SHOULD ICELAND JOIN THE EUROPEAN UNION?

by

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ABBREVIATIONS

CAP	*Common Agricultural Policy*
CFP	*Common Fishery Policy*
CFSP	*Common Foreign and Security Policy*
CPI	*Consumer Price Index*
EC	*European Community*
ECB	*European Central Bank*
ECJ	*European Court of Justice*
ECSC	*European Coal and Steel Community*
EFTA	*European Free Trade Area*
EMU	*Economic and Monetary Union*
EUR	*Euro Currency*
Euratom	*European Atomic Energy Community*
FOB	*Free on Board*
GDP	*Gross Domestic Product*
HDI	*Human Development Index*
ITQ	*Individually Transferable Quotas*
JHA	*Justice and Home Affairs*
LFA	*Least Favourite Area*
NATO	*North Atlantic Treaty Organization*
OECD	*Organization for Economic Cooperation and Development*
PPP	*Purchasing Power Parity*
QMV	*Qualified Majority Voting*
TAC	*Total Allowance Catch*
WTO	*World Trade Organization*

ABSTRACT

There are many benefits and costs for Iceland associated with a full membership to the European Union (EU). This is so because the country is currently a member of the inner European market through the European Economic Area agreement (EEA). It is, therefore, already enjoying most of the benefits a full membership has to offer. This work focuses on six areas of importance when contemplating whether Iceland should change its EU relations to full EU membership. They are how Iceland's fisheries, agriculture, sovereignty and economy will be affected along with how much the country would have to contribute financially to the EU as a member and finally how desirable EU's future is for Iceland. By examining other countries' experiences, the costs currently out-weigh the benefits were the country to join the EU. The conclusion is, therefore, that Iceland should not join the EU, continue to rely on the EEA agreement to secure its EU relations and keep a close eye on EU's development without ruling out future membership.

Chapter 1. - Introduction

1. INTRODUCTION

While all European countries seem to be rushing to become fully fledged members of the European Union (EU), Iceland has not even had a referendum. Yet as a small island country, with less than 300 thousand citizens, Iceland has been forced to rely strongly on trade and good relations with its neighbours. By being open to trade, Iceland has flourished in recent decades and provided living standards far higher than the European average. Does Iceland thus need an EU membership if the prevailing mentality in Iceland, as The Economist recently stated is "*being better than Europe?*"[1] This question is far from obvious and there are both pros and cons associated with full EU membership. By evaluating the costs and benefits it is the objective here to conclude how desirable full EU membership is for Iceland.

The EU is extremely important to Iceland culturally, geographically and historically but most importantly economically, since more than 70% of Iceland's exports go to the EU[2]. Obviously, good relations are crucial. Even though Iceland has decided to stay outside the EU it has access to the European market. Since 1994 it has been a member of the free-trade zone with the EU called the European Economic Area (EEA)[a]. The EEA agreement gave Iceland free mobility of labour, capital, products and services (a.k.a. the Four Freedoms) on the European market. These Four Freedoms however excluded agriculture and fisheries. Iceland's Prime Minister, Mr. Oddsson, accordingly argued that the EEA contract gave Iceland everything it wants from Europe and excludes everything it does not want[3]. While the full truth of the

[a] All EU members including Norway, Iceland and Lichtenstein are members of the European Economic Area (EEA). For simplicity, the EEA will from now on stand for the EFTA/EEA countries only: Norway, Iceland and Lichtenstein. The EU, on the other hand, will be used when referring to the 15 full members: Spain, Germany, Italy, France, Belgium, The Netherlands, Sweden, UK, Denmark, Ireland, Portugal, Greece, Austria, Luxemburg and Finland.

Prime Minister's words may be debatable it is nonetheless clear that through the EEA agreement Iceland has enjoyed many of the fruits a full EU membership offers, but with many limitations too.

The EU is an international cooperation which has been developing extensively since 1951. However, it did not get the name EU until 1992. Its core goal has always been economic cooperation designed to foster free trade between member nations. This cooperation has today expanded into many new areas, for example judicial, social and environmental. The EU is not a state, sovereignty is still in the hands of its 15 member nations, although some of their decision making powers are given to EU's supra-national institutions. In 1992 the European common market was completed when the so called Four Freedoms came into existence. In 2001 the EU took the final step from a common market to an economic union when EU's member nations adopted the common European currency, the Euro (three members decided not to adopt it). With this step the common market was completed. This made currency risks and transaction costs disappear when doing business within the EU market. The idea is that no country should be able to discriminate against other EU countries. In simple terms, a business man in Spain should be able to do business just as easily in France and enjoy all the same benefits as Frenchmen. Since the Euro was adopted the Spaniard could even use his own currency in France.

With increasing globalization, the world is changing and both Iceland and the EU with it. This makes the topic of this thesis a very important one for Iceland. Since the EEA agreement was signed in 1994 most of its founding members have left the EEA to become full EU members. In fact only Iceland, Norway and Lichtenstein are in the EEA today which makes it a far less important agreement for the EU, a conclusion it has not been hiding. In recent negotiations with EEA countries, the EU has shown no interest in developing the contract any further. So the alternative to joining the EU is sticking with the status-quo.

Being a native Icelander, this topic is of great interest to me, especially where EU membership seems to be a top priority on almost every European country's wish list. What makes Iceland so different? There are many areas of importance when contemplating whether the country should become a member of the European Union. The areas are too many to cover in this work so the focus will therefore be on the six most important issues for Iceland. They are how Iceland's agriculture, fisheries, economy and sovereignty will be affected, how much the country will have to contribute financially to the EU and finally how Iceland fits into EU's potential future.

The famous economist, John Kenneth Gailbraith once said: "*There are two kinds of forcasters, those who don't know, and those who don't know they don't know*"[4]. The objective of this thesis is to measure all the measurable issues that will affect Iceland were it to join, but without falling into Gailbraith's second group. The reason why this is important is because so many costs are unknown and will remain unknown unless Iceland actually starts membership negotiations with the EU. The best measurement is therefore to try to learn from other countries′ experiences with the EU and make predictions based on them. The research for this thesis consists of an extensive literature review on Iceland and the EU. Historical data, media interviews, books and journal articles will be exploited from a variety of sources. Based on the six issues examined in this thesis, a conclusion will be made on how desirable membership is for the country.

This thesis is structured into 6 chapters. Chapter 2 will give an overview of the European Union: what it is, its evolution, and its institutions are explained along with some of its policies and cooperation areas which are important to Iceland. The chapter then finally gives a brief explanation of the EEA agreement which Iceland currently has with the EU. Chapter 3 will present the standard arguments for customs unions of which the EU is a type, which are followed by chapter 4 which gives an overview of Iceland's economy, society and political structure. In chapter 5 the costs and benefits facing Iceland were it to join the EU are discussed and valued. The focus will be on the six areas mentioned earlier, and how they will affect the country were it to become a member. The final chapter, chapter 6, will summarize this thesis' findings and conclude whether Iceland should consider EU membership or stick to the status-quo.

NOTES

[1] *The Economist*, "Survey: Nordic Region – A Midsummer night's Dream", June 14, 2003.

[2] Central Bank 2003, 25

[3] Oddsson, David, Talk at Iceland's Chamber of Commerce, June 10th 2002, Available on the World Wide Web @ http://forsaetisraduneyti.is/interpro/for/for.nsf/pages/raeda0021, (Accessed October 10th, 2003)

[4] Gissurarson 1997, 122

Chapter 2. – The European Union

2. THE EUROPEAN UNION

To be able to understand the choices Iceland faces it is necessary to understand both the EU and the current relationship that the country has with the union. This chapter begins by discussing what the EU is. To understand the EU and how it works, a special focus will be on its major bodies, the common market and the Euro and finally the common agricultural and fishery policies. Following the explanation of the EU is a discussion about its evolution; how it has been changing through the years and finally Iceland's current contract with the EU, the EEA agreement, will be discussed,.

2.1 What is the EU

The EU is a common market among fifteen countries in Western Europe; twelve of its members have extended their relations to an economic union. In the beginning, the co-operation focused only on trade and economics but today the EU deals with many other issues, e.g. social and environmental issues, agriculture, regional development, research and development, home and foreign affairs, citizens' rights, consumer protection, transportation, health and education and cultural issues[5]. It is dedicated to increasing economic integration and strengthening cooperation among the member nations. All obstacles to free movement of goods, capital, labour and services between member nations have been abolished. This has been done by harmonizing rules and regulations along with removing border control and custom duties. The 15 EU member nations are: Ireland, United Kingdom, France, Portugal, Spain, Italy, Greece, Austria, Belgium, Luxembourg, Germany, The Netherlands, Denmark, Sweden and Finland. EU's size will increase by 10 more countries on May

1st 2004. Then Estonia, Latvia Lithuania, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Malta and Cyprus will become members.

The EU is more than just collaboration between countries, it is also an entity by itself. Sovereignty is still in the hands of member nations even though they have, by joining EU, given up some of their decision making powers to the EU's supra-national institutions. Academics have had a hard time defining the EU but it is somewhere between being an international institution and a federation. The EU is structured on three pillars. The first pillar is the European Community (EC). The EC has the supra-national functions and EU's governing institutions. Decisions in the first pillar are made by a majority vote and the decisions are binding for all member nations. The other two pillars are based on inter-governmental cooperation and cannot be enforced. They are Common Foreign and Security Policy (CFSP) and Justice and Home Affairs (JHA). The cooperation in the JHA pillar has been so successful that some of its areas now fall under EU's supra-national institutions (e.g. the Schengen agreement which gives passport and identity card free travel between the Union's member nations). The CFSP pillar, on the other hand, has not been as successful as was seen in the war with Iraq in 2003 where the EU nations were unable to agree on a common policy.

It has been very controversial whether to embrace more of JHA and CFSP pillars in the supra-national part of the Union which crystallizes EU's biggest past, present and future challenge. The challenge is its objective to deepen the relationship without member countries losing much more sovereignty. There are two opposite forces in the EU, one trying to deepen the relationship further into a federation and the other one trying to keep the status-quo and even reduce the number of co-operation areas.

The following five sections discuss areas in the EU important for Iceland, were it to join. First the administrative body is briefly explained, then the European market, the Euro, and finally the common agricultural and fishery policy.

2.1.1 Major Bodies

European Council

The European Council is the highest governing body of the EU. It consists of the member nations' heads of state (or government) and the President of the European Commission. The European Council meets four times a year and sometimes occasionally with short notice to settle any critical issues that may come up. The European Council's objective is to form the EU's future political agenda and take important political decisions along with working out critical disputes inside the Union. It is the highest level policy making body in the EU and oversees all three pillars. All its decisions are made by a unanimous vote and its meetings are called summits.

Council of the European Union

The Council of the European Union (Council) is EU's primary decision making body and, after the European Council, it is the highest governing body. When the Council meets, ministers from all member nations attend. Each nation sends the minister most familiar with the topic to be discussed, for example if the topic is agriculture they would send the Ministers of Agriculture. Every nation has one seat in the Council but they have a different numbers of votes based mainly on their population size (see Appendix A). The Council's responsibilities are to[6]: pass EU law but in many cases jointly with the European Parliament; manage the economic policies of EU members; conclude international agreements between the EU and international organizations; jointly with the European Parliament approve the EU's budget; develop the CFSP (second pillar) based on the European Council's guidelines; and finally, it co-ordinates members' national courts and polices in criminal matters (third pillar, JHA). Member nations take turns on being the president of the Council, each nation for six months at a time. The president leads the Council's cooperation, defines the agenda, and chairs the Council's meetings. This gives every member nation a chance to represent the Union to the outside world but not without problems. The president is supposed to reflect the consensus within the Union but in reality, this is not always the case. On many occasions countries have used the presidency to push their own country's agenda and made statements which have been regarded as EU's, but have in fact been only that of the country which made the statement[7].

Decision making in the council is done in three ways. The first method is by qualified majority voting (QMV), through which, for example, all decisions regarding the common market are taken. When the Council makes a decision with QMV it needs 62 out of 87 votes. Starting in November 1st, 2004 a qualified majority will require a minimum of 232 out of 321 votes. A country can in addition ask for a confirmation that the votes in favour represent at least 62% of the Union's total population. In some areas however, for example in the CFSP and JHA pillars, a unanimous vote is still needed.

European Commission

The European Commission's main objective is to ensure that the internal market is functioning and to protect EU's interests in and outside the Union. In simple terms it oversees all the daily managements of the EU. The Commission is the only institution that has the right to introduce new legislation which the Council of the European Union and the Parliament then debates (see Appendix C). It also manages and implements the Union's budget and policies. The Commission's third responsibility is to enforce EU laws through the Court of Justice and finally to represent the EU on the international stage. The Commission acts as EU's government by representing the member nations when negotiating about trade, agriculture and fisheries with other non-EU nations and institutions. In the Treaty of Nice it was decided that each nation will appoint one Commissioner after the expansion of the EU in 2004. Until the expansion, five of the largest member nations have two Commissioners but the other ten only one. The Council of the European Union appoints the president of the Commission but the president and the Council jointly decide who directs the other 19 executive positions. The executives' work is similar to cabinet ministers' in a government where each one oversees one area.

The Commission has been criticized extensively for the lack of democratic accountability. This is because the Commissioners are appointed by member governments but not elected democratically. That has lead to many speculations about Commissioners being biased towards their home country's best interest, rather than the Union as a whole. This is the main rationale for the so called democratic deficit within the EU.

European Parliament

The European Parliament shares the legislative power with the Council of the European Union. The power it has depends on the area in question but it is very marginal. It has the power to suggest changes to legislations and in some cases it can veto them but it does not have the authority to initiate new law. However, the

Parliament has to both approve EU's budget and new European Commissioners. The Parliament's objective is also to give EU institutions and especially the Commission a democratic supervision. It has the power to approve or reject the nomination of Commissioners. It also has the right to censure all the Commissioners if it sees the need. Today there are 626 seats in the Parliament but this number will increase to 732 after the new EU members join in 2004. Every member nation gets parliament seats according to, mainly, its population size and every country has their own democratic election to choose the candidates to fill their designated seats. The fly in the ointment is, however, that participation in these elections has been very low (39.4% on average in 1999[8]). Even in a recent survey in France, 2/3 of the population said they were not interested in the coming EU Parliamentary election in 2004[9]. This has caused the EU much concern and further contributes to talks of democratic deficits.

European Court of Justice

The European Court of Justice (ECJ) is the judicial arm of the European Union. It adjudicates whether member nations are working according to EU's laws and regulations. It judges in disputes between member nations, EU's institutions and member nations, and finally between individuals and the EU. In ECJ there are 15 judges, one from each member country. The court is responsible for the first pillar (EC) and has gained some competence in the Justice and Home Affair pillar. After the EU expansion in 2004, there will only be 13 judges needed in the Grand Chamber down from 15 before.

2.1.2 Common Market and Euro

The Common European Market is the most important part of the European Union and is the foundation for all European cooperation. The goal is for trade within the European market to be as free and easy as within each member nation. This objective crystallizes in one of EU's fundamental policies, that member countries cannot discriminate between member nations' citizens. To make this happen, member nations had to adopt hundreds of EU's laws and regulations, called Acquis Communautaire, and remove technical, regulatory, legal, bureaucratic, cultural and protectionist barriers that prevented free trade and movement inside the EU area[10]. Member nations also have to adopt EU's trade agreements with non-EU members and institutions and transfer all trade negotiation rights to EU's supra-national institutions.

With the Maastricht Treaty in 1994 the European common market was complete with free mobility of capital, labour, products and services between member nations. With the treaty the European Community became the European Union and the common market was complete. The common market is made of 18 nations (15 in the EU and 3 in EEA) with a total of 380 million people which is the biggest common market in the world. On May 1st 2004, this number will increase when ten new members join the Union. The common market will then have over 460 million citizens.

EU member nations benefit richly from having such a huge domestic market. Salvatore (2004) argues that inter-EU trade (trade within the EU market) is double the amount it would be without the EU's close integration[11]. Salvatore also states that static welfare benefits from the integration are estimated to be between 1-2 percent of GDP[12] but the dynamic benefits are around 5.3 percent of EU's GDP[13]. With specialization, countries can enjoy economies of scale, increased competition, stimulus to investments and much better resource allocation. A nation's productivity will thus get a boost by joining the Union, which leads to higher standards of living. According to the European Commission, the single market has created 2.5 million new jobs since 1993 and brought down prices on, for example, telephone calls by 50% (since 1998) and airfares by 41% (between 1992-2000)[14]. In addition, the benefits lie in the fact that the EU, which constitutes the largest single market in the world, is bound to get a better "deal" when making trade agreements with non-EU nations or institutions than a single member would ever be able to.

On January 1st 2002 after more than ten years of preparation, the single European currency, Euro, finally took over as the national currency of EU member nations. Three countries decided not to be a part of the Economic & Monetary Union (EMU): United Kingdom, Sweden and Denmark. The goal of the EMU is to increase stability and better the conditions for stable economic growth in Europe. With the Euro, transaction costs were reduced between member countries and price comparison between countries made easier. A tourist can now easily use the change from buying an opera ticket in Italy to pay for a dinner in Spain and use the cash he took out of an ATM in Greece to pay for a beer in Germany. It is estimated that transaction costs in inter-EU trade before the Euro were about 0.4 percent of GDP[15]. After member nations adopted the Euro, they adopted the collective monetary and exchange rate policy, controlled by the European Central Bank (ECB).

The Treaty of Maastricht established the condition that needed to be met before a country could become a member of the EMU. They are that inflation cannot exceed the average inflation in the three EMU countries with the lowest inflation, by more than 1.5%. Government debts cannot exceed 60% of GDP. Nominal interest rates on government bonds (10 years) cannot exceed the average nominal interest rates on the same bonds in the three EMU countries with the lowest inflation. Exchange Rate fluctuations can not deviate by more than +/- 15% in relation to the Euro for 2 years. Government deficit cannot exceed 3% of GDP (except under special circumstances.) Further an independent central bank is required[16].

The European Central Bank supervises the Union's monetary policy with an inflation target for the whole Union. By giving away control over their national monetary policy, member nations have to rely on fiscal policy (which is also limited by the EMU) to react to asymmetric economic shocks, not experienced by other member nations.

For countries inside the Union the lower transaction cost increases inter-EU trade and investments. Trade within the Union will increase which might be at the expense of trade with non-EU members. With the same currency, the exchange rate risk between member nations is gone so interest rates will become relatively lower in countries that before had high exchange rates fluctuations.

When EU's members have adopted the Euro they are disciplined by EU's Stability and Growth pact. Its objective is to ensure that the economic development in the member nations remain synchronized. It requires member states to keep their budget deficits, public debt and inflation under control, which also limits the capabilities to use fiscal policy to confront economic shocks.

2.1.3 Common Fishery Policy (CFP)

When countries become members of the EU, they give away their fisheries' management to EU's supra-national institutions. CFP is based on a Total Allowance Catch (TAC) quota system. CFP has the objective to ensure sustainable exploitation of the fish stocks, maximize the fishing industry's profit, ensure supply of good seafood for EU's consumers, respectable salaries for those working in the industry and finally to protect the environment[17]. The CFP is based on the fundamental fact that fish do not respect national legal jurisdictions and many EU member countries share the same fish stocks. It is also recognized that one country's decision on processing and accommodating the fisheries will affect other countries. It is thus in each member nation's best interest for the group to collectively control the fishing grounds and the industry's regulations.

Price setting on marine products within the Union is not free. The Council sets a guiding price every year for the whole Union. This is based on the average price of the product for the last three years and market stability. The Council also sets a withdrawal price. If the market price falls below this withdrawal price, the Union takes the products off the market and the company, or individual, involved is compensated until the price increases again[18].

The principle of Relative Stability is used to distribute EU's quotas between member nations. When a country goes into membership negotiations the Union sets the time period to use for the principle. Let's say the Union would decide using the years 1992-96 for an applicant country. If the country would then become a member, EU nations that caught fish in its waters during that time would, according to the Relative Stability principle, keep the same amount of quota in the future. It is the Council of the European Union that makes the final decision on EU's TAC for one year at a time which is then distributed between member nations according to the Relative Stability. The Council bases its decision on recommendations from the Commission which in turn, bases its opinion on scientists which examine the conditions of the fishing grounds.

Quota hopping is a phenomenon which fishing nations have been very worried about. It is when a company in a country buys a ship to get another country's quota.

Because of the Union's rule that it is illegal to discriminate against people with different EU nationalities, this was a real problem. In a dispute between Britain and Spain, where Spaniards had been quota hopping in the British market, EU gave Britain permission to exercise certain restrictions on investments in their fisheries. The result was that ships have to fulfill one of the following criteria to be allowed to get British quota: at least half the catch has to be landed in a British port, the majority of the crew has to be British or show economical ties by other means, for example a mix of the above conditions[19].

Fisheries have a small economic importance for the EU compared to other industries though it is the biggest market for marine products and the third fishing power in the world. EU's total catch in 2001 was 6,673,000 tons compared to Iceland's 1,718,136[20]. About 1% of EU's total budget goes to the CFP (about 0.011% of each member nation's GDP). The budget has mostly been used to help areas which have been hurt by contraction in the fishing industry, and some to amortize and renew vessels. A portion of the budget has also been used for contracts with non-EU countries, research and surveillance along with special marketing projects for marine products.

Though its objectives seem very reasonable, the CFP has been far from successful. For example TAC decisions have, through the years, been based on horse-trading between countries which have totally ignored scientific recommendation. This has lead to extreme overexploitation[21]. Scientists estimate that the cod stock has fallen by 60% over the last 20 years, and, because of extensive EU grants, the fishing fleet is now twice the size that the fishing stocks can sustain[22]. Because of this awful situation, the CFP was changed in the beginning of 2003. With the changes, the budget for building new ships was taken and used for the reformation of the industry.

People will also be assisted to go out of the industry and be given the chance to stop working earlier. Others will be helped to get jobs in new areas. Fishing grounds surveillance has also been increased and collective punishments for illegal fishing in all member countries established. A new multi national surveillance team now monitors the fishing grounds with a new satellite technology and a long term goal is set which is used when determining the annual TAC. Finally, interest groups will also have better access to influence the CFP in the so called Regional Advisory Councils.

2.1.4 Common Agricultural Policy (CAP)

Though agriculture is only 2.4% of EU's GDP and 6.5% of its workforce is in the field, it takes half of its total budget[23]. Its goal is to ensure acceptable income for farmers and to ensure steady supply of healthy agricultural products at good prices. EU's CAP is based on two pillars which the following objectives.

Guidance	*Guarantee*
✓ Further environmentally friendly farming within the union ✓ Give support to areas in which farming is harsh ✓ Support logging ✓ Support occupational education ✓ Support young farmers ✓ Provide assistance for investments and development	✓ Control prices on agricultural products ✓ Provides production support ✓ Manages production within the Union ✓ Manages trade with non-members

There is free trade with agricultural products inside the EU but collective barriers towards non-EU nations. The trade within the EU, however, is far from being totally free because the Council of the European Union decides every year the prices on most agricultural products. If the market prices are lower, EU cuts in and gives financial support to farmers so they can store overproduction. These stocks can then be released to the market when the prices have risen above the target level. The EU sets tariffs on imports to ensure their prices do not under-cut domestic prices. It also gives export subsidies. Subsidies are also given to improve production, develop new products and make the production more environmentally friendly. Farmers in areas where farming conditions are harsh and agree to reduce production or leave the industry, are also given special support.

In recent years there have been moves towards reforming the CAP mainly for two reasons. the enlargement of the EU in 2004 and the on-going trade negotiations with the World Trade Organization.

The reforms promote cutbacks on subsidies by cutting the link between production and direct payments which make farmers make decisions based on market demand and not EU's hand outs. It also makes these payments conditional on environmental, food safety, animal welfare and occupational safety standards. The reforms substantially increase EU's support for rural development as well, by changing the direct payments farmers get (with the exception of small farmers).

Without reforming CAP dramatically, the cost of the program would explode when the ten new member countries join in May 2004. For that reason EU's Ministers of Agriculture decided to limit the CAP spending to 2006's level until 2013 (with a 1% correction for inflation). That will keep CAP's expenditures down and force member countries to adjust their agriculture accordingly. These reforms make the CAP much more consumer oriented than it was before. Little has been accomplished, though, in opening up the EU market for increased agricultural trade with third world nations. This is bound to force EU to reform CAP again in the near future because of the increasing pressure to liberalize trade between developed and developing countries.

2.2 EU's Evolution and Future

Famous are the words of France's former foreign minister Robert Schuman who remarked in 1950: *"After two world wars we have come to realize that the best guarantee for nations no longer lies in our splendid isolation, nor in our own strength, no matter how powerful we are, but in solidarity between nations, guided by the same spirit and ready to carry out common tasks, in the common interest."*[24] His view (and many others at the time) was that the only way to prevent future wars between the war-torn nations of Europe was to bind them together economically using supra-national institutions. In 1951, Schuman's vision became a reality and the European Community for Steel and Coal (ECSC) was established. Six nations were the founding members: France, W-Germany, Belgium, Holland, Luxemburg and Italy. The ECSC eliminated all tariffs and quotas within the community on iron ore, coal, coke and steel. It also established a common external tariff on non-community members. Several supra-national institutions were established to supervise the community.

In 1957 the ESCS members signed two more treaties in Rome, the European Atomic Energy Community (Euratom) and the European Economic Community (EEC). Euratom was established to ensure peaceful use of atomic energy. The EEC on the other hand provided for a gradual elimination of quotas and import duties on all trade between member nations and set the groundwork to make future community decisions based on majority votes instead of unanimous. With EEC, member nations also agreed to adopt some common policies in transportation, agriculture, social insurance and free mobility of people and funds within the community.

The EEC, ECSC and Euratom merged in the European Community (EC) in 1968 and then gradually all tariffs were eliminated. De Gaulle, France's Prime Minister at the time, vetoed all new membership applications so no progress was made in enlargement until after he resigned in 1969. In 1973 the UK (after having its application vetoed twice by France), Ireland and Denmark joined the community but in a referendum in Norway, a membership was rejected the same year. Greece also became a member of EC in 1981 and Spain and Portugal in 1986.

In 1987 the next step to a closer integration was taken with the Single European Act (SEC). Its main goal was to remove all physical, technical and fiscal barriers in order to establish a single European market. In certain areas it was also accepted to use qualified majority voting, which means about 2/3 have to be in favour for a decision to be made inside the community. There were also new areas added to the cooperation like research, social and environmental issues and a goal was set to finish the inner market by 1992.

The EU's Declaration of Fundamental Rights and Freedoms was ratified in 1989. It acknowledged that with the economic freedom in the community it was necessary to ensure basic citizen's rights. After the Berlin Wall fell, East-Germany became a member when it was combined with West-Germany in 1990. That marked the beginning of EC's expansion into Eastern Europe.

The Treaty of Maastricht (a.k.a. Treaty of the European Union) was ratified in 1992 which changed the EC into the European Union (EU). With it, political, social and economical integration was extended and the goal to adopt a single currency (EMU) in 1999 was set. The supra-national institutions were extended to cover environmental issues, education, health and consumer protection. With the treaty, inter-governmental cooperation was also extended to judicial and police and foreign and security matters. There was fierce opposition and worries about the treaty among EU citizens. French voters accepted the treaty by a slim majority in a referendum; Danish voters rejected it and the British government as well. After getting opts-out from any future common defence policy and the EMU, Danish voters approved the treaty. Britain accepted the treaty as well after opting out of the social chapter and the EMU, but in 1997 they adopted the social chapter as well. In 1994 the European Economic Area was established which brought all the EFTA nations into the common market, although not without limits (see chapter 2.3). Sweden, Finland, Austria and Norway applied for a full EU membership at the same time the EEA was established. Out of the four countries, only Norway did not become a member after it had a referendum with 52% of the electorate being against membership[25]. However, Sweden, Finland and Austria became full EU members in 1995.

The Amsterdam Treaty was ratified in 1997, an amendment to the Maastricht treaty. It committed member nations to adopt the common currency, the Euro, starting on January 1st, 2002. Also to increase the efficiency of EU's institutions, to synchronize the Union's message internationally by making it speak increasingly with one voice, to safeguard consumer's rights and finally to remove the last barriers to free movement of labour inside the Union (Denmark, UK and Ireland did not participate in the removal of border controls.). Finally the treaty opened up the possibility for some member nations to develop a closer relationship without the need to involve other members.

The newest EU treaty is the treaty of Nice, which was ratified in 2000. Its goal is to make it easier for new members to join the Union by temporary adjustments to EU's institutions. The areas were also increased where the qualified majority vote was enough to make a decision. In January 2002 the Euro was finally adopted and became the national currency of 12 member nations (Britain, Sweden and Denmark are outside the EMU). Its goal was to increase stability inside the EU market, lower transaction cost and boost economic growth and thus employment. With the Euro, the EU became an economic union and the Common European Market was complete. Also in 2002 the EU accepted ten new member nations: Poland, Hungary, the Czech Republic, Slovenia, Slovakia, Malta, Cyprus, Estonia, Latvia and Lithuania to be accepted in May 1st 2004. Bulgaria and Romania could follow as members in five years but Turkey, which also has applied, has not gotten positive feedback mainly because of its poor human rights record. The EU though, has promised to re-evaluate its decision on Turkey in 2004.

The EU decided to launch a constitutional convention in 2002 with the main goals of reforming its institutions and decision making to be better able to handle the ten new member countries in 2004. Basically it sought to form a written constitution. The name, constitution, is deceiving because it really is nothing but another treaty to make Europe more efficient, simpler and democratic. The adoption of the constitution requires ratification of all member countries, including the ten new ones, before it can take effect. Talks in the European Council failed, in December 2003, to reach an agreement to accept the constitution. The failure was mainly due to disagreement about voting rights which Spain and Poland could not accept. Even if the European Council managed to agree on a constitution in the future, most member countries are also having a referendum which makes it even more unlikely to be ratified in the near future.

EU's future is very uncertain. The struggle between those members who want further integration (the so called federalists) and the others against giving away more sovereignty to EU's supra-national institutions is making the Union's future unpredictable. Through the years more and more decisions are being based on qualified majority, not unanimous voting, so by looking at recent history the federalists seem to be winning. It has been debated that the EU will probably evolve in a way where countries that want a closer relationship with other member countries can do so, without forcing the others to do the same. After the failed constitution talks in December 2003, German Chancellor Gerhard Schröder has stated that if the constitution was not ratified in 2004 he would go ahead and induce increased cooperation among the core-European countries (the six founding members), and leave the rest behind[26]. As explained above, it is very unlikely that the constitution will be ratified in the near future which makes it very probable that a "two-speed Europe", like Shröder suggested, will come into existence. If that happens, a group of EU countries would increase their relationship more than the EU currently does which could dramatically change the Union. This scenario is discussed further in chapter 5.6.

2.3 The European Economic Area

Norway's, Lichtenstein's and Iceland's current relationship with the EU is through the European Economic Area (EEA) agreement. The agreement is an offspring of the European Free Trade Association (EFTA) agreement which was ratified January 1st 1973. The EEA agreement came in to power in 1994 and gave Iceland the four freedoms, free mobility of labour, products, goods and services, inside the EU market. Not included in the EEA agreement are the Common Fishery Policy, Common Agricultural Policy and the second and third pillar Common Foreign and Defence Policy (though later Iceland became a Schengen member) and Justice and Home Affairs. The EMU and EU's trade agreements are also not included in the EEA agreement and neither do EEA countries get seats in EU's institutions e.g.

European Council, Council of the EU, Commission, EU's Parliament nor the Court of Justice.

With the agreement, Iceland's goal to secure markets for its fish was achieved along with protecting its domestic agriculture. When the agreement was to be ratified in Iceland there was a heavy debate in Iceland's parliament. In fact the country was so divided, and the debate so fierce, that the president at the time, Vigdis Finnbogadottir, considered not signing the law (see chapter 4.2 about political structure) after the majority of parliament had accepted the EEA[27].

With the EEA, 70% of the tariffs on Iceland's fish exported to the EU market were dropped[28]. Because of Iceland's demand for keeping foreigners away from investing in its marine industry, the negotiations were complicated. The EU finally decided to compromise and gave Iceland permission to keep its demand but at the expense of not getting a full free-trade with its marine products. Herring, lobster, scallop and salmon were among the excluded species which carry the highest tariff, 12-25 percent[29]. Others are confronted with much lower duties. The total tariff expenditure, as a share of the total FOB revenues of exported marine products, is estimated to be 0.2% after the ten new members join the Union in 2004[30].

EEA's goal was not only free trade but a single market. Thus it includes most of EU's Acquis Communautaire, for example regulations on consumer protection, antitrust laws, the environment, minimum social rights and rules on fair competition. Iceland also gets to participate in many research and development programs in the EU. The agreement is dynamic meaning that it changes every time the EU changes the inner market (or first pillar, EC). The agreement also gives EEA countries their own institutions to manage the agreement and all relations with the EU: EEA Joint

Committee, Standing Committee of the EFTA states, EFTA Surveillance Authority – ESA and the EFTA court (see Appendix D).

Since the EEA agreement was ratified the agreement has changed only with the new EU regulations it has adopted. It has been estimated that about 80% of EU's rules and regulations flow in to the EEA agreement[31]. Since established the acts have grown from 1500 to 3500[32]. The fly in the ointment, which is discussed in chapter 5.3, is that the EEA agreement gives its members no decision making power in the EU. EEA nations can give recommendations on the first stages when new laws or regulations are made but when the first draft is ready and the political debate between EU members begins, EEA nations can only influence the decision making by lobbying EU members.

In 2001, Iceland became a Schengen member. The Schengen agreement unifies border control and abolishes border control between EU members (along with Norway and Iceland). Iceland gets access to the Council of the European Union in matters regarding the third pillar, Justice and Home Affairs, which concern the Schengen agreement. It is therefore the only decision-making access Iceland has within the Council of the European Union[33].

On November 11th 2003, the EEA agreement was changed to accommodate the EU's enlargement. Iceland has been selling Poland, one of the ten new members, herring which is not included in the EEA agreement. Iceland would thus lose that trade when Poland joins the EU in 2004. An agreement was made for full market access to the new EU member nations markets according to the EEA agreement along with a quota on products which fall outside the EEA agreement based on the historical trade between Iceland and the new members. Iceland also had to increase by five fold its contribution to EU's development funds (from 500 million to 2,500 million ISK) but the Union showed no interest in the kind of technical changes to the EEA agreement Iceland had hoped for[34].

No one disputes the benefits Iceland has enjoyed from its EEA membership. It is universally acknowledged that the EEA agreement has been a success which Iceland's Prime Minister, Mr. Oddsson[35], and Foreign Minister Mr. Asgrimsson[36] endorse. Its limitation though, which was known from day one, is the lack of influence on decision making within the EU like Mr. Asgrimsson has stated: *"The EEA's benefits are mainly that it gives access to the most beneficial areas within the European cooperation while other areas, which are of no interests to Iceland, fall outside it. The agreement however has never given the EEA countries the same participating rights when discussing, developing and making decisions like the EU countries have*[37]*."*

The EU is satisfied with the EEA agreement and nothing suggests that the agreement will be dissolved or changed in the future according to Diana Wallis, a member of the European Parliament. The EEA countries have very conscientiously adopted all EU's regulations, in fact done it faster than some full members, and no problems or disputes have occurred because of the agreement[38]. Roman Prodi, the president of the European Commission, has even mentioned the possibility of using the EEA agreement to allow new members limited EU membership. This, Prodi mentioned, might be a solution for Turkey and possibly Russia in the future[39]. This is important because it emphasizes that the EEA agreement is not going to be discontinued in the foreseeable future.

NOTES

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[6] European Commission 2003, 14

[7] *The Economist,* "Europe in a Spin", January 10th 2004.

[8] Mahony Honor, "Cox to Fight for higher Election turnout" *Euobserver.com,* November 17th 2003, Available on the World Wide Web @ http://www.euobserver.com/index.phtml?aid=13570, (Accessed December 10th, 2003)

[9] Richard Carter, "Two thirds of French not interested in European elections", *Euobserver.com,* January 19th 2004, Available on the Word Wide Web @ http://euobs.com/?aid=14131&rk=1, (Accessed January 21st, 2004)

[10] European Union' Website, "Internal Market", Available on the Word Wide Web @ http://www.europa.eu.int/pol/singl/overview_en.htm, (Accessed January 11, 2004)

[11] Salvatore 2004, 330

[12] Ibid, 332

[13] Ibid, 333

[14] European Union' Website, "Internal Market", Available on the Word Wide Web @ http://www.europa.eu.int/pol/singl/overview_en.htm, (Accessed January 11, 2004)

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[16] Ibid, 177

[17] Delegation of the European Commission to Norway and Iceland, "Sjávarútvegsstefna ESB", Available on the World Wide Web @ http://www.esb.is/policies/fisheries.htm, (Accessed January 11th, 2004)

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[19] Bergmann 2003, 156

[20] Samfylkinging 2001, 88

[21] Bergman 2003, 157

[22] Delegation of the European Commission to Norway and Iceland, November, 2002, *Frettir fra ESB*, Available on the World Wide Web @ http://www.esb.is/ESBnov2002.pdf (Accessed December 12th, 2003)

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[27] Thorhallsson 2000

[28] Minstry of Foreign Affairs, 2000

[29] Bergmann 2003, 109

[30] Ibid, 112 and Iceland in Figures 2004

[31] Arnorsson 2003, 76

[32] Minstry of Foraign Affairs 2000

[33] Bergman 2003, 125-130

[34] Arnorsson 2003, 47

[35] *Morgunbladid*, "Olikar aherslur hafa ekki urslitaahrif a stjornarsamstarfid", June 23, 2002

[36] Ministry of Foreign Affairs 2003 March, 1

[37] Ministry of Foreign Affairs 2000

[38] *Morgunbladid*, "Enginn ahugi hja ESB um uppfaerslu EES samningssins", February 17th 2004

[39] Arnorsson 2004, 25

Chapter 3. – The Benefits of a Customs Union

3. THE BENEFITS OF A CUSTOMS UNION

A customs union is a group of two or more countries that abolish all trade restrictions, e.g. tariffs and quotas, between them and set a common external tariff and trade control. Countries join a customs union to be able to exploit their comparative advantage and thus increase their economic growth and, as a consequence, standard of living. Few economic theories have been backed up by more research and experience than David Ricardo's theory of comparative advantage. In brief, the theory says that in a world of two countries and free trade, each country should specialize in what they do comparatively better than the other. If the two countries specialized and then opened up their borders for trade, both would become much better off.

It is estimated that thirty two regional groups exist in the world today based on economics ties[40]. They range from free trade areas, where trade between member countries is unrestricted; customs unions which have the same qualities as the free trade areas along with sharing the same terms of trade towards non-member countries; common markets which add free movements of labour and capital to customs unions and finally economic unions which add collective monetary and fiscal policies to common markets.

Even though the European Union[2] involves deeper relations between countries than a customs union, the economic benefits to members are to a large extent derived from that part. This chapter will focus on customs unions and their economic effects which are both static (short term) and dynamic (long term). The last part of the chapter discusses the political gains from joining a customs union.

[2] In this chapter, the abbreviation "EU" will be used to refer to the European collaboration since established for simplicity though the Union did not bear that name until after 1994.

It was Jacob Viner who in "The Customs Union Issue" (1950) showed that the short term effects, from joining a customs union, could both be trade creating and trade diverting. Before that time, customs unions were universally thought to be good because they increased free trade which, as Ricardo had proved earlier, was a good thing. But that view only considered the trade creating union which will first be discussed.

Let us say that country A joins a customs union with country B. Trade creation occurs if, by joining the union, country A substitutes imports from country B for some of its more expensive domestic production. This makes the two countries specialize in the areas where they have a comparative advantage which leads to a more efficient allocation of resources. With trade creation, the customs union as a whole enjoys a higher economic growth and thus increased welfare. Non-union members will also gain from this because of increased demand, from within the now richer union, for their exports. Trade creation is thus always good for both the union and the world as a whole.

Trade diversion, on the other hand, has both a trade creating and diverting effect. Again we will use country A which is joining a customs union with country B. The only difference is that before joining the union country A is now importing products form the lowest-cost producer, country C (a non-union member). By joining the customs union a high tariff increases the prices on products from country C so they become higher than country B's products. The tariff thus diverts trade from the lowest-cost producer (C) outside the union to a union member (B) which is less expensive only because of the trade barrier. Trade diversion occurred when Spain joined the EU. Both the US and Spain had exported wheat to the Union and faced the same tariff. Before Spain joined, the US was the least cost producer. That changed after Spain became a member because it did not face the same tariff anymore and thus became the least cost producer[41]. Trade creation, on the other hand, occurred when both Finland and Sweden joined the EU which led to a 10 percent price fall of an average food basket in the two countries[42].

Whether welfare increases by joining a customs union depends on two forces: trade creation and trade diversion. If trade creation is stronger than the diverting effect, the union's welfare increases. Trade diversion, for the world as a whole, is always bad because it switches production from the country that is most efficient (has comparative advantage in the production) to another country which is not as efficient but cheaper only because of the trade barriers which protect it. The world's resources are thus allocated inefficiently which is always bad.

Salvatore (2004) points to six matters that can increase the likelihood of trade creation within a customs union. They are:

- If member countries have high-trade barriers before entering a union, then trade creation with another member country, rather then trade diversion from a non-member, is more likely.
- If the union has low trade barriers towards the rest of the world, it is less likely that trade diversion occurs.
- With a large union, and the larger the size of each member, the chances are higher that a low-cost producer will be among the members.
- If the countries within the union are similar, more competitive (which encourages specialization) than complimentary, it is more likely to lead to trade creation.
- Transportation cost is less of an obstacle to trade creation if the geographical distances between union members are smaller.

- Finally, the greater the economic relationship between a potential new member and the union increases the likelihood of trade creation were it to join.

In the case of the EU, trade creation occurred in machinery, transportation equipment, chemical and fuels when the union was established. Trade diversion on the other hand occurred in raw materials and agricultural products. It has been estimated that trade creation outweighed the trade diversion forces by 2 to 15 percent[43].

Salvatore (2004) argues that the dynamic gains from joining a customs union, that will now be discussed, are up to six times higher than the gains from the static effects[44]. The dynamic effects can be divided into three forces: increased competition, economies of scale and stimulus to investments. The first force is by far the most important one. When countries open up, more competition from abroad forces companies to become more efficient and competitive. Companies that before are in a monopolistic or oligopolistic position, because of high trade barriers, tend to become sluggish and complacent. When the trade barriers are removed they are faced with new competition from abroad. This forces them to make their businesses more efficient by investing in technology, equipment and product lines. Some companies go out of business, some merge together but others become much stronger on their own. Old products and services will become better, new services and products will be introduced and prices will most likely fall. Consumers thus benefit greatly. When a country joins a customs union, its market becomes much larger. It can thus enjoy the benefits from economies of scale. That means, by producing for a much larger market than before, each unit of production can become less expensive (see European refrigerator industry below). Last but not least is the stimulus to investments. On one hand domestic firms will invest in technology and factories to serve a larger and more competitive market but on the other hand foreign firms will invest inside the custom union. Foreign companies will do this to get around the trade barriers non-member countries face. This happened in the late 1950s when US firms invested heavily in the European market. This they did to prevent being excluded from the large European market. These factories have been called "Tariff Factories" and are a common phenomenon when customs unions are established[45].

The European refrigerator industry is a good example of the gains from the dynamic effects from a customs union. Before the EU, all the European manufacturers were small and supplied mainly their domestic market. Italian, French and German factories, for example, produced less than 100,000 units annually which were too low for automated production equipment to be used and thus made per unit cost very high. After the formation of the EU in 1960, a normal manufacturing plant made 850,000 units in Europe. That was enough for the industry to enjoy all the benefits from economies of scale using high tech manufacturing methods[46]. Today it is commonly believed, and rightly so, that countries can and do benefit from economies of scale without being in a customs union. This was the case with Belgium and The Netherlands before joining the EU. However, after joining, they enjoyed even more economies of scale with a smaller number of product lines being produced in much higher volume, e.g. increased specialization[47].

The political benefits from joining a customs union can be summed up as the strength in size. In today's world of increased globalization and international trade, it is vital for countries to have good access to foreign markets. This is especially important for small countries because specialization is hard with a small domestic market. Let us say, for example, that the US would place a tariff on steel imports from a small country like Ireland (given that Ireland was not a member of a customs union). It is hard to imagine that the US would take any threats from Ireland about retaliating, by putting tariffs on US imports, seriously. Even if Ireland would go ahead and implement high tariffs on US products, they would have very marginal (if any) effect on the US economy. Thus, a large country like the US will always win in a trade dispute with a country like Ireland. In March 2002, President Bush implemented tariffs on metal imports to the US[48]. The EU threatened to retaliate by imposing $2.2 billion worth of tariffs on EU's imports from the US. December 4th 2003, President Bush withdrew the steel tariffs to prevent a trade-war with Europe which would seriously hurt US interests. No individual country within the EU, neither Ireland nor any other country, would have the strength to face the US with this response. The example crystallizes what is meant by the strength in size.

Finally, when making trade agreements with other non-member countries, customs unions are much more likely to get "better deals" than any individual country would be able to.

These are very important topics which have to be factored in when valuing whether Iceland should join the EU or not. Is the trade creating effect going to be stronger than the trade diversion? How large are the gains from the dynamic effects going to be? As a member of the EEA agreement, the country has access to the European market. Trade creation thus has occurred in many fields and the country has been able to specialize and benefit from economies of scale. By becoming a full member the increased benefits have to be measured to the cost. The political benefits are the only ones that are clear. The EEA is a market with 4.8 million people compared to the EU's which currently has over 377 million people. The strength in size is thus far stronger in the EU but this, along with the static and dynamic effects, will be discussed in more detail in chapter 5.

NOTES

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[40] Czinkota 2002, 194

[41] Ibid, 198

[42] Ibid, 198

[43] Carbaugh 1998, 248

[44] Salvatore 2004, 329

[45] King 2000, 171

[46] Carbaugh 1998, 246

[47] King 2000, 170

[48] Richard Carter, "EU wins battle over US as Bush backs down on steel" *Euobserver.com*, December 5th 2003, Available on the World Wide Web @ http://www.euobserver.com/index.phtml?aid=13791 (Accessed December 13th, 2003)

Chapter 4. - Iceland

4. ICELAND

Iceland is an island republic in the North-Atlantic Ocean, east of Greenland and west of Norway. The country's coastline is 4,970 kilometres and it has a 200-nautical-mile economic zone in the surrounding waters. It is the most sparsely populated country in Europe with only three inhabitants per square kilometre but 4/5 of the land is mostly uninhabitable. The country got its independence from Denmark in 1944 and the country's population today is 290,490 citizens[49]. It was not until the 20th century that its industrial revolution began. Then the country started to prosper and went from being one of the poorest countries in Europe, with about 2/3 of its population working in agriculture, to one of the richest with 2/3 of the population working in the service sector[50]. Iceland is formally known for its midnight sun, number of volcanoes, glaciers and hot springs; indeed the tourism industry has been one of the fastest growing industries in recent years.

To better understand the country in question, this chapter introduces Iceland in some detail. The chapter is divided into three sections, with the first one looking at the Icelandic society. Section two discusses the political structure in the country and finally the third section discusses the economy.

4.1 Society

Iceland has a welfare state which offers its citizens universal access to healthcare, education and high social security. The public spending on these three categories was 25 percent of GDP in 2002[51]. The country's forefathers were Vikings that came from Norway but left the motherland for Iceland to be able to rule their own lives. It thus shares the same culture, history and ethnicity as its Nordic neighbours. The most noticeable aspect of the Icelandic society is the homogeneity of the population. The fact that 84.1 percent of the Icelandic population is a member of the state Evangelical Lutheran church emphasises the homogeneity[52]. Although the country has experienced a substantial increase in immigration during the past years, only 3.5 percent of the population had a foreign background in 2003 from 1.8 percent in 1990[53]. This proportion is much lower than in Iceland's neighbouring countries, but has been rising fast since it joined the EEA. Today, all EU citizens can come to Iceland to live and work without any obstacles. With the high standard of living the country has to offer, it is very likely that the share of foreign born citizens will rise. This could be of some concern as a study made by the Institute of Social Sciences at the University of Iceland showed in 1999[54] that 30 percent of Icelanders wanted to restrict immigration. Two thirds of those people wanted to restrict all immigration but only one third wanted to restrict immigration of people with dark skin and/or different beliefs.

Icelanders enjoy high life expectancy, 80.1 years[55] today compared to 72.5 years half a century ago[56]. Infant mortality rate is also low at 2.2 of every 1000 births 2002[57]. Although Iceland has its own language, almost everyone speaks English fluently and has some knowledge of Danish.

Table 1 shows the demographic trends in Iceland compared to high income OECD countries:[58]

TABLE 1

	Annual Population Growth rate (%)	*Population under 15 years old (5)*	*Population aged 65 and over (%)*	*Urban Population as a (%) of total*	*Total fertility rate (%)*
Iceland	.6	23.2	11.6	92.6	2.0
HI-OECD (Average)	.4	18.3	14.6	79.1	1.7

As the Table 1 shows, the Icelandic population is growing faster than the average in high income OECD countries. Like most developed countries today, the population is aging as well. However, it is doing so at a slower pace than that of most OECD countries. The labour force is also highly educated with 17.9% holding a university degree in 2002 and about a quarter of those go to universities overseas[59]. It is also noticeable that the average hours people spend working is very high in Iceland. In 2000, every worker spent 1860 hours on average at work per year which is higher than in most of Iceland's neighbouring countries. When factored into GDP per capita (see chapter 4.3), Iceland's ranking falls, though still it remains among the top 15 in the world[60].

There are two historical issues which are important to an understanding of Iceland's position regarding the EU. The first is the defence treaty that Iceland has had with the US since 1951. Because of Iceland's important geographical location after World War Two, the US invested heavily in the country to be able to monitor USSR's submarines. At one point in the 1950s, US's investments reached 1/5 of Iceland's GDP, which is ironic because at the same time Iceland had a barter arrangement with the USSR to exchange its fish for under-market-priced oil[61]. The country also enjoyed, relative to population size, larger Marshall Assistance than all other nations after World War Two (without ever having faced any real destruction during the war)[62]. The defence treaty is still valid and the US still has a military base in the country. This makes Iceland's situation different from its European neighbours because its defences are secured by the biggest military power in the world. The other issue is the extension of the country's territorial waters. The first extension of its territorial water's from 3 to 12 miles was met by fierce opposition from Germany and Great Britain in 1958. Later it extended it again in 1972 to 50 miles and finally 200 miles in 1975. Britain reacted by sending war ships to protect its vessels fishing within these territorial waters. After a long dispute, Britain finally accepted Iceland's demands but only after Iceland had on many occasions threatened to leave NATO were Britain not to comply. It is, without a doubt, because of US military interests in Iceland that Britain agreed to the country's demands[63]. Iceland has thus a very strong historical relationship with the US which has had huge influences on the society. These events influenced Iceland's determination to stand outside the European Economic Community and EFTA when they were formed[64].

4.2 Political Structure

Iceland has a written constitution, which is the country's supreme law. It came into effect when Iceland got its independence on June 17th, 1944. The country is a parliamentary democracy and the head of state is the president. The constitution states that power should be divided into three parts: legislative with the parliament, and the president; executive power with the president and ministers; and finally judicial with the Supreme Court which is completely independent of government. The president has only marginal power but the prime minister is the head of cabinet. In parliament there are 63 seats, chaired by elected members. Ministers also have seats in parliament but only those elected have voting rights. Both the presidential and parliamentary elections are held every four years by a popular vote and all citizens, 18 years and older, have suffrage. There is no term limit on either two. After every election the president usually approaches the biggest political party and gives it the authority to form a cabinet.

Iceland has a history of political stability and governments have normally been formed by a coalition of two or more parties. According to Transparency International, the level of corruption is very low in the country, in fact the second lowest in the world according to the Corruption Perception Index[65]. Iceland's public institutions are also very efficient, which the World Economic Forum has acknowledged by ranking them number three in its competitiveness report[66].

Since 1991 the Independence Party has formed the cabinet in Iceland. It is a right-of-center party and has since 1995 formed the cabinet with the Progressive Party. The distribution of the seats in parliament was changed before the last general parliamentary elections in May 2003. After the changes the Reykjavik area (Iceland's capital), where the majority of the electorate lives, holds for the first time the majority of seats in parliament (62% of the electorate elect 52% of the seats after the change). In recent decades between 80 and 90 percent of the electorate exercised their voting rights in the parliamentary elections[67]. Table 2 shows the 2003's election results and the distribution of MPS between the Reykjavik area and the countryside.

TABLE 2. The results from Iceland's parliamentary elections in 2003[68].

	Support Percentage	Total MPS	Regional MPS	Reykjavik MPS
Independence Party	33.7	22	8	14
The Alliance	31	20	8	12
Progressive Party	17.7	12	8	4
Left Green Movement	8.8	5	3	2
Liberal Party	7.4	4	4	0
Other	1.5	0	0	0
Total:	100	63	31	32

There has been a strong opposition against joining the EU in Iceland by the primary sectors, fishing and agriculture, which mainly operate in the countryside. With the changed distribution of seats, it is not unlikely that in the future this will influence the political agenda in the country and might even move it more towards Europe.

No political party has on its agenda the intent to apply for EU membership. However, the Alliance party, a social-democratic party, has been revising its policy towards the EU. Some of the Alliance's members have been favourably disposed towards joining the EU and stated that the Common Fishery Policy does not have to be unfavourable to Iceland[69]. Although the party has been moving more in favour of EU membership, it has not put application on its agenda. The Independence Party – the largest party in parliament – has led the opposition against membership. The party's leader, and Iceland's prime minister since 1991, Mr. Oddsson, has been very critical of the EU and has gone so far as to call the EU *"[...] the most un-democratic bureaucracy that has ever been invented"*[70], which has not pleased EU enthusiasts in Iceland. The party is strongly in favour of free trade and good relations with Europe which it considers secured by the EEA agreement. The Progressive Party, which is a party neither to the right or left, has been moving more in the direction of EU membership even though it has not stated so officially[71]. In a conference declaration in 2001, the party agreed to not rule out an EU membership. This is a major turnaround for the party because it has traditionally been known as the farmers' party and has defended their interests in parliament[72]. The party's leader, and Iceland's Foreign Minister, Mr. Asgrimsson, has on many occasions spoken positively about the EU and hinted that Iceland's interests might be best served as a full member of the EU[73]. The Left-Green Party is the party most outspoken against membership (and free trade, NATO and EEA for that matter)[74] and finally the Liberal Party is open to membership given that Iceland's fishery management will not be given to the EU[75].

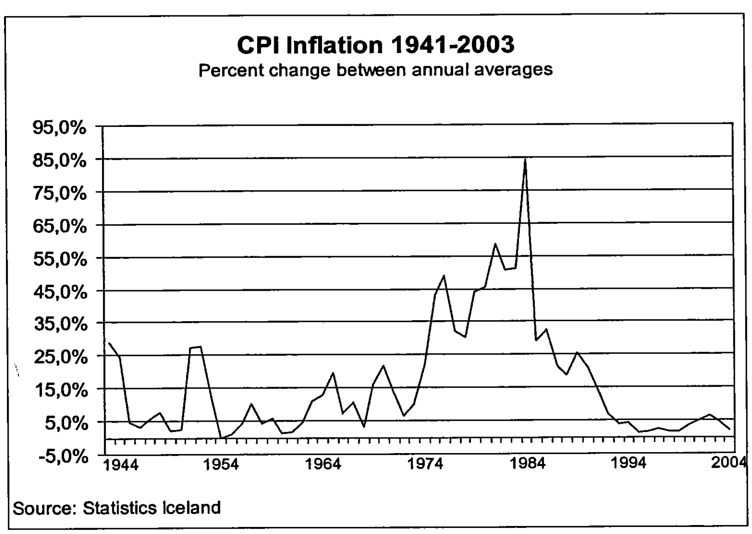
In September, 2004, Mr. Oddsson will step down as Iceland's prime minister and Mr. Asgrimsson will take his position. It seems very likely, given Mr. Asgrimsson's recent statements about the EU and that Mr. Oddsson has led the opposition, that the new prime minister might move the country closer to Europe, or at least move the discussion to a new level. This, however, remains to be seen.

4.3 Economy

Iceland's economy is one of the smallest in the world in absolute terms, 1200 times smaller than the US's- and 16 times smaller than Norway's economy. But when the population is factored in, Iceland proves that you don't have to be big to be successful. The country had the 6th highest GDP (PPP) per capita in 2002[76]. The country has achieved this success in a relatively short period of time, after it got its independence in 1944.

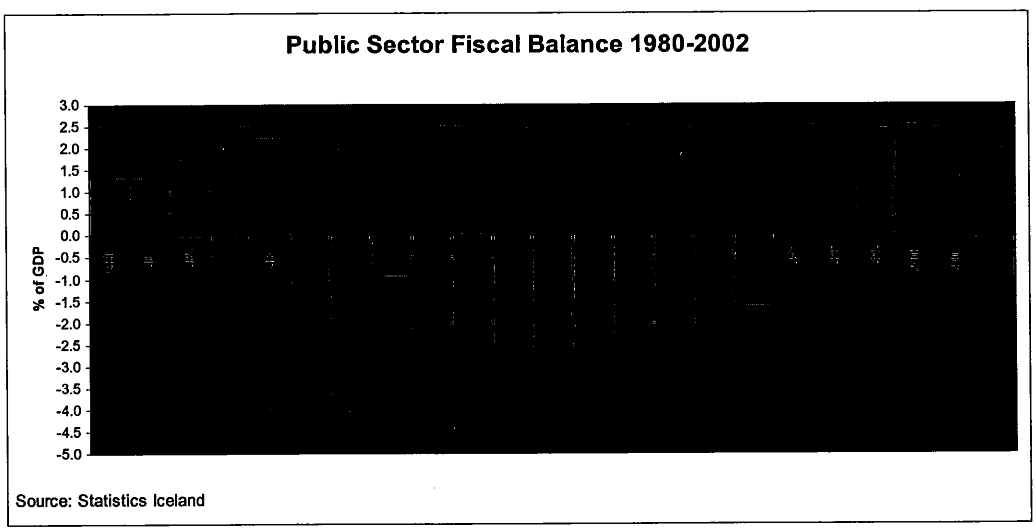
Iceland's economy is mostly made of private enterprises but the government still holds a considerable degree of control in some key sectors. The government's tax revenues as a share of GDP are a little less than 40%, which is less than in its Nordic neighbouring countries but still high. It is partially due to its generous welfare system[77].

FIGURE 1



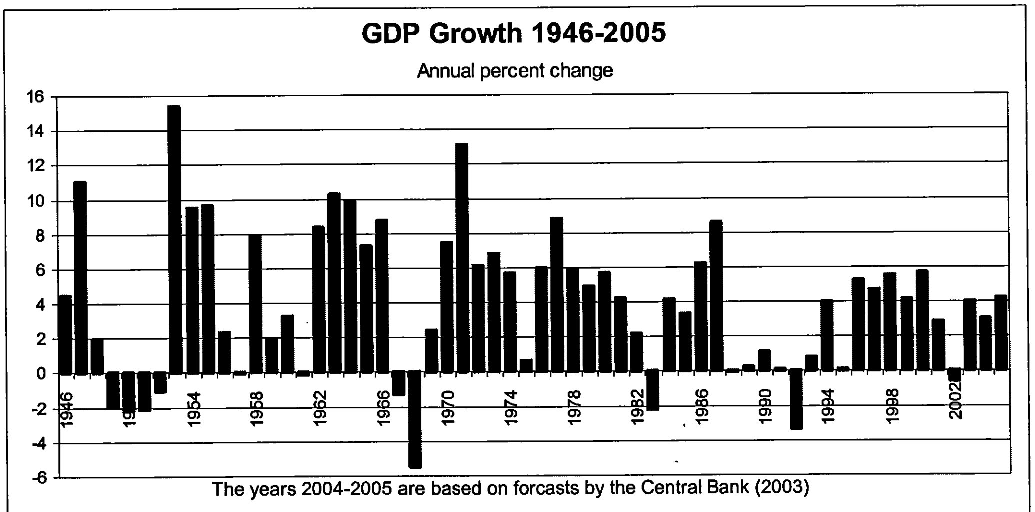
The Central Bank of Iceland is independent and its main objective since March 2001 has been to keep prices stable. This objective is met by keeping the 12 month change in consumer price index (CPI) at 2.5%. The country has a history of high inflation rates, in fact one of the highest inflation rates in OECD countries. However, the country also has a history of remarkably successful disinflations[78] (see Figure 1 above). After structural reforms the inflation rate fell to the same level as the country's main trading partners in the 1990's[79]. The public sector fiscal balance has mostly been in surplus since the mid 1990s. Before that time, like in most Western countries, it ran a deficit which was from 1985-1995 on average 3% of GDP[80] (see Figure 2). Total external debt (both private and public) is very high in the country or 126% of GDP in the end of 2002. Private sector debt has increased from 32% of GDP in 1995 to 92% of GDP in the end of 2002. This is explained by increased loaning by the banking sector because of extensive financial market liberalization and low domestic saving ratio[81].

FIGURE 2



The recent prosperity the country has enjoyed was fostered by market liberalization which began in 1960, after a period of high trade barriers and regulations like most Western countries had during that time. Since 1960, and especially after joining EFTA (1970) and the EEA (1994) liberalization has been extensive as noted by OECD, "*A shift in policies towards achieving financial stability and market liberalisation in the early 1990s contributed to the strong economic growth of the Icelandic economy seen since the middle of last decade*"[82]. Among those reforms was extensive elimination of trade barriers, deregulation, privatization and increased integration into the global economy. Today, according to the Fraser Institute's Freedom Index, Iceland's Economy is the 13th free-est economy in the world. It has gone from lagging behind its Scandinavian neighbours in 1970 with the grade 6.2 to 7.6 in 2001 when it outperformed them[83].

FIGURE 3



Source: Statistics Iceland and Central Bank (2003)

The average annual growth rate of GDP per capita from 1945 to 2002 was 4%[84] but the business cycle in Iceland is very different from other industrialized countries. This has been explained by the limited natural resource based export sector but as exports become more diversified and the economy more market driven this volatility has been slowly decreasing[85].

FIGURE 4

Iceland's labour force is very small, at 166.200 people, but the participation rate is high, 84.1% (second quarter of 2003) and has been over 80% in recent decades[86]. This is among the highest in OECD countries and has been explained by the very low unemployment rate (see Figure 4 above) and high participation rate by women on the labour market. 84% of the country's labour force is unionized and it has the questionable honour of having one of the highest numbers of strikes in the Western world[87]. During the period 1986-1990 the average number of working days lost because of strikes was 167 in the four Nordic states, 218 in Italy (usually assumed the highest) but 433 in Iceland[88].

According to the World Economic Forum's Global Competitiveness report for 1998, Iceland's competitiveness is as follows:[89]

TABLE 3.

56%	Natural Resources
29%	Human Capital
15%	Capital

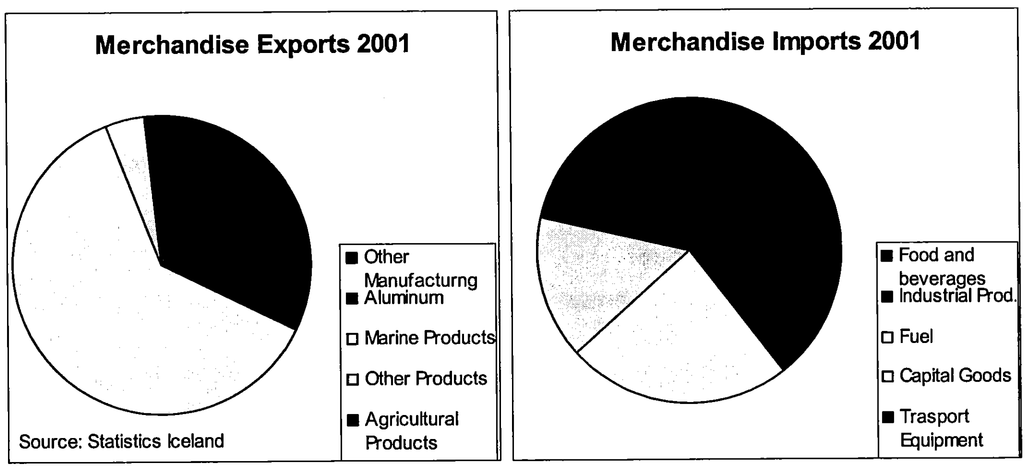
Pursuing these competitive advantages and being open to trade with its neighbouring countries has made economies of scale possible despite the small size of its domestic market.

Fish is Iceland's most important natural resource. The marine sector is mainly composed of fishing and processing of ground fish species which delivers 70% of the industry's export value. The main species are cod, haddock, saithe and redfish. The total fish catch in Icelandic waters in 2003 was 1.88 million tons which places Iceland in the 12th place among fishing nations[90]. Though still the most important sector in Iceland, the relative importance of the marine sector has diminished since 1960's when fish exports constituted over 90% of the country's merchandise exports[91] as against 63% today[92]. The fisheries in Iceland have been managed very successfully since 1990 but over exploitation and over capitalization was inherent in the industry before that time. In 1990 the individually transferable quota (ITQ) management system was established. Since then the quotas have been privately owned and freely tradable. The Marine Research Institute in Iceland sets the annual total allowable catch (TAC) of which each quota holder gets a percentage share, according to the amount of quota he holds.

The other important resources are geothermal and hydro power which has increasingly been exploited and can be sold at a low cost. This resource has been, for example, used by aluminium smelters that have been opened in Iceland. Only 17% of Iceland's potential hydro and geothermal energy is being exploited today. Compared to other countries in Western-Europe, Iceland is the only country that still has large-scale and competitively priced power which has not been harnessed. Both hydro and geothermal powers are sustainable and very environmentally friendly power resources.

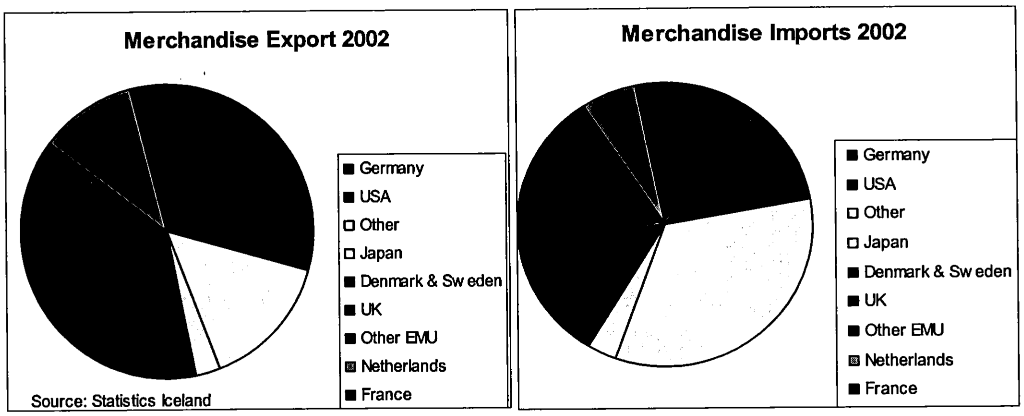
Human Capital is 29% of Iceland's competitive advantage. As discussed in section 4.1, the country's labour force is highly educated and is described by the Global Competitiveness report as being a group of knowledge workers and very entrepreneurial. This has lead to an increase in software and biotechnological industries, for example, in recent years.

FIGURE 5



Looking at Iceland's trading pattern, it is obviously exploiting its comparative advantage. Iceland's exports as a share of GDP were 38% in 2002 (from 33% in 1945)[93]. The country's main exports are primary products: fish and aluminium. Fish amounts for 63%- and aluminium 20% of merchandise export. Manufactured products have been increasingly exported in recent years, mainly because of increased aluminium smelting, and medical and pharmaceutical production. Services are also growing and in 2002 they accounted for 36% of the country's exports revenues[94]. As Figure 5 above shows, the main imports are industrial products, capital goods and durable and non durable goods. This is consistent with the size of the economy and the limited range of natural resources it has. The country thus has to import a variety of manufactured goods and commodities. The total exports were 3,584 million EUR but total imports were 3,412 million EUR in 2002[95]. As noted earlier, the importance of fish in its exports has been slowly decreasing, largely because of the growth in power intensive industries, mainly aluminium. Tourism has also been growing fast in recent years. In 1990, 142,000 tourists came to visit the country but the number was 278,000 in 2002, not far from the total population size. Exports of services have also been growing which accounts for 36% of total exports revenues[96].

FIGURE 6



The European Economic Area is Iceland's most important trading partner as Figure 6 shows (and Appendix F). Since joining the EFTA, and later the EEA; trade with Europe has increased on the expense of North-American trade. Today almost 75% of its exports go to the EEA (EU, Norway and Lichtenstein) countries and 63% is imported from them. Although, only 47.4% of Iceland's exports go to Euro countries and 30.8% of its imports comes from them. In terms of countries, UK is the largest trading partner, Germany next and then USA and Iceland's Nordic neighbours.

Shortly one of the largest investments ever to have been made in Iceland will occur. The aluminium company, Alcoa, is opening another aluminium smelter which is demanding another power plant as well. This project will increase aluminium production by 120%, and increase aluminium as a share of total exports from 20% to 34%. Another aluminium company; Nordural, is also considering expanding its operations in Iceland. If they do, aluminium production will increase (with Alcoa's expansion) by 155% which would make aluminium count for 37% of total exports. These investments are huge for a small economy like Iceland's. Alcoa's investment will, in economic terms, amount to 22% of one year's GDP but the construction will peak in 2006[97].

In 2004, the government is also planning an extensive income tax cut which will amount to almost 2% of GDP. The tax cuts along with the aluminium investments will demand sound economic policies in the coming years if economic stability is to hold. The government has already introduced cutbacks in public spending and the Central Bank has a tight monetary policy to prevent the economy from overheating.

It is thus clear that the Icelandic economy will continue to grow and prosper in the near future. It is important to keep these projects in mind when contemplating whether Iceland should join the EU because tight economic policy is needed at least until 2007 if the economy is to be prevented from overheating. This will be discussed in more detail in the next chapter, but if Iceland was a member today, its economy would without a doubt overheat were it to have the same monetary policy as Europe.

NOTES

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[69] Jon Steinar Valdimarsson, A talk at the Federation of Icelandic Industries, "European Integration in Malta", June 26, 2001.

[70] *Morgunbladid,* "David Oddsson", June 23rd, 2002

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[93] Central Bank 2003, 25

[94] Central Bank 2003, 24

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[97] Central Bank 2003, 14

Chapter 5. – A Cost and Benefit Analysis of Iceland's Possible EU Membership

5. A COST AND BENEFIT ANALYSIS OF ICELAND'S POSSIBLE EU MEMBERSHIP

In this fifth chapter, the costs and benefits for Iceland, were it to join the EU, will be examined. As can be expected in the case of a big issue like EU membership, it is impossible to cover all areas and thus the focus will be on the most important issues for Iceland.

It has to be kept in mind that the contracts countries make when joining the EU become primary law. The Union thus has quite a lot of leverage when negotiating with a new member. Indeed the EU's rules are seldom changed to suit new members and countries can not easily get opt-outs from those areas which are not favourable to them. Just the opposite, the Union emphasizes that the same regulatory framework has to apply to all members and exceptions are very rare, although they do exist[98].

5.1 Fisheries

Iceland's marine sector is the biggest obstacle for the country to join the EU. In the debate there is Iceland's PM, Mr. Oddsson, who states that the country has to have the final word on how its fishing grounds are managed, something not currently possible under EU policies and thus ruling out Iceland's membership[99]. Then there is the optimistic view held by many, including the political scientist Ulfar Hauksson from the European Movement, who argues that Iceland could get opt-outs from the Common Fishery Policy which would make membership very favourable to the country[100].

When countries join the EU, all legislative power over fisheries is given to EU's supra-national institutions. It is hard to predict exactly what kind of deal

Iceland could strike with the EU were it to apply for membership. Although, by examining other countries' experiences, like Norway's and Malta's, it can be predicted with some certainty.

This account of the fisheries problem discusses the four most important issues for Iceland's marine sector when contemplating whether the country should become an EU member or not. The first section talks about the country's quota and fishery management. The second discusses how foreign direct investments could affect the industry which is then followed by section three which discusses the competitiveness of the marine sector. Finally, the fourth section discusses the rules and regulations within the EU reflecting its other smaller but important issues.

5.1.1 Quota and Management Issues

Franz Fischler, EU's fishery commissioner, has said that were Iceland to join the EU it would have to adopt the Common Fishery Policy just as all other EU members have done[101]. As explained in chapter 2.1.3, the Council of the European Union decides the total allowable catch for all EU's fishing grounds, which then is divided among members according to the principle of Relative Stability (discussed in chapter 2.1.3). In Norway's contract, when it applied for EU membership in 1994, the past five years were used to determine the quota distribution between the country and the EU[102]. It would not matter much for Iceland which of the past 20 years would determine how Iceland's fishing quota would be distributed because no country has any fishing experience in its waters during that time. When Spain joined the EU, it unsuccessfully tried to make the period before it extended its territorial waters determine how its quota should be distributed. Accordingly, Iceland's quota distribution would be based on fishing in its waters after it extended its territorial waters in the 70s. As a consequence, the country would likely keep the same amount of total quota in its waters as it had before joining[103]. It has to be noted though that some EU members could be allowed to catch some of their pelagic quota in Icelandic waters from shared stocks but that would have no effect on Iceland's quotas.

As a member, the Marine Research Institute in Iceland would give a report on the Icelandic fish stocks to the Commission, which would then give its recommendation to the Council. The Council decides the TAC for the following period which would be distributed between Iceland and the Union according to the Relative Stability principle. The same research institute in Iceland would therefore decide the TAC after joining but instead of the Minister of Fisheries in Iceland, the Council of the European Union would make the final decision. This is what Mr. Oddsson and other Euro-sceptics say is the critical point, an issue that would never be acceptable for Iceland[104].

Although it would not be clear until actual membership negotiations, there is some evidence to suggest that the EU would demand a larger share of Iceland's quota than the Relative Stability principle suggests. This is supported by an unsolved dispute about EU's shares in the country's fishing grounds after it extended its territorial waters in 1972 and 1975. The last time the EU tried to open this case was when Spain and Portugal joined the Union but then withdrew the demand. According to Palsson (2003) it is not unlikely that the EU would open this case again were Iceland to apply to become a member. When Norway applied in 1994, some of the Union members also demanded increased shares in Norway's quota without any reference to the Relative Stability principle. Although EU's institutions made these claims their own, these demands were later dropped[105].

Another important factor is the actual application of the Relative Stability principle. According to the principle, Iceland would keep most, if not all, of its quota as an EU member. But the principle was a temporary solution to a long dispute among members on how to distribute the Union's quota. Franz Fischler has said: *"The Commission currently sees no other alternative to the Relative Stability principle which could give a result with as much reconciliation among the Union's members. [...] When the organizational problems within the fisheries have been resolved and when better social and economical stability within the industry has been reached, there might come the time when we would reconsider the principle of Relative Stability to let the market forces work in the fishery industry as in others [...]"*[106] That makes one question whether the Relative Stability principle would be dropped when the level of fishing activity within the EU reaches the same level as Iceland's current industry. No country has a veto right when changes are made to the CFP. Decisions are made by qualified majority voting (see chapter 2.1.1) and with Iceland's voting power (see chapter 5.3) the country would have only marginal say were the Union to change its fishery policy.

Iceland's Foreign Minster, Mr. Asgrimsson, has suggested, because of Iceland's unique geographical position, that the country could get opt-outs from some parts of CFP[107]. By looking at both Norway's experience and Malta's, this is very unlikely. Malta tried to keep control over its 25 mile territorial waters. This is against EU's CFP which states that countries keep control over 12 miles only. Within its 12 mile jurisdiction, Malta's contract stated that ships 12 meters or less were the only ones allowed to fish, but within the 25 mile jurisdiction boats 24 meters or less could fish. Though the size limit helps keep some foreign vessels away this conclusion was far from what the country had hoped for[108]. This is a temporary protective solution which Malta can not expect to keep forever[109].

Norway demanded full control over its fishing grounds north of the 62 latitude, but only got a temporary adjustment period. It also tried to keep control over fish species and stocks which were inside Norway's territorial waters but were not currently constrained by any catch limits or protected in any way. This was also denied along with no special deals regarding whale fishing (which Iceland is starting again[110]) and trading in whale meat[111]. The arguments Norway used were the same as Iceland would use during membership negotiation but the marine sector is of much more vital importance to Iceland. Norway emphasized the importance of fish for its exports and the importance of the industry for the costal regions. The Union acknowledged this but Norway got no opt-outs, only a temporary adjustment period to adopt the CFP[112].

5.1.2 Foreign Direct Investment into the Marine Sector

Icelandic law limits foreign direct investment in the marine sector. Foreigners cannot own more than 25%-33% of a company's common stock. This will almost certainly have to change were the country to join the EU[113]. The Federation of Icelandic Fishing Vessel Owners[114], along with other interest groups, has declared this unacceptable. As explained in chapter 2.1.3, quota hopping is a problem within the EU to which Iceland would be exposed to as a member.

There are, however, some arguments in favour of allowing foreigners to invest in the fishing industry. For example it may now be better for some companies to sell stock than to get foreign loans, as the Icelandic fishing industry carries high debts. Another argument is that foreign direct investment makes it possible for companies to merge, and for takeovers to take place, which could increase efficiency in the industry[115].

5.1.3 Competitiveness and Markets

As discussed in chapter 2.3, there are still some marginal tariffs on fish products between Iceland and the EU, although they fell by 70% by joining EEA[116]. Herring and lobster are two examples of species which still are faced with tariffs when exported to the EU but all of Iceland's main exporting species enter with marginal or not duties. Some trade creation would thus occur but tariffs are estimated at only 0.2% of the total FOB value of Iceland's marine exports (including the ten new members joining in 2004). This marginal possibility of trade creation has not made groups like The Federation of Icelandic Fishing Vessel Owners[117] become more favourable to membership.

The EU has many trade agreements with non-EU countries which Iceland could benefit from were it to join the Union. As explained in chapter 3, the EU is more likely to get a good "deal" when making trade agreements with non-members than Iceland would be able to on its own. This could benefit Iceland by opening up new markets but at the same time it is unlikely that Iceland's interests would be a high priority when the Union makes these contracts[118].

The EU has negotiated contracts with about 25-30 countries which provide market access and quotas in their waters for EU members. For this the EU is either paying in money or market access depending on the country in question. These contracts are mainly with countries in Africa and Asia which Iceland could potentially benefit from.

5.1.4 Regulatory Changes and Other Issues

Unlike the EU's fishing industry, Iceland's is free and without hand-outs or subsidies. The EU's fishing industry is more centralized and protected where prices and the amount of vessels, for example, are controlled. It is impossible to project the amount of subsidies Iceland's marine sector could get from the EU. But it is, however, a question as to how feasible it is for Iceland to integrate its decentralized, sustainable and profitable industry with a centralized and unsustainable one, riddled with one crisis after another. There is also evidence to suggest that, because of the small size of the fishing industry within the EU, decisions are often made with regional support for rural areas in mind, not on the basis of whether fisheries are sustainable and profitable if managed well. With the ten new member countries joining the EU in May 2004, the fishing industry is going to become even smaller relative to other industries. This should be of much concern to a fishing nation when considering whether, or not, to join the EU.

5.2 Agriculture

Agriculture will be extensively affected if Iceland decides to join the EU. Total transfers from the government's budget to farmers were about 1.2% of GDP in 2002. The country has currently the 4th highest agricultural support within OECD countries. Iceland's producers support estimate, which is an OECD index measuring agricultural support, is 63 but the average in the EU is 36 and 31 within OECD[119].

In this section, three issues regarding the CAP will be discussed: how will the competitiveness of Iceland's farmers change, how will their financial assistance be affected and how will prices be affected and thus consumers by Iceland joining the EU?

5.2.1 The Competitiveness of Iceland's Agriculture

If Iceland joins the EU, the country's agricultural policy would be dropped and EU's policy adopted. As a member, trade with all agricultural products would become free within the European common market. Currently Iceland's government has high restrictions on imports so the farming sector would be hurt if the country became a member. Food prices are much higher in Iceland than in the EU, as mentioned above, so extensive trade creation would occur because cheaper EU agricultural products would be substituted for the more expensive Icelandic production.

Iceland's aid to the farming sector is high but this would have to change were the country to join the Union because of the core rule that no discrimination can take place. The farmers would thus be hurt both by increased competition from lower-cost producers within the Union and also by the potential lower aid the sector could get.

5.2.2 Agricultural Support

When Sweden and Finland joined the EU they were allowed to continue to support their agriculture that was located north of the 62 latitude (called Nordic Aid). This they were allowed because without their continued government assistance, all farming in these areas would have disappeared. The areas were therefore given special protection within the Union and Sweden's and Finland's governments allowed to continue to aid them. Austria got a similar exemption for their agriculture based on its height over sea level[120].

During Malta's membership negotiations, they sought permission to continue their import restrictions because their agricultural prices were substantially higher than those in the EU. This the Union rejected but Malta nonetheless got an 11 year adjustment period so they could gradually decrease their agricultural prices to the same level as the Union thereby easing their farmers adjustments[121]. Cyprus, on the other hand, has been allowed to restrict agricultural imports from some parts within the EU. This has been allowed because the country's agriculture has been very isolated and thus not been exposed to some of the diseases that other areas in the EU have faced[122]. Using the disease argument, Iceland might get the same exception as Cyprus because its agriculture has been very isolated in the past

As the examples above show, there is some evidence to suggest that the aid farmers are getting in Iceland would not necessarily decrease by much. In fact the Institute of Economic studies in Iceland found in 2002 that farmers' aid would not change at all. This is, however, not certain. There are two methods Iceland could use to continue helping the country's farmers were it to join the EU. First they could get a temporary adjustment period during which the government could continue to support the farming sector by import restrictions and/or subsidies. How and by how much will not be known until the country starts membership negotiations. The second way is by getting the whole country to qualify for Nordic Aid, like in the case of Sweden and Finland[123] and/or by getting the country qualified as a least favourable area (LSA). LSA means that the country's agricultural land and environment is harsh and would be extensively hurt by adopting the CAP. Many countries have been qualified for some percentage of LSA which gives them support from the EU and allows the country's government to give extra support as well. Six arguments support Iceland qualifying for being able to both continue its own support to its farming sector and support from the EU[124]:

- ✓ It is the most sparsely populated country in Europe. That makes all public services expensive in Iceland.
- ✓ The whole country is north of the 62 latitude.
- ✓ The country is very far from central Europe and its main markets which makes it less competitive within the EU.
- ✓ Its economy is very undiversified but the EU's objective is to promote diverse industries.

✓ Finally the country is barren and is lacking good agricultural land.

If Iceland would be able to get its agriculture eligible for the Nordic Aid and LSA, support for the farming sector may not have to decrease significantly. Finland e.g. is allowed to support its agriculture by 35% more than other countries, but the EU pays only for 40% of its total support which mostly goes to the northern parts of the country (Nordic Aid)[125].

Although the support Icelandic farmers would receive might not decrease, its competitiveness is much lower than EU's so the sector would without a doubt lose revenues and contract[126]. It is impossible to predict by exactly how much the sector will decrease but that will largely depend on how much aid the sector will get and how it will be distributed between producers. In this respect it should be noted that the number of CAP subventions available in the EU is large which makes it hard to predict exactly how much subsidy Iceland could get.

5.2.3 Consumers

Consumers will think twice before choosing Icelandic agricultural products when confronted with the price difference were Iceland to become an EU member. In Iceland, food prices are estimated to be between 54%-69% higher than in the EU[127]. With trade restrictions removed, more varied agricultural products will also become available. Consumers will therefore benefit richly.

5.3 Sovereignty, Decision Making and Rules

The loss of Iceland's sovereignty is one of the key arguments used against the country joining the EU. Just the opposite is true in other small states in Europe. These countries want to join the EU to ensure that they have a say in important matters, for one country's decision will affect others[128].

In this section sovereignty within the EU and EEA will be discussed along with the question whether small states are able to influence decision making within the Union.

5.3.1 Sovereignty within the EEA compared to EU

There are two opposing views that exist in Iceland regarding the country's sovereignty. One is that an EU membership involves an intolerable loss of sovereignty. The other is that an EU membership is in fact necessary to ensure the country's sovereignty. This is argued for the reason that the EEA agreement gives no participation right in law-making within the EU which Iceland has to adopt as an EEA member.

EEA countries can only give recommendation to the Commission on the first stages when new laws or regulations are made. When the first draft is ready and the political debate between EU members begins, EEA nations can only influence the decision making by lobbying EU members. However, the EEA countries have a veto over the rules and regulations that flow into the agreement, but this has never been used. The reason is that the EU has a safeguard measure that allows it to drop parts of the agreement were the EEA countries to use their veto right. This they could do because of their determination to keep the homogeneity of the European market. If used, it is argued that it could potentially destroy the EEA agreement[129]. Diana Wallis, an EU MP, has termed this problem a double democratic deficit. The first democratic deficit arises because the EEA countries are not able to participate in decision making within the EU; the second because of the democratic deficit within the EU itself[130].

The movements in Iceland in favour of EU look at membership as ensuring Iceland's sovereignty because "*...being allowed on the field gives countries more* *leverage than being in the stand watching*[131]". As a member, Iceland would participate in all EU's decision making bodies. Although Iceland's voting power would only be marginal (see Appendix A) they would at least be "*on the field*".

The democratic deficit ranks among the most controversial issues relating to EU membership. This is because of the missing link between parliamentary representation and executive power, within the EU, which is the cornerstone of democracy within nation states. This lack of democracy within the Union can be explained by the two opposing forces, one wanting more movement into a federation and the other away from it, which causes the EU to end up somewhere between the two. The main concerns are, on one hand, about the Parliament which is the only democratically elected body within the EU's member states but one with very marginal power. On the other hand is the Commission which is appointed by the Council of the European Union and is therefore not democratically accountable to EU citizens. Nonetheless it holds considerable power. As briefly discussed in 2.1, Commissioners are supposed to work with the Union as a whole in mind, without being biased in favour of their own country. This has not always been the case and even in the debate in Iceland it is argued that were the country to become a member, the chances are that Iceland could get the chair of the EU's fishery commission. The reason why this is interesting is because if it were to get this chair, Iceland could easily influence the fishery policy in its favour, which obviously would be a violation of the Commission's role.

It is also important to mention the lack of interest in the Union among EU citizens and its elections (see discussion in chapter 2.1.1). "*More people vote for the TV show Big Brother than in the European Parliamentary elections*[132]" is a common joke in Britain but is not far from the truth. This has increased the talks of democratic deficits and the Union is thought to be moving further away from its people. In this respect it is interesting to mention a recent poll by the European Commission which showed that only 48% of EU citizens thought their country's membership was a good thing[133].

Finally it has to be mentioned that recently there have been talks about some countries being "more equal than others" within the Union. This is happening because Germany and France have been ignoring the Stability and Growth pact while others, e.g. The Netherlands and Portugal, have been forced to comply with it at huge costs[134]. This is of much concern for smaller countries within the Union because they see themselves being forced to obey rules and regulations which the larger countries only do if favourable to them.

5.3.2 Small countries within the EU

It is not an uncommon argument that a small country like Iceland would be suffocated within a large organization like the EU. As Appendix A shows, Iceland is predicted to get 3 votes out of 321 in the Council of the European Union and 25 seats in the European Parliament out of 732. This estimate is based on Malta's voting power which is of a similar size as Iceland. In the European Council, where the EU's future political direction is developed, every member nation gets one vote and decisions are taken by a unanimous vote (see chapter 2.1). The question is thus would Iceland, with its stated voting power, have any real influence within the EU as a full member?

Baldur Thorhallsson (2000), a political scientist, has done extensive research on small states within the EU. His findings show that countries like Iceland can make up for their small administration and lack of resources by prioritizing and pressing issues which are of vital importance to them and ignoring other issues not as important. Large EU members are not capable of this; they run huge administrations and actively participate in all issues. The small states usually have few sectors of vital importance which makes it easy for them to prioritize. Small states also rely more on intra-EU trade than the larger ones. However their economic interests seem to be very different from each other, which causes hardly any alliance formation between them.

Luxemburg and Greece are examples of small states which have been very successful in prioritizing and pushing the issues that are most vital to them. They have done it with informal working methods, flexibility in handling matters and by giving their officials in the EU a considerable scope for manoeuvring in issues which are not of vital interest to them[135].

Small states also develop a much closer relationship with the Commission. They rely on the Commission for resources and information on matters which are not of great importance to them. Larger states tend to be very inflexible in all negotiations within the EU but the small ones are inflexible only in matters of vital importance to them. On other issues, they are very flexible which makes it easy for them to use horse-trading to help them get their issues through[136].

Finally in the Council, large countries are understandably much more likely to be able to block issues or push them ahead than small ones, like the voting power in Appendix A shows.

5.3.3 EU Rules and Regulations

Hannes Holmsteinn Gissurarsson, a political scientist and member of Heimssyn an anti-EU organization in Iceland has stated: "*Support for unrestrained international trade is not necessarily a support for unrestricted international* *organizations*[137]". Homogenous rules on the common market are good if they make trade easier but, as Gissurarsson and more Euro-sceptics state, the EU has gone way beyond this and the bureaucracy and the flow of rules and regulations has reached the point of hurting trade. This is an important issue because it has been used often as an argument against membership. Mr. Oddsson recently pointed to regulations about truck driving between EU countries which Iceland had to adopt. He also mentioned rules about ship canals which the Minister of Transportation had to "*make an exclusive speech about in parliament*"[138] though neither law had any relevance to Iceland. There are also examples of rules about how to clean beaches and more absurdly, rules about the size and shapes of cucumbers and bananas which have to be free from any "*abnormal curvature*". These are just two examples of regulations that the EU has formed which is very hard to argue having any positive affects on trade[139].

Talks about preventing "harmful tax competition" by harmonising taxes within the EU have further made Iceland's Euro-sceptics worry but the country has been extensively cutting taxes during the recent decade. Though tax harmonisation has not been accepted within the EU, it has been extensively advocated and is likely to be so in the future[140]. If successful, Mr. Oddsson among his fellow Euro-sceptics in Heimssyn, worry that Iceland would be forced to increase taxes, not decrease them, which could very well turn around the attractive business environment that has been built in Iceland[141].

5.4 Financial Contribution

As a relatively rich country, Iceland would most likely be a net contributor to the EU. This can be confirmed by noting that Iceland's GDP is 36% higher per capita than EU's average and 3.5 times higher than in the ten new countries that are joining the Union in May 2004[142]. Still, one of the arguments in Iceland for EU membership is that the country could potentially get more from the EU than it would have to give[143]. Fredric Bastiat, the famous nineteenth century economist, once eloquently described the state as being "*...the great fictitious entity by which everyone seeks to live at the expense of everyone else*"[144]. And as it is impossible for all EU members to be able to free-ride on someone else, a relatively rich country like Iceland can never become a net receiver, as an EU member, as some Euro enthusiasts argue. The question is therefore not whether Iceland would become a net receiver, but how much it would have to contribute to the EU?

The Institute of Economic studies in Iceland (2002) predicted how much Iceland would have to contribute and what it would be able to get back from the EU. Its net contribution, after the expansion, is estimated to be between 8.3 to 10.1 billion ISK a year as Table 4 below shows:

TABLE 4

	Low	*Median*	*High*
Total contribution to the EU	**12.193**	**12.861**	**13.170**
Tolls and duties	2.556	2.556	2.556
Tax contribution	3.418	3.608	3.798
GDP contribution	6.719	6.817	6.916
Other payments	200	300	400
The EEA agreement (subtracted)	-700	-600	-500
Total contribution from EU to Iceland	**3.075**	**3.473**	**3.870**
Agricultural support	2.400	2.640	2.880
Structural funds	675	833	990
Net contribution to the EU	**8.323**	**9.209**	**10.095**

SOURCE: Institute of Economic Studies (2002)

Since this prediction was made, Iceland's contribution to the EEA has increased. The EEA subtraction in Table 4 above should thus go up five fold, which would change the range of net contribution to the EU to 5.523 to 8.095 Billion ISK per year. In the forecast, the ten new members are included along with Bulgaria and Romania (predicted to become members in 2007).

EU's budget for 2002 is used for the Low column. In the High column it is estimated that Iceland's contribution will increase by 34% from what it was in 2002 along with 20% contraction in agricultural support and 40% contraction in structural funds to Iceland. This is, however, a very rough estimation based on calculations from several of countries, e.g. Denmark, Germany, Italy and Austria.

It has to be taken into consideration as well that the structural funds demand that the receiver country contributes at least 50% of the total support given which could cause a strain on Iceland's public budget. Another cost not included is Iceland's establishment of embassies in all EU's member countries.

5.5 Iceland's Economy

This section will discuss the impact EU membership could have on Iceland's economy. We assume that Iceland would also become a member of the single Euro currency area. By joining, Iceland's economy will be affected first, by complete integration into the Common European Market, and second through the adoption of the Euro.

The first two parts of the section discuss Iceland's current status and capabilities of becoming an EU member. The third section discusses how the economy would be able to adjust to economic shocks along with the impact membership might have on unemployment, investment, trade and interest rates.

5.5.1 Optimal Currency Area

According to the economist Mundell and his theory of the Optimal Currency Area, one of the following conditions has to be met to make EU membership desirable for Iceland[145].

- ✓ Economic shocks within the area should be symmetric. That means if one area (Iceland for example as an EU member) would be hit by an economic recession, the other area (EU) would experience the same.
- ✓ Nominal wages should be flexible so if there is a shock in one area the nominal wages would change and thus the real wages would change. Within a currency area, flexibility of nominal wages is the only way possible to make real wages flexible. This is because each area can have little effect on prices if its monetary policy is controlled externally. If a shock has an affect on total demand for goods and services, then it is important that nominal wages and the price levels are flexible. If, on the other hand, it is the total supply that is affected then the flexibility of real wages is more important.
- ✓ The third condition is that labour should easily be able to move between areas. If one area (Iceland) is hit by an asymmetric shock but the other area (EU) not, then it is important that labour could move from the area with high unemployment (Iceland) to the one with a lower level (EU).

In a study by the Institute of Economic Studies in Iceland[146] it was examined whether Iceland qualified for any of the above conditions. In short, it failed on all of them. Economic fluctuations were much higher in Iceland than in other EU countries and also not in synchronicity. The institute explained this by Iceland's dependence on its marine and aluminium sector which is very different from Europe. Therefore the Institute concluded it was very unlikely that Iceland's economic peaks and lows would take place at the same time as EU's.

The study also found that nominal wages have not been flexible downwards in Iceland, although real wages have. This was explained by the price levels having repeatedly increased which cancelled out the excessive nominal wage increases in the past. Therefore, the condition for flexible nominal wages is not satisfied though there is evidence to suggest that if Iceland would adopt the Euro, these excessive nominal wage demands would decrease. In Austria, and other countries, the labour market adapted to the fact that it was impossible to decrease real wages by devaluing the currency. The labour unions realized this and the fact that unemployment would surge if they would not drop their excessive demands[147].

Iceland also fails on the final condition which demands high labour mobility within the area. Today, labour can move freely within the EU market but is currently too small to be able to equalize labour demands in Iceland and within the EU.

Mar Gudmundsson, the Central Bank of Iceland's chief economist, has verified the above findings which suggest that Iceland would be best served by having flexible exchange rates[148]. Gudmundsson goes on to state that Mundell's theory is not at all perfect and that there are other issues that need consideration. These are the micro-economic benefits from adopting the Euro, with lower transaction cost and less uncertainty caused by exchange rate risks. Also, the body controlling Iceland's monetary policy under a flexible exchange rate has to have discipline, credibility and competence. If not, chances are that increased economic volatility might be created in which case the Euro would be a better choice. By having its own currency, Iceland is also exposed to the probability of foreign reserve crises with very harmful consequences. Finally Gudmundsson mentions the long-term affects of adopting the Euro which could very well make Iceland's economy more like the EU's with time.

Following is a summary of Gudmundsson's main costs and benefits from joining the EU[149]:

Benefits	**Costs**

- ✓ Lower transaction cost
- ✓ More stable prices
- ✓ Prevents foreign exchange reserves crises
- ✓ Better access to Europe's large financial markets
- ✓ Access to decision making in the European Central Bank along with more security for the financial system

- ✓ Monetary policy given away
- ✓ Exchange rate fluctuations against third nations could increase

5.5.2 EMU Conditions

As discussed in chapter 2, certain conditions have to be met for a country to adopt the Euro. Iceland would satisfy the government deficit and debt, exchange rate fluctuation and the independent central bank condition, but fail on inflation and long-term interest rates. There is nothing to suggest that Iceland would not be able to adjust to the conditions. After becoming a member, the country would have to obey the Stability and Growth pact which states that government deficit can not exceed 3% of GDP.

When Finland, Ireland and Spain joined the EMU, they lowered their interest rates. The three countries all had higher economic growth than the average within the EU so the European Central Bank had a monetary policy much too loose for them. This did not cause any serious harm, although inflation increased in Ireland but has since decreased.

This suggests that Iceland should also be able to adjust its economic environment to meet these membership requirements without any considerable problems. The question is therefore not whether the country could meet the conditions, rather how will the monetary policy within the EU fit Iceland's future needs.

5.5.3 Economic Effects and Adjustments

Monetary policy within the EU is controlled by the European Central Bank (ECB). The ECB adjusts its policy according to the environment in the whole European market. As was noted earlier, Iceland's economy seems to fluctuate asymmetrically with the EU's economy. This can be explained by Iceland's dependence on fish and aluminium, but that have little or no impact on the business cycle in Europe. If, in Iceland, the fish catch was to drop and the ECB had a tight monetary policy, Iceland's economy would fall into a recession. In this case, it would be vital for Iceland to have low interest rates, but with the Euro, that would be impossible. Fiscal policy could be used but only to a limited extent because the government deficit cannot exceed 3% of GDP according to the Stability and Growth Pact.

There is currently no income transfer system to help countries adjust to economic asymmetric shocks within the Union, like in the case of the US. If one state in the US is in a recession, it gets assistance from the federal government which makes recovery much faster. Iceland would therefore have to rely on free capital and labour mobility along with changes in wages and prices which, as stated above, would have limited success. Iceland's fiscal policy would thus be the main adjustment mechanism.

As discussed in 5.5.1, the EU does not seem to be an optimal currency area for Iceland. Even though nominal wage flexibility, labour mobility and economic fluctuations are not similar now, with increased integration in to the EU, this could change. Iceland's marine sector has also been getting relatively smaller in recent years which support the proposition that Iceland's business cycle might become more like EU's. This is not certain though, and the increased importance of aluminium smelting with the investments ahead will do little to help. After Iceland joined the EEA it has also been very integrated into the European market. The question is therefore how much more integration would take place were it to become a member and more importantly would it be enough to make the benefits exceed the costs of losing its monetary policy?

If the country would join the EU today, it would only be able to rely on fiscal policy when its economy needs adjustment. Fiscal policy could be used by running a budget surplus over the long-term. That would make it possible to react by increasing government spending during an economic recession. This is good in theory but hard in practice because of the danger of government increasing its spending in both recessions and booms. The best way to go about this, as suggested by the Swedish government, would be to earmark a certain amount every year on the public's budget to be allocated to a contingency fund which could only be used under certain circumstances. By doing this, along with a balanced budget, fiscal measures could become effective in combating asymmetric economic shocks without risking a soaring unemployment rate[150].

The rest of this section will be dedicated to discussing the possible affects membership could have on unemployment, investments, trade and interest rates.

Unemployment

The aggregate unemployment rate in the European Union is quite high. This has led many to believe that EU membership may trigger an increased unemployment rate. Based on the conclusions from chapter 5.5.1, this is likely to happen in Iceland because the country does not satisfy Mundell's conditions in the short-term. It has to be noted however that the labour laws are mostly controlled by each member state which currently have very different employment protection legislation (EPL). Spain, for example has a very tight EPL and high unemployment rate but The Netherlands loose EPL and low unemployment. Unemployment rate is low in Iceland and the participation rate in the labour force high[151]. The same is true for many EU countries so there is no reason to believe that this will necessarily change with Iceland joining the EU[152].

Labour movement within the EU, just as in Iceland, is very rigid and EU workers are very reluctant to move from an area of high unemployment to an area of low unemployment. This can partly be explained by cultural and language differences but also because of generous unemployment compensation in many European countries[153].

With lower transaction costs and no exchange rate risk as an EU member, Iceland's trade and investments could increase economic growth. Higher economic growth could then spur the labour market and create jobs.

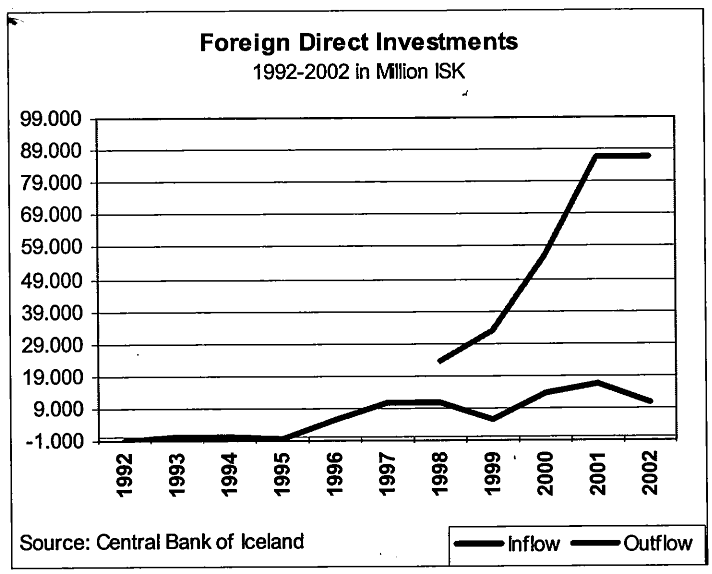
There are therefore many indications that Iceland's unemployment rate, all things being equal, would not increase, might even decrease, by becoming an EU member. But in a dynamic world, everything is not always equal and as stated earlier Iceland faces a business cycle that is different from the EU's. By failing on all the Optimal Currency Area conditions, the country would have to rely on fiscal policy to adapt to asymmetric economic shocks. Even though not certain, it has to be very likely that the unemployment rate could increase when faced with a monetary policy by the European Central Bank which is opposite to what the country needs.

Outside the EU, the country could very well manage to keep the unemployment rate very low and lower than as an EU member. Inside the EU, increased efficiencies and trade will likely spur economic growth which could decrease the unemployment rate more than outside the EU. But that can only happen if Iceland escapes from being hit by big asymmetric economic shocks or if it manages to adjust to them fairly positively.

Investments

Since Iceland joined the EEA and all capital controls were lifted, foreign direct investment to and from Iceland have soared as Figure 7 shows.

FIGURE 7



A study by a committee for Iceland's Foreign Minister's office concluded in 2002 that were Iceland to adopt the Euro, it would have only marginal effects on foreign investments in Iceland. This was mainly due to Iceland's small market. The study estimated that, like in the past, foreign investments would increase only in the use of Iceland's resources: energy and fish[154].

If Iceland joined the EU it would be completely integrated into the European financial system. The benefits from the integration have been estimated to be 0.7% of

GDP but half is more likely to be the case in Iceland. This is because the country has already enjoyed much of these gains with the EEA agreement[155].

Jon Steinar Valdimarsson, from the Confederation of Icelandic Industries, said recently in an interview that Icelandic companies are increasingly moving their businesses abroad. This, he said, is happening because of the transaction cost and exchange rate risk that Icelandic companies, trading with the EU, have to live with which makes them less competitive on the European market[156]. This has also happened in Britain as the case of the vacuum maker Hoover suggests. It was hit by a surprise when the sterling appreciated by 35% against the European leading currencies in the 1990s. Exports fell from 50% to 35% of production which forced the company to purchase its supplies from Spain, Portugal and Italy instead of Britain. The company also immediately dropped all plans to invest in Britain[157].

The above is a good reminder of how expensive it can be for businesses to face exchange rate fluctuations. This does, however, not tell the whole story. First, it is hard to argue that Icelandic companies would be better off if the country would constantly be confronted with a monetary policy opposite to what was needed, with the self-evident consequences. Second, as in the case of Britain, less than 50% of Iceland's imports and exports are to Euro countries. In Britain, the Euro fluctuated more with respect to Britain's other trading partners than with respect to the sterling. In other words, British companies would face more exchange rate fluctuation with a Euro membership than without[158]. A similar study has not been done for Iceland but is of great importance because the Euro area is currently not Iceland's dominant business partner (see Appendix F).

Trade

With the EEA agreement, Iceland secured free trade to the EU market with very few exceptions. The trade creation effect would therefore not likely be large were the relations to be changed to full membership. EU's trade contracts with non-members, which Iceland would have to adopt, are very similar to Iceland's. The weighted average of tariffs on industrial products is 4% within the EU but 2.5% in Iceland[159]. The EU, for example, has higher duties on cars and electronics from the US than Iceland but this would only have marginal effects on the country's trading pattern[160]. Many new markets, however, would become open to Iceland if it became a member which could trigger trade creation.

Currently, there are some tariffs on fully produced marine products in the EU which would be dropped were Iceland to become a member. The static customs union effect will thus likely be both trade creating and trade diverting. In agriculture, extensive trade creation with the EU will occur along with some trade with non-members. Although no estimate is available, trade creation will probably outweigh trade diversion. However, this effect will not be very strong because much of the benefits from trading with the EU are already seized with the EEA agreement. The dynamic effects of becoming a member will be increased economies of scale with lower production cost and increased competition, but again the effects will likely be only marginal because of its current relations with the EEA.

Before it changed its statues from an EEA partner to a full EU membership, it was estimated that the duties on Swedish exports to the EU were about 1.7% of total Sweden's exports to the Union[161]. It has also been estimated that Sweden's trade with the EU would increase by 50% were the country to adopt the Euro. The British Treasury has estimated that Britain's trade with the EU, as a Euro member could increase by 5% to 50% without diverting trade from non-members. In Britain's case, 50% increase in trade would raise living standards by almost 10% over 30 years[162].

This increased trade with the same currency is triggered by eliminating the exchange rate risk, transaction cost (estimated to be 0.4% of GDP on average[163]) and because all price comparison will lead to increased transparency and competition. This can increase economic growth and welfare. Trade within the EU fell, however, unlike the above estimates states from 1998 to 2001. By factoring out rising oil prices and America's boom, trade within the EU has been increasing but far from as much as the above estimates for Sweden and Britain state[164].

All the benefits mentioned before, however, depend on the fact that Iceland would be able to adjust to all asymmetric economic shocks quickly and surely. There are serious adjustment problems within the EU and Iceland's business cycle does not fluctuate in the same way as EU's does. This suggests that many potential benefits could be crowded out by a much worse business environment because of the inability to control interest rates and exchange rates. Iceland's geographical distance from the European market can also be an issue but Frankel (2000), among other economists, has found distance to be an important variable when estimating the benefits from joining a currency union.

Interest Rates

It is a common belief among Icelanders that by joining the EU, interest rates will become the same as within the EU. The Institute of Economic Studies in Iceland has estimated that the long-term interest rate differential between Iceland and the EU to be between 1-2%[165]. If Iceland were to join the Union, this premium would decrease by between 0.2-1 percent which is 1.2-6.5 billion ISK in interest payments per year. This will happen mainly because of the lower risk of exchange rates and inflation fluctuation. It is unlikely that interest rates will become the same as within the EU, as is commonly thought, because of increased bankruptcy and market risk, for example, after the country gives away its monetary policy to the EU[166].

The same study also states that with the appropriate monetary and fiscal measures, the same lower interest rates (even lower) could be achieved in Iceland without joining the EU. This can be seen in the case of Germany, Finland and Sweden. The nominal interest rates on bonds are almost the same in the three countries even though Sweden is not a Euro member and is not planning on becoming one[167]. Finally without sound domestic economic policy, interest rates could very well increase by substituting the Euro for the Krona and as stated before, become lower by Iceland staying outside the Union.

5.6 EU's Future

Up to now, the focus has been solely on how Iceland would benefit from joining the European Union as it is today. The EU is changing fast and with ten new member countries joining next year, new problems and issues are likely to appear. It is therefore important to briefly discuss EU's possible future.

No country has ever left the European Union and leaving the EMU is bound to be not only expensive but almost impossible. For a country to leave the Union, a serious conflict would therefore have to occur. If the Union were to change the principle of Relative Stability, with Iceland as a member, then Iceland could very well be forced to rethink its position within the EU. Were this to happen, Iceland could end up either outside the EU and with European relations probably worse than before entering, or forced to continue as a very unsatisfied member.

Increased talks about making the European Union more democratic are surely going to have an effect on its development in the future. In fact, in the recent constitutional discussions many interesting things can be seen that reflect on EU's future direction. Among the changes pressed were suggestions about eliminating the rotating presidency, changing the voting weight of EU members, letting only 15 (out of 25) Council members be able to vote, increased tax harmonization and moving foreign policy under qualified majority voting.

For Iceland, the increased democratically distributed voting weight would be very damaging. With a population of less than 300 thousand (0,065% of EU's population), its marginal voting power would likely become even more marginal. Not being able to vote in the Council on every issue and without getting the rotating presidency to press Iceland's issues it becomes harder to justify EU membership on the grounds that the EEA contract gives no saying in EU's law setting. Were these to be agreed on, the principle of Relative Stability could be changed without Iceland even being able to have any voting rights. As a member, not only is it likely that Iceland's voting power could become more marginal in the future but more sovereignty is likely to be delegated to EU's supra-national institutions. In simple terms, Iceland could end up having less voting power in more areas in the future as an EU member.

Talks of an EU tax and tax harmonization could harm Iceland's competitiveness and the increased bureaucracy with a very extreme regulatory framework (see chapter 5.3) as well. Roman Prodi, the president of the European Commission, has stated that it is important for the Union to have an increased central budget to be able to help members when faced with asymmetric shocks[168]. There have also been increased talks of preventing harmful tax competition. Taxes are currently low in Iceland so this would without a doubt cause a harmful tax increase[169].

After the recent failed constitutional talks there have been some speculations about a two speed Europe. In the Treaty of Nice, this possibility has been opened. Were this to happen, a group of countries could deepen their relationship without the Union as a whole being forced to as well. This could both become a threat and an opportunity. The opportunity would be for a country like Iceland to increase its relationship with the EU without sacrificing more of its sovereignty. In other words, the EU could become more relaxed about which aspects of the Union member nations participate in. This has to be seen as an unlikely development but the threat would be for a group of countries to increase their relationship and become a dominant force within the EU.

The final issue that is important to mention is whether the ten new member countries will be able to adapt and the Union as a whole develop and function after the expansion. The expansion is without a doubt going to bring new problems within the Union because some of the newcomers are not very fond of delegating more of their sovereignty than they currently need. Like the case of Greece, which has grown very slowly since joining the EU, it is also far from certain that these ten new members will be able to grow fast and catch up with the rest of the Union. The new members are relatively much poorer than the current EU members (see Appendix A) and environmental and social policies that they have to adopt have been predicted to hinder their growth. It is also impossible to predict the influences on EU's monetary policy the new members will have when adopting the Euro. Nonetheless, fish and aluminium will become more marginal in EU's business cycle with the new members joining.

Bergmann (2003) described the European cooperation, very eloquently, as *"...a train which either sweeps ahead or moves very slowly. Although unlike regular* *trains, it has no terminal*[170]*."* Bergmann's description is very relevant and important. It underlines that the European Union, Iceland would join today, might become completely different five or ten years from now. This is a very important factor when contemplating the costs and benefits from joining the EU especially with the enormous changes it faces with the expansion ahead. The question is therefore whether the road EU is taking is beneficial for Iceland. Should the country join now or stick with its current agreement with the Union? This question will be discussed and answered, in the following chapter.

NOTES

[98] Bergmann 2003, 23

[99] *Morgunladid*, "Evropuadild ekki a Dagskra", April 13th 2002

[100] *Morgunbladid*, "Ottafull Sjavarutvegssyn Stefans Mas", May 19th 2003.

[101] *Morgunbladid*, "Islendingar hafa ekkert ad Ottast", May 13th 2001

[102] Palsson 2003, 219

[103] Samfylkingin 2001, 92

[104] *Morgunladid*, "Evropuadild ekki a Dagskra", April 13th 2002

[105] Palson 2003, 231-232

[106] Morgunbladid, "Islendingar hafa ekkert ad Ottast", May 13th 2001

[107] Bermann 2003, 160

[108] Arnalds, Ragnar, "Einkalögsaga Möltu minnkar um helming við aðild að ESB" *Heimssyn.is*, September 9th, 2002, http://www.heimssyn.is/page_11.html?news_article=38562469

[109] Palsson 2003, 228

[110] *The Economist*, "A Bloody War", December 30th 2003

[111] Palsson 2003, 210-218

[112] Palsson 2003, 228

[113] Bergman 2003, 159

[114] The Federation of Icelandic Fishing Vessel Owners http://www.liu.is/template1.asp?Id=311&sid=98&topid=238

[115] Samfylkingin 2001, 98

[116] Ministry of Foreign Affairs 2000

[117] The Federation of Icelandic Fishing Vessel Owners Website, http://www.liu.is

[118] Samfylking 2001, 104

[119] Central Bank 2003, 31

[120] Bergman 2003, 166-167 and Minister of Foreign Affairs 2003 March, 6-7 and 64

[121] Minister of Foreign Affairs 2003 March, 19

[122] Ibid, 54

[123] Ibid, 70

[124] Bergmann 2003, 174

[125] Minister of Foreign Affairs 2003 March, 7

[126] Ibid, 4

[127] Bermann 2003,169

[128] Thorhallson 2000, 260

[129] Samfylkingin 2001, 23

[130] *Morgunbladid*, "Enginn Ahugi hja ESB a uppfaerslu EES samningsins", February 17th 2004

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[133] Richard Carter, "Support for EU falls in a New Commission Poll" *Euobserver.com*, February 2nd, 2004, http://euobs.com/?aid=14578&rk=1

[134] *The Economist*, "The death of the Stability Pact", November 27th 2003

[135] Thorhallsson 2000, 235

[136] Thorhallsson 2000, 239-240

[137] Gissurarson 2001, 55

[138] *Visbending*, "Storir draumar, litlar thjodir" 51, no. 21, 2003

[139] See for example online:
http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31994R2257&model=guichett and

http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31988R1677&model=guichett

[140] *The Economist*, "An Intergovernmental Tug-Of-War", November 20th 2003

[141] *Visbending*, "Storir draumar, litlar thjodir" 51, no. 21, 2003

[142] The Institute of Economic Studies 2002, 2

[143] Bergmann 2003, 198

[144] Bastiat 1964, 144

[145] Hall et.al. 1998, 1-2

[146] Ibid, 10

[147] Ibid, 47

[148] Samfylkingin 2001, 84

[149] Ibid, 85

[150] Ministry of Foreign Affairs 2002 April, 48

[151] Artis 2001, 375-378

[152] Samfylkingin 2001, 73-74

[153] King 2000, 321

[154] Ministry of Foreign Affairs 2002 April, 57

[155] University of Iceland 1995, 197

[156] *Morgunbladid* "ESB adild og Upptaka Evru er Besta vornin ad mati SI" February 24th 2004

[157] *The Economist*, "Now for the Big Push", November 29th 2001

[158] Minford, Patrick, A talk at the Cato Institute "Future of the Euro / talk by Patrick Minford", *Cato.org*, November 11th 2003, http://www.cato.org/events/monconf21/program.html

[159] Ministry of Foreign Affairs 2000

[160] University of Iceland 1995, 191

[161] Ministry of Foreign Affairs 2000

[162] *The Economist*, "The Euro, trade and Growth" July 10th 2003 and Rose 2001

[163] King 2000, 317

[164] *The Economist*, "The Euro trade and Growth", July 10th 2003

[165] Arnason 2003, 21

[166] Ibid, 25

[167] Ibid, 39

[168] *The Economist*, "Europe's Bid Idea", January 3rd 2002

[169] *Visbending*, "Storir draumar, litlar thjodir" 51, no. 21, 2003

[170] Bergmann 2003, 57

Chapter 6. - Conclusions

6. CONCLUSION

The European Union has been a historic success. Not only has it prevented the continuation of wars between its members, which were common before its formation, but it has also induced trade through its economic integration and helped its members reach some of the highest living standards in the world. Iceland has benefited from this increased prosperity within the EU but good relations with the Union is the foundation for the country's growth. This can be blinding and move people to conclude that an EU membership is essential. The previous chapters have touched on various issues and shown that the answer is not so clear. There are not only benefits from joining the EU; there are also high costs and uncertainties involved.

In this sixth and final chapter the question whether Iceland should join the European Union is answered. The chapter is divided into two sections, with the first one discussing the conclusions from the thesis' findings. The second section asks and answers the title question: should Iceland join the European Union? The latter section also briefly mentions some future research questions that have arisen.

6.1 Conclusions Discussed

Were Iceland to join the EU all its legislative powers regarding the marine sector would be given to EU's supra-national institutions where, for example, its TAC would be decided. Iceland would likely hold most of its current quota but the EU would probably try to increase its share in Iceland's waters during membership negotiations. Foreign investments in the marine industry would open, and because of the fundamental rule that no country can discriminate against another EU country, Iceland would become a victim of quota hopping. Therefore, the country could lose some of its current revenues from the marine sector to other EU members.

Even though the Relative Stability principle would ensure Iceland's share in its waters now, there is no guarantee that the principle will be used forever. Were it to be changed, Iceland would only have a marginal say, because the qualified majority voting is used to change the Common Fishery Policy, and could thus lose some of its quota. With membership, the marine sector in Iceland becomes centralized and subsidised, but is today a sustainable and profitable industry. Finally, some marginal trade creation might occur with marine products and EU's trade contracts with non-members might offer some opportunities for Iceland.

Agriculture is an industry which would be hurt extensively if Iceland would decide to join the EU. It is not certain whether Iceland's farmers would receive fewer subsidies but what is certain, however, is that they would be unable to compete with EU's agricultural products. Consumers, on the other hand, would benefit from getting more variety of agricultural products for a lower price.

Trade liberalization with agricultural products is on the agenda of the current Doha round of negotiation under the authority of the WTO. The outcome may force Iceland to change its current policy of heavy subsidising the agricultural sector. It would certainly be easier, politically, to reform the country's agricultural policy by joining the EU than by doing it independently. Although, by reforming it independently as an EEA member, Iceland's agricultural prices would become even lower than within the EU.

Iceland's sovereignty, strictly speaking, would likely be better secured within the EU than currently within the EEA. This is because almost 80% of the rules and regulations in the EU flow into the EEA agreement without Iceland hardly being able to have anything to say about it, except on first initial stages. Although this is the case, the EEA agreement is Iceland's only chance to be able to stay out of the Common Agriculture- and Fishery Policy, the second and third pillars (Justice and Home Affair and Common Foreign and Security Policy), fiscal and monetary policy and policies on taxation but still be a part of the inner European market. So being a full EU member would not necessarily make Iceland any better off because much more of its sovereignty would be delegated to the Union. Iceland would therefore benefit from joining the EU with respect to its sovereignty by getting a "*chair at the table*" where the decisions are made. However, the country's marginal voting power would absorb some of these benefits. Talks of a more democratic Union will absorb even more of Iceland's benefits because it would be the Union's smallest member and therefore, ironically, hurt by a more democratic EU.

As a member, Iceland could also face some costs due to the extensive amount of rules and regulations within the EU. However, many of these costs are already borne by the country through the EEA agreement.

Iceland is a relatively rich country compared to the EU average and will become even more so after the ten new members join. As a consequence, like the Institute for Economic Studies (2002) has found, Iceland would become a net contributor to the EU as a member.

The more synchronized countries are within a currency union, the more they will benefit. Currently Iceland's trade with Euro countries represents less than 50% of its total trade and it satisfies none of Mundell's conditions for the Optimal Currency Area. Therefore it is unlikely that Iceland would benefit from joining the EU and start using the Euro. The Euro is also new and largely untested, so it is still unclear how the Union, and the country involved, would handle a significant asymmetric shock. It is also unclear how the currency area will be able to perform after the ten new member countries join the Union and later adopt the Euro. What is clear, however, is that Iceland's dominant industries, fish and aluminium, will become even less important relative to other industries within the EU after the expansion.

In recent years, Iceland has managed to keep its inflation rate low, enjoyed a high economic growth and a low unemployment rate. The benefits from a complete integration to the European market would not be very substantial because Iceland is currently enjoying most of the customs union's effect as an EEA member. However, some trade creation would likely occur. The main benefits would be through substituting the Euro for its own currency, assuming that Iceland's business cycle becomes harmonized with the one in the EU. Were this to happen, increased economic growth, trade and employment could follow. However, if Iceland's business cycle does not fluctuate like EU's, then the country might be hurt by facing repeatedly a monetary policy not suitable for its economic situation which would likely decrease economic activity.

EU's future road and how beneficial it could be for Iceland is the last issue discussed. Were Iceland to become a member, it is clear that it would have to assume that EU's cooperation areas will increase in the future and therefore take away more of its sovereignty.

6.2 Should Iceland join the European Union?

As the previous section reveals, the costs from joining the EU are likely to outweigh the potential benefits in the six areas explored. Therefore the author's conclusion is that Iceland should not join the European Union.

Iceland should seize the opportunity of being part of the European common market but without being a full member. As such, the country is not as constrained by

EU's harmonization policies. Iceland can therefore move on to make its business environment even more attractive, with low taxes and more flexibility, and, at the same time, offer its businesses and people free mobility of products, services, labour and capital within the EU market.

This does not mean that membership can never become desirable for the country. If the EEA agreement were to change, so Iceland's interests within the EU market would no longer be satisfied, the country would have to rethink its position. But were that situation to come up, Iceland has an advantage over many other European countries. This is because the country is currently so integrated to the EU, through the EEA agreement, that it faces few obstacles to membership and is unlikely to be ever rejected because it is already half-way in.

There is no virtue in joining the EU today rather than after 10 years, like sometimes is stated. Iceland will not miss out on anything or get a better "deal" by becoming a member now rather than later. The only exemptions it is likely to get from EU's Acquis Communautaire (EU's laws) are temporary. In fact, it is likely to be more favourable to the country's interests to wait for at least 5-10 years before deciding to join because of the changes ahead within the EU. The dilemmas EU will face when adjusting its infrastructure from being a Union of 15, to a Union of 25 countries, can have unforeseeable consequences and could dramatically change Iceland's premises for membership. Iceland's current decision is therefore the most rational one, to foster the EEA agreement and good relations with the EU but to keep a close eye on EU's development without ruling out future membership.

Even though the six areas discussed are far from the only ones of importance when evaluating the merits of an EU membership for Iceland, they are the ones which highest priority should to be given to. As stated in the introduction, without actually starting membership negotiations it is impossible to know exactly what kind of a membership contract the country would be offered. What complicates things even more are the changes the Union is going through. Were Iceland to join today, it could very well find itself in a completely different kind of Union 5 years from now, no matter what kind of membership agreement it would get.

There are many interesting questions and issues which were not explored in this work which could affect Iceland's position. These are both in new areas and deeper exploration of the ones covered in this thesis. As an example of few interesting questions deserving future research are: Could the country peg its currency to the Euro and thus enjoy most of the country's desirable benefits a full EU membership offers? Were Iceland to be confronted with quota hopping like Britain, how high could the potential revenue loss be? How much would the Euro's fluctuation against Iceland's other trading partners affect the benefits from adopting the single currency? How likely is it that the country's business cycle could become more like EU's were it to become a member? These problems, however, are beyond the scope of this present thesis.

Appendices

Appendix A – Members and Votes

TABLE 5

	Population Size (000)	% of total EU population	Votes in Council	People behind each Vote	Seats in Parliament	People behind each seat
Belgium	10,274	0.023	12	856,167	24	428,083
Cyprus	767	0.002	4	191,750	6	127,833
Czech Rep.	10,256	0.023	12	854,667	24	427,333
Denmark	5,000	0.011	7	714,286	14	357,143
Germany	83,251	0.183	29	2,870,724	99	840,919
Greece	10,645	0.023	12	887,083	24	443,542
Spain	40,077	0.088	27	1,484,333	54	742,167
Estonia	1,415	0.003	4	353,750	6	235,833
France	59,765	0.132	29	2,060,862	78	766,218
Hungary	10,075	0.022	12	839,583	24	419,792
Ireland	3,883	0.009	7	554,714	13	298,692
Italy	57,715	0.127	29	1,990,172	78	739,936
Latvia	2,366	0.005	4	591,500	9	262,889
Lithuania	3,601	0.008	7	514,429	13	277,000
Luxembourg	448	0.001	4	112,000	6	74,667
Malta	397	0.001	3	132,333	5	79,400
Netherlands	16,067	0.035	13	1,235,923	27	595,074
Austria	8,169	0.018	10	816,900	18	453,833
Poland	38,625	0.085	27	1,430,556	54	715,278
Portugal	10,084	0.022	12	840,333	24	420,167
Slovakia	5,422	0.012	7	774,571	14	387,286
Slovenia	1,932	0.004	4	483,000	7	276,000
Finland	5,183	0.011	7	740,429	14	370,214
Sweden	8,876	0.020	10	887,600	19	467,158
UK	59,778	0.132	29	2,061,310	78	766,385
Iceland*	290	0.001	3	96,667	5	58,000
TOTAL	**454,361**		**321**		**732**	

Source: Microsoft Encarta Reference Library 2003 and The European Commission's Web

** Bergmann (2003) argued that Iceland would most likely get similar voting power as Malta.*

Appendix B – EU's History

TABLE 6

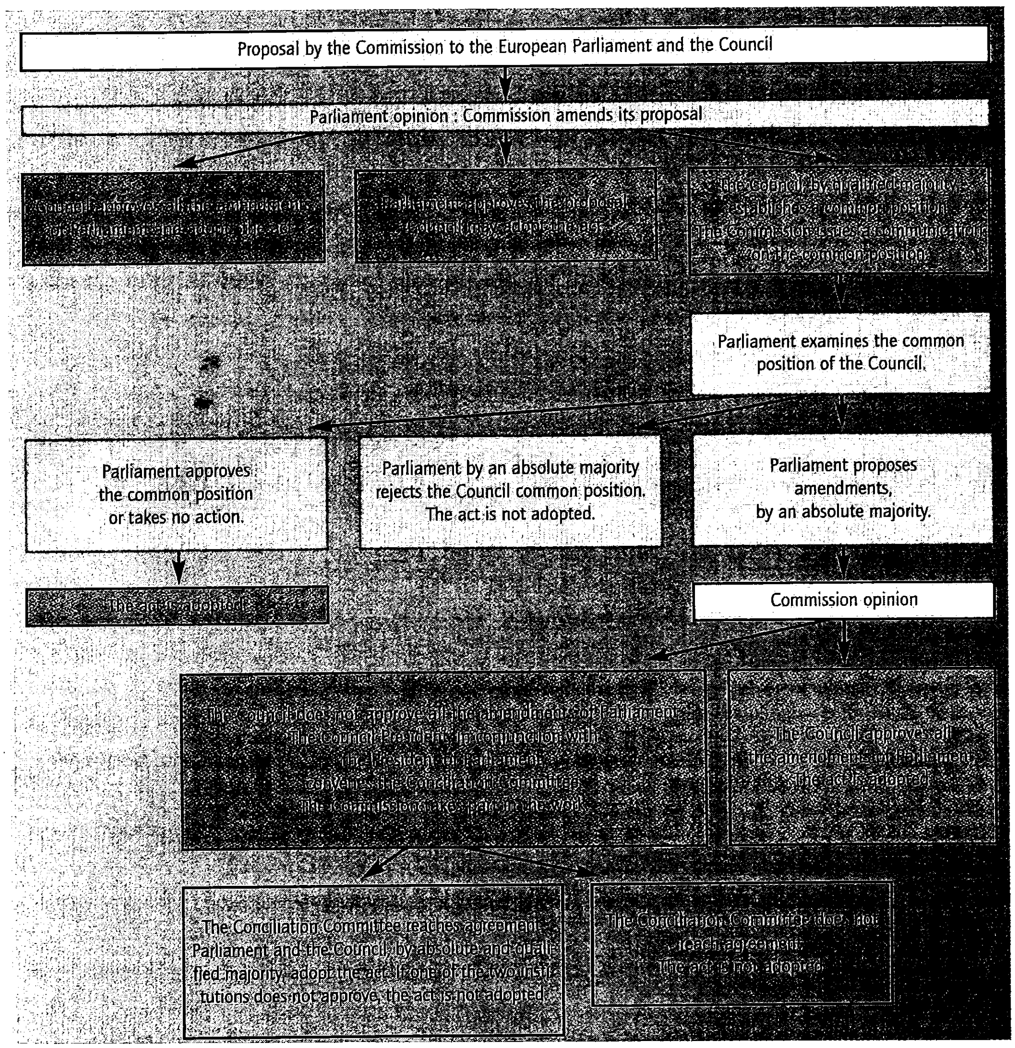
1951	The European Coal and Steel Community (ECSC) is established and includes France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg.
1957	The European Economic Community (EEC) and the European Atomic Energy Community (Euratom) are established by the members of the ECSC.
1960	In response to the ECSC, Denmark, Sweden, Norway, Austria, Portugal, Switzerland, and the United Kingdom establish the European Free Trade Association (EFTA).
1961	Denmark, Ireland, and the United Kingdom apply for ECSC membership. France veto's the applications.
1962	Norway applies for a membership but France veto's the application. The community sets a common agricultural policy
1965	Treaty is signed merging the ECSC, EEC, and Euratom into the European Community (EC).
1967	Again Norway, Denmark, Ireland and the UK apply for membership but France vetoes it again.
1968	The European Community customs union is completed, removing all customs duties between members of the EC and establishing a common external tariff.
1970	The EC gets its own budget. Membership negotiations with Norway, Denmark, Ireland and the UK begin again.
1972	Norwegian electorate rejects membership in the European Community in a referendum.
1973	The United Kingdom, Denmark, and Ireland join the European Community.
1976	Iceland's free trade agreement with the EC is fully implemented.
1979	The European Monetary System (EMS) is established to increase monetary stability within the EC and to promote eventual monetary union within the community. First direct elections are held for the European Parliament, the legislative body of the European Community (June).
1981	Greece joins the European Community.
1986	Spain and Portugal join the European Community.
1987	The Single European Act (SEA) is signed; it comprises amendments to existing European Community treaties to increase cooperation and integration within the EC. Turkey applies for a membership.
1988	Hungry signs an collaboration agreement with the EC. Other Middle and Eastern European countries follow.
1989	EC member states agree to establish Economic and Monetary Union (EMU), which includes the adoption of a single European currency for EC members.
1990	Following the reunification of Germany, the territory of the former East Germany becomes part of the European Community. Negotiations on the European Economic Area contract begin.
1991	The European Council meets at Maastricht, the Netherlands, and agrees to the Treaty on European Union which establishes the European Union (EU).
1992	The European Union and the remaining countries of the European Free Trade Association (EFTA)-Iceland, Norway, and Liechtenstein-agree to form the European Economic Area (EEA), an association establishing a single market and removing trade barriers among member countries. The Maastricht treaty is rejected in a referendum in Denmark. Eventually they get opt-outs from some parts of the agreement. Norway, Austria, Sweden and Finland apply for a membership.
1993	After ratification by member states, the Treaty on European Union goes into effect.
1994	The European Economic Area agreement goes in effect. A majority accepts membership in referendums in Austria, Finland and Sweden. Norway rejects membership for the second time.

1995	Austria, Finland, and Sweden join the European Union.
1997	The member governments of the European Union issue the Amsterdam Treaty, which revises the Treaty on European Union to provide for such things as cooperation in job creation throughout the EU and relaxing border controls between member states.
1998	The European Union opens discussions regarding membership with Cyprus, Poland, Slovenia, Estonia, Hungary, and the Czech Republic (March).
1998	As part of the plan for Economic and Monetary Union (EMU), 11 of the 15 EU member states agree to adopt the euro as a common currency. The United Kingdom, Sweden, and Denmark decline to participate in the common currency and Greece fails to meet the economic criteria to join (May).
1998	The European Central Bank (ECB) is created to oversee the inauguration of the euro and to take control of EU monetary policy (July).
1999	The euro is adopted for electronic transactions and for accounting purposes.
2000	Intergovernmental conference in Nice. EU's enlargement to eastern Europe iterated.
2001	Iceland and Norway become members of the Schengen cooperation about abolishing passports checks on EU's inner borders. Common border patrol is established on EU's outer borders. The UK and Ireland reject the Schengen. Ireland rejects the Nice treaty.
2002	The euro becomes the official currency of the 12 participating countries; euro coins and bills are issued and the currencies of the 12 states cease to be legal tender. Intergovernmental conference on EU's future is established. A plan is set to invite ten new member countries on May 1st 2004.
2003	The expansion is ratified by member countries and a draft constitution for the EU is introduced.

Source: European Union's Website – History – [http://www.europa.eu.int/abc/history/index_en.htm], Bergmann (2003) page 43-44 and Microsoft (2002) "European Union"

Appendix C – Decision making in the EU

FIGURE 8



Source: How the European Union Works – A citizens guide to EU institutions (2003)

Appendix D – The Institutes of the EEA

EEA Council

In the EEA Council are representatives from the Council of the European Union and the European Commission along with the foreign ministers of the EEA countries. There, rules and political directions are set for the EEA agreement which the EEA Joint Committee conducts. The EEA Council meets twice a year and makes decisions unanimously.

EEA Joint Committee

The EEA Joint Committee is the main collaboration area between the EFTA countries and the EU. Its goal is to ensure that the EEA agreement is being implemented. In the Committee are representatives from Iceland, Norway and Lichtenstein along with a representative from the European Commission. Representatives from the EU countries are open to attend their meetings. The Committee meets once every month and its main responsibility is to make decisions on applying EU laws into the EEA agreement. Also, it is the discussion forum for all issues regarding the EEA agreement. Decisions are made with unanimous votes from both parties, EFTA and EU.

Standing Committee of the EFTA states

The Standing Committee is directed by commissioners from the three EEA countries. Its main objective is to unify the EEA countries' positions towards the EU for the EU Joint Committee meetings. The Standing Committee meets once every month and has five committees and many workgroups to help prepare cases for the

Joint Committee. Representatives from ESA and Switzerland often attend their meetings but only to listen to what goes on.

EFTA Surveillance Authority – ESA

ESA is a surveillance authority which ensures that the EEA countries follow the EEA agreement. It also ensures that measures taken in the EEA countries are legal according to the contract. ESA therefore has a similar surveillance objective as the Commission within the EU.

EFTA Court

The EFTA Court has the same obligation towards the EFTA nations as the European Court of Justice has towards EU members. It is oblige to take the European Court of Justice as an example. The EFTA court's responsibilities are to cover charges ESA has against one or more EFTA nations settle disputes between EFTA countries and provide counselling on interpreting the EEA's legislations. The court has three judges and usually judges 5-10 cases every year.

EEA Consultative Committee

The EEA Consultative Committee has two parts, the EEA Parliamentary Committee and the EEA Consultative Committee. EEA's Consultative Committee is chaired by representatives from the labour market. It is an area for the labour market's representative in EU and EEA to communicate. The Parliamentary Committee is chaired by the European Parliament and parliament members from the EEA countries. Its goal is to increase understanding of EEA issues between EEA and the EU. The Parliamentary Committee has a consultative responsibility to EEA countries' parliaments and organizes meetings in the Consultative Committees.

Appendix E – Economic indicators for EU and Iceland

TABLE 7

% growth or ratio of GDP	*Iceland*	*EU*
Economic Growth 1991-2000	2,5	2,4
Inflation 1991-2000	3,2	3
Unemployment 1996-2000	2,9	9,6
Work force participation rate 1999	77,5	69,3
Public Balance	2,2	-,7
National Savings 1998	17,9	21,1

TABLE 8

	Economic Growth 1996-2000 Average	**Inflation Average 1996-2000**	**Unemployment rate Average 1996-2000**	**Work Force participation rate average 1999**	**Public Balance % of GDP 1996-2000**	**National Savings % of GDP 1996-1999**	**GDP per capita $US 1999**
Austria	2,5	1,3	5,4	77,5	-2,2	21,7	24,739
Belgium	2,7	1,7	8,9	63,8	-1,5	24,7	24,966
Denmark	2,7	2,3	5,5	80,3	1,2	21,2	27,235
Finland	5,1	1,6	11,7	73,7	1,0	23,8	22,696
France	2,5	1,2	11,5	68,5	-2,5	20,5	22,242
Germany	1,8	1,3	8,6	73,9	-1,6	21,5	23,831
Greece	3,3	4,9	10,8	61,8	-3,3	18,1	15,206
Ireland	9,6	2,5	7,9	68,6	1,9	23,6	25,420
Italy	1,9	2,4	11,5	59,3	-2,9	21,6	23,377
Luxemburg	6,2	1,6	3,1	63,5	3,9	-	41,534
The Netherlands	3,7	2,2	4,4	65,5	-0,1	27,6	26,100
Portugal	3,4	2,7	5,5	74,3	-2,5	3,5	16,795
Spain	3,7	2,6	18,4	64,2	-2,44	22,4	18,384
Sweden	2,9	0,7	6,6	75,7	0,48	20,2	23,150
UK	2,8	2,7	6,4	76,0	-0,56	17,3	22,923
EU - Total	**2,6**	**2,0**	**9,6**	**68,9**	**-1,7**	**20,2**	**22,469**
Iceland	4,4	2,8	2,9	77,5	0,8	17,8	26,327
Norway	2,9	2,3	3,7	70,7	7,7	28,9	28,370
US	4,3	2,5	4,6	67,1	0,1	17,8	33,817

Source: Samfylking 2001, 74

Appendix F – Iceland's Trade

EXTERNAL TRADE BY COUNTRY – 2002

TABLE 9

		Exports FOB % of total	Imports FOB % of total
EU-EMU			
	Austria	0.10	0.5
	Belgium	1.60	1.8
	Finland	0.90	1.7
	France	3.70	3.1
	Germany	18.50	10.7
	Greece	0.70	0.1
	Ireland	0.20	1.4
	Italy	1.40	3
	Luxembourg	0.00	0.1
	Netherlands	10.80	6
	Portugal	4.30	0.5
	Spain	5.20	1.9
		47.40	**30.8**
EEA			
	Denmark	4.60	8.5
	Sweden	1.10	5.9
	United Kingdom	17.50	7.4
	Norway	4.60	8
	Lichtenstein	-	-
		27.80	**29.8**
	Total EEA	**75.0**	**60.6**
Other			
	Other European countries	5.20	11.5
	United States	10.80	11.1
	Japan	3.30	3.1
	Other countries	5.60	13.8
		24.90	**39.5**

EXTERNAL TRADE BY PRODUCT

TABLE 10

EXPORTS FOB

%	1981-1985	1991-1995	2002
Marine products	72.6	77.1	62.9
Agricultural products	1.5	1.8	1.6
Manufacturing products	24.2	18.4	32.8
Other	1.7	2.7	2.6

IMPORTS FOB

%	1995	2000	2002
Food and beverages	10 3	8.3	10.1
Industrial supplies	28.7	24.0	29.0
Fuels and lubricants	7.1	9.1	8.3
Capital goods (ex. transp. equipm.)	20.6	23.1	19.7
Transport equipment	12.2	16.6	13.2
Consumer goods	21.1	18.9	19.7

TABLE 11

Million ISK	Exports fob	Imports fob	Balance of trade	% of GDP
1992	87,833	88,221	-391	-0.1
1995	116.607	103,539	13,068	2.9
2000	149,273	187,276	-38,003	-5.7
2002	204,303	191,205	13,098	1.7

Source: Statistics Iceland

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