

After the Big Storm. Should Iceland Become the 29th EU Member State? *by Chiara Bacci*

On 11 December 2008, Olli Rehn, the European Commissioner for Enlargement, said the European Commission was “mentally preparing for the possibility of an application from Iceland ... for early next year.”¹ Over the past weeks, after the so-called saucepan revolution which forced the Icelandic government into resignation, the possibility of a formal application from the small nordic island has become yet more realistic.

For now, it is only talks being made in Reykiavik about a referendum on EU membership - and the country should deal with the general elections next April and a change in its consitution before it can present a formal application to Brussels. However, increasing public pressure and a disastrous situation in its financial market have raised expectations of Iceland becoming the 29th EU member states to an all-time high.



Iceland hunts the euro, *The Economist*, 24-31 January 2009

To those who have learnt to think of Iceland as a gigantic “hedge fund” in the wake of the recent global financial crisis, the fact that the small island might decide to apply for EU membership might seem all but sensible. In fact, membership of the European Union and of the Eurozone might have spared Reykiavik the financial, economic and social unrest of the past months.

Nonetheless, one should not forget that Iceland has a record story of adopting a “wait-and-see” attitude towards the EU, and its government “has never seriously contemplated membership of the European Union.”² The reasons advanced for this cautiousness often refer to the small size of the island, and its vulnerability vis-à-vis the European bloc, or to national rethoric and political strategy. Of all, however, it is the issue of fisheries which has long been considered the hottest point to be discussed before any serious talk about membership is launched. Joining the EU would in fact imply for Iceland the obligation to open up its rich fishing waters to fishermen from Spain and Portugal - or even the United Kingdom, with which the country has a long-standing dispute following the “cod wars” of the 1970’s.

As Gunnar Helgi Kristinsson, professor of political science at the University of Iceland, noted, however, “opposition to membership in Iceland is to some extent pragmatic in nature rather than ideological.” (1996: p. 153) In fact, Icelandic public opinion has already shown sudden and significant changes in the support for EU membership under the spectre of isolation which the country faced in the early 1990’s, when the other Nordic countries opened the debate on accession to the EU. The recent financial crisis seems to have brought back those fears, with popular support for EU membership “rising from around 50 per cent before the crisis to around 70 per cent.”³

A member of the European Economic Area and of the Schengen Area, “Iceland has already enacted more than two-tirds of the most complicated chapters of the membership accession process.”⁴ With half of the country’s trade with the European Union, Anna-Kaisa Itkonen, a spokeswoman for the office of EU Commissioner Olli Rehn affirmed that “accession negotiations can progress clearly much faster than with other countries that do not have such strong ties with the EU.”⁵

¹ “Iceland ‘could apply to EU soon’,” BBC News, 11 December 2008.

² Kristisson, G. H. “Iceland and the European Union. Non-decision on Membership” in Miles, L. (Ed.) *The European Union and the Nordic Countries*, New York: Routledge, 1996: pp. 147-161.

³ Ibison, D. “Bank crisis prompts Iceland EU rethink,” *Financial Times*, 14 November 2008: p. 1.

⁴ “Iceland: Contemplating EU Membership,” *Stratfor Global Intelligence*, 17 November 2008.

⁵ “Iceland ‘could apply to EU soon’,” BBC News, 11 December 2008.

Hence both Brussels and Reykiavik seem to show growing conviction that Iceland will be the 29th Member State of the EU, and might join the Union as soon as 2011 together with Croatia. But would it really be an advantage for both sides? Would Iceland be truly better off in the European Union? And is the EU's gain limited to yet another step in the direction of reuniting the continent?

For Iceland, many analysts have argued, membership of the European Union and of the Eurozone is the only long-term viable solution to the current crisis. As Buiter and Silber explained, "the only way for a small country like Iceland to have a large internationally active banking sector that is immune to the risk of insolvency [...] is for Iceland to join the EU and become a full member of the euro area."⁶

As part of the Eurozone, Iceland would thus have a credible foreign currency lender of last resort - the European Central Bank - to keep its banking sector active, Buiten and Silbert have suggested. A unilateral euroisation, the first solution envisaged, would not in fact protect the country from future crises. Moreover, Frankfurt has made clear that Iceland cannot adopt the euro unless it joins the EU first.

On its part, the European Union would get "a strategic and stable country at a bargain price." From a strategic viewpoint, in fact, the EU needs to secure Iceland's permanence in the NATO camp - and make sure that Reykiavik's recent flirtation with Moscow does not go any further. Moreover, as the *Financial Times* noted, "the country's economic base remains strong"⁷ and "chances are it would become a net payer to the EU within a relatively short period."⁸ Last, having Iceland as Member State would facilitate the task of improving legislation of cross-border banking for the European Commission, a move strongly demanded by the UK.



Some commentators have warned Iceland against a too quick accession to the European bloc, arguing the country would be forced to trade in its fishing grounds while risking to be "denied admission to the Eurozone before the country is financially completely back on its feet."⁹ What this argument fails to consider, however, is that "Icelandic banks need a foreign-currency lender of last resort" and that the country will sooner or later "have to choose between an internationally active banking sector and its national currency."¹⁰ As Wolfgang Munchau of the *Financial Times* put it, "membership of the eurozone offers no panacea," but it can provide "a joint policy framework and protection from speculative attacks."¹¹

Iceland krona/Euro exchange rate 1999-2009
Source: European Central Bank

Icelandic membership of the European Union would thus benefit both Reykiavik and Brussels, and most of all Frankfurt. For Iceland needs the EU if it wants to maintain its banking sector internationally active. And Brussels would gain a strategic position in the North Atlantic area, an economically sound member and an energy provider given the country's abundant geothermal power. But according to most commentators the European Central Bank would be the big winner, for it will be able to stress the importance of the euro as a source of economic stability. As Munchau argued, "the crisis will ultimately produce stronger economic governance. It will also make the eurozone larger, sooner."¹²

⁶ Buiter, W. H. and Silber, A. "The Icelandic banking crisis and what to do about it: the lender of last resort theory of optimal currency areas," *Policy Insight No. 26* (October 2008), Centre for Economic Policy Research. Paper available at www.cepr.org

⁷ "In Praise of Iceland," *Financial Times*, 4 February 2009: p. 8.

⁸ van Laenen, F. "Will Iceland Join The EU in 2009?," *The Brussels Journal*, 27 December 2008.

⁹ Id.

¹⁰ Buiter, W. H. and Silber, A. "The Icelandic banking crisis and what to do about it: the lender of last resort theory of optimal currency areas," *Policy Insight No. 26* (October 2008), Centre for Economic Policy Research. Paper available at www.cepr.org

¹¹ Munchau, W. "Now they see the benefits of the eurozone," *Financial Times*, 3 November 2008: p. 11.

¹² Id.

One is nonetheless left wondering. As René Smits rightly noted in his book, “the ECB and the NCBs can be considered competent to furnish credit to the banking system for the purpose of avoiding systemic crises.”¹³ However, “the extension of liquidity finds its limits in the maintenance of price stability. This primary objective should guide the ESCB in all its activities and conditions its scope of action in any given situation.”¹⁴

Hence Smits’s warning: focusing on the its subsumed capacity of acting as lender of last resort, the European Central Bank might risk to lose sight of its main goal, namely the maintenance of price stability. One might thus questions whether this would not send the wrong signal and further aggravate a situation of financial turmoil such as the one we are facing today.

Icelandic membership of the European Union could thus prove advantageous for all parts involved. But only to the extent that membership is not pursued with the sole goal of satisfying current liquidity needs. A European Iceland would be a stronger financial actor, one that can respond more effectively to speculative attacks. And an EU enlarged to Iceland would gain both strategically and economically. But a sooner enlarged Eurozone, to paraphrase Munchau, might also mean a stronger Eurozone, provided that convergence criteria and the independence of the European Central Bank do not fall victim to political pressure.

¹³ Smits, R. “The European Central Bank: Institutional Aspects,” London, Hague: Kluwer Law International, 1997: p. 269. Published by Kluwer Law International, 1997

¹⁴ Id.