Annex XVII to the EEA Agreement lists the secondary legislation that is part of the EEA Agreement.

Iceland is implementing the *acquis* on **copyright and related rights**. The competent body is the Ministry of Education, Science and Culture. An expert committee advises the Minister on copyright issues. The arrangements for the functioning of collecting societies are in line with EU requirements.

The legislation in the area of **industrial property rights** largely complies with the *acquis*. Further efforts are needed to implement the rules on trade mark exhaustion and supplementary protection certificates for medicinal products. To date, Iceland has not notified to the EFTA Surveillance Authority (ESA) the trademarks Directive as fully implemented. The necessary administrative structures are in place.

Regarding **enforcement**, the Directive on the enforcement of intellectual property rights (Directive 2004/48/EC) has not been incorporated into the EEA Agreement. Some of its provisions have been transposed by the 2006 Act on the collecting of evidence in relation to suspected violations of intellectual property rights. Other requirements of the Directive should be fulfilled *inter alia* through legal provisions implementing the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights and general provisions in various acts on legal procedures. To be in line with the *acquis*, Iceland will have to ensure full alignment with the Directive and develop a comprehensive enforcement policy.

Conclusion

With some exceptions, Iceland applies the *acquis* on intellectual property law and should be able to take on the obligations of membership in this area. It will need to ensure full implementation of the Directive on the enforcement of intellectual property rights.

Chapter 8: Competition

The competition *acquis* covers antitrust, merger and state aid control policies. It includes rules and procedures to fight anticompetitive behaviour by companies (restrictive agreements between undertakings and abuse of dominant positions), scrutinise mergers between undertakings, and prevent governments from granting state aid that distorts competition in the internal market. Generally, the competition rules are directly applicable throughout the Union and Member States must cooperate fully with the Commission in enforcing them.

The EEA Agreement covers the *acquis* in the area of competition. More specific rules, regarding in particular cooperation and division of competences between the Commission and the EFTA Surveillance Authority (ESA) in competition and state aid cases, are laid down in Protocols 21 to 27 to the EEA Agreement. The Commission and the ESA are competent to investigate and control certain anticompetitive practices and certain mergers that affect the Icelandic market. In addition, the ESA is competent to scrutinise and authorise any state aid to be granted by the Icelandic authorities that affects trade between Iceland and the other EEA contracting parties (agriculture and fisheries being excluded from its scope).

The Icelandic Competition Act is closely modelled on the competition *acquis*; it applies to all sectors and to both public and private enterprises. The Icelandic Competition Authority enjoys investigatory powers that are comparable to those of the European Commission. The level of enforcement in the area of **antitrust and mergers** appears to be adequate. The Competition Authority is appropriately staffed. In recent years, it has dealt with many cases and has imposed a relatively high number of fines. The Commission will, however, need to assess the qualitative aspect of its decisions.

State aid granted by the Icelandic authorities is subject to ex-ante control by the ESA. The ESA, as an independent authority, closely monitors alignment with Commission decisions and the ECJ case-law in this field. The control of state aid in Iceland is comparable to that carried out within the EU.

Over the period 2004-2008, the total annual amount of state aid granted by the Icelandic authorities did not exceed €24 million, representing 0.12 % of GDP. In 2008, there was only one pending recovery case concerning Iceland. However, in response to the economic crisis, the Icelandic government has adopted a number of state aid measures, in particular in favour of the financial sector. These measures are in the process of notification to the ESA and will have to be closely monitored.

Finally, a number of undertakings enjoy special or exclusive rights, in the field of transport, energy, postal services, broadcasting and housing. Further analysis of their compatibility with the *acquis* will be required, although no systemic issue under Article 106 TFEU can be identified at this stage.

Conclusion

Iceland applies the *acquis* on competition and should be able to take on the obligations of EU membership in this area. Relevant administrative structures are in place. However, some further monitoring of the quality of the decisions of the Icelandic Competition Authority and of the aid measures adopted following the economic crisis will be necessary.

Chapter 9: Financial services

The main objectives of the EC *acquis* as regards financial services are to ensure financial stability, the financial soundness of companies operating in the financial sector, and appropriate protection of consumers, investors and policyholders. The aim is to build up confidence in the financial markets and to provide a common level playing field. The *acquis* on financial services includes rules for the authorisation, operation and supervision of financial institutions in the areas of banking, insurance, supplementary pensions, investment services and securities markets as well as with regard to financial market infrastructure. Financial institutions can operate across the EU in accordance with the ‘single passport’ and the ‘home country control’ principle, either by establishing branches or by providing services on a cross-border basis.

The *acquis* in the field of financial services is covered by the EEA Agreement. In addition, the EU secondary legislation listed in Annex IX to the EEA Agreement applies to the financial services sector in the European Economic Area. The rules of the EEA Agreement on financial services are focused on developing a single European financial market where providers of services can freely offer their services within the EEA. The EEA States can only apply national restrictions if the relevant field is not fully harmonised by EEA secondary legislation and provided that the restriction is justified under the criteria of the ‘general good’.

The **banking sector** in Iceland has been profoundly shaken by the financial crisis. In October 2008, the three main banks of the country, Glitnir, Landsbanki and Kaupthing, which amounted for 85% of the whole Icelandic private banking sector, had to halt their business as liquidity dried up and clients' confidence waned. The Icelandic authorities took control of the collapsed banks and introduced legislation giving depositors priority over other unsecured creditors. Three new separate entities were created, in which the domestic operations of the three banks were continued. Domestic deposits and some other liabilities were transferred to these new entities. Depositors at EU branches of the banks and other creditors were left with the residual banks which ceased business and went into liquidation. As compensation, the new entities were to issue bonds to the residual banks the values of which were to be equivalent to the net fair value of the assets transferred to the new entities. All three banks had significant operations in other EEA states. Foreign depositors and other creditors of the banks were thus strongly affected by the Icelandic government's emergency measures.

Following the collapse of the former privately owned Icelandic banks, the Icelandic deposit guarantee scheme (Depositors and Investors Guarantee Fund) did not have sufficient funds to reimburse the depositors at the foreign branches of the banks. The British and Dutch

depositors with Icesave, an on-line branch of Landsbanki that operated in the UK and the Netherlands, were particularly affected. Following the default of the Icelandic deposit guarantee scheme, the UK and Dutch governments decided to compensate their respective depositors from their own resources and asked the Icelandic government to reimburse them.

Differences between Iceland, on the one hand, and the UK and the Netherlands, on the other, over the interpretation of legal obligations with respect to the Deposit Guarantee Directive 94/19/EC in the European Economic Area led to consultations between Iceland, the EU institutions and the Member States in November 2008. All parties concluded that the Deposit Guarantee Directive had been incorporated in the EEA legislation in accordance with the EEA Agreement, and is therefore applicable in Iceland in the same way as it is applicable in the EU Member States. While reserving its right to have the issue of legal liability decided upon at a later stage by a competent adjudicator, the government of Iceland agreed to cover deposits of insured depositors in the Icesave accounts in accordance with the EEA law and up to the minimum requirements set forth in the Deposit Guarantee Directive. Later negotiations between Iceland, UK and the Netherlands led to the "Icesave agreements" and laws. The objective was the authorisation of an Icelandic state guarantee for special loans granted by UK and the Netherlands to reimburse them for the compensation already paid to their respective depositors holding Icesave accounts. A final resolution of this issue is still pending. On 30 December 2009, after months of intense debate, the Icelandic parliament approved the law putting into effect the Icesave agreement of October 2009. Soon after, on 5 January 2010, the Icelandic President, following of a petition signed by 25% of the electorate, withheld his signature from the bill thus creating the constitutional premise for a referendum due to take place on 6 March.

The Icelandic emergency measures in the aftermath of the banking collapse have raised questions as regards their compatibility with EEA law, in particular the treatment of retail depositors outside Iceland and of other institutional creditors. The EFTA Surveillance Authority (ESA) is the institution responsible for ensuring Iceland's compliance with the EEA Agreement. In October 2008, ESA started investigations on its own initiative. Several complaints were submitted to ESA by institutional creditors, foreign retail depositors as well as one Member State related to the emergency legislation and actions taken by Icelandic government. ESA's investigation on these issues is continuing. The European Commission is closely following the process and will continue to monitor the situation.

Currently, no foreign bank operates in Iceland at the retail level and Icelandic banks have extricated themselves from their foreign commitments - in so far as these can be easily divested - and have fallen back, to the extent possible, on their national market. This indicates that the Icelandic banking market is currently very focussed on the domestic market, at least at retail level. (*see also under "economic criteria"*)

The banking crisis in Iceland, and its effects, have highlighted problems regarding compliance with the *acquis*. In particular, Iceland needs to address the problems in the area of supervision and deposit guarantees as well as the practical application of the EU banking directives (e.g. improve the institutional structure of banking supervision, ensure application of the regime of large exposures and of the criteria for bank shareholders and managers).

Iceland also has to start implementation of the *acquis* regarding both the prudential assessment of acquisitions in the financial sector and the new coverage level of deposit guarantee schemes. Moreover, implementation of the *acquis* on financial conglomerates has

to be completed. According to the EFTA Surveillance Authority, Iceland has notified only a partial implementation of the Financial Conglomerates Directive.

In terms of administrative capacity, the investigatory and sanctioning powers of the Financial Supervisory Authority (FME) whose staff has been reinforced lately are in line with those of Member States. The Ministry of Economic Affairs is preparing a reform of the financial services legislation and supervisory structure to strengthen the FME's powers, bringing the Central Bank and the FME under the same administrative umbrella and creating a National Credit Registry for overview of large exposure at the national level.

The FME is currently an observer on the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance Supervisors (CEIOPS) and Committee of European Securities Regulators (CESR). For the continued integration of the FME into the EU supervisory structure, Iceland should have observer status in the new three European Supervisory Authorities. These Authorities will replace the above mentioned committees.

In the **insurance sector**, Iceland still has to transpose the *acquis* in the field of re-insurance as well as some of the provisions concerning life assurance. There are some pending doubts, as formally raised by the EFTA Surveillance Authority, regarding full and complete implementation of the Insurance Group and Insurance Mediation Directives.

Iceland implements all the relevant legislation in the field of **securities markets and investment services**.

Conclusion

Iceland generally applies the *acquis* on financial services and should be able to take on the obligations of EU membership in this field. However, in light of the 2008 financial crisis, improvements to certain aspects of Icelandic financial services legislation, as well as to its enforcement, will be necessary in order to fully implement the *acquis*. In particular, Iceland will need to address the organisation and functioning of the financial supervisory system and the deposit guarantee system at an early stage. It will also need to improve the practical application of prudential rules provided for by the EU banking directives.

Chapter 10: Information society and media

The *acquis* on information society and media aims to eliminate obstacles to the effective operation of the internal market in electronic communications services and networks, promote competition and safeguard consumer interests in the sector, including the universal availability of basic modern services. It also includes rules on information society services and a transparent, predictable and effective regulatory framework for audiovisual media services in line with European standards.

All main elements of the *acquis* in information society and media are covered by the EEA Agreement. Moreover, Iceland participates in several EU policies supporting the development at national and European level of the information society, such as broadband strategies and policies for e-Government, e-Health, and e-Inclusion.

In the field of **electronic communications and information technologies**, the relevant EU regulations and directives are transposed with two exceptions: the Directive on data retention has not yet been transposed. Moreover, the amended Regulation on roaming is not yet applicable in Iceland. The legislative and administrative structure is similar to most EU

Member States. The competent ministry is in charge of policy-making, whereas the national regulatory authority oversees the implementation of the policies and the legislation, and monitors the market. The managing director of the regulatory authority is appointed by the government for a renewable five-year term. Considering that the independence of the national regulatory authority is a cornerstone of the EU regulatory framework, Iceland will need to ensure transparent and objective appointment procedures, as well as high standards regarding security of tenure.

In the field of **information society services**, the main directives have been transposed into the Icelandic legal order, i.e. the Directives on electronic signatures, e-commerce and conditional access. As regards the transposition of the latter, the legal protection needs to be extended to conditional access devices other than broadcasting services decoders. Information society policy is developed by the Prime Minister's Office. Implementation is ensured by the relevant ministries and institutions.

In the field of audiovisual policy, the 2000 Broadcasting Act fully implements the Television without Frontiers Directive. The Icelandic authorities have submitted a draft bill in order to further align the legislation with relevant *acquis* in this field (in particular the Audiovisual Media Services Directive). However, as regards the principle of freedom of reception and retransmission, Iceland will need to ensure that there are no restrictions on the reception and retransmission of television broadcasts from other EU Member States, in particular in the context of the Icelandic rules on advertising. The level of alignment with the rules on film heritage and protection of minors is advanced. The competent authority in the field of audiovisual policy is the Ministry of Education, Science and Culture. The Broadcast Licence Committee is the regulatory body which grants legal and natural persons a temporary broadcast licence, oversees compliance with rules pursuant to broadcast licences and supervises the implementation of the Broadcasting Act. Its board members are appointed by the government and the Supreme Court.

Conclusion

With a few exceptions, Iceland applies the *acquis* on information society and media and should be able to take on the obligations of EU membership in this area.

3.1.2. Chapters partially covered by the EEA

Chapter 12: Food safety, veterinary and phytosanitary policy

This chapter reflects the EU's integrated approach aimed at ensuring a high level of public health, animal health, animal welfare and plant health through coherent farm-to-table measures and adequate monitoring, while ensuring the effective functioning of the internal market. The *acquis* sets hygiene rules for foodstuff production and rules in the veterinary field, which are essential for safeguarding animal health, animal welfare and the safety of food of animal origin in the internal market. In the phytosanitary field, EU rules cover issues such as quality of seed, plant protection products, harmful organisms and animal nutrition. Member States must have appropriate administrative structures to be able to carry out inspection and control of food products, including an appropriate laboratory capacity.

Iceland, as a party to the EEA Agreement, implements the EU legislation on veterinary matters with respect to fish and fish products, fish diseases, feed, seed, fertilisers, foodstuffs and other food chain-related issues. Protocol 1 to the EEA Agreement exempts Iceland from

implementing the veterinary *acquis* for live animals and germplasm other than fish and aquaculture animals, as well as fresh meat, eggs and milk.

In the area of **general food safety**, although covered by the EEA Agreement, the *acquis* is not yet implemented. The corresponding Food law package amending the law on food and feed has been adopted by the parliament in December 2009 and is expected to enter into force in March 2010. The existing administrative and control structure in place is largely aligned with the *acquis*. The Ministry of Fisheries and Agriculture is responsible for the implementation of the legislation and its supervision. The Icelandic Food and Veterinary Authority (Matvælastofnun — MAST) is the central competent authority (CCA). In 10 control districts environmental and public health offices are established as local competent authorities (LCAs). MAST (the CCA) and the LCAs are responsible for food safety controls, with MAST coordinating and supervising control activities including those of private inspection bodies accredited for control of fish and fish products. The legal powers of the CCA (MAST) towards LCAs, laboratories and in the animal feed sector need to be increased. There is a risk of conflict of interest for District Veterinary Officers carrying out official controls in inspection bodies. A multi-annual national control plan is not yet in place. Laboratories for official controls and national reference laboratories for each of the Community reference laboratories have to be designated.

In the **veterinary sector**, the national law covers all areas of the *acquis* establishing a CCA (MAST) empowered to enforce health and welfare rules. However, Community rules are not implemented for trade in live animals or germplasm, other than fish and aquaculture animals, as well as fresh meat, eggs and milk (exemption from the EEA Agreement), which means that all imports of live animals except for fish and fish germplasm are prohibited. Derogations from this ban are based on evaluation of the sanitary situation of a country without consideration of disease-free zones as practised by EU Member States. This will need alignment with the *acquis*. Iceland has established eight border inspection posts which are based on legislation aligned with the *acquis*. However, procedural shortcomings were detected during recent audit missions by the Food and Veterinary Office (FVO).

Rules for identification and registration of animals are largely aligned with the *acquis*. Contingency plans for animal diseases are in place; the list of notifiable diseases exceeds Community rules for mammals and for fish and shellfish. Veterinary services are competent and capable of controlling animal diseases as there is no record of an outbreak of a notifiable 'List A' animal disease in the past 50 years. However, on zoonoses, no specific acts or regulation exists for the implementation or monitoring of the *acquis* in this field. Since 2008, a National Control Programme for Salmonella and Campylobacter has been in place.

Legislation on contaminants and the monitoring of certain substances and residues is not implemented in Iceland although the use of growth promoters and hormones is prohibited. The legislation for animal welfare is largely aligned with the *acquis*.

As regards **the placing on the market of food, feed and animal by-products** the Icelandic legislation in force meets the general objective of the *acquis*, i.e. to ensure a high level of hygiene and consumer protection. The CCA (MAST) has sufficient powers to enforce the law. The Icelandic Food Act and specific legislation on meat hygiene, game, milk, fishery and aquaculture products, organic production and slaughter are largely aligned with the *acquis*. However, the 'hygiene package' is not implemented yet and consequently the obligation to carry out hazard analysis critical control point (HACCP)-based self-controls in food establishments does not apply. Provisions on the funding of controls will need to be aligned.

The *acquis* on animal by-products not intended for human consumption is not yet implemented in Iceland, although covered by the EEA Agreement. Iceland has no incineration capacity for carcasses that are potentially infected with Transmissible Spongiform Encephalopathy (TSE).

Concerning **food safety rules** national legislation on labelling, presentation and advertising, additives and contaminants, contact materials, and food for particular nutritional uses is either fully or to a large extent aligned with the *acquis*; in some areas updates to take account of new *acquis* are missing. No legislation exists for either novel food or the traceability and labelling of genetically modified food and feed. National legislation on **specific rules for feed** is to a large extent aligned with the *acquis* except for medicated feed, the prohibition of certain materials for animal nutrition purposes, the marketing of feed and the rules for general feed hygiene.

In the **phytosanitary sector**, Iceland has implemented the *acquis* on seeds except for plant health. Import controls and certification for plants, seeds and propagating material as well as for wood packaging material and soil are applied. As regards potatoes, a system of domestic registration of growers authorised to sell seed potatoes is in place. However, Iceland does not apply the EU plant passport system. National legislation related to harmful organisms is based on principles of the International Plant Protection Convention (IPPC). The authorisation of plant protection products will need to be aligned and fully harmonised. Maximum residue limits (MRLs) are implemented. Laboratory capacity for pesticide residue analyses will have to be adjusted to meet the requirements of the agreed monitoring programmes of EU Member States. The current capacity is insufficient to follow up the obligations of monitoring substances and for accredited laboratories to process the required number of samples.

Conclusion

Overall, Iceland has a good legal and administrative framework (including controls) in place to take over the *acquis* on food safety, veterinary and phytosanitary policy. Some areas of the *acquis* are already implemented. However, some fields of the *acquis*, such as trade in live animals, the hygiene package, animal by-products, food labelling, additives and contact materials, novel foods and genetically modified organisms, plant health, authorisation of pesticides, will still need to be implemented in order to meet the obligations of EU membership. As regards the infrastructure, there are weaknesses in analytical laboratory capacity and there is no incineration facility for animal by-products.

Chapter 14: Transport policy

EU transport legislation aims to improve the functioning of the internal market by promoting safe, efficient, environmentally sound and user-friendly transport services. The transport *acquis* covers the sectors of road transport, railways, inland waterways, combined transport, aviation, and maritime transport. It relates to technical and safety standards, security, social standards, competition and state aid control, and market liberalisation in the context of the internal transport market.

The main elements of the *acquis* on transport policy are covered by the EEA Agreement. Annex XIII to the Agreement covers general transport matters such as facilitation at frontiers and combined transport. It also covers market access, fares, competition, taxation, technical harmonisation and safety in maritime transport, aviation, roads and inland waterways. Iceland has formally incorporated the Single European Sky Regulations into its legislation and is

geographically located in the North Atlantic (NAT) Region. It is not a member of Eurocontrol. Acts which have not been incorporated into the EEA Agreement include agreements between various EU Member States and the Community, agreements between EU Member States, the Community and third countries as well as acts relating to the summer time arrangements.

In the field of **road transport**, the *acquis* is, in general, applied by Iceland. However, implementation of the *acquis* is still pending in some areas, for instance social rules relating to driving times, the adequate level of checks and inspection measures, driving licences and technical equipment of vehicles.

As regards *taxation and road charges*, vehicles registered in the EU will need to be exempted from the annual tax on foreign vehicles and compliance with the minimum taxation levels will need to be monitored. In the field of *transport of dangerous goods*, Iceland is applying the European Agreement on the International Carriage of Dangerous Goods by Road (ADR) in line with the *acquis*, but it will have to apply the updated 2009-2011 ADR rules. The Road Administration, the Road Traffic Directorate and the Administration of Occupational Safety and Health in Iceland have administrative capacity to enforce legislation concerning social and technical regulations in the field of road transport. The total number of employees is seventeen.

In the **air transport** sector, the *acquis* is applied by Iceland, including the updated *acquis* on slots allocation and access to ground-handling services at airports. However, regarding aviation security, the current derogation for domestic air services is not compatible with the *acquis*. In the field of air traffic management it needs to be ensured that the national supervisory authority is an independent entity of the Civil Aviation Administration and that the air navigation service provider has been designated and certificated by the national supervisory authority. The compatibility with the *acquis* of the existing and envisaged air navigation charging system will need to be monitored.

Regarding **maritime transport**, Icelandic legislation is well aligned with the *acquis*, in particular on safety and security issues. In the area of market access and registration of ships, Iceland needs to ensure that the principle of freedom of establishment is observed with regard to ship registration in Iceland. Given the size of the Icelandic fleet the administrative capacity of the Maritime administration is sufficient to implement the *acquis*.

Regarding **satellite navigation**, Iceland asked to participate in the relevant EU programme. However, in the context of the economic crisis its participation was suspended, including its financial contribution.

There are no **rail** or **inland waterway transport** sectors in Iceland.

Conclusion

Overall, Iceland is implementing a substantial part of the *acquis* under this chapter and should be able to take on the obligations of membership. However, further alignment will be needed to implement the pending EEA acts and the more recent *acquis*, in particular in the road and aviation sectors. Iceland will need to guarantee freedom of establishment with regard to ship registration. Relevant structures are in place and Iceland should be able to meet the obligations of membership. Further efforts will be needed to ensure the independence of the supervisory body in the area of air traffic management.

EU energy policy objectives are to improve competitiveness, ensure security of energy supplies and protect the environment. The energy *acquis* consists of rules and policies covering competition and state aid, the internal energy market (liberalising electricity and gas markets in particular), the promotion of renewable energy sources, energy efficiency, crisis management and oil stock security obligations, nuclear energy and nuclear safety and radiation protection.

A large proportion of the EU legislation on energy matters has been incorporated into the EEA Agreement, and Icelandic legislation is broadly in line with the EU energy *acquis*. However, some exceptions exist due to Iceland's unique energy mix and isolated electricity system. Legislation still to be implemented relates to areas not covered by the EEA (such as security of supply, in particular minimum oil stocks) or not deemed relevant to Iceland, as well as legislation covered by the EEA, but not yet transposed by Iceland.

In 2008, Iceland's domestic production accounted for 80% of its primary energy supply. As there is no domestic coal, gas or nuclear production, all its indigenous energy comes from renewable sources. The remaining 20% of its energy supply is imported coal and oil. Due to its many energy-intensive industries, electricity consumption per capita is the highest in the world even if the system is small in absolute terms. Iceland's electricity system is isolated. The electricity sector is predominantly publicly owned. It was opened to competition and third party access for transmission and distribution networks in January 2006.

In the area of **security of supply**, Iceland has no natural gas networks and no plans to be supplied by gas. The EU Directive on the security of natural gas supply should therefore not apply. Although the Directive on measures to safeguard security of electricity supply and infrastructure investment is incorporated into the EEA Agreement, it has not been transposed by Iceland. With respect to oil stocks, key legislation is not in place in Iceland. Oil companies and others are not mandated to maintain minimum reserves. The Icelandic authorities estimate that current reserves are in the region of 40-45 days, whereas the EU requirement for emergency oil stocks is 90 days. A steering group was recently appointed to develop a comprehensive energy policy for Iceland, including security of supply.

As regards the **internal energy market**, the second package's Directive on electricity is notified as fully implemented in Iceland (pending a conformity assessment by the EFTA Surveillance Authority). Iceland will also have to implement rules for the electricity internal market, as set out in the recently adopted third package. As provided for in the Directive, Iceland would be eligible for derogations for its system, as it has no cross-border connections. Iceland will need to set appropriate conditions for investments from other EU countries, as it has considerable potential to increase its electricity production.

Iceland's Electricity Act designates two regulatory authorities: the National Energy Authority (NEA), under the Minister of Industry, and the Competition Authority, under the auspices of the Minister of Economy. In accordance with the third package, the independence of regulators from government needs to be ensured. The independence of Icelandic structures will have to be assessed carefully. Iceland is likely to have to distance its regulators from their currently associated ministries.

There is no coal production in Iceland..

With regard to EU legislation on **renewable energy**, Iceland currently implements the Directives on renewable energy in electricity, and on biofuels as required under the EEA. It will have to ensure compliance with the newly-adopted Directive on renewable energy; renewable energy had a 54% share in Iceland's gross final energy consumption. The main sources of renewable energy are hydro and geothermal energy. According to the methodology of the Renewable Energy Directive, Iceland's target for 2020 would be 64% of gross final energy consumption, including a minimum of 10% renewable energy in transport. Iceland will need a National Renewable Energy Action Plan, in which it clarifies how to meet its 2020 targets.

Iceland's legislation in the area of **energy efficiency** is limited to labelling of household appliances and equipment and ecodesign. Iceland also participates in the Intelligent Energy for Europe Programme. Although the Directive on the energy performance of buildings is incorporated into the EEA, Iceland has been exempt from transposing it into national law, and will need to do so in order to comply with the EU *acquis*. Iceland's exemption from implementing the Directive on the promotion of cogeneration based on a useful heat demand in the internal energy market is under review. Iceland does not have national energy saving targets. Iceland will need to implement EU legislation on energy end-use efficiency.

As regards **nuclear energy, nuclear safety and radiation protection**, Iceland has no nuclear power plants, fuel cycle facilities or research reactors. It uses radioisotopes only for medical, industrial and research purposes. Iceland is a member of the IAEA and the OECD/NEA, and a contracting party to all the Conventions necessary for membership. The Radiation Protection Act harmonised Icelandic legislation with IAEA Basic Safety Standards and the Euratom *acquis* in the field of radiation protection. It ensures that the small volume of low activity radioactive waste is returned to the supplier, or sent to a foreign waste management facility, unless it can be securely stored until decayed.

There is a competent and independent regulatory authority for nuclear and radiation safety. Iceland participates in the European Radiological Data Exchange Platform but will need to become a member of the European Community Urgent Radiological Information Exchange upon accession.

In the area of **nuclear safeguards**, Iceland signed and ratified the Non-Proliferation Treaty and has signed and implemented a Comprehensive Safeguards Agreement with the IAEA as well as an Additional Protocol thereto. However, Iceland has also adopted a Small Quantities Protocol with the IAEA, which will need to be rescinded at the latest by the time of accession to the EU. Iceland has no international co-operation agreements with third countries. It has no national legislation or policy in the field of nuclear material supply, accountancy and safeguards.

Conclusion

Iceland is relatively advanced in implementing the internal energy market, bearing in mind that the gas legislation will not apply. It should not have major difficulties in applying EU electricity legislation of the third internal market package. Iceland is particularly advanced in the use of renewable energy sources, and should have few problems meeting EU requirements. It lags behind on transposing energy efficiency legislation. Iceland will need to build up its emergency oil stocks to 90 days. There are only minor issues relating to Euratom legislation. Overall, Iceland is at an advanced stage of alignment with the *acquis* on energy, and should be able to take on the obligations of EU membership in this area.

The *acquis* on statistics consists almost exclusively of legislation which is directly applicable in the Member States, such as European Parliament and Council Regulations and Commission Decisions or Regulations. The statistical *acquis* contains also a range of methodological handbooks and manuals. International agreements provide a further basis for statistical production.

Iceland, as a party to the EEA Agreement, has the obligation to ensure the production and dissemination of coherent and comparable statistical information for describing and monitoring all relevant economic, social and environmental aspects of the European Economic Area. Exemptions exist for the legal acts mentioned under Annex XXI to the EEA Agreement.

In the area of **statistical infrastructure** the level of alignment is high. The national statistical institute is Statistics Iceland. In January 2008 a new Act on Statistics Iceland and official statistics took effect. The statistical law is in line with international recommendations. Icelandic statisticians are independent in their work and apply the principles of confidentiality. Cooperation of some ministries and agencies with Statistics Iceland needs to be strengthened. The insufficient allocation of human and financial resources for statistical work is of concern.

The main statistical **classifications** are in place and follow the *acquis*. However, this is not the case for the statistical business **register**, where a functioning register needs to be developed.

In the area of **sector statistics**, alignment is satisfactory, with a good level of compliance with the *acquis* in many areas. However, there are shortfalls in particular in the fields of business, macroeconomic and agriculture statistics. Alignment in the area of business statistics (structural business statistics and short-term statistics) is low even if there is good information available on Icelandic businesses from various administrative sources. This information will need to be integrated and aligned to create a comprehensive statistical business register which can form the basis for supplying structural business statistics. Further improvements in the area of national accounts are also necessary with a view to full application of the required methodology and the provision and dissemination of comprehensive data as required by the *acquis*, in particular concerning the production approach, financial and non-financial sector accounts and price and volume measures. For agriculture statistics, substantial work will be necessary in all fields, and especially on crop statistics, agricultural land use and agri-monetary statistics. The current set-up in agricultural statistics will need to be reviewed and a strategy for developing the area established. The financing of essential surveys will need to be secured, in particular the agricultural census to be conducted in 2010 and the Housing and Population Census to be conducted in 2011. Efforts will also need to be stepped up in labour market statistics and environment statistics.

As regards fisheries statistics, Iceland provides data in compliance with the *acquis*. However, the timely delivery of data needs to be improved; measures in this regard are being taken. The detailed methodological report on fishery statistics still needs to be submitted to the Commission.

Conclusion

Iceland's statistical production shows a satisfactory level of implementation in many areas. However, Iceland will need to improve the availability of statistical data in line with EU

methodology, in particular in the business, macroeconomic and agriculture statistics sectors. Relevant structures are in place, but human and financial resources need to be strengthened. Overall, Iceland should be able to assume the obligations of membership in this area.

Chapter 19: Social policy and employment

The *acquis* on social policy and employment includes minimum standards in areas of labour law, equal opportunities, health and safety at work and anti-discrimination. Member States participate in EU policy processes in the areas of employment policy, social inclusion and social protection. The social partners of Member States participate in social dialogue at European level. The European Social Fund (ESF) is the main financial tool through which the EU supports the implementation of its employment strategy and contributes to social inclusion efforts.

The EEA Agreement, particularly Annex XVIII thereto, lays down specific obligations in the areas of labour law, health and safety at work and equal treatment of women and men. The EEA Agreement also contains provisions on employment policy, and provides for cooperation on social inclusion, people with disabilities and elderly. The EEA Agreement does not cover anti-discrimination.

As a member of the EEA, Iceland has implemented the *acquis* in the area of **labour law**. Iceland has opted to do so without a codified body of labour legislation. Collective agreements between social partners play an important role in Iceland's industrial relations system. There is no Labour Inspectorate competent for labour law. Collective disputes are settled mainly by the State Mediator and/or social partners; individual disputes are settled by the Labour Court or an ordinary court.

The Act on the working environment and health and safety in the workplace, which applies to both private and public sectors, aims to implement the central elements of the *acquis* in the area of **health and safety at work**. As regards specific sectors, Icelandic legislation provides for three separate sets of rules and regulations on health and safety depending on whether activities are carried out on land, at sea or in the air. The system of control and enforcement of health and safety legislation is well developed. Responsibility for control and supervision of legislation on health and safety at work rests with the Minister of Social Affairs and Social Security as regards activities carried out on land and with the Minister of Communications for the air and the sea. The number of labour inspectors dealing with health and safety matters is sufficient⁸. The national legislation guarantees the independence and impartiality of labour inspectors and lays down procedures, penalties and sanctions for breaches of health and safety legislation, while also providing for accident reporting and investigation procedures.

Social dialogue is regulated by the 1938 Trade Unions and Industrial Disputes Act with subsequent amendments. Industrial relations are marked by the very strong position of trade unions⁹. There are no restrictions on the right of employees to organise, and trade unions have no obligation to register with government authorities. The predominant trade union is the Icelandic Confederation of Labour, embracing 64 trade unions with a total of 112 000 members. The Federation of State and Municipal Employees and the Alliance of

⁸ There were 166 332 employees on the Icelandic labour market in 2008 and around 70 people performing inspections in all three sectors in eight regional inspection areas, the largest one being Reykjavík.

⁹ More than 85 % of the workforce is unionised.

Graduate Civil Servants represent employees of the public sector. Some other trade unions outside the umbrella organisations bring together teachers, airline pilots, nurses, bank employees and journalists. On the employers' side, the Confederation of Icelandic Employers has eight member associations and includes around 2000 companies accounting for about 50 % of workers.

As regards tripartite social dialogue, there is a very well developed mechanism for consultation of social partners, albeit without a formal institution. Social partners have influence over the decision-making process as well as policy development: the whole Icelandic labour market is governed mainly by collective agreements.

Employment policy reforms only became necessary recently, following the effects of the financial crisis. The employment policy is currently being transformed into a system of active labour market measures including activating and training of unemployed people. These policies are mainly the responsibility of the Labour Directorate, which is supervised by the Ministry of Social Affairs and Social Security (MSASS). As Iceland traditionally did not apply active labour market measures, there is a need to strengthen policies and capacity in this area. Iceland has not so far developed either a comprehensive strategy or an Action Plan on employment.

Iceland's labour market was traditionally characterised by a high participation rate (82 %) with very low registered unemployment¹⁰. However, following the financial crisis in autumn 2008 the country experienced a steep increase in registered unemployment, reaching 8.2 % in December 2009. The increase in unemployment affects men more than women as the highest increase is to be found in the construction sector. At the same time, the rise in unemployment has been more pronounced in the metropolitan areas. Increasing unemployment also means an increase in both youth and long-term unemployment, although these are still at a relatively modest level. (*See also Economic criteria*)

In terms of preparations for management of the **European Social Fund (ESF)**, a large number of elements required by the *acquis* in the area of cohesion policy are already in place. The government administration is small but flexible. Overall, more than 20 staff work directly on the promotion of various EU programmes. There is, however, limited experience within government, municipalities and higher education institutes in certain areas of EU funding. Therefore, administrative capacity and structures need to be built up to allow smooth management and implementation of projects financed under the cohesion policy. (*See also Chapter 22 — Regional policy and coordination of structural instruments*)

As regards preparation for full participation in the open method of coordination (OMC) on **social inclusion**, Iceland appears to be well prepared. Statistical data on poverty and social exclusion are comprehensive, and indicate a policy for an egalitarian and inclusive society.

Policies regarding **persons with disabilities** appear to be aligned with those of the EU. Specifically, in 2007 a disability policy was formulated, as well as a corresponding Action Plan for 2007–2016. Iceland has signed the UN Convention on the Rights of Persons with Disabilities. The Minister of Social Affairs and Social Security (MSASS) is responsible for disability issues. There is also a governance structure based on task forces and boards established on an inclusive basis. Each of the eight Icelandic regions has a Regional Office for the Affairs of the Disabled which acts as focal point for service provision. Furthermore,

¹⁰ In 2005 registered unemployment was as low as 2.1 % and decreased to 1 % in 2007.

Iceland participates in the EU High Level Group on Disability, allowing it to keep abreast of policy developments in the EU.

The share of expenditure on **social protection** benefits in Iceland's GDP is lower than the average in the EU-27 (in 2007 21.3% and 25.2% respectively). This is partly due to low public pension expenditure and the large role of private pension provision and extensive use of income-testing of benefits. The health care system achieves good results.

Regarding **anti-discrimination**, the principle of equality is enshrined in the Constitution of the Republic of Iceland. However, Icelandic legislation does not provide for any detailed protection against discrimination on the labour market, as required by the *acquis*, but for some protection in certain fields. The Act on the affairs of persons with disabilities provides that persons with disabilities are to be given priority regarding work for the state and municipalities, where qualifications are equivalent. Outside employment, there is no specific legislation prohibiting discrimination. However, preparation of a law aligning with the anti-discrimination *acquis* is ongoing. As regards administrative capacity, there is no institution especially responsible for combating discrimination on grounds of racial or ethnic origin, religion or belief, age, disability or sexual orientation, although the MSASS is responsible for equality matters in a broad sense.

In the area of **equal opportunities**, legislation concerning gender equality is largely in line with the *acquis*. Gender mainstreaming is a well established practice. The new Act on equal status and equal rights of women and men, or Gender Equality Act, was adopted in 2008. It prohibits discrimination of all types, direct or indirect, on grounds of gender in a number of sectors: labour market, pay, vocational training, reconciliation of work and family life and education. It contains definitions of direct and indirect discrimination which are crucial for the meaningful implementation of legislation. The Act on maternity/paternity leave and parental leave provides that both women and men have an equal, non-transferable right to take three months' leave in connection with the birth, first-time adoption or fostering of a child, irrespective of whether they work in the private or the public sector, or are self-employed. As regards both general and occupational pension schemes, there are no differences between men and women in terms of retirement age or other aspects of pension rights. However, Iceland does not have specific provisions on gender equality in social security in general (as required by Directive 79/7) and as regards access to goods and services (as required by Directive 2004/113).

Conclusion

With some exceptions, Iceland implements the *acquis* in the areas of labour law, health and safety at work and equal opportunities. Social dialogue is very well established, and Iceland seems to be well prepared for participation in the European Social Fund and in the open method of coordination on social protection and social inclusion, provided its administrative capacity is strengthened in these areas. Relevant administrative structures are in place. However, Iceland will need to align with the anti-discrimination *acquis*. Additional efforts are also necessary in the field of employment policy, particularly as regards strengthening policy formulation and implementation, as well as increasing administrative capacity. Overall, Iceland should be able to assume the obligations of membership in this area.

Chapter 20: Enterprise and industrial policy

The *acquis* under the enterprise and industrial policy chapter consists largely of policy principles and policy recommendations which are reflected in communications, recommendations and Council conclusions as well as being debated in consultation forums. By establishing general policy principles, EU enterprise and industrial policy, including SME policy, seeks to promote the formulation of competitiveness-enhancing enterprise policies and industrial strategies. Overall, EU enterprise and industrial policy is strongly driven by the renewed Lisbon strategy for growth and jobs and by the Small Business Act, adopted in 2008, which forms the new comprehensive policy framework for EU SME policy. Enterprise and industrial policy comprises policy instruments, including financial support and regulatory measures. It also includes sectoral policies, including recommendations for more targeted policy analysis as well as for new initiatives and consultations at sector level.

The EEA Agreement covers Directive 2000/35/EC on combating late payment in commercial transactions.

Iceland's **enterprise and industry policy** focuses on SME and entrepreneurship policies, on R&D and innovation stimulation as well as on regional growth agreements, with separate policy documents in the area of sustainable development. So far, Iceland has not developed any specific industrial policy strategy.

The financial crisis resulted in the government revising policies or initiatives relating to industrial and competitiveness policies. In May 2009, the Icelandic government adopted the Government's Coalition Platform, whose economic development components aim to stimulate domestic industries. The platform also calls for the establishment of a new comprehensive industrial policy by 2010, the preparation of which has recently started. Its main objective is to create new and stronger foundations for Icelandic businesses and industries for the future. Emphasis will be placed on industrial diversification, stable and steady growth, innovation and sustainable resource utilisation both on land and at sea. The government also launched work on developing a long-term comprehensive strategy up to 2020, *Bringing Iceland Forward 2020*, a long-range vision for development of the economy, employment and quality of life.

Iceland's SME policy is defined through a Development Strategy for SMEs based on recommendations of the Science and Technology Policy Council. The Ministry of Industry, Energy and Tourism and the Innovation Centre Iceland (ICI) under it are the main government bodies responsible for SME policy. The Innovation Centre Iceland is responsible for support services to SMEs. The share of SMEs in the economy is similar to that of the EU (99%). Iceland generally applies the EU definition of SMEs.

Iceland's business environment is very conducive to entrepreneurship and business development. A two-year simplification plan concerning the regulatory environment has been ongoing since September 2007. Measures have been taken to improve stakeholder consultation and impact assessment. All legislative proposals are supported by an assessment of the potential effects of the proposal on business. Iceland has a very simple (2 steps) and fast (less than 3 days) procedure for opening a business.

Iceland follows an integrated approach in innovation policy, implemented as a horizontal policy with long-term objectives and a focus on necessary skills for the maintenance and

renewal of competitiveness. Regional Growth Agreements set targets in regional economic development for local, regional and national actors.

The ICI plays a central role in technology dissemination towards SMEs. It provides education and training for staff and managers of SMEs as well as various other means of support to entrepreneurs, growth companies and innovative enterprises. The ICI and the Trade Council are the main institutions responsible for helping SMEs to access foreign markets. The ICI hosts an Enterprise Europe Network centre, the Trade Council and the Icelandic Centre for Research.

In relation to **enterprise and industrial policy instruments**, Iceland participates in the EU Competitiveness and Innovation Programme (CIP), in the framework of the EEA Agreement. Iceland is also part of the Enterprise Europe network through the ICI.

Iceland is implementing the Directive on combating late payment in commercial transactions in the context of its obligations under the EEA Agreement.

However, following the financial and economic crisis, SMEs' access to finance has dramatically deteriorated in the wake of the collapse of the major Icelandic banks in October 2008. Bank financing is very limited and investors are primarily striving to protect their previous investments, making new venture capital scarce. Restoring a business-friendly environment and regular access to finance is one of the priorities of the recovery programme currently implemented by the Icelandic authorities on the basis of the IMF Stand-By Arrangement.

In relation to **sector policies**, Iceland has in general not implemented or launched sector-specific development measures or initiatives in the last two decades, with the exception of certain exemptions and incentives provided to attract foreign direct investments in energy-intensive industries such as primary aluminium production since 1969.

Iceland's industry represents around 15% of GDP in the period 2007-2008, below the EU-27 average of 20% for the same period. The main sectors of the economy are: the financial and real estate sector, with a 26% contribution to GDP in 2008 (out of which 9% for financial services), construction (10.5% of GDP), industry (15.8% of GDP in 2008), of which the main contributor was the manufacturing sector with 11%. The main exporting sectors are fisheries, with 36% of total exports in 2008, and aluminium, with 38%.

The Icelandic industrial sector is modest but relatively diversified. Within the main sector of manufacturing, a very limited number of industrial sub-sectors rise marginally above the other sectors, in particular the manufacture of food products and beverages (with a self-supply ratio of 80%). Even if it also suffered from the financial crisis, tourism remains a key industry in Iceland as it generates up to 19% of foreign exchange revenues. The tourism share in GDP in 2006 was on average 4.6% and the number of foreign visitors increased by 60% in 2007.

Conclusion

Iceland is at an advanced stage of implementing the *acquis* in the area of enterprise and industrial policy and should be able to take on the obligations of EU membership.

Chapter 21: Trans-European networks

This chapter covers the trans-European networks policy in the areas of transport, telecommunications and energy infrastructures, including the Community guidelines on the development of trans-European networks and the support measures for the development of projects of common interest. The aim of establishing and developing trans-European networks and promoting proper interconnection and interoperability of national networks is to take full advantage of the internal market and contribute to economic growth and job creation in the European Union.

The EEA Agreement covers the Trans-European Transport Network Outline Plan.

As far as **transport networks** are concerned, Iceland is participating in the TEN-T network in line with the *acquis*. The TEN-T policy is currently under revision in the EU and Iceland should be associated to it. In Iceland the Strategic National Transport Plan and the National Transport Plan cover the development of all state transport infrastructure projects. The latter are prepared by the Transport Council of the Ministry of Transport, Communications and Municipalities in cooperation with agencies under the Ministry. The parliament finalises the process by adopting a resolution.

Regarding trans-European **energy networks**, in 2008 the Icelandic electricity transmission system consisted of 3 171 km of high-voltage lines. The electricity sector is regulated by the Electricity Act and regulations established on the basis of this Act, which transpose the EU common rules for the internal market in electricity into Icelandic legislation. The Act fully opened the Icelandic electricity market to competition in January 2006 and introduced third party access for transmission and distribution networks.

Iceland's electricity market is isolated, with no interconnections. Iceland has no official policy on electricity and gas exchanges or network interconnections with neighbouring countries or regions. The competent body is the Icelandic National Energy Authority. In 2007, it concluded a preliminary study on the feasibility of connecting the electricity system of Iceland with that of the Faeroe Islands, but with no practical implications so far. There are no projects as regards electricity or gas interconnectors.

According to the Icelandic National Energy Authority only 20 to 25 % of the technically and environmentally feasible hydropower, and only 20 % of the conventional geothermal potential available for electricity production in Iceland has been harnessed so far.

There are no pipelines or other natural gas infrastructure for general use. There is no special regulatory framework regarding gas.

A legal framework for interconnections does not exist and no agreements have been made with respect to access to such networks. The Regulation on conditions for access to the gas transmission networks and the Regulation on conditions for access to the network for cross-border exchanges in electricity have been incorporated into the EEA Agreement. However, the latter Regulation on electricity exchanges has not yet been implemented.

Iceland is currently not participating in the revision of the TEN-E policy. It needs to consider aspects of this policy relevant to its particular energy system.

Regarding **telecommunication networks**, Iceland has been participating in the ICT Policy Support component of the Competitiveness and Innovation Framework Programme since 2007.

Conclusion

Iceland is well aligned with the *acquis* on trans-European networks, especially in the field of transport. Relevant administrative structures are in place and Iceland should be able to assume the obligations of membership in this area. Given its specific geographical position and the isolation of its electricity system, Iceland has not developed any TEN-E related policy so far. It will have to consider relevant aspects of this policy.

Chapter 25: Research and development

The *acquis* in the field of science and research does not require transposition of EU rules into the national legal order. Implementation capacity relates to the existence of the necessary conditions for effective participation in the EU's Research Framework Programmes and the contribution to the Lisbon Agenda with the Barcelona 3 % of GDP financial target and the European Research Area. In order to ensure full and successful association with the Framework Programmes, Member States need to ensure the necessary implementing capacities in the field of research and technological development, including adequate staffing.

Iceland, as a party to the EEA Agreement, is associated to the EU Framework Programmes.

Close to 3 000 persons work on RTD in Iceland. Of those, 1 400 are from industry, and close to 800 from higher education and public research respectively. In terms of research results Iceland ranks 2nd among the OECD countries, 1st in agriculture & fisheries and medicine & health, 4th in humanities, 13th in social sciences, 15th in natural sciences and 14th in engineering & technology.

The Science and Technology Policy Council (STPC) is the main body responsible for developing and adopting the three-year general **policy for science, research and technology**. Four Ministers have permanent seats in the Council and the chair (the Prime Minister) can call upon four extra Ministers. 16 other stakeholders (including socio-economic partners) also have permanent seats in this Council.

As regards the ethical, legal and social aspects (ELSA) of science, Iceland's legislation and control systems as well as funding mechanisms are comparable to those in the EU.

Since the launch of the 7th **Framework Programme** of the European Community for research and technological development (FP7) in 2007, Iceland participates effectively as an associated country in European R&D projects with the majority of the Icelandic FP7 contributors taking part in health and environment projects. Iceland does not engage in nuclear research and has never been associated to the Euratom framework programmes for research and technological development.

There is a strong tradition of industry-related research institutions in Iceland, particularly in marine research, health & medicine and agriculture. Iceland is involved in the Standing Committee for Agricultural Research as an observer. Iceland is also involved in the governance of the **European Research Area** (ERA) through its observer role in the Scientific and Technological Advisory Committee of the EU (CREST) and other relevant ERA governance bodies.

International participation by Iceland in work on science, technological development and innovation is one of the cornerstones of its scientific and technological strategy. Iceland participates in the Nordic Research and Innovation Area (NORIA) which has been developed under the Nordic Council of Ministers. A white paper on NORIA was produced in 2003, paving the way for important institutional changes in the Nordic region. Iceland is included in the three Nordic institutions for science and technology: NordForsk (for cooperation in science), Nordic Innovation Center (for cooperation in innovation projects) and Nordic Energy Research.

The environment for conducting scientific research and technological development is favourable and knowledge is applied to underpin a wide range of innovations in industry as well as in public services. There are no quantitative targets similar to the Barcelona 3 % objective set for Iceland. However, overall expenditure on R&D, as a share of GDP, continues to remain above the 3 % mark.

The Icelandic Centre for Research (Rannís) participates in a number of ERA-Net projects. Some of those projects have the objective of becoming classed as Article 185 initiatives¹¹ in the future. *Eurostars* has been running as an Article 169 initiative since 2008, with Icelandic participation from the start. Iceland has not had an official policy towards participation in the governing bodies of Article 187 initiatives¹². Icelandic organisations do, however, participate in Innovative Medicines and Hydrogen and Fuel Cells initiatives.

With regard to actions related to the mobility of researchers, Iceland does not have a special plan aimed at specifically attracting young people to sciences, or to ensure human resource capacity in research, nor does it have an official programme designed to ensure mobility of researchers. However, the official policy has proved successful in recent years in increasing the number of university students and strengthening the universities.

The promotion of RTD innovation is well organised and well connected with the business community. The Icelandic Centre for Research (Rannís) organises events and the University of Iceland hosts the Icelandic Web of Science, which contributes to creating an environment favourable to dissemination of scientific knowledge to the public at large. A law on R&D incentives came into effect in December 2009. The government has decided to double the size of the competitive funds in four years from 2008 to 2011. Industry mainly funds its own RTD work. Only some 5 % of BERD (Business Enterprise Expenditure on R&D) is financed by public sources and some 11 % by foreign funds.

Conclusion

As a long-standing associated country to the EU Research Framework Programmes and having the necessary legal safeguards and requirements, Iceland appears to be well prepared to take on the obligations of EU membership in this chapter. The high research capacities as well as the good level of its education system should enable Iceland to meet the major RTD challenges and to play an active role in the development of the European Research Area.

¹¹ Article 185 of the Treaty on the functioning of the European Union (former Article 169 of the EC Treaty) allows the EU to participate in RTD programmes undertaken by several Member States.

¹² Article 187 of the Treaty on the functioning of the European Union (former Article 171 of the EC Treaty) allows the EU to set up any structure necessary for the efficient execution of research, technological development and demonstration programmes. It allows a wide range of possible implementation structures for EU research and development programmes, of which the most prominent is a 'joint undertaking'.

Chapter 26: Education and culture

The *acquis* on education and culture consists mainly of a cooperation framework through programmes and the open method of coordination (OMC), which aims at convergence of national policies and attainment of shared objectives. In the field of education and youth, Member States need to ensure sound management of decentralised EU programmes. The *acquis* also requires the Member States to facilitate the education of children of EU migrant workers and to prevent discrimination against EU nationals. In the field of culture, the Unesco Convention on the Protection and Promotion of the Diversity of Cultural Expressions, ratified by the EC, is a major element of the *acquis*.

The EEA Agreement partly covers the provisions of the *acquis* in the field of education and culture, namely concerning the coordination of policies (Articles 1(2) and 78) and the education of children of EU migrant workers (Annex V).

There is a long history of cooperation with Iceland in the field of **education, training and youth**. Iceland's participation since 2002 in the OMC ('Education and Training 2010'), including clusters and peer learning activities, has paved the way to the adoption of policy reforms such as the recent lifelong learning strategy in line with the EU strategy. In relation to the 2010 OMC benchmarks, Iceland is above the EU average with respect to adult lifelong learning. Largely due to easy access to the labour market, Iceland performs below the EU average as regards early school leavers and upper secondary attainment. The Ministry of Education, Science and Culture is responsible for implementing the *acquis* in this area. Iceland participated in the last OMC on Youth and intends to take part in the new cycle as well. The Ministry of Education, Science and Culture is the main governmental focal point for youth policy in Iceland. The government has adopted a comprehensive and cross-cutting approach giving emphasis to the key components of the EU Youth Strategy 2010-18. Iceland has since 1970 had a legislative basis supporting the non-governmental youth sector and promoting non-formal education. Iceland is encouraged to envisage specific measures to facilitate the mobility of volunteers from EU and EU candidate countries to Iceland.

The country has been participating in EU programmes on education and youth for about fifteen years.

However, Iceland needs to clarify its legal framework as regards the Directive on education of children of EU migrant workers and the principle of non-discrimination between nationals and EU citizens in access to education in order to implement the *acquis* uniformly and equally across the country.

In the field of **culture**, the country fully subscribes to the objectives of the European Agenda for Culture. It ratified the Unesco Convention on the Protection and Promotion of the Diversity of Cultural Expressions in 2007. Iceland has a well developed support system in the field of cultural activities. The state's role is primarily to ensure a fertile and creative environment for culture. Iceland intends to participate in the OMC on culture once invited to do so.

Iceland participates in the Culture Programme 2007-2013 and more generally has been taking part in cultural programmes since 1994.

Conclusion

Iceland has largely taken over the *acquis* in the field of education, training, youth and culture. Its ongoing reforms are inspired by the EU standards and policies. It should therefore be in a position to take on the obligations of EU membership in this area.

Chapter 27: Environment

EU environment policy aims to promote sustainable development and protect the environment for present and future generations. It is based on the integration of environmental protection into other EU policies, preventive action, the polluter pays principle, fighting environmental damage at source and shared responsibility. Ensuring compliance with the *acquis* requires significant investment, but also brings significant benefits. A strong and well-equipped administration at national and local level is imperative for the application and enforcement of the *acquis*.

A considerable part of the *acquis* has been incorporated into the EEA Agreement and is thus applicable to Iceland. This is generally done on the basis of Part V, Chapter 3 of the EEA Agreement. The *acquis* related to nature protection has not been included so far in the EEA Agreement, neither are a number of directives in the water sector.

There are no constitutional provisions related to environment protection. Sectoral legislation exists in each sector. A National Strategy for sustainable development serves as a policy framework until 2020 but does not contain provisions related to budgetary or other resources for achieving environmental goals set therein.

Environmental policy is formulated, implemented and enforced at national and local level. An administrative reform is under consideration, by which the Ministry for the Environment would merge its own and other ministries' agencies, as well as transfer responsibilities between executive agencies with a view to ensuring optimal administrative efficiency.

There is no overall environmental investment plan to specify or prioritise investments required for the implementation of the *acquis*. National investment in the environment is low, 0.4% of GDP, and will need to be increased in order to achieve compliance with the *acquis*. Available data suggest that the level of enforcement of environmental laws is low. There are some mechanisms for the integration of the environment into other policies, mainly at strategic document level. However, the use of mechanisms for integrating environmental concerns into other policies is not widespread.

As regards **horizontal legislation**, Environmental impact assessment (EIA) and strategic environmental assessment (SEA) requirements are implemented. A draft bill is pending adoption by parliament on environmental liability. However, Iceland is not a party to the Espoo Convention on Environmental Impact Assessment in a Transboundary Context, its Protocol on Strategic Environmental Assessment and the Aarhus Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters.

Air quality legislation is aligned to a large extent with the *acquis*, with certain limit values that are even stricter than the *acquis*. However, the National Emissions Ceilings Directive is not transposed.

Waste management legislation is to a large extent transposed. However, Iceland still needs to transpose the new Waste Framework Directive, the latest amendments to the Directive on batteries and accumulators, the Mining Waste Directive and the Packaging and Packaging Waste Directive. The definitions regarding waste management need to be harmonised with the *acquis*. Shipment of waste is carried out in accordance with the Waste Shipment Regulation.

As regards **water quality** a number of secondary acts to the Water Act correspond to a certain extent to the *acquis*. Alignment and implementation of the Water Framework Directive is in progress. However, a system for river basin management is not yet established, even though coordination of relevant authorities is ensured. Iceland needs to transpose the Floods Directive as well as the Marine Strategy Framework Directive, the Nitrates Directive and the Bathing Water Quality Directive.

As far as **nature protection** is concerned, the Nature Conservation Act takes into account the main international nature/biodiversity agreements to which Iceland is a party. However, it does not fully meet the requirements of the nature protection *acquis*. As regards the conservation of wild birds, there is no universal system of strict protection for all bird species. Icelandic legislation is in conformity with the general prohibition regarding commercialisation of wild birds. However, Iceland allows the hunting of many bird species currently not listed under Annex II of Directive 79/409/EEC. As regards conservation of natural habitats and of wild fauna and flora (other than birds), there is no general scheme of species protection in place which meets the standards laid down in Articles 12-14 of Directive 92/43/EC. There are differences between Icelandic law and the Directive for several key species such as Arctic Fox, Harbour Seals and Grey Seals.

Furthermore, Iceland allows the hunting of whales, which is not in line with the *acquis*. Necessary steps will need to be undertaken as regards the protection of cetaceans. Iceland will need to identify a network of areas to fulfil the protection requirements of the Habitats Directive and Birds Directive, especially those to be listed for protection in Natura 2000, including in its marine waters and continental shelf.

Iceland treats marine mammal products as any other seafood products when it comes to international trade. There is no legislation equivalent to the ban on the import of seal products into the EU. Alignment with the *acquis* will be needed in this area.

Industrial pollution control and risk management is to a large extent aligned with the *acquis*. The *acquis* concerning integrated pollution prevention and control (IPPC), large combustion plants, waste incineration plants and installations using organic solvents is implemented. There are national provisions relating to environmental audit schemes (EMAS) and eco-labelling and structures to implement them.

The legislation on authorisation of **genetically modified organisms (GMOs)** is implemented and supervised by the Environment Agency. As regards **chemicals**, Iceland has transposed the REACH Regulation and participates in the work of the European Chemicals Agency (ECHA). Implementation of the Regulation 2008/1272 EC on classification, labelling and packaging of substances and mixtures needs to be ensured. Icelandic classification, packaging and labelling rules for chemicals apply equally to plant protection products (PPPs) and biocidal products. As regards biocides and PPPs, limited provisions exist as regards the use of PPPs. A system for PPP data collection exists, but may require changes to be brought into line with the *acquis*. Iceland is not a party to the Rotterdam Convention. It currently has no legal provisions and no

customs control system related to exports of dangerous chemicals. Iceland has not signed the provisions of Council of Europe Convention ETS 123 on the protection of laboratory animals.

As regards **noise**, legislation in line with the *acquis* is implemented and a law provides for the development of environmental noise mapping and action plans.

With regard to **climate change**, Iceland is an Annex I party to the UN Framework Convention on Climate Change (UNFCCC). It is also a party to the Kyoto Protocol, has a greenhouse gas limitation commitment of +10% and expects to meet this target. Iceland has a national system for greenhouse gas monitoring and reporting in place in accordance with UNFCCC and Kyoto Protocol requirements and fulfils its reporting obligations under the Convention and the Protocol. Iceland is covered by the EU Emissions Trading Scheme (ETS) through the EEA Agreement.

Iceland has requested to conclude a joint delivery agreement with the EU for the emission reduction commitments that the EU and Iceland will undertake in the framework of a new international climate treaty. Such an agreement will ensure that non-ETS sectors will be covered by the EU Effort-Sharing Decision with a specific target for Iceland, based on the same criteria that have been used to calculate the targets of the EU Member States thereunder. Iceland will have to devote substantial management resources and organisational arrangements to ensure that monitoring and implementation of the ETS is in line with the *acquis*. National legislation provides for the implementation of the Regulation on ozone depleting substances but may require some changes to fully align with the *acquis*.

Conclusion

Overall, the legislative framework in Iceland is to a large extent aligned with the *acquis* and should be able to take on the obligations of membership. Further efforts will be needed to achieve compliance with the nature protection *acquis* in particular as regards protection of whales, seals and wild birds as well as conservation of natural habitats and of wild fauna and flora. Iceland will need to become a party to and implement key multilateral environmental agreements such as the Espoo and Aarhus Conventions. As regards administrative capacity, the Ministry for the Environment will need to continue to be reinforced and responsibilities need to be clearly defined. Efforts will also be needed to ensure that adequate political will is in place and resources allocated to ensure effective implementation and enforcement of the *acquis*, including at local level.

Chapter 28: Consumer and health protection

The *acquis* on consumer protection covers the safety of consumer goods as well as the protection of the economic interests of consumers in a number of specific sectors. Member States need to transpose the *acquis* into national law and to put in place independent administrative structures and enforcement powers which allow effective market surveillance and enforcement. Appropriate judicial and out-of-court dispute resolution mechanisms, consumer information and education, and a role for consumer organisations should be ensured as well. This chapter also covers rules in the area of public health.

Consumer protection is covered by Annex XIX to the EEA Agreement, except for the Directive on distance marketing of financial services (non-safety related issues), which is covered by Annex IX on financial services. The EEA Agreement also contains provisions on public health (Protocol 31 and Annex II).

The overall responsibility for general **consumer protection** policy lies within the Ministry of Justice and Human Rights and the Ministry of Economic Affairs. There is a Committee for Settlement of Disputes in Consumer Sales of Goods and Services Contracts as well as various alternative dispute resolution bodies to deal with consumer complaints. The Consumer Association of Iceland has around 13 000 members, and also various NGOs are involved in consumer protection issues. Iceland is an observer in the Consumer Protection Cooperation Committee.

Product safety-related issues are regulated by the Act on product safety and official market control (the 'APSOMC'), the Regulation on the safety of toys and dangerous imitations, the Regulation concerning marketing restrictions on child-resistant and novelty lighters and the Act on the Consumer Agency and Consumer Spokesman. However, the level of transposition of the APSOMC in Iceland needs to be further assessed. As regards administrative capacity in the area of product safety, the Consumer Agency is the national market surveillance authority responsible for the enforcement of product safety rules, including sector-specific legislation, and acts as the national RAPEX Contact Point. No market surveillance activities have been performed *vis-à-vis* products not falling under sector-specific EU legislation, with the exception of decorative articles. With respect to products falling under sector-specific legislation, such as toys, electrical appliances and construction products, market surveillance seems to consist only in documentary checks without any assessment of whether such products may pose a risk to health and safety of consumers. Iceland participates in meetings of the General Product Safety Directive (GPSD) Committee, the Consumer Safety Network and RAPEX Contact Points.

Concerning *non-safety related issues*, the new *acquis* on credit agreements for consumers needs to be transposed, as well as the new *acquis* on timeshares and injunctions.

In the field of **public health**, life expectancy in Iceland is among the highest in the world and perinatal mortality among the lowest. Main diseases affecting the population are cardiovascular diseases and cancer. The overall responsibility for public health policy lies with the Ministry of Health, the Directorate for Health and the Public Health Institute. Preventive health care is offered by health care centres throughout the country. A Health Service Act was adopted in 2007 dividing the country into seven health regions. The National Health Plan sets out a strategy until 2010 putting special emphasis on the health of children and young people as well as of the elderly. A health promotion policy and action plan was launched in October 2008. E-Health is used as a policy tool. Information on health care quality is collected at national level. In general, the Icelandic health care system ranks as one of the best in Europe. Following the crisis however, budgetary cuts are planned in 2010. Iceland participates in the meetings of the European Centre for Disease Prevention and Control (ECDC), and, as an observer, in the EU Health Programme and in comitology committees on health.

In the area of *tobacco*, the *acquis* on tobacco control and tobacco advertising is implemented. The introduction of pictorial health warnings on tobacco products is under way. Iceland ratified the Framework Convention on Tobacco Control in 2004.

The basic act regulating *communicable diseases* is the Act on health security and communicable diseases. Structures for epidemiological surveillance and for early warning and response to communicable diseases are in place.

Implementation of the *acquis* on *blood, tissues and cells* is well on track. A competent authority is in place.

There is no legislation directly linked to *mental health*. However, this is listed among the priorities of the National Health Plan, and the measures taken by the Icelandic authorities are similar to those in the EU Member States. Mental health promotion is a relatively new concept and has yet to gain solid ground. Nevertheless, good examples of EU-based mental health services can also be found in Iceland.

Drug abuse prevention, nutrition and alcohol abuse prevention are among the priorities of the National Health Plan. Screening for breast and cervical *cancer* is performed in accordance with the European guidelines. However, colorectal cancer screening has not yet started. Nevertheless, survival rates after cancer diagnosis are among the best in Europe. Technical capacity is in place to fulfil also the requirements of the *acquis* on *electromagnetic fields*.

Conclusion

A significant part of the *acquis* in the area of consumer and health protection is already implemented. Administrative structures are in place to allow further developments in the future. In the area of consumer protection, proactive market surveillance needs to be developed. Further efforts are necessary as regards the processing of RAPEX notifications. Overall, Iceland should be able to assume the obligations of membership in this area.

3.1.3. Chapters not covered by the EAA

Chapter 11: Agriculture and rural development

The *acquis* on agriculture and rural development covers a large number of binding rules, many of which are directly applicable. The proper application of these rules and their effective enforcement and control by an efficient public administration are essential for the functioning of the common agricultural policy (CAP). Running the CAP requires the setting-up of a paying agency and management and control systems such as an integrated administration and control system (IACS), and the capacity to implement rural development measures. Member States must be able to apply the EU legislation on direct support schemes and to implement the common market organisation for various agricultural products.

The EEA Agreement does not cover the *acquis* on agriculture and rural development except for organic farming. In 2007, the Icelandic market for agricultural products from the EU, originally excluded from the EEA, was partially opened under Article 19 of the EEA Agreement.

In 2008 agriculture accounted for 1.4% of Iceland's GDP and the agriculture sector covered 2.5% of the total labour force. Iceland is located north of the 62nd latitude. Only 15% of the land is considered flat and suitable as arable land. Most arable plots are scattered, separated by large drainage channels, rivers, grassland and rocks. Arable land account for about 7000 ha, cultivated grassland for 120000 ha and greenhouses for 19.2 ha. There are 3045 farms in Iceland. 6.5% of the population of Iceland live in rural areas.

The EU is Iceland's main trading partner, with regard to all commodities, as well as for agricultural products. As regards trade in agricultural products, the EU accounted for about 65% of all Icelandic imports and about 47% of all Icelandic agricultural exports in 2008. In general, Iceland applies high import tariffs to protect its local agricultural production, with the

exception of tomatoes, cucumbers and peppers (tariff free). Following the partial opening of the Icelandic market for agriculture products under Article 19 of the EEA Agreement, bilateral trade concessions have been implemented since 2007. Import tariffs will have to be aligned with EU levels by accession.

The current administrative capacity of the Ministry of Fisheries and Agriculture is limited, counting about 40 staff. Activities are concentrated on policy formulation whereas implementation is delegated to the Farmers' Association, agencies and research institutes. Agricultural statistics are not well developed and in many cases based only on estimates. (See Chapter 18 — Statistics)

Iceland's agricultural policy is based on two framework laws: the Act on the production, pricing and sale of agricultural products sets the official objectives of the agricultural policy and provides the general policy framework for agricultural production; the Agriculture Act lays down provisions for support for farm construction projects, livestock improvement and extension (advisory) services. Food security remains a key objective of agricultural policy. In 2009 Iceland's PSE¹³ stands at 51 % (EU: 25 %), mainly built on direct payments and import tariffs. Total agricultural support by the Ministry of Fisheries and Agriculture in 2008 amounted to 13 billion króna.

Concerning **horizontal issues**, national schemes are currently managed and payments are made by the Farmers' Association on behalf of the Ministry of Fisheries and Agriculture. There is no structure in place equivalent to an integrated administrative and control system (IACS) or paying agency. The cadastre-based land registry system is currently unfit for the purpose of handling the EU area-based direct payments. Iceland will need to establish a proper framework for meeting the CAP management and control systems. Furthermore Iceland does not apply EU cross compliance.

In their current form, *direct payments* in Iceland are not in line with the EU rules. Contrary to the reformed CAP, which provides for 85 % decoupling (93 % in 2013), direct aid payments are coupled, and will need to be brought into line with the EU *acquis*. Direct aid payments are currently granted in Iceland's key production sectors: milk production, cows (a headage payment), sheep production and horticulture. In all cases, a yearly budgetary ceiling is fixed which limits the individual payments. The aid rate therefore changes annually. Iceland will have to put in place an information system for beneficiaries of CAP payments under shared management and ensure yearly publication of names of beneficiaries.

A good basis for the development of a fully compliant *farm accountancy data network* (FADN) exists in Iceland.

With regard to *state aid*, the Agriculture Act provides for support for structural change, improvement of cultivation, livestock improvement and advisory services, whereas the Act on the production, pricing and sale of agricultural products provides for operating aid. State aid will have to be aligned with EU rules.

Due to its difficult structural and pedoclimatic conditions and its remoteness, Iceland has developed a very protective agricultural policy. The production and marketing of dairy, sheep and horticulture are regulated by agreements signed between the Ministry of Fisheries and

¹³ PSE: Producer Support Estimate, an OECD indicator measuring the level of support for agricultural production (for 2009, Iceland: 51 %, EU: 25 %).

Agriculture and the Farmers' Association, all recently updated to take into account the negative effects of the economic and financial crisis. The milk market is controlled by quotas and administrated prices, both being subject to adjustments depending on market developments. For sheepmeat, the association of sheepmeat producers fixes annually a recommended price for slaughter. In contrast, greenhouse vegetables are marketed freely; no customs tariffs apply, and producers receive high coupled direct payments in return.

Arable crop production is limited to barley (2008: 15 000 tonnes) produced for feed and potatoes (2008: 12 000 tonnes). Iceland does not produce any other arable crops or protein crops or oil seeds. In 2008, the dry hay yield amounted to 133 829 m³ and the silage hay yield 2 174 647 m³.

The sector of **animal production** in Iceland provides 87% of farm income. It benefits from large support measures and administered prices. In 2008, 26 000 dairy cows, about 450 000 sheep, 4 200 pigs (sows) and in total 4.7 million poultry were kept in Iceland. Iceland allows only local breeds for sheep, cattle and horses. The policy of recommended prices, pricing committees and exchange of price information is out of line with EU competition rules and will have to be aligned with the *acquis*.

Regarding **specialised crops**, production of vegetables is rather limited. There is no commercial fruit production, except for limited production of strawberries. Greenhouse production accounts for 19.2 ha and covers mainly tomatoes, cucumbers and peppers. Imports of these three products have been fully liberalised. However, market measures and labelling are not in compliance with the EU *acquis*. Iceland produces only a few tonnes of turnips, carrots and cabbages, which are not regulated. Producer organisations as defined by the EU *acquis* do not exist. Reporting of prices for imported fruit and vegetables does not exist. There are no crisis management measures in place.

No institution has overall responsibility for **rural development policy** and there is currently no overall strategy in line with the EU strategic approach to rural development. A wide range of programmes and measures are being implemented by several different institutions and funds. Existing local partnerships may facilitate the process of establishment of local action groups. A rural development paying agency will need to be established.

As regards **quality policy**, Iceland applies a quality management scheme different from the EU scheme of geographical indications and traditional names. This will have to be brought into line with the EU *acquis*. Legislation on **organic farming**, covered by the EEA Agreement, is largely aligned with the *acquis*. 1% of Icelandic farmers are involved in organic production (vegetables, seaweed, milk, sheepmeat).

Impact

The **estimated impact** of Iceland's possible accession on the EU common agricultural policy has to be related to the structure and size of the Icelandic agricultural sector. The agricultural sector in Iceland accounts for a similar share of GDP (1.4%) as that of the EU-27 (1.2%) whereas in terms of agricultural employment its share is lower (2.5%, against EU-27: 5.6%). Iceland would add about 127 000 ha of agricultural land (0.07%) and 3 045 farms to the EU agricultural sector. The production of milk, beef and sheep represents around 0.1% or less of total EU-27 production. Crop production, mainly barley for feed, is negligible when compared to EU production. Iceland has a highly protected market which was partially opened to EU agricultural products as of 2007. Taking the above into account, under the current *acquis*,

CAP expenditures, i.e. market expenditure, direct payments and rural development payments, would most likely account for less than 0.1 % of EU-27 CAP spending. Overall, a preliminary assessment indicates that Iceland's membership of the EU would have a minor impact on the CAP.

Conclusion

Iceland's agricultural policy is not in line with the *acquis* and will need to be adapted before accession. This applies in particular to support measures, many of which are not currently in line with EU competition and state aid rules. The agricultural policy will require adjustments, moving towards decoupled support measures. Iceland will have to strengthen its administrative capacity. Furthermore, the country will need to improve the collection and processing of agricultural statistics and start preparations for setting up basic instruments and institutions for managing the common agricultural policy, in particular an EU-compliant paying agency and an integrated administration and control system (IACS). Iceland will also need to develop an EU-based rural development policy. Overall, Iceland has the potential to assume the obligations of membership in this area in the medium term, provided it undertakes the necessary steps to align with the *acquis*.

Chapter 13: Fisheries

The *acquis* on fisheries consists of directly applicable Regulations, which do not require transposition into national legislation. However, it does require the introduction of measures to prepare the administration and operators for participation in the common fisheries policy (CFP), which covers resource and fleet management, inspection and control, structural actions, market policy and state aid control. In some cases, existing fisheries agreements and conventions with third countries or international organisations will need to be adapted.

The fisheries sector remains extremely important for Iceland's economy, although its relative significance has declined over the last ten years due to the diversification of the Icelandic economy. In 2008, around 4 100 people were employed in the harvesting sector. The income generated by the fish harvesting sector averaged 85 billion króna (€ 800 million¹⁴) per year during 2006-08. In 2008 there were 197 enterprises involved in fish processing, employing around 5 500 people. The processing sector averaged around 600 thousand tonnes of production during 2006-08, representing around 135 billion króna (€ 1270 million) per year.

Icelandic fisheries production (harvesting and aquaculture) has averaged 1.7 million tonnes in recent years. Iceland's fisheries production represents almost a third of the combined EU-27 production (4.6 million tonnes in 2006). In terms of annual production per inhabitant, the Icelandic 4 tonnes per inhabitant compare to 10 kg per inhabitant in the EU, which explains the importance of fish as an exported good: over the last ten years between 25 and 50 % of all exported goods and services have involved marine products, four fifths of which go to the EU.

Fisheries production has declined over the last ten years, from a peak of around 2 million tonnes in 2000 to 1.3 million tonnes today. Employment levels have dropped significantly in the last ten years, from over 16 300 employees in 1999 to around 9 600 in 2008, a decline of over 40 %.

¹⁴ Applying an average exchange rate for 2006-2008 of € 1 = 106 króna.

The Icelandic fleet comprises over 1 100 vessels. The latest estimates place the fleet's capacity at 143 102 GT for an aggregated engine power of 408 797 kW. The fleet is overall highly efficient and includes among the large vessels 70 demersal trawlers (110-2 850 GT), 18 long-line vessels (200-700 GT) and 27 pelagic vessels (570-3 200 GT).

Fisheries management in Iceland is based on the principle that commercially exploited stocks in Icelandic waters are the common property of the Icelandic nation and that the public has to ensure the conservation and productivity of fish stocks and their marine environment. Icelandic laws set and implement the framework for the private exploitation of fishery resources while the technical and economic development of the sector within this boundary is up to private operators and the market. Iceland therefore implements a policy of relatively low intervention: there is no fleet capacity policy, no funds for direct subsidies and no market intervention.

The relevant administrative authority is the Ministry of Fisheries and Agriculture, assisted by the Icelandic Directorate of Fisheries and the Marine Research Institute. Overall, adequate administrative structures are in place.

Iceland has shown an interest in the development of integrated maritime policy in the EU, has set up a maritime policy governance structure and already contributes to this policy as a member of the High Level Focal Points Group.

Regarding resource management, the range of stocks exploited in Iceland includes 35 species, of which 19 are subject to catch limitations. Among the targeted species cod and haddock are of primary importance in terms of landed value (about 50 % of total value in recent years), while capelin and herring are most important in terms of landed weight. Other key species (in decreasing order of landed weight) are blue whiting, mackerel, saithe, redfish and Greenland halibut. Overall, and particularly in light of biomass trends, the Icelandic management system can be considered as relatively successful.

The overall design and implementation of Icelandic fisheries policy is similar to those implemented in the EU. Iceland subscribes to the principles of sustainable development and has incorporated the precautionary approach as a guiding principle for decision-making in its basic fisheries legislation. Iceland has for many years been managing its fish stocks according to harvest rules, similar in effect to the EU's long-term management plans, but these rules have not been translated into legislative acts. It subscribes to the general objective of harvesting stocks at a level that provides maximum sustainable yield (MSY). Iceland should be prepared to take on board the *acquis* in this respect. The same assessment can in general terms be made with regard to the administrative structures in place to support this policy.

However, Icelandic legislation on investment in fishing (acquisition of vessels or fishing companies) includes restrictions on investment that are not in line with the *acquis*. Icelandic law provides that only ships owned by Icelandic legal entities and Icelandic citizens legally resident in Iceland may be registered for fishing operations in Icelandic waters. Access by foreign vessels is limited by licenses issued under international agreements. Tradable catch quotas (Individual Transferable Quotas, ITQs) are assigned directly to vessels, but cannot be acquired by foreigners, as only nationals are allowed to enter a vessel in the vessel registry to engage in fishing operations. Foreigners cannot acquire more than a minority share in an Icelandic company that harvests or processes fish.

In the area of services in fisheries, Iceland has a relatively open market, with the exception of services where a requiresfishing permit is required (e.g. use of foreign fishing vessels for scientific purpose). Iceland restricts access to ports and the provision of port services to foreign vessels. These restrictions are not in line with the *acquis* on the right of establishment, the freedom to provide services, the free movement of capital and the relevant case-law of the Court of Justice. (See also Chapter 3, *Right of establishment and freedom to provide services* and Chapter 4, *Free movement of capital*)

Iceland will have to accept the principles of exclusive Community competence and freedom of access to waters. Article 17 of the basic CFP Regulation (Council Regulation EC No 2371/2002) establishes that a vessel from any Member State has the right of access to another Member State's waters, subject to agreed rules.

Iceland has been a major contributor to the development of environmental aspects of fisheries management, such as the ecosystem approach. The Reykjavik Declaration on responsible fisheries in the marine environment of October 2001 is a milestone in this respect. Iceland has practical experience in managing area closures for protecting vulnerable habitats, and in general seems well prepared to take up the EU *acquis* in this area. However, this assessment needs to be qualified in relation to certain provisions of the EU environmental *acquis* dealing with conservation of cetaceans. (See Chapter 27 — Environment)

Iceland includes a general ban on discards in its legislation, and presents this element as being of key importance in relation to the objective of minimising the impact of fishing on the environment. This ban is accompanied by technical measures on minimum mesh sizes and small-fish sorting grids. The Icelandic regime differs clearly from the EU regime, since discarding is only partly illegal in the EU and sometimes necessary to comply with EU fisheries regulations. The EU is currently examining possible changes in its regime in this area. This will need to be discussed during the negotiation process in light of regulatory developments in this area in the EU.

As regards fleet management, the development of Iceland's fleet capacity is not subject to specific rules. However, the capacity of the Icelandic fleet has contracted at an average annual rate of 2.3 % in terms of tonnage and 1.95 % in terms of power during the past 12 years. These figures are very similar to those for the EU fleet.

Icelandic authorities do not intervene in fleet development and do not regulate capacity restrictions since the market mechanism created by the ITQ system is sufficient to adjust fishing capacity automatically to the available fishing possibilities. The Government decided to discontinue effort management in 2004.

As no decommissioning aid has been provided, the steady reduction in fleet capacity suggests that the Icelandic fleet should have no difficulty in complying with the 'entry-exit' regime of fleet management under Community law. However, the existence of a detailed and complete registry of all fishing vessels, which includes their main technical characteristics, is compulsory in the EU. Setting up an EU compatible registry in Iceland may require a re-measurement of each vessel's tonnage and power according to Community law. Establishing the vessel register should not be difficult as Iceland already has a general vessel register in which licences to undertake fishing operations are recorded.

Concerning inspection and control, Iceland has developed detailed rules regarding the control of fishing activities. Iceland will need to implement the recently adopted Community control

system. The administrative structure and the human, technical and economic resources available to the Icelandic control services seem to be commensurate with the requirements of rigorous control of fishing activities. Iceland will have to adapt its regulatory regime, as well as the distribution of its resources, to achieve an integrated monitoring, surveillance and inspection mechanism based on risk analysis. This analysis should result in the definition of control and inspection objectives, as well as specific benchmarks and compliance indicators.

Concerning the fight against illegal, unregulated and unreported fishing, Iceland should be able to make a positive contribution to this policy. The control systems in place in Iceland are similar to the control regime laid down in the *acquis*. This was formally recognised by an agreement between the EU and Iceland reached in November 2009.

In the areas of structural actions and state aid, Iceland provides only very limited financial support to the fisheries sector. Apart from aid for vocational training, no support measures similar to those provided for by the European Fisheries Fund (EFF) are applied. Some public support schemes do relate to the fisheries sector, such as the 'Adding value to marine catch' research and development fund or the seamen's tax deduction regime. The compatibility of these schemes with Community state aid rules will have to be assessed.

With regard to state aid to the fisheries sector other than direct subsidies and grants, Iceland does not have a wide range of schemes of indirect support for fishing activities. There should be no major problems for Iceland to take on the obligations of membership in this area as harmonised state aid rules based on the EEA Agreement are in place. All state aid measures, including direct and indirect support to the fisheries sector, will have to be brought into line with the Treaty provisions and the guidelines adopted in this area.

Support for the sustainable development of fisheries areas, pilot projects, promotion measures, and collective actions are likely to be the most interesting EFF measures for Iceland. However, Iceland's experience in programming, managing and controlling Community-type support and multi-annual funding programmes is limited, in particular in the Ministry of Fisheries and Agriculture.

The Icelandic government has launched preparations for a "Comprehensive Strategy 2020", which could provide a basis for programming of the national strategic plan for fisheries and the operational programme as required by the European Fisheries Fund. Moreover, there are basic rules, mechanisms and bodies for the management and control of financial support in place upon which a management and control system that complies with Community provisions can be built. To benefit from such support Iceland will have to comply with the programming mechanisms of the European Fisheries Fund. This includes the provision of national funds to match Community funds. It will also have to set up a management and control system to ensure the sound and efficient management of those funds in the framework of shared management, including the detection and handling of financial irregularities.

Regarding market policy, Iceland has a limited, though efficient, legislative and administrative framework covering internal and external trade in fish and fishery products. Provided some adaptations are made to this framework, Iceland could easily implement the Community *acquis* concerning the common organisation of markets for fisheries products. Icelandic fishermen's associations could become the basis for setting up producers' organisations in Iceland. Nonetheless, the role of these associations, as it relates to the Community *acquis*, will have to be clarified and brought into line with Community legislation

An important difference with regard to Community legislation is the absence of commercial minimum sizes of fish products and/or of freshness types and the possibility for unrestricted landing of herring and mackerel for purposes other than human consumption.

Iceland has no specific legislation on information to the consumer for fish offered for retail sale. It will have to adapt its legislation in this area as Community rules on this subject include certain obligations on the traceability of products linked to the information provided to the consumer. Iceland is in the process of creating a legal framework for the certification of Icelandic products of marine capture fisheries in accordance with FAO guidelines for certification and ecolabelling.

Regarding international agreements, Iceland has ratified or otherwise become a party to the various instruments of international fisheries law and is an active contributor to international cooperation to ensure the governance of the global marine commons. Iceland has, however, not accepted the 1993 FAO Agreement to Promote Compliance with International Conservation and Management Measures by Fishing Vessels on the High Seas.

Iceland is a member of the regional fisheries management organisations with competence over areas of the high seas where its fleet operates, namely the North East Atlantic Fisheries Commission (NEAFC) and the Northwest Atlantic Fisheries Organisation (NAFO), and of the Atlantic Tuna Commission (ICCAT). There are five bilateral fisheries agreements in force between Iceland and other states or territories, and two further trilateral agreements for specific regional cooperation.

Iceland is party to arrangements which involve direct cooperation between the Coastal States of the North-East Atlantic. Through such arrangements, these Coastal States jointly manage the highly migratory stocks straddling the respective economic zones. The Icelandic approach to the management of these stocks is quite often divergent from that of the Community. This divergence is most marked in relation to mackerel, on which species Iceland, not being formally recognised as a Coastal State, has unilaterally expanded its fisheries over the last three years.

In the case of the regional fisheries management organisations mentioned, the EU is a full contracting party and Iceland's participation and positions will need to be subsumed into the EU's rights and obligations. Regarding bilateral agreements entailing the allocation of fishing opportunities, only the EU is entitled to conclude and manage such agreements.

Impact

Iceland is a large net exporter of fish products (trade surplus of €1.4 billion), while the EU is a net importer (trade deficit of €11 billion). As over 80% of Icelandic exports are to the EU, the EU's trade balance in fish products would improve significantly. Tariffs on those fish products originating in Iceland have already been removed to a very large extent, so the loss of revenue for the EU and corresponding advantages for Iceland would be quite limited. Overall fish production in the EU would increase by more than 20% and production of wild fish by more than 25%. With such increases, the EU would maintain its third position in world production of fish after China and Peru, and would increase its share in world production from 4.4 to 5.5%.

The Icelandic fishing fleet would increase the Community fleet by 8.6% in terms of gross tonnage and by 6.9% in terms of engine power (2008 data). As overcapacity is not a major

issue in Iceland the overcapacity problem in the EU would not be substantially affected. With regard to reducing discards, Iceland's experience would have a positive impact on the EU's policy debate on this subject.

Iceland's adaptation to the CFP would require incorporating Icelandic harvest patterns into the total allowable catch (TAC) and quota system. The EU fixes annual TACs per species and area, and subdivides these figures into quota allocations to Member States. The quota allocation takes into account catch records and remains stable by virtue of the principle of relative stability among Member States. During the accession negotiations, this integration process will require a particular focus.

Iceland will have access to the European Fisheries Fund. However, in view of its GDP level and relevant parameters of the fisheries sector the EU contribution to Iceland for structural actions under the EFF are likely to be limited. Iceland would also benefit from Community support for measures for control and enforcement and for data collection for scientific advice. Iceland's accession would facilitate a rigorous control regime in the North-East Atlantic. It would strengthen the EU's position in regional fisheries organisations. More generally, in view of its geographical position, Iceland could play a significant role in the development of the EU's policy in the Arctic.

A preliminary assessment indicates that Iceland's accession to the EU would have a significant impact on the common fisheries policy. However, the CFP is currently undergoing a review with a view to its reform, which would be effective from 2013. The Commission's policy analysis, as reflected in its Green Paper of April 2009, and the subsequent public debate, point to a reform which in some respects may move in the direction of the present Icelandic approach.

Conclusion

Fisheries policy in Iceland is similar to the system implemented in the EU. Iceland has well developed administrative structures in the area of fisheries management.

Iceland will, however, need to align with EU common fisheries policy instruments, in particular fishing capacity management, technical conservation measures and integrated control mechanisms. It will need to make substantial efforts to set up mechanisms of implementing and controlling Community support measures. Iceland will have to subscribe to the EU principle of access to waters. It will also have to comply with the internal market *acquis* regarding the right of establishment and the freedom to provide services as well as the free movement of capital in the fisheries production and processing sectors. Its international relations in fishery matters will have to be incorporated into the EU's international arrangements.

Provided Iceland subscribes to these principles and makes the necessary efforts to align its legislation, Iceland should be in a position to apply the *acquis* in this area in the medium term.

Chapter 16: Taxation

The *acquis* on taxation covers the areas of indirect taxation, definitions and principles of value-added tax (VAT) and excise duties, and direct taxation. Excise duties on energy, tobacco products and alcoholic beverages are subject to EU directives as regards the structures of the duties, the levels of minimum rates and the holding and movement of

excisable goods. Regarding direct taxation, the *acquis* covers some aspects of corporate taxes and is aimed mainly at removing obstacles to cross-border activities between enterprises. The *acquis* in the area of administrative cooperation and mutual assistance provides tools to avoid intra-Community tax evasion and tax avoidance.

In the area of **indirect taxation**, Iceland applies a VAT system which is fairly similar to the EU system. As regards exemption from VAT and reduced rates, some changes will be needed to bring the Icelandic legislation into line with the VAT Directive, in particular when the applicable rate for imported/foreign products is different, in principle, from that applied to similar domestic products.

The *excise duty* system is fairly similar to the EU system. Excise duties are applicable to alcohol and alcoholic beverages, tobacco products and energy products.

On *alcohol* duties, Iceland will need to adapt the product definitions to match the categories laid down in the *acquis*. In charging duties, Iceland applies a system based on centilitres of alcohol in the content of alcoholic beverages, which is different from the volume of alcohol in the finished products as applied in the EU. Iceland's levels of excise duties on alcohol are well above the minimum limits set in the *acquis*.

Excise duty is levied on *tobacco* and tobacco products which have been imported or produced in the country. The rates are the same for imported and domestically produced products. The tobacco tax is specific but comprises a taxation base for value-added tax. The Icelandic categories for tobacco products differ from those of the EU. In addition, Iceland applies only a specific rate for cigarettes, whereas the *acquis* requires a specific and an ad valorem rate levied on cigarettes.

The Icelandic travellers' allowances system applicable to alcoholic and tobacco products differs from the one used in the EU, in respect of amounts which can be imported as well as the beneficiaries of such allowances.

Also, as regards Icelandic excise legislation on *energy*, the scope of products and uses subject to excise payments in Iceland is currently significantly smaller than what is required by the *acquis*. The national tax rates for petrol and gasoil used as motor fuels will have to be aligned with ranges laid down by the *acquis*. The reductions in or exemptions from the current taxation of transport fuels will also need aligning with the *acquis*. Consumption of coal and petroleum as heating products by industry will also have to be included in the taxable basis by the time of accession.

Furthermore, Iceland will need to adopt the Community's system of warehousing and duty suspension for excisable products, and ensure compliance with the duty points (times for charging duty) required by that system.

As far as **direct taxation** is concerned, Iceland will need to implement certain parts of Community legislation enacted in the direct tax area which are currently not reflected in Iceland's tax system. In particular, Iceland will need to align its legislation with the Merger Directive, the Interest and Royalties Directive, the Savings Directive (including conclusion of bilateral Savings Agreements with dependent or associated territories of the Netherlands and the United Kingdom), the Parent-Subsidiary Directive and the Capital Duty Directive. Iceland will also need to explicitly commit itself to respecting the Code of Conduct for business taxation. Finally, there are provisions on income taxation of individuals and corporate income

tax which, on the basis of ECJ case-law, need to be amended to ensure compliance with the *acquis*.

Concerning **administrative cooperation and mutual assistance** in the VAT area, Iceland will need to set up a central liaison office for the exchange of information, staffed with a sufficient number of trained personnel and using adequate national procedures for gathering the requested information within the deadlines imposed by the *acquis*. Similarly, Iceland will also need to set up an excise liaison office. Iceland will also need to implement the *acquis* provisions related to mutual assistance for assessment in direct tax matters.

As regards mutual recovery assistance, Iceland is party to the Nordic Mutual Assistance Treaty and the OECD Convention on mutual administrative assistance in tax matters. Iceland has double taxation agreements with some countries containing a provision on mutual recovery assistance for income taxes. Iceland will need to further adapt its administrative organisation to meet the requirements imposed by the *acquis* on mutual recovery assistance.

As regards **operational capacity and computerisation**, Iceland will have to adapt its IT network to introduce and operate the systems needed for interconnectivity and interoperability with the EU's IT systems for taxation (currently the VAT Information Exchange System — VIES, VIES on the Web, the Excise Movement Control System, and the Taxation on Savings System).

Conclusion

Overall, tax legislation in Iceland is partially aligned with the *acquis*. However, Iceland will have to undertake further significant approximation in the indirect taxation area, in particular on VAT and excise duties. Regarding direct taxation, Iceland will need to implement part of the *acquis* in the direct tax area which is currently not reflected in Iceland's tax system. Iceland should conclude bilateral Savings Agreements with a number of territories.

Iceland has a good level of administrative capacity in the field of taxation. Nevertheless, further efforts will be necessary to effectively implement the EU *acquis* upon accession. In particular, it will have to establish a central liaison office and an excise liaison office, and to achieve full interconnectivity with the EU's computerised systems.

Chapter 17: Economic and monetary policy

The *acquis* in the area of economic and monetary policy contains rules requiring the independence of central banks in Member States and prohibiting direct financing of the public sector by the central banks and privileged access of the public sector to financial institutions. Member States are expected to coordinate their economic policies and are subject to the provisions of the Excessive Deficit Procedure as well as of the Stability and Growth Pact. The national central banks will be subject to the Statute of the European System of Central Banks (ESCB). New Member States are also committed to complying with the criteria for adopting the euro. Until they adopt the euro, they will participate in the Economic and Monetary Union as Member States with a derogation and must treat their exchange rate policy as a matter of common concern.

In the area of **monetary policy**, the functional independence of the Central Bank is enshrined in the 2001 Act on the Central Bank of Iceland (CBI), which provides for a primary objective — price stability — in a clear manner. However, as to institutional independence the Act provides on several occasions that the Bank has to seek or take instructions from other

authorities (e.g. Articles 3, 5, 18), which is not in line with Article 130 TFEU. Hence, clear provisions will need to be put in place prohibiting the giving of instructions to the CBI, the approval, suspension, annulment or deferral of the CBI's decisions, and participation (with a right to vote) in decision-making bodies of the CBI. Moreover, the CBI is organised as a state-owned body, administratively falling under the Ministry of Economic Affairs, which can affect the CBI's independence. This will therefore have to be limited by law.

Regarding individual independence, there are no appropriate safeguards to protect the independence of the members of the decision-making bodies (Governor, Monetary Policy Committee, Supervisory Board). Provisions concerning grounds for dismissal of the CBI's decision-making bodies are not in line with the requirements of the TFEU.

According to the principle of financial independence, the central bank must have sufficient means to meet its objectives and perform its tasks in an unimpaired and autonomous manner. The CBI Act remains silent on many aspects related to financial independence, such as: determination of and influence on the CBI's budget; clear accounting rules laid down for the CBI; distribution of profits of the CBI. The principle of financial independence will need to be appropriately reflected in the law, in order to ensure that the CBI has sufficient financial means to meet its own objectives and is able to perform autonomously the ESCB's related tasks, as required by the TFEU and the ESCB and ECB Statutes.

In the area of **economic policy**, Article 7(2) of the CBI Act allows the CBI to extend guarantees or loans to credit institutions in exceptional circumstances. Emergency liquidity assistance through which liquidity is provided for a short period to a solvent credit institution against adequate collateral is a normal function of the central bank and is in line with the TFEU. However, national legislation providing for financing of credit institutions by the central bank other than in connection with its tasks (such as monetary policy, payment systems or temporary liquidity support operations), in particular to support insolvent credit and/or other financial institutions, is not in line with the prohibition on monetary financing, unless it is established that the central bank is acting only as a fiscal agent of the state. The Central Bank legislation will need to clearly integrate those conditions. Regarding the fiscal agent function, the CBI Act is aligned with Community law and the monetary financing prohibition. In addition, the Act should provide that the remuneration margin on deposits/current account balances should be at or below market rates.

Regarding the prohibition on monetary financing, the CBI Act does not contain provisions establishing privileged access by the public sector to financial institutions, which is in line with the *acquis*. All acts that provide specific incentives for or requirements imposed on the financial sector to acquire and hold liabilities of the public sector need to be aligned with the *acquis*. In particular, the Act on mandatory pension insurance and the activities of pension funds and the Regulation on deposit guarantees and an investor compensation scheme contain provisions which effectively give the public sector privileged access to financial institutions.

As a member of EFTA, Iceland participates in an annual meeting between the EFTA Ministers of Finance and the EU Economic and Financial Council. Administrative capacity will need to be strengthened with a view to formulation and implementation of economic policy as required by the TFEU. (*See also Economic criteria*)

Conclusion

There is a significant gap in the legislative alignment of Iceland with the *acquis* in the field of economic and monetary policy. Several aspects of the legislation, in particular central bank independence, and the prohibition on monetary financing and privileged access to financial institutions, will need to be aligned. Provided that Iceland aligns with the *acquis* in this field, the country's participation in EMU as a Member State with a derogation should not pose major problems and Iceland should be able to assume the obligations of membership.

Chapter 22: Regional policy and coordination of structural instruments

The *acquis* on regional policy and coordination of structural instruments consists mostly of framework and implementing regulations, which do not require transposition into national legislation. They define the rules for drawing up, approving and implementing programmes financed by the Structural Funds (the European Regional Development Fund and the European Social Fund) and — for some Member States — Cohesion Fund programmes reflecting each country's territorial organisation. These programmes are negotiated and agreed with the Commission. Implementation is a shared responsibility of the Member States and the Commission. Member States must comply with the provisions of the *acquis*, for example in the areas of public procurement, competition and the environment, equality between men and women and non-discrimination, as well as sustainable development, when selecting and implementing projects.

Iceland has a **legislative framework** in place for regional policy. Having regard to Iceland's specificity (sparsely populated — density of 3.1 inhabitants/km², two thirds of the population living in the capital area, remoteness), regional policy in Iceland is primarily understood as a rural development policy for economic development in rural areas outside the main capital region and is best described as an SME policy for economic development. The budget law does not explicitly provide for multi-annual budget programming, but allocations for implementing multi-annual policies/programmes are reported in the annual budget bill as 'binding agreements'. As a result of the EEA Agreement, Iceland has some experience/practice of co-funding EU programmes through its participation in programmes such as Lifelong Learning (*see Chapter 26 — Education and culture*) and 7th FP Research (*see Chapter 25 — Science and research*). Amendments to the budget law will be needed to allow the transfer of national co-financing budgets between EU programmes, funds and years.

Iceland has two levels of governance: national/central government and local authorities (municipalities). There is no regional self-government level. However, the state administration is divided into a number of districts, for the purpose of carrying out different public tasks. There is a long tradition of voluntary cooperation between municipalities at regional level which may take place within the context of, for instance, regional boards, co-owned agencies established by several municipalities in order to provide certain services, regional federations, or the Icelandic Association of Local Authorities. Municipalities have their own sources of funding, in which income tax takes the lion's share. However, the central government still takes responsibility for many of the costly functions handled by local authorities.

Iceland is classified as one NUTS level 2 area and is divided into two NUTS level 3 areas.

Iceland has established an **institutional framework** for implementing its regional development policy, comprising different institutions. The Ministry of Industry, Energy and

Tourism produces the government's regional development plan, in cooperation with the Institute of Regional Development (a government agency under the Ministry) and in consultation with municipalities, and other bodies. The Institute of Regional Development implements regional policy. Economic development agencies, co-owned by municipalities, operate in rural areas to support and strengthen business development and innovation. There are a number of relevant bodies operating in the field of employment and social policies including the Ministry of Education, the Ministry of Social Affairs and Social Security, the Association of Employers and the Union of Employees. The Ministries have, to varying degrees, experience of EU funding through their participation in EU programmes. Iceland is currently not eligible for IPA funding.

As regards **administrative capacity**, Iceland has a small but flexible government administration. Around 20 staff in different ministries have experience — through direct involvement — of EU programmes. However, experience with multi-annual programming and management of EU-funded projects is limited mostly to the EU programmes implemented under centralised management. Additional administrative capacity and structures will need to be built up in order to allow smooth management and implementation of projects financed within the scope of EU cohesion policy.

Iceland has designed and is implementing a number of **programming** documents either directly or indirectly relevant for regional policy. The government's four-year regional development plan provides financial support for long-term, viable projects. In addition, a number of public-private partnerships in the form of growth agreements have been set up or are planned. These are implemented through governance procedures and are led by the regional development centres. Furthermore, long-term planning documents do exist in the area of transport, sustainable development, use of hydro and geothermal energy resources, telecommunications and tourism. However, a stand-alone human resources development policy does not exist, and human resources issues are integrated into other policies, in particular gender equality policies.

The government has launched work on a comprehensive strategy towards 2020 — *Bringing Iceland Forward 2020*. Operational plans are envisaged for Iceland as a whole and will be implemented through multi-annual programming. The strategy may serve as a basis for the national strategic reference framework required by the cohesion policy *acquis*. The national strategic reference framework will take into account the Lisbon strategy for growth and jobs/Europe2020 priorities.

There is some experience in **monitoring and evaluating** EU co-funded programmes. Regular monitoring and evaluation of programme implementation is carried out by relevant ministries and the results are provided to the Commission. However, additional systems and procedures for monitoring and evaluating EU programmes relevant to cohesion policy will need to be established.

A framework for **financial management and control (including audit)** exists. It is limited, however, in terms of instruments relevant to cohesion policy. The national authorities are responsible for the implementation of programmes and the proper use of EU funding; monitoring and audit form the basis for the declaration of assurance each year. The Ministry of Finance is responsible for issuing regulations regarding the execution of the general budget and for the financial management of the state. The National Audit Office is the main supervisory body with regard to the general budget as well as state entities.

Impact

Iceland has a nominal GDP of €10.2 billion in 2008. This equals about 0.08% of EU-27 GDP for about 0.06% of the EU-27 population. Considering the size of its economy and population, Iceland's accession would only marginally modify the EU's average GDP/head (PPS) compared to today's EU-27 average and hence would not influence the eligibility of regions. Given Iceland's above-EU average GDP/head (PPS), EU contributions to Iceland under the cohesion policy are likely to be limited. On this basis, following a preliminary assessment, the **estimated impact** of Iceland's possible accession on EU cohesion policy and funding in the current situation and under current conditions is considered minimal.

Conclusion

Iceland has experience and capacity in designing and implementing regional policy measures and in participating in EU programmes. Legislation relevant for EU cohesion policy is mostly in place. The administration is small but flexible and has considerable experience in programming and monitoring/evaluation. Iceland will need to adjust its budget law to allow transfer of national co-financing budgets between EU programmes, funds and years. Efforts will be needed to strengthen multi-annual programming and the related coordination and integration of policies. Iceland will also need to establish institutional structures in line with the choices of operational programmes it makes and allocate and prepare staff for the implementation of these programmes. Overall, Iceland should be able to assume the obligations of membership in this area.

Chapter 23: Judiciary and fundamental rights

EU policies in the area of the judiciary and fundamental rights aim to maintain and further develop the Union as an area of freedom, security and justice. The establishment of an independent and efficient judiciary is of paramount importance. Impartiality, integrity and high standards of adjudication by the courts are essential for safeguarding the rule of law. This requires a firm commitment to eliminating external influences over the judiciary and to devoting adequate financial resources and training. Legal guarantees for fair trial procedures must be in place. Likewise, Member States must fight corruption effectively as it represents a threat to the stability of democratic institutions and the rule of law. A solid legal framework and reliable institutions are required to underpin a coherent policy of prevention and deterrence of corruption. Member States must ensure respect for fundamental rights and EU citizens' rights as guaranteed by the *acquis* and by the Charter of Fundamental Rights.

Judiciary (*See also Political criteria — Democracy and the rule of law*)

The **independence of the judiciary** is enshrined in the Icelandic constitution. The constitution lays down the main principles regarding the functioning of the courts. Together with the Act on the judiciary, it ensures the **impartiality** of the judiciary. The primary rule is that a judge cannot be removed from his/her position. However, certain exceptions apply. The autonomy of prosecutors is provided for in the Criminal Procedure Code.

In conformity with the ‘principle of the natural judge’¹⁵, the 1998 Act on the judiciary contains provisions on the division of competences between different courts and on the assignment of cases to judges.

There is no higher council of the judiciary in Iceland, but a **Judicial Council** is established for the district courts. The Judicial Council is composed of five members appointed by the Minister of Justice. Four of its members are elected from among the district court judges, while the fifth member, who is not an active judge, is appointed by the Minister of Justice to serve as chairman. The functions of the Judicial Council are among other things to monitor the financial affairs of the district courts, organise continuing education for judges, issue rules on coordinated judicial practice, etc. with the goal of ensuring the independence of the judiciary from the executive.

The criteria for the selection of **district court judges** are set out in the Act on the judiciary; district court judges are appointed for an indefinite period of time by the Minister of Justice. A special Evaluation Committee composed of three members, appointed by the Minister of Justice for three years, considers the qualifications of applicants and gives non-binding advice to the Minister.

The selection of **Supreme Court judges** is based on the Act on the judiciary. Judges are appointed for an indefinite period by the President of Iceland, as proposed by the Minister of Justice, after the Supreme Court has expressed its opinion as regards the competence and qualifications of the applicants.

The predominance given to the Minister of Justice and Human Rights in judicial appointments, given the consultative role of the Evaluation Committee and the Supreme Court, raises questions in terms of the effective independence of judges.

As to the **disciplinary procedure** for judges, a judge may be relieved of his/her duties, if he/she has been reprimanded and fails to observe the warning within a suitable period of time, or if a criminal action is brought against him/her; furthermore, such charges — if sustained — would have the effect of depriving the judge of the general qualifications for judicial office. The President of Iceland would relieve a judge of the Supreme Court from office temporarily as proposed by the Minister of Justice; the Minister of Justice has this power with regard to district court judges. The Minister must seek a written opinion from the **Committee on Judicial Functions** before a judge is temporarily removed from office. The three members of the Committee on Judicial Functions (and their three alternates) are appointed by the Minister of Justice, as proposed by the Icelandic Association of Judges and the Law Faculty of the University of Iceland. The decisions taken by the Committee on Judicial Functions cannot be referred to any higher administrative authority. When a judge has been temporarily relieved from office, the Minister of Justice shall, however, take legal action against him before the District court of Reykjavik, requesting dismissal from office by judgement.

Both the role of the Minister of Justice in this respect and the fact that decisions taken by the Committee on Judicial Functions cannot be referred to any higher administrative authority give cause for particular concern.

¹⁵ The principle of the natural judge means that cases should be allocated to courts and individual judges according to criteria which have been previously laid down by the law concerning jurisdiction, competence and assignment of cases.

All **prosecutor** positions are advertised publicly. The Minister of Justice is responsible for the appointment of the Director of Public Prosecutions, the National Commissioner of Police and the Special Prosecutor in matters relating to the bank crisis. The Director of Public Prosecutions is the highest holder of prosecutorial authority. He or she is appointed for an indefinite period. However, most prosecutors are appointed for a period of five years. The Director of Public Prosecutions is assisted by a Deputy Director. The Ministry of Justice is responsible for evaluating applicants' eligibility. Prosecutors do not enjoy immunity. The Minister of Justice can also temporarily remove the Director of Public Prosecutions from office, but must take legal action within two months before the District Court of Reykjavik in order to have the Director dismissed. The role of the Minister of Justice in relation to the prosecutors raises particular concern.

Provisions regarding **conflicts of interest** are laid down in the 1991 Act on civil procedure. According to the provisions of this Act a judge is disqualified from conducting a case if he/she is a party to the case, is or has been a spouse of the party in question, or if there are other conditions or circumstances which are likely to cast reasonable doubt on the judge's impartiality. Furthermore, the Criminal Procedure Code regulates the disqualification of judges with respect to penal cases.

Judges do not enjoy penal immunity. The General Penal Code provides sanctions against persons seeking to influence a judge and prevents judges from receiving invitations of bribery, yet there are no specific provisions regarding the criminal liability of judges. The General Penal Code applies to criminal offences committed by judges inside as well as outside the scope of their office, as does all other sectoral penal legislation.

The district court of Reykjavik has established a specific lifelong **training** system for judges. However, no specific training courses are organised within the judiciary itself, nor is there an independent national training centre for the judiciary. There is no formal training for the clerical staff of the courts, even though an agreement with their union specifically provides for the training of these employees.

The **length of proceedings** is not a problem in Iceland to date. Excessive length of proceedings is extremely rare within the court system.

Anti-corruption policy and measures (*See also Political criteria — Democracy and the rule of law*)

Until the financial crisis, corruption was not considered an issue of concern in Iceland. Corruption is defined as a criminal offence in line with the Council of Europe Criminal and Civil Law Conventions. The relevant anti-corruption provisions in the General Penal Code include active and passive bribery in the public and private sector and provisions on confiscation of proceeds and disqualification measures.

After the banking sector collapsed in Iceland a new Office of the Special Prosecutor was created. It has authority to investigate and bring charges in cases covering economic crime, crimes of enrichment and tax offences. By October 2009, the Special Prosecutor had launched more than 40 cases.

Prior to accession Iceland must ensure that its legislation is in line with the *acquis* and ratify all international instruments in this field. In this view, Iceland should ratify the Council of Europe Civil Law Convention and sign and ratify the United Nations Convention against Corruption. Iceland should also implement recommendations made during the third evaluation

round of the Group of States against corruption (GRECO), in particular relating to bribery, trade in influence, training for law enforcement and proper implementation of the legislation on financing of political parties.

Fundamental rights (*See also Political criteria — Human rights and the protection of minorities*)

Iceland has a comprehensive system of protection of fundamental human rights based on its constitution. The constitutional amendments of 1995 (*see Political criteria*) were largely inspired by, and to a great extent reflect, the European Convention on Human Rights (ECHR). The legal protection of human rights in Iceland was enhanced considerably as a result of these constitutional amendments.

In the field of personal data protection, the Icelandic legislation is generally in line with the main provisions of the *acquis* and with the Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data (Convention 108). Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and the free movement of such data is a part of the EEA Agreement.

Iceland should ensure full alignment with the *acquis*, with particular regard to the complete independence of the Data Protection Authority from the government and the right of data subjects to appeal to courts of law against decisions of the Authority. In addition, it should ratify the Additional protocol to Convention 108 regarding supervisory authorities and trans-border data flows (ETS No. 181), and apply the Council of Europe Recommendation No. R (87) 15, which regulates the use of personal data in the police sector.

With regard to the relationship between international and domestic law, Iceland has adhered to the principle of dualism. It is a general principle in Icelandic law that provisions of domestic law are to be interpreted in accordance with the principles of international law.

Iceland has introduced a system of close mainstreaming of new legislation affecting fundamental rights: when draft legislation is discussed in the relevant parliamentary committee as a rule the opinion of various human rights bodies, institutions, associations, non-governmental bodies and independent experts is called for wherever human rights issues may be at stake.

Iceland, as all Member States of the United Nations, undergoes regular monitoring by the various bodies established on the basis of the international instruments on human rights, namely the Committee against torture and the Committee on elimination of racial discrimination. There are no major problems of fundamental rights violation in Iceland.

For the *right to privacy, freedom of expression, freedom of thought, conscience and religion, right to ownership and discrimination and equality* issues, see *Political criteria*; for the *media* see also *Chapter 10 — Information society and media*.

EU citizens' rights

Regarding **the right to vote** and stand as a **candidate in elections**, the national legislation in place grants EU citizens the right to vote and to stand in municipal elections after a minimum of five years' residence. As an exception, citizens of Denmark, Finland, Norway and Sweden acquire this right after three years of residence. The current differentiation of three years'

residence for these citizens and five years' residence for citizens of the other Member States is not in line with the *acquis*. The legislation of Iceland will therefore need to be modified.

Article 23 TFEU provides for EU citizens who are in third countries to be entitled to protection by the diplomatic or consular authorities of any Member State, under the same conditions as nationals of the State.

In order to comply with the *acquis*, Iceland will have to implement in particular the Decision regarding protection for citizens of the European Union by diplomatic and consular representations and the Decision on the establishment of an emergency travel document.

Conclusion

(See the conclusion of Part 1 — Political criteria)

Chapter 24: Justice, freedom and security

EU policies aim to maintain and further develop the Union as an area of freedom, security and justice. On issues such as external migration, asylum, border control, visas, judicial cooperation in criminal and civil matters, police cooperation, the fight against organised crime and terrorism, cooperation in the field of drugs and customs cooperation, Member States need to be properly equipped to adequately implement the growing framework of common rules. Above all, this requires strong and well-integrated capacity within the law enforcement agencies and other relevant bodies to attain the necessary standards. A professional, reliable and efficient police organisation is of paramount importance.

The Schengen *acquis* is an important part of the EU policies on justice, freedom and security. Iceland is an associated member of the **Schengen Agreement**, and has the required national legislation to implement this *acquis*. Iceland applies these provisions since March 2001. Iceland is on the whole applying the Schengen *acquis* in a very satisfactory manner. Border checks and border surveillance of Iceland's sea and air borders have been positively assessed in a Schengen evaluation. Iceland also participates in Frontex.

Regarding **migration**, legislation on residence permits, family reunification, students and long-term residents is largely in place, although it is not fully in line with the *acquis*. Important divergences exist for instance as regards the absence of a specific scheme for researchers and the scope of application of the right to family reunification, which should not only be granted to certain categories of third-country nationals. As regards illegal immigration, smuggling and trafficking, the legislation of Iceland provides for fines or alternatively detention. Deportation and a re-entry ban can be enforced in case of illegal stay. The legislation on facilitation of unauthorised entry, transit and residence is not fully in line with the *acquis*. All readmission agreements which Iceland has concluded are aligned with those of the EU Member States.

The Icelandic **asylum system** is governed by the legislation, which enshrines the right to asylum under the 1951 Geneva Convention. It contains provisions on humanitarian protection, on the principle of non-refoulement, on safe third countries and on manifestly unfounded claims, and establishes normal and accelerated asylum procedures. However, a subsidiary protection regime, covering persons falling outside the scope of the Geneva Convention, will need to be established in line with Council Directive 2004/83/EC.

Under the normal asylum procedure, asylum seekers may appeal for administrative review of a first instance refusal to the Ministry of Justice. No appeals are possible under the accelerated asylum procedure. In line with Council Directive 2005/85/EC and the case law of the European Court of Justice regarding effective judicial protection of rights conferred on individuals by EU law, Iceland will need to guarantee the right to an effective remedy before a court or tribunal in the form of an appeal of review, in fact and in law, of all negative decisions made during the administrative procedures. Iceland should also provide for rules allowing applicants to remain in the territory or request suspension of a removal pending a decision on this appeal or review.

Iceland already fully implements the Eurodac Regulation and the Dublin II Regulation on the criteria and mechanisms for determining the Member State responsible for processing an asylum application. However, legislation on reception conditions will need to be further developed to include safeguards concerning the use of detention and better define the rights of asylum seekers to health care, social assistance and other benefits.

In the area of **police cooperation and the fight against organised crime** Iceland has relevant structures and systems in place while facing capacity challenges in some areas. One concern relates to the accumulation of powers and responsibilities of the Minister of Justice and Human Rights, who is also the supreme head of the police in Iceland (*see also Political criteria and Chapter 23 — Judiciary and fundamental freedoms*). The National Commissioner of the Icelandic Police administers police affairs under the Minister's authority. In terms of police cooperation, further efforts will be necessary to fully comply with the requirements of the relevant Council Decision (Treaty of Prüm, May 2005). Iceland concluded an operational agreement with Europol in 2001 and a cooperation agreement with CEPOL in 2006. Since 2008, Iceland has also been a member of the Police Working Group on Terrorism.

Organised crime, even if at a low level, is of some concern as a growing phenomenon in Iceland, with **drug smuggling** being the single most serious aspect of organised crime in the country. Only small amounts of illicit drugs are produced or manufactured in Iceland. Iceland is not a transit country for illicit drugs entering the EU; however, increased cross-border activity by criminal groups has been observed. Iceland is a party to the 1988 UN Drug Convention, the 1971 UN Convention on Psychotropic Substances, and the 1961 UN Single Convention on Narcotic Drugs and its 1972 Protocol. Iceland does not yet participate in the work of the European Monitoring Centre for Drugs and Drug Addiction.

Concerning trafficking in human beings, at present Iceland does not comply with the obligations of the *acquis*. Ratification of the UN Convention against Transnational Organized Crime (Palermo Convention), including its two protocols on smuggling and trafficking, and of the Council of Europe Convention against trafficking in human beings is pending. Furthermore, Icelandic law enforcement may face a challenge in terms of its capacity to cope with trafficking in human beings, as well as the fight against sexual exploitation of children and child pornography. At present, the number of cases of trafficking in human beings brought to the court is low. It is to be noted that the maximum criminal penalties for trafficking in human beings are low in comparison to other serious crimes. It is important that prior to accession, mechanisms to protect, assist and support victims of trafficking, procedures for identifying victims and referral mechanisms are in place.

As regards the fight against money laundering, all three relevant Directives are covered by the EEA (*see also Chapter 4 — Free movement of capital*). The main challenge facing Iceland in this context is the capacity of the Financial Intelligence Unit and of the Economic Crime Unit

to cover all functions and responsibilities related to money laundering and financial crime. Iceland will also need to improve its statistics related to the number of investigations initiated each year on the basis of Suspicious Transaction Reports, the number of freezing/seizing orders, prosecutions, indictments, confiscation orders, actual confiscations, as well as the value of the assets and properties frozen/seized and confiscated. In this regard Iceland should implement the technical recommendations of the Financial Action Task Force (FATF).

Iceland has a national confiscation system which provides for value confiscation, but not third party confiscation (except in a rather narrow case) and extended confiscation. Iceland will need to ensure that its legislation implementing the UN Convention on Transnational Organised Crime also fully implements the relevant EU Framework Decisions (which would imply for example the setting up of an asset recovery office). Iceland does not have provisions on non-conviction based (NCB) confiscation and foreign NCB orders cannot be enforced in Iceland. While it is not mandatory to establish NCB confiscation, assistance to countries using NCB procedures should be provided by Iceland. The country will also need to ratify the 2005 Warsaw Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism. It should also fully implement the 1990 Council of Europe Convention (Strasbourg Convention). Prosecutors and judges need training on confiscation and asset recovery issues.

Iceland has signed and ratified a range of relevant **counter-terrorism** conventions, some of which still need to be ratified. Provisions of the Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing are implemented. Administrative structures and capabilities are in line with the perceived threat in Iceland.

Iceland has a relevant framework in place and is active in **customs cooperation**. It is a party to the Convention establishing the Customs Cooperation Council. Further cooperation with EU countries and third countries is based on UN Conventions, EEA-relevant EU *acquis* and bilateral agreements.

As regards **judicial cooperation in civil matters**, Iceland is a party to several important Hague Conventions. Regarding family law matters, Iceland is party to the 1993 Convention on Inter-Country Adoption and the 1980 Convention on Child Abduction. Foreign judicial decisions in family matters are recognised and enforced unless they are against the *public order* of Iceland. Iceland should also join the 1996 Child Protection Convention and the 2007 Child Support Convention and its protocol on applicable law.

Iceland has also ratified the 1988 Lugano Convention. Iceland still needs to ratify the new Lugano Convention signed in 2007. Regarding international insolvency proceedings Iceland will need to align with the relevant EU *acquis*.

The Icelandic legislation on **judicial cooperation in criminal matters** implements the 1957 European Convention on Extradition and its two additional protocols (the 1959 European Convention on Mutual Legal Assistance in Criminal Matters and its first additional protocol; the second one is signed but not yet ratified by Iceland) as well as the relevant Schengen principles. Iceland also partly implements the principles of the European Union Convention on Mutual Legal Assistance in Criminal Matters. At present, extradition between Iceland and the EU is based on an agreement between the Member States of the EU, Iceland and Norway signed in 2006 (Agreement on the surrender procedure between the Member States of the European Union, Iceland and Norway, OJ L 292, 21.10.2006). Iceland concluded a cooperation agreement with Eurojust in 2006.

The level of computerisation of the court system and the existence of a legal framework establishing a criminal register should enable Iceland to fully implement the Council Framework Decision on the organisation and content of the exchange of information extracted from the criminal record between Member States and the Council Decision on the establishment of the European Criminal Records Information System in application of Article 11 of the Framework Decision. However, additional IT development and modification of the legislative framework may be required.

As regards **protection of the euro against counterfeiting**, Iceland has not acceded to the 1929 International Convention on the Suppression of Counterfeiting. The General Penal Code covers counterfeiting of money, including euros. In general, the legislation is broadly in line with the *acquis*.

Conclusion

Iceland applies the Schengen Agreement and has reached an advanced level of alignment with the *acquis* in the field of justice, freedom and security. The legislation in some of the areas will need to be brought fully into line with the *acquis* and relevant international instruments will need to be signed and/or ratified. Relevant structures and policies are in place and Iceland should be able to assume the obligations of membership. The main challenge, stemming from the size of the country, is its administrative capacity to cope with the implementation of some of the requirements.

Chapter 29: Customs union

The customs union *acquis* consists of the EU Customs Code and its implementing provisions, the Combined Nomenclature, the Common Customs Tariff and provisions on tariff classification, customs duty relief, duty suspensions and certain tariff quotas, all of which are directly applicable upon accession, and other customs-related legislation outside the scope of the Customs Code. Member States must ensure that the necessary implementing and enforcement capacities, including links to the relevant EU computerised customs systems¹⁶, are in place. The customs administration must also ensure adequate capacity to implement and enforce special rules laid down in related areas of the *acquis* such as external trade, health and security provisions.

The EEA provides for the establishment of a free trade area with the Community and the removal of customs duties on products listed in Article 8 of the EEA Agreement. It also contains provisions for administrative cooperation on customs matters, as well as rules of origin which have to be observed in order to benefit from the trade preferences.

The Customs Act, with subsequent amendments, and its implementing regulations, is generally aligned with the provisions of the Community Customs Code and implementing provisions, even though important discrepancies exist in various areas.

Iceland's tariff system is based on the Harmonised System and is identical to the EU Combined Nomenclature in respect of the first six digits. However, significant differences exist at eight-digit level. Upon membership, Iceland will have to align fully with the Combined Nomenclature. Iceland applies tariff suspensions, tariff quotas and tariff ceilings. The system applied by Iceland for Binding Tariff Information and Binding Origin Information

¹⁶ Tariff-related systems, NCTS, ECS, ICS, EOS.

is broadly in line with the provisions of the EU Customs Code. EU membership would require some limited adaptations, for instance with respect to delegation of powers. However, the management of tariff quotas is not in line with the *acquis*. Iceland's legislation allows the sale of duty-free goods at entry into the country, which is not in line with EU law. Rules on valuation are not fully in line with the *acquis* or with international standards.

Iceland only applies preferential rules of origin in the framework of trade with EFTA partners or within the framework of EFTA with third countries. Iceland introduced in 2001 a system of Generalised System of Preferences (GSP) based on rules of origin largely similar to the EU's. Iceland does not apply any non-preferential rules of origin.

Iceland applies simplified procedures for postal consignments, small consignments and approved exporters. However, further approximation with the *acquis* will be required, including the establishment of a legal framework for Authorised Economic Operators. Iceland applies legislation related to transit procedures and is indirectly linked to the New Computerised Transit System (NCTS). The rules on customs debt and repayment are not fully in line with the *acquis*. As regards cash controls at the borders, Iceland applies the general principles of the Financial Action Task Force, but it will need to further align its legislation with the *acquis*. Legislation in the area of protection of intellectual property rights is not fully in line with the *acquis*, in particular with regard to non-applicability to exports, transit and other suspensive procedures. Legislation on control of drug precursors is not fully in line with EU *acquis* either. Some fine-tuning of its legislation will be required.

As regards *administrative capacity*, Iceland generally has a good level of capacity and should not encounter major problems in implementing the *acquis* in this field. The use of IT within the Customs Administration is extensive. IT systems are well developed and capable of ensuring good management of customs procedures, including through effective risk analysis techniques. The Customs IT system is connected to shipping companies, traders and government departments. All offices are connected to the central IT system and 97% of customs declarations and import/export manifests are dealt with electronically. Duties are collected and reimbursed electronically, with a direct link to the state revenue accounting system. However, Iceland will have to undertake major efforts to develop and operate all EU customs-related IT applications for tariff management, transit and security, including the connection to the CCN/CSI gateway.

Conclusion

The customs legislation of Iceland is to a large extent aligned with the *acquis*. However, significant further alignment is necessary, not least in the areas of the Combined Nomenclature, valuation, origin, cash controls, control of drug precursors and measures to protect intellectual property rights. Iceland applies certain customs fees which are not in line with the *acquis*. Iceland will also have to align duty-free legislation and practice with that of the EU.

In the field of customs, Iceland has achieved a good level of administrative capacity. Nevertheless, further efforts will be necessary to effectively implement the *acquis* upon accession, with particular attention to achieving full interconnectivity with the EU's computerised systems.

The *acquis* in the field of external relations consists mainly of directly binding EU legislation which does not require transposition into national law. In the area of humanitarian aid and development policy, an applicant country will need to comply with EU legislation and international commitments as well as ensure the capacity to participate in the EU's development and humanitarian policies.

Upon accession, the country will be bound by the **common commercial policy**. Iceland will have to apply the autonomous (preferential) trade regime that the EU grants to certain third countries, including the Generalised System of Preferences (GSP). Iceland will also have to terminate all its current preferential trade agreements with third countries and bring all other agreements, including non-preferential trade agreements, in line with the obligations of EU membership. Finally, Iceland will have to apply upon accession all EU international trade agreements as well as all EU autonomous regimes.

Iceland has been a member of the World Trade Organisation since its foundation in 1995 and before that was party to the GATT. As far as the Plurilateral Agreements are concerned Iceland is a party to the Agreement on Government Procurement and to the Information Technology Agreement.

At present, the Customs Act comprises the generalised system of preferences (GSP) scheme of Iceland, which offers GSP treatment for least developed countries (LDCs). In comparison with the relevant EU legislation, both the level of the preferences and the scope of the beneficiary countries are more limited in Iceland.

The Customs Act of Iceland also serves as a legal basis for anti-dumping actions and countervailing measures to offset injury caused by subsidised imports. Upon accession Iceland will have to repeal national legislation and measures concerning the GSP and its defence instruments.

The average Icelandic most favoured nation (MFN) bound ad valorem tariff rate for agricultural products is 43.2%, for fish and fishery products 2.8% and for other goods 9.8% with an overall average of 13.4%. The EU average MFN bound ad valorem tariff rate for agricultural products is 5.8%, for fish and fishery products 11.4 % and for other goods 3.8% with an overall average of 4.1% (based on HS 1996). The average Icelandic MFN applied tariff rate 2006 for agricultural products is 6.4%, for fish and fishery products 1.3% and for other goods 2.4%. The average EU MFN applied tariff rate 2006 for agricultural products is 5.9%, for fish and fishery products 11.8% and for other goods 3.8% (based on HS 2002; all on 6-digit-level). With regards to exports, Iceland applies a surcharge on exports of raw fish. The surcharge was temporarily suspended in 2007, but not abolished. Upon accession, the country will have to apply the EU common customs tariff.

Icelandic commitments under the General Agreement on Trade in Services (GATS), both horizontal limitations and sector-specific commitments, are broadly in accordance with those undertaken by the EU. Like the EU, Iceland has undertaken GATS commitments in many sectors and it respects the boundaries of the EU's MFN exemptions. However, in the financial sector, Iceland's GATS schedules do not include a market access limitation regarding undertakings for collective investment in transferable securities (UCITS). This is scheduled by all EU Member States. In the area of transport services, Iceland has undertaken more liberal commitments than those prevailing in the Member States. In order to avoid

compensation under Article XXI of GATS, Iceland will have to consider modification or withdrawal of its commitments in this and other sectors upon accession. None of Iceland's GATS commitments hinder its ability to take on the obligations of EU membership.

Iceland is a member of the European Free Trade Association (EFTA) and the European Economic Area (EEA). It has a total of 18 agreements in force within the framework of EFTA, of which 16 with third countries covering various sectoral issues (industrial, fish, and processed agricultural products). The other 2 agreements are the EFTA Convention and the EEA Agreement. At the same time, basic agricultural products are covered in the framework of **bilateral free trade agreements** with the same 16 third countries. Furthermore, 4 bilateral FTAs are in force, of which two with the EU, one with the Faroe Islands and one with Denmark on trade with Greenland. In addition, FTAs with 4 third countries are concluded but not yet in force.

Iceland has concluded **Bilateral Investment Treaties (BITs)** with 11 countries. Some of the provisions included in Iceland's BITs will need to be aligned with the *acquis* in conformity with the obligations pursuant to Articles 64, 66 and 75 TFEU and relevant case-law. Some BITs are not in line with the *acquis* in so far as they permit the free transfer of funds relating to investments between the signatory countries and feature pre-establishment national treatment for third country investors with respect to services.

Iceland's system of **export credits** is in line with the EC Communication on short-term export credits as well as with the OECD arrangement.

Within the EEA framework, Iceland has a control scheme for exports of **dual-use goods** that reflects the relevant EU legislation. Iceland is not associated to the Kimberley process; therefore its legislation is not in line with the *acquis*.

Icelandic **development policy** is based on international conventions and takes well into account the UN Millennium Declaration as well as the Monterrey Consensus on Financing for Development and the Paris Declaration on Aid Effectiveness. About 60% of its assistance is concentrated on cooperation through the World Bank, Nordic cooperation and UN agencies. Bilateral aid is managed by the Icelandic International Development Agency (ICEIDA). In 2008, Icelandic official development assistance, as measured by the OECD methodology, has amounted to 0.43% of GNI, however due to financial crisis the estimated figure for 2009 is 0.31%.

Iceland accepts the principles of **humanitarian aid**, as defined by the EC Humanitarian Aid Regulation (No 1257/96), and the European Consensus on Humanitarian Aid. However, the Icelandic guidelines for humanitarian aid do not include a non-discrimination clause as enshrined in the Humanitarian Aid Regulation.

Conclusion

With regard to external relations, Iceland should be able to meet EU requirements upon accession. In order to smooth its preparation for membership, Iceland will need to ensure that its actions and commitments concerning international organisations are aligned and coordinated with those of the EU.

Chapter 31: Foreign, security and defence policy

The common foreign and security policy (CFSP) and European security and defence policy (ESDP) is based on legal acts, including legally binding international agreements, and on political documents. The *acquis* consists of political declarations, joint actions, common positions and agreements. Member States must be able to conduct political dialogue in the framework of the CFSP, to align with EU statements, to take part in EU actions and to apply agreed restrictive measures. Applicant countries are required to progressively align with EU statements, and to apply restrictive measures when and where required.

Iceland fully supports the efforts of the European Union to strengthen its role as a cohesive force in international relations and its ability to promote European interests and values on the international scene.

With regard to the **political dialogue**, Iceland has close political consultations with EU Member States on the basis of the 1995 Declaration of the EEA Council on Political Consultations. It has in most instances, when invited, aligned itself with EU statements, declarations and demarches. The Ministry of Foreign Affairs is in charge of general supervision and implementation of all aspects of foreign policy; it is responsible for and has a coordinating role regarding the CFSP and ESDP. The administrative structures are small, but adequate: Iceland has 26 diplomatic and consular missions; the Icelandic Foreign Service consists of 242 staff, 120 employed by the Ministry of Foreign Affairs.

Iceland has diplomatic relations with 186 countries. Its bilateral relations are without significant problems.

With regard to **restrictive measures**, Iceland has implemented all United Nations Security Council restrictive measures and economic sanctions and implemented most EU restrictive measures. However, Iceland has not aligned itself to the declaration on the arms embargo against China. Iceland has not implemented the Common Position on the application of specific measures to combat terrorism or the Joint Action concerning measures protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom.

In relation to **non-proliferation** and weapons of mass destruction / small arms and light weapons (WMD/SALW) strategy, Iceland participates in international export control regimes and instruments concerning the non-proliferation of weapons of mass destruction. It complies through national laws and control systems with international commitments on small arms and light weapons, including with the aims of the EU strategy on SALW. Iceland has no arms export industries.

With regard to **cooperation with international organisations**, Iceland is member of the UN, NATO, the OECD, the Council of Europe, the OSCE and many other international organisations and agreements. It participates actively in regional organisations involving the northern regions of Europe, including the Arctic Council, the Council of Baltic Sea States (CBSS) and the Barents Euro-Arctic Council (BEAC).

An EU-Iceland security agreement, which entered into force in March 2007, allows for the exchange of classified information. Iceland has equivalent security measures in place, which allow the secure handling of classified information under conditions equivalent to those established in the relevant Council security of information decision of 2001. Iceland's full

compliance, however, with all aspects of the **EU security requirements** is the subject of further analysis.

On **civil and military crisis management**, Iceland participates in international peacekeeping through a specialised Crisis Response Unit to recruit and train civilian personnel. In addition to UN missions, Iceland participated in the ESDP operations EUFOR Concordia (the former Yugoslav Republic of Macedonia) and EUPM (Bosnia and Herzegovina) and is considering providing personnel for EULex (Kosovo under UNSCR 1244/99). Iceland has no military of its own, but on the basis of the North Atlantic Treaty, Iceland and the United States concluded a bilateral defence agreement in 1951.

Conclusion

Iceland should be ready to fully and actively participate in the CFSP and the ESDP and be able to assume the obligations of membership in these areas.

Chapter 32: Financial control

The acquis on financial control relates to the following policy areas: public internal financial control (PIFC), which covers internationally agreed standards and EU good practices for implementation across the entire public sector, and external audit, which relates to the operational and financial independence of the external audit function (national audit office). While the management and control of EU funds is treated under the relevant other policy chapters (e.g. agriculture and rural development, regional policy and coordination of structural instruments, fisheries), this chapter covers the more general aspects of internal control and external audit of national funds.

This chapter also comprises the protection of EU financial interests, including administrative cooperation and the criminal-law protection of the EU's financial interests (PIF Convention and its protocols). Finally, the protection of the euro against counterfeiting deals with the first-pillar aspects of this issue.

In Iceland, the **PIFC** system is based on a 1995 government policy paper and there is no specific law on PIFC. Managers are responsible for the efficient use of public funds under their authority. Financial management and control concentrates on the legality and regularity of financial transactions. The system does not explicitly consider the triangle of economy, efficiency and effectiveness. The ministries do not have internal audit units; external expertise is consulted occasionally. Iceland has a body that can be considered a central harmonisation unit for internal control; however, its role is limited to the legislative sphere. Moreover, the Icelandic National Audit Office (INAO) advises government entities on strengthening internal control, which risks confusing the internal audit responsibilities of the government.

In the area of **external audit**, the INAO reports to the Icelandic parliament. The INAO is operationally independent, but this is not guaranteed in the constitution. The scope of its responsibilities remains limited to central state interests. No central government institution is responsible for the external audit of municipalities. The INAO is free to determine the scope of its activities but does not follow a strategic development plan. INAO activities relating to improving internal audit in the public sector could, under certain circumstances, conflict with its main role as external auditor.

As for the **protection of the EU's financial interests**, the Icelandic General Penal Code and the Criminal Procedure Code are broadly in line with the Convention on the Protection of the

EU's Financial Interests (PIF Convention) and its protocols. Individual provisions, such as the definitions of enrichment offences and the liability of company managers, remain to be aligned. Currently, no specific bodies are in place for the investigation and treatment of suspected fraud and other irregularities affecting EU or other international funds, nor have specific procedures been devised for cooperating with EC investigators.

Concerning the **protection of the euro** against counterfeiting, the legal framework appears to be well established as all responsibilities lie within competent authorities, the Central Bank and the National Police Commissioner. The police (National Police Commissioner and Metropolitan Police) are the competent authorities for dealing with counterfeit foreign currency. The administrative capacity for enforcing legislation with regard to foreign currency is to be monitored.

Conclusion

The Icelandic financial control system concentrates on budgetary and accounting controls. It does not provide a structured PIFC environment, as promoted under this area of the *acquis*. The INAO's independence is not anchored in the constitution and its remit is defined narrowly. Iceland's legislation is largely prepared for the protection of the EU's financial interests according to the PIF Convention and its protocols.

Iceland will need to undertake considerable efforts to strengthen its public internal financial control and external audit capacities.

Chapter 33: Financial and budgetary provisions

This chapter covers the rules concerning the financial resources necessary for the funding of the EU budget ('own resources'). These resources are made up mainly of contributions from Member States based on traditional own resources from customs duties and sugar levies, a resource based on value-added tax, and a resource based on the level of gross national income. Member States must have appropriate administrative capacity to adequately coordinate and ensure the correct calculation (including forecasts), accounting, collection, payment and control of own resources. The *acquis* in this area is directly binding and does not require transposition into national law.

The basic principles and institutions for the underlying policy areas affecting the own resources system are in place in Iceland. A national VAT system is in operation, customs duties are levied on imports, and national accounts and GNI are compiled based on ESA95 standards. The Ministry of Finance has overall responsibility for financial and budgetary issues.

As regards the operational management of the own resources system, Iceland will need to ensure in due course the human and administrative resources necessary to apply the EU rules concerning payments to the EU budget.

Impact

Given its size and GDP level, the impact of Iceland's accession on the EU budget is expected to be very limited. This applies both in terms of its likely receipts under the various EU expenditure programmes as well as its expected contribution to the EU budget based on application of the own resources rules.

Conclusion

There are no significant divergences between the systems in Iceland and the EU in terms of the basic principles and institutions in the policy areas underlying application of the own resources rules. Iceland should have no major difficulties in meeting the requirements of the own resources system.

3.2. General Evaluation

Iceland's ability to assume the 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 percentage for EU Member States. The total number of infringement proceedings¹⁷ against Iceland decreased significantly in recent months.

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: 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.

¹⁷ For cases concerning lack of conformity with or incorrect application of EEA provisions, as well as legislation not at all or not fully transposed.

Statistical Annex

STATISTICAL DATA (as of 1 February 2010) Iceland

Basic data

	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Population (thousand)		276	279	283	287	288	291	294	300	308	315
Total area of the country (km ²)		103 000	103 000	103 000	103 000	103 000	103 000	103 000	103 000	103 000	103 000

National accounts

	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Gross domestic product (GDP) (million national currency)		632 399	683 747	771 894	816 450	841 322	928 889	1 026 718	1 168 183	1 301 409	1 476 463
GDP (million euro)		8 194	9 421	8 830	9 474	9 709	10 660	13 124	13 311	14 851	10 265
GDP per capita (euro per capita)		29 600	33 500	31 000	32 900	33 600	36 400	44 400	43 700	47 700	32 100
GDP (in Purchasing Power Standards (PPS) per capita)		24800	25100	26200	26600	26000	28400	29300	29200	30200	30200
SI: GDP per capita (in PPS per capita, EU-27=100)		139.1	131.0	132.2	129.8	125.5	131.1	130.5	123.4	121.3	120.6
SI: Growth rate of GDP (national currency, at constant prices, % change on previous year)		4.1	4.3	3.9	0.1	2.4	7.7	7.5	4.3	5.6	1.3
SI: Employment growth (national accounts, % change on previous year)		:	:	:	:	:	:	:	:	:	:
Labour productivity growth: GDP growth per person employed (% change on previous year)		:	:	:	:	:	:	:	:	:	:
SI: Unit labour cost growth (national accounts, % change on previous year)		:	:	:	:	:	:	:	:	:	:
SI: Labour productivity (GDP in PPS per person employed, EU-27=100)		107.8	102.8	103.6	104.2	101.2	107.7	105.5	98.7f	96.3f	97.9f
Gross value added by main sectors (%)											
Agriculture and fishing	1)	9.7	9.0	9.2	9.3	7.9	6.8	6.2	6.4	5.7	6.1
Industry		17.9	17.3	19.2	16.8	15.8	15.2	13.7	14.8	13.9	15.8
Construction		8.0	8.6	7.8	7.5	7.5	8.8	10.4	11.2	11.9	10.5
Services		64.4	65.1	63.8	66.4	68.9	69.2	69.7	67.6	68.6	67.6
Final consumption expenditure, as a share of GDP (%)		82.9	84.0	79.8	80.2	83.3	82.2	84.0	82.6	82.1	78.4
Gross fixed capital formation, as a share of GDP (%)		21.8	22.9	21.5	18.2	20.0	23.5	28.4	34.0	28.2	24.2
Changes in inventories, as a share of GDP (%)		0.0	0.4	-0.3	0.0	-0.2	-0.1	-0.1	1.2	0.5	0.2
Exports of goods and services, relative to GDP (%)		33.6	33.6	38.8	37.4	34.3	34.1	31.7	32.3	34.8	44.6
Imports of goods and services, relative to GDP (%)		38.3	40.9	39.9	35.9	37.4	39.7	44.0	50.0	45.6	47.3

Industry

	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Industrial production volume index (2000=100)		:	:	:	:	:	:	:	:	:	:

Inflation rate

	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
SI: Annual average inflation rate (HICP), (total, % change on previous year)		2.1	4.4	6.6	5.3	1.4	2.3	1.4	4.6	3.6	12.8

Balance of payments	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Balance of payments: current account total (million euro)		-558	-957	-382	143	-465	-1 047	-2 119	-3 406	-2 166	-4 537
Balance of payments current account: trade balance (million euro)		-290	-516	-68	163	-183	-419	-1 190	-1 784	-1 004	-46
Balance of payments current account: net services (million euro)		-90	-160	-18	-10	-108	-168	-412	-547	-502	-194
Balance of payments current account: net income (million euro)		-168	-269	-285	-23	-160	-446	-495	-1 047	-616	-4 272
Balance of payments current account: net current transfers (million euro)		-9	-10	-11	14	-13	-14	-22	-28	-44	-24
of which government transfers (million euro)		-9	-11	-13	-10	-8	-15	-20	-23	-41	-27
Net foreign direct investment (FDI) (million euro)		-51	-241	-192	-254	-42	-1 486	-3 228	-1 017	-8 455	5 022
Foreign direct investment (FDI) abroad (million euro)	2)	-116	-427	-386	-347	-336	-2 079	-5 708	-4 238	-7 673	4 862
of which FDI of the reporting economy in EU-27 countries (million euro)		:	:	:	:	:	:	:	:	:	:
Foreign direct investment (FDI) in the reporting economy (million euro)		64	185	194	93	294	593	2 480	3 221	-782	160
of which FDI of EU-27 countries in the reporting economy (million euro)		:	:	:	:	:	:	:	:	:	:

Public finance	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
General government deficit/surplus, relative to GDP (%)		1.1	1.7	-0.7	-2.6	-2.8	0.0	4.9	6.3	5.4	-13.6
SI: General government debt, relative to GDP (%)		40.0	36.0	40.5	44.5	39.9	36.0	26.1	28.0	29.3	57.5

Financial indicators	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Gross foreign debt of the whole economy, relative to GDP (%)		74	99	110	101	120	159	262	420	515	858
Gross foreign debt of the whole economy, relative to total exports (%)		220	294	284	270	349	465	827	1301	1478	1924
Money supply: M1 (banknotes, coins, overnight deposits, million euro)		900	1 000	811	1 018	1 242	1 606	2 209	2 411	4 688	3 957
Money supply: M2 (M1 plus deposits with maturity up to two years, million euro)		1 771	1 814	1 672	1 854	2 183	2 778	3 886	4 137	7 399	6 938
Money supply: M3 (M2 plus marketable instruments, million euro)		3 479	4 113	3 922	4 586	5 358	6 126	8 405	8 958	14 040	11 609
Total credit by monetary financial institutions to residents (consolidated) (million euro)		5 188	8 278	7 737	8 061	9 484	13 108	21 996	27 752	36 308	33 277
Interest rates: day-to-day money rate, per annum (%)		11.1	13.5	13.1	6.5	5.1	7.6	9.3	16.2	14.0	18.3
Lending interest rate (one year), per annum (%)		10.0	12.4	12.0	8.2	7.7	10.3	12.0	15.3	15.3	22.0
Deposit interest rate (one year), per annum (%)		4.5	6.9	6.7	3.3	2.8	6.3	9.0	12.8	13.3	15.0
Euro exchange rates: average of period - 1 euro = ... national currency	3)	77.180	72.580	87.420	86.180	86.650	87.140	78.230	87.760	87.630	143.830
Effective exchange rate index (2000=100)		:	115.4	135.0	120.6	121.4	111.9	102.7	128.0	120.2	216.4
Value of reserve assets (including gold) (million euro)		464	472	418	432	671	752	860	1 913	1 858	2 994

External trade	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Value of imports: all goods, all partners (million euro)		2 363	2 798	2 525	2 406	2 498	2 988	4 024	4 788	4 881	4 152
Value of exports: all goods, all partners (million euro)		1 878	2 044	2 246	2 359	2 111	2 322	2 487	2 758	3 479	3 650
Trade balance: all goods, all partners (million euro)		-485	-754	-278	-47	-387	-666	-1 537	-2 030	-1 403	-502
Terms of trade (export price index / import price index, 2000=100)		104.6	100.0	102.5	103.7	97.2	95.1	94.7	101.2	101.0	94.8
Share of exports to EU-27 countries in value of total exports (%)		65.2	68.7	70.0	72.6	73.7	75.2	74.7	71.0	74.7	75.9
Share of imports from EU-27 countries in value of total imports (%)		58.8	60.7	59.0	58.2	63.0	59.8	61.4	56.9	59.1	53.5

Demography	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Natural growth rate: natural change (births minus deaths) (per 1000 inhabitants)		7.9	8.8	8.3	7.7	8.0	8.3	8.2	8.3	8.4	9.0
Infant mortality rate: deaths of children under one year of age per 1000 live births		2.4	3.0	2.7	2.2	2.4	2.8	2.3	1.4	2.0	2.5
Life expectancy at birth: male (years)		77.4	77.9	78.3	78.5	79.5	78.9	80.2	79.4	79.6	80.0
Life expectancy at birth: female (years)		81.4	81.5	82.9	82.3	82.3	82.8	83.3	83.0	83.4	83.3

Labour market	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Economic activity rate (15-64): share of population aged 15-64 that is economically active (%)		87.9	88.6	88.5	87.5	86.9	85.4	86.7	87.8	87.8	86.9
SI: Employment rate (15-64): share of population aged 15-64 that is in employment (%)		86.3	86.6	86.5	84.7	84.0	82.8	84.4	85.2	85.7	84.2
Share of male population aged 15-64 that is in employment (%)		90.3	90.2	89.9	87.7	86.7	86.1	87.4	88.6	89.5	87.8
Share of female population aged 15-64 that is in employment (%)		82.1	82.8	82.9	81.6	81.2	79.4	81.2	81.6	81.7	80.3
SI: Employment rate of older workers (55-64): share of population aged 55-64 that is in employment (%)		85.9	84.2	85.6	87.2	83.2	82.0	84.8	84.4	84.9	83.3
Employment by main sectors (%)											
Agriculture and fishing		8.8	8.0	7.2	7.3	6.6	6.0	6.5	6.7	5.8	4.7
Industry		16.3	16.0	15.7	14.7	15.2	15.4	14.2	12.3	11.7	12.2
Construction		6.8	6.7	7.2	8.0	7.3	7.4	7.7	8.6	9.4	9.9
Services		68.0	69.3	69.9	70.0	70.9	71.1	71.6	72.4	73.1	73.3
SI: Unemployment rate: share of labour force that is unemployed (%)		2.0	2.3	2.3	3.3	3.4	3.1	2.6	2.9	2.3	3.0
Share of male labour force that is unemployed (%)		1.5	1.8	2.0	3.6	3.6	3.2	2.6	2.7	2.3	3.3
Share of female labour force that is unemployed (%)		2.6	2.9	2.5	2.9	3.1	2.9	2.6	3.1	2.3	2.6
Unemployment rate of persons < 25 years: share of labour force aged <25 that is unemployed (%)		4.4	4.7	4.8	7.2	8.3	8.1	7.2	8.2	7.2	8.2
SI: Long-term unemployment rate: share of labour force that is long-term unemployed (%)		0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.1
Social cohesion	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Average nominal monthly wages and salaries (national currency)		207 000	225 000	249 000	266 000	284 000	301 000	336 000	377 000	414 000	446 000
Index of real wages and salaries (index of nominal wages and salaries divided by the CPI) (2000=100)		96.6	100.0	103.7	105.7	110.6	113.5	121.8	128.0	133.8	128.3
SI: Early school-leavers: share of population aged 18-24 having not completed upper secondary education and not currently in education or training (%)		:	29.8	30.9	28.8	20.3	24.9	24.9	25.6	23.2	24.4
Standard of living	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Number of passenger cars per 1000 population		547.7	569.8	564.7	566.5	580.2	603.6	631.4	647.5	668.4	662.1
Number of subscriptions to cellular mobile telephone services per 1000 population		580.6	758.4	865.9	903.7	962.5	992.5	1013.7	1049.3	1045.5	1073.1
Infrastructure	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Density of railway network (lines in operation, per 1000 km ²)		:	:	:	:	:	:	:	:	:	:
Length of motorways (thousand km)		0.009	0.011	0.011	0.011	0.011	0.019	0.019	0.019	0.019	0.041
Innovation and research	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
SI: Spending on human resources (public expenditure on education) relative to GDP (%)		6.6	6.7	7.0	7.6	7.6	7.5	7.6	7.6	7.4	7.6
SI: Gross domestic expenditure on research & development, relative to GDP (%)		2.3	2.7	3.0	3.0	2.8	:	2.8	3.0	2.7	2.7
SI: Percentage of households who have Internet access at home (%)		:	:	:	78	78	81	84	83	84	88
Environment	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
SI: Greenhouse gas emissions, CO2 equivalent (1990=100)		111.1	109.5	109.1	109.3	109.0	109.9	108.8	124.2	:	:
SI: Energy intensity of the economy (kg of oil equivalent per 1000 euro GDP)		341.0	343.4	342.6	345.5	336.5	322.8	311.3	358.5	:	:
SI: Share of renewable energy in electricity consumption (%)		99.9	99.9	100.0	99.9	99.9	99.9	99.9	100.0	100.0	100.0
SI: Road share of inland freight transport (modal split) (% of tonne-km)		100	100	100	100	100	100	100	100	100	:

Energy

	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Primary production of all energy products (thousand TOE)		2 191	2 306	2 451	2 462	2 457	2 519	2 636	3 259	3 946	4 397
Primary production of crude oil (thousand TOE)		0	0	0	0	0	0	0	0	0	0
Primary production of hard coal and lignite (thousand TOE)		0	0	0	0	0	0	0	0	0	0
Primary production of natural gas (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Net imports of all energy products (thousand TOE)		972	1 036	947	969	937	1 072	1 063	1 099	1 070	976
Gross inland energy consumption (thousand TOE)		3 079	3 235	3 354	3 388	3 379	3 489	3 616	4 349	5 016	5 374
Electricity generation (thousand GWh)		7 188	7 684	8 033	8 416	8 500	8 623	8 686	9 930	11 976	16 468

Agriculture

	Note	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Agricultural production volume index of goods and services (producer prices, previous year=100)		:	:	:	:	:	:	:	:	:	:
Total utilised agricultural area (thousand hectare)	e	120	120	120	120	120	120	120	120	120	120
Livestock: cattle (thousand heads, end of period)		75	73	70	67	66	65	66	69	71	72
Livestock: pigs (thousand heads, end of period)		4	4	5	4	4	4	4	4	4	4
Livestock: sheep and goats (thousand heads, end of period)		491	466	474	470	463	456	455	456	455	459
Production and utilisation of milk on the farm (total whole milk, thousand tonnes)		107	104	106	111	108	112	109	118	126	126
Crop production: cereals (including rice) (thousand tonnes, harvested production)		2	3	4	5	7	10	10	11	11	15
Crop production: sugar beet (thousand tonnes, harvested production)		:	:	:	:	:	:	:	:	:	:
Crop production: vegetables (thousand tonnes, harvested production)		13	14	16	14	12	12	12	20	19	19

SI = Structural Indicator

: = not available

e = estimate

f = forecast

- Fishing (predominantly marine fishing) represents between 80% (in 1999) and 77% (in 2008) of this share.
- Using the balance of payments sign convention, a negative value for FDI abroad means investment abroad by the reporting country whereas a positive value means de-investment.
- Average annual exchange rate as published by the European Central Bank. This rate is very close to the rate published by the Central Bank of Iceland for all years except 2008. For 2008, as a result of the financial crisis which lead to high exchange rate volatility and very narrow markets for the Icelandic Krona, the average annual rate published by the Central Bank of Iceland (127.46 ISK for 1 EUR) differs by more than 10% from the ECB rate