Will an Economic Crisis Give Iceland the Final Push?

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Will an Economic Crisis Give Iceland the Final Push?*

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1 Introduction

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

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

2 The Political Front

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


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³ Central Bank of Iceland, “Interest rates”. http://sedlabanki.is/?PageID=224
the new views on EU membership that generated following the economic crisis. Subsequently, the chair of the SDP implied that if the IP would not come to the conclusion to apply for EU membership, there would have to be a revaluation of the coalition. The question of EU membership had become an ultimatum issue in Iceland.

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

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

3 Public Opinion

Numerous opinion polls have been taken in Iceland on EU membership and an EU membership application since last spring (2008). Before the crash in October Icelanders had been experiencing the consequences of a steadily weakening currency, with the Icelandic krona devaluing 26% against the euro from January until May 2008. That development gave rise to increased support for EU membership, in the hope of being able to get rid of the Icelandic krona for the euro by joining the EU. Since then support has in general been steady at around 55-65%, although fluctuating somewhat. According to a poll taken in July 2008 60% of Icelanders favored an EU membership application and 50% supported EU membership at that time. The support for an EU application then went from 69% in October 2008, down to 46% in March 2009, to go up again.

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to 58% in last June\textsuperscript{11}. In general the support for an EU application is substantially higher than EU membership support, understandably so, given that most Icelanders feel that they first need to see how negotiations, especially on fisheries, will go. In addition, the polls have showed that support for an EU membership application is in general stronger amongst those living in the capital area, the highest in the age group 35-44, and amongst women, the more educated and the wealthier.\textsuperscript{12}

### 4 What will the negotiations center on?

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

Although the relative importance of fisheries for the Icelandic economy has decreased somewhat in the last decades it is still high and even more so now, following the collapse of the banking system. Around 50\% of Iceland’s export is fisheries products\textsuperscript{14}, counting for one third of the country’s foreign exchange in 2007.\textsuperscript{15} Fisheries account for 8\% of GDP\textsuperscript{16} (expected to rise to 10\% in 2009, due to the collapse of the banking system\textsuperscript{17}) and 5\% of the working force in Iceland\textsuperscript{18}. The general view in Iceland is that the result of accession talks will depend on how willing EU negotiators will be to meet Iceland’s demands regarding fisheries by really taking into account the high importance of the industry to Icelanders, and negotiate accordingly. Negotiations on agriculture might prove somewhat difficult as well, but it is not likely that the chapter will become a deciding factor like fisheries.

### 5 Iceland’s Entry Number

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

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\textsuperscript{15} Statistics Iceland, “Þjóðhagsreikningar”, http://www.hagstofa.is/Pages/983


\textsuperscript{17} Arnórsson, A., p. 122.

\textsuperscript{18} Iceland Ministry for Foreign Affairs, p. 8.
treatment in that regard.\textsuperscript{19} They have, however, stated that since Iceland is already a member of the EEA and Schengen, the country’s route to entry will consequently be shorter than for other candidate countries.\textsuperscript{20} It is difficult to predict how these things will develop, it depends on the outcome of the negotiations and the referendum that follows. In addition, many European leaders have stated that in order for the Union to be able to absorb additional members the Lisbon treaty needs to be ratified. Ireland, which notably rejected the treaty last year, will vote on it again next October. All the same, EU’s Commissioner for Enlargement, Olli Rehn, has implied that if negotiations go well and the agreement is accepted in a national referendum it is possible that Iceland would join at the same time as Croatia (which is already well on its way in the accession process). Iceland would thus become the EU’s 29\textsuperscript{th} member state, since entry is in alphabetical order.\textsuperscript{21} Rehn has even said that Iceland could end up competing with Croatia to become EU’s next member state.\textsuperscript{22} Now it is safe to say only time can tell how these things will develop, and whether Iceland will indeed become an EU member state at all.

6 Conclusion

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

\textsuperscript{19} Financial Times, “EU gives boost to Icelandic membership”, July 27\textsuperscript{th}, 2009. 
http://www.ft.com/cms/s/0/47b77600-7ac1-11de-8c34-00144feabdc0_dwp_uuid=70662e7c-3027-11da-ba9f-
00000e2511e&html?ftcamp=rss

http://epaper.visir.is/media/200907280000/pdf_online/1_8.pdf

\textsuperscript{21} The Guardian, „Iceland to be fast-tracked into the EU“, January 30th, 2009.
http://www.guardian.co.uk/world/2009/jan/30/iceland-join-eu

\textsuperscript{22} Rehn, O., “Prospects for enlargement in the South-Eastern and North-Western corner of Europe“, December 10th, 2008). 
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