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**ICELAND 2010 PROGRESS REPORT**

*accompanying the*

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

**Enlargement Strategy and Main Challenges 2010-2011**

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# COMMISSION STAFF WORKING DOCUMENT

## 2010 Progress Report

### 1. INTRODUCTION

#### 1.1. Preface

This is the Commission's first report to the Council and Parliament on progress made by Iceland since the Council's decision to open accession negotiations.

This report:

- briefly describes the relations between Iceland and the Union;
- analyses the situation in Iceland in terms of the political criteria for membership;
- analyses the situation in Iceland on the basis of the economic criteria for membership;
- reviews Iceland's capacity to assume the obligations of membership, that is, the *acquis* expressed in the Treaties, the secondary legislation, and the policies of the Union.

The period covered by this report is from February to early October 2010. Progress is measured on the basis of decisions taken, legislation adopted and measures implemented. As a rule, legislation or measures that are under preparation or are awaiting parliamentary approval have not been taken into account. This approach ensures equal treatment across all reports and permits an objective assessment.

The report is based on information gathered and analysed by the Commission. In addition, many sources have been used, including contributions from the government of Iceland, the EU Member States, European Parliament reports and information from various international and non-governmental organisations.

The Commission draws detailed conclusions regarding Iceland in its separate communication on enlargement based on the technical analysis contained in this report.

#### 1.2. Context

Iceland presented its **application for membership** of the European Union in July 2009. Subsequently, the Council of the European Union requested the Commission to submit its opinion on this application.

The Commission concluded in its **Opinion of February 2010** that Iceland meets the political criteria and can be considered a functioning market economy which should be able to cope with competitive pressures and market forces within the Union in the medium term provided that it swiftly implements the necessary policy measures and structural reforms.

The Opinion also noted the good overall level of preparedness to take on the obligations of membership in the medium term due to Iceland's participation in the European Economic

Area. It, however, highlighted a number of areas (fisheries, agriculture and rural development, environment, free movement of capital and financial services) where serious efforts would be required to take on the obligations of membership. Finally, the Opinion concluded that Iceland's accession would have a limited overall impact on the European Union and would not affect the Union's capacity to maintain and deepen its own development.

In light of these considerations, the Commission recommended that negotiations for accession to the European Union should be opened with Iceland. The European Council subsequently decided in June in favour of opening negotiations. The **first Intergovernmental Conference**, officially launching accession negotiations, took place on 27 July 2010. Preparations for the screening exercise are on-going.

### 1.3. Relations between the EU and Iceland

Iceland and the European Union have been cooperating extensively across a broad range of areas for the last forty years.

Iceland joined the European Free Trade Association in 1970 and has been a **party to the Agreement on the European Economic Area (EEA)** since its entry into force in 1994.

The first EU-Iceland Joint Parliamentary Committee met in October 2010.<sup>1</sup>

Iceland has been associated with the development of the Schengen agreements since 1996 and has applied their provisions since 2001.

Following Iceland's membership application, the Commission proposed that Iceland becomes eligible for pre-accession financial support under the **Instrument for Pre-Accession Assistance (IPA)**. The amended IPA regulation entered into force in July 2010. A Multi-annual Indicative Planning Document is expected to indicate the priorities for IPA support to Iceland for 2011-2013. IPA financial assistance to Iceland will be channelled through three main tools: the Technical Assistance and Information Exchange (TAIEX) instrument, multi-beneficiary programmes and a National Programme.

The **EU Delegation** in Reykjavík is fully operational: it opened in January 2010 and found permanent premises where it is expected to move by the end of the year.

Preparations are on-going for opening an EU information centre in Iceland in 2011.

Iceland has been included in the **EU Pre-Accession Fiscal Surveillance** procedure, and has received an invitation to submit its first Pre-Accession Economic Programme with a medium-term macroeconomic and fiscal programme, by January 2011.

This first progress report assesses the developments in Iceland since the publication of the Commission's Opinion. The reporting period for Iceland is therefore shorter than for the other countries included in the 2010 enlargement package as this report covers the period from February 2010 to October 2010. Iceland's ability to assume the obligations of membership has been assessed in light of its participation in the European Economic Area (EEA) and taking into account exemptions granted under the EEA.

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<sup>1</sup> The European Parliament's rapporteur for Iceland is Mr Dan Preda.

## 2. POLITICAL CRITERIA

The first progress report on Iceland confirms the assessment of the Commission's Opinion of February 2010 that Iceland meets the political criteria. Iceland is a functioning democracy with strong institutions and a stable constitutional and legal order. The judicial system is well established and the judiciary is of a high standard. Iceland's public administration remains, in general, efficient and free of political interference. As regards human rights and the protection of minorities, Iceland continues to safeguard fundamental rights.

This chapter assesses political developments with a focus on the measures taken by Iceland to address the shortcomings identified in the Opinion, in particular as regards judicial appointments and conflict of interests.

The coalition **government** remained stable over the reporting period. There are diverging views on the prospect of EU accession among the Icelandic political forces and population. A number of opposition parties as well as some members of the coalition oppose EU accession. Opinion polls show a mixed picture as regards EU membership. While membership as such remains a contested issue, support for the accession process has increased at the end of the reporting period with a majority in favour of conducting accession negotiations.

The domestic political scene in Iceland changed following the local elections of May 2010; new local parties won over ruling parties in several big municipalities (Kópavogur, Akureyri and Reykjavík). The leader of the Best Party was elected Mayor of Reykjavík in June and the council majorities in Iceland's big municipalities changed.

As regards internal preparations for accession, the Chief Negotiator, who reports to the Minister of Foreign Affairs, continued to coordinate the EU accession process. The Chief Negotiating Committee, established in November 2009, consists of 18 members. In addition, there are ten negotiating groups (European Economic Agreement I and II, fisheries, foreign and security affairs, financial affairs, economic and monetary affairs, regional policy and coordination of structural instruments, justice and home affairs, agriculture and rural development, and legal matters).

Legislation to elect an advisory constitutional assembly was adopted in June. The task of the assembly is to prepare a proposal to parliament for a new constitution. Among the issues to be addressed is delegation of powers by the State to international organisations.

Ensuring translation of the *acquis* by the date of accession is likely to be a challenge given the size of the Icelandic administration and its financial constraints.

The independent **Special Investigation Commission (SIC)**, set up in December 2008 to investigate and analyse the processes leading to the collapse of the banking system in Iceland, delivered its report in April 2010. The report identified the rapid growth of the banking system, as well as the difficulties of the government authorities to respond to and assess the excessive risks taken by the banks, as the main causes of the economic collapse. The report concluded in particular that, shortly before the collapse, leading banks maximised the benefits accruing to the bigger shareholders to the detriment of the interests of all shareholders. The report pointed to the responsibility of key political actors, regulators and supervisory bodies in failing to enact and enforce sufficient regulatory authority over the financial markets in order to prevent it from jeopardising the whole economic system.

The publication of the SIC report led to a wide and open debate in Iceland as well as the establishment of an *ad hoc* parliamentary review committee, comprising nine MPs from all political parties. This committee was set up to analyse ministerial responsibilities in the period before the crisis and follow up on the SIC proposals for new legislation to prevent another banking crisis. It is also mandated to examine the role of the media, the supervision of financial services, the activities of financial actors as well as ethical aspects of business practices. In September 2010 the committee delivered its opinion. The nine members unanimously agreed with the main findings of the SIC and made a number of proposals for revision and reform. The majority of the members (seven out of nine) recommended that certain former ministers be charged with gross negligence. The committee's recommendation was referred to the parliament that decided to indict only the former prime minister at the time of the banking collapse, thus activating the Court of Impeachment for the first time in the country's history.

The recommendations of the Special Investigation Commission and their follow-up measures have contributed to addressing some of the shortcomings identified in the Opinion. However, implementation of these recommendations requires a continuous follow-up.

The **Office of the Special Prosecutor**, which was also created after the 2008 financial crisis, questioned 155 individuals and processed some 74 cases, of which 20 have been dismissed or discontinued. The Special Prosecutor mostly investigated cases of market manipulation and embezzlement. The Office of the Special Prosecutor also carried out arrests of individuals and filed two indictments in connection with the collapse of the banks.

As far as the reform of the **public administration** is concerned, a committee of independent experts was set up in January 2010 to analyse how the government could address the SIC conclusions. The committee delivered its report in May 2010 and recommended reducing the number of ministries with a view to creating stronger units and ensuring better coordination among government departments. A governmental reshuffle took place in September 2010, reducing the number of ministers from twelve to ten with immediate effect.

In accordance with the SIC conclusions, the committee of independent experts recommended further strengthening the public administration, in particular through better training of civil servants and reinforcing the internal procedures and the monitoring powers of the public administration, including in the financial sector. A new programme of specialised training within the public administration was launched in September.

Iceland also started to address shortcomings identified in the Opinion as regards the predominance given to the Minister of Justice in judicial appointments. Further developments can also be noted in tackling possible conflicts of interests.

The **Judiciary** Act was amended in May 2010 to change the rules on the appointment of judges with the aim of strengthening the independence of the judiciary. The amendments are intended to reinforce the powers and composition of the evaluation committee. According to these changes, the Minister of Justice may only deviate from the recommendation of the evaluation committee to appoint a judge if parliament approves a motion from the Minister to appoint another candidate. The full effect of these amendments requires a continuous follow-up.

As regards **conflict of interests**, parliament adopted in June 2010 a bill laying down the obligation to establish codes of conduct for all government officials and for members of the



Prime Minister's Office, under the supervision of the parliamentary Ombudsman. It also specifies penalties for ministers in breach of their responsibilities. (*See also Chapter 23 — Judiciary and fundamental rights*).

The amended Act on the *finances of political parties*, stipulating obligation of political parties and their candidates to provide information about their finances, was adopted in September 2010. This new legislation addresses the GRECO (Council of Europe's Group of States against Corruption) recommendations to the 2006 law of political finance: it provides new rules as regards donations to political parties, financing of elections and the allocation of public funding to support operational activities of political parties through annual contributions from the state Treasury. (*See also Chapter 23 — Judiciary and fundamental rights*).

As regards **human rights and protection of minorities**, Iceland continued to safeguard fundamental rights (e.g. economic and social rights, respect for and protection of minorities, cultural rights) and to ensure a high level of cooperation with international mechanisms for the protection of human rights.

In September 2010, 14 cases against Iceland were pending before the European Court of Human Rights (ECtHR). A judgement was issued in one case.

The new media law, providing for limitations on the ownership of media companies, the Council of Europe Framework Convention for the Protection of National Minorities and the UN Convention on the Rights of Persons with Disabilities remain to be ratified.

### **3. ECONOMIC CRITERIA**

In examining economic developments in Iceland, the Commission's approach has been guided by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires the existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union.

#### **3.1. The existence of a functioning market economy**

##### *Economic policy essentials*

Following the collapse of the country's financial sector in October 2008, economic policy has been oriented towards stabilising the economy. Economic policy is formulated by the newly established Ministry of Economic Affairs and the Ministry of Finance in cooperation with other relevant ministries. The current IMF stand-by programme provides an important anchor for economic stabilisation. It has been implemented successfully so far, with some temporary delays. Broad political consensus on the key essentials of a market economy and the preservation of the welfare state remains. However, the previous political cohesiveness has been stretched by the negative effects of the crisis and the polarising domestic debates over causes of and responsibilities for the crisis. The country has been included in the EU Pre-Accession Fiscal Surveillance procedure, and has already received an invitation by the Commission to submit its first Pre-Accession Economic Programme with a medium-term macroeconomic and fiscal programme, by January 2011.

##### *Macroeconomic stability*

Following the banking sector crisis in October 2008, economic activity and domestic demand started to drop sharply. The decline of annual economic growth rates accelerated during 2009, leading to a marked fall in real GDP by 6.8% for the year as a whole. The recession was strongly driven by a 50% drop in total investments, particularly pronounced in construction and the services sector, and a 16% decline in private consumption. As a result, domestic demand made a large negative contribution to GDP growth. Shrinking imports as well as export growth turned the contribution of net exports positive. The economy contracted further in the first half of 2010, when real GDP fell by 7.3% year-on-year. Moreover, the quarterly growth rate (in seasonally adjusted terms) deteriorated from -1.2% in the first quarter to -3.1% in the second quarter, also indicating that the recession has not yet bottomed out. The rebound in private consumption, which started growing in the second half of 2009, turned out to be temporary as growth rates again turned negative in the first half of 2010. The speed of contraction of investment slowed somewhat but prospects for a rebound in investment growth remain uncertain, partly owing to delays in energy-intensive projects, reflecting, *inter alia*, financing constraints in the corporate sector. In the third quarter of 2010, consumer sentiment and expectations have somewhat improved, but high frequency indicators do not yet suggest a growth recovery. As a result of the crisis, average per capita income (in Purchasing Power Standards) fell to 120% of the EU-27 average in 2009. *Overall*, the crisis led to a deep and prolonged recession and economic activity has not yet started to pick up.

External deficits have shrunk markedly following the recession. The sharp contraction in domestic demand and depreciation of the exchange rate (around 50% during the crisis) contributed to a substantial improvement in the balance of goods and services, which recorded a surplus of around 9% of GDP in 2009, compared to deficit of 3% a year before. The current account deficit fell from more than 20% of GDP in 2008 to 2.2% last year, also helped by a much lower deficit in the income balance. Recent developments suggest further improvements in external trade. In the first half of 2010, thanks to a good export performance, the surplus in trade of goods and services increased to around 10% of GDP, compared to around 7.5% in the first half of the previous year. However, the current account deteriorated and its deficit increased to 3.5% (compared to a surplus of 2.8% in the first half of 2009), mainly due to a three-fold increase in the deficit of the income balance. More recent merchandise trade data suggest some deterioration as exports dropped in August by 5% year-on-year. *Overall*, external deficits have shrunk and the merchandise trade surplus has continued to strengthen.

Total net capital inflows in 2009 were larger than the amounts needed to finance the current account deficit.<sup>2</sup> As a result, gross official foreign exchange reserves held at the central bank increased by an amount equivalent to 1.7% of GDP. In 2010, reserves continued to increase and stood at around 38% of GDP in mid-2010, compared to 25% a year before. The increase in reserves partly reflects official financing provided in the context of the IMF programme and through bilateral loans, totalling around 6% of GDP. The very high level of external debt continues to represent a key challenge to the Icelandic economy. Estimates of the size of the country's external debt have been rapidly changing following the financial crisis, due to uncertainties about the impact of the collapsed banks on the level of foreign debt. Excluding the latter, the stock of gross foreign debt is now estimated at around 230% of GDP at mid-2010, compared to a pre-crisis level (end-2007) of around 570% of GDP. The private sector

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<sup>2</sup> The magnitude and direction of capital inflows remains largely influenced by ongoing external asset recovery and revaluation in the context of the winding-up and liquidation of the 'old' banks and by the existence of capital controls. Balance of payments statistics are volatile, comprising huge net errors and omissions positions.

accounts for two thirds of the external debt stock (the private non-financial sector for about 55%). *Overall*, foreign exchange reserves strengthened, partly backed by official external financing, but foreign indebtedness remains considerable.

The crisis seriously affected developments on the labour market as unemployment increased markedly and the number of employed dropped compared to pre-crisis levels. Those effects were still being felt through 2010, and adjustments in the over-leveraged construction sector have particularly contributed to unemployment. Elements of flexibility seem to have provided a degree of cushion, such as a reduced level of hours worked, increased part-time work and real wage flexibility. Nonetheless, according to the Labour Force Survey, the unemployment rate rose to 9% in the second quarter, from 7.7% in the first quarter, but was lower than the 9.4% in the corresponding period of the previous year. Total employment levels increased by 1.2% year-on-year in the second quarter, following a drop of 1% in the first quarter, bringing the average employment in the first half of the year to the same level as in the corresponding period of the previous year. In the first half of 2010, nominal gross wages and salaries increased by around 4%, similar to the wage growth rate in 2009. This translates into a real wage decline of 3% during the same period. However, since mid-2010, the growth of nominal wages accelerated to 6% in both July and August, which led to positive real wage growth by around 1.2%. *Overall*, the recession has led to a significant decline in employment and increase in unemployment.

Regarding monetary policy developments, increased stability of the exchange rate enabled the Central Bank to continue to gradually ease the monetary policy stance. In 2010, the key policy rate (i.e. the seven days collateralised lending rate) was cut several times to reach 6.25% by September. This compares with a peak rate of 18% at end-2008 in the aftermath of the banking sector collapse. The Central Bank has followed and intends to continue a strategy of exchange rate stabilisation supported for the time being by a regime of capital controls that have been reinforced since last November. The underlying trade surplus, improved terms of trade, and the declining risk premium have supported the appreciation of the Icelandic króna by around 15% vis-à-vis the euro during the first eight months of the year. This enabled the Central Bank to cease intervening on the foreign exchange market to support the króna since December 2009. Indeed, the Central Bank began foreign exchange purchases in August to bolster non-borrowed reserves. Under the current policy framework, exchange rate risks continue to appear rather limited over the short term. However, looking forward, the temporary capital account restrictions are to be gradually lifted in due time as the economy stabilises further; nevertheless, this could still entail potential risks. Annual inflation gradually came down to 6.6% in January 2010, from its peak of 18.6% in January 2009. It temporarily accelerated slightly to 8.5% in March on the back of increases in energy prices, indirect taxes and government fees, but continued to decelerate to 3.7% in September. Inflation expectations have stabilised and inflation risks appear relatively balanced. Low domestic demand and falling house prices would lower the inflation rate, while further tax -and administrative price increases and wage pressures in the tradable sectors may exert some upward movements. A weaker króna and therefore higher import prices would immediately be felt through higher inflation as imported goods account for one third of the price index. *Overall*, exchange rate stability and lower inflation have allowed some flexibility to reduce interest rates. However, capital controls are still in place and their gradual lifting, albeit necessary, represents a significant challenge.

Public finances suffered a marked deterioration in the wake of the October 2008 crisis with the general government deficit increasing to 9.9% of GDP in 2009, prompting the government to launch a series of fiscal adjustment measures in the context of the IMF programme which

continued into 2010. The 2010 budget foresees a reduction of the general government deficit by three and a half percentage points to 5.6% of GDP. To that extent, the budget comprises a series of additional fiscal measures on the revenue side, such as tax increases (VAT, excise duties, energy tax) and increases in social security contributions, as well as cuts in spending. Budget implementation in the first half of 2010 showed an increase in general government revenues by close to 10% year-on-year, supported by higher VAT rates, excises and energy taxes as well as marked increase in social contributions which compensated for shortfalls in personal income tax collection. Overall, budget revenue execution was above plan, but some downside risks remain in the second half of the year due to a slower than expected economic recovery. The increase in total spending was contained at 4%, helped by a reduction in the wage bill (-2%), cuts in social spending (-7%) and much lower capital investments (-27%). Some planned expenditure cuts remain still to be implemented during the remainder of the budget year. The general government deficit in the first half of 2010 amounted to 3.5% of projected annual GDP, lower than the 4.6% recorded in the first half of 2009.

Looking forward, fiscal risks remain significant. The 2011 budget can be considered as an expression of the government's commitment to continued fiscal consolidation. In order to achieve a primary surplus, the budget contains fiscal measures equivalent to around 3% of GDP, including freezes on wages and transfers and significant cuts in spending, which may however be difficult to implement. Moreover, the budget is based on optimistic growth and revenue assumptions and necessary revisions are likely to lead to a higher budget gap, unless the government introduces additional spending cuts or tax increases, posing additional challenges. Risks are also related to contingent liabilities. Additional financing requirements will result from government guarantees provided for the Housing Financing Fund, which indicated the need for recapitalisation. The costs are currently estimated at 2-3% of GDP. A Supreme Court decision of June 16<sup>th</sup> 2010 declaring foreign-exchange-indexed loans illegal originally introduced considerable uncertainty in the financial system. Before the crisis, banks offered such loans linked to a basket of foreign currencies with lower interest rates. However, with the collapse of the króna, debt and debt payments in króna increased correspondingly. Following a second Court ruling on this matter in mid-September, which provided some clarifications, the authorities announced legislation to convert illegal foreign currency private household indexed loans to domestic currency loans. These conversions will reduce the outstanding principles of the loans considerably. While the second ruling has reduced risks to the financial system compared to the initial decision, uncertainty over the precise financial implications remains, notably on the treatment of corporate sector loans. The ruling is likely to weaken the banks' equity base, potentially requiring an injection of fresh capital by the government. Furthermore, other significant contingent liabilities arise from a potential settlement of Icesave, the total amount being dependent on recovery rates for Landsbanki's assets and interest rates to be agreed on deposit insurance guarantee obligations. Overall, a process of fiscal consolidation has been launched, primarily supported by tax increases, while the implementation of projected spending cuts remains a challenge. Significant fiscal risks arise from contingent liabilities mainly related to the financial sector.

Gross general government debt increased from around 30% of GDP in 2007 to 88% at end-2009. The increase resulted from the cyclical effects on the budget balance, government borrowing to strengthen foreign currency reserves as well as from the costs of financial sector restructuring. The latter comprises the restructuring and recapitalisation of the three large domestic banks as well as the capital injection into the central bank to cover losses from central bank loans to banks granted on weak collateral. Further progress has been made in establishing a medium-term public debt management framework. This aims to lengthen the average maturity of public debt to 4.5 years by 2011, smooth the profile of debt coming due

and reduce the share of debt denominated in foreign currency. To that end, the government concluded agreements on bond buy-backs and other debt regulations. *Overall*, the government has taken measures to reduce refinancing- and currency risks in view of the high level of public debt.

The policy mix, with a strong focus on exchange rate stabilisation and fiscal consolidation, has been supportive in re-establishing a higher degree of macroeconomic stability. In response to higher trade surpluses and exchange rate appreciation the central bank has introduced a careful easing of monetary conditions by lowering base rates in successive steps. Efforts to strengthen public revenues and implement spending cuts have continued with a view to lowering the public savings-investment gap. However, continued fiscal adjustments remain a challenge and the implementation of the 2011 budget will be an indication as to what extent fiscal consolidation will progress. Finally, macroeconomic stabilisation occurred in a situation of temporary protection through capital account restrictions. Looking forward, their removal will remain a key policy challenge.

#### *Interplay of market forces*

Prices of goods and services continued to be determined by supply and demand conditions. As a member of the EEA, Iceland has already liberalised most economic sectors and removed special government protection in most sectors. In the context of the crisis, the government took over the domestic operations of the three major banks that had collapsed. Following recapitalisation and restructuring, the banks' equity was sold to foreign creditors. The government at this time still retains majority ownership (81%) of one of the three banks (NBI) and minority stakes in the other two banks. The private sector accounts for 73% of GDP. Some sectors remain in government ownership, such as the postal services, broadcasting, and parts of the financial sector (including the state-owned Housing Financing Fund). Moreover, the energy sector remained predominantly publicly owned (by the central and local governments), offering attractive wholesale contracts to industry, mostly aluminium companies. Overall, market mechanisms are to a large extent driven by free prices and private ownership, with the exception of some strategic sectors. Efficient financial intermediation is still hampered by the ongoing but still incomplete bank restructuring process.

#### *Market entry and exit*

Starting a business is facilitated by a generally low administrative burden and a supportive regulatory framework. The business environment remained characterised by low bureaucratic hurdles and, in general, efficient administration. However, high barriers to market entry continue to exist in some strategic sectors that are not covered by the EEA such as fisheries, energy, air transport and real estate. Of these, restrictions on investment in fisheries are the only ones that apply to EEA-residents. The recession has significantly affected company start-ups. New business registration dropped further by around 8.5% in the first six months of 2010. Bankruptcy proceedings are generally straightforward and take less time than the OECD average. However, the financial crisis has put a large part of the corporate sector under severe financial distress. The number of insolvent companies increased by close to 8% in the first half of 2010 and the construction sector accounted for the largest share. Firms are suffering from a significant gross debt overhang as outstanding loans to the corporate sector amount to roughly 300% of GDP. Around 9% of outstanding debt is owed by firms already in bankruptcy. Half of outstanding loans to larger companies and one third of loans to SMEs are in default, based on the book value of the loan. Under these difficult circumstances, a new insolvency regime has been adopted to support large-scale corporate debt restructuring. Since

court capacity is insufficient to handle a large number of cases, the new regime aims to keep cases out of court to the extent possible while securing creditors' rights. *Overall*, high barriers to market entry for non-residents remain in key strategic sectors and market exit is complicated by a large corporate sector debt overhang.

### *Legal system*

The legal system continued to support a business-friendly investment climate. It offers good protection and enforcement of property rights and provides a clear and stable framework for agents to take economic decisions in a situation of legal certainty.

### *Financial sector development*

The reconstruction of the banking sector has progressed. The market remains dominated by the three 'new' banks that emerged from the financial collapse in autumn 2008. They have been recapitalised and are now much smaller in size compared to pre-crisis levels, focusing on domestic operations. Domestic credit to the private sector is estimated at 110% of GDP in mid-2010, only a fraction of the pre-crisis level. The government retains majority ownership in one of the banks, and minority stakes in the other two banks; with the majority stakes (indirectly) owned by non-residents. However, the banks are faced with significant vulnerabilities as asset quality is subject to considerable uncertainty. Assets are largely denominated in or indexed to foreign exchange whereas liabilities are in domestic currency and at variable interest rates. Private households and businesses are faced with significant operational problems and default is widespread. Efforts have been made at private sector debt restructuring, but due to its complexity, the process has advanced more slowly than expected. The sheer magnitude of balance sheet imbalances poses a significant challenge to financial sector stability, in spite of banks' currently rather high capital adequacy ratios (16%). Non-performing loan ratios are exceptionally high. Currently, just under one fifth of the banks' restructured loans are being paid on time, while 40% are in default. Write-offs are likely to increase, weakening the profitability and capital base of banks. In addition, the Supreme Court decisions on loans indexed to a foreign exchange clause could further erode the financial situation of the domestic banks. Furthermore, banks are currently relying to a large extent on domestic deposits. This source of financing has been growing slowly despite the government's blanket deposit guarantee, which has recently been increased. Looking forward, the deposit base could weaken as other investment opportunities arise (and capital controls are lifted). At the same time, foreign direct investment and access to foreign credit still remains limited. The restructuring and recapitalisation of the savings banks has further progressed, but savings banks remain burdened with foreign exchange risks due to balance sheet mismatches. *Overall*, banking sector restructuring has further progressed, but significant vulnerabilities remain with respect to banks' asset quality and capitalisation.

Further progress has been made in strengthening bank regulatory and supervisory practices. A new legal framework aims to improve risk management systems and governance, strengthens provisions on large exposures and connected lending, and enhances fit and proper requirements for major shareholders. Moreover, the discretionary powers of the Financial Supervisory Agency have been strengthened, *inter alia* through the setting up of a large exposures credit registry to reinforce control and transparency. Also, deposit insurance regulations are being revised to bring coverage into line with EU legislation.

The non-banking financial sector comprises the government-owned Housing Finance Fund, investment banks, leasing companies, payment card companies and investment credit funds.

Total credit provided by the sector grew by 10% in 2009, reaching the equivalent of 60% of GDP, but the increase was largely due to loan indexation rather than to new borrowing. The government-owned Housing Financing Fund represents two thirds of the sector's total assets and private households constitute by far the largest group of the Fund's borrowers. However, many of the institutions continued to suffer from equity problems, a weak capital base and uncertainties with respect to future financing. The financial situation of the Housing Financing Fund has been undermined by the weakening performance of its loan portfolio, which had induced the Fund to introduce household debt restructuring measures and to encourage its borrowers to utilise government programmes. Increases in defaults led to a significant decline in the equity ratio below the envisaged long-term threshold. A government capital injection is currently being considered. *Overall*, a large part of the non-banking financial sector remains confronted with significant credit risks and weak equity ratios.

Since the collapse of markets in late 2008, domestic equity markets have been playing a much smaller role in financial intermediation. The lack of confidence in the equity market is reflected in extremely low turnover, which in 2009 reached 4% of the 2008 turnover. The market value of all listed companies stood at 17% of GDP (end-April 2010), compared to 120% prior to the crisis. In contrast to equity markets, turnover on bond markets seems to have recovered rather strongly, also due to rising demand for government-guaranteed bonds following the failure of the domestic banks. The market capitalisation of all listed bonds increased to close to 100% of GDP (end-April). *Overall*, domestic financial markets have somewhat recovered on the back of a more lively bond market while confidence in equity markets remains rather weak.

### **3.2. The capacity to cope with competitive pressure and market forces within the Union**

#### *Existence of a functioning market economy*

Given the serious impact of the banking crisis, the country's economy has not yet recovered a level of macro-financial stability allowing for an efficient allocation of economic resources. The balance sheets of private households and non-financial firms have been seriously damaged and a large number of firms are in the process of or about to enter into debt restructuring. Under these circumstances, investment activity remains markedly restrained, holding back the recovery process. An efficient allocation of resources remains rather limited in parts of the economy, also due to financial sector weaknesses and capital restrictions. *Overall*, there remains scope for improving the functioning of markets.

#### *Human and physical capital*

The economic crisis severely affected the labour market situation. The unemployment rate increased from 3% in 2008 to 7.2% in 2009; the activity rate dropped from close to 87% to around 85%. Moreover, the unemployment rate of the young population has doubled to 16% and the share of long-term unemployed has risen markedly. The government continued to implement active labour market policies aimed at retraining and upgrading skills of the labour force. However, with unemployment well above equilibrium levels, human capital remains significantly underutilised. The crisis has also led to an increase in outward migration of professionals and high-skilled workers. Despite the crisis, education spending has slightly increased to around 7.8% of GDP in 2009 (from 7.6% in 2008), but is foreseen to drop in 2010 and 2011. The country enjoys a strong capital endowment and the basic infrastructure is in line with the high income level of the economy.

Abundant geothermal sources have attracted substantial foreign investment in the aluminium and hydropower sectors over the past, but the financial crisis has put several investment projects on hold. The share of investment in GDP has fallen markedly in the context of the crisis, from around 30% over previous years to 12% in 2009. Investments in the manufacturing sector (aluminium, food processing) have been particularly affected, but they have also dropped in the energy and construction sector. At the same time, the fall in real estate activities reflects also some normalisation following the earlier 'boom' years. Public investments have also fallen, from 4% to 3% of GDP, with the largest declines in transport infrastructure. Inward FDI was negative in 2009 as foreign investors reduced their exposure; however, the net FDI balance remained positive as residents reduced outward investments to a much larger extent. The total stock of inward FDI remained at around 75% of GDP.

Spending on research and development has remained high at around 2.7% of GDP.

*Overall*, the country enjoys good basic infrastructure, abundant natural resources, and a generally well educated population. Investments remain concentrated in a few manufacturing sectors.

#### *Sectoral and enterprise structure*

Although some new segments in manufacturing and services have expanded over the past years, in particular in some high-tech areas such as software production and biotechnology, the economy's industrial sector is characterised by a limited degree of diversification. The relatively small industrial sector (excluding construction), mainly steel manufacturing, represents roughly 9% of output and one fifth of employment. The share of the service sector in total output declined somewhat in the context of the crisis, mainly due to reduced economic activity in the real estate, retail trade and financial sectors. However, services still account for two thirds of the economy and almost three quarters of employment. Tourism and transport continued to be an important source of foreign exchange income in 2009, accounting for a quarter of total export earnings. However, in the first half of 2010, the number of foreign tourists dropped by 1.2% year on year, probably due to volcanic activity. Lastly, the share of construction in GDP has fallen markedly, from around 10% of GDP over previous years to 7.4% in 2010, reflecting adjustments in an over-leveraged sector as well as completion of large energy-related projects.

Regarding network industries, energy production is predominantly publicly owned, but third party access to transmission and distribution is granted. Non-nationals are not granted market access to production. The telecommunication sector is liberalised and privately owned while government interventions remain limited to infrastructure investments in remote areas.

The importance of small firms in the economy remains high, accounting for 99% of the total and 70% of employment and output.

*Overall*, the country's industrial sector remained not very diversified and the construction sector is in a process of deleveraging.

#### *State influence on competitiveness*

The relatively small agriculture sector continued to benefit from government subsidies, import protection, and a system of production quotas. Certain industries, such as, energy, air transport and fishing remain heavily protected from foreign competition as non-residents from the EEA and/or third countries are not granted access to markets. The level of state subsidies



amounts to 1.8% of GDP. The fishing industry, however, does not receive any kind of state support from the budget but its future structure and performance is to a large extent contingent upon choices to be made by the state as regards the domestic allocation of fishing quotas. Energy production remained in government ownership, with large consumers being offered relatively favourable electricity prices. Following its intervention in the banking sector, the state continued to divest by selling its shares; it retains majority ownership of one of the three new banks. The government announced that it will continue the restructuring of the savings banks sector. While the government announced it would give creditors a chance to hold most of the equity, the process will involve some state support. The Housing Financing Fund remained state-owned and indicated it requires recapitalisation with public funds. State interference remains significant in some areas, including the banking sector as long as its restructuring and privatisation is not completed.

#### *Economic integration with the EU*

Iceland is an open economy with total trade in goods and services representing around 95% of GDP. The country's export structure is not very diversified. Marine products and aluminium account for two thirds of merchandise exports. The share of services, mainly travel and transport, has increased to around one third of total exports. The import structure is much more diversified, reflecting the country's dependence on a wide range of manufactured goods and some commodities. The EU has continued to be the largest trading partner. Its share in Icelandic merchandise exports increased to over 80% (January to April 2010, from around 75% a year before), and half of the country's imports originate in the EU. *Overall*, integration with the EU in the areas of trade and investment remained high.

In 2009, real wages declined on average by 7.3% as annual inflation (12.3%) was significantly higher than the growth of average nominal wages (3.9%). The increase in nominal labour costs was more pronounced in the non-tradable sectors (e.g. construction) compared to the tradable sector (e.g. manufacturing, transport, storage, communication). Rough estimates point to a slight deterioration of average labour productivity in 2009, suggesting an increase in unit labour costs. The exchange rate of the króna vis-à-vis the euro has appreciated by around 15% in the first nine months of 2010. In real effective terms (trade-weighted and adjusted for price differentials) a similar significant appreciation took place, suggesting a deterioration in price competitiveness vis-à-vis the main trading partners. An analogous picture arises for the real exchange rate when measured on the basis of unit labour costs. *Overall*, recent changes in indicators suggest a real appreciation of the króna. However, this reflects a gradual rebound from the strong overshooting in the aftermath of the financial crisis, when the domestic currency lost half of its value vis-à-vis the euro.

#### **4. ABILITY TO ASSUME THE OBLIGATIONS OF MEMBERSHIP**

This section examines Iceland's ability to assume the obligations of membership – that is, the *acquis* as expressed in the Treaties, the secondary legislation and the policies of the Union. It also analyses Iceland's administrative capacity to implement the *acquis*. The analysis is structured in accordance with the list of 33 *acquis* chapters. In each sector, the Commission's assessment covers progress achieved during the reporting period, and summarises the country's overall level of preparations.

#### 4.1. Chapter 1: Free movement of goods

Iceland is highly aligned and applies, with a few exemptions, the *acquis* in this field due to its EEA membership.

No additional developments can be reported in the area of **general principles**. The legislation on alcoholic beverages remains to be adopted.

With regard to **horizontal measures**, Iceland continued to apply the *acquis* on *standardisation* and *metrology*. No developments can be reported in the areas of *conformity assessment*, *accreditation* and *market surveillance*. The latest changes in the *acquis* in the field of conformity assessment, covering the establishment of a common framework for the marketing of products, have not yet been incorporated into the EEA Agreement and thus have not been fully implemented. Internal and external coordination of market surveillance requires further improvement.

In March 2010 the EFTA Surveillance Authority sent a reasoned opinion to Iceland for failure to implement EU legislation laying down uniform rules for the names, composition and labelling of textile products.

As regards the **old approach product legislation**, Iceland's alignment with the *acquis* is well advanced. No additional developments can be reported in the automotive sector, where Iceland accepts vehicles produced and marketed according to technical requirements and standards other than the international ones on which EU legislation is based.

Iceland continued to apply the *acquis* in the areas of **new and global approach product legislation** and **procedural measures**.

##### *Conclusion*

Overall, Iceland continues to be highly aligned with the *acquis* in the area of free movement of goods. No new developments can be reported on horizontal measures and on the old approach product legislation.

#### 4.2. Chapter 2: Freedom of movement for workers

Iceland applies the *acquis* in this field due to its EEA membership, with a few derogations.

Iceland continued over the reporting period to apply the *acquis* on **access to the labour market** and to fully participate in the European Employment Services network (**EURES**).

Progress can be reported under the **coordination of social security systems**. Preparations for electronic data exchange within the Electronic Exchange of Social Security Information (EESSI) system, which was put into place in the EU in May 2010, advanced over the reporting period. A steering group has been established to introduce the EESSI system in Iceland and work on the installation of an Access Point is in progress.

##### *Conclusion*

Overall, Iceland continues to apply the *acquis* in the area of free movement of workers. The preparations to apply the new regulations for social security coordination are on track.

### 4.3. Chapter 3: Right of establishment and freedom to provide services

Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in this field due to its EEA membership.

No developments can be reported in the area of **right of establishment**.

There has been limited progress in the area of **freedom to provide cross-border services**. The horizontal law transposing the Services Directive and the bill with sector-specific legislative amendments required by this Directive have not been adopted yet. Work on the Point of Single Contact, required by the Services Directive, has advanced; but adoption of the above-mentioned legislative texts is required before the Icelandic Point of Single Contact can be made operational.

The EFTA Surveillance Authority decided in June 2010 to bring a case before the EFTA Court against Iceland as it considers that the Icelandic rules are in breach of the freedom to provide services and the Posting of Workers Directive. The case concerns legislation regarding foreign undertakings posting their workers in Iceland for temporary work.

Restrictions as regards the right of establishment and the freedom to provide services in the fisheries sector remain in place.

No developments can be reported in the area of **postal services**. In May 2010, the Ministry of Transport, Communications and Local Government requested from the EFTA Surveillance an adaptation regarding the implementation of the Third Postal Directive. The goal of this adaptation is to allow Iceland to take necessary steps to ensure the interests of consumers as well as the smooth functioning of the postal market as a whole.

Some progress can be reported in the area of **mutual recognition of professional qualifications**. The main Directive on the recognition of professional qualifications was incorporated into national law and partly implemented through national regulations. However, technical implementation remains to be achieved. For this reason the EFTA Surveillance Authority decided in July 2010 to bring Iceland before the EFTA Court regarding its failure to fully implement the EEA rules corresponding to the Directive on the recognition of professional qualifications. Iceland has still to put in place all necessary changes.

#### *Conclusion*

The overall alignment with the *acquis* in the field of right of establishment and freedom to provide services is at a satisfactory level. However, the current rules are not in line with the Services Directive and the Third Postal Directive. The restrictions to foreign investment in the fisheries sector remain in place. Further efforts have to be undertaken to complete the framework for mutual recognition of professional qualifications. The administrative capacity for effective implementation and enforcement of EU rules and policies needs to be further strengthened.

### 4.4. Chapter 4: Free movement of capital

Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in this field due to its EEA membership.

In November 2008, against the background of the financial crisis, Iceland took protective measures which restrict capital flows between Iceland and EEA Member States. Comprehensive exchange controls are still in force on transactions between Iceland and other countries. Certain controls were further tightened in April and November 2009 with a view to facilitating closer monitoring of the rules while capital inflows in foreign currency for new investment were authorised.

As regards **capital movements and payments**, Iceland introduced in April 2010 new rules on foreign exchange which reduce the maximum amount of foreign currency that can be bought for travel. The new rules provide for a revision of the foreign exchange regime every six months in close cooperation with the IMF. An amendment to the Act on foreign exchange, adopted in June 2010, extended the validity of the clause on capital flow restrictions from November 2010 to August 2011, thus giving the Central Bank the power to restrict or temporarily suspend any or all categories of capital movements and related exchange transactions. These provisions are not in line with the EU *acquis*. The permanent exception which restricts foreign investment in fisheries remains in place. No development can be reported in lifting the investment restrictions applied to third country (non-EEA) nationals in the sectors of energy, air transport and real estate.

No developments can be reported in the areas of **payment systems** and in the **fight against money laundering**. The Act laying down measures implementing the third Anti-Money Laundering Directive remains to be fully implemented. The administrative capacity of the Financial Intelligence Unit needs to be further strengthened.

#### *Conclusion*

Overall, Iceland applies the *acquis* on free movement on capital, with some exceptions. Significant and sustained efforts are needed to remove the existing restrictions on capital movements, including foreign investment in fisheries. The administrative capacity of the Financial Intelligence Unit requires further strengthening.

### **4.5. Chapter 5: Public procurement**

Iceland is fully aligned with the **general principles** of the *acquis*.

The entire *acquis* in this chapter is covered by the EEA Agreement, with the exception of two technical Directives and the new Remedies Directive. Iceland has implemented the main body of the *acquis* on public procurement in line with its EEA obligations.

Regarding *administrative capacities*, no developments can be reported.

There has been some progress as regards the **award of public contracts**, where preparations for implementation of the two technical directives have started.

Little progress has been made in the area of **remedies**. The law on remedies, transposing the new EU directive, has yet to be adopted.

#### *Conclusion*

Overall alignment in the field of public procurement is very good as Iceland has already implemented the main body of the *acquis* and is currently preparing full implementation.

However, administrative capacity remains to be further enhanced to ensure proper implementation of public procurement policy at all levels.

#### 4.6. Chapter 6: Company law

Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of company law due to its EEA membership.

Good progress was made in the area of **company law**. Transposition of the 2007 Directive on the exercise of certain rights of shareholders in listed companies was completed and notified to the EFTA Surveillance Authority in January 2010. The European Commission's Recommendations of April 2009 on remuneration policies in the financial services sector were incorporated into national law and entered into force in June 2010.

In the area of **corporate accounting**, no developments can be reported on the implementation of parts of the Directive amending certain provisions on annual and consolidated accounts or on the implementation of the Regulations on equivalence of accounting standards. In April 2010, the EFTA Surveillance Authority delivered a reasoned opinion to Iceland for failure to incorporate the Commission Regulation, as amended in 2009, on international accounting standards. Some elements of the legislation leading to the reasoned opinion, have since been implemented by Iceland.

Iceland continued to apply the *acquis* on **auditing**.

##### *Conclusion*

Overall, Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of company law. However, full alignment with accounting standards is not yet achieved.

#### 4.7. Chapter 7: Intellectual property law

Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of intellectual property law due to its EEA membership.

Iceland continued to implement the *acquis* on **copyright and neighbouring rights**. A new amending bill was adopted in June. However, only one collecting society is legally recognised. The legal recognition of copyright collecting societies has not been reviewed or extended. The Ministry of Education, Science and Culture is responsible for extending collective licensing.

Good progress can be reported in the area of **industrial property rights**, with the adoption in December 2009 of revised legislation on trademarks. However, no developments can be noted as regards implementation of the rules on trademark exhaustion and supplementary protection certificates for medicinal products.

A comprehensive **enforcement** policy, which is not covered under the EEA, remains to be developed and adopted.

##### *Conclusion*

Overall, Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of intellectual property law. A comprehensive enforcement policy remains to be adopted.

#### 4.8. Chapter 8: Competition Policy

Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of competition due to its EEA membership.

Iceland has reached a high level of alignment in the field of **anti-trust, including mergers** and no developments can be reported. Some further monitoring of the quality and enforcement of the decisions of the Icelandic Competition Authority and of the aid measures adopted following the economic crisis remains necessary.

Iceland notified the EFTA Surveillance Authority of several **state aid** measures taken in response to the financial crisis. These state aid measures relate to the restructuring of the banking system, the recapitalisation of savings banks and the permission for the Housing Financing Fund to purchase mortgage loans secured against collateral in residential property. Iceland also provided information on the restructuring of its main insurance company.

#### *Conclusion*

Overall, Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of competition. Further monitoring of the state aid measures taken in response to the financial crisis is necessary.

#### 4.9. Chapter 9: Financial Services

Iceland is highly aligned and applies a substantial part of the *acquis* in this field due to its EEA membership.

Good progress has been made on **financial conglomerates** with the adoption in June 2010 of the Act on insurance activities. This completes the implementation of the Financial Conglomerates Directive and consequently of the *acquis* in this field.

Iceland adopted in June 2010 a bill amending the Act on financial undertakings with a view to improving the overall regulatory and supervisory framework. The bill strengthens the supervisory powers of the Financial Supervisory Authority (FME) and introduces improvements in the regime for and monitoring of large exposures by *inter alia* creating a separate national registry, laying down stricter rules on financial institutions' trading their own stock and prohibiting lending with collateral in own shares. It also introduces provisions for good business practices. The new framework is to be supplemented with further measures to be adopted by the FME and by an agreement between the FME and the Central Bank on the operation of the large exposures registry.

In **banking**, little progress has been made on rules regarding a new coverage level (at present maximum €50,000 per account holder) of the deposit guarantee scheme, where legislation has yet to be adopted.

Regarding Icesave, in December 2009 the Icelandic parliament passed a law authorising a state guarantee on the obligations of the Icelandic depositors insurance scheme, putting into effect the Icesave agreement between Iceland, the UK and the Netherlands of October 2009.

However, in January 2010, the Icelandic President refused to sign the bill. In accordance with the provisions of the Icelandic constitution the bill was subsequently put to a referendum which, in March, resulted in a 93.6% 'No' vote with a 62.7% participation rate. Since then, talks among the three parties have slowed down. In June Iceland's Finance Minister contacted the UK Chancellor of the Exchequer and the Dutch Minister of Finance to reconfirm Iceland's commitment to repay the Icesave loans and suggested restarting negotiations. Meetings between Icelandic, UK and Dutch representatives took place in July and in September.

In May the EFTA Surveillance Authority (ESA) issued a letter of formal notice on Iceland's application of the EU Deposit Guarantee Directive, on the ground that, by failing to ensure payment of the minimum amount of compensation to Icesave depositors in the UK and the Netherlands within certain time limits, Iceland had failed to comply with its obligations under the Directive and the principle of non-discrimination. Iceland had until early September to respond to the letter. The European Commission indicated that it supported the legal analysis of ESA. At this stage the Icesave dispute still remains unresolved.

Some progress can be reported in the area of **insurance and occupational pensions**. Since the adoption in June 2010 of the Act on insurance activities, Iceland has been implementing the provisions of the Reinsurance Directive. However, some provisions concerning the Life Assurance Directive as well as the Insurance Group Directive and the Insurance Mediation Directive remain to be transposed.

No developments can be reported in the area of **financial market infrastructure**.

Iceland has already notified the implementation of all relevant EU legislation in the area of **securities markets and investment services** and no developments can be reported. However, ongoing and upcoming reviews of several securities markets directives remain to be carried out in order to transpose amending directives.

No development can be reported on administrative capacity.

### *Conclusion*

Overall alignment in this area is good, although the reforms introduced are, for the moment, only partial. However, implementation is not complete in some key areas, notably insurance and securities. The supervisory capacity needs further improvement. The Icesave dispute remains unresolved at this stage.

## **4.10. Chapter 10: Information society and media**

Overall, Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in this field due to its EEA membership.

Some progress can be reported in the area of **electronic communications and information technologies**, with the entry into force in April 2010 of the new regulation on roaming. Iceland's legislation is not yet in line with the Directive on data retention, which is not part of the EEA Agreement. The EU electronic communications reform package, as amended in 2009, has yet to be adopted. Discussions have been carried out over the reporting period on the need for greater independence of national regulatory authorities.

No further developments can be reported in the area of **information society services**. Regarding the transposition of the Directive on conditional access, legal protection was not extended to conditional access devices other than broadcasting services decoders.

As regards **audiovisual policy**, the Audiovisual Media Services Directive was not transposed into national law. Iceland continued to participate in the MEDIA 2007 Programme.

### *Conclusion*

Overall, Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the field of the information society and media. However, the provisions of the telecoms reform, the Audiovisual Media Services Directive and the policies introduced by the recent adoption of the European Digital Agenda remain to be implemented.

## **4.11. Chapter 11: Agriculture and rural development**

As regards **horizontal issues**, no legislative developments can be reported. However, the administration has been concentrating on gaining a better understanding of the *acquis* in the area. The limited administrative capacity has not been addressed.

Preparations for the establishment of administrative structures, in particular the setting-up of an EU-compliant *paying agency* and an integrated administration and control system (*IACS*), remains at a very early stage. A working group involving stakeholders was set up over the reporting period to review the administrative structures in Iceland with a view to designing appropriate structures in order to meet the *acquis*. The emphasis was put on the paying agency, management and control structures. A working group was formed in May to analyse the current land registration system.

No developments can be reported to align with EU rules on support measures. As regards payment, Iceland is in a position to disseminate information each year on beneficiaries. The current support system already requires the administration to have detailed information on direct payments beneficiaries. This applies to dairy farming, sheep farming and horticulture.

A strategy for agricultural statistics was finalised in September by a task force including Statistics Iceland in cooperation with the Ministry of Fisheries and Agriculture.

No developments can be reported as regards the single **Common Market Organisation**.

In the field of **rural development** experts are working on a plan to set out how Iceland could coordinate its rural development strategies within the EU framework. A formal working group on rural development is still to be set up. Appropriate structures including a rural development paying agency remain to be set up.

No developments can be reported in the areas of **quality policy** and **organic farming**, although the latter is covered by the EEA Agreement and largely in line with the *acquis*.

### *Conclusion*

Overall, Iceland's agricultural policy is not in line with the *acquis* and no new legislative developments can be reported. Working groups were set up to review basic instruments and institutions for managing the common agricultural policy. The resources for addressing the necessary preparations in this chapter will require strengthening.



#### 4.12. Chapter 12: Food safety, veterinary and phytosanitary policy

Progress can be reported as regards **general** food safety with the entry into force in March 2010 of the new Food Law Package, which brings Iceland further into line with EU *acquis*. The new legislation reinforces the powers of the central competent food and veterinary authority (CCA-MAST) in the area of food and feed controls. The CCA-MAST is now responsible for the inspection of businesses producing foods of animal origin and for accrediting laboratories for the official control. Laboratories for measuring salmonella were designated in June 2010. However, the exact distribution of control tasks between central and public health authorities is still under discussion and inspections plans have not yet been prepared.

The legal powers of the central competent food and veterinary authority over the local competent authorities and the reference laboratories were not reinforced. Central oversight of the effectiveness of controls remained limited. The CCA-MAST has not signed inspection contracts with all reference laboratories.

In the **veterinary sector**, Iceland continued to benefit, under the EEA Agreement, from an exemption from EU rules on trade in live animals and germplasm enabling it to prohibit all imports of live animals except for fish and fish germplasm. Icelandic legislation was, however, slightly amended in December 2009 to enable the food and veterinary authority to allow the import of frozen pig semen under special conditions. Iceland already largely fulfils the *acquis* on identification and registration of animals. The general Act on protection against infectious diseases is in line with EU *acquis* on zoonoses. Iceland also adopted rules transposing EU legislation on contaminants that are expected to enter into force in November 2011. However, no developments can be reported in aligning with the *acquis* in the area of import of live animals.

Limited progress can be reported as regards the **placing on the market of food and feed** with the entry into force in March 2010 of provisions in line with the *acquis* on animal by-products not intended for human consumption. However, these provisions only cover fish products. The hygiene package remains to be fully implemented. A national upgrading plan to bring food establishments in line with the hygiene rules remains to be prepared. There is no collection system and incineration facilities for carcasses that are potentially infected with transmissible spongiform encephalopathy (TSE).

Iceland is not in line with the *acquis* on *novel foods and genetically modified foods*; which is not covered by the EEA. The competent authority cannot test the full range of pesticide residues. With the exception of the entry into force in 2010 of EU requirements on feed hygiene, the *acquis* on specific rules for feed as well as on the placing on the market and the use of feed is not transposed.

No developments can be reported in the **phytosanitary policy**. The capacities of accredited laboratories remain to be enhanced. EU rules on plant protection products and plant health are not applied.

#### *Conclusion*

Overall, Iceland is partially in line with the *acquis* on food safety, veterinary and phytosanitary policy. Efforts are required to strengthen administrative and laboratory capacities and to close the remaining gaps with regard to the *acquis* on the hygiene package, plant protection products, novel foods and genetically modified foods.

#### 4.13. Chapter 13: Fisheries

As regards **resource and fleet management** the working group reviewing the fisheries management system continued its work over the reporting period and delivered a final report in September. The administration has been working on gaining a better understanding of the *acquis* in the area. No developments can be reported in lifting the restrictions to the internal market *acquis* regarding the right of establishment and the freedom to provide services as well as the free movement of capital in the fisheries production and processing sectors.

The overall design and implementation of Icelandic fisheries policy is similar to that implemented in the EU. Iceland continued to subscribe to the principles of sustainable resources management and has incorporated the precautionary approach and the ecosystem approach as guiding principles for decision making in its basic fisheries legislation. Iceland continued to manage its fish stocks according to harvest rules, similar in effect to the EU's long-term management plans, but these rules have not been translated into legislative acts. In addition, alignment with the *acquis* on harvesting stocks at a level that provides maximum sustainable yield has not yet started. Iceland implements a policy of relatively low intervention: there is no fleet capacity policy, no funds for direct subsidies and no market intervention. The relevant administrative authority is the Ministry of Fisheries and Agriculture, assisted by the Icelandic Directorate of Fisheries and the Marine Research Institute. Overall, adequate administrative structures are in place. An EU-compatible vessel registry has not been set up.

No developments can be reported in the area of **inspection and control**. However, preparations were made with a view to ratifying the 2009 Agreement on port state measures to prevent, deter and eliminate illegal, unreported and unregulated fishing.

There have been no developments as regards **structural actions and state aid**. Iceland provides only very limited support to the fisheries sector. Preparations for the implementation of the European Fisheries Fund (EFF), including the setting-up of management and control systems, have not started.

In the area of **market policy**, Iceland has a limited but efficient legislative and administrative framework which, however, is not in line with the EU *acquis* as regards the common organisation of markets for fisheries products. There are no commercial minimum sizes of fish products and/or freshness types and unrestricted landing of herring for other than human consumption is allowed.

In the area of **international agreements**, Iceland has started to prepare for amendments to its legislation with a view to accepting the 1993 FAO Agreement to promote compliance with international conservation and management measures by fishing vessels on the high seas.

Iceland is a party to arrangements which involve direct cooperation between the Coastal States of the North-East Atlantic. Through such arrangements, these Coastal States jointly manage the highly migratory stocks straddling the respective economic zones. In relation to mackerel, Iceland was formally recognised as a Coastal State in 2010 but it has not been possible to reach an agreement on the management of mackerel stock for 2010 between the Coastal States. Iceland's rapidly expanded fishery of mackerel over the last three years is an issue of widespread concern within the EU, also with regard to the principles of sustainable resources management.

*Conclusion*

Overall, Iceland has a fisheries policy which has similar objectives to those being pursued in the EU, but some rules differ substantially. No new development can be reported in aligning with the EU common fisheries policy. Particular attention needs to be paid to the internal market *acquis* regarding the right of establishment, the freedom to provide services as well as the free movement of capital in the fisheries production and processing sectors where the restrictions in place are not in line with the *acquis*. Mechanisms for implementing and monitoring EU support measures remain to be set up.

#### **4.14. Chapter 14: Transport policy**

Iceland already applies a significant part of the *acquis* on transport policy.

No developments can be reported in the area of **road transport**. Implementation of the *acquis* regarding social legislation, technical equipment, public passenger transport services and road transport activities remains unfulfilled.

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

Good progress can be reported in the area of **combined transport**, where Directives on the establishment of common rules for certain types of combined transport of goods between Member States have been implemented as well as the Decision on Community guidelines for the development of the trans-European transport network. Combined transport is in the case of Iceland mainly restricted to road transport, since there are no railway systems or inland waterways.

There has been some progress with regard to **air transport**, with the implementation of the *acquis* in areas including exchange of flight data and information on civil aviation occurrences. However, no developments can be reported in aviation security or in lifting the restrictions on direct foreign investment in the aviation sector. Regarding air traffic management, the independence of the national Supervisory Authority needs to be ensured.

The *acquis* alignment is pending in several areas of **maritime transport**, including marine equipment, training, and safety rules on passenger ships. The ESA has launched infringement proceedings in two cases (on minimum level of training of seafarers in September 2009 and on Marine equipment in December 2009). No development can be reported in ensuring freedom of establishment with regard to ship registration, or in the area of **satellite navigation**.

#### *Conclusion*

Overall, Iceland applies a substantial of the *acquis* on transport policy. However, the restrictions to foreign investment in air and maritime transport have not been brought into line with the *acquis*. The independence of the Supervisory Authority in air transport remains to be ensured.

#### **4.15. Chapter 15: Energy**

Some progress can be reported with regard to **security of supply and the internal energy market**. The Directive on measures to safeguard security of electricity supply and infrastructure investment was implemented through the Electricity Act approved by parliament in December 2009. The steering group with the task of developing a comprehensive energy policy for Iceland issued its first consultation paper in May 2010. It

worked out steps to increase energy security, in particular through participation in the International Energy Agency. The Ministry of Industry, Energy and Tourism started to reflect on whether and how the independence of the National Energy Authority can be further strengthened. However, the process of adopting key legislation with respect to oil stocks has not been launched.

Against the background of existing restrictions in energy sector, the Icelandic government has appointed an independent task force to investigate and report whether the acquisition of one of Iceland's geothermal energy companies by a Swedish subsidiary of a Canadian company is within the framework of the Icelandic law and the EEA regulations. In September, the task force acknowledged the legality of the acquisition.

Iceland's share of **renewable energy** in its gross final energy consumption has been constantly increasing over the last years. The preparations and consultations with a view to implementing the new Directive on renewable energy and establishing a national target and a national renewable energy action plan are at an early stage.

No development can be reported in the area of **energy efficiency**. Iceland is currently exempted under the EEA from transposing the Directive on the energy performance of buildings into national law and from implementing the Directive on the promotion of cogeneration based on useful heat demand in the internal energy market. Iceland does not have national energy saving targets and implementation of the *acquis* on energy end-use efficiency is at an early stage.

Iceland's is highly aligned with the *acquis* in the area of **nuclear energy, nuclear safety and radiation protection**. Iceland participates in the Community radiological data exchange system (EURDEP) and the European Commission is preparing to propose membership in the European Community Urgent Radiological Information Exchange.

### *Conclusion*

Overall, Iceland continues to be highly aligned with the *acquis* in the field of energy. However, alignment in the areas of oil stocks, independence of the regulatory authority and energy efficiency is moderately advanced.

## **4.16. Chapter 16: Taxation**

A working group on taxation started in early 2010 to evaluate the overall impact of *acquis* alignment in particular as far as the VAT Directive, company tax legislation, the Savings Directive and means to achieve interconnectivity/interoperability with the EU are concerned.

In the area of **indirect taxation** - VAT or *excise* duties - no developments can be reported. Tax legislation is only partly in line with the *acquis*, in particular on VAT and excise duties, with special reference to rates and product category definitions, including for alcohol and tobacco, petrol and diesel fuels, travellers' allowances, warehousing, duty suspension and duty-free.

With regard to **direct taxation**, no developments can be reported in aligning with the provisions of the Merger Directive, the Interest and Royalties Directive and the Savings Directive. Further adaptation to ensure compliance in particular with the Parent-Subsidiaries Directive and the Capital Duty Directive and the explicit commitment to observe the Code of Conduct for business taxation did not start over the reporting period. Amendment of several

detailed provisions of Iceland's legislation on the basis of European Court of Justice case law to ensure compliance with the *acquis* is also pending.

Concerning **administrative cooperation and mutual assistance** and **operational capacity and computerisation**, no developments can be reported. A central liaison office and excise liaison office remain to be established, and the implementation of *acquis* provisions relating to mutual assistance for assessment in direct tax matters has not started. The need to further adapt the administrative organisation to meet EU *acquis* on mutual recovery assistance has not been addressed. Adaptation of the IT network to achieve interconnectivity and interoperability with the EU's IT systems for taxation remains unfinished.

Iceland has achieved substantial progress in the delivery of statistical data on taxation, in line with the *acquis*.

#### *Conclusion*

Overall, limited progress can be noted. Iceland's tax legislation remains partially aligned with the *acquis*. Iceland has already achieved a good level of administrative capacity in the field of taxation. Nevertheless, liaison offices and IT interconnectivity remain to be set up.

#### **4.17. Chapter 17: Economic and Monetary Policy**

No progress has been made in the area of **monetary policy**. Following the Act on the Central Bank of 2001, central bank functional, institutional, personal and financial independence, are not in line with the EU *acquis*. National legislation foreseeing the financing by the central bank of credit institutions other than in connection with the support of insolvent credit and/or other financial institutions is incompatible with the prohibition on monetary financing, unless it is established that the Central Bank acts only as a fiscal agent of the State. The 2001 Act on the Central Bank of Iceland does not regulate aspects necessary for the integration of the central bank into the European System of Central Banks.

Some progress has been made in the area of **economic policy**. Iceland continued to submit fiscal notifications to the European Commission. As a candidate country, Iceland is being included into the pre-accession fiscal surveillance. The country is requested to submit its first Pre-accession Economic Programme by end-January 2011, for which preparations have started. However, inter-departmental coordination and communication needs to be improved. Administrative capacity needs to be strengthened with a view to formulating and implementing economic policy in line with the Treaty on the Functioning of the European Union.

#### *Conclusion*

Some progress can be reported in the area of economic policy while efforts are necessary to improve departmental coordination in preparing the Pre-accession Economic Programme. Several shortcomings still exist in the field of monetary policy, in particular regarding full independence of the central bank and the prohibition of monetary financing of the public sector.

#### 4.18. Chapter 18: Statistics

Limited progress has been made in the area of **statistical infrastructure**. The coordination of the statistical system by Statistics Iceland, the national statistical institute, has improved and a cooperation agreement was signed between Statistics Iceland and the Central Bank in May 2010. However, Statistics Iceland had to further reduce its staff level and operational budget. The resources available for statistics are not sufficient for maintaining and advancing the current level of operations.

The main statistical classifications are in place and follow the *acquis*. Limited progress can be reported on **classifications and registers**. Work on the statistical business register has progressed slowly.

In the area of **sector statistics**, there has been some progress. Work on a strategy for improving agriculture statistics is ongoing, dealing in particular with how to move the collection of statistical data from the Farmers Association to Statistics Iceland. Statistics Iceland has started preparations for the farm structure survey to be conducted in autumn 2010 but the budget for conducting the survey has not been allocated. As regards fisheries statistics, the methodological report was delivered to Eurostat in December 2009. The timeliness of data delivery has also been improved. Statistics Iceland has taken steps to improve the coverage of missing variables on households in the Icelandic labour force survey. The financing of the housing and population census to be conducted in 2011 is not secured. Significant weaknesses remain in the area of sector statistics such as business, macroeconomic and agriculture statistics where further efforts are needed.

#### *Conclusion*

Overall Iceland is already highly in line with the *acquis* on statistics. However, it needs to improve the availability of statistical data in line with EU methodology, in particular in business, macroeconomic and agriculture statistics. Medium term funding of major statistical operations, such as the farm structure survey and the population and housing census, remains to be ensured. Human and financial resources have been further cut back.

#### 4.19. Chapter 19: Social Policy and employment

Iceland already implements substantial parts of the *acquis*. No additional developments can be reported in the fields of **labour law** and **health and safety at work**.

Iceland has a well established tradition of a functioning **social dialogue**. In this context, the tripartite Stability Pact between labour, employers and government was signed in June 2009. It aimed to limit labour disputes by extending existing collective agreements and stimulating economic recovery through investments and reforms of pension funds. However, social partners were not systematically involved by the government in the decision-making process, which led to their withdrawal of the Confederation of Icelandic Employers in March 2010. The bi-partite social dialogue is functioning very well. In June 2010 the social partners signed an agreement on working place identification cards aimed at reducing illegal labour.

Some progress can be reported regarding Iceland's **employment policy**. The surveyed unemployment rate amounted to 9% in the second quarter of 2010, a small decrease compared to the 2009 figures. Youth unemployment remained particularly high. Long-term unemployment has particularly affected low-skilled workers. The government further developed active labour market measures focusing on activation and training of the

unemployed. From January to April 2010, the Ministry of Social Affairs and Social Security launched two initiatives aimed at mobilising unemployed youth. Young people between the ages of 16 and 25, who had been unemployed for three months or longer, were given the opportunity to engage in various activities (jobs, voluntary work, vocational training). The second initiative targeted young unemployed immigrants who, after a language placement test, were offered a language course at an appropriate level. Both projects had a high success rate. However, an overall employment strategy has not yet been prepared.

No additional developments can be reported in terms of preparations for participation in the **European Social Fund**.

Iceland continues to take appropriate **social inclusion** measures for the vulnerable groups in society, based on the Nordic welfare approach. A close monitoring and evaluation of the social situation of single parent families, low income elderly, children and social assistance recipients is necessary. The aim would be to assess the impact of the economic crisis on those groups, also in view of the reduced public expenditure. Iceland took part in the 2010 European Year for combating poverty and social exclusion.

Iceland managed to ensure the quality of **social protection** services over the reporting period against a difficult economic background. Overall, expenditures on social welfare were cut at a lower rate than other sectors of public expenditure. The government also took measures to shelter the lower income groups from the effects of the crisis, e.g. with social protection, tax and debt relief measures.

In the field of **anti-discrimination**, parliament legalised same-sex marriages in June 2010.

Iceland's standards in the field of **equal opportunities**, and particularly gender equality, remained very high. In March 2010, parliament passed a law on gender quotas for the boards of public limited companies, whereby such companies must now ensure that the board consists of as close as possible to an equal number of females and males. Moreover, companies with 25 or more employees are required to disclose the number of male and female employees as well as the number of men and women in management positions. Two Equal Opportunities Directives on gender equality in social security and on access to goods and services remain to be transposed.

### *Conclusion*

Overall, Iceland has already reached a high level of alignment and continued to apply a substantial part of the *acquis* in this chapter, partly due to its EEA membership. Social dialogue mechanisms are well established, although the current financial and economic situation has affected the quality of tripartite dialogue. A comprehensive employment strategy remains to be worked out.

## **4.20. Chapter 20: Enterprise and industrial policy**

Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in this field due to its EEA membership.

No additional developments can be reported in the areas of **enterprise and industrial policy principles**, and **sector policies**. Work continued on the 'Iceland 2020 strategy' which is aimed at setting socio-economic priorities of the country for the next decade.

In the field of **enterprise and industrial policy instruments** Iceland continued to participate in the enterprise and innovation programme (EIP) and to be a full member of the Enterprise Europe network.

Against the fallout of the financial and economic crisis, Iceland was not in a position to develop any specific industrial policy strategy and SMEs' access to finance has not improved. Sector-specific development measures or initiatives are at an early stage of preparation, including the area of green energy in the transport sector.

#### *Conclusion*

Overall, alignment in the area of enterprise and industrial policy is at high level. However, new measures in industrial and SME policy are needed in particular to address the challenges of the current economic difficulties.

### **4.21. Chapter 21: Trans European Networks**

Iceland continued to participate in the TEN-T network in line with the *acquis* and no further developments can be reported as regards **transport networks**.

Good progress can be reported in the area of **energy networks** with the full transposition in April 2010 of the Regulation on conditions for access to the network for cross-border exchanges in electricity. However, no developments can be reported regarding the establishment of a TEN-E-related policy.

No additional developments can be reported in the area of **telecommunication networks**, where Iceland continued to participate in the ICT Policy Support component of the Competitiveness and Innovation Framework Programme. There are four submarine communication cables, connecting Iceland to the Faroe Islands, Greenland, Denmark, Scotland and Canada.

#### *Conclusion*

Overall, alignment with EU standards is already high and some progress can be reported in this chapter. However, TEN-E-related policy requires further development.

### **4.22. Chapter 22: Regional policy and coordination of structural instruments**

As far as the **legislative framework** is concerned, no developments can be reported. The budget law does not yet provide sufficient flexibility for transfers between budget lines and years.

Iceland set up two working groups within the negotiating team on regional policy and coordination of structural instruments in January and March 2010. The working groups started to analyse and reflect on: (i) the required administrative capacity and its institutional set-up and (ii) application of the NUTS classification to the Icelandic system. The ongoing preparations demonstrate the interest and the commitment of the national and regional authorities and social partners in the process.

No developments can be reported over the reporting period as regards the **institutional framework, administrative capacity, monitoring and evaluation and financial management and control**.



## Conclusion

Iceland is at an early stage of preparations for the implementation of the cohesion policy instruments. Limited progress has been made under this chapter over the reporting period. An appropriate needs analysis, including identification of the institutions responsible for the implementation of the cohesion policy, remains to be performed.

### 4.23. Chapter 23: Judiciary and fundamental rights

Iceland's **judiciary** is of a high standard and the judicial system is well established.

Good progress can be reported in strengthening the *independence* of the judiciary with the adoption in May 2010 of amendments to the Act of Judiciary related to the *appointment of judges*. The amendments aim at reinforcing the powers and the composition of the Evaluation Committee and broaden its mandate to cover applications for the Supreme Court. According to these changes, the Minister of Justice may only deviate from the recommendation of the Evaluation Committee if the Parliament approves a motion from the Minister to appoint another candidate.

It can not be excluded that there is a risk that the decision taken in such a case is based not on qualifications but on political grounds due to the involvement of a parliamentary vote.

As regards training of judges, the Judicial Council continued to provide training over the reporting period to district court judges and other lawyers in service of the district courts.

No developments can be reported on disciplinary procedures for judges where the decision of the Committee on Judicial Functions to remove a judge is not binding and cannot be referred to any higher administrative authority.

No developments can be reported in reviewing the role of the Minister of Justice in relation to the appointment and, to a lesser extent, the dismissal of *prosecutors*.

The Office of the Special Prosecutor continued to carry out a number of criminal investigations over the reporting period. (*See also political criteria*)

Good progress can be reported in the **anti-corruption policy**.

The Parliament adopted in June 2010 a bill providing for the obligation to establish, under the supervision of the Parliamentary Ombudsman, Codes of conduct for all government officials and for members of the Prime Minister's Cabinet. It includes provisions to train the public administration on ethics related issues, gives protection to whistle blowers and specifies penalties for ministers in breach of their responsibilities. This bill aims at tackling possible conflicts of interest and takes into account parts of the recommendations of the Council of Europe's group of states against corruption (GRECO). The UN Convention against Corruption is not ratified yet. However, effective prevention and awareness raising activities on all forms of corruption across the country are required.

The ratification of the Council of Europe Civil Law Convention is still in process and all the relevant Ministries were informed about the need to change legislation accordingly.

Iceland amended its legislation regarding the financing of political parties and the obligation of political parties and their candidates to inform about their finances. The relevant amended act on finances of political parties was adopted in September.

On **fundamental rights**, Iceland provides for a high level of protection and no additional development can be reported.

No developments can be reported in further strengthening the independence of the Data Protection Authority from the Government. The Additional protocol to Council of Europe Convention 108 for the Protection of Individuals with regard to Automatic Processing of Personal Data remains to be ratified.

On **EU citizens' rights**, no developments can be reported regarding the exception on the right to vote and to stand in local elections that are granted to citizens of Denmark, Finland, Norway and Sweden after three years of residence against five years' residence to other EU citizens. These exceptions are not in line with EU *acquis*.

### *Conclusion*

Overall, Iceland's judiciary is of a high standard and Iceland provides for a high level of protection on fundamental rights. However, the new provisions on conflict of interest and financing of political parties as well as of the act of judiciary remain to be fully assessed. The legislation on citizens' rights and data protection is not yet in line with the *acquis*.

## **4.24. Chapter 24: Justice, freedom and security**

Being an associated member of the **Schengen Agreement**, Iceland already implements a large part of the *acquis* in the area of justice, freedom and security, in particular as regards external borders and visa policy. In these areas the Schengen Agreement is being correctly implemented by Iceland. Iceland also continues its involvement in Frontex and contributes to its activities.

Overall, Iceland is advanced in the area of **migration** and the legislation is largely in line with the *acquis*. No additional developments can be reported in this area. Iceland needs to tackle some of the outstanding issues such as the absence of a specific scheme for researchers and as regards the right to family reunification.

Overall, Iceland is well advanced in the area of **asylum** but further steps are necessary. Amendments to the Act on Foreigners were adopted in September on the rights for asylum seekers and refugees.

In the area of **judicial cooperation in civil and criminal matters**, no developments can be noted with regard to joining the 1996 Child Protection Convention and the 2007 Child Support Convention and its protocol on applicable law. Iceland took further steps over the reporting period with a view to ratifying the Lugano Convention. No development with regard to judicial cooperation in criminal matters can be noted. Iceland continues a good cooperation with Eurojust. Overall, Iceland is well advanced in these areas.

As regards **police cooperation, the fight against organised crime and the fight against terrorism**, Iceland ratified the UN Convention against transnational crime (Palermo Convention) in May 2010 and its protocol on trafficking in persons in June. In relation to the implementation of the Palermo Convention, the Economic Crime Division serves as an asset recovery office. The protocol on smuggling of migrants and the protocol on illicit manufacturing and trafficking in firearms remain to be ratified.

In the area of police cooperation, Iceland signed the Agreement between the European Union and Iceland and Norway on the application of certain provisions of Council Decision on the stepping up of cross-border cooperation particularly in combating terrorism and cross-border crime (Treaty of Prüm, May 2005) in November 2009. The Agreement still needs to be ratified. Iceland also continues a good cooperation with Europol and implements well the operational agreement.

A law amending the Police Act was prepared pending parliamentary approval. It includes provisions on the division of Iceland into six police administrative areas instead of fifteen. These entities will be controlled by six police commissioners. The aim is to reduce administrative costs by cutting down executive positions and increase efficiency and cooperation between the police commissioners.

Iceland has not ratified the Council of Europe Convention against trafficking in human beings. Legislation to align with the convention by adding two new types of residence permits for victims of trafficking was passed in September.

Overall, Iceland is advanced in the fight against money laundering (*see also Chapter 4 — Free movement of capital*). No developments can be reported in improving the statistics relating to the number of investigations initiated each year on the basis of Suspicious Transaction Reports, the number of freezing/seizing orders, prosecutions, indictments, confiscation orders, actual confiscations, as well as the value of the assets and properties frozen/seized and confiscated. The technical recommendations of the Financial Action Task Force (FATF) have not been implemented.

Overall, Iceland is close to applying the EU rules on in **the fight against terrorism**.

Overall, Iceland is advanced in the area of **fight against drug** trafficking. Iceland does not yet participate in the work of the European Monitoring Centre for Drugs and Drug Addiction (EMCDDA). No developments can be reported in the areas of the fight against drugs or **customs cooperation**. Iceland is well advanced as regards customs cooperation.

Overall, Iceland's legislation in the area of **counterfeiting of the euro** is broadly in line with the *acquis*. However, Iceland is not party to the 1929 International Convention on the Suppression of Counterfeiting.

### *Conclusion*

Overall, Iceland applies the Schengen Agreement and continues to be highly aligned with the *acquis* in the field of justice, freedom and security. Further efforts are needed to ratify and implement relevant international instruments.

## **4.25. Chapter 25: Science and research**

**Research policy** is already well developed in Iceland.

Iceland continued to participate in the EU's 7th **Framework Programme** for research and technological development and was particularly involved in the research themes dealing with health, the environment, socio-economic sciences and humanities. The participation of Icelandic research entities in the framework programmes is generally strong, indicating well-established cooperation with European partners.

Iceland remained involved in the **European Research Area** through its observer status in the European Research Area Advisory Committee (formerly the EU's Scientific and Technological Advisory Committee) and other related advisory bodies.

No additional development can be reported regarding *research funding*, where public spending in research and development remained, over the reporting period, higher than the EU average, with 2.7% of GDP in 2010.

#### *Conclusion*

Overall, Iceland continues to actively participate in the Framework Programme and is already involved in European Research Area activities. Iceland is thus well advanced in terms of integration into the European Research Area.

### **4.26. Chapter 26: Education and Culture**

Overall, there has been further progress in the area of **education, training and youth**.

Regarding *cooperation in the field of policies*, Iceland continued to participate very actively in the open method of coordination in the field of education as a member of the European Economic Area. The country consolidated its performance in relation to the EU-level benchmarks of the strategic framework for European cooperation in education and training. It has reached the EU target for 2020 for tertiary education attainment and participation in pre-school education, as well as for adult participation in lifelong learning. The rate of early school leavers decreased in the last year, although it is still above the EU average. Upper secondary completion rate remains below the EU average.

Progress can be noted as regards the *access to education for EU citizens*, where there were further developments regarding the transposition of the *acquis*.

Regarding *community programmes*, Iceland continued to participate in the Lifelong Learning, Youth in Action and Erasmus Mundus programmes.

In the area of **culture**, Iceland continued to participate in the Culture Programme 2007-2013 and reiterated its interest in taking part in the open method of coordination once invited to do so.

#### *Conclusion*

In the field of education and culture, alignment with the *acquis* is already advanced and there has been some progress.

### **4.27. Chapter 27: Environment**

Iceland's environmental policy is to a large extent in line with the EU *acquis* through the EEA Agreement.

**Horizontal legislation** continued to be largely in line with the EU *acquis*. However, no developments can be reported in adopting the pending law on environmental liability and in ratifying the Espoo Convention on environmental impact assessment in a transboundary context and the Aarhus Convention on access to information, public participation in decision-making and access to justice in environmental matters. No legislation was adopted over the

reporting period to ensure access to justice in environmental matters. An updated strategy on sustainable development, *inter alia* aiming at integrating environment into other policy areas was agreed by the Government in July.

**Air quality** legislation is to a large extent in line with the *acquis*. A new strategy for **air quality** as well as a regulation setting a maximum level for hydrogen sulphide in the atmosphere and the rules for measuring and monitoring it and informing the public were adopted. A law transposing the National Emissions Ceilings Directive remains to be adopted.

The **waste management** *acquis* is to a large extent transposed. The transposition of some of the provisions of the Waste Framework Directive and of amendments to the Batteries and Mining Waste Directives needs to continue.

Some progress can be reported as regards **water quality**. A law aimed at aligning and implementing the Water Framework Directive, including river basin management plans, remains to be adopted. Iceland continued to work on transposing the Marine Strategy Framework Directive and the Floods Directive. The gaps related to bathing water quality have been identified by the Icelandic Environment Agency while measures remain to be taken.

**Nature protection** is not covered by the EEA and poses a challenge: a task group was set up to identify gaps in the national nature legislation as compared to the Birds and Habitats Directives. A regulation on ballast waters was adopted. Work is ongoing to develop management plans for the National Parks. No developments can be reported in aligning with the *acquis* on protection of whales nor on the trade ban on seal products into the EU.

As **industrial pollution control and risk management** is to a large extent in line with the *acquis*, no development can be reported in the area.

As regards **chemicals**, no developments can be reported in the area of laboratory animals and implementation of the Regulation on Classification, Labelling and Packaging is still outstanding. The Rotterdam Convention on the prior informed consent procedure for certain hazardous chemicals and pesticides in international trade remains to be ratified.

Concerning **climate change**, Iceland is covered by the EU Emissions Trading Scheme (ETS) through the EEA Agreement. Implementing legislation in this area needs to be adopted and further steps taken to enhance implementation. Iceland associated itself with the Copenhagen Accord. Iceland keeps on fulfilling its reporting obligations under the UNFCCC and the Kyoto Protocol. The Environment Agency is analysing necessary steps to meet the *acquis* on substances that deplete the ozone layer.

As the legislation on **noise** is in line with the *acquis* and is being implemented, no new developments can be reported in this area.

### *Conclusion*

Overall, Iceland has reached a high level of alignment and applies a substantial part of the *acquis* in this chapter due to its EEA membership and further progress can be reported. However, compliance with the nature protection *acquis*, in particular as regards protection of whales, seals and wild birds as well as conservation of natural habitats and of wild fauna and flora, remains to be achieved. The ratification of key multilateral environmental agreements such as the Espoo and Aarhus Conventions is pending.

#### 4.28. Chapter 28: Consumer and health protection

Iceland has already implemented a significant part of the *acquis* on consumer and health protection.

No developments can be reported in the field of **consumer protection**.

As far as *product safety-related issues* are concerned, no market surveillance activities were carried out *vis-à-vis* products not falling under sector-specific EU legislation, with the exception of decorative articles. With respect to products falling under sector-specific legislation, such as toys, electrical appliances and construction products, market surveillance consisted only in documentary checks without any assessment of whether such products may pose a risk to the health and safety of consumers. No progress can be reported on the processing of RAPEX notifications.

There has been no development in the area of *non-safety related issues*. The transposition of the new *acquis* on credit agreements for consumers as well as on timeshares and injunctions remains outstanding.

Good progress can be reported in the field of **public health**. Progress has been good in the areas of *blood* as well as *tissues and cells*. Alignment with the *acquis* is completed since Directive 2009/135<sup>3</sup> has been incorporated into national law.

There has been good progress in the areas of *communicable diseases* and *cancer*. Vaccinations against pneumococcal infections were approved in June 2010 and will start as of 2011. Vaccinations of all 12 year old girls against HPV infection and cervical cancer were approved. A decision on when to start these vaccinations has yet to be taken. However, colorectal *cancer* screening has not started.

Pictorial health warnings on *tobacco* products still need to be introduced.

No legislative developments can be reported in the field of *mental health*. The issue is one of the priorities of the National Health Plan, and the measures taken by the Icelandic authorities are similar to those in the EU Member States.

#### *Conclusion*

Overall, Iceland has already implemented a significant part of the *acquis* in the field of consumers and health protection, partly due to its EEA membership and little progress can be reported. However, the processing of RAPEX notifications requires further streamlining. Some further efforts are also needed in the field of public health.

#### 4.29. Chapter 29: Customs Union

Overall, the customs legislation of Iceland is to a large extent in line with the *acquis*. Iceland set up a working group to analyse the overall impact of aligning with the *acquis* in this area in January 2010.

There has been little progress in the area of the customs union. With regard to **customs legislation**, no developments can be reported. The *acquis* related to the Combined

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<sup>3</sup> Allowing temporary derogations to certain eligibility criteria for whole blood and blood components donors.

Nomenclature, valuation, origin, cash controls, control of drug precursors, duty-free and measures to protect intellectual property rights is partially transposed. Iceland applies certain customs fees that are not in line with the *acquis*.

There has been no development on **administrative and operational capacity**. The Directorate of Customs is measuring its operational capacity and best practices against the Customs Blueprints. Further efforts to ensure that the Iceland Customs Administration is able to effectively implement the EU *acquis* upon accession are needed. In particular, major preparations for interconnectivity and interoperability with the EU's computerised systems remain to be completed.

### *Conclusion*

The customs legislation is largely in line with the *acquis*. However, further significant efforts are needed to meet EU rules on duty-free legislation and EU related practices.

Iceland has a good level of administrative capacity in the field of customs. Nevertheless, further efforts to effectively implement the EU *acquis* upon accession remain to be undertaken, including developing interconnectivity with the EU's IT systems.

## **4.30. Chapter 30: External relations**

With regard to the **common commercial policy**, Iceland is in the process of assessing the adaptations required in order to align with the *acquis*.

Iceland started work on a database providing an overview of all international agreements in the area of external relations that are relevant for EU relations. The database will indicate which agreements would have to be terminated and which ones would have to be renegotiated. This overview is meant to become the basis for developing an action plan needed in accession negotiations.

The Ministry for Foreign Affairs started to collect information in order to further align its horizontal limitations and sector-specific commitments under the **General Agreement on Trade in Services (GATS)** with those undertaken by the EU.

In June 2010 Iceland introduced export controls on **dual-use goods** on the basis of the Act on the control of services and items that may have strategic significance, which is intended to implement the Regulation setting up the EU regime for the control of dual use goods. Iceland is not a member of the Kimberly process. An amendment to the Act on the control of services and items is in line with Regulation 2368/2002 covering the Kimberley process obligations.

In the area of **development policy**, Iceland's Official Development Assistance (ODA) amounted to approximately €26.1 million, i.e. 0.32% of GNI, in 2009. For 2010, the estimate is approximately €21.5 million, i.e. 0.28% of GNI.

With regard to **humanitarian aid** approximately €900,000 was allocated to humanitarian and emergency assistance, approximately €650,000 being channelled through NGOs and the rest through UN agencies. Revised guidelines from 2009 on cooperation with NGOs that provide humanitarian and emergency assistance were issued in September. These guidelines include expanded provisions on non-discrimination and thus take account of the non-discrimination clause enshrined in the Humanitarian Aid Regulation.

## *Conclusion*

Some progress can be reported in the field of external relations. Iceland has started preparations for assessing its obligations in terms of the need to amend or renounce its international agreements; it has also begun preparations related to the common commercial policy. Progress has also been made in the dual-use area. Measures need to be taken to assure that Iceland's Official Development Assistance does not decline further.

### **4.31. Chapter 31: Foreign, Security and Defence Policy**

The regular **political dialogue** between the EU and Iceland has continued to cover foreign policy issues.

As regards the **common foreign and security policy (CFSP)**, Iceland has aligned itself, when invited, with 68 out of 74 relevant EU declarations and Council decisions (92 % alignment).

all the relevant EU Council decisions and EU declarations, when requested, except in cases relating to Eritrea, two restrictive measures imposed against Liberia and specific measures to combat terrorism and restrictive measures against the Democratic People's Republic of Korea. Furthermore, Iceland issued its own statement regarding the Israeli military operation against the flotilla.

The Director-General for International and Security Affairs in the Ministry of Foreign Affairs acts as Political Director. The post of 'European Correspondent' is under preparation.

With regard to *sanctions and restrictive measures*, Iceland has implemented all United Nations Security Council Resolutions. There has, however, been no progress in implementing the Common Position on the application of specific measures to combat terrorism or the Joint Action concerning measures protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom.

No particular developments can be reported with regard to *conflict prevention or non-proliferation and the strategy on weapons of mass destruction/small arms and light weapons (WMD/SALW)* as Iceland is already involved in these areas.

Iceland has kept up its good *cooperation with international organisations*, such as the UN, NATO, the OECD, the OSCE and the Council of Europe. It actively participated and played an important role in the Arctic Council, the Conference of Parliamentarians of the Arctic Region (CPAR), the Barents Euro-Arctic Council (BEAC), the Northern Dimension, the Nordic Council of Ministers and the West Nordic Council.

There have been no particular developments with regard to *security measures (classified information)*.

As regards **Common security and defence policy (CSDP)** contributing capacities, no particular developments can be reported in the field of *civil crisis management*. Iceland continued to support EU civilian missions, such as in Kosovo (Eulex Kosovo), and the Eupol Mission in Afghanistan.

## *Conclusion*



Overall, Iceland has reached a good level of alignment in the area of foreign, security and defence policy. Iceland has aligned with most EU declarations and Council decisions and continues to participate in CSDP operations. It continued to play an active part in regional organisations in northern Europe.

#### **4.32. Chapter 32: Financial Control**

Some progress can be reported in the initialisation of reforming the field of **public internal financial control**. A working group was set up in January 2010 in the Ministry of Finance; the group is currently evaluating the requirements for alignment with the *acquis*. However, no steps were taken over the reporting period with a view to better separating public internal and external financial control in accordance with international standards.

No measures have yet been identified to guarantee the constitutional independence of the Icelandic National Audit Office (INAO) or to reform the systems of internal and **external audit**.

Iceland's legislation is not in line with the Convention on the **Protection of the EU's Financial Interests**. Institutional capacity for effective and efficient cooperation with OLAF needs to be further strengthened. In the field of protection of the Euro against counterfeiting Iceland needs to further develop institutional capacity by establishing a National Central Office for centralisation, technical analysis and processing of information on counterfeit bank notes and coins, both Euro and other currencies.

##### *Conclusion*

Overall, some progress can be reported in the initialisation of reforming the field of public internal financial control. A gap assessment needs to be carried out in the areas of financial management and control systems, internal audit and external audit to take into account internationally accepted standards. Preparations regarding the protection of the EU's financial interests remain to be enhanced.

#### **4.33. Chapter 33: Financial and budgetary provisions**

The basic principles and institutions for the related policy areas affecting the **traditional own resources** are in place and continued to function well. No particular developments can be reported regarding the functioning of the national **VAT** system. National accounts and **GNI** continued to be compiled based on ESA95 standards.

Regarding **administrative infrastructure** and the operational management of the own resources system, a working group has been set up in January to analyse the overall impact of aligning with the *acquis*.

##### *Conclusion*

Overall, there are no significant divergences between the underlying systems in Iceland and the EU as far as the own resources are concerned. There has been some progress under this chapter as Iceland has started to identify the required alignment with the *acquis* on *financial and budgetary provisions*. Appropriate coordination structures and administrative strengthening will be needed for implementation of the rules on own resources.

## Statistical annex

### STATISTICAL DATA (as of 14 October 2010)

#### Iceland

<b>Basic data</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Population (thousand)		279	283	287	288	291	294	300	308	315	319
Total area of the country (km <sup>2</sup> )		103 000	103 000	103 000	103 000	103 000	103 000	103 000	103 000	103 000	103 000

<b>National accounts</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Gross domestic product (GDP) (million national currency)		683 747	771 894	816 450	841 322	928 889	1 026 718	1 168 577	1 308 518	1 477 938	1 500 765
GDP (million euro)		9 421	8 830	9 474	9 709	10 660	13 124	13 316	14 932	10 276	8 692
GDP (euro per capita)		33 500	31 000	32 900	33 600	36 400	44 400	43 800	48 000	32 176	27 226
GDP (in Purchasing Power Standards (PPS) per capita)		25100	26100	26600	26000	28400	29300b	29200	30400	30300	28300
GDP per capita in PPS (EU-27 = 100)		131.4	131.8	129.8	125.6	130.9	130.2b	123.2	122.1	120.7	119.9
Real GDP growth rate (growth rate of GDP volume, national currency, % change on previous year)		4.3	3.9	0.1	2.4	7.7	7.5	4.6	6.0	1.0	-6.8
Employment growth (national accounts, % change on previous year)		2.0	1.7	-1.4	0.1	-0.4	3.3	5.1f	4.5f	0.8f	-2.0f
Labour productivity growth: GDP growth per person employed (% change on previous year)		:	:	:	:	:	:	:	:	:	:
Real unit labour cost growth (national accounts, % change on previous year)		:	:	:	:	:	:	:	:	:	:
Labour productivity per person employed (GDP in PPS per person employed, EU-27 = 100)		102.8	103.7	104.3	101.2	107.6	105.4b	98.7f	96.8f	98.0f	99.9f
Gross value added by main sectors (%)											
Agriculture and fisheries	1)	9.0	9.2	9.3	7.9	6.8	6.2	6.3	5.6	6.4	7.7
Industry		17.3	19.2	16.8	15.8	15.2	13.7	15.3	14.4	17.5	18.1
Construction		8.6	7.8	7.5	7.5	8.8	10.4	11.1	11.6	9.5	5.3
Services		65.2	63.8	66.4	68.9	69.2	69.7	67.3	68.4	66.6	68.9
Final consumption expenditure, as a share of GDP (%)		84.0	79.8	80.2	83.3	82.2	84.0	82.6	81.7	78.3	77.5
Gross fixed capital formation, as a share of GDP (%)		22.9	21.5	18.2	20.0	23.5	28.4	34.0	28.5	24.4	13.9
Changes in inventories, as a share of GDP (%)		0.4	-0.3	0.0	-0.2	-0.1	-0.1	1.2	0.5	0.2	-0.1
Exports of goods and services, relative to GDP (%)		33.6	38.8	37.4	34.3	34.1	31.7	32.2	34.6	44.5	53.0
Imports of goods and services, relative to GDP (%)		40.9	39.9	35.9	37.4	39.7	44.0	50.0	45.3	47.4	44.2

<b>Industry</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Industrial production volume index (2000=100)		100.0	104.3	103.7	104.5	109.9	107.2	113.0	119.1	132.0	125.3

<b>Inflation rate</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Annual average inflation rate (HICP, % change on previous year)		4.4	6.6	5.3	1.4	2.3	1.4	4.6	3.6	12.8	16.3

	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>Balance of payments</b>											
Balance of payments: current account total (million euro)		-957	-382	145	-463	-1047	-2119	-3173	-2424	-2274	-232
Balance of payments current account: trade balance (million euro)		-516	-68	163	-183	-419	-1 190	-1 784	-1 004	-46	628
Balance of payments current account: net services (million euro)		-160	-18	-8	-106	-168	-412	-547	-502	-194	330
Balance of payments current account: net income (million euro)		-269	-285	-23	-160	-446	-495	-815	-874	-2 010	-1 128
Balance of payments current account: net current transfers (million euro)		-10	-11	14	-13	-14	-22	-28	-44	-24	-62
of which government transfers (million euro)		-11	-13	-10	-8	-15	-20	-23	-41	-27	-38
Net foreign direct investment (FDI) (million euro)		-241	-192	-254	-42	-1 486	-3 228	-1 352	-2 457	3 135	-1 838
Foreign direct investment (FDI) abroad (million euro)	2)	-427	-386	-347	-336	-2 079	-5 708	-4 425	-7 445	2 574	-1 902
of which FDI of the reporting economy in EU-27 countries (million euro)		:	:	:	:	:	:	:	:	:	:
Foreign direct investment (FDI) in the reporting economy (million euro)	2)	185	194	93	294	593	2 480	3 073	4 988	561	64
of which FDI of EU-27 countries in the reporting economy (million euro)		:	:	:	:	:	:	:	:	:	:

	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>Public finance</b>											
General government deficit/surplus, relative to GDP (%)		1.7	-0.7	-2.6	-2.8	0.0	4.9	6.3	5.4	-13.5	-9.9
General government debt relative to GDP (%)		36.0	40.5	44.5	39.9	36.0	26.0	30.3	28.5	70.5	87.8

	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>Financial indicators</b>											
Gross foreign debt of the whole economy, relative to GDP (%)	3)	107	123	111	140	179	286	444	568	971	1005
Gross foreign debt of the whole economy, relative to total exports (%)	3)	319	318	296	407	525	901	1380	1641	2181	1922
Money supply: M1 (banknotes, coins, overnight deposits, million euro)		1 000	811	1 018	1 242	1 606	2 209	2 411	4 688	3 855	2 974
Money supply: M2 (M1 plus deposits with maturity up to two years, million euro)		1 814	1 672	1 854	2 183	2 778	3 886	4 137	7 399	8 075	5 863
Money supply: M3 (M2 plus marketable instruments, million euro)		4 113	3 922	4 586	5 358	6 126	8 405	8 958	14 040	12 117	9 302
Total credit by monetary financial institutions to residents (consolidated) (million euro)		8 278	7 737	8 061	9 484	13 108	21 996	27 752	36 359	15 403	9 721
Interest rates: day-to-day money rate, per annum (%)		13.5	13.1	6.5	5.1	7.6	9.3	16.2	14.0	18.3	9.0
Lending interest rate (one year), per annum (%)		12.4	12.0	8.2	7.7	10.3	12.0	15.3	15.3	22.0	11.5
Deposit interest rate (one year), per annum (%)		6.9	6.7	3.3	2.8	6.3	9.0	12.8	13.3	15.0	8.5
euro exchange rates: average of period - 1 euro = ... national currency	4)	72.580	87.420	86.180	86.650	87.140	78.230	87.760	87.630	143.830	172.670
Effective exchange rate index (2000=100)		115.4	135.0	120.6	121.4	111.9	102.7	128.0	120.2	216.4	232.8
Value of reserve assets (including gold) (million euro)		434	400	439	647	785	901	1 774	1 785	2 533	2 696

	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>External trade</b>											
Value of imports: all goods, all partners (million euro)		2573	2317	2207	2291	2742	3682	4558	4520	3292	2378
Value of exports: all goods, all partners (million euro)		2057	2249	2371	2107	2322	2492	2774	3492	3246	2901
Trade balance: all goods, all partners (million euro)		-516	-68	163	-184	-419	-1190	-1784	-1028	-46	523
Terms of trade (export price index / import price index)		100.0	102.5	103.7	97.2	95.1	94.7	101.2	101.0	94.8	84.3
Share of exports to EU-27 countries in value of total exports (%)		68.7	70.0	72.6	73.7	75.2	74.7	71.0	74.7	75.9	77.7
Share of imports from EU-27 countries in value of total imports (%)		60.7	59.0	58.2	63.0	59.8	61.4	56.9	59.1	53.5	51.8

<b>Demography</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Natural growth rate: natural change (births minus deaths) (per 1000 inhabitants)		8.8	8.3	7.7	8.0	8.3	8.2	8.3	8.4	9.0	9.5
Infant mortality rate: deaths of children under one year of age per 1000 live births		3.0	2.7	2.2	2.4	2.8	2.3	1.4	2.0	2.5	1.8
Life expectancy at birth: male (years)		77.9	78.3	78.5	79.5	78.9	80.2	79.4	79.6	80.0	79.7
Life expectancy at birth: female (years)		81.5	82.9	82.3	82.3	82.8	83.3	83.0	83.4	83.3	83.3

<b>Labour market</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Economic activity rate (15-64): share of population aged 15-64 that is economically active (%)		88.6	88.5	87.5	86.9	85.4	86.7	87.8	87.8	86.9	85.3
Employment rate (15-64): share of population aged 15-64 that is in employment (%)		86.6	86.5	84.7	83.3	82.3	83.8	84.6	85.1	83.6	78.3
Employment rate male (15-64) (%)		90.2	89.9	87.7	86.3	85.8	86.9	88.1	89.1	87.3	80.0
Employment rate female (15-64) (%)		82.8	82.9	81.6	80.1	78.8	80.5	80.8	80.8	79.6	76.5
Employment rate of older workers (55-64): share of population aged 55-64 that is in employment (%)		84.2	85.6	87.2	83.0	81.8	84.3	84.3	84.7	82.9	80.2
Employment by main sectors (%)											
Agriculture		8.0	7.2	7.3	7.0	6.4	6.8	6.5	6.2	5.0	5.4
Industry		16.0	15.7	14.7	14.6	14.7	14.2	12.4	11.8	12.3	12.5
Construction		6.7	7.2	8.0	7.0	7.7	7.4	8.9	9.0	10.1	7.1
Services		69.3	69.9	70.0	71.3	71.2	71.6	72.2	73.0	72.6	75.0
Unemployment rate: share of labour force that is unemployed (%)		2.3	2.3	3.3	3.3	3.1	2.6	2.9	2.3	3.0	7.2
Share of male labour force that is unemployed (%)		1.8	2.0	3.6	3.6	3.2	2.6	2.7	2.3	3.3	8.6
Share of female labour force that is unemployed (%)		2.9	2.5	2.9	3.1	2.9	2.6	3.1	2.3	2.6	5.7
Unemployment rate of persons < 25 years: share of labour force aged <25 that is unemployed (%)		4.7	4.8	7.2	8.2	8.1	7.2	8.2	7.2	8.2	16.0
Long-term unemployment rate: share of labour force that is unemployed for 12 months and more (%)		0.2	0.3	0.3	0.2	0.3	0.3	0.2	0.2	0.1	0.4

<b>Social cohesion</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Average nominal monthly wages and salaries (national currency)		225 000	249 000	266 000	284 000	301 000	336 000	377 000	414 000	446 000	433 000
Index of real wages and salaries (index of nominal wages and salaries divided by the CPI) (2000=100)		100.0	103.7	105.7	110.6	113.5	121.8	128.0	133.8	128.3	111.2
Early school leavers - Share of population aged 18-24 with at most lower secondary education and not in further education or training (%)		29.8	30.9	28.8	20.3b	24.9	24.9	25.6	23.2	24.4	23.2

<b>Standard of living</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Number of passenger cars per 1000 population		569.8	564.7	566.5	580.2	603.6	631.4	647.5	668.4	662.1	646.5
Number of subscriptions to cellular mobile telephone services per 1000 population		758.4	865.9	903.7	962.5	992.5	1013.7	1049.3	1045.5	1055.0	1069.5

<b>Infrastructure</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Density of railway network (lines in operation, per 1000 km <sup>2</sup> )		:	:	:	:	:	:	:	:	:	:
Length of motorways (thousand km)		0.011	0.011	0.011	0.011	0.019:	0.019:	0.019:	0.019:	0.041	0.041

<b>Innovation and research</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Spending on human resources (public expenditure on education in % of GDP)		6.7	7.0	7.6	7.6	7.5	7.6	7.6	7.4	7.6	7.8
Gross domestic expenditure on R&D in % of GDP		2.7	3.0	3.0	2.8	:	2.8	3.0	2.7	2.7	:
Percentage of households who have Internet access at home (%)		:	:	78	78	81	84	83	84	88	90

<b>Environment</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Greenhouse gas emissions, CO2 equivalent (tons, 1990=100)		110.8	109.9	110.6	109.6	111.1	109.7	125.4	132.6	143.5	:
Energy intensity of the economy (kg of oil equivalent per 1000 euro GDP)		343.4	342.6	345.5	336.5	322.8	311.3	358.5	335.9	522.9	655.3
Electricity generated from renewable sources in % of gross electricity consumption		99.9	100.0	99.9	99.9	99.9	99.9	100.0	100.0	100.0	100.0
Road share of inland freight transport (% of tonne-km)		100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

<b>Energy</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Primary production of all energy products (thousand TOE)		2 306	2 451	2 462	2 457	2 519	2 636	3 259	3 946	4 397	4 819
Primary production of crude oil (thousand TOE)		0	0	0	0	0	0	0	0	0	0
Primary production of hard coal and lignite (thousand TOE)		0	0	0	0	0	0	0	0	0	0
Primary production of natural gas (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Net imports of all energy products (thousand TOE)		1 036	947	969	937	1 072	1 063	1 099	1 070	976	877
Gross inland energy consumption (thousand TOE)		3 235	3 354	3 388	3 379	3 489	3 616	4 349	5 016	5 374	5 696
Electricity generation (thousand GWh)		7 684	8 033	8 416	8 500	8 623	8 686	9 930	11 976	16 468	16 835

<b>Agriculture</b>	Note	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Agricultural production volume index of goods and services (producer prices, previous year=100)		:	:	:	:	:	:	:	:	:	:
Total utilised agricultural area (thousand hectare)	e	120	120	120	120	120	120	120	120	120	120
Livestock: cattle (thousand heads, end of period)		73	70	67	66	65	66	69	71	72	73
Livestock: pigs (thousand heads, end of period)		4	5	4	4	4	4	4	4	4	4
Livestock: sheep and goats (thousand heads, end of period)		466	474	470	463	456	455	456	455	459	469
Production and utilisation of milk on the farm (total whole milk, thousand tonnes)		104	106	111	108	112	109	118	126	126	126
Crop production: cereals (including rice) (thousand tonnes, harvested production)		3	4	5	7	10	10	11	11	15	16
Crop production: sugar beet (thousand tonnes, harvested production)		:	:	:	:	:	:	:	:	:	:
Crop production: vegetables (thousand tonnes, harvested production)		14	16	14	12	12	12	20	19	19	20

: = not available

b = break in series

e = estimate

f = forecast

1) Fishing (predominantly marine fishing) represents between 80% (in 1999) and 77% (in 2008) of this share.

2) The balance of payments sign conventions are used. For FDI abroad a minus sign means investment abroad by the reporting economy exceeded its disinvestment in the period, while an entry without sign means disinvestment exceeded investment. For FDI in the reporting economy an entry without sign means that investment into the reporting economy exceeded disinvestment, while a minus sign indicates that disinvestment exceeded investment.

3) This includes nominal foreign debt of the Icelandic banks currently in bankruptcy procedures

4) Average annual exchange rate as published by the European Central Bank for years 2000-2008. This rate is very close to the rate published by the Central Bank of Iceland for all years except 2008. For 2008, as a result of the financial crisis which lead to high exchange rate volatility and very narrow markets for the Icelandic Krona, the average annual rate published by the Central Bank of Iceland (127.46 ISK for 1 EUR) differs by more than 10% from the ECB rate. For 2009, no ECB rate is available so that the rate published by the Central Bank of Iceland is used.