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The political economy of joining the European Union: Iceland's position at the beginning of the 21st century

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3. Political Debate on Europe⁵⁰

3 – 1 EU as a Political Choice

The question must be asked, why join the EU? Is joining the EU just a political fashion “to be European” or are there underlying economic reasons? In the case of the United Kingdom, Denmark, Sweden, Austria and Finland, joining the EU was based on the economic reason of increased trade (increased welfare) and the political idea to be in Europe. These countries, however, were joining others in a union of similar economic capability. For Ireland, Spain, Portugal and Greece, there was also an incentive to join a group of countries with economic production above their national average. But for the newest members, Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia, it was not only a question of being a part of political Europe with harmonised rules and regulations, but there was a large economic incentive to join a club of richer nations. For the poorer members, not only does their lower price level attract foreign direct investment, but structural funds such as the European Regional Development Fund and European Social Fund are a source of money, - where the richer members have to support the poorer ones. (Annex 1 on page 249 shows EU member states’ population and GDP per capita).

Considering the above, when studying an ever-larger EU, it is also worth noting that there has been some hesitation by some countries as well. As briefly noted in the introduction, Switzerland turned down becoming a EU member in a national referendum. Switzerland’s “no” to joining the EU and the European Economic Area (EEA) appears to have been based on a policy of neutrality and independence, just as Switzerland was not a member of the United Nations for many years. Norway has twice turned down EU membership in referendums. The Norwegian government applied twice for EU membership and its people voted “no” on both occasions. However, it is widely believed that it is just a question of time when Norway applies a third time and the voters say “yes”. Norway, because of the North Sea oil, has become a very wealthy country and richer members contribute more to the EU than poorer ones. Greenland is the only country that has left the EU. Greenland became a

⁵⁰ The specific debates on the EMU, Agriculture, and Fisheries are discussed in chapters, five, six, and seven, respectively.

EU member when Denmark joined, but left the Union a few years later.⁵¹ Greenland has a GDP per capita of approximately USD 20 000 per year, comparable to the less well off EU members at the time. At first, being a EU member might have been appealing for Greenland. However, the only reason Greenland left the EU was that the EU Common Fisheries Policy (CFP) was not acceptable and fisheries have a very large profile in the economy of Greenland. (Fisheries Policy is discussed in chapter 7 and Greenland's EU fisheries relations are discussed in part 7-2 on the EU CFP). Iceland has a GDP per capita close to USD 38 000 per year, which is well over the EU average, which was at USD 23 000 before the 2004/2007 enlargements.⁵² As such, the Icelandic state treasury would be a net contributor to the EU. However, for Iceland, the main objection cited in political discussion is that the EU fisheries policy is unacceptable. But since Iceland has not applied for Union membership until now, it is unknown what the exact results of accession negotiations will be.

Of the countries that joined in the past, it has also sometimes been with a narrow majority voting. The same has applied to joining the Monetary Union. Of those EU members who fulfil the Monetary Union convergence criteria⁵³ and thus would be qualified to use the Euro as their national currency, not everybody has accepted it. Why that is the case is not straight forward. When national voting takes place, not every voter is a qualified economist able to decide for himself or herself if there would be an advantage of EU membership. In some cases voters are asked to vote on EU treaties that many of them have not read. Not every citizen is willing or capable to read and thoroughly understand hundreds of pages of legal texts. However, leaving the decision on EU membership to national governments might be considered undemocratic, although the governments were voted in through democratic elections. Voters let themselves be influenced by election propaganda and the difference between propaganda and information can often be a very fine line. In fact, even for economists, there can be arguments both for and against EU membership, although most tend to favour EU membership and economic cooperation. Not surprisingly, the three countries hesitating to become

⁵¹ Greenland is a Danish territory with self-governance for home affairs. Despite leaving the EU, Greenland keeps some links to the EU as a Danish overseas territory, in a similar manner as British and French overseas territories do.

⁵² After the EU 2004/2007 enlargements, the EU average GDP per capita is somewhat less. However, the economies of the new members are developing rapidly.

⁵³ The convergence criteria are discussed in chapter five.

members, Norway, Switzerland and Iceland, are all richer than the EU average.

Many opinions voiced in the press in Iceland about EU membership are based on political feelings about independence and supranational authorities and alliances, more than actual study of economic facts. Beyond the Icelandic state budget, we find it being important to study eventual EU membership as a whole macroeconomic package and which factors in the political economy would change by EU membership. Some industries may see an advantage in EU membership, other may see it as a hindrance to their dominating situation and choose a protectionist approach instead. The latter seems to apply to fisheries and agriculture, although for different reasons. The Icelandic farmer, under harsh climatic conditions, is relatively unproductive and fears that cheaper imports of food products would push him out of his domestic production. On the contrary, the Icelandic fisherman is highly productive and fears competition from others who would like to use his exclusive natural resources, perhaps to the point that they will be overexploited and destroyed.

A parallel between the EEA accession negotiations at the time and EU membership negotiations today would be a gross simplification. Political opinions in Iceland about European cooperation have varied. Stephensen (1996) focused on Iceland and the EEA. He divided his work into two main parts, the first one on the build up to the EEA negotiations and on the negotiation process, including Icelandic demands and requests, and the second part on the viewpoints of the different political parties in Iceland. The title of his book “*Afangi a Evropufor*” (loosely translated: A Stepping-Stone on the Road to Europe) indicated the viewpoint (in year 1996) that the EEA is only a stepping-stone on the road to Europe but not the end itself. Stephensen focused on the political history of the EEA negotiations from an Icelandic perspective. His analyses of the attitudes of the Icelandic political parties towards the EEA indicates a certain parallel between those parties which traditionally have supported liberal capitalist trade, which also supported the EEA, and those parties which have been considered more sympathetic to communist ideology, which tended to oppose the EEA. Nevertheless, he finds the relationship between left and right, vis-à-vis opposing and supporting the EEA, not 100% clear-cut. The Women’s Party⁵⁴ opposed the EEA, the People’s

⁵⁴ The Women’s Party (Kvennalisti) was a left wing feminist party. It ceased to exist as an independent political party in 1998 and joined others.

Alliance⁵⁵ opposed the EEA but was open to bilateral discussions with the EU, the Progressive Party⁵⁶ was split in its position, the Independence Party⁵⁷ supported the EEA with a few individual exceptions, and the People's Party (Social Democrats)⁵⁸ were firm supporters of the EEA participation. Stephensen notes that there were individual Icelandic parliamentarians deviating from the official party lines on the EEA issue. According to Stephensen, the reasons for opposition were not only concerns about possible negative economic impacts stemming from free movements of goods, services, capital, and labour, but equally much a consideration of ideas about national independence and not being subject to foreign or international authority. This, we find, supports the idea that joining the EU is ultimately a political decision, but not only an economic calculation.

In this context it is interesting to note Figures 6 and 7 on next page, showing results from Icelandic opinion polls on attitudes towards EU membership over the last few years.

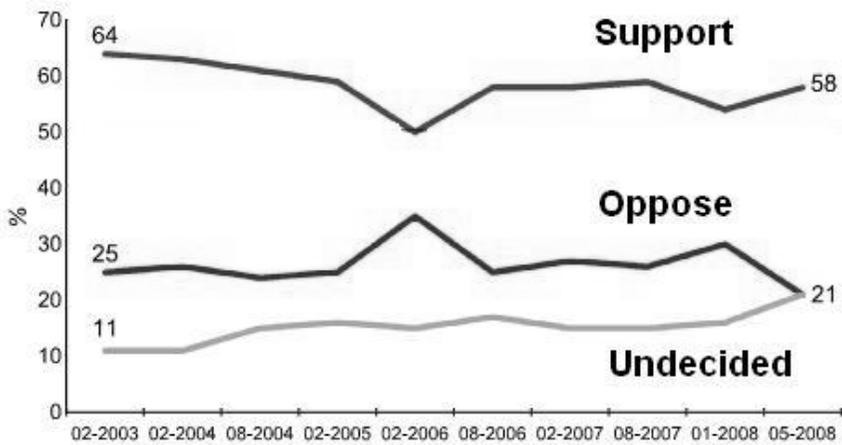
⁵⁵ The People's Alliance (Althydubandalag) was a leftist party, its supporters ranging from social democrats to communists. It ceased to exist as an independent political party in 1998 and joined others.

⁵⁶ The Progressive Party (Framsoknarflokkur) is a somewhat open-ended centre party and participates in government coalitions on both the left and the right, pending on election results. It used to have a large power base amongst farmers.

⁵⁷ The Independence Party (Sjalfstaedisflokkur) is a right leaning liberal capitalist party. Its name stems from old times and is not related to supranational EU or EEA participation.

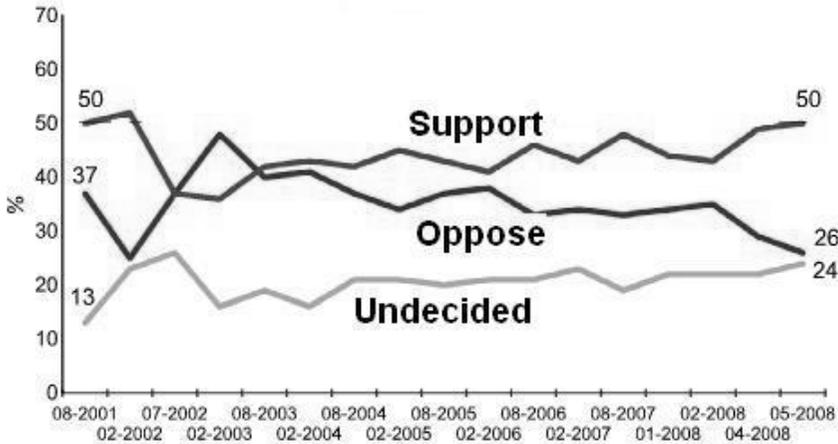
⁵⁸ The People's Party (Althyduflokkur) was a traditional social democratic party, a left leaning workers party, but in contrast to the People's Alliance (Althydubandalag), the People's Party (Althyduflokkur) was a firm supporter of West European social values and opposed non-democratic communist ideology. It ceased to exist as an independent political party in 1998 and joined others.

Figure 6. Percentage of Icelandic population who supported EU accession negotiations in the period 2003 - 2008.



Source: Federation of Icelandic Industries, based on inputs from Capacent Gallup (2008).

Figure 7. Percentage of Icelandic population who supported EU membership in the period 2001 - 2008.



Source: Federation of Icelandic Industries, based on inputs from Capacent Gallup (2008).

It is worth noting that the polls indicate more support to start accession negotiations with the EU, than the actual support for membership. Although the majority of people have already more or less made up their minds on EU membership, this is nevertheless an indication that there are some members of the public who care about the outcome of accession negotiations and will make up their minds based on the deal made in an accession treaty.

The report made by the Committee on Europe (Evropunefnd, 2007) indicated the opinion of politicians and political parties in Iceland on European Cooperation as it was in 2007. The Progressive Party indicated that it can turn both ways and is open to status quo as well as to consider EU accession negotiations.⁵⁹ This point of view corresponds well to their split opinion when Iceland joined the EEA. The Liberal Party⁶⁰ had serious reservations about Icelandic EU membership, the main objection being EU fisheries policy and the fact that Iceland has prospered well outside the EU. The Social Democratic Alliance⁶¹ supports Icelandic EU membership. The Left-Green Movement⁶² on the left and the Independence Party on the right, - at the two extremes in Icelandic politics, - both agreed on that there were no pressing needs to join the EU and both believe that the disadvantages of EU membership are greater than the advantages. However, the Left-Green and the Independence Party disagree on some important aspects. The Left-Green believe that the EU is too capitalist oriented and non-democratic and that Iceland should develop the EEA agreement into bilateral cooperation with the EU, which indeed reflects somewhat the opinions of its forerunner, the socialist and communist oriented People's Alliance at the time of the EEA negotiations. The Independence Party is a firm supporter of the EEA agreement and its economic freedoms, which reflects well its liberal capitalist background.

⁵⁹ The Progressive Party indicated in January 2009 that they would support conditional EU accession negotiations.

⁶⁰ The Liberal Party (Frjálslyndi Flokkurinn) is a centre-right party. The Liberal Party did not exist when Iceland joined the EEA.

⁶¹ The Social Democratic Alliance (Samfylkingin) did not exist when Iceland joined the EEA. The Social Democratic Alliance consists mainly of the former People's Party (Althyduflokkurinn), the former Women's Party (Kvennalisti) and the moderate elements of the former People's Alliance (Althydubandalagid).

⁶² The Left-Green Movement (Vinstri Graenir) is a relatively hard-line socialist party. The Left-Green Movement did not exist when Iceland joined the EEA. Many of its supporters came from the former People's Alliance (Althydubandalagid).

In 2008, when the economic boom of 2000-2007 came to an abrupt end, followed by allegations of corruption and financial misconduct within the major Icelandic banks⁶³, eventually forcing the government to step down, the discussion on Iceland's economic and political future took a different course. It was now clear that the *laissez-faire* policy of the previous years would have to be reconsidered. Following early parliamentary elections in 2009, a new coalition government was formed by the Social Democratic Alliance and the Left-Green. The months before and after the elections were filled with many heated discussions on the causes of the economic collapse, who should bear the burden of the tremendous financial losses sustained, finding scapegoats, investigating fraud allegations, and if EU membership would be helpful for Iceland. During the years of the economic upswing, many Icelandic banks, enterprises and individuals were overoptimistic about the economic and financial future. In order to avoid the traditionally high interest rates in Iceland, many had taken loans denominated in foreign currencies. With a free flow of capital, large differences in interest rates are not sustainable in the long run and that put pressure on the exchange rate. Eventually the value of the Icelandic Krona depreciated rapidly (Figure 9 on page 99) and the accumulated foreign debt, measured in Kronas, multiplied accordingly. Many political voices then pointed out that if Euros were the official Icelandic currency, the burden of paying back Euro nominated debt would not have skyrocketed. Since the EU basically rejects that non-EU members adopt the Euro as their national currency, EU membership was suddenly seen as a solution.⁶⁴

The Social Democratic Alliance had stated before the 2009 elections that they would support an Icelandic application for EU membership. However, the Left-Green Movement had serious reservations about any steps taken to approach EU membership. Despite the disagreements within the coalition government, the Icelandic parliament voted in July 2009 to apply for EU membership, with 33 votes for, 28 votes against, and two abstentions. The only political party in parliament that did not have a split opinion was the Social Democratic Alliance, where all members voted for the application. Members off all

⁶³ At the time of this writing the allegations are still under investigation and only a few minor sentences have been passed.

⁶⁴ As we show in chapter 5, Iceland is for the time being not in an economic position to join the European Economic and Monetary Union (EMU) and to adopt the Euro. Domestic economics have to be in order before an EMU member can be accepted. This procedure will therefore take several years, but may in due time reduce the chance of a similar crisis.

other parties availed themselves of the freedom to vote in accordance with their personal opinion, regardless of official party lines. Eventually, Iceland intends to hold a national referendum on EU membership, - if and when an accession treaty has been worked out.

3 – 2 Studies and Opinions on the European Integration Process

Iceland joined EFTA in 1970, 10 years after its establishment, but did not consider EU membership until 2009, after almost all European states had already joined the Union. As pointed out in part 3-1, there are several political voices in Iceland both for and against EU membership. For states, such as Iceland, with a GDP per capita over the EU average, it is far from straight forward to join a Union poorer than itself. As shown in chapter 4, part 2, it appears clear that in case of EU membership, the Icelandic state treasury would have to contribute more to the EU than would be returned directly from Union funds. Pro-unionists point towards other rich EU nations and the fact that on a long-term basis their economy is far from hurt by EU membership. Icelandic anti-unionists and sceptics refer to the Common Fisheries Policy (CFP) as an absolute obstacle for Iceland, mentioning how important fisheries are to the Icelandic economy and that the CFP has almost depleted parts of the ocean of wild fish, far beyond what marine-biologists consider sustainable yield.

Free Trade Agreements (FTAs) are in many cases an alternative solution for those countries hesitating to accept too much economic and political integration. EFTA is a good example. EFTA and the European Economic Community (EEC, the forerunner to the EU), are of similar age, both conceived in the late 1950s. Over the years they developed differently. EFTA remained a free trade association, but the EEC aimed at a much deeper integration, which is still continuing to this day, to the point the current EU is a supranational alliance. The EU is still growing and admitting new member states, but the EFTA is shrinking, with only four members left. As we noted in the Historical Overview, those states who have left EFTA have all moved over to the EU, and three of the four remaining EFTA states have applied for EU membership, where two applications were narrowly turned down in national referendums and the third one is still undecided.

Going a bit back in history, it is interesting to look at what were the motives behind EFTA's creation. Balassa's paper (Balassa 1963) "European Integration: problems and issues" is written only a few years after the creation of the EEC and EFTA. He mentions the same point as Schopflin (1964) that EFTA did not aim at as deep economic and political integration as the EEC did. Balassa used the expression "the Outer Seven" for the then EFTA members. He referred to the EEC and EFTA as two trade blocks, which indeed was much the case until the creation of

the EEA three decades later, and his paper consequently focussed on the EEC. Interestingly, EFTA hasn't changed much from being the "outer" parts, or perhaps after the creation of the EEA, to be the EU satellite states, this of course being further emphasised in the 1990s by the EFTA members wishing to become EU members and thereby abandoning EFTA. Today, when EFTA is almost five decades old, it is easy for us to state what EFTA is and became, and what EFTA was and is not. However, to make statements on the future of EFTA in the organisation's first years was not as straight forward. Schopflin's (1964) attempt to forecast the future in "EFTA: The Other Europe" turned out to be very right. Schopflin pointed out the same as Balassa the year before, that although EFTA and the EEC originated in the same period, the ultimate goal was not really the same, where the EEC aimed at a deep political co-operation, but EFTA was a much simpler free trade arrangement. Already in those early years it was clear that Britain, then being the largest EFTA member, was not willing to go into the deeper political co-operation that was underlying the EEC. Interestingly, Britain is still a laggard in many European cooperation matters despite having joined the EU. Schopflin pointed out that EFTA was a reaction to the EEC common market and common external customs tariffs, and the future of the EFTA would be closely linked to the outcome of European integration and a Europe-wide market. Forty years later, European integration under the EEC/EU umbrella has been very successful, and EFTA has been reduced to a dwarf next to the EU, only serving those members who for some reason have not (yet) been willing to accept EU membership. EFTA received some further attention in 1965 when the journal *International Organisation* published an article on it under the headline of *Political and Regional Organisations*. Although this article was just a political-empirical discussion, the fact that EFTA received international attention in its early years is interesting. We believe that when the United Kingdom left EFTA in 1973 and joined the EEC, the course was set to a growing EEC (later EU) and reduced importance of EFTA as a major European organisation.

Free Trade Areas (FTAs) are not always a magic economic solution, as shown in Wonnacott's (1996) analyses. FTAs can include complex forms of agreements, where e.g. countries A and B have an FTA, and B and C have an FTA, but A and C do not. This produces a hub-and-spoke system, where trade and additional manufacturing channels through the central country (country B in this example). Although FTAs may be good, Wonnacott finds that when FTAs multiply, as is the contemporary economic fashion, they may be less than desirable because they channel trade to certain countries where there is no guarantee that the goods are

cheapest. We believe that Wonnacott's theory could be applicable in the case of EFTA, where EFTA has been working on establishing free trade agreements with several third countries (Figure 3 on page 33). Wonnacott does not provide estimation, he merely points towards the theory where hubs and spokes can create trade diversion. Such issues may be trivial in the big picture, but they illustrate that it is far from easy to build a model showing economic changes caused by EFTA-EEA countries moving over to the EU.

As we already pointed out, in an effort to bridge the gap between the EU and EFTA, the European Economic Area (EEA) was established in the early 1990s. It is composed of all the EU and EFTA states, except Switzerland, which turned the EEA agreement down and made bilateral agreements with the EU instead. The EEA as it is today provides for only a part of the EU cooperation, notably the free flow of industrial goods, people, capital and services, but not for participation in the Customs Union, the Economic and Monetary Union (EMU), Common Agricultural Policy (CAP), Common Fisheries Policy (CFP), nor in EU's political cooperation and development of the Union's Common Foreign and Security Policy (CFSP). As the name implies, the EEA focus is on economic affairs along the EFTA lines, but not on a political union like the EU is. We have not seen any indication of that this will change as an institutional arrangement, although more EFTA-EEA states will undoubtedly move to EU membership.

A few years after the EEA creation, Ersboll (1994)⁶⁵ gave a personal political viewpoint of EU expansion priorities and how new members must be accommodated, at least with transitional arrangements, until the full impact of a common market would take place. Ersboll was positive on the EU enlargement to the east and believed there were solutions to the obstacles and questions raised. Although we now know that it took another decade before most of Eastern Europe became EU members, it is interesting to note the political willingness to accommodate new Union members. Fontaine (1998) also mentioned EU's expansion and the Union's relations to the rest of the world. His expansion focus was to the east, to the former communist countries in Europe, Turkey and the former Soviet Union. The Mediterranean states outside Europe were only considered under the rest of the world, and the European states hesitating about membership (EFTA-EEA) are not mentioned beyond the historical overview of the signing dates of the EFTA and the EEA treaties.

⁶⁵ Niels Ersboll (1994) was the Secretary General of the Council of the EU when he wrote his paper "The European Union: the immediate priorities".

Fontaine's writing is not published as his personal viewpoint, but accredited by the European Commission, which adds political weight to it. We see that as an indication that the EU doesn't pay any attention to if the small remaining EFTA-EEA states are members or not, although there is no indication that they would not be welcome if they so wished.

In this study we try to quantify the economic gain or loss in Iceland from joining the EU, although we accept that joining the EU is ultimately a political decision based on a broader perspective than just economics. Phinnemore (1999) in "Association: Stepping-Stone or Alternative to EU Membership?" mentions, as late as in 1999, that only a few associate states have actually become members of the EU, and that raises doubts about whether association should be seen as a stepping-stone to EU membership. Today, only a few years after his publication, time has shown that of those states that had signed association agreements, which entered into force in 1999 or before, most are already, or will soon be EU members. Phinnemore considered the EEA as one type of EU association agreement, albeit with relatively strong links to the EU. Although an association agreement is no automatic key to EU membership, most association states have looked at it as a stepping-stone to bolster their applications. In this context it is worth noting the possibility of a "Swiss-model", as discussed by Arnorsson et al. (2003). In a "Swiss-model" the relationship with the EU is fostered by bilateral agreements rather than by Union membership. However, the EU has indicated that a "Swiss-model" is not an option for Iceland. Politically the EU is not willing to make a complicated network of bilateral agreements with Iceland, like the Union concluded with Switzerland following that country's failure to ratify both its EU membership and its EEA membership. This basically excludes other options for Iceland than either the current EFTA-EEA arrangement or full EU membership.

When studying eventual EU membership, the driving forces behind the integration are of importance. Many of the early factors are still relevant and although Balassa (1961) "The Theory of Economic Integration" is relatively old literature when discussing European economic integration, many of his definitions and economic principles are still valid, such as on customs unions, technology as a growth factor, harmonisation of social policies as an economic issue, and fiscal issues in a union. An interesting fact is that Balassa often compares the European integration at the time to cooperation efforts in Latin America, whereas many contemporary writers compare the current EU economy to the United States. Living up to a comparison with the United States economy is not easy and not all literature is a glorification of an economically

united European superpower. The Sapir report (Sapir et al. 2004) is based on the overall impression that Europe has failed to deliver a satisfactory economic growth performance. It notes, perhaps with certain envy, that the EU GDP per capita has stagnated at about 70% of the United States level and finds that faster growth is paramount to the sustainability of the European model. The Sapir report notes the opinion of its authors that Europe's unsatisfactory growth performance during the last decades is a symptom of EU's failure to transform into an innovation based economy, that the old economic model of existing technologies, mass production with economics of scale and an industrial structure dominated by large firms with stable employment, should change for a new model leaving room for new entrants, greater mobility of employees, more retraining, more market financing and higher investments in both research and development as well as in education. As a fact finding report suggesting remedies the Sapir report has done a good job. However, the problem will remain for the politicians and the executive to implement economic and social policies that will have to shake up the culture, mentality, thinking, and rent seekers in the current system in the "Old World⁶⁶".

The European political-economic model is not the same as in the United States. Some of Krugman's (1983, 1986, 1994, 1996, 1997) writings provide an interesting aspect. Often critical, he manages to shed a different light on many current issues, e.g. criticising the (then) President of the European Commission, Jacques Delors, for hesitating to tell EU leaders in 1993 that their economic problems were caused by regulations imposed by the European welfare states, too high taxes, and the EMU after the German reunification. Instead Delors told European leaders that Europe's problems are a lack of competitiveness vis-à-vis the United States and Japan, and that the solution would be investments in infrastructure and technology. (Krugman, 1997). We strongly believe that most of EU's economic activity is within the Union and not a competition with Japan and the United States in selling their products to an imagined third party outside client. This should be seen in the context of the Sapir report (2004) on Europe's unsatisfactory growth when compared with the United States. However, Japan would make a favourable comparison today, as its economy has been almost stagnant for well over a decade.

The discussion on being a small country, from a political and economic perspective, or being a large country, is subjective. Alesina and Spolaore (2003) mention the size of nations from both a political and an

⁶⁶ Old World meaning Europe, New World referring to the Americas.

economic perspective. Amongst their findings is that nation-states can afford to be small if they are economically open. They find that when considering international trade and growth, that country size mediates the correlation between trade and growth. This indicates that for smaller countries, borders are more costly than for large countries. If we apply this to Iceland, it means that open borders would be preferable as the country is very small. Alesina and Spolaore (2003) findings on open borders are somewhat in line with Frankel and Romer (1999).

Small states influence on the EU is an important question for Iceland. We want to draw attention to Hosli's (1993) analyses of the theoretical effects on voting power in the EU Council of Ministers if the EFTA states became EU members. According to Hosli, Iceland would have had the same voting power as Luxembourg, which is trivial, unless used in alliance with other members. Intuitively, Hosli's theory falls within what appears to be the experience of small states in large multinational alliances. We feel that since it is not objectionable to small EU members like Luxembourg to have limited influence in the voting process in the EU Council of Ministers, there should be little reason for Iceland to think differently. From our viewpoint, the only potential concern is when EU Fisheries Ministers decide on total fish catch quotas, where Iceland objects to catching more fish than marine biologists recommend as sustainable fishing, Iceland might find itself in a difficult position unless guidelines on quota allocation are pinned down in an accession treaty. On the other hand, having a limited voting power in the EU Council of Ministers, seems much more desirable than the current EFTA-EEA arrangement with no voting rights.

European law is supranational and member states are obliged to incorporate EU rules and directives into their national law. This raises questions about democratic influence. Phelan (1993) intended to be thought provoking on that EU citizens should not accept everything without critic of what politicians and "Brussels bureaucrats" serve for them. Phelan points out some of the problems in the EU integration process; propaganda to influence voters concerning issues they are asked to vote on, and alternatively governments not bringing up to vote critical issues which influence national sovereignty and its transfer over to EU institutions from national capitals. We have the overall impression that Phelan is in a way voicing many of the concerns sceptical British politicians regularly mention about European integration and we accept that healthy and constructive criticism is good. The issues of national sovereignty are also frequent in the political discussion in Iceland, although the economic discussion seems to overshadow most other

concerns. In a democracy a constructive debate is necessary and political scepticism may be justified, but it has not stopped the ongoing trend towards increased European integration.

Although not related directly to the estimation of the impact if Iceland joined the EU, there are some interesting points raised by Lasok (1990 second edition, and 1998 third edition). Lasok gives a thorough overview of how free trade areas, tax and customs unions work, their differences, and problems associated with economic integration. His work reflects his education in law and includes legal examples, which are beyond our scope. Nevertheless, Lasok gives general current and historical explanations, which include examples of economic integration that are not always successful, such as Italy, with the rich north and the poor south. We also note that Lasok points out that the importance of regional policy in the European Union is a potential correction to regional economic imbalances. From our viewpoint, at this stage it is not possible to state if Iceland would be considered a region on the periphery of the EU, in need of special support or consideration, or if it would be considered well developed and more in a position to contribute than receive. From a state economic perspective in terms of GDP per capita, Iceland would fall in the category of the rich parts of Europe, but with a relatively non-diversified economy and relatively dependent on fishing, it would indeed also need some regional consideration. We ought to bear in mind that there is no exact standard packet new EU members get. There are always accession negotiations, based on certain principles (*Acquis Communautaire*), on the criteria new members join the Union. Because Iceland has never before applied for EU membership, it is not possible to jump to conclusions and state exactly what the effect of an un-negotiated and undecided deal would be.

3 – 3 Political and Social Rights

We consider the rights of states as political issues and the rights of citizens as social issues. The EEA agreement has provisions for social policy, health and safety at work, labour law, equal treatment for men and women, and consumer protection. There will not be much change in the social rights of Icelandic (and European) citizens if Iceland abandoned the EFTA-EEA for EU membership. Under the EEA agreement, there is already a provision for the freedom of movement of persons, both to work and to set up businesses. Furthermore, since the culture and social structure in Iceland is very similar to the other EEA and EU states, there is not to be anticipated any change in social security, pension rights, work rules or civil and political rights.⁶⁷

On the political front, however, considering the rights of states, the matter looks different from what concerns private citizens. Under the EFTA agreement, all member states are considered sovereign states. In contrast, the Treaty on the European Union is a supranational treaty, where EU law has priority over national legislation. Under the agreement on the EEA, the EFTA-EEA states are obliged to adopt in their national legislation a number of EU laws in order to harmonise all of the EEA market. The politically sensitive question arises how these laws are enacted and formulated. The EFTA-EEA states are not represented in the European Council nor are they represented at the Commission. Consequently, they have no voting rights on EU laws, although the European Commission consults the EFTA states representatives when it is drafting legislation that concerns them. The European Commission treats its member states like company shareholders, but the associated states,

⁶⁷ It is interesting to note that the United Kingdom, often regarded as a laggard in EU cooperation, opted out of the social chapter in the Maastricht Treaty of 1992 (then with a conservative government), but accepted the social provisions in the Amsterdam Treaty of 1997 (then with a labour government). This leads directly to the question on the European social model with high protection for employees, compared to the social model in the United States. High worker protection makes it difficult and expensive for employers to fire workers. However, because of the difficulty in firing redundant workers, European employers and enterprises often refrain from hiring personnel they may actually need, in order to avoid possible problems later. In the United States it is generally easier to get hired, - and to get fired -, than in Europe. On the other hand, many Europeans complain about the difficulty in finding jobs and that nobody wants to take them on. From a macroeconomic point of view, it is obviously more beneficial to society that people work than if they live of unemployment benefits.

such as the EFTA-EEA states, are considered outsiders. The associated states have to deal with the commission by inputs and negotiations, but do not have the same influence as full members of the club. In the case of the EFTA-EEA states, there is also the Joint Committee composed of the EU and the EFTA-EEA states (explained in chapter 2, part 3 on the EEA), whose main function is to take decisions extending European Union regulations and directives to the EFTA-EEA states. However, when a giant talks to a dwarf, the EU being the giant and the EFTA-EEA states the dwarf, the giant is in a much stronger position. There is considerable willingness by the European Commission to consider the EFTA-EEA states wishes, but if they have too serious objections, they will be ignored. The same applies also to smaller EU states, if they are not allied with others in their proposals, their negotiating position and voting power will be marginal (see e.g. Hosli 1993). Consequently, being a Union member gives a stronger position than being just an associate. It is wrong to say that the EFTA-EEA states have to adopt EU legislation without having any influence on its formulation, but it is correct that not being full EU members, their influence is less than the influence of Union members of the same size.

Another political reality is that if Norway applies a third time for EU membership and the Norwegian voters say “yes” this time, it is not viable for Iceland and Liechtenstein to continue the EFTA-EEA arrangement simply because of their small size, lack of political and economic weight, and the expenses of keeping the EFTA and the EEA administration going.

It may be speculated that the EU Common Foreign and Security Policy (CFSP) may at a future stage be a matter of diverging views and interests, but as of this writing the CFSP is in too an early stage of development to be more than an open question. At the current stage, the EFTA and the EFTA-EEA states do not participate in formulating a future EU CFSP beyond individual bilateral diplomatic relations. When looking at EU regional policy, increased economic cooperation has led to increased regional political cooperation such as cooperation in both justice and home affairs. Under the EEA umbrella, some of EU’s regional cooperation is also already taking place in Iceland, e.g. participation in the Schengen agreement on passport free travel, despite that Iceland is not a EU member.

Table 5 (on next page) is presented to give an idea of the differences between the various forms of economic integration EU and EFTA states face. A more detailed description of EFTA and the EEA is in the chapter two.

Table 5. Union comparisons

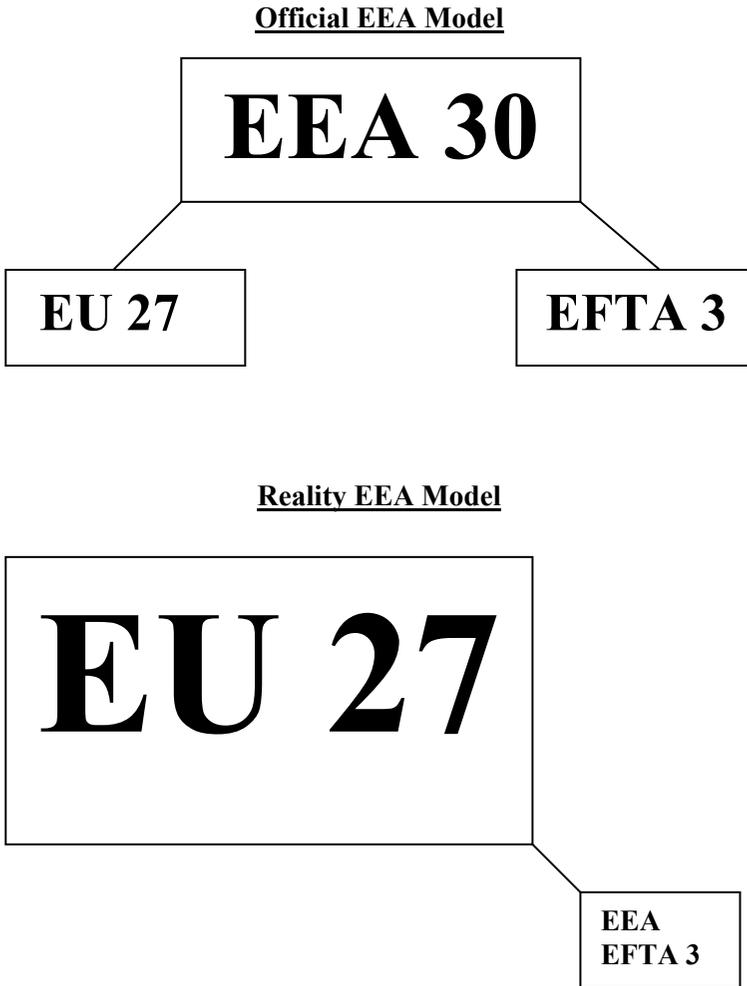
	Political Union	Economic Union	Free Trade Area
EFTA	No	No	Yes
EU	No ⁶⁸	Yes	Yes
EEA	No	Only partially	Yes

Table 5 (above) requires some explanations. A Free Trade Area is a relatively clear concept although Free Trade Areas can have different rules on origin of goods and how much imported goods must be processed to qualify for free trade. There is no universal definition of a Political Union or Economic Union and these definitions can be open to discussion, e.g. the United States (political union) with 50 states, not all applying the same local law, but nevertheless all having the same federal government. The EU is increasingly harmonising its policies, both internally and vis-à-vis the outside world, but it does not have a federal government. Nevertheless, many EU regulations are supranational and member states are obliged to incorporate them into national legislation.

EFTA and the EEA are only of minor political and economic interest to the EU as a whole because of the relatively small size of the EFTA members. However, on the contrary, the EU part of the EEA is very important for the EFTA-EEA states trade. For neighbouring countries, e.g. Sweden (EU and EEA member) and Norway (EFTA and EEA member) or Germany (EU and EEA member) and Switzerland (EFTA member), bilateral and multilateral political and economic affairs also play a significant role. Figure 8 on next page shows the EEA theory versus the EEA political reality. The three EFTA states that are members of the EEA would like to see the EU as their counterpart under a giant EEA umbrella. The reality is that the EU is a political and economic giant and the EFTA part of the EEA and the EFTA states themselves are just considered as EU associated states but not as full team players. They are welcome to join, but if they want to stay on the side it is their choice.

⁶⁸ Under the assumption that a political union refers to being one country. However, every new treaty signed by EU member states goes a small step closer to a federal Europe, e.g. CFSP after the Lisbon Treaty.

Figure 8. Official EEA model compared to the reality EEA model.⁶⁹



⁶⁹ We apologize to the many Icelandic bureaucrats and politicians who feel offended by this model, but we cannot see a better way to demonstrate that the EEA and EFTA are not EU's equal counterparts, nor are they EU's central concern.