

Icelandic Economists: Have They Made a Difference?

A Personal View

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Abstract

This paper offers a personal view of Icelandic economists and the influence they have had on economic policy making in Iceland since the 19th century. The independence hero Jón Sigurðsson (1811-1879) is identified as Iceland's first economist in a modern sense, even if he was not an economist by training. A brief description of economic developments since home rule was attained from Denmark in 1904 is followed by an attempt to explain, by appealing to considerations of mentality, social psychology, and unbalanced education among other things, why Icelandic economists may perhaps have had less influence than they would have liked.

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A Personal View

According to the registry of the Icelandic Economic Association, there are now about 2,400 economists in Iceland. This number, which is equivalent to almost 1 per cent of the country's population, includes both economists in the traditional sense ("nationalekonomer") and business economists ("företagsekonomer"). Economists in the traditional sense constitute perhaps about a fourth of the total.

For comparison, The American Economic Association (AEA) now has about 20,000 members, all of them economists in the usual sense; this number includes approximately 1,000 foreign members. The local membership is equivalent to less than 0.01 per cent of the population of the United States, compared with approximately 0.25 per cent in Iceland (i.e., ca. 19,000 in the United States against ca. 600 in Iceland). However, most members of the AEA are Ph.D.s, so that the two groups are not fully comparable.

In any case, the economics profession in Iceland is more numerous per capita than its American counterpart.¹ There is a saying in Iceland that we have more of everything per capita than anyone else except the remainder. Our profession is no exception to this rule. This is remarkable, because the Icelandic Economic Association (*Hagfræðingafélag Íslands*, later *Félag viðskiptafræðinga og hagfræðinga*) was not established until 1938, and because university education in economics was launched as late as 1941.

Our republic is a young one and understandably immature in many ways, as I will discuss briefly below, and so, indeed, is our economics profession. Yet, the students at the Faculty of Economics and Business Administration at

¹ An Icelandic economist, a friend of mine, who was educated at Harvard and worked at the International Monetary Fund for a number of years, was often asked whether he did not intend to "go home" and make a career in Iceland rather than

the University of Iceland constitute no less than 0.25 per cent of the country's population. Not even counting the students, the University is the largest single workplace in the country. The Faculty of Economics and Business Administration produces about 15 economists and 100 business economists every year, and has been a prime source of managers and other professionals for Icelandic industry over the years, including the chief executive officers of virtually all the largest firms in the country. In addition, a significant number of Icelanders each year earns undergraduate and advanced degrees in economics from universities abroad. In the past few years, the Faculty of Economics and Business Administration has awarded nearly 20 Master's degrees in economics, several of them to foreign students.

The first Icelandic doctorate in economics was awarded at The University of Kiel in Germany in 1926, the second and third at the same place in 1934 and 1936, the fourth at Harvard University in 1946 (under Joseph Schumpeter's supervision), the fifth in Leipzig in 1944, the sixth at The London School of Economics in 1953 (in sociology), the seventh at The University of Frankfurt am Main in Germany in 1954, the eighth again at The London School of Economics in 1965, and so on.²

Thus far, 46 Icelanders have earned doctoral degrees in economics, including 17 at universities in the United States, 7 in the United Kingdom, 7 in Germany, 5 in Sweden, 4 in Denmark, and 3 in Canada. Per capita, this number exceeds the local membership of the American Economic Association by a substantial margin. All but six have made a career in Iceland, at least in part. Of the total, three doctoral degrees were awarded in the 1960s, six in the 1970s, eleven in the 1980s, and eleven in the first half of the 1990s plus seven more in 1997 and 1998.

Thus, on average, the number of new doctorates in economics awarded to

America. His reply was that it would probably be somewhat tedious to compete with 250,000 economists.

² This list does not include a Ph.D. degree awarded by the University of Iceland in 1936 to an economist for a thesis on an historical subject. It does, on the other hand, include a doctoral dissertation on sociology by an economist, who later became Central Bank governor.

Icelanders has increased by about one or so per year over the last 15 years, at an accelerating rate. Per capita, this number would correspond to more than 1,000 new doctorates in economics per year in the United States, not including foreign students, who accounted for almost a half of all Ph.D. degrees in economics awarded in the United States in the late 1980s. For comparison, 812 doctoral degrees in economics were awarded in the United States in 1985.³

I. The Pride of Iceland, Its Sword and Shield

The first Icelander to earn a degree in economics, from The University of Copenhagen, in 1877, was Indriði Einarsson (1851-1939), who is better known in Iceland as a playwright. Our National Theater was inaugurated in 1950 with a production of his main play, *New Year's Night*, with a plot revolving around elves and fairies.

However, Arnljótur Ólafsson (1823-1904) has generally been considered to be the first Icelandic economist, as the author of the first book on economics in Icelandic, *Auðfræði (The Theory of Wealth)*, published in Copenhagen in 1880.⁴ This book was not an original work, but rather an accessible, eloquent account of the economic theory of the day, influenced, in particular, as acknowledged by the author in the preface to the book, by Bastiat's *Harmonies économiques* (1850).

Ólafsson had studied economics at The University of Copenhagen, but he had not received a degree in the subject; he was a minister by training and profession. A country priest in Iceland most of his life, he was also for a time a member of parliament, which convened for a few weeks every other summer. There he espoused his strongly held liberal views on economics.

If we accept the definition by which Arnljótur Ólafsson has been generally regarded as Iceland's first economist, namely, by virtue of having written the first book on economics in Icelandic, then it seems to me that the

³ See Colander and Klamer (1987).

⁴ See Ólafsson (1880).

distinction should rather go to our independence hero, Jón Sigurðsson (1811-1879). Like Ólafsson, he did not earn a degree in economics at The University of Copenhagen (or in any other subject for that matter), but he nevertheless studied economics and political theory in addition to ancient history and classical philology at the university in the 1830s. During his years of study in Copenhagen in the 1840s, Ólafsson was a protégé of Sigurðsson and, through him, developed his life-long interest in economics.

Almost 40 years before the publication of Ólafsson's book, Sigurðsson published a long and learned essay, "On Trade in Iceland," in 1843, a brilliant piece where he pleads for freer foreign trade with all the right arguments and nuances, even from the point of view of modern economics.⁵ His essay demonstrates that he was well versed in economic theory and history. He owned and read the major works of Ricardo and Say, among others. His formulations can be cited *verbatim* in response to the misinformed arguments of many modern protectionists.

Jón Sigurðsson viewed free trade as a source not only of increased efficiency, but also of education and inspiration. In his words, "That nation which only receives, is clinging to the world (if I may word it so) by a single thread, and the light of knowledge shines on it from one side alone. This foils its attempts to progress in many ways, keeping it ignorant of the world, stubborn, and prone to prejudices."⁶ "When trade was free in ancient times," he also wrote, "the country lived its golden age."⁷ To many educated Icelanders, his essay must have felt like a ray of bright light in an otherwise murky intellectual climate.

And he had influence: twelve years after the publication of his essay, in 1855, the Icelanders decided to adopt free foreign trade (i.e., to abolish the age-old Danish trade monopoly).⁸ Even so, they committed a serious mistake

⁵ See Sigurðsson (1843).

⁶ See Jakobsson (1994), p. 181. Translation by Keneva Kunz.

⁷ *Ibid.*, p. 190. Translation by Keneva Kunz.

⁸ An earlier step in the same direction had been taken in 1787, when the monopoly of a single Danish merchant company was abolished, or rather replaced by a monopoly granted to the subjects of the Danish King.

in not removing various self-imposed restrictions on domestic trade, wage and price formation, labor mobility, and industrial development. This failure continued to hamper economic progress in Iceland for many decades to come.

Sigurðsson's path-breaking essay from 1843 was not his last word on economics. He published four small books, in 1859, 1861, 1867, and 1875, one of which was intended as a kind of textbook in applied economics. In 1872, he published a new substantive essay in continuation of the first one, "On Trade and Trade Organizations,"⁹ in addition to numerous other essays and articles.¹⁰

Jón Sigurðsson spent all his adult life in Copenhagen, where he made a modest living, mostly by gathering and editing old Icelandic manuscripts, both literary and legal. Most of this time, or nearly 45 years, he worked as a stipendiary at the Arnamagnaeian Collection. For a few years, he served as an archivist in the service of the Danish government.

Only twice did he apply for a position in Iceland, first as head teacher (he did not get the job) and later as principal of Reykjavík College. He confided in a friend that he needed the job for the money, but if he took it, it would shut him up, for he would then be unable to continue to express his views in writing against the wishes of his superiors. The authorities were in no hurry to fill the position. Having been kept waiting for a year and a half, Sigurðsson withdrew his application.

Through his determined efforts, among those of others, the old Icelandic parliament dating all the way back to the year 930 was reconvened in 1845 as

⁹ Sigurðsson (1872).

¹⁰ Before the days of Jón Sigurðsson, two Icelandic contemporaries of Adam Smith actually produced significant essays about economics, one each. One was country sheriff Skúli Magnússon (1711-1794), whose essay, "Country Farmer," published in 1784, discusses production costs and profitability in a way that indicates some familiarity with the writings of Quesnay and Smith. The other was bishop Hannes Finnsson (1739-1796), whose essay, "About Depopulation from Famines in Iceland," published in 1796, traces the history of famines in Iceland and their causes and consequences from the settlement of the country, in 874, to 1793. However, unlike Sigurðsson's essay, "On Trade in Iceland," these works were not parts of larger bodies of work on economics, but they were nevertheless the precursors to the more

an advisory body after a lapse of almost six centuries. From 1845 until his death, Sigurðsson was elected to parliament from a small constituency in the north-western fjords of Iceland, always with all the votes cast, with two minor exceptions. For many years he was speaker of the parliament, and, for that reason, did not give many speeches there himself.

In retrospect, his main contribution as the father of the republic was perhaps not his political work in parliament, but rather his intellectual leadership and the persistent encouragement that he provided through his numerous writings on economics, education, history, law, and politics. The journal which he edited and in which he published much of his work did not sell particularly well (it had a paid circulation of about 400). His writings were nevertheless the main source of his reputation and political influence, in addition to his afore-mentioned work on old Icelandic manuscripts. He also initiated the production of systematic reports on the economy of Iceland.

Shortly after his death in 1879 (his epitaph is "The Pride of Iceland, Its Sword and Shield"), his bust by the Norwegian sculptor Brynjulf Bergslien, who is best known for the large statute of King Karl Johan on horseback in front of the Royal Palace in Oslo, was placed in the new parliament building in Reykjavík. On his centenary, in 1911, a statute of him was erected in front of the government house in Reykjavík; it was subsequently moved to parliament square in 1931. Our fully independent republic was founded on his birthday, June 17, in 1944. His picture adorns our 500 krónur bill.

The point of this account is not that Iceland may be the only country of the world whose founding father was also its first economist. No, the point is that, to this day, most Icelanders have no idea that this is so. In the history taught at school to three generations of Icelanders, Jón Sigurðsson is described as the romantic independence hero he was, without, however, a word being said about his devotion to free trade, education, and other liberal economic causes.

Therefore, most modern Icelanders are ignorant of their independence

hero's stand on free trade. Had they known, an outright ban on agricultural imports could perhaps have been averted in the early 1930s; indeed, proposals to that effect had been soundly defeated in the legislature in the late 1880s. The prohibition against agricultural imports remains almost intact to this day to the considerable detriment of consumers, the recent GATT agreement notwithstanding. Extreme though it is, the import ban is, in some respects, symptomatic of the mentality that has shaped economic policy in Iceland ever since 1927.¹¹

The Icelanders' patchy knowledge and understanding of Jón Sigurðsson's ideas of how to run a free society may also help explain the reluctance of many Icelanders—even today, after the collapse of communism in Central and Eastern Europe—to appreciate and accept the principles and rules of a liberal, pluralistic market economy. For decades, the allocation of bank credit and foreign exchange in Iceland was monopolized by the central authorities, involving, one would venture, as always, considerable waste and corruption. To this day, the government still controls about three quarters of the assets of the Icelandic banking system. We even had a Central Bank governor—from 1994 to 1998—who is of the opinion that western macroeconomic management methods do not apply in Iceland.¹² However, an alternative macroeconomic policy framework—specifically tailored to Icelandic circumstances, one would presume—remains to be spelled out, in a coherent and persuasive manner.

The following story further illustrates the cultural and social background to the pervasive prejudice towards economic thought among the Icelandic population in general and the political class in particular.

In the late 1850s, French boat owners asked for permission to build a fish processing facility in a small village in the north-western fjords of Iceland.

¹¹ That was the year when the Progressive Party, representing farmers, the cooperative movement, and rural interests in general, secured its long-lasting hold on political power in Iceland. A few years later, in 1931, the Progressive Party gained a majority in parliament with only about a third of the popular vote.

¹² It may be added that the author of the afore-mentioned history books was, as the governor, the leader of the Progressive Party for a time.

The historical records show that Jón Sigurðsson was, and was known to be, in favor of granting the permission: it was, indeed, very much in his spirit to want to take advantage of such opportunities to open up the economy to foreign trade and foreign investment. In this case, he was keen that the Icelanders should learn new construction and fish-processing techniques, among other things, from the French. In an attempt to avoid antagonizing his supporters, he nevertheless kept a low profile in the intensely emotional debate of the French request. On the other hand, the local farmers and those in other parts of the country objected strongly to such blatant foreign covetousness, which some of them even perceived as an outright threat to the nation's sovereignty and cultural identity. In the end, the permission was not granted.

This affair would hardly be worth remembering if, more than a hundred years later, in the 1970s, a renowned Icelandic historian had not recounted the story in a book about the history of the extension of Iceland's fishing zone.¹³ In the book, he correctly describes the farmers' opposition to the French request, and includes Jón Sigurðsson among those who most vehemently opposed the French plan, indirectly praising him for his steadfastness.¹⁴ As it turned out, the author mistook one of the protectionists in parliament, a farmer and Jón Sigurðsson's namesake, for the independence hero by, *inter alia*, attributing a speech by the former in parliament to the latter.¹⁵

Jón Sigurðsson did, of course, derive his main support from farmers, who were a dominant political force in his time, but he understood the need to use freer trade to strengthen the emerging towns and thus gradually to create alternatives to agriculture. He did confront his supporters on one occasion: he urged them to cure rather than cut their sheep stock, when a serious disease (scab) broke out in the late 1850s. His popularity then declined

¹³ See Thorsteinsson (1976).

¹⁴ See Ólafsson (1986, 1987).

¹⁵ This error was later repeated in a book by a professor of history, published in 1982, and in another book by a former prime minister, published in 1991. For details, see Sverrisson (1995).

considerably for a time. He was not invited to the official celebration of the 1000th anniversary of settlement in Iceland at Thingvellir in 1874, ostensibly because he lacked an official position.

Perhaps because he depended on farmers for his support, Sigurðsson never took up the fight against the near-equivalent of slavery in Iceland. By this arrangement, farm workers were tied by law to individual farms and land owners and thus were prevented from seeking more lucrative work in the infant fishing industry in the small villages that were beginning to emerge around the coast. This practice was discontinued after a change in the law in the early 1890s. Even so, various hindrances were erected against the migration of labor from the farms to the seashore, and, more generally, against the development of villages and towns. Some of these restraints were kept in place at least until the middle of the 20th century.

II. Recent Economic Developments

The half-century since Iceland became an independent republic in 1944 has been marked by rapid progress in the economic and cultural life of the nation, even though the achievement of home rule from Denmark in 1904 was perhaps a more significant turning point in the economic development of the country.

One of the keys to the country's success in this century is no doubt the high standard of culture and education inherited from earlier times. Despite abject poverty for hundreds of years, most Icelanders were always literate. They thrived on their old literature, and so, in some ways, were well prepared to adopt quickly the new technology that became available to them in the 20th century, especially after World War II. The mechanization of the fishing industry together with the gradual extension of the fishing limits from 3 miles in 1901 to 200 miles in 1976 was an important engine of economic growth in this period.

This mechanization was made possible by a well-trained work force, and so was the harnessing of the hydroelectric and geothermal energy potential

that began in earnest in the 1960s. This development coincided with the build-up of manufacturing, trade, communications, and services that now employ five sixths of the labor force. The fishing industry now accounts for about one-sixth or so of gross domestic product and a little more than a half of total export earnings (i.e., from goods and services). Today, Iceland is a diversified, affluent industrial society, where services are by far the most important occupation.

Even so, the mechanization of the fishing industry has been a mixed blessing. It opened the door to serious overfishing that, among other things, has resulted in the decline by about a third to a half in the most valuable fish stocks in Icelandic waters over the past 30-40 years. The overfishing was accompanied by excessive investment in the fishing industry (Figure 1). The investment boom, in turn, was fuelled by high inflation and excessive borrowing abroad, especially in the 1970s and 1980s. Consequently, one of the main challenges facing the government of Iceland in the new millennium is to implement and enforce effective policies against overfishing by creating appropriate market-based incentives through property rights and Pigovian fees, and thus to see to it that the fishing fleet is reduced in a fair and efficient manner to a size that is commensurate with the maximum sustainable catch of fish.

Figure 1 here.

Source: National Economic Institute, Reykjavík.

Note: The value of the catch and the fishing fleet are both measured in Icelandic krónur at constant prices.

Since 1984, fishing rights in the form of individual transferable quotas (ITQs) have been allocated free of charge to selected boat owners. The idea is that, in the end, this will bring the maximum allowable catch on shore at minimum cost, thus insuring maximum efficiency. But this arrangement—giving valuable common-property quotas to a selected few for free—entails

not only gross inequity,¹⁶ but also inefficiency by reducing the transparency of fiscal and monetary operations (a) by hiding huge *de facto* government subsidies to the fishing industry, while the public sector remains in a quasi-permanent state of fiscal crisis, which has hit public-expenditure allocations to education and health care especially hard, and (b) by keeping serious structural weaknesses in the state banking system from plain view by enabling fragile fishing firms to use their quota allocations to service their debts rather than declare bankruptcy.¹⁷

Today, it is estimated that the fishing fleet is at least 25 per cent too large. This excess capacity causes substantial macroeconomic waste that needs to be reduced or eliminated in a timely fashion. The required reforms need to be undertaken in a way that will boost industry, trade, services, and exports in an effort to diversify the economy further, as is necessary to create conditions for sustained economic growth. In 1996, following a prolonged economic downturn which coincided with the stabilization of prices after a long period of high inflation, gross domestic product per capita was about the same as in 1987 (Figure 2). Even so, since the turn of the century, gross national product per capita has grown by 2.6 per cent per year on average, compared with 1.9 per cent in Denmark (Figure 3). Economic growth has been brisk since 1995.

Figure 2 here.

Source: National Economic Institute, Reykjavík.

Note: The smooth, broken curve shows potential output per capita based on its average rate of growth from 1960 to 1987. The irregular, solid curve shows actual output per capita from 1960 to 1998 (the figure for 1998 is provisional).

¹⁶ In December 1998, the Supreme Court of Iceland ruled unanimously that the legislation behind the current system of allocating the fishing rights free of charge to individuals who happened to own boats in 1981-1983 violates the constitutional provision protecting the general principle of equality. The parliament reacted by revising the law in a way that does not, however, change the system of allocating the fishing rights free of charge and that many observers accordingly view as a futile attempt to circumscribe the substance of the unanimous ruling by the Supreme Court, which, before long, it is hoped, will have to make a ruling on the revised legislation.

¹⁷ Nonetheless, from 1987 to 1997, the Icelandic banking system had to write off bad debts equivalent to about 13 per cent of GNP in 1997, including a large chunk of the bad debts of fishing firms.

Figure 3 here.

Source: *Statistics Iceland*, Reykjavík, 1997, and National Economic Institute, Reykjavík.

Note: The smooth, broken curve shows potential output per capita based on its average rate of growth from 1901 to 1998. The irregular, solid curve shows actual output per capita from 1901 to 1998 (the figure for 1998 is provisional).

With exports hovering around a third of gross domestic product ever since 1945, an unusually small proportion for such a small country, Iceland has an opportunity to expand its exports substantially in the years ahead. Small countries need extensive foreign trade relations to make up for the inefficiency of small domestic markets.

The rapid economic, social, and cultural advancement of Iceland in this century has not, however, been matched by corresponding progress in the political arena. Over the past 75 years, the country has been governed by shifting coalitions of four main political parties, whose candidates are elected to the parliament based on an electoral law that, despite gradual revisions over the years, still grants rural areas substantial and permanent overrepresentation in the legislature. Consequently, agrarian interests (including those of fish producers) have wielded considerably more political influence in Iceland in this century than in the other Nordic countries, or in Europe at large for that matter. This bias, together with an inadequate separation of powers of the executive and legislative branches of government, has delayed and hindered reforms that are necessary to enhance economic efficiency in agriculture, the fisheries, banking and finance, and other areas.

This also helps explain why the government of Iceland—alone in Europe—has not yet shown much interest in joining the European Union, even though the Union has become by far the most important trading partner of Iceland.

Constitutional, political, and economic reforms are the key to continued prosperity and progress in Iceland in the 21st century.

III. Mentality and Social Psychology

The brief assessment of economic developments in Iceland in the 20th century offered above may seem to suggest that, in their role as policy advisers, Icelandic economists have generally not met with much success since the days of Jón Sigurðsson. Why not? More to the point, perhaps, why has a well-educated nation amply endowed with able professional economists not achieved greater success and promise in the economic arena?

Let me suggest three possible explanations, all of which concern mentality and social psychology in one way or another. The discussion to follow is deliberately of a general nature. A detailed analysis of the role of Icelandic economists and the substance, orientation, and quality of the advice that they have offered will not be attempted at this time.

Abundant resources. First, a newly independent country awash in fish and foreign credit, a *nouveau riche* among nations, does not readily sense the need to worry about efficiency in the allocation of resources. An abundance of natural resources tends to be perceived as a licence to spend. The experience of many OPEC countries over the past 20 years is another case in point, and so is the sorry tale of several fishing communities, including those in Newfoundland, the Faeroe Islands, and Greenland.¹⁸

Overfishing, overborrowing, and, until recently, persistent overheating of the Icelandic economy have given the Icelanders a false sense of economic prosperity and progress. The Icelanders have, for instance, persisted in keeping direct foreign investment at bay, albeit with two important exceptions.¹⁹ In other respects, direct foreign investment, gross and net, has

¹⁸ Recent empirical evidence seems to indicate that excessive dependence on primary exports may be conducive to sluggish total exports and slow economic growth. See Gelb (1988), Sachs and Warner (1995), Gylfason (1999), and Gylfason, Herbertsson, and Zoega (1999). See also Paldam (1994).

¹⁹ The two major exceptions are a Swiss-owned aluminium smelter established in the mid-1960s and a joint-venture ferro-silicon factory built in the mid-1970s. The production of these two pillars of Icelandic industry has amounted to about 10 per cent of Iceland's total exports in recent years. In 1996, the Swiss owners of the aluminium smelter decided to increase its production capacity by 60 per cent. In 1997, a decision was made to expand the above-mentioned ferro-silicon factory, and

been negligible over the years. Very recently (1996), for the first time, there has been a serious discussion in parliament of permitting limited foreign investment in the fishing industry.

Also, through distorted incentives, the productivity of the capital stock was hampered by the rapid inflation of the 1970s and 1980s.

For years, national income per capita has been maintained at levels comparable with those of the other Nordic countries partly by running down the stocks of fish and foreign assets (net), among other things, as if to compensate for and conceal the underlying inefficiency of the allocation of resources. This has been done in four main ways:

- a) by overfishing by 25 per cent a year on average (i.e., by exceeding the sustainable catch recommendations of the Marine Research Institute by 25 per cent a year on average) over the past 30 years or so;²⁰
- b) by running up foreign long-term debts that are headed for the equivalent of nearly 60 per cent of gross domestic product in 1999, involving a debt servicing burden that in the 1990s has hovered between a fifth and a third of export earnings;
- c) by allowing the symptoms of the Dutch disease to take hold, thus neglecting the legitimate needs of export industries outside the fishing sector; and
- d) by neglecting the education system, at all levels, from underpaid teachers to inadequately funded research and development.²¹

In short, a high and ultimately unsustainable level of national income has been maintained at the expense of the long-term growth potential of the

the construction of a new American-owned aluminium smelter was begun. Further projects are now being discussed.

²⁰ In recent years, the authorities have adhered more strictly to the recommendations of the marine biologists, but the extent of continued overfishing through discarded catch (thrown back into the sea because the fishermen want to fill their quotas with more valuable fish) remains an unsettled issue.

²¹ For example, Iceland has devoted only 0.5-1.0 per cent of GDP to research and development in recent years, compared with 1.5-2.0 per cent in Denmark, Finland, and Norway, and 2.5-3.0 per cent in Sweden, the United States, Germany, and Japan. See OECD (1993). This has not, however, at least not yet, diminished the

economy. Repeated pleas by economists for greater efficiency in the allocation of resources—in the fishing industry, in agriculture, and in the banking system, for example—have generally met with insufficient interest or understanding, at least among the political class, even though the two main newspapers, whose combined circulation exceeds the number of households in Iceland by a considerable margin, have begun to side vocally with the economists on most of these issues.

Iceland's purchasing-power-parity-adjusted gross domestic product per hour worked is now lower than anywhere else in the OECD area except in Greece, New Zealand, Portugal, and Turkey (excluding the most recent members, Mexico, Hungary, the Czech Republic, and Korea), and is about 25 per cent below that of the United States (1997).²² This fact may, with time, increase the Icelanders' awareness of their economic situation. Yet, some observers have expressed fears that a deep and protracted economic decline relative to neighboring countries, or even a Faeroese-style crash (more on this below), is necessary to alert the general public, and thus, through the democratic process, also the political class, to the need for more substantial economic and structural reforms, including privatization and liberalization, than have been undertaken thus far.

Unbalanced education. The second explanation that I want to suggest has to do with education. I mentioned before that a literate and generally well-educated work force was a prerequisite for the success of the technological revolution that has been an important source of rapid economic growth in Iceland in the post-war period. Even so, this education was and still is somewhat selective—as it is, for example, in Russia, where intimate knowledge and understanding of literature, music, arts, and science often go hand in hand with an appalling disregard for practical affairs, economics in

willingness of young economists to earn a doctorate in economics, as was indicated in the introduction.

²² The most recent figures available at the time of writing are from 1997. It needs to be emphasized that the available estimates of hours of work are subject to some uncertainty, and may not be comparable across countries, but neither factor seems likely to affect the ranking of Iceland.

particular.

Educated people in Iceland often show similar signs of indifferent, even proud, ignorance about economic affairs. This is apparently not so much a reflection of an impractical frame of mind as of an insufficient ability to analyze economic phenomena and to see them in context. This is partly a consequence of our education system where, as in most other European countries, economics is studied almost exclusively at universities, and then only by those students who have chosen to become professional economists. Thus, lawyers, doctors, natural scientists, historians, philosophers, and, indeed, most politicians and journalists, have never encountered even the most elementary concepts of economic analysis.

How many of them, in Iceland and elsewhere, could have been spared the time wasted flirting with, believing in, or practicing communism?—and, in many cases, the ultimate embarrassment involved.

It has happened time and again that some of my esteemed colleagues in the Department of Natural Sciences at the University of Iceland have published utter, albeit innocent, nonsense about economics. Apparently, they have not found it necessary to consult economists before expressing their views on economics.²³ The dire lack of education in economics is not confined to those who have not had access to education in other respects.

This situation has been exacerbated by a political atmosphere where profit, private enterprise, and even common efficiency have been widely frowned upon from an ideological point of view—a phenomenon also familiar in parts of France and Sweden, for example. I recall a jovial Icelandic boat owner who was asked how his business was going, and he answered: “Very well, thank you, except financially.”

There seems, indeed, to be reason to expect that such “econophobia” may

²³ And they are not alone. Another example that comes to mind is that of the Central Bank governor who defended his appointment to the governorship by claiming that a few years in parliament are equivalent to a Ph.D. in economics. This was in 1994. In recent years, three current professors of economics have served on the boards of directors of the Central Bank and of The National Bank of Iceland, the largest

make it difficult to bring economics into the curriculum of the high schools, where it belongs on par with, say, chemistry and physics, in order to achieve a healthy balance between social and natural sciences in the general education of the population. But this problem is not specifically an Icelandic one, even if the scope of the problem seems larger in Iceland than in many other European countries. If so, why?

Perhaps a false sense of economic security derived from abundant natural resources—fish in this case—reduces the appeal of education in general in the eyes of many, and of an education in economics in particular.²⁴ Moreover, if natural resources rather than human resources are widely perceived as the main source of a nation's economic well-being, and if the natural-resource-based industry can, in good times at least, pay wages that exceed those of the better educated classes, sometimes by a substantial margin, then there is perhaps small wonder that education does not seem to pay.²⁵

There is also another possibility that needs to be considered. Perhaps the Icelandic economy remains so natural-resource intensive and our general education so selective because, in some sense, that is the way we want it. Perhaps what we have here is a political-economy equilibrium of sorts, a natural outcome of the interaction of interest groups in the political arena. The rural bias of economic policies in Iceland over the years, including the insufficient emphasis on education in general, and economics education in particular, may simply reflect the relative bargaining power of different social groups within a political system that gives disproportionate influence to voters in rural regions, as indicated in Section II. But if so, this does not necessarily mean that better and more balanced education would not remedy the situation. Rather, just as institutional, including electoral, reforms would help increase the quantity and quality of education over time by directing

commercial bank. All three resigned from the boards in protest against politically motivated appointments of bank governors, on two separate occasions.

²⁴ In Iceland, for example, the fishing industry, which accounts for about 16 per cent of GDP, employs 6 per cent of the country's economists.

²⁵ Some of the linkages between natural resource abundance, education, and economic growth are traced in Gylfason, Herbertsson, and Zoega (1999).

resources away from relatively low-skill-intensive fisheries and agriculture towards more high-skill-intensive manufacturing, trade, and services, so would improved education facilitate institutional reforms. The benefits would most probably be mutual.²⁶

Pervasive politization. In the third place, Iceland remains a deeply politicized society despite the gradual, albeit only partial, depolitization of, for example, the main newspapers and other media in recent years. The interests and attitudes of political parties and politicians, and of producers, continue to permeate most aspects of economic and social life.

The economics profession has been a part of this pattern. Until recently, most economists belonged to political parties, with some exceptions. This was generally perceived as a prerequisite for professional advancement. The four main parties have all had prominent local economists in their ranks.

For a long time, this state of affairs severely limited the range and quality of economic debate and decision-making in the country. The general rule of behavior was: Remain silent. Do not rock the boat. Do not protest against prevailing economic policies, unless they are also, simultaneously, opposed by your party. This problem was no doubt compounded by the inevitably small absolute number of economists in a small country: economists tended to compromise their independence as advisors by getting involved on several fronts at the same time.

Given that all four political parties have followed fundamentally deficient economic policies in several important respects for most of the post-war period, some more so than others, the range of views presented to the general public in economic debate was far too narrow for the good of the country. For example, the subservience of the Central Bank to political interests was no doubt instrumental in sustaining the second highest rate of inflation in the

²⁶ This conclusion is in keeping with a finding that has been reported in the political-economy literature: that is, that successful economic reforms do not necessarily require institutional reforms to be undertaken first. There have been cases where the two seemed to go hand in hand and to provide mutual support to one another. See Williamson (1994).

OECD region in the post-war period (after Turkey), and *vice versa*.²⁷

The experience of the Faeroe Islands is an even clearer case in point.²⁸ A few years ago, the Faeroese economy collapsed: gross domestic output fell by a third like in several Eastern European countries, unemployment shot up to 25 per cent of the labor force, and 10 per cent of the population fled the country. All this occurred without any audible advance warnings from the country's economists, most of whom were party members.

Just as the Faeroese case may be viewed as a caricature of the Icelandic one, so the politization of Icelandic society through and through and its economic and social consequences may perhaps be regarded as a caricature of the situation in the other Nordic countries in the not very distant past, and perhaps even to this day, to varying degrees. In recent years, however, Icelandic economists in general have begun to distance themselves from political parties, thus helping create conditions for a more open, pluralistic debate of economic issues, policies, and prospects, and for better decision-making.

These parallels must not be extended too far, however. Clearly, the experience of the Faeroe Islands and that of Sweden are worlds apart. Specifically, some Swedish economists have warned persistently against the consequences of certain elements of prevailing economic policies, such as, for example, the deleterious effects of excessive government intervention in the economy and of tightly regulated, monolithic labor markets. In this connection, Professor Assar Lindbeck's exemplary civil responsibility and courage deserve special mention.

There is another aspect of this general problem, unrelated to politics in the

²⁷ It may be added that the chief governor of the Central Bank from 1960 to 1994, was also, from 1965 to 1995, director of the board of the National Power Company, which stood behind a large part of the accumulation of external debt from the 1960s onwards. Because of inadequate countervailing monetary restraint, among other things, the large influx of foreign credit into the country played a significant part in fuelling double-digit inflation in the 1970s and 1980s. As another example, the chief governor of the Central Bank (a different one) sat for several years in the 1990s on the board of the country's largest investment fund (The Fisheries Fund), which was subject, by law, to supervision by the Central Bank.

usual sense of the word. No economist can deny the tremendous waste caused by prevailing agricultural policies in Europe and elsewhere. For example, the gross cost of the agricultural policies of the OECD countries to consumers and taxpayers in those countries until recently exceeded the combined gross domestic product of Australia and New Zealand, and was only slightly smaller than the combined gross domestic product of Austria and Switzerland.²⁹ The need for radical farm policy reform in Europe, in particular, could hardly be more evident than it is, even if the indirect costs imposed on Central and Eastern Europe, and also on the developing countries, are not taken into account.

Yet, most economists choose to stay away from agriculture. Their private acknowledgement of wasteful farm protection is most often accompanied by silence in public.³⁰ In France, especially, the silence of the economists has been such that most French newspaper readers or television viewers have no idea of the true cost of the Common Agricultural Policy of the European Union, unless they read foreign papers or view foreign channels. Many agricultural economists, in France and elsewhere, have seemed particularly reluctant to criticize prevailing agricultural policies in public. Similarly, many labor market economists in Sweden, for example, have appeared

²⁸ See Jónsson (1994).

²⁹ See Johnson (1995) and Gylfason (1995). The cost of farm protection has decreased a bit relative to GDP over the past few years because of the continued decline of the farm population. Even so, the cost of agricultural protection per farmer in the OECD as a whole has increased since the mid-1980s. See Gylfason (1998).

³⁰ The most devastating criticism of agricultural protection in Iceland after 1930 was offered not by our economists, who kept quiet, but by our national poet, Halldór Laxness (1902-1998). In a series of scathing newspaper articles in the early 1940s, he criticized the agricultural import ban with incomparable brilliance and wit based on impeccable economic analysis (except for his conclusion, which he nevertheless did not pursue, namely, that collective farms were the solution to the problem). His articles are reprinted in his collections of essays (Laxness 1979, 1980). Laxness later won the Nobel prize for literature, in 1955. Subsequently, he received his sole official recognition in Iceland. Much later, in conversation, he expressed surprise at the limited interest generated by his essays compared with his novels, and implied that he regarded the essays as no less remarkable in their own way than the novels. See Björnsson (1985, p. 30). Selected essays by Laxness have appeared in Danish and Swedish translation (e.g., Laxness 1959), but these collections do not include the pieces referred to above.

defensive in public about current labor market arrangements, even though deep flaws in the structure and functioning of labor markets are now generally viewed by economists as a major obstacle to a permanent reduction in unemployment.

To take another example of a similar kind, I have been struck by the number of influential politicians in Iceland who have acknowledged in private that they favor fishing fees as an efficient and fair fisheries policy instrument from a macroeconomic point of view, but who have nevertheless remained silent on this important issue in public.

My aim here is not to discuss the possible motives behind such behavior, but simply to point out that this psychosocial phenomenon of "fear of fights" or "preference falsification"—saying one thing in private and another in public—can be a serious obstacle to economic reform, and is, in fact, the subject of serious study among social scientists.³¹

IV. In Conclusion

It would be a mistake to conclude without reservation that Icelandic economists have not made a difference during the first fifty years of the republic, because they have. A fair assessment of the economic policies and practices that were actually followed in the post-war period must involve a comparison not only with those policies that *could* have been followed, but also with those that most likely *would* have been followed, had they been determined exclusively by, say, lawyers, fish producers, and farmers, without an input from economists. This distinction is crucial.

It was, in particular, a team of well-educated, well-informed, and experienced economists that drew up and implemented the plan for a major economic liberalization effort at the beginning of the 1960s. In one way or another, the team included three of the country's first five Ph.D.s in economics (listed in the introduction), and one economist with significant

³¹ See Kuran (1995). See also Frank (1996).

work experience from the World Bank.³² In retrospect, it can be argued that their program was not sufficiently ambitious, as it left the immature banking system in government hands and the determination of fish and farm prices in the hands of committees, and so on.³³

Even so, this was, by Icelandic standards, a singularly successful policy reform program, involving extensive liberalization of foreign trade, a substantial devaluation of the króna accompanied by (moderate) monetary restraint, a unified exchange rate, and more. This set of policies created favorable conditions for rapid economic growth and political stability for a while, the latter by laying the basis for the longest-lived coalition government in the history of the republic, one that served for three consecutive four-year terms; since the beginning of home rule, in 1904, no other Icelandic government has served more than one term.

More recently, economists have also been influential in helping formulate the current fisheries-management policy based on the principle of individual transferable quotas, as described in Section II. Even so, many economists have argued strongly, for more than 20 years, on the grounds of both efficiency and fairness, that the hugely valuable fishing quotas should be sold in an open market or allocated to the population at large rather than being given to boat owners free of charge, as they have been since 1984.

Economists have also been instrumental in opening the eyes of the authorities, the labor market organizations, and the general public to the ravages of inflation in the 1970s and 1980s and to the need for fiscal and monetary restraint and, indeed, for wage restraint and increased productivity

³² Since the 1970s, two Ph.D.s, the fourth and sixth listed in the introduction, have been directly involved in economic policy making at a senior level of government, one as Central Bank governor, the other as budget director. The latter resigned from his position and joined the staff of the International Monetary Fund in the 1980s. An economist with a Ph.D. in political science was minister of finance from 1988 to 1991; he was elected president of the republic in 1996. On the role of well-trained economists in economic policy reform in various countries, see Williamson (1994).

³³ The last-mentioned member of the reform team and main economic adviser to the government in the 1960s later became chief managing director of the largest state bank (The National Bank of Iceland), from 1969 to 1989, and joined the largest political party.

of labor and capital to keep inflation in check. Specifically, they were to some extent instrumental in the restoration of positive, market-based real interest rates in the 1980s as well as the attendant liberalization of financial markets that took place with the introduction of new financial instruments, including indexed bonds, and with the establishment of some new, privately owned financial firms competing with the commercial banks.³⁴

Economists—especially economists outside government—have also drawn the attention of the government to the need for institutional and structural reforms, including, for example, privatization of commercial banks (and investment funds), increased independence of the Central Bank, decentralization and deregulation of the labor market, a more liberal agricultural policy, and fisheries management by fees as well as freely transferable catch quotas. In the last few years, such recommendations have also been made by international organizations in their reports on the Icelandic economy, namely, the (former) GATT, the OECD, and the International Monetary Fund (IMF). However, these calls remain to be heeded for the most part. Until they are, there is, in my view, a danger that living standards in Iceland will, despite reasonably rapid economic growth from time to time, continue to lag behind those of our neighboring countries.

If so, Iceland may, like Ireland earlier in this century, gradually lose its ability to hold on to many of its young people, an appalling prospect for such a small country.³⁵ Until recently, Ireland was one of the poorest countries in Europe. The history of Ireland in this century demonstrates the grave and frequently long-lasting consequences of gross economic mismanagement

³⁴ The indexation of bank credit and various other financial instruments played a significant part in reducing inflation in the early 1990s by, among other things, increasing the cost of inflation to indebted wage earners. Recently, however, the gradual, premature relaxation of some forms of financial indexation has reduced the cost of inflation to increasingly indebted households, thus creating a risk of renewed inflation triggered by excessive wage demands aimed, in part, at reducing the debt burden.

³⁵ Iceland's share of the population of Europe as a whole is considered to have fallen roughly by a factor of five since the year 1100, or from 0.1-0.2 per cent to 0.03 per cent.

over an extended period.³⁶

An extrapolation of recent economic trends led some observers in the mid-1990s to expect a similar fate to befall Iceland (recall Figures 2 and 3). I did not and do not, however, nor do I foresee a Faeroese-style crash. The reason is not the current economic upswing, which may not last. No, I rather expect, or hope, that, little by little, and with the help of gradual advances in general economics education and the attendant elimination of ignorance, obstinacy, and prejudice, necessary reforms will be deemed inevitable and will take place. Nevertheless, in my view, rapid, radical reforms would be more likely to succeed, just as in Central and Eastern Europe since the collapse of communism, not least because too slow reforms tend to favor the guardians of the *status quo*. As I see it, precious time has been lost, especially in the 1990s, when the wave of radical, market-friendly reforms that swept the world bypassed Iceland to a large extent, but there is still hope. Unexploited opportunities abound.

So, to conclude, I believe that Icelandic economists ultimately will be deemed to have made a difference, but not as much as they could or wished to have. Time will tell.

It is sometimes said that Iceland, like many other countries near and far, needs more economists in politics and in government. I agree. I also think that Iceland now has at least as great a need for economists *outside* politics and government circles, to clear the climate and expedite the necessary depolitization of economic and social life. For this, we need many more economists.

³⁶ The more recent experience of Ireland is also a refreshing reminder of the great potential for economic recuperation. Since the early 1980s, economic growth in Ireland has been brisk, bringing the country's purchasing-power-parity-adjusted GDP per capita from about two-thirds of the European Union average up above the average.

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Figure 1. Iceland: Catch and Fleet, 1945-1997 (1945 = 100)

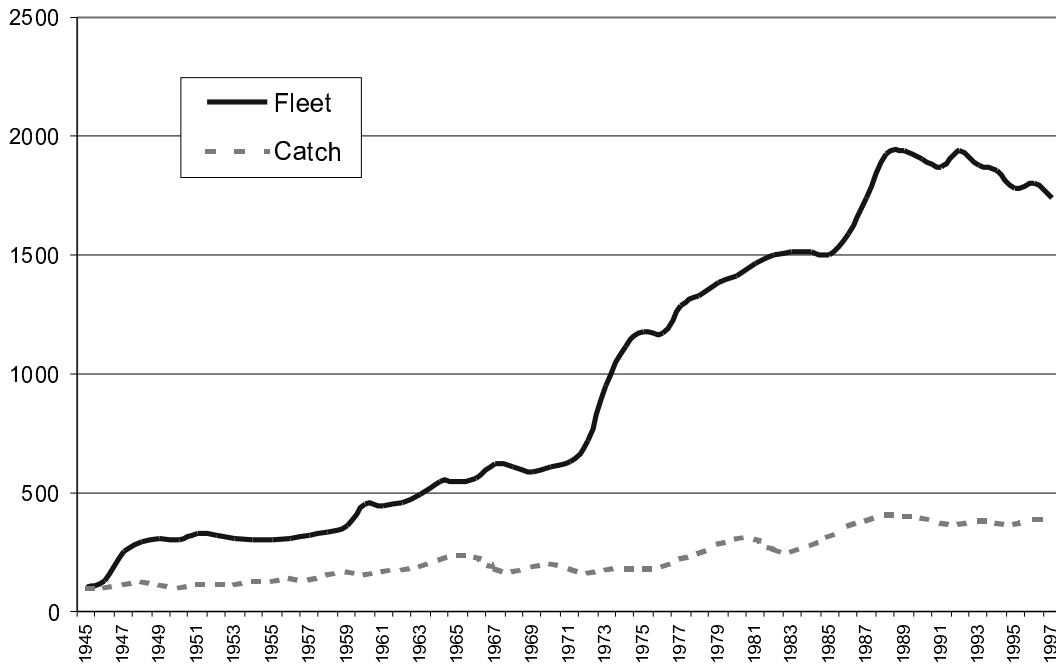


Figure 2. Iceland: Gross Domestic Product Per Capita Relative to Trend, 1960-1998 (1960 = 100)

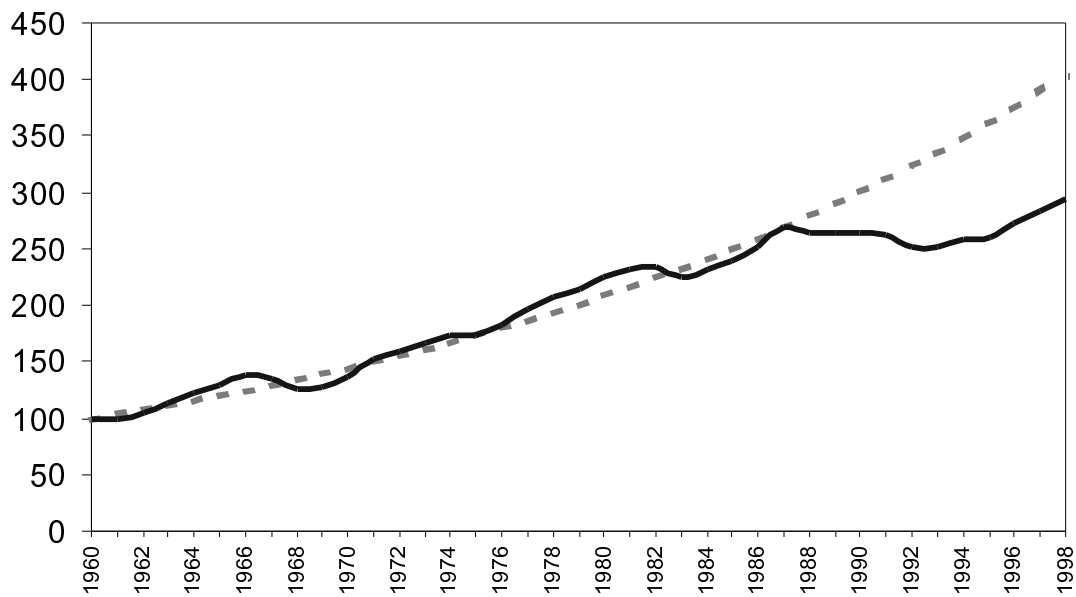


Figure 3. Iceland: Gross Domestic Product Per Capita Relative to Trend, 1901-1998 (1990 = 100)

