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**ICELAND
2013 REPORT**

Accompanying the document

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

Enlargement Strategy and Main Challenges 2013-2014

{ COM(2013) 700 final }

CONTEXT AND OVERVIEW

Following the 27 April 2013 general elections, the new Icelandic government decided to put the EU accession negotiations on hold and has indicated that the negotiations will not be continued unless approved through a referendum. This decision means that the accession process, where negotiations were started following the opinion by the Commission and a positive decision thereto by the June 2010 European Council, has come to a halt. The government has stated that it will undertake an assessment of the status of the negotiations to date as well as on the developments of the European Union, which will be submitted to the Icelandic parliament for discussion in the coming months.

In view of this development, the Commission's report provides a brief assessment of the political and economic criteria as well as the state of alignment of Iceland with the EU *acquis*. The report includes elements of further progress made by Iceland in the period September 2012 to the taking of office by the new government in May 2013, when the Icelandic authorities ceased contributing to this report. Additionally, the Commission has drawn concise conclusions regarding Iceland in its separate communication on enlargement¹.

Iceland, as a well-established and functioning democracy, continues to fully meet the **political criteria** for EU membership.

As regards the **economic criteria**, Iceland can be considered a functioning market economy. However, financial sector weaknesses and capital movement restrictions still impede an efficient allocation of resources. Iceland should be able to cope with competitive pressures and market forces within the Union over the medium term, provided that it continues to address current structural weaknesses through appropriate macroeconomic policies and structural reforms.

Iceland's **economy** continued to recover, albeit at a decelerating pace. So far, the recovery has been largely supported by private consumption, while investment remained weak. Low investment translated into low import growth, which helped to maintain a surplus in the trade balance and a largely balanced underlying current account. Record increases in tourist revenues largely compensated a weaker export performance. The labour market situation improved, leading to a significant reduction in unemployment. Nevertheless, unemployment among the young population and long-term unemployed remain a policy challenge.

Inflationary pressures subsided slightly in the first half of 2013. However, annual inflation is still clearly above the central bank's target of 2.5 %. Despite continued fiscal consolidation, the speed of adjustment has slowed down further. Fiscal risks persist due to spending pressures and sizeable contingent liabilities. Public debt levels remain high. Financial sector consolidation made progress, although debt restructuring of private households and companies is not completed yet. The efficiency of financial sector supervision is still not in line with international standards. In some sectors competition remained limited, either as a result of legal entry restrictions or of substantial state involvement, hampering investment and the growth potential of those sectors.

Capital controls continue to lead to distortions in the financial and capital markets and impede Iceland's investment climate and thus growth potential. Preparing a detailed strategy on how to lift these restrictions and proceeding with necessary measures, while preserving exchange rate stability remains a key challenge. An ad-hoc group on the removal of capital controls, including experts from the European Central Bank, the Commission and the International Monetary Fund was set-up in June 2012 at the request of the Icelandic government, within the framework of accession, to assess prospects for lifting these controls.

¹ Enlargement Strategy and Main Challenges 2013-2014, COM(2013) 700

As regards the **Instrument for Pre-accession Assistance (IPA)** for Iceland, given the purpose of this instrument and the government's decision on the accession negotiations, the Commission has suspended preparatory work on IPA II. The Commission will not sign any new contracts under IPA I. As concerns projects for which contracts have already been signed, the Commission is undertaking a project-by-project assessment, together with the Icelandic authorities in order for the Commission to determine which projects would be continued.

ABILITY TO TAKE ON THE OBLIGATIONS OF MEMBERSHIP

Iceland's alignment with the *acquis* as expressed in the Treaties, the secondary legislation and the policies of the Union is presented below. The analysis is structured in accordance with the list of 33 *acquis* chapters. Iceland has already reached a high level of alignment in a significant number of **policy areas covered by the *acquis***, mainly due to its membership of the European Economic Area. In a number of areas, the administrative capacity for effective implementation and enforcement of EU rules and policies is not fully in place. Since the opening of accession negotiations in June 2010, 27 chapters have been opened, of which 11 have been provisionally closed.

Iceland continues to be highly aligned with the *acquis* in the area of *free movement of goods*. Progress was made in the area of 'Old Approach' product legislation (automotive sector, REACH and cosmetics). Legislative alignment of horizontal measures in the area of 'New and Global Approach' product legislation is not complete.

Iceland continues to be highly aligned with the *acquis* on *freedom of movement for workers*. Iceland has not aligned with the Posting of Workers and Residence Directives, has not extended social security rules to legally resident third-country nationals and preparations for setting up an electronic data exchange system have not been finalised.

There is a high level of alignment with the *acquis* on the *right of establishment and freedom to provide services*. Alignment with the Third Postal Directive has not been achieved and restrictions in the fisheries sector remain. Iceland is almost fully aligned with the *acquis* in the field of mutual recognition of professional qualifications.

Iceland applies parts of the *acquis* on *free movement of capital*. Exceptions remain, due to extensive capital controls and in connection with investments in the fisheries sector.

Good progress has been made in the area of *public procurement*. Iceland applies most of the *acquis* in this field.

Iceland has reached a high level of alignment and applies a substantial part of the *acquis* in the field of *company law*. Good progress was achieved over the reporting period in meeting EU requirements on corporate accounting and auditing. Alignment with the company law *acquis* has not been completed.

Iceland has reached a high level of alignment with the *acquis* on *intellectual property law*. The alignment of Iceland's enforcement policy and legal framework on industrial property rights is not complete.

Iceland has reached a high level of alignment and applies a substantial part of the *acquis* in the field of *competition*. Iceland's state aid measures taken in response to the financial crisis continue to be in line with the *acquis*.

Alignment in the area of *financial services* is satisfactory. Work on alignment with and implementation of the new *acquis* in all the areas covered by this chapter is not complete.

Iceland has reached a high level of alignment and applies a substantial part of the *acquis* in the field of the *information society and media*. Good progress was achieved in the area of audiovisual policy. The 2009 Telecom Package has not been transposed and remaining gaps in alignment with the *acquis* in the field of audio visual policy and information society services, in particular the e-Commerce Directive have not been addressed.

In the area of *agriculture and rural development*, Iceland's policies are not aligned with the *acquis*. No further developments were reported in the areas of common market organisation, rural development and organic farming.

Iceland is partially aligned with the *acquis* on *food safety, veterinary and phytosanitary policy*. The current import restrictions on fresh meat and live animals are not in line with the *acquis*. There are gaps in legislation in the areas of animal by-products, food safety rules, plant health, genetically modified organisms and novel foods, and animal welfare.

In the area of *fisheries*, Iceland applies a management system which has similar objectives to those pursued in the EU, but some rules differ considerably. Overall, Iceland's fisheries policy is not in line with the *acquis*. Existing restrictions in the fisheries sector on freedom of establishment, services and capital movements as well as the management of shared fish stocks are not in line with the *acquis*.

Iceland has a good level of alignment with the *acquis* on *transport policy*. Good progress was made in air and maritime transport. Alignment with the relevant EU legislation on air and road transport is not complete.

Iceland is partly aligned with the *acquis* in the field of *energy*. In the field of renewable energy, the National Renewable Energy Action Plan to meet the EU 2020 targets was published in December 2012.

In the area of *taxation*, Iceland's legislation remains partially aligned with the *acquis* and some progress has been made. Preparations to ensure IT interconnectivity and interoperability with EU IT systems for taxation have not started.

Iceland has a good level of alignment with the *acquis* on *economic and monetary policy*. There are gaps in alignment with the *acquis* in the area of monetary policy, including as regards the independence of the central bank and the prohibition of monetary financing of the public sector.

Iceland is partly aligned with the *acquis* in the area of *statistics*. Iceland has not developed comprehensive sectoral statistics according to EU statistical standards and methodologies.

Iceland has reached a high level of alignment and continues to apply a substantial part of the *acquis* in the area of *social policy and employment*. Further preparations for participation in the European Social Fund have been made. Further progress was made in the field of labour law, employment policy and social inclusion. Legal alignment in the areas of anti-discrimination and equal opportunities is not complete.

Iceland's alignment with the *acquis* in the area of *enterprise and industrial policy* remains at a high level. Access to finance for SMEs remains difficult.

Iceland maintains a good level of alignment with the *acquis* in the area of *trans-European networks*.

In the area of *regional policy and coordination of structural policies*, Iceland started preparations in order to meet EU cohesion policy requirements.

Iceland continues to have high standards in the area of the *judiciary and fundamental rights*. The legislation on data protection is not fully in line with the *acquis*.

Iceland continues to apply the Schengen Agreement and is well advanced in aligning with the *acquis* in the area of *justice, freedom and security*. Alignment with the *acquis* in areas including migration, asylum, judicial cooperation and cybercrime is not complete.

Iceland has achieved a high level of alignment in the field of *science and research* and continued to participate actively in the EU's 7th Framework Programme for research and technological development. Iceland continues to be well advanced in meeting the targets and objectives of the European Research Area and the Innovation Union.

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

Iceland's policy is to a large extent in line with the *acquis* in the area of the *environment*. Compliance with the *acquis* on nature protection has not been achieved, in particular with regard to the protection of whales, seals and wild birds and the conservation of natural habitats and of wild fauna and flora. The same applies to the water sector, with special reference to alignment with the Marine Strategy Framework Directive and the Floods Directive. Progress was made in the areas of waste management, chemicals and climate change. Iceland is not aligned with the Directives on fuel quality and the geological storage of carbon dioxide and has not ratified the Espoo Conventions or the Environmental Crime Directive.

Iceland has achieved a high level of alignment and applies a substantial part of the *acquis* on *consumer and health protection*. Iceland has made further progress in the field of public health. Alignment with the *acquis* is not complete, especially in the area of consumer protection, in particular related to product safety issues.

Iceland applies to a large extent the *acquis* in the area of *customs union*. Preparations for addressing the identified gaps with EU legislation and practice, in particular regarding customs procedures, updating of the corporate and sectoral strategies and the development of interconnectivity with the EU-related IT systems have been initiated.

Iceland is highly aligned with the *acquis* in the area of *external relations*. Iceland and the EU have held regular trade policy consultations on WTO issues but Iceland has maintained its line in support of two currently pending cases in the WTO against the EU trading regulations for seals products.

Iceland has reached a high level of alignment in the area of *foreign, security and defence policy*. It has aligned with most EU declarations and Council Decisions when invited to do so. It further advanced the agenda on Arctic affairs given its objective to play an active and prominent role in regional organisations in northern Europe and the Arctic region.

Iceland's *financial control* system is partly in line with international standards and EU best practices. No progress was made in establishing internal audit and limited progress with ensuring compliance with the standards issued by the International Organisation of Supreme Audit Institutions in the area of external audit. Work is incomplete on the public internal financial control policy paper and on protection of the EU's financial interests.

Iceland has a good level of alignment with the *acquis* in the policy areas affecting *financial and budgetary provisions*. Gaps remain as regards the correct application of own resources rules.