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Iceland



COUNTRY BRIEFING

Abstract

On the eve of the second Icesave referendum, the restructuring of Iceland's economy in co-operation with the IMF appears to be on track, with a return to modest GDP growth expected for 2011. Nevertheless, the left-of-centre coalition government remains divided on many policy issues, and its long-term stability is uncertain. Public opinion seems to be marginally less hostile to EU accession, though less than one third are fully in favour. The preliminary screening stage is proceeding well, paving the way for negotiations proper to begin in autumn.

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ABOUT THE EDITOR

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1. DOMESTIC POLITICS

Ever since the economic collapse in 2008 the political landscape in Iceland has been changing, with trust in politicians and political parties diminishing greatly. Revelations of large political donations to leading political figures (of left and right) before the collapse have fuelled further resentment. The Reykjavik city council elections in May 2010 demonstrated this lack of trust in the political process, with the four main political parties losing their former support, while the self-styled Best Party – set up as a satire on the political establishment - won 6 out of the 15 council seats and saw its leader, a well known comedian, become mayor of Reykjavik last June.

1.1 GOVERNING COALITION

The coalition of the **Social Democratic Alliance (SDA)** and the **Left-Green Movement (LGM)**, which had formed a transition government in early 2009, was confirmed by elections in April of that year, but has had a hard time dealing with the legacy of the crisis: a rapidly shrinking tax base, stringent measures imposed by the IMF, pressure from foreign creditor governments, and a plan for rescue through EU accession rejected by much of the LGM as well as of the public.

With 34 of 63 seats in the Althingi, the coalition led by Prime Minister Johanna Sigurdardottir (SDA) has a narrow enough majority. It was brought to the brink in December 2010, when three LGM MPs voted against the budget, which was passed by just one vote.

The LGM as junior partner of the coalition is divided internally, its left wing openly disagreeing with key policies, including the IMF programme that is central to the government's economic strategy. Subsequently, in March 2011 two LGM MPs announced that they would no longer support the government.

Prime Minister Sigurdardottir has had to work closely with the LGM leader and Minister of Finance, Steingrímur Sigfússon, to introduce unpopular measures viewed as necessary to deal with the crisis that the government inherited. The Economist Intelligence Unit's central forecast remains that the coalition will continue during 2011-12, but the risk of breakdown is considerable.¹

The next elections are not due before April 2013, but the possibility that a government collapse could prompt an early vote is rising.

1.2 OPPOSITION PARTIES

The **Independence Party (IP)** was the dominant governing party for decades before being forced from office in 2009, receiving just 24% of the vote (down from 37% in 2007) and 16 seats in the April 2009 elections. Though arguably carrying the largest share of responsibility for the economic and financial collapse of 2008, it has since recovered ground through portraying the coalition as too weak in the face of foreign impositions. As a result, it would probably re-emerge as the largest party if an early election were to be held soon.

Support for the **Progressive Party (PP)** exceeded expectations in the April 2009 elections, with it gaining 9 seats in Parliament, although part of that support has since eroded. The party, which had been in government with the IP from 1995-2007, turned the page following the banking collapse by replacing its leadership.

A new party, the **Civic Movement (CM)**, was founded in February 2009 by some of the grass-roots movements which had organized the January 2009 demonstrations that led to the collapse of the IP-SDA government. The CM received 7% support in the April elections, gaining four seats in Parliament. By mid-September however, three CM members of Parliament and two deputy MPs left to form a new political party, Hreyfingin, or **the Movement**, while the fourth MP had left CM to sit as an independent.

¹ Economist Intelligence Unit, Country Report: Iceland, January 2011

1.3 LEGACY OF CRISIS

Following the financial crisis, two new bodies were set up by Althingi to investigate and prosecute alleged criminal acts in the context of the bank collapse: the Special Investigation Commission and the Special Prosecutor.

The **Special Investigative Commission** was tasked with collecting information on the main events leading to the collapse of the Icelandic banks and with identifying its causes. It presented its report in April 2010, finding that successive governments, the central bank and the supervisory authority had all failed to address signs of the impending banking collapse. This led to the appointment of a parliamentary committee to consider the judicial follow-up, which in turn recommended that four former ministers be indicted for "negligence". In the end, the Althingi voted 33:30 not to indict former finance minister Arni Mathiesen (IP), former business minister Bjorgvin Sigurdsson (SDA) or former foreign minister Ingibjorg Gisladdottir (SDA). As a result, only former prime minister **Geir Haarde** (IP), who presided over the IP-SDA government from 2006 to 2009, will be charged with violating his ministerial responsibilities, before a special constitutional court created for such cases in 1905 but so far never convened.

While the commission and the parliamentary committee essentially had to weigh political responsibility, the **Special Prosecutor Olafur Hauksson** and his staff are tasked with investigating "*suspensions of criminal actions in the period preceding, in connection with or in the wake of the collapse of the Icelandic banks*".² Armed with special investigative rights and a whistleblower provision, they can build cases against both legal entities and individuals, with the first cases coming to court last summer. Until October 2010, the Special Prosecutor was advised by MEP Eva Joly, based on her achievements as an investigative judge in high profile fraud cases.

In addition to currency stabilisation and bank restructuring (*see below*), the programme agreed with the IMF, which circumscribes all government activity for the time being, focuses on **fiscal consolidation**. The latter is being progressively implemented through a range of tax increases and spending cuts, which ought to see the budget deficit fall to 5% of GDP in 2011 and 3.8% in 2012 (from more than 10% of GDP in 2009). What little room for manoeuvre remains is mostly being used to salvage tax incentives for research and development as investments into the future.

2. THE ECONOMY

Iceland has a free market economy, while maintaining an extensive welfare system with free health care and free universal education. Before the economic crisis unemployment had traditionally been low and income relatively evenly distributed (excluding the years leading up to the crisis). The economy depends heavily on the fishing industry, even more now following the collapse of the banking sector, with fisheries accounting for around 42% of Iceland's export earnings and 13.7% of GDP in 2009, and 4.1% of the country's working force in 2008. Other main industries include aluminium smelters (due to the plentiful availability of geothermal energy) and tourism. Iceland is very dependent upon imports of almost all categories of goods, with prices being sensitive to currency fluctuations, even before the financial crisis.

Economic growth³

The bankruptcy of the Icelandic financial sector in late 2008 contributed to a severe fall in domestic purchasing power and consequently to a fall of 21% in domestic demand in 2009. Domestic demand continued to contract in 2010 and GDP fell by 3.5% over the year as a

² cf. Althingi website - <http://www.serstakursaksoknari.is/english/special-prosecutor/>

³ Economist Intelligence Unit, Country Report: Iceland, March 2011 Updater

whole. There are indications of a slowly recovering domestic consumption since the last quarter of 2010, and export growth appears to be holding up, albeit slightly dampened by a strengthening of the krona. As a result, GDP is currently forecast to return to moderate growth from this year, at 1% for 2011 and 1.8% in 2012.

Inflation

As a result of a stronger currency, inflation fell sharply to under 2% in February 2011, from 8.5% in March 2010, and should remain low by Icelandic standards until mid-2011. The central bank's inflation target is set at 2.5%. If capital controls will subsequently begin to be eased, as is widely expected, the exchange rate is then likely to depreciate, leading to moderately higher inflation. Average inflation is therefore forecast to reach 2.5% in 2011 and 4% in 2012.

Wages were rising a little more than inflation in late 2010 and are likely to continue to do so in early 2011. Negotiations for new wage rounds are under way. Unions are likely to try to ensure that real wages are maintained if inflation rises again.

Unemployment

After peaking at over 9% in Spring 2010, unemployment has started to decline, stabilising around 7.5% during the Winter. This development was probably aided by emigration (estimated to have contributed between 1 and 2 percentage points) and part-time working.

The share of those unemployed for over a year has, however, risen slightly in recent months to its current rate of 38%. Since this is the first time in recent history that Iceland faces extensive long-term unemployment, there is increasing concern that this lead to higher structural unemployment and dampen the barely re-emerging economic growth.

Economic Policy

Largely focused on the need to stabilise the economy and rebuild the banking system, the government's policy is guided by a **programme agreed with the IMF** in November 2008, and most recently reviewed in early February 2011. Its main elements include currency stabilisation and bank restructuring, in addition to the obligation of fiscal consolidation referred to above.

The commercial **banking sector** has now been recapitalized. The three failed banks have been restructured, with Kaupthing bank hf.(now Arion bank) and Glitnir bank hf. (now Islandsbanki) now mostly owned by foreign creditors, and Landsbanki hf. being 80% state owned, the remaining 20% held by foreign creditors.

Currency stability has been tentatively achieved through **capital controls**, introduced under a special safeguard clause in the European Economic Area (EEA) agreement and recognised by the European Commission as a necessary temporary restriction. These greatly helped to stabilise the krona during 2010. With both the relevant legislation and the IMF programme set to expire in August 2011 however, it is widely expected that controls will be progressively lifted thereafter. EIU forecasts are for a slight depreciation of the krona, but include the risk of a much sharper fall in exchange rates.

With real estate values falling dramatically and mortgage debt rising, the **restructuring of household debt** has been high on the agenda ever since the 2009 elections. Following a Supreme Court ruling of July 2010 which declared the indexing of loan contracts to foreign currencies illegal, an agreement has finally been reached to share the cost of restructuring between the government and the banks. Private-sector debt is also being addressee, and Iceland's banks have set themselves the objective of restructuring their loan portfolios by the end of the year - a target date seen as somewhat ambitious by many observers, given that some 40% of loans are currently non-performing.

The Icesave Agreement - Mk. II

Icesave was the name of an online savings brand owned and operated by Landsbanki in the United Kingdom from 2006 and the Netherlands from 2008. When the Icelandic State seized Landsbanki in October 2008 it guaranteed deposits for Icelandic creditors only. A liability dispute between Iceland and the British and Dutch governments followed, with the latter accusing Iceland of breaching the EEA Agreement. The UK then froze Landsbanki's assets in the UK, using the Anti-terrorism, Crime and Security Act 2001.

The Icelandic government has agreed to comply with EEA law and cover the deposits of insured depositors up to the minimum requirements set forth in the Deposit Guarantee Directive, but it reserves the right to have the issue of legal liability decided upon at a later stage by a competent adjudicator.

A first version of an agreement with the United Kingdom and the Netherlands, stipulating repayment of € 3.8 bn at 5.55% interest between 2016 and 2024, was approved by Althingi in December 2009, but rejected by the citizens in a March 2010 referendum. Even before the referendum, agreement had been reached on a revised agreement. This stipulates an interest rate of only 3.2%, no back interest for most of 2009, and repayments starting in 2011, thus considerably reducing the cost of the operation to the Icelandic taxpayers. Approved by Althingi, the agreement has again be put to a referendum, scheduled for 9 April 2011.

3. FOREIGN AND DEFENCE POLICY

Iceland's regional status is largely determined by its membership of the *European Economic Area* (EEA) and its historical and cultural ties with the Nordic countries, joined together in the *Nordic Council*. The country's close relationship with Scandinavian countries is being extended to both the Baltic region and the Barents region: Though technically situated outside both regions, Iceland is a member of the Council of Baltic Sea States (CBSS) and the Barents Euro Arctic Council (BEAC), as well as of the Arctic Council. It has been a member of the Council of Europe since 1950, of EFTA since 1970, and of the OSCE since 1975.

It is to be noted that the EEA agreement does not cover EU policies such as the Common Foreign and Security Policy (CFSP), the Economic and Monetary Union, the Common Trade Policy, the Customs Union, and Justice and Home affairs. However, Iceland has been a member of the Schengen Cooperation since 1996, aligns itself with the CFSP, and has participated in EU peacekeeping operations.

Iceland is a founding member of *NATO* and has traditionally relied on the United States for its security, based on a bilateral defence agreement of 1951. In a surprise move which caused considerable resentment, the US unilaterally closed down its airbase in Keflavik in 2006. The defence plan agreed at that point covers defence against traditional military threat in times of war, but the US relinquished its responsibility for Iceland's air defence during peacetime. Iceland reacted by concluding agreements with Norway, Denmark and the United Kingdom on cooperation in the areas of security and defence, search and rescue, civil defence and preparedness. Canada, Germany and France are also seen as potential partners in this respect. The increased activity of *Russian* military forces in the North Atlantic (breaching the Icelandic air control zone over 60 times since the US army's departure in 2006) is seen to have resulted in the government establishing new ties with NATO: Peacekeeping efforts in Afghanistan, Iraq, Palestine and the Balkans are perceived as a way to maintain NATO's support in the North Atlantic and Arctic regions.

The financial crisis has, however, forced the government to diminish Iceland's international commitments, with development aid and peacekeeping having already been cut substantially and a number of embassies closed down or downsized. The Icelandic Defence Agency (IDA), only recently established as such, was closed down again, its tasks largely devolving to the

Coast Guard, as well as the police and the ministry of foreign affairs. Nonetheless, Iceland will continue to fulfil all of its security and defence obligations under NATO. The Left-Green Movement, which opposes NATO's air surveillance missions and Iceland's participation in any military activity, opposed the creation of the IDA and highly promoted its closure.

Among major third countries, Iceland's relations with **China** have been increasing gradually, with a three-year bilateral currency swap agreement worth 393 million Euros being signed in June 2010, to be used to finance trade between the two countries. The two countries furthermore made a formal agreement in July to collaborate on harnessing geothermal energy in developing countries, especially in Eastern Africa. China has been increasing its presence in Iceland, opening the largest embassy in Reykjavik and showing interest in an investment in the hydroelectric industry and in developing possible oil fields off the north-east coast of Iceland.

The foreign policy of the comparatively young republic is often coloured by a preoccupation with **preserving its independence and cultural identity**, often equated with maintaining control over the country's main resources, the fisheries. This is illustrated by attitudes to **whaling**, which Iceland resumed in 2003 despite widespread international protests, as an exercise in maritime sovereignty and fisheries management more than for any sizeable commercial advantage as such.

4. EU-ICELAND RELATIONS - THE ACCESSION PROCESS

Since the country gained independence in 1944, the hardest and most protracted debates within Icelandic society have centred on participation in international cooperation, i.e. membership of NATO, EFTA and the EEA. Strong nationalism lay at the centre of these debates, just as it does today when contemplating EU membership. Being an independent nation is largely equated with maintaining full sovereignty over the island's own affairs, including the marine resources perceived as vital, and protecting its cultural identity from outside influence. Since Iceland did not suffer from WWII like most other European nations, nor experience the Cold War in quite the same way, most Icelanders would not see themselves as sharing the main European narrative.

4.1. JOINING THE EUROPEAN ECONOMIC AREA

During the 1940s and 1950s Iceland's trade relations with Europe remained moderate, with the focus being more on domestic investment and economic growth. Fisheries products constituted 85% of Iceland's exports and the country maintained very strong trade relations with the Soviet Union and Eastern Europe. While trade liberalization was becoming dominant in Western Europe, Iceland remained reluctant to open up its markets, - given its trade deficit, current account deficit and lack of foreign currency. The Marshall Fund's high contribution to Iceland was also a large factor, in addition to the fact that trade within Europe at the time was mostly with industrial products, which were of very limited interest to Iceland.

Various interest groups in Iceland started to become more interested in either full EU membership or associate membership during the 1960s, whilst the labour unions remained against. Iceland became a member of the GATT in 1976 and the IP-SDP government then steered Iceland into EFTA in 1970, with two political parties divided on the issue, the Progressive Party and the People's Alliance.

Direct relations between Iceland and the European Union formally commenced in 1973 with a bilateral free-trade agreement. The agreement only covered part of the trade between Iceland and EU member states at that time, and after the EU adopted the Single European Act in 1986 the bilateral agreement was replaced by the European Economic Area Agreement (EEA), to prevent trade barriers between EFTA states Iceland, Norway and Liechtenstein, and EU Member States. The EEA agreement was heavily debated at the time, with three political parties divided on the issue - the IP, the PP and the Women's Movement (WM).

Besides giving Iceland free access to the EU's Single Market, the EEA agreement also includes common rules in various areas to ensure fair competition, environmental protection, consumer

protection and minimum social standards. In addition the three EFTA EEA states can participate in EU's framework programmes, on research and development, education, information services, social policy, the environment and the audio-visual sector. Since 1994, Iceland has also contributed to the EFTA/EEA Financial Mechanism, which is aimed at reducing social and economic disparities within the EEA. As the EEA agreement does not cover agriculture and fisheries, Iceland has bilateral agreements with the EU covering trade in agricultural and fisheries products.

4.2 TOWARDS EU MEMBERSHIP ⁴

The collapse of the currency system in September-October 2008 led to a temporary shift in favour of applying for EU membership, and strengthened the SDA, which had long been supporting that foreign policy option for Iceland's future. With the three parties supporting an EU membership application - the SDA, the centrist Progressive Party (PP) and the new Citizen's Movement (CM) - together receiving 52% of the vote, the election results of April 2009 were seen by many as a sign that a majority of the nation was now in support of at least an EU application as a solution to Iceland's woes.

However, despite the European Commission's positive assessment of Iceland's application, and its efforts to separate the difficult Icesave negotiations from the accession issue, public opinion soon swung back against membership: By May 2010, less than 20% of people polled were in favour, with a solid 45% opposed to EU membership. A motion to withdraw the application was even tabled in Althingi (though not enacted). According to the latest Eurobarometer of February 2011, views of the EU have improved slightly, with support for membership up to 28%, and outright opposition down to 34%. Since EU membership was widely seen from the start as a means to the end of adopting the Euro, it is no surprise that support for the monetary union is more than twice as strong at 61%.⁵

Meanwhile, after the Council accepted Iceland's application for membership in July 2010, the accession process is following its course. The **screening stage** is currently underway and proceeding well, although the sensitive fisheries chapter has not yet been reached. Through the EEA agreement, Iceland has already largely accepted 21 of the 35 chapters to be covered in accession negotiations, often heading the scoreboard of implementation. Screening is expected to conclude by June 2011, clearing the way for negotiations proper to start under Polish presidency in the autumn.⁶

The Icelandic government is itself divided on the issue, the LGM having reluctantly accepted the application in its coalition agreement with SDA, without however making any commitment to support eventual accession treaty. The foreign ministry is going to great lengths to make the process as transparent as possible, through an information office in Reykjavik and a dedicated webpage which details every step of the screening process so far.⁷

However, if proof were required of the extreme importance Icelanders attach to full control over the country's marine resources, it can be found in Iceland's Cod Wars with the United Kingdom during the Cold War. The prospect of EU membership and the surrendering of sovereignty it entails, in particular on the Common Fisheries Policy (CFP), is thus highly suspect to many citizens. For them, the idea of giving up the full control of the country's most important natural resource is still unthinkable, prompting informed observers to conclude that *"negotiations are proceeding but seem increasingly pointless, as accession will almost certainly be defeated in a referendum"*⁸.

⁴ For detailed background information on Iceland's application for EU membership, public opinion and the negotiating mandate adopted by Althingi, see our Policy Briefing no. 2010/353 of September 2010.

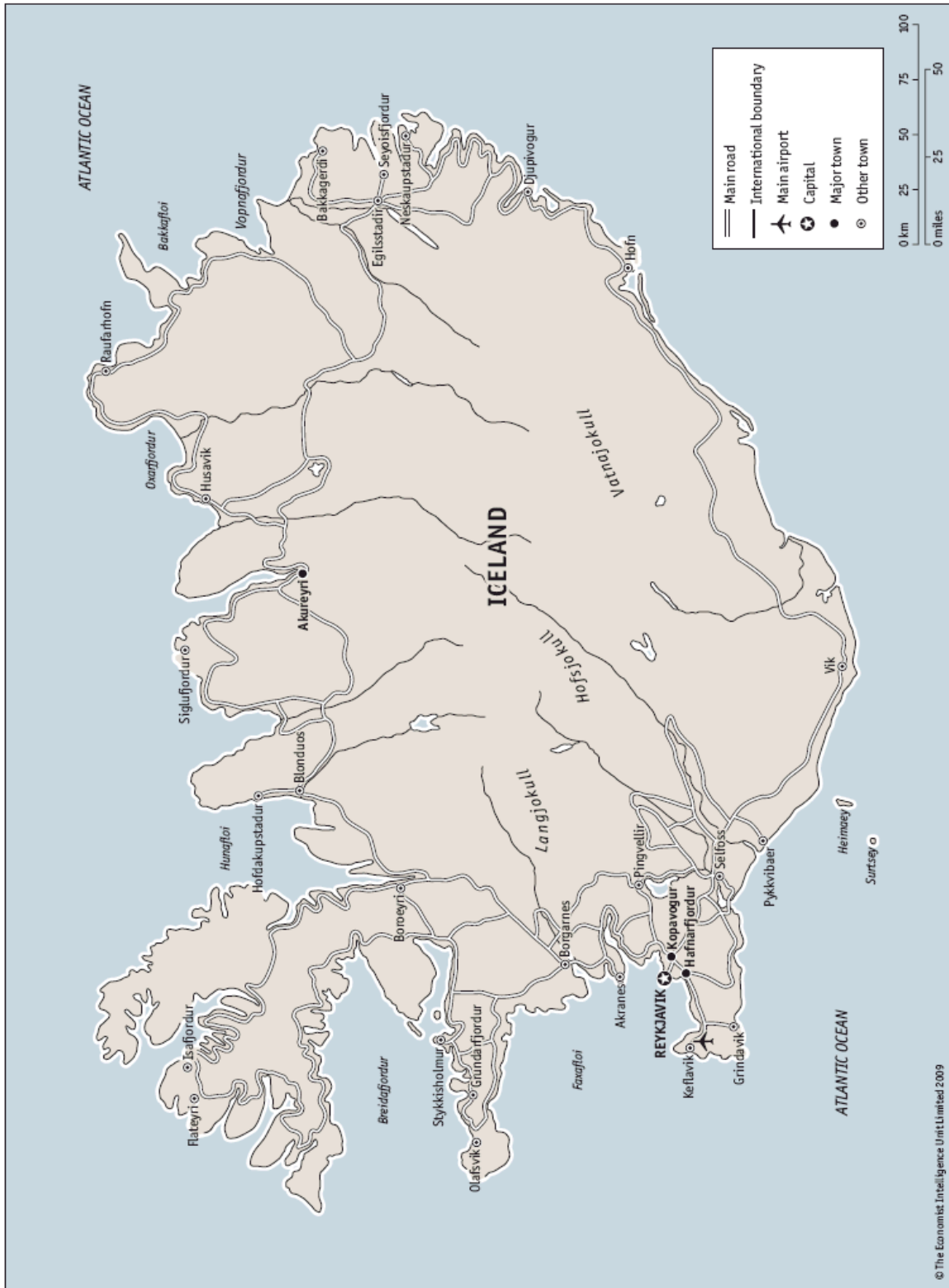
⁵ http://ec.europa.eu/public_opinion/archives/eb/eb74/eb74_fact_is_en.pdf

⁶ DG Enlargement, oral communication to the SIN-EEA Delegation on 29 March 2011

⁷ <http://europe.mfa.is/>

⁸ Economist Intelligence Unit, Country Report: Iceland, March 2011 Updater

5. ANNEX I: MAP OF ICELAND



6. ANNEX II: GENERAL DATA

Location: The North Atlantic Ocean, on the Mid-Atlantic Ridge, approx. 21° W 64°N

Size: 103, 000 sq km

Inhabitants: 317.900 (July 2010)

Capital: Reykjavik (118.326 - the greater Reykjavik area: 200.852)

Other main towns: Kopavogur (30.357), Hafnarfjordur (25.913), Akureyri (17.573), Reykjanesbaer (14.091), Gardabaer (10.643).

Language: Icelandic - a North Germanic language, originating in Old Norse and Old English.

Currency: the Icelandic krona (ISK), at at 1 euro= 161 ISK [4 April 2011]

Time: GMT all year round

Climate: mild winters and cool summers - average temperature: 0-10 °C.

7. ANNEX III: POLITICAL STRUCTURE

Official name

Republic of Iceland

Form of state

A representative democracy and a parliamentary republic.

Legal system

A civil law system based on the Constitution of 1944.

National legislature

The Althingi, Iceland's Parliament, is composed of 63 members, elected by proportional representation for four-year terms. Candidates are elected from party lists. As stipulated in the Constitution legislative power is exercised by the President and the Parliament, executive power by the President and other governmental authorities, and the judicial power by the judiciary. The President's signature is needed to validate legislative acts and government measures. If withheld the government either withdraws the draft law or a referendum is held.

National elections

25 April 2009; next to be held April 2013.

POLITICAL FIGURES⁹

Head of State: President Olafur Ragnar Grimsson

Prime Minister: Johanna Sigurdardottir (SDA)

Minister of Economic Affairs: Árni Páll Árnason (SDA)

Minister of Education, Science and Culture: Katrín Jakobsdóttir (LGM)

Minister for the Environment: Svandís Svavarsdóttir (LGM)

Minister of Finance: Steingrímur J. Sigfússon (LGM)

Minister of Fisheries and Agriculture: Jón Bjarnason (LGM)

Minister for Foreign Affairs: Össur Skarphéðinsson (SDA)

Minister of Industry, Energy and Tourism: Katrín Júlíusdóttir (SDA)

Minister of the Interior: Ögmundur Jónasson (LGM)

Minister of Welfare: Guðbjartur Hannesson (SDA)

Chairs of Political Parties

The Social Democratic Alliance: Johanna Sigurdardottir

The Left Green Movement: Steingrímur J. Sigfússon

The Independence Party: Bjarni Benediktsson

The Progressive Party: Sigmundur David Gunnlaugsson

The Movement: Birgitta Jónsdóttir (current chair of the parliamentary group – no official chair for the Movement)

⁹ In January 2011, the government merged the Ministry of Health and the Ministry of Social Affairs and Social Security into the Ministry of Welfare; and merged the Ministry of Communications and the Ministry of Justice and Human Rights into the Ministry for the Interior. It also plans to merge the Ministry of Fisheries and Agriculture and the Ministry of Industry, Energy and Tourism into the Ministry of Employment and Innovation.

Distribution of MPs in Althingi

Social Democrat Alliance (SDA): 20

Left Green Movement (LGM): 14

Coalition Total: 34

Independence Party (IP): 16

Progressive Party (PP): 9

Movement: 3

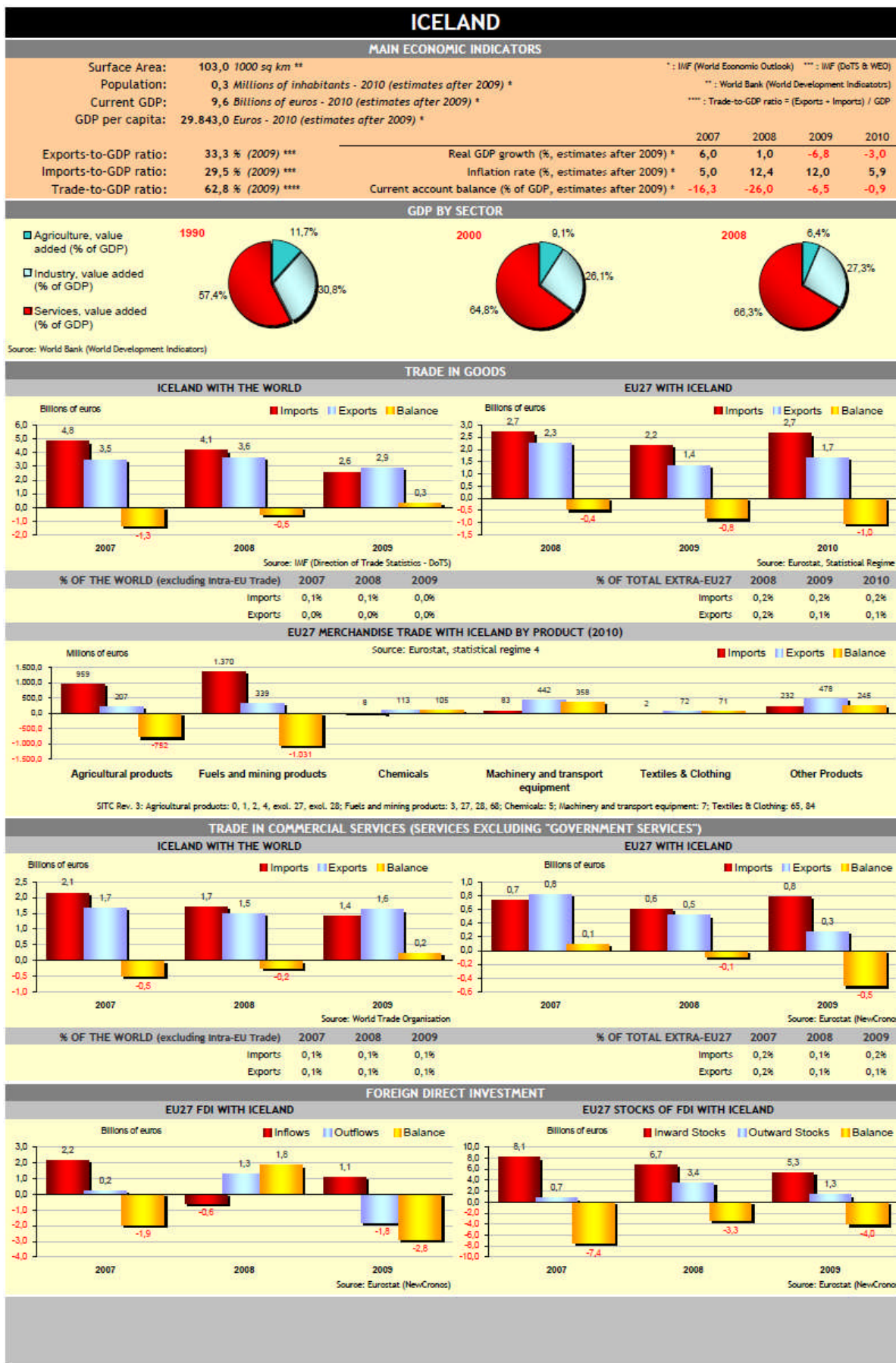
Independent: 1

Total Membership: 63

Speaker of the Althingi: Asta Ragnheidur Johannesdottir

Central Bank Governor: Mar Gudmundsson

8. ANNEX IV: TRADE STATISTICS



9. ANNEX V: HISTORICAL BACKGROUND

BEFORE THE REPUBLIC (870-1944)

The first settlement on Iceland was in 870, by people of Norwegian, Scottish and Irish origin. The Icelandic Parliament, Althingi, was established in 930 at Thingvellir, often depicted as the world's oldest parliamentary institution. There was no central executive power to enforce law at the time, which gave rise to blood feuds. The settlers were mainly pagans worshipping Norse gods but with increased political pressure from Europe during the 10th century to convert to Christianity Iceland became Christian in 1000. During the 11th and 12th century there were constant blood fights over the power over Iceland, until Norway's sovereignty over Iceland was accepted in 1264. Althingi intended to hold on to its legislative and judicial power but with one tenth of earnings going to the churches power gradually shifted to ecclesiastical authorities with Iceland's two bishops in the forefront.

In 1380 Norway (and thus Iceland), Sweden and Denmark formed the Kalmar Union, with Denmark as the dominating power. With the forming of the absolute monarchy in Denmark-Norway in 1660 Iceland surrendered its autonomy, including the right to initiate and consent to legislation. In 1627 Iceland, under the protection of Denmark, was raided by an Ottoman pirate fleet that abducted almost 300 Icelanders into slavery. Iceland became a Lutheran country in 1550, a change pressured by the King of Denmark at that time, Christian III. Denmark forbade Iceland to trade with any other countries in 1602, which remained in effect until 1854.

The 18th century was particularly tough on Icelanders, with climate conditions and floods, ash and fumes from the eruption of Volcano Laki in 1783 killing 9,000 people and 80% of the livestock. The kingdoms of Denmark and Norway separated in 1814, with Denmark keeping rule over Iceland. The hardship during the 19th century led to mass emigration to the New World, in particular to Manitoba, Canada, but it also developed a new national consciousness among Icelanders, who started fighting for their independence. Denmark granted Iceland home rule in 1874 and full sovereignty in 1904, with Iceland requesting Denmark to take care of its foreign affairs and defence interests. The Act was up for revision in 1940, but with Denmark being occupied by Nazi Germany at that time and onwards until the end of World War II, Iceland unilaterally decided to become independent on 17 June 1944.

THE REPUBLIC OF ICELAND 1944-2010

Since the founding of the Republic coalition governments have almost been the exclusive form of government in Iceland. The conservative Independence Party (IP) has been dominant since its founding in 1929, with left-wing parties only being able to form a government seven times out of the 29 governments in the history of the Republic, the latest being the current one, since April 2009. The most controversial and dividing issues in Iceland during the second half of the 20th century include membership of NATO, the defence agreement with the United States, - in particular with regards to the US air base in Keflavik (1941-2006), relations with the Soviet Union and Eastern Germany, and Iceland's integration into Europe. The extension of fishing limits, with the subsequent Cod Wars with the United Kingdom (UK), was also of high importance.

Regarding membership of NATO and relations with the United States and the US air base in Keflavik the Independence Party remained the most supportive throughout while the Socialist Party the most opposed. Other main parties, including the Progressive Party (PP) and the Social Democratic Party (SDP), were divided on the issue, with the latter being more united in

support than the former. Concerns over American influence on Icelandic culture and society remained at the forefront of the debate, as well as the neutrality of Iceland as a peace loving nation. During the mid 1970s the issue ceased to be at the heart of the political debate in Iceland. The Socialist Party developed and maintained political, economic and cultural relations with both East-Germany and the Soviet Union throughout the Cold War, with left wing governments increasing relations when in power, especially during the 1950s, with relations gradually decreasing from the late 1960s onwards. Strong nationalism amongst Icelandic socialists prevented relations from becoming stronger than witnessed.

Series of confrontations between Iceland and the UK over fishing rights in the North Atlantic, the so-called "Cod Wars", took place from 1958-1976. The cause of the first Cod War was Iceland's unilateral extension of its fishing rights from 4 to 12 nautical miles (nm), the second an extension from 12-50 nm and the third to 200 nm. The confrontations included a series of net-cutting incidents and of vessels hitting each other. The UK in the end accepted Iceland's claims, following its threats to leave NATO. The fact that the Law of the Sea was developing in Iceland's favour at the time, also had an affect. All political parties in Iceland agreed on the country's right to extending its fishing rights, with the Progressive Party and the People's Alliance (PA) remaining fiercer in the debate than the IP and the SDP.