

FOREIGN AND COMMONWEALTH OFFICE
Western European Department
WRC014/002/96

30 December 1996

(6)

PAPJC12/2

ICELAND: ANNUAL REVIEW FOR 1996

HER MAJESTY'S AMBASSADOR AT REYKJAVIK TO THE SECRETARY
OF STATE FOR FOREIGN AND COMMONWEALTH AFFAIRS

SUMMARY

- 2-4 New President politically oriented: coalition government stable: possible left-wing alliance;
- 5-7 Nordic co-operation continues: Icelandic focus on Baltic States: EU (and EMU) thoroughly debated;
- 8 Resumption of whaling can not be ruled out;
- 9-10 Economy in good shape;
- 11-14 Bilateral relationship good: our exports increase: effect of our educational fees policy a longer term danger: lack of funding for cultural diplomacy.

REC 0141/1

[REDACTED]

BRITISH EMBASSY
REYKJAVIK

30 December 1996

The Right Honourable Malcolm Rifkind QC MP
Secretary of State for Foreign and
Commonwealth Affairs
London

Sir,

ICELAND: ANNUAL REVIEW FOR 1996

1. A stable year for Iceland. Domestic and foreign affairs, the economy and our bilateral relations are in good shape and should continue so in 1997, give or take a couple of possible pitfalls.

Internal

2. Highlight was the Presidential election. After 28 years of figure-heads, Iceland elected as President a controversial left-wing politician. Olafur Ragnar Grimsson's election did not signal any national shift to the left: rather, he was the only nationally known candidate. He was also, with his political experience, by far the most able operator. He is though the deadly enemy of the Prime Minister, David Oddsson, and the hierarchy of the right-wing Independence Party, not to mention the Establishment. Their fear is that he will not be able to resist playing a political role. His ambitions are obviously political but so far, with minor exceptions, he has behaved himself and has concentrated on building support at grass-root level. Latest polls show that he is twice as popular as the Prime Minister. He was, incidentally, educated at Manchester University.

3. In any case, the time is not ripe for a clash with the right-of-centre Government. The coalition of Independence and Progressive Parties is too secure. It has a large parliamentary majority. But perhaps of more significance in a nation of coalition governments which tend to fall through personal or party relationships, both parties have the will, the desire and the flexibility to continue together. There is no sign of any souring in the relationship although there is some strain over fishing fees for trawler owners. The Government can be expected to see out its term, helped by a lack of real opposition from a fragmented left-wing.

[REDACTED]

[REDACTED]

4. A left-wing alliance is however back on the agenda. The removal from Party politics of Olafur Ragnar Grimsson, the new President and former leader of the left-wing People's Alliance, was matched by the resignation of the only other left-of-centre heavyweight. Jon Baldvin Hannibalsson, a former Foreign Minister educated in Edinburgh, retired in November after 12 years as leader of the Social Democratic Party. Both were seen as obstacles to any alliance. No-one underestimates the difficulties but with the People's Alliance moving more towards the centre, the chances are perhaps better than ever. Combined left-wing vote is almost the same as for the Independence Party. The aim is to have something in place by the next election in 1999. Until then, an alliance would have little practical effect. Given the present policies of the SDP and the People's Alliance, there is little for us to fear from Iceland's left-of-centre.

External

5. Iceland's security policy is firmly based on NATO and the transatlantic link. Views remain not dissimilar to ours and Iceland can be a useful ally. Nordic co-operation continued satisfactorily. Sweden and Finland joining Denmark in EU was recognised, after initial hesitancy, as an enhanced channel for Iceland to influence EU via the back-door. Iceland is apparently more involved now in Nordic defence policy than ever before because of the Baltic States. Iceland strongly supports Baltic NATO and EU aspirations.

6. Fishing disputes with all the major players in the region, including the EU, continued throughout the year. Iceland adopted a generally tough and inflexible line everywhere. (Iceland did however acquiesce to an agreement on herring quotas in December despite a national conviction that the EU quota was far too high.) Fortunately these disputes have not so far escalated to the point of affecting bilateral relations.

7. Will Iceland join the EU? The question was thoroughly debated. The coalition government remained adamant that it would not: Iceland had to retain full control of its fishing resources. Towards the end of the year attention turned towards the effects on Iceland of EMU and enlargement. These are being studied. If warranted, I believe Iceland will seek a special arrangement to associate with EMU. It meets the Maastricht criteria. But it will still not apply for membership as such of EU: the benefits of EEA membership are sufficient for the moment. An application, however, can not be ruled out in the medium term if a formula can be found to suit the Icelandic fishing industry. Iceland is too dependent on foreign trade to stay out forever.

[REDACTED]

Whaling

8. The Icelandic Government believes the time could be ripe to resume whaling. They look enviously at Norway's record, particularly the lack of any effective counter-measure from Governments or NGOs which could impact on other sectors of the economy. There is a ground-swell of popular opinion which none of the parties can afford to oppose. Some sections of export business do point to the dangers but to little effect. A Committee is to report early next year but before then Parliament is to be asked to rescind the legislation which in effect stopped Icelandic whaling. That would leave the Government free to decide. The Minister of Fisheries told me earlier this month that if whaling did not begin again this coming summer, it would surely be the next. The Icelandic Government is well aware of our position on resumption, as well as that of Germany, France and USA. If a decision is taken to resume, we will have to consider our reaction carefully given the emotion the subject generates both with Government and public.

Economy

9. Recovery continues with consumer demand driving growth to around 6%. Inflation remains in check at under 3% but unemployment at about 4% is high in Icelandic terms. Signs of some overheating were dealt with quickly and skilfully. But personal debt is a problem. So too, but to a lesser extent, is an expected trade deficit after some years of surplus. Imports and exports increased by 21.8% and 9.5% respectively and the trend is expected to continue next year before reverting to surplus.

10. It is difficult to judge performance next year simply because projections which point to another healthy year rely on two major assumptions, the result of the current wage negotiations and the possibility of a very large inward investment for another aluminium plant. If the assumptions are not correct there will be a great danger of overheating. Some physical infrastructure projects have already been put on hold. Price stability is paramount: to maintain it, wage increases will have to be agreed at around 3.5%. The unions are looking for much more. Bilateral Relationship

11. Your visit in June to open our new Embassy building, which we harmoniously share with the Germans, and your talks with the Prime Minister and Foreign Minister were very well received by the Icelanders. In a different category, the visit by the Lord Mayor of Hull (Humburside is the main area of Icelandic activity in Britain) was a great success too. and the visit of HMS Gloucester did us proud. The last ship's visit was in 1991: and the last Ministerial visit was made by

[REDACTED]

Mr Heathcoat-Amory in June 1994. Iceland is a good friend but, like all good friends, requires reassurance. We may want to consider more frequent, but certainly not excessive, higher-level visits. Reykjavik is a stepping-stone to or from North America and might fit nicely into visits there. The Icelandic Prime Minister made that very point when he probed for a visit by the Prime Minister.

12. Our main thrust is commercial. We are Iceland's main trading partner and nearest neighbour with a strong manufacturing and technological base. Icelandic tastes are similar to ours. Per capita, we export more to Iceland than to anywhere else in Europe with the exception of Ireland. For the first 10 months of 1996 we increased our visible exports by 31.9% and our share of the market to 10.4%. We are closing the gap with the Germans but remain adrift of the Norwegians, the suppliers of oil. (This year we only just missed recapturing the oil market which we lost in the 1950s but I remain hopeful for next year.) An Icelandic Trade Mission to Humberstone, which I led, was the first such mission in either direction for many a long day. It was well received. So too was a nationwide British Week. We need more such initiatives but it is not proving easy to attract British business to a market of only a quarter of a million people.

13. Iceland is within our top 65 export markets. That is quite remarkable for a nation of about a quarter of a million people. We can do better but there are some factors beyond our control which might prove a hindrance. One is the strength of the pound. Another, given the nature of a large segment of our exports, is the very high level of Icelandic personal debts to which there must be a ceiling. And we will need to steer very carefully our reaction to any resumption of whaling.

14. The bilateral relationship is good and our profile is high. We are genuinely liked. There are many reasons, the most important of which is that many Icelanders now in influential positions were educated in Britain. Education in Britain continues but we have lost our prime position to USA and Germany. Fees are high in Britain for Icelandic students. The special facility we offer to students from EU countries does not extend to EEA countries, a sore point for the Icelandic Government. In due course, when American and German educated Icelanders reach positions of influence, we will have here the perfect example of the very negative effect of our student fees policies. Chevening Scholarships do of course help but the lack of any British Council presence or dedicated funding obstructs us in, for example, University twinning, an area mentioned to me by the link building Icelandic Minister of Education. That lack of dedicated funding also hurts us in the cultural field. Cultural diplomacy pays disproportionate dividends in Reykjavik. The Germans managed to bring the

[REDACTED]

[REDACTED]

Berlin Symphony Orchestra and Vladimir Ashkenazy to the biennial Reykjavik Arts Festival this year. They are still reaping the rewards.

15. I am copying this Review to my colleagues at Copenhagen, Helsinki, Oslo, Stockholm and to UKRep Brussels and UKDel NATO.

I am, Sir,

Yours faithfully

J R McCulloch

J R McCulloch

[REDACTED]