EXECUTIVE SUMMARY

Iceland is a fast-moving and dynamic marketplace whose scale and transparency make it an ideal test market for new products and services. The Icelandic economy is largely based on three pillars: fisheries, aluminum production and tourism. Although fish has been central to Iceland's trade for centuries, significant U.S. and other foreign investments in aluminum production rank among the largest foreign direct investments in the country. In the aftermath of the country's economic collapse and subsequent devaluation of the krona in 2008, Iceland has sustained double digit growth in tourism for the past three years. In 2013, 780,000 tourists from all over the world flocked to Iceland -- well more than twice the country's population. Its new status as a must-see tourism destination for adventurous travelers from North America, Europe and Asia make it an increasingly interesting market for U.S. retailers and consumer products. Six years after the collapse, the country achieved 3.3 percent annual growth in its Gross Domestic Product (GDP) in 2013.

1. Openness To, and Restrictions Upon, Foreign Investment

Attitude Toward FDI

There is broad recognition within the Icelandic government that foreign investment would contribute to the country's economic revival after its financial collapse in 2008. Iceland's growing tourism sector is expected to supply ample investment opportunities, but much work remains to identify investment-ready projects. Meanwhile, IT startups seeking investment are burgeoning and foreign investors have expressed growing interest in Iceland's retail sector. As part of its investment promotion strategy, the state operates the "Invest in Iceland Agency," which facilitates foreign investment and provides information to potential investors.

The government has stated its desire to attract foreign direct investment (FDI) in certain sectors and has pledged to draft new policies to facilitate such investment. Draft legislation that would address incentives for foreign investors is pending with parliament. The capital controls are a significant hindrance in the eyes of many foreign investors since there is not a clear timetable for their elimination. Although the capital controls do not apply to new investments, they may block investors who invested prior to their implementation from exiting from certain investments, and they create uncertainty around new investments.

There is significant debate regarding the appropriate types and level of FDI in Iceland, particularly within the energy sector and with regard to job creation and the environmental impact associated with certain projects. The majority of past foreign investment has been in energy-intensive industries, such as aluminum smelting, that take advantage of the country's abundant renewable energy resources. The current administration has signed both investment agreements and power purchase agreements for a silicon metal factory in Bakki and an investment agreement for an algae factory in Sudurnes, the region of the country with the highest unemployment. The current government has also started to address zoning issues that may open new areas for further expansion of electricity production in Iceland.

Laws/Regulations of FDI

Icelandic laws regulating and protecting foreign investments are consistent with Organization for Economic Cooperation and Development (OECD) and European Union (EU) standards. As Iceland is a member of the European Economic Area (EEA), most EU commercial legislation and directives are in effect in Iceland. The major law governing foreign investment is the 1996 Act on Investment by Non-residents in Business Enterprises, which grants national treatment to non-residents of the EEA (including U.S. citizens). The law dictates that foreign ownership of businesses is generally unrestricted, but limited in the fishing, energy and aviation sectors.

Limits on Foreign Control

Only entities with at least 51 percent Icelandic ownership can hold fishing rights. Non-EEA residents cannot hold hydro- and geothermal power harnessing rights; cannot manufacture or distribute energy; and cannot own more than 49 percent of aviation companies. However, there are precedents of such restrictions being circumvented by non-EEA companies that establish holding companies somewhere within the EEA. Icelandic law also restricts the ability of non EEA-citizens to own land, but this may be waived by the Ministry of Interior. Currently only 1.33 percent of total registered land in Iceland is owned either fully or partially by foreigners. The managers and the majority of the board of directors in an Icelandic enterprise must be domiciled in Iceland or another EEA member state, though exemptions from this provision can be granted.

Competition Law

Icelandic courts uphold the sanctity of contracts as a matter of course. Depending on the turnover of the companies in question, the Icelandic Competition Authority shall be notified of mergers and acquisitions. The Authority may annul mergers or set conditions with the objective of preventing harmful oligopolies and the restriction of competition.

Screening of FDI

There is no automatic screening of foreign investors although bidders in privatization sales may have to go through a pre-qualification process. Potential U.S. bidders in privatization auctions need to follow the process closely since the procedures are often ad hoc and deadlines can be short.

The U.S. does not have a bilateral investment treaty (BIT) with Iceland. A Trade and Investment Framework Agreement (TIFA) was signed in January 2009.

Investment Trends

The Icelandic Krona (ISK), which depreciated 60 percent against the dollar during the 2008 economic crisis, has been relatively stable since 2009. Capital controls remain in effect for all but new investments, though the current government is exploring its options for eventually lifting the restrictions.

	Year	**Rank**	**Score**
TI Corruption Index	2013	12	78
Heritage Economic Freedom	2014	23	72.4

World Bank Doing Business	2013	14	N/A

2. Conversion and Transfer Policies

Foreign Exchange

The Central Bank of Iceland imposed capital controls in October 2008 to prevent a massive capital outflow by foreign investors with stakes in the Icelandic economy after the collapse of the financial sector. The capital controls are intended to be a temporary measure. The 1996 Act on Investment by Non-residents in Business Enterprises states that "non-residents who invest in Icelandic enterprises shall have the right to convert into any currency, for which the Central Bank of Iceland maintains a regular exchange rate any dividends received or other profits and proceeds from sales of investments." Transactions involving imports and exports of goods and services, travel, interest payments, contractual installment payments and salaries are still permitted.

The Central Bank first published its Capital Controls Liberalization Strategy in 2009 and later updated it in 2011. The strategy stated that the controls will be lifted in stages. The first step, permitting the inflow of foreign currency for new investments and the outflow of capital derived from such investments, was implemented in November 2009. For the outflow of this foreign currency to be allowed, the new investments must be registered with the Central Bank. The Central Bank has also held auctions to buy offshore krona for currency in conjunction with an auction that is held to buy foreign currency in exchange for krona. These auctions have been settling close to the offshore rate for the krona.

A parliamentary committee reviewing the capital controls proposed that their elimination should not be tied to a specific date but rather to certain financial goals to prevent jeopardizing the financial stability of the Icelandic monetary system. There is still no timeline for lifting the capital controls but both the Central Bank and the Finance Ministry are looking at scenarios that would not jeopardize the balance of payments for Iceland when the capital controls will be lifted.

3. Expropriation and Compensation

The Constitution of Iceland proclaims that no one may be obliged to surrender his property unless required by public interests and that such a measure shall be provided for by law and full compensation be paid. A special committee is appointed every five years to review and proclaim the legality of expropriation cases. If the committee proclaims a case to be legal, it will negotiate an amount of compensation with the appropriate parties. If an amount cannot be agreed upon, the committee determines a fair value after hearing the case of all parties.

As far as the U.S. Embassy is aware, the Icelandic government has never expropriated a foreign investment. However, private investors described some actions of the Icelandic government before and during the financial crisis in October 2008 related to the takeover of three major banks as an expropriation of sorts.

4. Dispute Settlement

Legal System

The Icelandic civil law system enforces property rights, contractual rights and the means to protect these rights. The Icelandic court system is independent from the parliament and government. Foreign parties must abide by the same rules as Icelandic parties, and they enjoy the same privileges in court; there is no discrimination against foreign parties in the Icelandic court system. When trade or investment disputes are settled, the settlement is usually remitted in the local currency.

Under the Constitution, sentences may be passed by the courts only. The courts are generally divided into two classes: the lower courts, where most cases are heard, and the Supreme Court, which hears appeals from the lower courts. There are eight lower courts and one Supreme Court, all hearing public and private cases. The Landsdómur is a special high court or impeachment court established in 1905 with the mandate to handle cases where members of the Cabinet of Iceland are suspected of criminal behavior. The Landsdómur has 15 members — five supreme court justices, a district court president, a constitutional law professor and eight people chosen by parliament every six years. In 2011, the court assembled for the first time to prosecute the former Prime Minister for alleged gross misconduct in the events leading up to the 2008 Icelandic financial crisis.

Investment Disputes

Economic Surveillance Authorities under the EFTA agreement have ruled that the emergency laws put in place when the Icelandic banking sector crashed were legal. At this writing, the Embassy is unaware of any other cases of major investment disputes involving foreign investors in Iceland.

International Arbitration

Iceland has ratified the major international conventions governing arbitration and the settlement of investment disputes. Iceland accepts binding arbitration of investment disputes.

Iceland has been a member of the International Center for Settlement of Investment Disputes (ICSID) since 1966.

5. Performance Requirements and Incentives

Broadly speaking, Iceland currently does not offer direct subsidies for business investment. Its primary incentives are in providing for a favorable environment for businesses, including relatively low corporate tax rates and low energy prices. However, due to the State's fiscal gap following the financial crash, the government has raised taxes to generate revenue. Past investment agreements have been made on a case-by-case basis and have included, among other incentives, some tax exemptions. In 2010, the government created a standardized investment agreement to serve as a template for all future agreements. Local communities may offer certain additional incentives.

As a member of the EEA, Iceland has access to various EU funding programs, including the Seventh Framework Program. Icelandic entities, including companies established in Iceland, can obtain funding from the Program for joint research and development ventures with entities from other EEA countries.

Film and TV production in Iceland are subsidized by the Icelandic state in the form of a rebate of a portion of production costs through 2016. A branch or a representative office must be established in Iceland for these purposes. There are no requirements as to the production budget, but the film should promote Icelandic culture as well as introduce Iceland's history and natural beauty. The film and TV production cost rebate rate for costs incurred over the 2007-2016 period is 20 percent. The program does not provide a rebate for the production of commercials or music videos. More information is available at www.filminiceland.com.

6. Right to Private Ownership and Establishment

Foreign entities are free to establish and own any type of business enterprise and engage in all forms of legal remunerative activity other than in fishing, energy, and aviation. Companies established in the EEA, however, are not subject to these limitations in the energy and aviation industries. If a foreign citizen from outside the EEA wishes to purchase land or real estate in Iceland, a permit is required from the Ministry of Interior.

Icelandic law treats public and private enterprises with equality when it comes to market access and other business operations. Foreign investors are permitted to participate in the privatization of government-owned businesses, subject to restrictions imposed by the government.

A foreign party must obtain an identity number (kennitala) before establishing a bank account.

7. Protection of Property Rights

Iceland adheres to key international agreements on property rights (e.g., Paris Union Convention for the Protection of Industrial Property). Trademarks, copyrights, trade secrets and industrial designs are all protected under Icelandic law. As with many other issues, Iceland is following the European lead in protection of property rights and adheres to the European Patent Convention of 1973. In 2005, Iceland signed the Patent Cooperation Treaty (PCT).

As a member of the EEA, Iceland therefore accepts jurisdiction of the EEA Court. Property rights are recognized and protected in the Constitution of Iceland. Secured interests in property are bound by law and enforced as such and there is a reliable system which records such security interests.

Intellectual Property Rights

The Icelandic Patent Office -- a governmental agency under supervision of the Ministry of Education, Science and Culture -- handles all patent disputes in Iceland. The legal framework concerning intellectual property rights (IPR) in Iceland is in all respects equivalent to that of other industrialized countries in Europe. Iceland is a World Trade Organization (WTO) member, and Icelandic legislation complies with WTO Trade-Related Aspects of Intellectual Property Rights (TRIPS) requirements.

As an EFTA state and member of the EEA, Iceland has implemented all relevant EU regulations and directives in the field of IPR. Furthermore, Iceland is bound by bilateral EFTA free-trade agreements which include provisions on IPR.

Iceland is a member of the European Patent Organization. Iceland is a member of WIPO and a party to most WIPO-administered agreements.

For additional information about treaty obligations and points of contact at local IP offices, please see WIPO's country profiles at http://www.wipo.int/directory/en/.

Embassy point of contact: Olafur Sigurgeirsson Reykjavikeconomic@state.govLocal lawyers list: http://iceland.usembassy.gov/attorney_list.html

8. Transparency of the Regulatory System

Icelandic laws regulating business practices are consistent with those of most OECD member states and are increasingly based on European Union directives as a result of Iceland's EEA membership. Much of Iceland's financial regulatory system was put in place only in the 1990s, thus transparency is occasionally a concern (i.e. in public procurement, and in privatization sales where the process is established by the government on an ad hoc basis). In response to the financial crisis of 2008, the government is working to increase its regulatory role in the financial sector.

The Competition Authority is responsible for the enforcement of anti-monopoly regulations and the promotion of effective competition in business activities. This includes eliminating unreasonable barriers and restrictions on freedom in business operations, preventing harmful oligopoly and restriction of competition and facilitating the access of new competitors to the market.

The Consumer Agency holds primary responsibility for market surveillance of business operators, transparency of the markets with respect to safety and consumers' legal rights, and enforcement of legislation concerning protection of consumers' health, legal and economic rights.

The system as a whole is transparent, though bureaucratic delays can occur. All proposed laws and regulations are published in draft forms for the public record and are open for comment.

The Icelandic parliament (Althing) consists of a single chamber of 63 members and a simple majority is required for ordinary bills to become law. All bills that are introduced in the parliament are in draft form. Drafts are open to the public and are published on the parliament's web page. Interested parties can comment on proposed law and regulations.

9. Efficient Capital Markets and Portfolio Investment

All companies have access to regular commercial banking services in Iceland, even if it is likely that financing for large-scale investment projects will largely need to come from abroad. The ISK strengthened by 9.8% in 2013, mostly due to strong inflow of capital related to increased tourism and a low level of big payments in foreign currency by the government and private companies to creditors.

Iceland has been running a positive trade surplus that has helped in stabilizing the ISK. There is ample demand for foreign currency, but selling large amounts of ISK in a single transaction might be difficult. The Central Bank has often intervened itself in the market since the collapse by buying ISK, and those permitted to sell ISK under the capital controls have been able to do so.

The combined assets of Iceland's three largest banks amount to roughly 1.69 times Iceland's GDP in 2012. There are also a number of other smaller financial institutions active in Iceland, notably MP Bank, which acquired a commercial banking license in 2008 and has assets valued at 69 billion ISK ($610 million). MP Bank is the only Icelandic private bank that has not been recapitalized by the Icelandic state after the economic crash of 2008. MP Bank is in a strong position after outside investors bought the bank in spring 2011. Current capital ratio is 14 percent which is below the suggested Financial Supervisory Authority's (FME) 16% capital adequacy requirement but above the 8 percent mandated capital requirement. The three large banks in Iceland met this requirement by June 2012. At the end of the second quarter 2013, nonperforming loans in the Icelandic banking system were 5.1 percent. Iceland's large financial institutions were leveraged at 4.5 times assets at the end of the second quarter 2013, a low ratio compared to international banks.

The estates of the former banks are still under Chapter 11 procedure. The Central Bank of Iceland must approve the composition agreements resulting from that process before the creditors can take full possession of the estates. Press stories have generated some discussion regarding disbursements of the proceeds and subsequent transfer of the funds to non-Icelandic investors. Iceland's disposition of these estates will have significant impact on how foreign investors regard its investment climate.

The OMX Nordic Exchange operates the market for securities in Iceland and trades various products. Activity has been limited since the crash, but the infrastructure is in place. In 2013, 86 percent of all volume on the OMX exchange in Iceland was in bonds. Daily turnover was around $64 million in bonds and $9 million in equities. The Central Bank frequently issues and auctions ISK-denominated government bonds and welcomes foreign participation.

10. Competition from State-Owned Enterprises

Private enterprises are generally allowed to compete with public enterprises under the same terms and conditions in all sectors except energy manufacturing and distribution. State-owned enterprises (SOEs) are most active in the banking, energy, health and alcohol sectors. In some cases, politicians are on the boards of SOEs.

In the midst of the banking crisis, the state, through the Financial Supervisory Authority (FME), took over Iceland's three largest commercial banks in October 2008 and subsequently took over several savings banks to allow for uninterrupted banking services in the country. As of January 2011, creditors of two of the three largest banks acquired a majority of shares in the newly established commercial banks. The state has a considerable stake in many companies through its shares in the banks; however, it is the policy of the government not to interfere with internal or day-to-day decisions of these companies.

In 2009, the state established the Bank Shares Management Company to manage the state-owned shares in financial companies. The Minister of Finance appoints the three board members, who appoint a committee that determines the state representatives on the boards of financial companies.

While most energy producers are either owned by the state or municipalities, there is free competition in the energy market. In 2008, one of the major energy companies was split into two companies: one that produces energy and another that distributes it. Subsequently, a foreign company bought approximately 95 percent of the energy-producing company through its EEA subsidiary, but subsequently sold a portion of its shares and now owns 66.6 percent. In June 2012, the company received an offer to buy out its stake, but negotiations are still ongoing.

The universal healthcare system is mainly state-operated, though the Embassy is aware of plans to build private health tourism facilities in Iceland. Few legal restrictions exist; however, private clinics need an agreement with the Icelandic state, a foreign state or an insurance company regarding payment for services.

The State Alcohol and Tobacco Company of Iceland (ÁTVR), has exclusive rights for the retail sale of all alcoholic beverages. Importers and wholesale companies are privately run.

11. Corporate Social Responsibility

In general, there is an awareness of corporate social responsibility among both producers and consumers. Promote Iceland has signed the United Nations' Global Compact and pledges to promote discussion of the subject. In the aftermath of the financial collapse, Iceland's main banks have adopted social charters. Reykjavik University has created a Center for Corporate Social Responsibility. Iceland's Ministry of Foreign Affairs participates in the Nordic Business Outreach effort to direct private sector resources for development purposes.

12. Political Violence

Iceland experienced political protests stemming from the October 2008 financial crisis. Public protests spurred the government to dissolve and a new coalition was formed prior to early elections in spring 2009. In early 2014, frustration among voters who are dissatisfied with the current government's reluctance to hold a referendum on EU accession led to the most notable protests since the financial collapse. Although sizable, these protests did not lead to any violence. There have been limited cases of politically motivated vandalism of foreign holdings in recent years, directed primarily at the aluminum industry.

13. Corruption

Isolated cases of corruption occur but are not an obstacle to foreign investment. In 2013, Iceland tied for 12th place out of 175 countries in Transparency International's Corruption Perceptions Index Ranking.

14. Bilateral Investment Agreements

According to the UNCTAD Website, Iceland has bilateral treaties in force (as of June 1, 2013) with Chile, China Egypt, India, Latvia, Lebanon, Lithuania, Mexico and Vietnam.

http://unctad.org/Sections/dite_pcbb/docs/bits_iceland.pdf

The United States has neither a bilateral investment treaty (BIT) nor a Free Trade Agreement with Iceland. Discussions are ongoing to complete a Social Security Totalization Agreement, which would eliminate the need for some dual citizens to pay into both countries' social security programs. There is a U.S.-Iceland bilateral taxation treaty and a Trade and Investment Framework Agreement (TIFA).

15. OPIC and Other Investment Insurance Programs

Political risk insurance and project financing have traditionally been available on the local and international markets. As a result of the financial crisis in fall 2008 and the current restructuring of the banking sector, however, project financing may be temporarily limited. Iceland is a member of the Multilateral Investment Guarantee Agency.

16. Labor

The labor force in Iceland consists of just over 185,000 people aged 16 and older and is highly skilled. Until the economic crisis in October 2008, demand for labor exceeded supply. Foreign labor moved to Iceland to fill the majority of unskilled service jobs and semi-skilled construction jobs as the EEA-agreement allows for the free movement of labor within the area. Layoffs followed in the wake of the economic crisis, particularly in the financial and construction sectors. Unemployment rose quickly and peaked at 9.1 percent in April 2009. As of March 2014, unemployment was 6.1 percent.

The labor market is highly unionized with 80-85 percent of employees belonging to unions. Icelandic labor unions are decentralized and non-political. Contractual wage agreements cover general terms of employment, including a basic minimum wage, but specific terms are usually negotiated on a more job-specific basis. Collective bargaining power, in both the public and the private sectors, rests with individual labor unions. The government has imposed mandatory mediation when strikes have threatened key sectors in the economy such as the fishing industry.

The basic legal work week is 40 hours over 5 days, but some professions have 37.5 – 39.5 hours per week, mainly office clerks and sales assistants. Most employees are paid for overtime, or alternatively allowed time off in lieu of paid compensation. Typical shift-work rates are an extra 40 percent on top of the daytime rate and an extra 45 percent if total work hours exceed the definition of full-time employment. On public holidays there is an extra 40 percent on the daytime rate. A continuous rest period of 11 hours is typically guaranteed during each 24-hour period. In certain circumstances the rest period may be shortened to eight hours.

Iceland has ratified approximately 20 International Labor Organization (ILO) conventions, including those that protect basic workers' rights.

17. Foreign Trade Zones/Free Trade Zones

Under the EEA agreement, free ports or foreign trade zones are not allowed in Iceland.

18. Foreign Direct Investment Statistics

The following tables reflect data available as of December 2012. Information in this chapter was obtained from the Central Bank of Iceland. The Central Bank of Iceland does not provide information on specific investments, but the majority of U.S. investment in Iceland is in the aluminum sector.

The Central Bank confirms that the United States is by far the leading foreign director investor in Iceland. However, its data cannot be traced back to the original source of investment, and a significant amount of investment flows come to Iceland via other countries. A large part of the FDI stocks from Belgium/Luxembourg and the Netherlands also may be held by Icelanders residing in these countries.

The total 2013 FDI flows to Iceland amount to 7.16 percent of GDP, which was flat in comparison over 2012 levels.

FDI stocks in Iceland by country (in millions of USD):

			2010	**2011**	**2012**
U.S.			215	357	386
Belgium/Luxembourg			9,538	9,759	7,136
Netherlands			1110	1.,082	981
Norway			229	203	217
Switzerland			183	397	560
Denmark			214	237	420
Sweden			151	105	136
U.K.			8	50	159
Total			11,766	12,656	10,386

FDI stocks in Iceland by industry (in millions of USD):

			2010	**2011**	**2012**
Holding companies			4,610	5,086	2,087

Financial activities			15	8	183
Trade and Repairs			201	176	87
Tele-communication			-0,212	42	1
Electricity/water			148	100	179
Transport and Storage			120	134	128
Total			11,766	12,656	10,386

FDI flows to Iceland by country (in millions of USD):

			2010	**2011**	**2012**
U.S.			-10,7	68	-1
Belgium/Luxembourg			283,7	757	551
Netherlands			-37,8	-33	-51
Norway			15,2	-10	-11
Switzerland			5	238	160
Sweden			157	-57	-23
Denmark			2,4	21	28
U.K.			0.782	21	83
Total			505	1,046	996

FDI flows to Iceland by industry (in millions of USD):

			2010	**2011**	**2012**
Holding companies			188,5	469	565
Metal and mech. production			75,4	167	-9
Financial activities			1,2	-1	17
Trade and Repairs			1,6	0,8	42
Tele-communication			-0,82	-80	-1
Food Production			0	37	66
Transport and Storage			13,1	12	-19
Total			505	1,046	996

Icelandic FDI stocks abroad by country (in millions of USD):

			2010	**2011**	**2012**
U.S.			1,253	1,303	2,915
Netherlands			2,270	1,684	3,275
U.K.			2,471	3,748	2,101
Denmark			533	494	399
Sweden			413	497	632
Norway			170	266	320
Canada			157	163	130
Belgium/Luxembourg			2,135	2,470	1,256
Total			11,137	11,520	12,328

Icelandic FDI stocks abroad by industry (in millions of USD):

			2010	2011	2012
Financial activities			2,281	2,259	505
Petro, rubber and chemical			842	828	3,252
Trade and repair			1,621	2,543	760
Food production			877	296	94
Transportation and Storage			273	176	300
Prosthetic aids			859	853	730
Real Estate			153	230	107
Scientific activities			56	76	291
Holding companies			3,519	3,927	5,441
Total			11,137	11,520	12,328

Icelandic FDI flows to abroad by country (in millions of USD):

			2010	2011	2012
U.S.			367	11	220
Netherlands			154	-165	16
U.K.			244	88	-2,099
Denmark			855	17	24
Sweden			35	26	-4
Norway			54	61	226
Canada			4,8	12	2
Belgium/Luxembourg			792	108	-1,371
Total			-2,673	17	-3,114

Icelandic FDI flows to abroad by industry (in millions of USD):

			2010	2011	2012
Financial activities			749	40	-1,407
Petro, rubber and chemical			267	92	2,399
Trade and repair			30	-220	4,074
Food production			136	-31	34
Transportation and storage			135	18	21
Prosthetic aids			193	52	22
Real estate companies			108	122	3
Scientific activities			39	25	4
Holding companies			1,273	31	-120
Total			2,416	2,673	-3,114

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