

СЕКЦІЯ 2 СВІТОВЕ ГОСПОДАРСТВО І МІЖНАРОДНІ ЕКОНОМІЧНІ ВІДНОСИНИ

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INTEGRATION TENDENCIES OF ICELAND INTO THE EU UNTIL THE GLOBAL FINANCIAL CRISIS AND THE IMPACT OF ITS ECONOMIC SITUATION ON THE EU MEMBERSHIP

ANNOTATION

The aim of this paper is an analysis of potential integration tendencies of Iceland before the financial crisis into the European Communities / the European Union. We will also focus on political preferences of the country in context of the membership in international organizations and on economic benefits or negative implications of staying independent. This research indicates that before the outbreak of the global financial crisis, Iceland as a traditionally EU reluctant country, was not forced due to economic situation to apply for the EC/EU membership and preferred the membership in the EFTA or the EEA, by which the national sovereignty as well as sensitive political issues were not endangered. In times of potential recessions, Iceland reached immediate economic needs beneficial for the country without political integration and membership in the EC/EU.

Keywords: Iceland, European Union, financial crisis, integration, sovereignty.

Introduction. Before the outbreak of the global financial crisis Iceland was known as the most eurosceptic country in Europe, since according to common expectations a small country as Iceland should tend to become a member of a regional or international organization to secure its safety and economic interests. However, Iceland decided not to join the European Communities (the EC) mainly due to the economic miracle at the beginning of the 50's. Economic development was as well as stable political situation with strong independent leaders are very important factors in the decision process of becoming or not becoming an EC member state, particularly in the country, which belonged to the most reluctant ones with regard to the EC membership. Due to the accretion of integration tendencies beginning from 70's, it's important to examine the Icelandic approach in the context of its economic situation.

This paper will focus on potential integration tendencies of Iceland before the financial crisis and the potential membership in the European Communities, resp. the European Union. The aim of this article is to analyze the economic and political situation in Iceland and its impact on integration tendency into the EC/ EU. The research will also indicate political preferences of the country in context of the membership in international

organizations and economic benefits or negative implications of staying independent.

1. Integration tendencies of Iceland until the end of the 20th century

After Icelandic declaration of independence after the end of the 2nd World War, Iceland was perceived as an independent country in terms of its involvement in international organizations. It was expected, that Iceland as a small island country would become a member of regional or international organizations to ensure the safety of the nation, enlargement of its export markets, stabilization of its economy and the currency.

Rather than considering memberships in European regional organizations, that were established in the 50's, such as the European Coal and Steel Community (ECSC), Iceland decided to enter the United Nations and the NATO and its national security issues were solved by signing an Agreement on defense with the US. In comparison with other Nordic states, which focused on developing closer relations with the European countries, Iceland was more interested in cooperation with the US and Great Britain [9, p. 2-3]. While the ECSC was mainly oriented on security questions and control of the trade with steel and coal, Iceland saw no particular advantages in joining this organization and focused on getting benefits from overseas agreements, such as expanding its fishing zone or trade agreements and cooperation with the UN and NATO, to ensure support for its national security.

With the deepening of the integration tendencies in Europe in the 60's and the emergence of two major regional organizations, the European Free Trade Association (the EFTA) and the European Communities, which acted as counterparty of the EC, Althingi (the parliament of Iceland) decided in 1970 to join the EFTA. The EFTA membership was based on a free trade of industrial products, later also of fish and fish products – the most important commodity for the Icelandic economy. With this accession and newly signed bilateral agreement with the EC countries, the Icelandic

market managed to become largely liberalized of handicapping international trade tariffs, whilst without any loss of its sovereignty. The Stockholm Convention ensured that Iceland was able to trade with the most important trading partners in the EFTA – Denmark, Sweden and Norway, with industrial goods and fish products [1].

With the worldwide globalization and development of international trade, Althingi recognized the need for closer relations with the European Communities. Since Iceland was not interested in the EC integration, the idea of joining the European Economic Area (the EEA) in the 90's offered an attractive alternative path that met the Icelandic integration criterion. Purpose of the EEA was to extend the EU internal market on countries of the EFTA, which did not wish to join the European Union or were not yet ready for that [7]. According to Baldur Thorhallsson «the main purpose of accession negotiations of Iceland with the EEA was the opening of a free market with fish products to the market of the EU countries without the need for participation in the common fishery policy. Iceland carved out an exception in the Agreement which prevented the entry of foreign investment in the fishing industry» [8, p. 65-66]. After becoming a member of the EEA and obtaining exemption, Iceland reached its economic and political goals without the need for further integration and loss of sovereignty.

Nevertheless, a deeper political cooperation between the EFTA and the EU countries in form of the EEA also took place, because of nearly «1,400 legal acts, which the EFTA countries were willing to integrate into their legislation» [6]. Still, the positive aspect for Iceland was that member states did not have to transfer part of their sovereignty. With a membership in the EEA Iceland focused mainly on gaining economic benefits, whereby the most important aspect of Icelandic membership in the EEA was to increase its exports of fish and fish products to the European market without the participation on the EU Common fishery policy. This aim was reached with bilateral specific terms of trade in the area, thus Iceland increased exports to the European market, but not without having to accept certain limitations.

With the participation in the EEA, Iceland had to accept nearly 80% of the EU legislation, reflecting the change in its political attitude that would not have been possible just a few years earlier. According to Baldur Thorhallsson, this political turnaround might be attributable mainly to changing perceptions and preferences of a large part of the political elite and to external pressures reflecting greater demands on small states by the international system [9, p. 2-3].

2. Economic situation in Iceland before the Global financial crisis as a reason of not being an EU member state

The economic miracle in Iceland, which started in the 50's, still continued at the beginning of the 21st century until the outbreak of the global finan-

cial crisis. The economic and political situation in the world was stable and the small Icelandic economy, being well linked to developments on foreign markets and integrated in world economics, had a chance to develop and rise rapidly. Althingi supported changes in Iceland's banking system that led to the establishment of three major banks in Iceland – Landsbanki, Kaupthing and Glitnir. These banks soon begun to also engage actively in international businesses, mainly in the UK and the Netherlands and managed to get through the dot-com bubble crisis in the US in 2001 without major problems or bigger negative economic or political consequences.

In years, when on the continent the biggest enlargement of the European Union by the gradual integration of new, mainly Eastern European member states was in process, Althingi did not consider the possibility of joining the EU and the accession into the EU was considered as being more risky than advantageous, particularly with regard to potential limitations in fishery policy, the banking sector as well as Iceland's capital flows. However, when looking back today, such potential restrictions might have helped the country already earlier by slowing down overheating economy by capping the noticeable bubble effects in the growth rate, real estate market prices and decreasing of the speed of bank loans.

With prevailing low interest rate levels on an international base, growing wages and foreign direct investments in most of the developed countries, the Central Bank of Iceland also lowered the domestic interest rates. In addition, increased foreign investment inflows led to the creation of new job possibilities, therefore the living standard of Icelanders increased, which was mirrored also in the growing domestic consumption and e.g. were able to invest on the real estate market. Icelandic companies were also in a good position and employed more people abroad than in Iceland. The three Icelandic banks mentioned above held total assets of more than 10 times of Iceland's total GDP.

The living standard, social security and life style in Iceland also grew to new high levels. In 2007 the UN awarded Iceland as the 3rd most developed country in the world. Althingi spent a significant part of the national budget on social security such as unemployment benefits, pensions and insurance; thus Icelanders could take even higher risk and invest further on the real estate market, took mortgages and build or buy new houses. Low wage differences and the well-functioning social system led to high economic benefits.

According to the below mentioned tables, Iceland's unemployment rate before the global economic crises reached the lowest level since the late 80's. This level was accomplished through high foreign direct investments, what resulted in new job opportunities. Also the inflation in Iceland was at a low level. It is necessary to mention, that the inflation rate in Iceland was not always

stable. Over the course of time there were some fluctuations caused by small economic bubbles, mainly due to the dot-com bubble at the beginning of the 21st century. However, Iceland's inflation was almost constantly less than 10% and reached the lowest peak before the outbreak of the global economic crisis in 2007 of 2%.

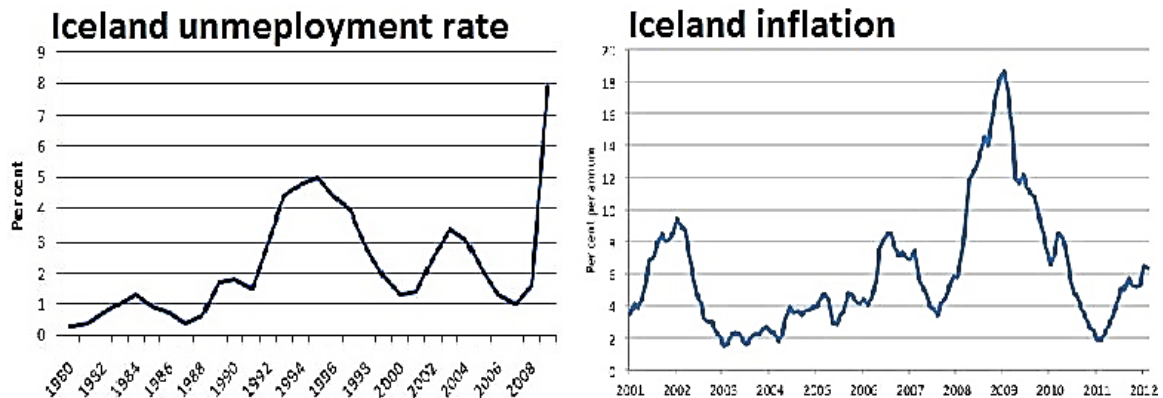
Before the crisis, Iceland was the fastest growing state among the Nordic countries. Between years 2004 and 2005 the GDP growth reached a peak of almost 8%, what could not have been sustainable for years. For comparison, the other Nordic countries reached 3-4% GDP increases in years of their highest GDP growth. Even if Iceland's GDP growth could not be healthy on a longer term, Althingi did not take any action to slow down the GDP growth. Also the investment share on GDP had reached a top of 35%, representing the highest level since the economic miracle in the mid 70's.

Because of all of these well developing economic indicators, though not necessarily economically healthy, Althingi had not taken in consideration Iceland's entrance into the European Union. But the most important economic motivation of staying outside the EU was still the fishery pol-

icy. According to the Table 1, the fisheries in Iceland in 2007 reached almost 1,500,000 tons of fish catches, i.e. the 2nd position right behind Norway in Europe.

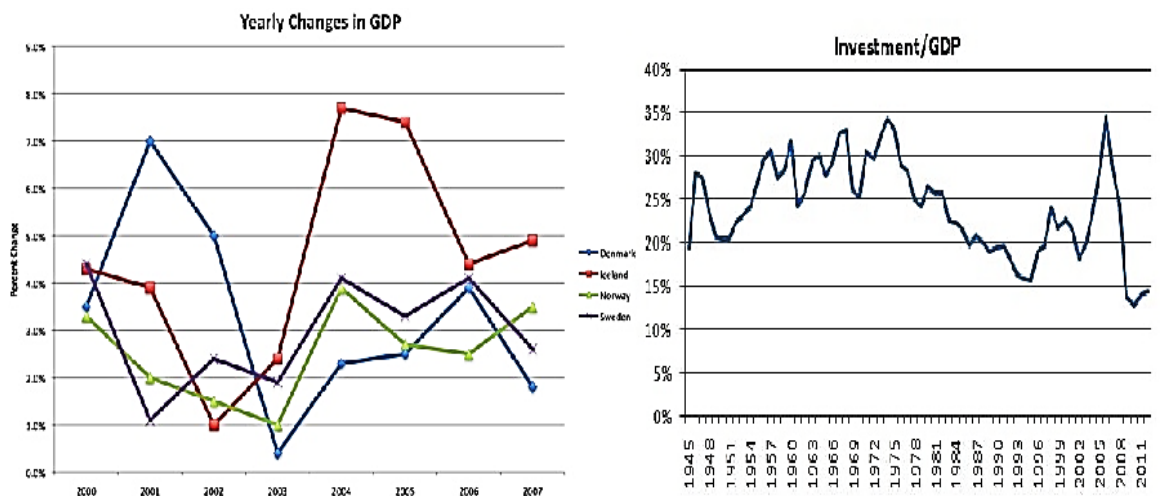
The EU fishery policy was substantially reformed at the beginning of 21st century, due to declining number of fish species in the world's waters. Under the supervision of the European Commission, at the end of each year new quotas for fish catches for each member country were set, being calculated according to statistics on the number of fish species, the economic importance of fishery in each member country and the territory of the country [3, p. 423].

According to the Table 1 below Iceland exceeded the quota, which the EU member states obtained. Compared to Spain that territory is significantly larger than the Icelandic one and thus would obtain higher quotas for fish catches, the Icelandic fishing industry produced more than twice as much as the Spanish fishing industry. Compared to Portugal that covers nearly identical area, Iceland fish catches are 7 times bigger than the Portuguese. This statistics show that Iceland, in the case of the EU membership, would clearly exceed the comparable quotas for fisheries, a fact



Graph 1. Unemployment rate and inflation in Iceland

Source: Mitchell, B., 2012



Graph 2. Changes in GDP and investment share on GDP in Iceland

Source: Margeirsson, O., 2013

that logically would need to be adjusted in case of joining the EU.

Conclusion. Until the outbreak of the global financial crisis, Iceland was the most eurosceptic country in Europe. The impact of economic situation and political stability on integration tendency of Iceland played an important role. Due to the economic miracle in 50's, there was no need for the EC integration from the economic point of view. Althingi resolved the safety question with an Agreement on defense with the US and the economic needs were reached by the membership in the EFTA membership and bilateral agreements with the EC member states.

At the end of 20th century with the importance of closer relations with the EU, Iceland joined the European Economic Area and became an equal partner to other EU members in terms of economic cooperation. The fear of losing the national sovereignty, endangering of fishing industry and limitations in capital flows made Icelanders and Althingi reluctant about their membership, thus they focused on immediate economic needs, which were covered by the EEA membership and favorable exceptions in fisheries. Therefore, also political goals and preferences of political elite were reached without the need for further integration.

With a beginning of 21st century, recession resulted from dot-com bubble and the EU

enlargement in 2004, Iceland became the most growing state among the Nordic countries, thus the EU integration would not have been beneficial. Iceland experienced another economic miracle with low unemployment and inflation rates, growing living standard, domestic consumption, investments and boom on real estate markets. Due to potential limitations in fisheries and economic instability in the EU and significant economic growth in Iceland, Althingi did not consider the EU membership, mainly due to economic reasons.

To conclude this research, before the outbreak of the global financial crisis, Iceland as a traditionally EU reluctant country, was not forced due to economic situation to apply for the EC/ EU membership. Althingi preferred the membership in the EFTA or the EEA, by which the national sovereignty as well as sensitive political issues were not endangered. In times of potential recessions, Iceland entered already mentioned EFTA or EEA and reached immediate economic needs beneficial for the country without political integration and membership in the EC/EU.

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Total fish catches in Europe (in 1,000 tons)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
EU-28	6 136	5 707	5 710	5 496	5 245	4 906	4 909	4 804	4 996	4 832	4 420
Belgium	29	26	26	24	23	24	22	21	22	22	24
Bulgaria	14	10	6	3	6	8	8	7	10	9	8
Czech Republic (†)	-	-	-	-	-	-	-	-	-	-	-
Denmark	1 442	1 031	1 090	911	868	653	691	778	828	716	503
Germany	199	238	238	264	276	227	207	195	215	218	205
Estonia	97	75	86	97	84	97	98	95	92	78	63
Ireland	282	266	280	267	211	215	205	269	316	206	276
Greece	93	90	91	91	93	94	87	82	70	63	62
Spain	793	798	715	717	676	683	849	686	742	799	758
France	694	699	661	586	583	549	490	430	440	487	461
Croatia	21	20	30	35	38	49	49	55	52	71	64
Italy (†)	266	291	274	294	312	283	232	248	230	213	196
Cyprus	2	2	2	2	2	2	2	1	1	1	1
Latvia	113	114	125	150	140	155	158	163	164	156	90
Lithuania	149	155	160	138	153	150	157	150	138	137	70
Luxembourg (†)	-	-	-	-	-	-	-	-	-	-	-
Hungary (†)	-	-	-	-	-	-	-	-	-	-	-
Malta	1	1	1	1	1	1	1	2	2	2	2
Netherlands	451	524	520	547	434	366	376	341	376	365	345
Austria (†)	-	-	-	-	-	-	-	-	-	-	-
Poland	188	152	163	131	120	125	116	175	130	176	180
Portugal	202	209	221	219	229	251	224	199	223	214	196
Romania	2	2	2	2	1	1	0	0	0	1	1
Slovenia	1	1	1	1	1	1	1	1	1	1	0
Slovakia (†)	-	-	-	-	-	-	-	-	-	-	-
Finland	109	86	99	95	113	128	119	125	127	125	138
Sweden	294	285	269	255	268	236	230	202	211	180	150
United Kingdom	684	631	652	665	615	609	588	580	605	595	626
Iceland	2 144	2 002	1 749	1 661	1 344	1 420	1 306	1 164	1 063	1 154	1 452
Liechtenstein	-	-	-	-	-	-	-	-	-	-	-
Norway	2 740	2 549	2 524	2 392	2 246	2 337	2 367	2 480	2 562	2 178	2 047
Switzerland	-	-	-	-	-	-	-	-	-	-	-
Montenegro	0	0	0	0	1	1	1	1	1	0	0
FYR of Macedonia	-	-	-	-	-	-	-	-	-	-	-
Serbia	-	-	-	-	-	-	-	-	-	-	-
Turkey	523	463	505	380	489	589	453	425	446	478	396

(†) Total catches in the seven regions covered by legal acts, namely: 21 - Atlantic, Northwest; 27 - Atlantic, Northeast; 34 - Atlantic, Eastern Central; 37 - Mediterranean and Black Sea; 41 - Atlantic, Southwest; 47 - Atlantic, Southeast; and 51 - Indian Ocean, Western. Consequently catches in inland waters are excluded.

(‡) Landlocked countries without a marine fishing fleet.

(§) 2012: partially estimated due to incomplete data sets.

Source: Eurostat (online data code: fish_ca_main)

Source: Eurostat, 2014

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