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IN DEFENCE OF SMALL STATES

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INTRODUCTION

In 1944, as the Second World War was coming to a close, British historian Alfred Cobban published a book for the Royal Institute of International Affairs in London where he criticized the idea of national self-determination:

> To take examples, can it reasonably be believed that the national demands of Wales, White Russia, Alsace, or Flanders, would be met, or should be met, by the granting of political independence? Should French Canada self-determine itself as a separate state? Would it be better for the national liberty of the Maltese if they abandoned the British connection and endeavoured to set up as a completely independent state, regardless of the ambitions of their Mediterranean neighbours? Can Iceland afford to be without economic links with some larger and more prosperous state?[1]

Professor Cobban's words turned out to be less than prophetic, as both White Russia (or Belarus) and Malta now are independent states, whereas powerful separation movements have risen both in Flanders and in French Canada (or Quebec). Indeed, the world has seen a proliferation of small states since the War. The number of independent countries has gone up from 76 in 1946 to 195 in 2016, 193 members of the United Nations, together with the Vatican City and Taiwan. If protectorates and semi-independent territories like Greenland, Puerto Rico, Kosovo and Palestine are included, then the number would be still higher.[2] Iceland—one of the countries which Cobban mentioned—had become a sovereign state in 1918, in a personal union with Denmark, and in 1944, she unilaterally revoked the Danish-Icelandic Act of Union and declared herself a republic. However, after the dramatic 2008 Icelandic bank collapse, some scholars, notably Professors Anne Sibert of Birkbeck College, London, and Baldur Thorhallsson of the University of Iceland, followed Cobban in arguing that Iceland was too small a political unit to be sustainable. She had to forge closer links with some larger political unit, by which they both had in mind the European Union.[3] The arguments provided by Sibert and Thorhallsson are of general interest: Are some states too small to be sustainable? Do economies of scale apply to states as well as to economic products? Does the principle of national self-determination make any sense? Does the future belong to big and powerful federal states rather than to loosely-bound federations of small states? In this paper, the arguments offered by Sibert and Thorhallsson will be examined in some detail from an Icelandic perspective, but with special reference also to small states inside and outside the European Union, such as Greenland, the Faroe Islands, Estonia, the other two Baltic states and Slovenia. •

1 Alfred Cobban, National Self-determination (Oxford: Oxford University Press, 1944), p. 74.

2 Alberto Alesina, The Size of Countries: Does It Matter? Journal of the European Economic Association, Vol. 1, (2–3: 2003), 301–16. The present number of UN countries is from the UN website, http://www.un.org/en/members/index.shtml

3 Anne Sibert, Undersized: Could Greenland be the new Iceland? Should it be? Voxeu.org 10 August 2009, http://www.voxeu.org/article/could-greenland-be-new-iceland. Baldur Thorhallsson, Domestic buffer versus external shelter: viability of small states in the new globalised economy, European Political Science, Vol. 10 (2011), pp. 324–336.

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AGAINST SMALL NATIONS: MARX AND ENGELS

In his scepticism about, or even hostility towards, small nations and states, Professor Alfred Cobban had many forerunners, including the German revolutionaries Karl Marx and Friedrich Engels. They despised those small and "backward" nations, including the Nordic ones, that they considered impediments to the necessary evolution of human society. In December 1846, for example, Engels wrote to Marx that he had been studying Denmark:

> You would find it a beastly place. Better the smallest German than the greatest Dane! Such a miserable atmosphere of morality, guild-cliquishness and consciousness of social status exists nowhere else any more. The Dane thinks of Germany as a country one visits in order "to keep mistresses with whom one can squander one's wealth".

The Nordic nations all were coarse and primitive, Engels said, and the more backward the nation was, the more it considered itself to be genuinely Nordic. Thus, the Icelanders were of course the real Nordic people:

> The Icelander still speaks the very same language as the greasy Vikings of anno 900. He drinks fish-oil, lives in an earthen hut and breaks down when the atmosphere doesn't reek of rotten fish. I was many times tempted to be proud, that I am at least no Dane or even an Icelander but only a German.[4]

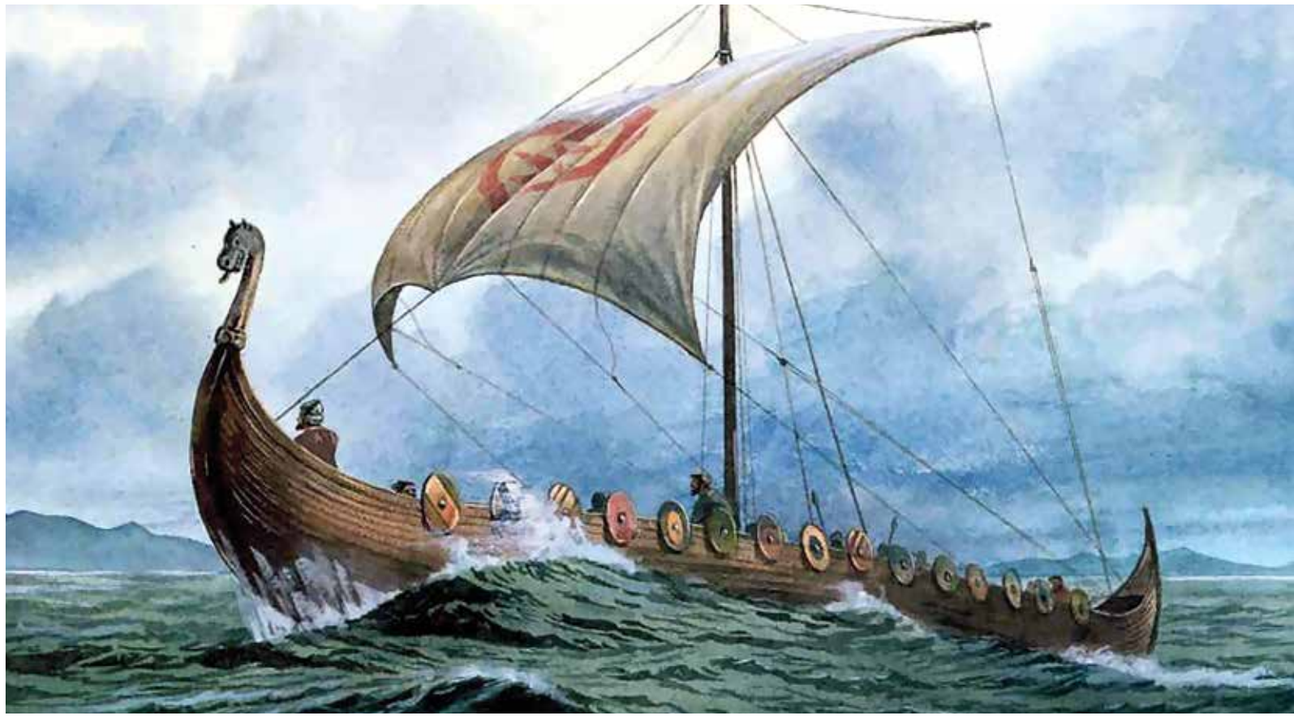
Probably Engels had read the same sensationalist reports of Iceland as French philosopher Jean-Jacques Rousseau who had written almost a century earlier that the Icelanders, like other primitive nations, were ill at ease in civilized society. Those Icelanders who had been brought to Denmark either withered away there, Rousseau said, or drowned at sea when trying to swim back to their homeland![5]

Engels was soon to comment again on the Nordic nations. In a war breaking out in 1848 between Denmark on the one hand and German separatists in Schleswig and Holstein on the other hand, supported by Prussia and Austria, he and Marx firmly sided with the Germans. In a newspaper edited by Marx, *Neue Rheinische Zeitung,* Engels discussed the proposal that the Danes should receive help from their Nordic cousins under the banner of Scandinavian solidarity:

> Scandinavianism is enthusiasm for the brutal, sordid, piratical, Old Norse national traits, for that profound inner life which is unable to express its exuberant ideas and sentiments in words, but can express them only in deeds, namely, in rudeness towards women, perpetual drunkenness and the wild frenzy of the Berserker alternating with tearful sentimentality... Scandinavianism was the pattern of the Danes' appeals for Swedish and Norwegian support. But as always happens with the Christian-Teutonic nation, a dispute immediately arose as to who was the genuine Christian-Teuton, the true Scandinavian.

4 Engels to Marx, Paris, December 1846. Karl Marx, Friedrich Engels, Werke, Vol. 27 (Berlin: Dietz, 1963), p. 72. Tr. by Jesse Byock.

5 Jean-Jacques Rousseau, Discours sur l'origine et les fondements de l'inégalité parmi les hommes, Part II, Notes. The Political Writings of Jean Jacques Rousseau, ed. C. E. Vaughan, Vol. 1 (Oxford: Basil Blackwell, 1962), p. 218.



The Swede contended that the Dane had become "Germanized" and had degenerated, the Norwegian said the same of the Swede and the Dane, and the Icelander of all three. Obviously, the more primitive a nation is, the more closely its customs and way of life resemble those of the Old Norse people, the more "Scandinavian" it must be.[6]

Marx seems to have agreed with Engels on both Danes and Icelanders. In one of his letters to Engels he reported on a conversation with Bruno Bauer taking place in London on 12 December 1855. Bauer had remarked that the English language had been corrupted by Latin. Marx responded by telling Bauer that Dutchmen and Danes said the same about the German language and that the "Icelanders" (to show his disdain, Marx put inverted commas around the name) were the only true people untainted by Southern European influences.[7]

In the writings of Marx and Engels, the Icelanders and Danes found themselves in the company of many other small European nations. For example, Engels wrote that in the Habsburg Empire, only the Germans, the Poles and the Magyars could be regarded as progressive: "All the other large and small nationalities and peoples are destined to perish before long in the revolutionary world storm." Engels added: "There is no country in Europe which does not have in some corner or other one or several ruined fragments of peoples, the remnant of a former population that was suppressed and held in bondage by the nation which later became the main vehicle of historical development." He specifically mentioned Gaels in Scotland, Bretons in France, Basques in Spain and Southern Slavs in the Habsburg Empire. Engels ended his diatribe against small nations on a threatening note: "The next world war will result in the disappearance from the face of the earth not only of reactionary classes and dynasties, but also of entire reactionary peoples. And that, too, is a step forward."[8] After the United States annexed large parts of Mexico after a war in 1846–1848, Engels found it rather fortunate that "splendid California has been taken

6 Friedrich Engels, Der dänisch-preußische Waffenstillstand, Neue Rheinische Zeitung, No. 99, 10 September 1848. Karl Marx, Friedrich Engels, Werke, Vol. 5 (Berlin: Dietz, 1959), p. 394. English translation, https://www.marxists.org/archive/marx/works/1848/09/10a.htm

7 Marx to Engels, 14 December 1855. Karl Marx, Friedrich Engels, Werke, Vol. 28 (Berlin: Dietz, 1963), p. 467.

8 Friedrich Engels, Der magyarische Kampf, Neue Rheinische Zeitung 13 January 1849. Karl Marx, Friedrich Engels, Werke, Vol. 6 (Berlin: Dietz, 1961), pp. 168, 172 and 176. English translation, http://marxists.anu.edu.au/archive/marx/works/1849/01/13.htm

away from the lazy Mexicans". Commenting again on the Habsburg Empire, he said that

> The Germans and Magyars untied all these small, stunted and impotent little nations into a single big state and thereby enabled them to take part in a historical development from which, left to themselves, they would have remained completely aloof! Of course, matters of this kind cannot be accomplished without many a tender national blossom being forcibly broken. But in history nothing is achieved without violence and implacable ruthlessness.[9]

Engels also commented contemptuously on the "lousy Balkan" nations under Ottoman rule: "These wretched, ruined fragments of one-time nations, the Serbs, Bulgars, Greeks, and other robber bands, on behalf of which the liberal philistine waxes enthusiastic in the interests of Russia, are unwilling to grant each other the air they breathe, and feel obliged to cut each other's greedy throats."[10]

Even if Marx was usually not quite as outspoken as Engels, he also preached revolutionary violence and the merciless survival of the fittest nations. He wrote, for example, that "there is only one way in which the murderous death agonies of the old society and the bloody birth throes of the new society can be shortened, simplified and concentrated, and that way is revolutionary terror."[11] Echoing Engels, he referred to the European territories under Ottoman rule as having "the misfortune to be inhabited by a conglomerate of different races and nationalities, of which it is hard to say which is the least fit for progress and civilisation".[12] In a comment on Great Britain as a naval power, he wrote: "Such is the redeeming feature of war; it puts a nation to the test. An exposure to the atmosphere reduces all mummies to instant dissolution so war passes supreme judgments upon social organizations that have outlived their vitality."[13] Faithful disciples of Marx and Engels took power in Central and Eastern Europe in the 20th century, turning words into deeds, or misdeeds. One of them, Joseph Stalin, even earned the surname "Breaker of Nations".[14]

Marxist intellectuals in the West, such as historian Eric Hobsbawm, President of Birkbeck College, London, tend simply to ignore Marx' utterings and to explain away Engels' outbursts. Hobsbawm says in Engels' defence: "However, it is sheer anachronism to criticize him for his essential stance, which was shared by every impartial mid-nineteenth-century observer. *Some* small nationalities and languages had no independent future. So much was generally accepted, even by people far from hostile to national liberation in principle, or practice."[15] One wonders whom Hobsbawm would see as an "impartial mid-nineteenth-century observer". Engels would at least hardly qualify as one. And were the Icelanders—numbering only 58,000 in 1848—for example among those nationalities that "had no independent future" according to Hobsbawm? Who was to be the judge of that? When Engels was ridiculing the Icelanders, poet Jonas Hallgrimsson and other writers, inspired by Danish philologist Rasmus Christian Rask, had already been busy for decades reviving Icelandic, creating a lot of new words, and expunging danicisms which had crept into the language during the long Danish dominance of the country. The same year as Engels published his article about Scandinavianism and the Nordic nations, in 1848, Jon Sigurdsson wrote his "Exhortation to the Icelanders", arguing that the Icelanders formed a distinct nation with a right to rule herself.[16] •

9 Friedrich Engels, Der demokratische Panslawismus, Neue Rheinische Zeitung, 15 February 1849. Karl Marx, Friedrich Engels, Werke, Vol. 6 (Berlin: Dietz, 1961), pp. 273 and 278–279. English translation at http://marxists.anu.edu.au/archive/marx/works/1849/02/15.htm

10 Engels to August Bebel 17 November 1885. Karl Marx, Friedrich Engels, Werke, Vol. 36 (Berlin: Dietz, 1967), p. 391. Tr. by Bertram Wolfe. This letter is, for some reason, not published online at the Marxist Archive, where Engels' other letters to Bebel are to be found.

11 Karl Marx, Sieg der Kontrerevolution zu Wien, Neue Rheinische Zeitung 7 November 1848. Karl Marx, Friedrich Engels, Werke, Vol. 6, p. 457. English translation, https://www.marxists.org/archive/marx/works/1848/11/06.htm

12 Karl Marx, Britische Politik. British Politics, New York Daily Tribune 7 April 1853. Karl Marx, Friedrich Engels, Werke, Vol. 9 (Berlin: Dietz, 1960), p. 7. English version https://www.marxists.org/archive/marx/works/subject/russia/crimean-war.htm#01

13 Karl Marx, Eine neue Enthüllung in England [A New British Revelation], New York Daily Tribune 24 September 1855. Karl Marx, Friedrich Engels, Werke, Vol. 11 (Berlin: Dietz, 1961), p. 522. The article is, for some reason, not published online at the Marxist Archive, but it can be found in English in Vol. 14 of Marx, Engels, Collected Works (London: Lawrence & Wishart, 2010), p. 516.

14 Robert Conquest, Stalin: Breaker of Nations (New York: Viking, 1991).

15 Eric Hobsbawm, Nations and Nationalism since 1780: Programme, Myth, Reality, 2nd ed. (Cambridge: Cambridge University Press, 1992), pp. 34–5.

16 Jon Sigurdsson, Hugvekja til Islendinga, Ny felagsrit, Vol. 8 (1848), pp. 1–24;

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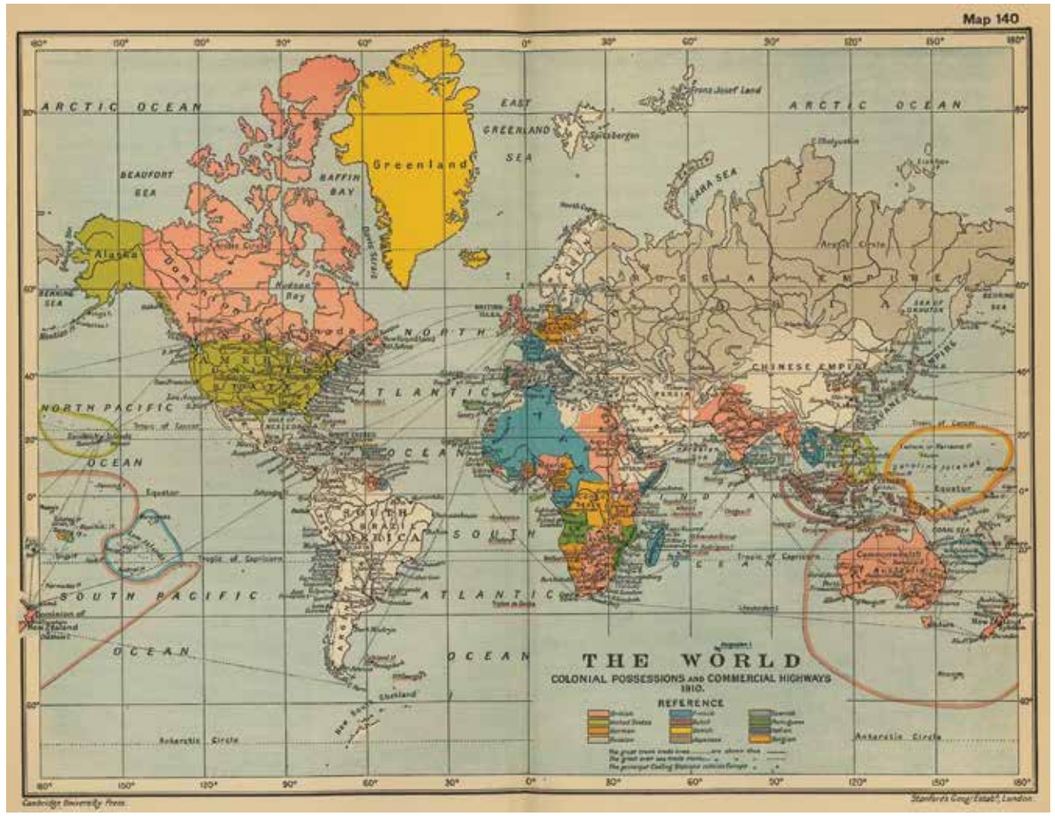
THE PROLIFERATION OF SMALL STATES



It is certainly true that small nations rarely pass the test of successful wars suggested by Marx and Engels. The argument for their sustainability cannot be success or survival in a military conflict. There have to be other reasons why their number has so markedly increased in modern times. An obvious reason is the collapse of colonial empires, beginning with the 1776 American revolution when thirteen small British colonies successfully fought for their independence and formed a federation, the United States of America. The 19th century saw however three different trends, the break-up of the Spanish and Portuguese empires in Latin America; the formation, or consolidation, of colonial empires controlled by three major European powers, Great Britain, France and Russia; and the unification of Germany and Italy by military means, but in the name of nationality. The second trend was somewhat reversed in the 20th Century. In 1917, the Romanov Empire collapsed, with the result that Poland, Finland and the three Baltic countries became independent nation-states, whereas the Bolsheviks, faithful followers of Marx and Engels, managed to subdue Ukraine, Georgia, Armenia and other Russian territories which had briefly tried to

become independent. In 1918, the Habsburg Empire disintegrated, with the new states of Czechoslovakia and Yugoslavia being established on its ruins, neither of which was however a nation-state, but rather a state with one dominant nation, the Czechs and the Serbs respectively, and some national minorities. Besides Finland, two other Nordic countries became independent states. In 1905, Norway seceded peacefully from Sweden,[17] and in 1918 Denmark accepted Iceland's sovereignty. In early 20th century, also, some British dominions became independent states, Australia, Canada, New Zealand and South Africa, albeit in a personal union with the UK.

It is an interesting question whether colonialism was abandoned because it turned out to be unprofitable for the European powers or because the idea of national self-determination had been accepted by European elites. While these two answers are not necessarily mutually exclusive, supporters of economic liberty tend to emphasise the former view. Bentham, for example, advised the French Revolutionary Assembly to emancipate their colonies. The gains of empire, he argued, were either sectional or illusory. Adam Smith took a similar view of colonialism. In the years 1894–1913, it has been computed, Germany spent 1002 million marks on her colonies, excluding military expenses, while the total German trade with them amounted to 972 million marks.[18]

Be that as it may, after the Second World War almost all European colonies were granted independence while in one case, that of Hong Kong, a colony was returned to a major nearby power, against the will of the inhabitants. Whereas the Baltic countries had been occupied and annexed by the Soviet regime during the War, they became independent again after the downfall of the Soviet Empire; so did countries with a much briefer period of independence like Belarus, Ukraine, Georgia and Armenia. With the demise of communism in Central Europe, both Czechoslovakia and Yugoslavia disintegrated.

The collapse of colonial empires went together with the triumph of democracy: In 1914, there were only 13 democracies in the world; in 2009 their number had increased to 87. In 1914, most people lived in autocracies; now, more than half the world population lives in democracies.[19] Historically, most states have been ruled by dictators or small elites that have used their monopoly of power to conquer and to exploit as many peoples as they could, as shown not only by the Ottoman and Romanov empires, but also by smaller political units such as the France and Spain of the past. The dictators or ruling elites were constrained by their counterparts in other countries rather than by their own subjects. Peaceful secession was the exception rather than the rule. In 1830, the Belgians had to fight for their independence against the Dutch, whereas in 1905 the Swedes did not use force to try and stop the Norwegians from establishing their own kingdom. General Franco would never have allowed the Basques and the Catalonians to secede from Spain while today this is regarded as a matter to be resolved by elections and negotiations. The same can be said about Quebec in Canada, Scotland in the UK and Flandern in Belgium. In early 20th century, the UK government tried by force to stop Irish secession, but it finally gave in and divided up Ireland. Tito ruled Yugoslavia with an iron hand, but after his death the various nations there formed their own states, no less than seven of them, the Slovenes, Croats, Serbs, Bosniaks, Montenegrins, Macedonians, and Kosovan. The Czechs and the Slovaks parted peacefully, but it was mainly due to a temporary lack of resolve in the Kremlin which enabled the Baltic nations to reclaim their independence. Still, modern despots deny self-rule, let alone sovereignty, to Chechnya and Tibet. Nevertheless, the modern triumph of democracy has made a peaceful resolution of many national conflicts possible. "Even though liberal states have become involved in numerous wars with nonliberal states, constitutionally secured liberal states have yet to engage in war with one another."[20]

The most important reason, however, for the proliferation of small and medium-sized states in the last one or two centuries undoubtedly is increased economic integration, brought about mainly by the expansion of international trade, and greatly facilitated by improved technology, not least in transport and telecommunications. In 1776, Adam Smith gave what became accepted as the classical explanation of wealth creation: division of labour and free trade. But, as Smith famously noted, "the division of labour is limited by the extent of the market".[21] This is not an acute problem for a large political unit like the United States, or the Habsburg Empire where the domestic market is, or was, quite big. But for a small country, protectionism is much more costly. If its economy is closed, the inhabitants forgo the benefits of a more extensive market. If the economies of many countries are open and the inhabitants trade freely with one another, on the other hand, they reap the benefits of the division of labour. Thus, perhaps somewhat paradoxically, economic integration makes political disintegration, or at least decentralisation, less costly and therefore more likely. It should be emphasised that Smith's argument was not about the scale of the units of production, but about the extent of the market. From his argument it does not necessarily follow that big units of production are the most efficient ones.

Indeed, the economies of small states usually are more open than those of large states. They rely more on international trade. It is therefore not surprising that they tend to be wealthier. Harvard Professor Alberto Alesina points out that of the ten richest countries in the world, in terms of GDP per capita, only four have populations over 1 million. They are the United States (260 million people), Switzerland (7 million people), Norway (4 million people) and Singapore (3 million people).[22] Three of those four states would normally be considered small. Again, of the five largest countries in the world in terms of population, China, India, the United States, Indonesia and Brazil, only one, the US, is really a rich country. Chicago Professor Gary Becker mentions two additional reasons why small countries tend to have open economies and to be wealthier than large countries:

> Political interest groups tend to be less able in smaller countries in distorting political decision in their favor. This is partly because smaller countries are more homogeneous, so it is harder for one group to exploit another group since the groups are similar. In addition, since smaller nations have less monopoly power in world markets, it is less efficient for them to subsidize domestic companies in order to give these companies an advantage over imports. The greater profits to domestic companies from these subsidies come at the expense of much larger declines in consumer well being.[23]

Becker suggests that these factors may partly explain the great increase in the number of small countries in the latter half of the 20th century. •

17 In his book about nationalism, p. 105, Professor Hobsbawm wrongly says that Norway seceded from Sweden in 1907. He also says that secession had not been proposed by anyone in Norway until the 1890s! He seems unaware of the abortive attempt by Norway to declare independence in 1814 and her few months as a sovereign kingdom.

18 Lionel Robbins, The Economics of Territorial Sovereignty, The Economic Basis of Class Conflict (London: Macmillan, 1939), p. 93 and 96.

19 States with under 500,000 inhabitants are not included. Max Roser, Democracy, Our World in Data (Oxford: 2016). https://ourworldindata.org/democracy/ [Online Resource]

20 Michael W. Doyle, Kant, Liberal Legacies, and Foreign Affairs, Philosophy and Public Affairs, Vol. 12 (3: Summer, 1983), p. 213.

21 Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, ed. E. Cannan (London: Methuen & Co., 1904; first published 1776), Book 1, Ch. 3 (title of the chapter).

22 Alberto Alesina, The Size of Countries: Does It Matter? Journal of the European Economic Association, Vol. 1, (2–3: 2003), pp. 301–16.

23 The Becker-Posner website, http://www.becker-posner-blog.com/2012/12/breakup-of-countries-no-economic-disaster-becker.html

4

IS ICELAND TOO SMALL?

Turning to Iceland, she had done quite well economically and socially in the 1990s and early 2000s, even being held up by some as a model country.[24] But the 2007–9 international financial crisis hit Iceland harder than many other countries, bringing about a total collapse of the banking sector, a 50% loss of value in the Icelandic currency, *krona*, and a bitter conflict with the United Kingdom about the financial responsibility for operations of the Icelandic banks there. The Icelanders, previously regarding themselves as a modern, successful Nordic nation, suddenly felt like outcasts. This feeling was shared by some foreigners. On 10 August 2009, Eric Hobsbawm's colleague at Birkbeck College, Professor Anne Sibert published an article in VOX, the online policy portal of CEPR, Centre for Economic Policy Research. VOX is financed by the European Union, "through its programme of support for bodies active at the European level in the field of active European citizenship." Sibert asks whether "the recent experience of Iceland" suggests "that a country can be *too* small to be a nation state". Her answer is: "I argue that there is little economic justification for preferring small size and that there can be significant costs. I also argue that Iceland's small size was probably a key factor in Iceland's failure to stop its financial crisis."[25] In her paper, Sibert submits that Greenland's "progression toward independent statehood is strikingly reminiscent of Iceland's experience (especially its desire to maintain its own culture and protect its natural resources at the cost of isolation from the rest of the world and its wish to limit its economic relationship with Europe)."

The parallels between the two countries are somewhat exaggerated by Professor Sibert. Iceland has a much stronger cultural identity than Greenland. The Icelandic nation has an unbroken history of more than 1100 years. The island was settled in 874–930, and the Icelandic Commonwealth was in place for more than three centuries, in 930–1262, longer than many political structures in Europe of the same period. The nation developed her own culture, with her own strong literary tradition written in her own distinct language. In an essay on small nations, Czech novelist Milan Kundera writes:

> I think of Iceland. In the twelfth and thirteenth centuries, a literary work thousands of pages long was born there: the sagas. At the time, neither the French nor the English had created such a prose work in their national tongue! We should certainly ponder this thoroughly: the first great prose treasure of Europe was created in its smallest nation, which even today numbers fewer than three hundred thousand inhabitants.[26]

In 1262, the country became a Norwegian, later a Danish, dependency, gaining home rule in 1904 and sovereignty in 1918. One of the main arguments advanced by the Icelanders, led by Jon Sigurdsson in the 19th century and by Hannes Hafstein and Jon Thorlaksson in the early 20th century, for autonomy and sovereignty was that Iceland had from the very beginning been a separate country with her own distinct language, culture and history.[27]

The history of Greenland was different. While from late 10th century there were small Icelandic settlements in the southwestern part of Greenland, they disappeared in late 15th century, most likely as a result of a combination of factors: isolation, cooling (the "little ice age") and conflicts with Eskimos, or Inuits, arriving from North America in the 13th century. Neither the Icelandic-Greenlanders nor the Inuits developed rich cultures of their own, even if the Inuits spoke their own language and developed traditions and customs enabling them to survive in the harsh climate. The Icelandic-Greenlanders had accepted

24 Bjorn G. Olafsson, Small States in the Global System: Analysis and Illustration from the Case of Iceland (Brookfield VT: Ashgate, 1998). I only came across this book after I had written this report, but the author's conclusions are in important aspects the same as mine.

25 Anne Sibert, Undersized: Could Greenland be the new Iceland? Should it be? Voxeu.org 10 August 2009. http://www.voxeu.org/article/could-greenland-be-new-iceland

26 Milan Kundera, Die Weltliteratur, New Yorker 8 January 2007, see http://www.newyorker.com/magazine/2007/01/08/die-weltliteratur

27 Jon Sigurdsson, Hugvekja til Islendinga (1848); Jon Thorlaksson, Fra fyrstu stjornararum Hannesar Hafstein, Odinn, Vol. 19 (1–6: 1923), pp. 8–10; Jon Thorlaksson, Sameining flokkanna, Morgunbladid 30 and 31 May 1929.

the Norwegian king as sovereign at the same time as the Icelanders, in 1262, but contact was lost with them in the 15th century. When Denmark reasserted her control of Greenland in 1721, just a few scattered Inuit groups were found on the vast island. In 1979, Greenland gained limited autonomy, and in 2009 the country became semi-sovereign, with Denmark maintaining control of foreign affairs and defence. In 1985, Greenland chose to leave the European Union (which the country had automatically joined in 1973 with Denmark).

Surprisingly, Professor Sibert leaves out of her paper the main reason why both Iceland and Greenland have chosen to remain outside the European Union. It is not because these countries want to isolate themselves from Europe (of which Greenland is not even a part, as it is traditionally regarded as a North American country), but mainly because of the Common Fisheries Policy, CFP, of the EU, which requires equal access of all member states to all fishing grounds nominally belonging to individual member states.[28] Thereby hangs a tale. The EU hastened to introduce the principle of equal access, the cornerstone of the CFP, in the summer of 1970, as it anticipated applications for membership from the United Kingdom, Norway, Denmark and Ireland—four countries which between themselves controlled some of the largest fishing grounds in Europe. The EU was trying to ensure that other member states would have access to these immense fishing grounds. The EU therefore presented the four applicant states with a *fait accompli*, reckoning that membership was so important to them (and their fisheries not so significant politically) that they would accept the new policy, for which there was no authority in the Treaty of Rome. The EU had its way with three of the four applicant states, but the fourth one, Norway, turned down membership in a referendum.[29]

The CFP is the main reason why Norway rejected EU membership, Greenland left the EU and Iceland did not apply for membership (until in very special circumstances in 2009, disheartened after the bank collapse, and then quickly changing her mind). The fisheries are significant in Norway, especially politically, but they are of paramount importance both in Greenland and Iceland. The CFP is generally regarded as a failure, both in maintaining healthy fish stocks and in harvesting fish profitably: Many fish stocks in European waters are depleted, at the same time as the fisheries have required heavy subsidies.[30] By contrast, Iceland has developed an efficient system of utilising her fertile fishing grounds, the system of ITQs, Individual Transferable Quotas: A fishing firm holds a share of the total allowable catch over the season in a fish stock, and it can either harvest this given amount or sell its quota or a part of it, or it can buy quota from other firms. Thus, the quotas are transferred in mutually beneficial market transactions to the most efficient fishing firms which can also, because the quotas are permanent, efficiently plan their operations over the foreseeable future. In short, the resource is taken into stewardship.[31]

Professor Sibert also seems to overlook the fact that the boundaries both of Greenland and Iceland are natural rather than merely a matter of choice: They are islands, far away from other countries, both in Europe and North America. Even if Greenland might have too small a population to be an independent political unit, as Professor Sibert suggests, it is a separate country with a culture and language different from that of other countries. Arguably, also, the Greenlanders are better judges of what is in their own best interest than are others, whether Canadians, Danes, or Icelanders. Even if Greenland would become an independent state, she could perhaps cope with the problem of her tiny population by outsourcing some core functions of government, such as defence (as she has done in the past). Sometimes, people are presented with limited choices. An independent Greenland might not be an efficient political unit in some sense, but it would be preferable, some might think, to Greenland as a Danish colony or dependency.

In this context, two other small countries in Europe should be mentioned, Estonia and Slovenia. Unlike Iceland and Greenland, they do not have any obvious natural boundaries except Estonia on the Baltic Sea and Slovenia on the Adriatic Sea. Despite being subdued and oppressed first by the German Baltic

28 Professor Jon Danielsson stresses this in a VOX paper which Professor Sibert actually refers to (misspelling his first name as Joh). Jon Danielsson, Iceland applies for EU Membership, the Outcome is Uncertain, VoxEU.org 21 July 2009.

29 Angelika Volle and William Wallace, How Common a Fisheries Policy? The World Today, Vol. 33 (2: February 1977), pp. 62–72.

30 See, for example, Green Paper: Reform of the Common Fisheries Policy (Brussels: The European Commission, 2009), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0163:FIN:EN:PDF

31 Hannes H. Gissurarson, The Icelandic Fisheries: Sustainable and Profitable (Reykjavik: University of Iceland Press, 2015).

barons in 1227, and then by the Swedes in 1561–1721 and finally by the Russians in 1721–1918, the Estonian peasants maintained their national identity and their language and seized the opportunity which presented itself in 1918, after the fall of the Russian Empire, to establish an independent state. The Estonians certainly had, and still have, a strong desire to maintain their own culture, just like the Icelanders, and their culture survived the country's military occupation by the Soviet Union and Nazi Germany in 1940–1991. (The last Russian soldiers left in 1994.) Even if the Estonians form one of the smallest nations in Europe, there is little doubt that they would reject arguments against the feasibility of small nations.[32] Their concern about security issues has unsurprisingly expressed itself in a strong commitment to membership both of NATO and of the European Union, whereas Iceland and Greenland rely more on the unwillingness of the US and the UK to see any other major power obtain influence on those two North Atlantic islands. Slovenia, never having been an independent state historically, but united by a common language and religion, had for centuries been both a trade centre and a battleground for bigger nations. In 1990 she decided in a national referendum, with 88% of the votes, to secede from Yugoslavia and to establish an independent state. In 1991, the Yugoslav army tried to hinder the secession of Slovenia, but after a "Ten-Day War" an armistice was agreed on, and the last Yugoslav soldiers left in the autumn. Like Estonia, Slovenia relies on her membership both of NATO and of the EU to ensure her security.

Iceland, Estonia and Slovenia are all small nation-states. But an argument for small states is not necessarily also an argument for nation-states. The Anglo-Austrian philosopher Sir Karl Popper once

32 Cf. Ants Oras, Baltic Eclipse (London: Victor Gollancz, 1948). This book was translated into Icelandic in 1955.

wrote that the two main curses of modern times were communism and nationalism. The utter absurdity of the principle of national self-determination must be, he said, plain to anybody who devoted a moment's effort to criticizing it. The demand was for the border of a state to coincide with the location of an ethnic group:

> But nation-states of this kind do not exist. Even Iceland—the only exception I can think of—is only an apparent exception to this rule. For its limits are determined, not by its ethnic group. but by the North Atlantic—just as they are protected, not by the Icelandic nation, but by the North Atlantic Treaty. Nation-states do not exist, simply because the so-called 'nations' or 'peoples' of which the nationalists dream do not exist. There are no, or hardly any, homogenous ethnic groups long settled in countries with natural borders.[33]

Popper makes a valid point: The nation is notoriously hard to define. The Swiss form one nation even if they speak four languages and are divided into two major religious groups. The Canadians and the inhabitants of the US (who call themselves somewhat misleadingly the Americans) speak the same language, but they are two different nations. But French philologist Ernest Renan had responded to Popper's point long ago. According to Renan, language invited people to unite, but it did not force them to do so. He argued that the concept of a nation should be based not on dynastic claims, ethnicity, language, or religion, but on spontaneous and voluntary self-identification of a group: "It presupposes a past; it is summarized, however, in the present by a tangible fact, namely consent, the clearly expressed desire to continue a common life. A nation's existence is, if you will pardon the metaphor, a daily plebiscite, just as an individual's existence is a perpetual affirmation of life."[34]

Paradoxically, both Popper and Renan are right. The Icelanders, for example, are not defined as a nation by their location on a remote island, even if that may have helped to bring about their nationhood through eleven centuries of a shared struggle for survival. There are other islands which are inhibited by two nations, such as Cyprus and Ireland. While the Orkney Islands belong to Scotland, the Faroe Islands nearby used to belong to Denmark, even if she has now been granted some autonomy. Corsica is a part of France and Sardinia a part of Italy. But the reason why Iceland, Estonia, Slovenia and some other small nations in Europe wanted to form their own states was that they self-identified as nations. They, or at least an overwhelming majority of their population, felt that they shared something intrinsically valuable with other members of the same group and that they were better off by sharing political power between themselves, if possible, than by relinquishing it to distant masters. They could no less help belonging to the same nation than family members could help being related to one another, even if the national ties were mostly historical rather than biological. The nation was a fact of which they became conscious rather than an invention, let alone a fantasy, as Professor Hobsbawm and some other scholars claim.

The relatively recent increase in the number of independent small states does not only make economic sense, since small states do not tend as much as larger ones to pursue inefficient protectionist policies. It also makes political sense: It implies devolution, decentralisation, increased cohesion of the political unit, a healthy proximity between the rulers and the ruled, an increased sense of participation. As Anglo-Austrian economist and Nobel Laureate Friedrich A. Hayek wrote in *The Road to Serfdom*: "In a small community common views on the relative importance of the main tasks, agreed standards of value, will exist on a great many subjects. But their number will become less and less the wider we throw the net: and as there is less community of views, the necessity to rely on force and coercion increases." Hayek goes on to offer a view on small states diametrically opposed to that of Marx and Engels: "It is no accident that on the whole there was more beauty and decency to be found in the life of the small peoples, and that among the large ones there was more happiness and content in proportion as they had avoided the deadly blight of centralisation."[35] Sociologists Jan Delhey and Kenneth Newton reinforce Hayek's argument in their research. They find that the more homogeneous the population is, the higher the level of trust will be. The prime example is the Nordic countries, but the pattern is similar elsewhere.[36] Moreover, in a comprehensive comparative study, Swedish economist Heather C. Fors finds, contrary to what Professor Sibert would suggest, that small island states tend to have better institutions and to perform better economically than is the average.[37]

However, as critics of national self-determination hasten to point out, this leaves unresolved the problem of national minorities, Russians in Estonia, Serbs in Slovenia, and so on. Suffice it to say, here, however, that many such states are small and homogeneous enough that there are very small minorities there, unlike Czechoslovakia which had both the Sudeten Germans and the Slovaks within her borders, or Yugoslavia, not to mention first the Russian and then the Soviet Empire. Of course, support for the establishment of small states is not support for the oppression of minorities within their borders. Even if such minorities have sometimes been forcibly moved to the countries in question, against the will of the original population, that cannot be a ground for depriving members of those minorities of the rights that every human being should enjoy. Moreover, as Renan pointed out, the existence of a nation can only be maintained in a daily plebiscite. The citizens must be able to exit. If one is to love one's country, it has to be lovely.[38]

This suggests yet another political argument for the proliferation of small states: It increases the informal competition between states, large and small, about citizens, or rather tax-payers and wealth creators, and may thus act as a constraint on the abuse of power.[39] This argument was forcefully stated by Edward Gibbon in his celebrated *History of The Decline and Fall of the Roman Empire:*

> The division of Europe into a number of independent states, connected, however, with each other, by the general resemblance of religion, language and manners, is productive of the most beneficial consequences to the liberty of mankind. A modern tyrant who should find no resistance either in his own breast or in his people, would soon experience a gentle restraint from the example of his equals, the dread of present censure, the advice of his allies, and the apprehension of his enemies. The object of his displeasure, escaping from the narrow limits of his dominions, would easily obtain, in a happier climate, a secure refuge, a new fortune adequate to his merit, the freedom of complaint, and perhaps the means of revenge. But the empire of the Romans filled the world, and, when that empire fell into the hands of a single person, the world became a safe and dreary prison for his enemies. The slave of Imperial despotism, whether he was condemned to drag his gilded chain in Rome and the senate, or to wear out a life of exile on the barren rock of Seriphus or the frozen banks of the Danube, expected his fate in silent despair. To resist was fatal; and it was impossible to fly. On every side he was encompassed with a vast extent of sea and land, and restored to his irritated master. Beyond the frontiers, his anxious view could discover nothing except the ocean, inhospitable deserts, hostile tribes of barbarians, of fierce manners and unknown language, or dependent kings, who would gladly purchase the emperor's protection by the sacrifice of an obnoxious fugitive. 'Wherever you are,' said Cicero to the exiled Marcellus, 'remember that you are equally within the power of the conqueror.'[40]

A common European market, or better still, a world market, is desirable because then all European nations benefit from the international division of labour. A European Empire, replacing the Roman Empire, unified and harmonised, may however be more of a danger to political freedom, for the reasons stated by Gibbon. There may be a common European identity, slowly forged in a millennium, from the battle of Tours in 732 to the siege of Vienna in 1683, when the Christian nations of Europe successfully resisted invasions from the South, but it is hardly strong enough to serve as the basis for a European state. •

33 Karl R. Popper, The History of Our Time: An Optimist's View, Conjectures and Refutations (London: New York, 2002), p. 494.

34 Ernest Renan, What Is a Nation? Lecture 1882. Many English editions, including Nation and Narration, ed. Homi K. Bhabha (New York: Routledge, 2004), p. 19.

35 Friedrich A. Hayek, The Road to Serfdom (London: Routledge & Kegan Paul, 1979, originally published 1944), pp. 164–5 and 174.

36 Jan Delhey and Kenneth Newton, Social Trust: Global Pattern or Nordic Exceptionalism, Discussion Paper, Wissenschaftszentrum Berlin für Sozialforschung (Berlin, June 2004).

37 Heather C. Fors, Do island states have better institutions? Journal of Comparative Economics, Vol. 42 (2014), pp. 34–60.

38 Edmund Burke, Reflections on the Revolution in France (London: J. Dodsley, 1790), p. 116.

39 See various papers in Tax Competition: An Opportunity for Iceland? eds. Hannes H. Gissurarson and Tryggvi Thor Herbertsson (Reykjavik: University of Iceland Press, 2001).

40 Edward Gibbon, The History of he Decline and Fall of the Roman Empire, Vol. I, Ch. III (New York: Harper & Brothers, 1841, originally published 1783), p. 49.

5

ECONOMIC GROWTH AND VOLATILITY

While small economies tend actually to be wealthier than bigger ones, they have of course their own problems. In her paper, Professor Sibert tried to identify a few. She says that formal empirical evidence linking size to growth-promoting policies appears to be lacking:

> Easterly and Levine (1997) find a strong negative correlation between ethnic diversity and indicators of growth-promoting public goods such as the number of telephones and paved roads and the amount of schooling. However, Easterly and Kraay (1999) assert that a lack of consistent data makes it hard to test whether small size is associated with growth-promoting public goods.

She also says: "Easterly and Kraay (1999) find that, after controlling for location, small states are wealthier than large states but do not have significantly different growth rates."

Here, however, Professor Sibert seems to make the opposite point to what she wants to do. The 1997 study by Easterly and Levine about Africa states found that the more heterogeneous they were, the less economic growth they tended to have. This is an argument for smaller and more homogeneous states, not against them. These findings therefore also seem relevant to the five Nordic countries, Sweden, Denmark, Finland and Norway as well as Iceland.[41] As noted earlier, they are, or have until recently been, very homogeneous, and despite political conflicts, inevitable in every well-functioning democracy, they have developed a strong social consensus. The reason why the rather small Nordic nations are relatively wealthy may be that they have been able to maintain open and competitive economies, as a result of this consensus. Moreover, because of their homogeneity, they could perhaps cope better than many other nations with the growth of government which they all experienced in the 20th century. The Icelanders, living on an island far from other countries where immigration has been negligible, may indeed form one of the most homogeneous nations in the world, as Karl Popper observed: Basically all Icelanders speak the same language, share the same religion and are descended from the same original settlers. It should be noted, however, that such homogeneity can both be a benefit and a cost. It may facilitate social interaction, but it may also limit innovation and the expression of individuality (although that is not mentioned by Sibert).

While Professor Sibert sees no clear evidence that small states experience higher average growth rates than big states, surely the very fact that small states tend to be wealthier than bigger states, over the long term, would be regarded by most as sufficient evidence. A country becomes wealthy by the growth of her economy. Be that as it may, Sibert also says that the recent experience of Iceland suggests that small states have more volatile growth rates. "Iceland's output growth is less smooth than that of either the UK or the US. The reason for this seems clear. As a small country, Iceland has far less diversified in endowments and production than the much larger UK or US." She quotes studies that purport to show a negative correlation between variances of both output growth and consumption growth on the one hand and population size on the other hand.[42] She recognises that there are exceptions, such as Norway and Luxembourg, but she notes that for example the Icelandic economy is highly volatile. Professor Baldur Thorhallsson makes a similar argument. Small states rely on special markets and special products. "This makes them more vulnerable to international economic fluctuations and structural change in the world economy. Economic downturns may hit small states swiftly and can become deeper than in large states, particularly if the narrow-based export industry is badly hit."[43]

Undeniably, Iceland's economy was and is more volatile than many bigger economies. The direct cause of this is not however that it is small, but rather that it has largely been undiversified, close to being a single commodity economy, relying primarily on the export of fish. Some much bigger countries have also been close to being single commodity economies, for example Chile with her copper mines, Cuba with her sugar plantations and New Zealand with her sheep farms. Nevertheless, while much bigger than the Icelandic economy, these economies admittedly are relatively small: As Professors Sibert and Thorhallsson correctly point out, in general smallness does not allow for the same diversification as bigness. Therefore, the smallness of the Icelandic economy can be regarded as an indirect cause of its volatility. This has been changing, however, in the last few decades, for two main reasons. The ITQ system has stabilised the fisheries by largely removing one important risk factor, fluctuation in catch from one fishing season to another (while Iceland still has to deal with another risk factor, fluctuation in price). The second reason why volatility has been somewhat reduced is that the economy has been diversifying. The energy sector is important, and the aluminium factories which buy electricity from it; tourism has been greatly increasing; and human capital seems to be accumulating.

Moreover, the Icelanders have a long experience in dealing with economic volatility. The economy is transparent and flexible, and adjustments to external shocks tend to be quick. In Iceland, as in many other small states, economic flexibility tend to coincide with political stability. The words of Professor Peter Katzenstein seem particularly apt about Iceland:

> The adjustment strategy of the small European states is summed up by the story of the snake, the frog, and the owl. Fearful of being devoured by the snake, the frog asks the owl how he might survive. The owl's response is brief and cryptic. Learn how to fly. None of the small European states have to soar like the eagle. What they have learned to cultivate is an amazing capacity to jump. Although they appear to land on their stomachs, in fact they always land on their feet and retain their ability to jump again and again in different directions, correcting their course as they go along. In a world of great uncertainty and high-risk choices, this is an intelligent response. Frogs can escape snakes, and the small corporatist states can continue to prosper—not because they have found a solution to the problem of change but because they have found a way to live with change.[44]

It is interesting, however, given Katzenstein's emphasis on corporatism in small European states, that Iceland is not a typical corporatist state: Unlike the three Scandinavian countries she does not have an extensive welfare system, and the labour market has until recently not been characterised by any kind of social contract. Neither is Switzerland, for that matter, a typical corporatist state. This suggests that the explanation for the adaptability of small states, their singular combination of political stability and economic flexibility, should be sought elsewhere than in generous welfare benefits or in relatively stable labour relations, as Katzenstein would have us believe.

Moreover, economic volatility is not confined to small states. Big economies are not immune to sudden shocks. After all, the Great Depression of the early 1930s and the great financial crisis of 2007–9 both had their origin in the United States, the world's largest economy. Volatility is not only economic; it can be political, too. In 1930, the German economy was the largest one in Europe.[45] The Great Depression had the effect on Germany that in 1933 Hitler's Nazis took power, starting the 2nd World War some six and a half years later and committing unbelievable atrocities. When Iceland was occupied by the British in the spring of 1940, there were only six functioning democracies in Europe, the United Kingdom, Ireland, Sweden, Switzerland, Finland—and Iceland. Five of the six would hardly be considered big countries. •

41 William Easterly and Ross Levine, Africa's Growth Tragedy: Policies and Ethnic Divisions, Quarterly Journal of Economics, Vol. 112 (1997), 1203–1250.

42 Allen C. Head, Country Size, Aggregate Fluctuations, and International Risk Sharing, Canadian Journal of Economics, Vol. 28 (1995), 1096–1119.

43 Baldur Thorhallsson, Domestic buffer versus external shelter (2011), pp. 325.

44 Peter J. Katzenstein, Small States and Small States Revisited, New Political Economy, Vol. 8 (1: 2003), p. 27. Katzenstein is quoting from his earlier book, Small States in World Markets: Industrial Policy in Europe (Cornell University Press, 1985).

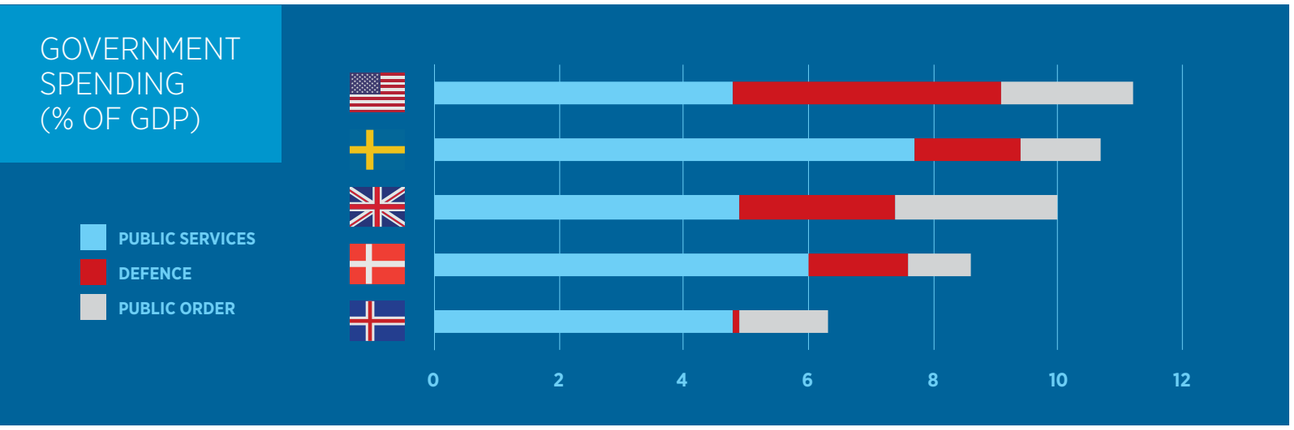
45 Angus Maddison, Historical Statistics for the World Economy, 1–2003 AD. GDP Levels, International Geary-Khamis dollars. The Maddison-Project. Retrieved at http://www.ggdc.net/maddison/maddison-project/home.htm, 2013 version

6

THE COSTS AND BENEFITS OF SMALL SIZE

Professor Sibert lists three additional costs of a tiny population. "First, as the provision of many public goods has an important fixed cost component, the per capita cost of public good provision is likely decreasing in country size." At first sight, this seems plausible. For example, one government activity which would definitely seem to have an important fixed cost component would be a country's foreign service. Could Greenland and the Faroe Islands for example sustain their foreign services? The most important change when Iceland revoked the 1918 Danish-Icelandic Act of Union was indeed that she took foreign affairs into her own hands.[46] Previously, Denmark had represented Iceland abroad. It is therefore interesting to compare the sizes of the British and Icelandic foreign services. In 2013, the staff of the British foreign service was around 14,000, in a country of 64.1 million, while the staff of the Icelandic foreign service was around 250, in a country of 320,000.[47] In other words, the proportion of people employed in the foreign service was 0.0002% in the United Kingdom and 0.0008% in Iceland. Thus, the Icelandic foreign service was relatively bigger than its British counterpart, but it is also clear that the expenditure on it was really insignificant. It does not make or break a nation whether it spends 0.0008% or 0.0002% of its GDP on a foreign service. Therefore, Sibert's point about some public goods, especially those which go with statehood, may be true, but it may also be of little relevance, as the cost of their provision seems to be just a tiny fraction of total government expenditures, let alone gross domestic product.

Moreover, this claim becomes less plausible when other and perhaps more relevant data are analysed. Consider expenditures in Iceland and some of its neighbouring countries in 2006 on three core government functions: general public services—the executive and legislative organs, external affairs and public debt transactions—and defence, and public order and safety (here as % of GDP):[48]



46 Out of necessity, Iceland had actually done this already in the spring of 1940, after Denmark was occupied by Nazi Germany.

47 On the UK: A Short Guide to the Foreign & Commonwealth Office (London: National Audit Office, June 2015), 3. On Iceland: Information from Urdur Gunnarsdottir, press officer at the Icelandic Ministry of Foreign Affairs.

48 Government at a Glance 2009, Table 5.1. (Paris: OECD, 2009).

These data were picked because they would have been available to Professor Sibert when she was writing in 2009. It can be seen that the proportion of GDP spent on general public services in 2006 was actually lower in Iceland than in much bigger countries.

The provision of another public good, defence, indeed seems to cost relatively less in small countries than in big ones. Iceland spends almost nothing on defence, and two small countries, Sweden and Denmark, spend much less on it relatively than the two much bigger countries, United Kingdom and the United States. Arguably, this is because small countries tend to be "free riders" in matters of international security. But there is also another possible, and related, explanation: Small countries are usually not as belligerent as big ones. They have not the same tendency to embark on military adventures, simply because they perceive their lack of capacity to do so.[49] It is almost a tautology that small countries are not tempted to engage in empire building (with some short-lived exceptions such as Ancient Athens and Venice in the Middle Ages). To paraphrase the description by the famous Austrian journalist Karl Kraus of psychoanalysis: Perhaps militarism is the mental illness for which it regards itself as therapy.[50] Be that as it may, the fact about defence in modern times seems to be quite the reverse of what Professor Sibert asserts. The per capita cost of defence is increasing rather than decreasing by country size.[51]

The provision of the third public good, order and safety, costs about the same relatively in the three Nordic countries in the sample, Sweden, Denmark and Iceland. However, expenditures on public order and safety in the two much bigger countries, the United Kingdom and the United States, are almost double, as a proportion of GDP, what they are in the Nordic countries. There is an obvious explanation for this which has already been discussed: The Nordic countries are, or have until recently been, quite homogeneous, with a high level of mutual trust, and spontaneous social monitoring is probably more powerful than in the UK and the US. Therefore, law enforcement actually turns out to be relatively cheaper than in the two bigger countries in the sample. Again, contrary to what could be inferred from Professor Sibert's analysis, here is an example where the per capita cost of providing a public good is increasing rather than decreasing by country size. Perhaps a more plausible correlation would be between the per capita cost of providing a public good and the heterogeneity of the country rather than its size, but then it has to be stressed that heterogeneity is usually more common in big rather than small states.

When all three core government functions are considered together the result is clear: In total, Iceland spends 6.3% of GDP on them and the US 11.2%. There seems to be a pattern here: The smaller countries in this sample spend relatively less on public goods than the bigger ones. If Professor Sibert has a point, then it is not a point directly relevant to that region of the world where Iceland finds herself. A thesis opposite to hers has been argued by an anthropologist, Professor Joseph Tainter. According to him, the more complex societies become, the more costs of meeting new challenges rise, until they reach a point where extra resources devoted to meeting new challenges produce diminishing and then negative returns. At this point, societies become less complex. They collapse. This is for example, Professor Tainter submits, what happened to the West Roman Empire.[52] Perhaps computers and the internet have simplified some tasks that a modern public administration has to perform. But this would be the case in small as well as big countries. Another way of illustrating the inefficiency of big bureaucracies is by a simple calculation of the costs of communication within an administrative structure. Compare two bureaucracies, with three levels in a small country and five levels in a big country. Assume that a bureaucrat on each level uses 9/10 of his time to implement the orders and wishes communicated to him by his superior and 1/10 for other purposes. This means that the man on the third level in the small country uses $(9/10)^3$ of his time, or 72.9%, to implement the orders and wishes communicated to him by the chief administrator whereas the man on the fifth level in the big country uses $(9/10)^5$ of his time, or 59.0%, to do this.[53]

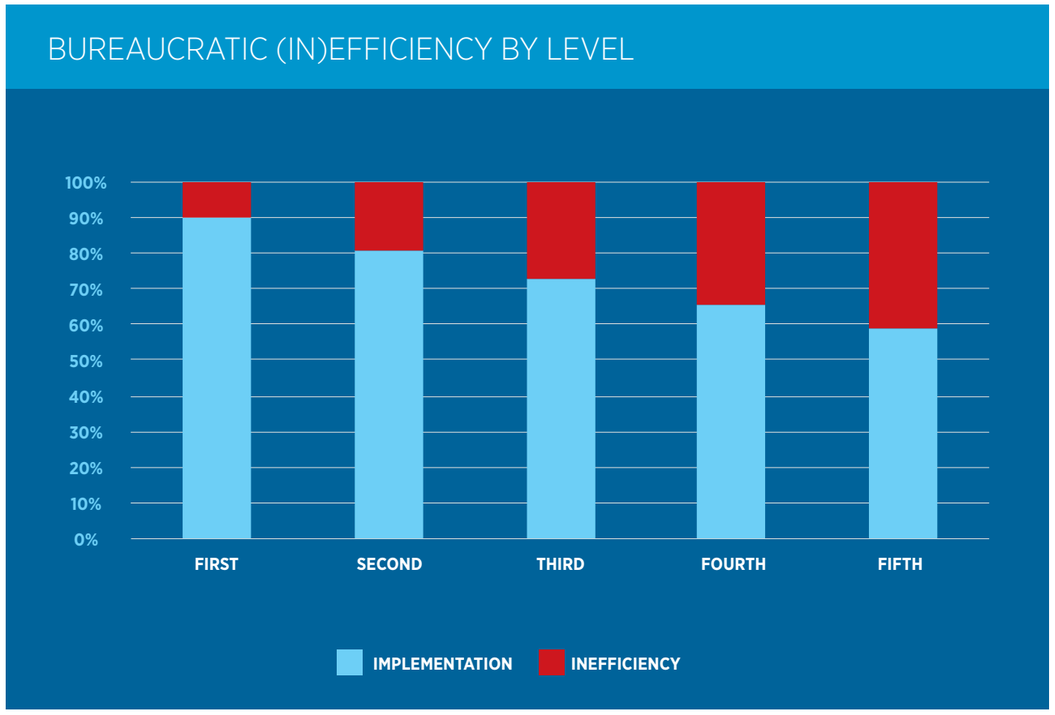
49 Fridtjof Nansen, The Mission of the Small States, The American-Scandinavian Review, Vol. 6 (1: 1918), pp. 9–13.

50 "Psychoanalyse is jene Geistekrankheit, für deran Therapie sie sich hält." Karl Kraus, Die Fackel, 30 May 1913, p. 21.

51 This does not seem to have changed since 2006, see the World Bank, Military expenditure (% of GDP). Retrieved at http://data.worldbank.org/indicator/MS.MIL.XPND.GD.ZS

52 Joseph Tainter, The Collapse of Complex Societies (Cambridge: Cambridge University Press, 1990).

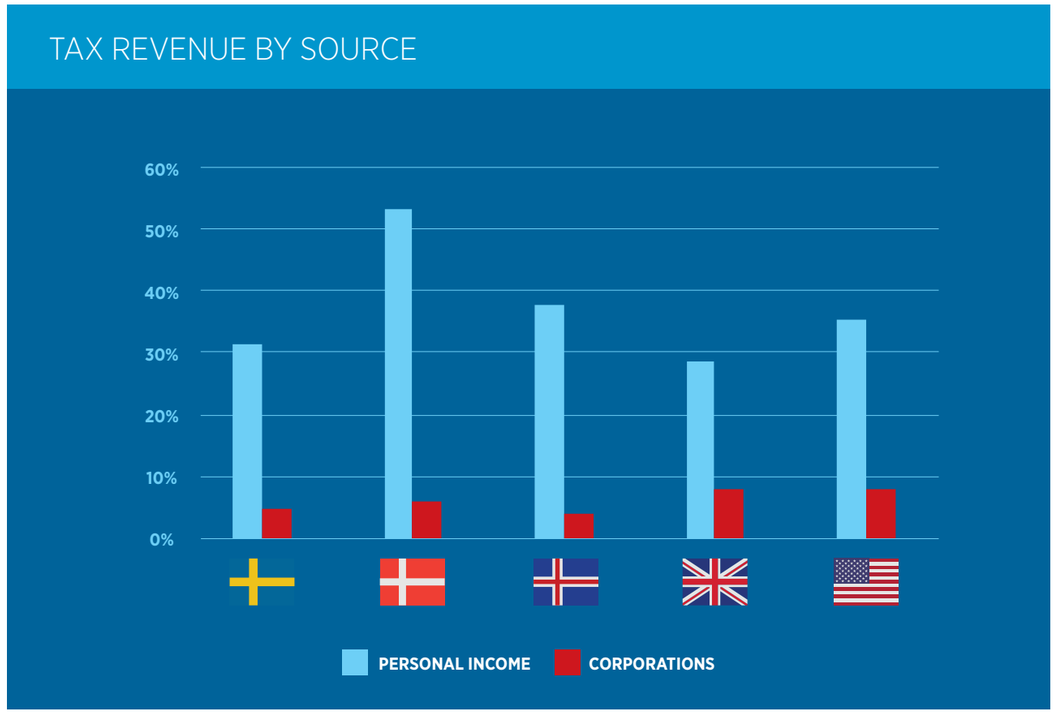
53 The example is mine, but the argument is developed in detail in Gordon Tullock, The Politics of Bureaucracy (Washington DC: Public Affairs Press, 1965).



Complexity has its costs. In vast government bureaucracies in big countries there are few short-cuts and limited transparency, often found however in small countries. As Professor Sibert worries about Greenlandic autonomy it should be observed that a bureaucrat in Copenhagen in Denmark may be intelligent, hard-working and well-intentioned, but inevitably there will be problems of communication between him and the Inuits in Greenland. One argument for autonomy is that decisions tend to be more in accordance with local knowledge if they are made at a local level.

The second additional economic cost caused by a small population is, according to Professor Sibert, that it is "likely that the per capita administrative cost of income taxes is decreasing in country size. As a result, smaller countries tend to rely less on relatively efficient income taxation and more on relatively inefficient taxes, such as customs taxes." In support of her claim, Sibert quotes a 1993 paper by economists Easterly and Rebelo. They had found that the bigger the population was, the more the country tended to rely on income taxes. For example, in the 18th century almost all US tax revenue came from customs, whereas this source of revenue provided little in late 20th century. The main explanation provided by Easterly and Rebolo for this connection was that costs of administration and compliance were different for different sources of tax revenue. Customs require little overhead expenditure, but are costly to administer per unit of tax collected. Income taxes imply high overhead costs, but once such costs are paid, the marginal cost of an additional unit of tax collection is low.[54]

There may have been a strong correlation between income, the structure of tax revenue and the scale of the economy in the sample studied by Easterly and Rebelo. But their results seem not to be directly applicable to Iceland, at least not in recent years. Consider the different sources of tax revenue in the five countries which have been compared here. In 2003–4, revenues from the personal and corporate income taxes were as follows there (as % of total tax revenue):[55]



The ratio of the revenue from personal income tax to total tax revenue turned out to be higher in Iceland than in Sweden, the United Kingdom and the United States, but lower than in Denmark. These figures, published in 2006, would have been available to Professor Sibert when she wrote her paper. Not many comparative data are available on the ratio of administrative costs and net revenue collections (i.e. costs per 100 units of revenue) in different countries, but in 2004 it was reported to be 0.59 for Sweden, 0.83 for Denmark, 1.02 for Iceland, 0.97 for the United Kingdom, and 0.56 for the United States.[56] It was true, in other words, not unsurprisingly, that the costs of tax administration and compliance were higher in Iceland than in bigger economies, but these costs were by no means significant and only a little higher than in the much bigger economy of the United Kingdom.

The third additional cost from a small population is, according to Professor Sibert, that the "lack of competition in the provision of non-traded goods in small countries can lead to inefficiency." This may be more plausible than her other two claims. A small country like Iceland is, for example, unlikely to have the financial means to operate more than one or two high-quality hospitals or one or two first-rate universities. Such institutions simply require more human and physical capital than Iceland could provide on her own. It would actually be more likely that no such hospitals or universities were to be found in the country. And if there are too few such institutions in the country, then there will be no proper evaluation of different results produced by different structures. Another example is the National Power Company of Iceland (Landsvirkjun) which produces electricity from both hydro-electric and geothermal power plants. It is difficult to find out whether it is really making the most efficient decisions since no other comparable company is operated in the country.

The question is however whether this kind of inefficiency is necessarily and directly bound up with the smallness of an economy, or rather with the fact that the goods are non-traded. Moreover, some such goods may not contribute much to a country's economic performance. Consider universities. Intellectuals, typically employed by universities, tend to exaggerate their economic benefits. Luxembourg, the wealthiest country

54 William Easterly and Sergio Rebelo, Fiscal Policy and Economic Growth: An Empirical Investigation, Journal of Monetary Economics, Vol. 32 (1993), pp. 417–57.

55 Tax Administration in OECD and Selected Non-OECD Countries: Selective Information Series (Paris: OECD, 2006), Table 22.

56 Ibid., Table 24.

in Europe, did not have a university until 2003. Surely Hong Kong and Singapore did not achieve economic success because of their universities. In a 2003 OECD study it was found, to the surprise and embarrassment of its authors, that while privately funded research and development stimulated economic growth, publicly funded research and development had no such impact.[57] In other words: Basic education may be a public good, but it is not at all certain that the kind of science carried out in universities generally is. But what about clearer cases of non-traded public goods? One response to Professor Sibert's claim about them is that sometimes such non-traded goods can be produced in cooperation with bigger countries, thus overcoming the limits of size. Arguably, for example, a reasonably good health care system is necessary to maintain economic growth, but elements of competition could be introduced into such a system by diversifying over countries: The Icelandic hospitals may have competent teams to undertake some tasks, while other tasks would be delegated to hospitals in the US, the UK, Sweden or Denmark. Moreover, small countries may benefit from the extensive medical research and development taking place in big countries such as the United States, without having to pay the full price for it. As in defence, they would be "free riders" on medical research and development. Non-traded goods can also become tradable as a result of technological innovation. Competition is for example now possible in telecommunications, also in Iceland.

None of this can however change the fact, pointed out by Professor Sibert, that competition and specialisation are not likely to be as extensive in certain sectors of a small economy as they would be in a bigger economy. Even if Professors Sibert and Thorhallsson, with their obvious agenda of European political integration, may exaggerate the costs of small size, and overlook or ignore some of its benefits, smallness has its costs. •

57 The Sources of Economic Growth in OECD Countries (Paris: OECD 2003), p. 17. http://www.oecd-ilibrary.org/economics/the-sources-of-economic-growth-in-oecd-countries_9789264199460-en

7

SIZE AND NATURAL DISASTERS

Having discussed recent research on wealth and economic growth and some possible additional costs of small populations, Professor Sibert adds:

> I have focused on costs associated with small populations, but there is also an important cost associated with small geographical size. Many countries are vulnerable to natural disasters and environmental damage and self-insurance against these sorts of shocks is easier for larger countries. If an American city is damaged by a hurricane, residents can move to another American city. If global warming causes sea levels to rise sufficiently, the consequences for the residents of Tuvalu are likely to be less favourable.

This is a valid point, but it is somewhat peculiar to introduce it in connection with a discussion about whether or not Iceland and Greenland are feasible political units, because both countries are indeed quite big, even if thinly populated. Iceland is approximately 103,000 square kilometres, the 17th largest country in Europe, out of 50 countries. If the sea level would rise, even only slightly, then the Netherlands would be much more vulnerable, for example, than Iceland. And Greenland is indeed the largest island in the world.

That is not to say that Iceland is not vulnerable to natural disasters and environmental damage. It surely is, but this is not because it has a small population, but because the country is not very hospitable. Volcanic eruptions, earthquakes, avalanches, and cold spells both in the short summer and the long winter have ravaged the country almost from the beginning. But, again, the Icelanders have learned to cope with such difficulties, and they have usually recovered quickly from natural disasters, as Bishop Hannes Finnsson pointed out in a book written shortly after great hardships visited on the nation in the early 1780s resulting from volcanic eruptions and earthquakes.[58]

Professor Sibert makes another point, often seen in the literature on small states, that self-insurance against natural disasters is easier for larger countries. This seems plausible, but perhaps more so in theory than practice. Actuaries may, in their calculations, focus on the apparent fact that there seem to a be larger number of people who are sharing the risks. But whether or not non-affected parts of a large country are willing to share in the costs of natural disasters in one part of the country would depend on the kind of regime in place. It is not clear, for example, that in very big countries such as China, India and Russia the ruling elites in the capitals are much concerned about calamities in distant corners of their territories. Big countries tend to be heterogeneous: This means that victims of a natural disaster in one part of the country may not expect the same solidarity from the rest of the population as would be the case in smaller and more homogeneous countries. Moreover, big countries have big bureaucracies which tend to move slowly. Even if a decision is made to assist some hard-hit area in a remote corner of a country, it then needs to be implemented. Consider the UK and the US, two big countries much more homogeneous than China, India and Russia. Relief was not quick to arrive to Ireland in the famines of the late 1840s, or to Louisiana in 2005 after hurricane Katrina ravaged the state. Self-insurance can also be "temporal" rather than "spatial". If a country is vulnerable to natural disasters, then it may try to soften the effects by establishing special emergency and relief funds. This has been the case in Iceland, where there is a strong social consensus that victims of volcanic eruptions, earthquakes, and avalanches should be compensated to the extent possible. •

58 Hannes Finnsson, Mannfaekkun af hallaerum [Depopulation by Hardships], 2nd ed. (Reykjavik: Almenna bokafelagid, 1970).

8

SIBERT'S ATTACK ON DAVID ODDSSON

Professor Sibert adds yet another special cost for small nations. It is the burden it places, according to her, on senior government officials. "First, it is difficult for such a small country to find enough talented civil servants, and second, each civil servant is forced to play more roles than he would in a more populous society." She gives an example:

> In October 2005, David Oddsson was appointed chairman of the board of governors of the Icelandic central bank. The multi-talented Oddsson had studied law, been a theatre director, the producer of a comedy radio show, a political commentator, and the co-author of several plays. He had previously been the mayor of Reykjavik, a long-time prime minister and, for a brief period, the foreign minister. Unfortunately, he appears to have had no expertise in economics and banking and was ineffective at either averting the financial crisis or playing a positive role in its aftermath. — In addition to Oddson's [sic] apparent acquiescence in the face of looming disaster, neither the prime minister, nor the finance minister or financial regulator seems to have made any serious attempt to stem the growth of the Icelandic banks. This suggests that a significant cost of small size is the burden that it places on senior government officials.

Professor Baldur Thorhallsson makes a similar general point, albeit in a different context, writing about the "lack of expertise and limited human resources in Iceland's central bureaucracy."[59]

The general point is certainly worth discussing: Does a small nation have a sufficiently large talent pool for operating an independent state? But first, Professor Sibert's extraordinary personal attack on David Oddsson, the leader of the conservative-liberal Independence Party in 1991–2005 and Prime Minister in 1991–2004, calls for several comments. First, there are some inaccuracies in it: Oddsson was never a theatre director nor a professional political commentator. (During his years as a law student, he was part-time secretary to a theatre director in 1970–1972 and a part-time parliamentary reporter for *Morgunbladid* in 1973–1974.)[60]

In the second place, for most of his adult life David Oddsson was not a civil servant, but a politician. It has often been regarded as an advantage for a political leader to have some abilities and interests outside of politics, or to be "multi-talented" as Professor Sibert puts it. UK Prime Minister Winston Churchill was for example an accomplished writer (receiving the Nobel Prize in Literature in 1953), a former soldier and a amateur landscape painter. Another widely-admired politician, US President Thomas Jefferson, was a farmer, architect, and philosopher. It might be argued that an efficient political leader has to be mature, responsible, skilful in communicating with others, possessing common sense and sound judgement, and that this can probably only be acquired by experience, preferably in many fields. Some of these considerations may also apply to leaders in other fields than politics. Economists need not be reminded of John Maynard Keynes, who pursued many interests outside of economics: he was a connoisseur rather than a dilettante. As Friedrich A. Hayek wrote: "The physicist who is only a physicist can still be a first-class physicist and a most valuable member of society. But nobody can be a great economist who is only an economist—and I am even tempted to add that the economist who is only an economist is likely to become a nuisance if not a positive danger."[61]

Thirdly, before David Oddsson became Prime Minister, he had, as Professor Sibert mentions, been Mayor of Reykjavik for nine years, so he had in effect been the general manager of one of Iceland's largest company. Then, he had been Prime Minister of Iceland for more than thirteen years, closely involved with designing and implementing economic policy: In Iceland, the Prime Minister traditionally is in charge of general economic policy. It sounds therefore strange to say of someone with a past career like that of Oddsson that he appeared "to have had no expertise in economics and banking." What Sibert is presumably criticizing is Oddsson's appointment in 2005 as one of the three governors of the Central Bank of Iceland. But it can be argued that his long and varied experience provided a better preparation for such a job than a Ph. D. in technical economics. A governor of a central bank needs leadership qualities such as common sense and sound judgement rather than technical skills to be displayed at seminars.

Fourthly, at the risk of stating the obvious, people with academic degrees in economics are by no means infallible. Oddsson was one of the governors of the CBI in the period leading up to the international financial crisis of 2007–9. He regularly met with his colleagues from other Western countries, governors of the central banks of much bigger countries. None of them seemed to have an inkling that a crisis was approaching. They were almost all taken by surprise, even if many of them had an acknowledged "expertise in economics and banking", including Dr Alan Greenspan of the US Fed and Dr Mervyn King of the Bank of England.

Other less well known experts also failed to foresee the financial crisis, let alone the Icelandic bank collapse. Professor Sibert quotes Economics Professor Thorvaldur Gylfason.[62] But in her testimony to the SIC, the Special Investigation Commission on the bank collapse, the leader of the Social Democrats, Foreign Minister Ingibjorg S. Gisladottir, said that she had sought the advice of Gylfason on economics and that he had never suggested anything such as an imminent bank collapse.[63] Sunday 5 October 2008, as the Icelandic banks were about to collapse, Professor Gylfason appeared on a television programme and talked about the necessity of relocating Reykjavik airport, thus acquiring building lots which could be worth 78 billion Icelandic kronur, he said, then equivalent to $0.9 billion or £0.5 billion.[64] This does not suggest much awareness of a coming economic collapse. Another example would have been available to Sibert. On 10 July 2008, Gylfason published an article in the very same online magazine, VOX, where she published her piece 13 months later. In this article, Gylfason made some criticisms of economic policy in Iceland, for example that the CBI was not building up "adequate foreign exchange reserves", but he concluded: "Even so, thanks in part to its young people who keep returning home from abroad, Iceland's medium-term prospects are bright."[65] This was only three months before the bank collapse. •

59 Baldur Thorhallsson, Iceland's contested European Policy, Jean Monnet Occasional Paper (Msida, Malta: University of Malta Press, 2013), p. 15.

60 There is a short overview of Oddsson's career in David Oddsson i myndum og mali 1948–2008 (Reykjavik: Samband ungra sjalfstaedismanna, 2008).

61 Friedrich A. Hayek, The Dilemma of Specialization, Studies in Philosophy, Politics and Economics (London: Routledge and Kegan Paul, 1967), p. 123.

62 She misspells his name as Thorvaldor. Indeed, she misspells the name of almost all the Icelanders she mentions!

63 SIC Report, Vol. 6, Ch. 19, p. 140.

64 Transcript of interview with Thorvaldur Gylfason 5 November 2008 in "Silfur Egils" on Icelandic government television station, provided by Creditinfo. Professor Gylfason quoted an official report, Reykjavikurflugvollur – Uttekt a framtidarstadsetningu [Reykjavik Airport – A Report on Its Future Location] (Reykjavik: Samgonguraduneytid and Reykjavikurborg, April 2007). According to the report, the land on which the airport was built was worth an estimated 74 billion Icelandic kronur in April 2007.

65 Thorvaldur Gylfason, Iceland's blend of old and new, VoxEU.org 10 July 2008. http://voxeu.org/article/iceland-and-its-financial-predicament-history-and-context

9

WAS THE CBI LEADERSHIP ACQUIESCENT IN THE FACE OF DISASTER?

Professor Sibert speaks of David Oddsson's "apparent acquiescence in the face of looming disaster". In the same vein, Professor Thorhallsson submits that the CBI underestimated the "risk of foreign currency shortage and later lack of access to foreign currency." Thorhallsson adds that the CBI had committed the error of focusing too narrowly on the risk involved in operations of individual banks instead of giving "a much wider attention" to "the risk involved in the operation of the financial sector as a whole."[66]

These criticisms of the CBI leadership are not well-grounded.[67] First, it should be noted that while Oddsson was Prime Minister and therefore at more liberty to speak his mind than later as CBI governor, he had been an outspoken critic of the bankers' excesses. Friday 21 November 2003, for example, Oddsson went to the newly-privatised Bunadarbanki and closed his private savings account there in protest against generous share deals that the new leadership of the bank had made with themselves. Publicly, he expressed dismay at the behaviour of the bankers, quoting a famous passage on greed from the *Hymns of the Passion* by the 17th century poet Hallgrimur Petursson.[68] His action sent shock waves through Icelandic society: Some depositors immediately followed Oddsson in withdrawing money from the bank, while important shareholders became uneasy. Subsequently, the bank leadership backed out of the share deals. They did so grudgingly. Sigurdur Einarsson, Chairman of Bunadarbanki's Board, said that "he found it strange that a nation's leaders could attack a private company in this way. This would not happen anywhere else except perhaps in Russia and some African countries."[69]

In the autumn of 2005, when Oddsson took office as one of the three CBI governors, the Icelandic banks had already been rapidly expanding for two years. Their combined external growth had been 57.5% in 2004 and 24.7% in 2005, and was negligible after that. Their organic real growth had been 43.5% in 2004 and 59.5% in 2005, falling to 27.2% in 2006 and 28.8% in 2007.[70] In other words, in his new job Oddsson faced *a fait accompli.* If the banks had become too big, then this had already happened

66 Baldur Thorhallsson, Domestic buffer versus external shelter (2011), p. 328.

67 As a member of the CBI Board of Overseers 2001–2009 I could observe this personally. However, in what follows I only refer to warnings and admonitions which were recorded.

68 Hallgrimur Petursson, Hymns of the Passion, tr. by Arthur Charles Cook (Reykjavik: Hallgrimskirkja, 1978), 16, 8. The verse is a variation of Timothy 1, 6, 10: "For the love of money is the root of all evil."

69 Falla fra kauprettinum vegna hardrar gagnryni, Morgunbladid 22 November 2003.

70 SIC Report (English version), Vol. 7, Chapter 21, Table 1, p. 2. The difference between external and organic growth is, briefly, that the former consists in acquisitions and the latter in the expansion of business by means of an increase in output or the number of customers and the development of new products.

when he took office. It has to be stressed, too, that the CBI did not regulate the banks. Only the IFSA, Icelandic Financial Supervisory Authority, had access to the relevant information on the Icelandic financial market and powers to act on such information.

What the CBI could was to advise the IFSA, Icelandic Financial Supervisory Authority, and the government. So it did. For example, Friday 9 February 2007, at a meeting of the management of the CBI and the IFSA, Governor David Oddsson "said that the question was now when the liquidity and equity of the banks were again good, whether the bankers would not be tempted to begin a new expansion abroad. He added that in the case of problems, liquidity could disappear in one day."[71] Friday 30 March 2007, Governor Oddsson spoke at the annual meeting of the CBI, recalling a short-lived crisis of the previous year and adding:

> What remains, however, is of course that people are now more aware of the widespread risks that the future may hold in store. Global market conditions can change suddenly. Credit access, which in recent times has been exceptionally favourable for Icelandic and other banks, may change suddenly if unexpected conditions arise. It is important to be prepared for such a contingency.[72]

Tuesday 6 November 2007, Governor Oddsson gave a speech at a breakfast meeting of the Icelandic Chamber of Commerce. While his words were carefully chosen, they contained an unmistakably warning to the Icelandic banking sector:

> For a while, cheap capital was readily available, and some were bold enough to grab the opportunity. But the flip side of expansion, and the side that cannot be ignored, is that Iceland is becoming uncomfortably beleaguered by foreign debt. At a time when the Icelandic government has rapidly reduced its debt and the Central Bank's foreign and domestic assets have increased dramatically, other foreign commitments have increased so much that the first two pale into insignificance in comparison. All can still go well, but we are surely at the outer limits of what we can sustain for the long term.[73]

As CBI governor, however, Oddsson found himself in a "Catch-22" situation: If he was seen to take steps to avert the crisis which he feared, he would almost certainly bring about that very crisis. This is well described by the American phrase: "Damned if you do, damned if you don't."

An account of some of Governor Oddsson's activities in 2007–8 is given in the 2010 Report by the Special Investigation Commission, SIC. Abroad, Oddsson tried hard, but without much success, to obtain credit facilities from central banks so that the three Icelandic banks would not appear vulnerable. He only succeeded, in May 2008, in obtaining currency swap deals with the three Scandinavian central banks. The US Federal Reserve, the Bank of England and the European Central Bank refused to make such deals. Governor Oddsson's colleague, Governor Ingimundur Fridriksson, said in his statement to the SIC: "It was only through the unflinching determination of Governor Oddsson that the deal with the Scandinavians was finally concluded; one could say that they were really pushed to sign the agreement."[74] At the same time, the foreign exchange reserves were gradually increased so that they became bigger relative to GDP than in almost all other Western countries.[75]

In Iceland, Governor Oddsson privately warned political leaders and the bankers themselves of the risks and publicly, but cautiously, expressed some misgivings about the rapid expansion of the banks. For example, Sunday 13 January 2008, Governor Oddsson met with two leading members of his old team from the Independence Party, Prime Minister Geir H. Haarde and Finance Minister Arni M. Mathiesen, and told them that he had grave worries about the Icelandic banks and their ability to survive in the next twelve months.[76]

71 SIC Report, Vol. 6, Ch. 19, p. 79.

72 Speech by David Oddsson, 30 March 2007, http://www.cb.is/publications-news-and-speeches/news-and-speeches/news-and-speeches/speeches/2007/04/02/Address-by-Dav%C3%AD%C3%B0-Oddsson--Chairman-of-the-Board-of-Governors-of-the-Central-Bank-of-Iceland/

73 Speech by David Oddsson, 6 November 2007, http://www.cb.is/lisalib/getfile.aspx?itemid=5491

74 SIC Report, Vol. 6, Ch. 19, p. 172. Fridriksson uses the Icelandic word "hardfylgi".

75 In July 2008, they were 13% of GDP and only surpassed by the reserves of New Zealand which amounted to 14% of GDP. Willem Buiter and Anne Sibert, The Icelandic banking crisis and what to do about it (Report for Landsbanki, 23 July 2008), p. 16.

76 SIC Report, Vol. 6, Ch. 19, p 102. Interview with Arni M. Mathiesen 13 January 2016.

One of the most important encounters with government ministers took place Thursday 7 February 2008. Governor Oddsson and his two colleagues, Eirikur Gudnason and Ingimundur Fridriksson, met in the Prime Minister's Office with Prime Minister Geir H. Haarde, Finance Minister Arni M. Mathiesen and Foreign Minister Ingibjorg S. Gisladottir, leader of the Social Democrats. Also present were Tryggvi Palsson from the CBI and Bolli Thor Bollason, Permanent Secretary in the Prime Minister's Office. Oddsson gave an account of a recent trip to London where he had met with rating agencies and banks. He said that there were great concerns abroad about the Icelandic banks in general. They had apparently lost all credibility. "It is criminal if they are falling and bringing the country down as well," Oddsson said. In particular, the governor described a meeting with representatives of the ratings agency Moody's. The representatives of Moody's expressed concerns about Landsbanki's Icesave accounts, on offer in the UK and the Netherlands. A run on the bank might be possible. Since the deposits were in a branch of an Icelandic bank, and not in a British subsidiary of an Icelandic bank, their basic guarantee was that provided by the Icelandic Depositors' and Investors' Guarantee Fund. When Oddsson left the meeting, he said to the CBI staff members who accompanied him: "If this does not move them, then nothing will." Later, Foreign Minister Gisladottir stated that she had thought that Oddsson had been "a little dramatic" in his presentation at this meeting.[77]

The Icesave accounts and other problems of the banks were discussed at many more meetings in 2008. Friday 8 February 2008, Governor Oddsson and his two CBI colleagues took up the issue with Landsbanki's two CEOs, Halldor J. Kristjansson and Sigurjon Arnason. Director Kristjansson tried to reassure the three CBI governors by saying that a transfer of the Icesave accounts from Landsbanki's London branch to a subsidiary (which would have made them the responsibility of the British deposit insurance scheme, not the Icelandic one) was being considered.[78] Thursday 6 March 2008, Oddsson met with Prime Minister Geir H. Haarde, giving him an account of a recent meeting with Bank of England officials. He told Haarde that the British officials were concerned about Landsbanki's Icesave accounts. He also gave the Prime Minister a report which had been prepared at the CBI by an English expert, Andrew Gracie, on the possible collapse of the banks and how to prepare for it. Oddsson did not mince words at this meeting, speaking of his suspicion of a "scam" at Kaupthing Bank and of potentially criminal behaviour of some bankers.[79] Tuesday 18 March Oddsson and his two CBI colleagues met with Prime Minister Haarde, and Sunday 30 March Governor Oddsson met with Prime Minister Haarde and Finance Minister Arni M. Mathiesen, informing them that he thought that the banks were not providing sufficiently reliable information about their situation.[80]

At the CBI annual meeting 28 March 2008, Governor Oddsson had to tread carefully. He criticized however those who were overly optimistic about the near future:

> Of course, it is far from inconceivable that strong gusts of wind could come from any direction, dispersing pitch-black storm clouds in a moment's time, bringing leveraged buyouts of heavily indebted companies under the aegis of credit institutions offering minimum terms and slick collateral, and bright, sunny morning would smile on markets in Iceland and elsewhere. But even though this is not inconceivable, and though history shows that the market is living proof of the most improbable outcomes, the likelihood is that the probability of winning the wait-and-hope game is measurably poorer than that accompanying the purchase of a Lotto ticket. Therefore, it is appropriate to assume that the situation will not right itself very much in the short term, and if it does right itself to any measurable degree, it will hardly return to its prior state. If people haven't prepared themselves already, there is no reason to wait. We must seek all possible ways to strengthen the liquidity position of companies—particularly financial companies—and at the same time we must re-examine market models. In athletic terms, one could say that this means that now is the time to consolidate our defences and be content with a goal if opportunities emerge in spite of all odds. Though exaggerated pessimism is obviously unnecessary, it is as bad or worse to paint the situation in rosy colours for the benefit of ourselves and the public and imply that there is some sort of magical solution to the problem that faces us. As the saying goes, "Lying to others is a wicked bent; lying to oneself breeds a lethal event."[81]

This could only be read as an admonition to the Icelandic banks and a warning that they had to prepare for a severe crisis, as the CBI had reached the upper limit of what it could reasonably do to increase its currency reserves.

Tuesday 1 April 2008, Governor Oddsson and his two CBI colleagues met with Prime Minister Geir H. Haarde and Foreign Minister Ingibjorg S. Gisladottir. Oddsson said that a run on Landsbanki was entirely possible, adding that the British FSA wanted Landsbanki to transfer the Icesave accounts from its London branch to a subsidiary.[82] Wednesday 7 May 2008, Oddsson and the other two CBI governors met with three government ministers, Prime Minister Haarde, Finance Minister Arni M. Mathiesen and Foreign Minister Gisladottir. Oddsson gave an account of recent meetings with European central bankers, stressing the lack of trust in the Icelandic banks and concerns about Landsbanki's Icesave accounts.[83] Thursday 8 May 2008, Oddsson said, in a response to a question at a press conference:

> What we are seeing is that, all of a sudden, when liquidity contracts in the markets, the idea emerges that central banks are

77 SIC Report, Vol. 6, Ch. 19, pp. 117–124.

78 SIC Report, Vol. 6, Ch. 19, p. 124.

79 SIC Report, Vol. 6, Ch. 19, pp. 136–137.

80 SIC Report, Vol. 6, Ch. 19, p. 143 and 148.

81 Speech by David Oddsson, 28 March 2008, at http://www.cb.is/publications-news-and-speeches/news-and-speeches/news-and-speeches/speeches/2008/03/29/Speech-by-Dav%C3%AD%C3%B0-Oddsson--Chairman-of-the-Board-of-Governors--at-the-Annual-Meeting/

82 SIC Report, Vol. 6, Ch. 19, p. 152.

83 SIC Report, Vol. 6, Ch. 19, p. 173.

> considered some sort of guarantee fund for banks, no matter how large they are. It's a new development if banks are supposed to be able to expand at will and take the risk that they choose to take, and then the public, through the central bank, is believed to function as some sort of inexhaustible guarantee fund. Such a thing would not be considered seriously anywhere. It is not the role of the Central Bank as such. However, the Central Bank of Iceland wishes to—and should—promote monetary stability and the stability of the financial system.[84]

This could also be read as a critique of the Icelandic banks, as well as a reaffirmation of the traditional role of central banks.

During the summer of 2008 the CBI governors and the Landsbanki CEOs met several times to discuss the Icesave issue. Perhaps the most important meeting was Thursday 31 July 2008 when Governor Oddsson, his two colleagues and the two Landsbanki CEOs discussed the technical and legal problems of transferring the Icesave accounts from Landsbanki's London branch to a subsidiary and the position of the Icelandic Depositors' and Investors' Guarantee Fund. Oddsson stressed that the obligations of the Guarantee Fund were not obligations of the Icelandic state. He strongly objected to the opinion expressed by Landsbanki CEO Halldor J. Kristjansson that the €20,000 minimum guarantee of deposits under EU and EEA regulation might be regarded as legally binding for the Icelandic state. Oddsson said: "No state guarantee unless stipulated by law." When Kristjansson said that such a guarantee should then be stipulated by law, Governor Oddsson said: "You are raising deposits without speaking to the nation about the commitment. The two of you cannot bankrupt the nation."[85] But the Icelandic banks found themselves also in a "Catch 22" situation: With no credit available from foreign central banks (except possibly from the Scandinavian ones) and from commercial banks, their only way of financing themselves was by collecting deposits abroad; but this in turn further alienated the already sceptical management teams of central banks and commercial banks.

In the light of strenuous efforts by Governor David Oddsson and his CBI colleagues to obtain liquidity abroad, repeated warnings by Oddsson in private meetings with government ministers about the banks—"a little dramatic" according to Foreign Minister Ingibjorg S. Gisladottir—and several meetings with the Landsbanki CEOs, urging them to resolve the Icesave issue, it seems unfair to write, as Professor Sibert did in 2009, of Oddsson's "apparent acquiescence in the face of looming disaster". It also seems unfair, as Professor Thorhallsson did, to accuse the CBI governors of underestimating the "risk of foreign currency shortage and later lack of access to foreign currency" and of focusing too little on "the risk involved in the operation of the financial sector as a whole". Of course, not all the activities of Governor Oddsson and his colleagues were known at the time, but some of them were, such as Oddsson's critical attitude towards the banks and his public warnings about their expansion. When Professor Thorhallsson wrote his paper in 2011, the SIC Report, with all the details above, had been published.

It also seems unfair to write, as Professor Sibert does, that "neither the prime minister, nor the finance minister or financial regulator seems to have made any serious attempt to stem the growth of the Icelandic banks". Even if these ministers and officials had believed Governor Oddsson instead of dismissing him as being "a little dramatic", as Foreign Minister Gisladottir did, it is hard to see what they could have done "to stem the growth of the Icelandic banks", especially after the rapid expansion of the banks in 2004–5. The banks grew because they found willing customers, and government ministers and officials did not have the legal power to order them to stop growing. As Governor Oddsson had said in November 2007: "For a while, cheap capital was readily available, and some were bold enough to grab the opportunity." It seems in any case far-fetched to use the inability of Icelandic government ministers and officials to stem the growth of the Icelandic banks as an example of the burden that small size may place on senior government officials, as Sibert does. The rapid growth of RBS in the United Kingdom and of Santander in Spain was not hindered by government ministers or officials. Indeed, it was welcomed.[86] •

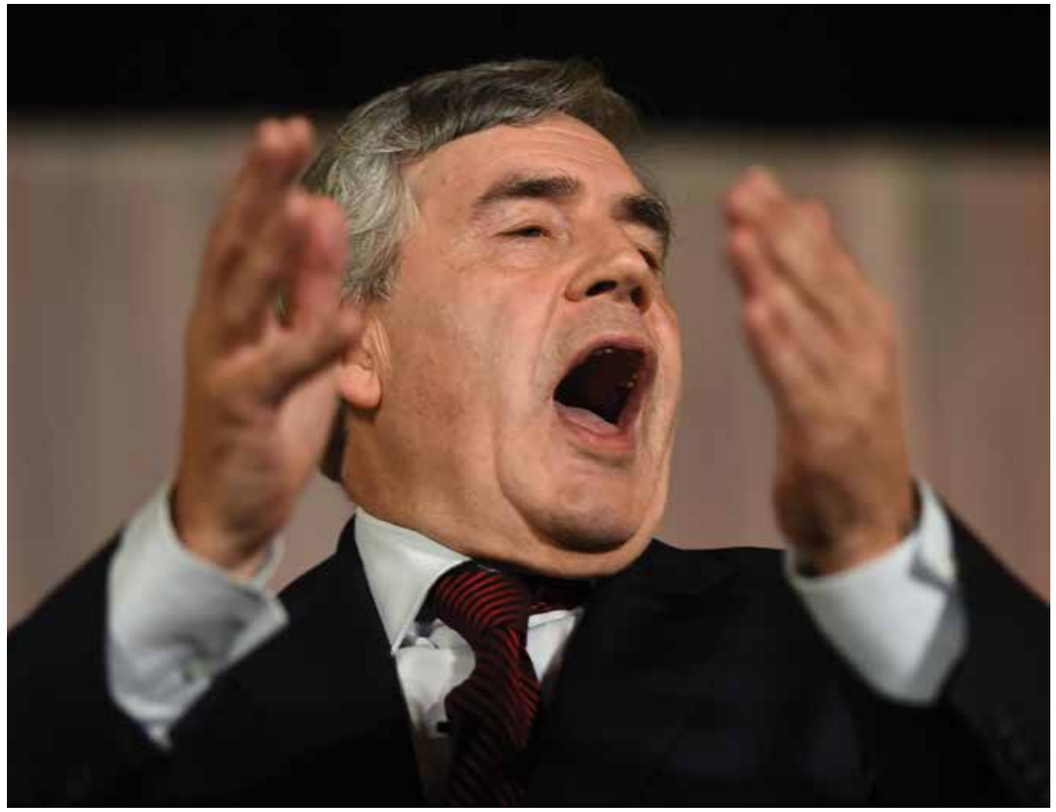
84 Board of governors press conference, 8 May 2008, at http://gamli.sedlabanki.is/?PageID=287&NewsID=1762

85 SIC Report, Vol. 6, Ch. 18, 20–21.

86 Cf. Alex Brummer, Bad Banks (London: Random House Business Books, 2014), 42.

10

ICELAND RING-FENCED



Professor Sibert asserts that Governor David Oddsson was "ineffective at either averting the financial crisis or playing a positive role in its aftermath." This raises the question how Oddsson or for that matter anyone could have been more effective before and after the bank collapse. What was really necessary in 2007–8 was to reduce the risk of a run on the Icelandic banks, and this would have required credit facilities from important central banks, such as the US Fed, the Bank of England or the European Central Bank. It is difficult to see how any other CBI governor of could have obtained such credit facilities in the circumstances.

It is also difficult to see how any other CBI governor could have hindered the British Labour government from closing the British banks owned by Icelandic banks—which definitely brought about the fall of Kaupthing, if not also of Landsbanki—or in invoking an anti-terrorist law against both Icelandic institutions and Landsbanki.[87] These were decisions and factors beyond the control of the CBI. It has, incidentally, since turned out that both these actions, closing the British banks owned by Icelanders, at the same time as all other British banks were rescued, and invoking an anti-terrorism law against Icelandic institutions and banks, allegedly in order to hinder illegal transfers

87 HM Treasury, Landsbanki Freezing Order 2008. http://www.legislation.gov.uk/uksi/2008/2668/pdfs/uksi_20082668_en.pdf

from the UK, were unnecessary. The British banks owned by Icelanders, Heritable and KSF, were solvent, and before the bank collapse the UK Financial Services Authority, FSA, had issued a confidential order to Landsbanki prohibiting the transfer of money abroad without the written consent of the FSA, given three days in advance, also confidentially informing the bank which handled all transfers (Barclays).[88] It is hard to explain the two fateful decisions of the British Labour government, closing the banks and invoking the anti-terrorism law. Possibly, it was trying to draw attention away from the fact that it was using an enormous amount of taxpayers' money to bail out all other British banks, with a rescue package of £500 billion, mainly directed, as it turn out, at the two Scottish banks, HBOS and RBS. Possibly, it also wanted to demonstrate to Scottish voters (who were leaving the Labour Party in droves for the Nationalists) the dangers of independence. Both Prime Minister Gordon Brown and the Chancellor of the Exchequer Alistair Darling were Scottish. As Darling wrote, almost with glee: "Iceland, along with Ireland, was part of what Scotland's nationalist first minister, Alex Salmond, like to refer to as an 'arc of prosperity', to which he yearned to attach Scotland. It was now an arc of insolvency."[89] However that may be, it is farfetched to hold Governor Oddsson responsible for these extraordinary decisions by the British Labour government.

The role Governor Oddsson and his two colleagues played when the banks were about to collapse is clearly brought out in the SIC Report and elsewhere. They had come to the conclusion that the banks could not be saved and that the most important task was to ring-fence Iceland in order to avoid sovereign default and to minimise the negative impact of the crisis on ordinary citizens. The government wavered. Some ministers and their economic advisers still seemed to think that the banks could be saved. They had ceased to listen to Governor Oddsson who then sent for a team from JP Morgan in London. They were flown in by the CBI a private jet and were able to meet the leading government ministers in the early hours of Monday 6 October 2008. The members of the team, led by Michael Ridley, finally convinced the government ministers that the banks could not be saved and that swift action was necessary.[90] Then the Emergency Act which had already been prepared was put before Parliament and passed in the afternoon of Monday 6 October. The law enabled the IFSA to take over the banks and prevented a run on the banks, as claims on the banks by depositors were given priority over other claims.

It was not enough, however, to convince the government ministers about which action to take. It has perhaps not been sufficiently emphasised that the CBI management and staff faced a very difficult situation during the bank collapse and in its immediate aftermath, where they had to ensure that payment channels for Icelandic companies and travellers around the world would continue to function, as the banks had collapsed: The use by the British government of the anti-terrorism law had the consequence that many banks and other financial institutions, such as credit card companies, immediately stopped all transactions to and from Iceland. Suddenly, Icelandic companies could not get credit from old customers; Icelandic travellers found their credit cards rejected in automatic teller machines. The CBI management acted swiftly: An agreement was made with JP Morgan that they would act as a facilitator in currency transactions; the Central Bank issued a guarantee for all Icelandic credit cards, without which most Icelanders travelling abroad would have been stranded; a team of former bank employees was quickly assembled to operate the payments system out of the CBI building. The CBI staff worked day and night for days and weeks, and they managed to keep the payments system going for ordinary Icelanders, almost a miracle in the circumstances.[91]

Professor Sibert says that Governor David Oddsson was ineffective at playing a positive role in the aftermath of the bank collapse. This judgement is hardly based on a careful reading of the facts. What happened was that after street riots (where Professor Thorvaldur Gylfason whom she quotes

88 Interviews with Mark Durrant-Sismey 28 November 2014 and with Lilja B. Einarsdottir 3 March 2016. Financial Services Authority, First Supervisory Notice, Landsbanki, 3 October 2008. https://www.fca.org.uk/publication/supervisory-notices/landsbanki.pdf This Notice would have been sufficient to stop all illegal transfers out of the country.

89 Alistair Darling, Back from the Brink: 1000 Days at Number 11 (London: Atlantic Books, 2011), p. 138.

90 SIC Report, Vol. 7, Ch. 20, pp. 102–105.

91 Interview with Eirikur Gudnason 25 October 2011.

was a prominent participant)[92] a left-wing minority government was formed 1 February 2009, and it made it a priority to oust Oddsson and his two CBI colleagues, Eirikur Gudnason and Ingimundur Fridriksson. A law abolishing the positions of the three governors was passed by parliament on 26 February 2009 by 33 votes against 18 votes. All the no votes belonged to members of parliament for the Independence Party.[93] After leaving the CBI, Oddsson fought against the deals on the Icesave accounts which the new government made with the British and Dutch governments, arguing, as he had insisted while CBI governor, that the Icelandic state was not responsible for transactions between private parties, Landsbanki and its customers. Opposing him and supporting the Icesave deals were many Icelandic intellectuals, including Professors Thorvaldur Gylfason and Baldur Thorhallsson.[94] After two referenda where the deals were rejected by Icelandic voters, in early 2013 the EFTA Court decided that the Icelandic state was indeed not responsible for these transactions: There was, the Court held, no government guarantee of these obligations.[95] The Icesave deals would have been very costly to Icelandic taxpayers: According to an estimate made in early 2016 by an Icelandic financial expert, the first agreement, in the summer of 2009, would have cost the Icelandic Treasury and hence the Icelandic taxpayers, at least 208 billion Icelandic kronur, or 8.8% of GDP. This was only the interest on the "loan" which the UK and the Dutch governments pretended they had given to the Icelandic state in 2008 when they unilaterally compensated Icesave depositors; this would have been the total cost even if the whole of the principal had been covered by Landsbanki's assets (as proved to be the case).[96] This would have been equal to US$ 1.6 billion.[97] Arguably, therefore, Oddsson played a more positive role in the aftermath of the bank collapse than at least the supporters of the Icesave deals, like Professors Gylfason and Thorhallsson. •

92 Motmaela threytandi thogn radamanna, DV 24 October 2008; Verdum ad tala um fullveldid, Morgunbladid 2 December 2008.

93 Nyr madur i bankann i dag, Morgunbladid 27 February 2009. One of the three governors, Ingimundur Fridriksson, had previously resigned.

94 Thorvaldur Gylfason, Loglegt? Sidlegt? Frettabladid 25 June 2009; Eins og ad deila vid domarann (interview with Baldur Thorhallsson), Frettabladid 31 March 2011.

95 Judgement of the EFTA Court, 28 January 2013, http://www.eftacourt.int/uploads/tx_nvcases/16_11_Judgment_EN.pdf

96 Hersir Sigurgeirsson, Hvad hefdu Svavarssamningarnir kostad ef their hefdu verid samthykktir? http://visindavefur.is/svar.php?id=70473

97 Exchange rate 9 February 2016 (when the calculations were made public).

11

NEPOTISM AND CORRUPTION IN SMALL STATES

Professor Sibert makes a related point, "that very small countries may also suffer because of their high degree of interpersonal relations. In a tiny nation, everyone knows everyone. This can facilitate things getting done quickly, but it has its costs." In general support of this point she quotes a paper by a Maltese educationalist, Charles Farrugia, who had argued that in "extreme cases, close personal and family connections lead to nepotism and corruption."[98] On Iceland in particular, Sibert quotes Professor Thorvaldur Gylfason who had written that Iceland was "a clan-based society more heavily permeated by politics than any other in Northern or Western Europe."[99] Professor Baldur Thorhallsson makes a similar point as Sibert, speaking of a problem which Iceland has, the "widespread corruption within ministries and governmental institutions, where relatives and friends or party members are hired over of [sic] qualified people."[100] Thorhallsson also says that "Iceland's small size in terms of the state's bureaucracy and its lack of expertise, coupled with a blind belief in the neo-liberal agenda and political favouritism, played a part in the collapse."[101]

First, it should be pointed out that Farrugia's thesis, invoked by Professor Sibert, was developed as mainly an account of the problems of administration in small and developing ex-colonies, with fragile institutions and weak traditions. Iceland is a developed country, and she was never a colony: She was a Danish dependency, gaining home rule in 1904 and sovereignty in 1918. While the rather limited public service which existed in this vast and sparsely populated country was based on Danish traditions, it employed mostly Icelanders. In the 18th and 19th centuries, the county sheriffs, typically law graduates from Copenhagen University, were for example almost all Icelanders. While the population was tiny, neither were the institutions fragile nor the traditions weak, as in some ex-colonies.

In any serious analysis of corruption in different countries it has to be recognised that it takes many different forms. There is "soft" corruption like nepotism, favouritism, clientelism and political patronage, and "hard" corruption like bribery, embezzlement, theft, fraud and extortion. Iceland has, like the other Nordic countries, often been perceived as a country without much "hard" corruption. Apart from quoting Professor Gylfason, Professor Sibert presents no evidence to the contrary. Neither does Professor Thorhallsson. But what about "soft" corruption such as political patronage? Is, or was, Icelandic society as "permeated by politics" as Gylfason claims? Is it true that in Iceland, "relatives and friends or party members" are hired in ministries and government institutions, but not qualified people, as Thorhallsson asserts?

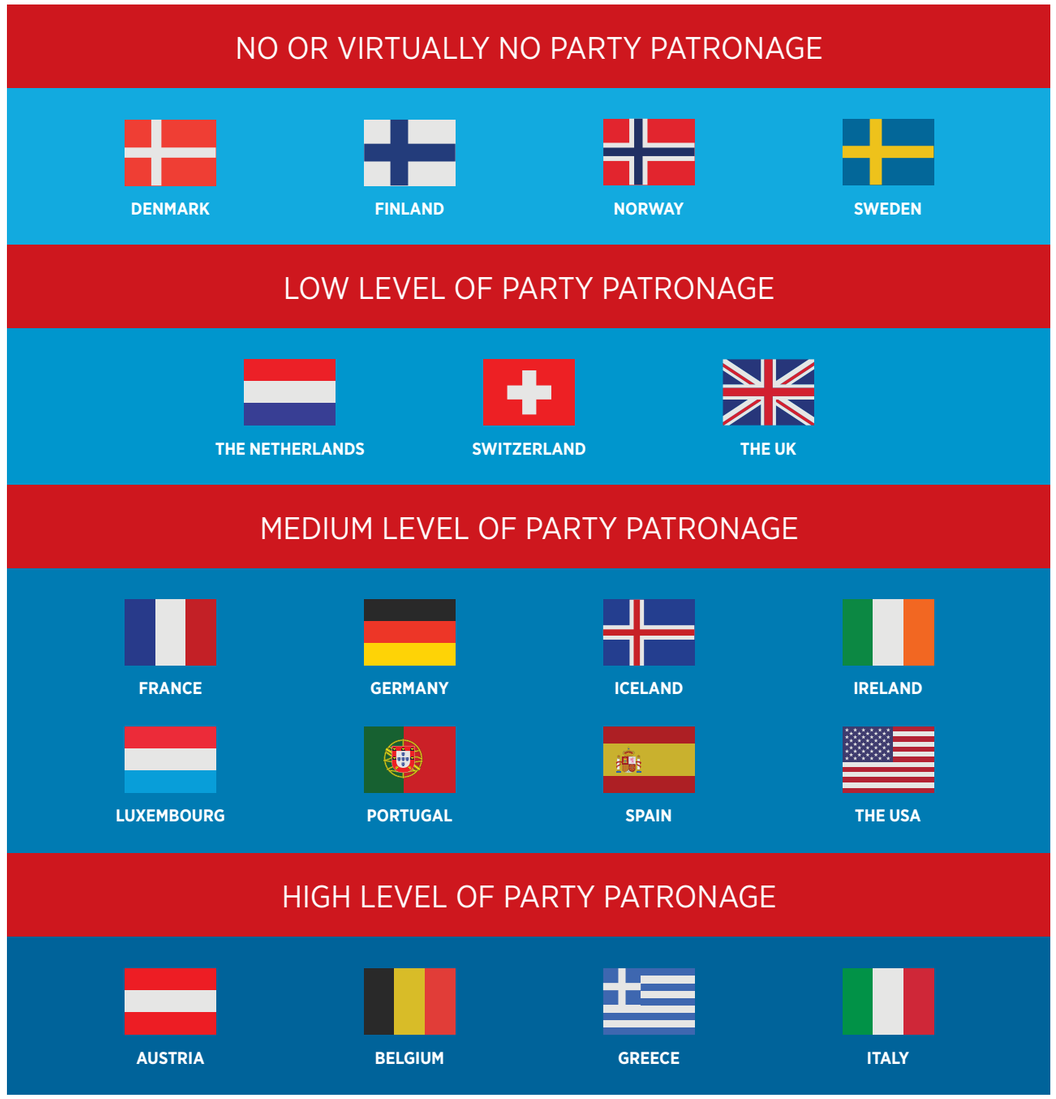
It is hard to find any reliable evidence supporting this. Nevertheless, in a paper published in 2006 on party patronage, Professor Wolfgang Müller distinguishes between four categories of Western democracies:

98 Charles Farrugia, The Special Working Environment of Senior Administrators in Small States, World Development, 21, 1993, pp. 221–6.

99 Thorvaldur Gylfason, Iceland Warms to Europe, VoxEU.org 21 July 2009.

100 The European Union (interview), Reykjavik Grapevine, Vol. 8 (8: August 2010), p. 19.

101 Baldur Thorhallsson and Peadar Kirby, Financial crises in Iceland and Ireland: Does EU and Euro membership matter? Working paper (Reykjavik: Centre for Small State Studies, November 2011), p. 24.



But it is not clear why Müller puts Iceland in the third category. At the time he wrote his paper, Iceland was perceived as one of the least corrupt countries in the world: According to the corruption perceptions index of Transparency International, she was 4th out of 102 countries in 2002, 2nd out of 133 in 2003, 3rd out of 145 in 2004 and 1st out of 158 in 2005.[103] It should also be noted that since Professor Müller puts Iceland in the third and not the fourth category for party patronage, he seems at least to disagree with Professor Gylfason's sweeping statement that Iceland is a "clan-based society more heavily permeated by politics than any other in Northern or Western Europe". Certainly, Belgium, here in the fourth category, one below Iceland, belongs to Western Europe, like Iceland. Moreover, Professor Müller's classification of Western countries does not show any correlation between size and political patronage. Big countries like the US and France are put in the same category as tiny Iceland and medium-sized Spain. Therefore, at least it does not support Sibert's arguments on the disadvantages of small states. •

102 Wolfgang C. Müller, Party Patronage and Party Colonization of the State, in Richard S. Katz and William J. Crotty, eds. Handbook of Party Politics (London: Sage Publications 2006), 189.

103 Transparency International, Corruption Perceptions Index, http://www.transparency.org/research/cpi/overview

12

POLITICAL PATRONAGE IN ICELAND

There do not seem to be many data available comparing political patronage in Iceland to that in other Western democracies. Politics Professor Gunnar H. Kristinsson has done some research on the subject, mostly deriving his information from interviews with people in or close to public administration. While his papers do not provide comparative data and while some of his findings certainly can be contested, most Icelanders would find the basic outline of his story cogent: It is that until the late 1920s, the Icelandic public service adhered to Danish traditions, basing appointments at least nominally on merit. In 1927–32, a minority government of the Progressive Party, with the support of the Social Democrats, tried to break with these traditions making a lot of controversial political appointments.[104] (In all fairness, it should be pointed out that this government believed that it was loosening the grip that an elite or "old boy network", from Reykjavik Grammar School and Copenhagen University, had had on civil administration.)[105] Subsequently, in the three decades from 1930 to 1960, Icelandic society became quite politicized. This development was reinforced by extensive currency and import controls imposed in the Great Depression, providing ample opportunities for nepotism, clientelism, favouritism and patronage. The Independence Party, tending towards economic liberalism and originally fighting against the politicization of society, and in opposition 1927–1932 and 1934–1939, eventually joined the Progressive Party and the Social Democrats in working within the new system and employing political patronage. The fourth political party, originally the Communist Party, then the Socialist Party, and from 1956, the People's Alliance, was rarely in government and therefore usually not participating in Icelandic political patronage. In the three decades from 1960 to 1990, on the other hand, political patronage was gradually reduced, as the political parties became weaker, and economic controls were lifted. As a result, the Icelandic public service became more professional, even if some appointments are still made politically.[106]

While Professor Kristinsson's analysis of political patronage and public administration in Iceland in the 20th century would seem cogent to most, some of his observations on it may be less well-founded. He writes, for example: "The only party partially left out in the patronage system was the left-socialist People's Alliance which was an outsider to government except for rare occasions until the 1970s and hence had to motivate it's [sic] membership differently, — primarily on ideological grounds."[107] But the People's Alliance was not a political party until 1968; before that it was an electoral alliance where by far the biggest and most powerful element was the well-organised Socialist Party, formed in 1938

104 Even Professor Thorvaldur Gylfason seems to agree that 1927 was a crucial year. He writes in his 2008 Vox piece, already referred to: "For decades, beginning in 1927 when a farmers' party gained majority in parliament with the support of just a third of the electorate, the Icelandic economy was more heavily regulated than most in Western Europe, with the possible exception of Ireland. Interference and planning were the norm; enterprise and markets were viewed with scepticism if not hostility. Without much exaggeration, the state tried to restrain almost anything that moved." Professor Gylfason leaves out that the minority government formed by the Progressive Party in 1927 was indirectly supported by the Social Democrats.

105 This comes out clearly in the biography of government minister Jonas Jonsson by Gudjon Fridriksson, Saga Jonasar fra Hriflu, Vols. I–III (Reykjavík: Idunn, 1991–3).

106 Gunnar Helgi Kristinsson, Parties, States and Patronage, West European Politics, Vol. 19 (3: 1996), pp. 433–457; Clientelism in a Cold Climate: The Case of Iceland, in Simona Piattoni, ed., Clientelism, Interests, and Democratic Representation (Cambridge: Cambridge University Press, 2001), pp. 172-192; Patronage and public appointments in Iceland, working paper 2006, https://ecpr.eu/Filestore/PaperProposal/f48667ec-8cc9-4137-bfc7-45352b3fe2f7.pdf. An almost identical paper was published the same year in Icelandic, Politiskar stoduveitingar a Islandi, Stjornmal og stjornsysla, Vol. 2 (1: 2006), pp. 5–29.

107 Gunnar Helgi Kristinsson, Patronage and public appointments in Iceland, working paper 2006, p. 5. This statement is repeated in a more recent publication, but in the context of a more accurate description of the Icelandic party system. Kristinsson writes: "Only the Socialists, an outsider party in Icelandic politics, never quite managed to become part of the patronage and clientele system, and had to rely instead on their supports to do party work without the offer of material rewards." Party Patronage in Iceland: Rewards and Control Appointments, Party Patronage and Party Government in European Democracies, ed. by Petr Kopecky, Peter Mair, and Maria Spirova (Oxford: Oxford University Press, 2012), p. 189.

by a merger of the Communist Party and the left wing of the Social Democrats. The leadership of the Socialist Party was in close contact with the Communist Party of the Soviet Union and enjoyed generous financial support from it. This was well-known and confirmed already in 1999.[108] It has been calculated that in 1940–1972 the financial contributions from Moscow to the Socialist Party and its front organisations amounted to at least $3.5 million in today's dollars, a hefty sum indeed for a population then around 150,000.[109] The members of the Socialist Party were therefore not only motivated "on ideological grounds" as Kristinsson puts it: The party itself and its newspaper as well as some front organisations employed many people; the party handed out grants to university students going to the communist countries and countless invitations to much-coveted tours to the Soviet Union and other communist countries.[110] It is true that, not least because of its close ties to Moscow, quite well-known at the time, the Socialist Party did not have continuous access to the power structure in Iceland, but it certainly had access to the power structure in the Soviet Union; thus, it was able to extend patronage to its members.

Whatever can be said about political patronage in Iceland before the early 1990s, Professor Kristinsson points out that reforms of public administration in Iceland were partly brought about by changes in public opinion and partly by foreign influences: "Hence, in a rather sweeping series of public sector reforms during the 1990s the Icelandic administration took significant steps away from the political-bureaucratic system towards a professional one." Professor Kristinsson specifically refers to the Civil Service Act of 1996 and stresses that "the potential for ministerial involvement at lower levels of the administration has been greatly reduced". He adds that liberalisation of the economy and growing professionalism in different spheres has greatly reduced the previously extensive control of Icelandic society by political parties.[111] While plausible, this seems to be at odds with Professor Gylfason's assertion, quoted by Professor Sibert, that Iceland is a "clan-based society more heavily permeated by politics than any other in Northern or Western Europe", and also to Professor Thorhallsson's remark about "widespread corruption" in Iceland.

Professor Kristinsson presents a survey that he did in 2005 of 111 appointments of high officials in 2001–2005. Of those officials, 82 were heads of government agencies, while the remainder were Ambassadors, Permanent Secretaries and Supreme Court judges. Kristinsson interviewed 17 people in or close to public administration. The people interviewed were asked to explain the 111 appointments according to three models or categories (which were not mutually exclusive, and often overlapping): the bureaucratic model where people advanced according to present norms in the hierarchy, a deputy director for example becoming director in the course of time; the professional model where people were appointed according to their perceived ability irrespective of their previous position or political affiliation; and the political model where people were appointed because of their political affiliation. The main conclusion of the survey is that "the professional model has become the predominant model of appointments in Iceland". 68% of the appointments were compatible with the professional model, 57% with the bureaucratic model, and 41% with both models. 44% of the appointments were compatible with the political model, according to Professor Kristinsson, and of them 16%—18 appointments altogether—were only compatible with that model, by which he presumably means that they could not be explained by professional or bureaucratic considerations.

Some problems, or limitations, should however be noted with Professor Kristinsson's 2005 survey. First, it cannot be used in a meaningful comparison between party patronage in Iceland and other countries, such as the other four Nordic countries. The survey may suffice to refute Professor Gylfason's claim that Iceland is a "clan-based society more heavily permeated by politics than any other in Northern or Western Europe", at least after the early 1990s, whatever may have been true in the period of extensive economic controls and general politicisation of Icelandic society in 1930–1960. It may also suffice to refute Professor Thorhallsson's assertion about "widespread corruption" in Iceland. But Kristinsson's survey does neither confirm nor refute Professor Wolfgang Müller's assessment that party patronage is more extensive in Iceland than in the other Nordic countries. It only tells us that in the first few years of the 21st century most appointments in Iceland are professional and that this seems to be a change from the past. In the second place, the survey was made of appointments in 2001–2005 when there was in place the same coalition government of the Independence Party and the Progressive Party. It would have been more fruitful to survey appointments during different types of coalitions. For example, in 1986–1990 there were four coalition governments: 1986–1987 the Progressive Party and the Independence Party; 1987–1988 the Independence Party, the Progressive Party and the Social Democrats; 1988–1989 the Progressive Party, the People's Alliance and the Social Democrats; 1989–1990 the three aforementioned parties and the Citizens' Party (a splinter group from the Independence Party). By a survey of appointments in this period, Professor Kristinsson would have had information about all the main parties, not only the Independence Party and the Progressive Party.

Thirdly, it would have been helpful to see on what criteria the 17 people interviewed in the survey were chosen. Were the criteria objective or subjective? Professor Kristinsson himself is a fierce critic of the Independence Party, once stating in a television interview that it was controlled (or at least heavily influenced) by "monsters".[112] As Professor of Politics, he has also personally vetoed invitations to former Independence Party leader David Oddsson to talk at events organised by the Institute of Public Administration and Politics affiliated with the Politics Department at the University of Iceland.[113] Moreover, Professor Kristinsson is also, as some other university professors, at the margin of politics rather than in the mainstream. For example, he was one of those who supported the first Icesave deal between Iceland and the United Kingdom in 2009, rejected by 98% of the voters in a national referendum.[114] It is therefore by no means certain that 17 people chosen and interviewed by him (and agreeing to be interviewed by him) would reflect any mainstream view or general opinion.

A clear example of Professor Kristinsson's bias against the Independence Party is when he writes about what he sees as the reluctance of the Independence Party to give up its dominant role in the media: "In 1995 the Minister of Education (Independence Party) appointed the former Mayor of Reykjavik (Independence Party) as director of the agency."[115] He omits to mention that this former Mayor of Reykjavik, Markus Orn Antonsson, was a career journalist who worked as a televison reporter at the Icelandic Broadcasting Agency from its inception in 1966 until 1970 when he started writing for magazines and also became a Reykjavik city councillor. Kristinsson also omits to mention that Antonsson sat on the Overseeing Board of the Government Broadcasting Agency in 1978–1985 and was appointed general director of the Agency in 1985, holding that position until 1991 when he became Mayor of Reykjavik. He was then appointed director of the Television division of the Government Broadcasting Agency in 1995 and general director of the Agency in 1998 (not in 1995, as Kristinsson says). When Kristinsson simply writes that "the Minister of Education (Independence Party) appointed the former Mayor of Reykjavik (Independence Party) as director of the agency", he is at best reporting a half-truth, leaving out that this former Mayor of Reykjavik was a former television reporter, journalist, Chairman of the Overseeing Board of the Government Broadcasting Agency for seven years and its general director for six years prior to his reappointment after a brief interlude of three years as Mayor of Reykjavik. As Lord Tennyson said, "A lie that is half-truth is the darkest of all lies."

Fourthly, the 17 people interviewed in the survey were said to be mainly in or close to public administration in Iceland. This means that they were mostly, if not solely, public employees or "insiders" which may have created a bias against all "outsiders", for example officials who would be appointed against the wishes of the staff of the agency where they are serving. Fifthly, it would have been interesting to see a list of the 111 appointments in the survey and especially a list of those 18 appointments which Professor Kristinsson and the people he interviewed considered to be purely political. This list has not been made available despite requests.[116] •

108 Arnor Hannibalsson, Moskvulinan (Reykjavik: Bokafelagid, 1999); Jon Olafsson, Kaeru felagar (Reykjavik: Mal og menning, 1999). Both authors had gone to Moscow and done research in the Comintern archives.

109 Hannes H. Gissurarson, Hvers virdi var Russagullid? Visbending, Vol. 33 (29: 2015), pp. 3–4.

110 Hannes H. Gissurarson, Islenskir kommunistar 1918–1998 (Reykjavik: Almenna bokafelagid, 2011).

111 Gunnar Helgi Kristinsson, Patronage and public appointments in Iceland, working paper 2006, p. 6 and 8.

112 Television interview 19 August 2009, http://www.mbl.is/frettir/innlent/2009/08/19/bjarni_fridar_skrimsladeild/

113 A colleague of his, Professor Omar Kristmundsson, then the chairman of the board of the Institute, had asked me to invite David Oddsson (who rarely appears in public) to give a lecture at the Institute. I managed to get Oddsson's consent to give such a lecture in 2013. But Professor Kristmundsson came to me and asked me to withdraw the invitation, because Professor Kristinsson was opposed to it!

114 Interview on State Television 10 August 2009, http://eyjan.pressan.is/frettir/2009/08/10/gunnarhelgi-kristinsson-stjornarkreppa-ef-althingifellir-icesave/

115 Gunnar Helgi Kristinsson, Patronage and public appointments in Iceland, working paper 2006, p. 18. Professor Kristinsson repeats this highly misleading statement in his more recent paper, Party Patronage in Iceland: Rewards and Control Appointments (2012), already referred to.

116 Email from Hannes H. Gissurarson to Gunnar Helgi Kristinsson 5 December 2016. Kristinsson has not answered the email.

13

APPOINTMENTS OF SUPREME COURT JUDGES

Since Professor Gunnar Helgi Kristinsson specifically mentions the appointments of two Supreme Court judges in 2003 and 2004 as having raised "concern", it is likely that he and the people he interviewed for his survey of appointments in 2001–2005 include them in the 18 political appointments made in the period. But it is at least debatable whether the two appointments were political in nature. In 2003, Minister of Justice Bjorn Bjarnason from the Independence Party appointed the chief justice of the Southern District Court, Olafur Borkur Thorvaldsson, as Supreme Court judge. In an evaluation of the applicants, the incumbent judges had expressed the opinion that Thorvaldsson was qualified, but that two other applicants were better qualified, a law professor, Eirikur Tomasson, and an attorney at law, Ragnar H. Hall.[117] On the bureaucratic model of appointments, Thorvaldsson's appointment was the most natural one, as he was the only applicant who was not only a district judge, but also the chief justice of a district court. There was therefore at least a bureaucratic element in the appointment. Was there a political element in it, also? Thorvaldsson was a known supporter of the Independence Party. When he had been a deputy sheriff in Northeastern Iceland, he had been an alternate member of the municipal council at Husavik for the Independence Party. But one of the two applicants preferred by the Supreme Court, Ragnar H. Hall, was also a known supporter of the Independence Party, having been, as a deputy sheriff in Eastern Iceland, a member of the municipal council of Seydisfjordur. The applicant who had however the strongest political profile was Professor Eirikur Tomasson, son of a Progressive Party government minister, himself a vocal supporter of the Party, having worked as a political assistant to a government minister from the Party. It is therefore difficult to say that the appointment was political.

It was sometimes pointed out that Olafur Borkur Thorvaldsson is a first cousin to David Oddsson, then Prime Minister. But this seems to be irrelevant as it was not Oddsson who made the appointment, but Justice Minister Bjorn Bjarnason who had no known connection to Thorvaldsson. The appointment of Thorvaldsson was hotly contested for a different reason. A fourth applicant, Hjordis Hakonardottir, a district judge, felt that Minister Bjarnason had bypassed her because she was a woman. She referred the appointment to the Icelandic Gender Equality Committee that issued an opinion criticizing Minister Bjarnason for not having appointed a qualified woman to the position. The Committee took it upon itself, somewhat controversially, to decide that Hakonardottir was better qualified than Thorvaldsson so that she had been unfairly treated.[118] But if this was a justified opinion, it could be directed not only against Justice Minister Bjarnason, but also against the incumbent judges who had decided that Tomasson and Hall, and neither Thorvaldsson nor Hakonardottir, were the best qualified or most suitable applicants.

The undeniable grain of truth in Professor Sibert's comments about the smallness of Icelandic society was however revealed in the debate about this appointment. The most vocal critic of Thorvaldsson's appointment, Law Professor Sigurdur Lindal, has family ties to one of Thorvaldsson's fellow applicants, his colleague Professor Eirikur Tomasson who is

117 The incumbent judges had actually used the words "more suitable" (heppilegastir). Osattir vid rokstudning domsmalaradherra, Morgunbladid 4 September 2003.

118 Case no. 14/2003, decided 5 April 2004, http://www.urskurdir.is/Felagsmala/KaerunefndJafnrettismala/nr/1622

married to Lindal's niece.[119] Moreover, Professor Kristinsson, who gives this specific example, works with Law Professor Bjorg Thorarensen on an academic project.[120] She happens to be the wife of Supreme Court Justice Markus Sigurbjornsson, who was Deputy Chief Justice in 2003. The couple would be expected to hold a negative opinion about the minister of justice going against the recommendations of the Court. Was Thorarensen perhaps one of the 17 people whom Professor Kristinsson interviewed for his survey? Professor Thorhallsson—who spoke of "widespread corruption" in Iceland expressed in appointments according to family ties, friendship or political views—has also co-written academic papers with Thorarensen,[121] and they have both been involved in the process of EU membership for Iceland: Thorhallsson as the Guy Monnet Professor of European Studies and outspoken supporter of membership, and Thorarensen as the Vice-Chairman of the Icelandic negotiation team with the EU for the brief period when Iceland considered applying for membership.

Indeed, many people saw the controversy about Thorvaldsson's appointment as being about who should control appointments to the Supreme Court, the incumbent judges or the justice minister, elected by the Icelandic voters. The real conflict may have been about judicial activism, as exercised by Justice Sigurbjornsson, or judicial restraint, supported by Justice Minister Bjorn Bjarnason and perhaps also by Justice Olafur Borkur Thorvaldsson, although at the time the debate was certainly not couched in such clear terms. Professor Kristinsson makes somewhat of the same point when he observes that in the late 1990s and early 2000s the Supreme Court had broken with its long tradition of being very cautious in striking down laws as being unconstitutional; it had gone against the parliament majority in some cases.[122] The conclusion is that the appointment of Thorvaldsson was according to the bureaucratic model and only partly according to the political model, in that the justice minister appointed someone who shared his own idea of the proper role of Supreme Court justices. If it is said that the

119 Hord gagnryni a domsmalaradherra [Justice Minister Severely Criticized], Frettabladid 6 February 2004.

120 They cooperate on a research project on democracy, http://vol.hi.is/rannsoknarverkefni/

121 Baldur Thorhallsson and Bjorg Thorarensen, Iceland's democratic challenges and human rights' implications, European institutions, democratization and human rights protection in the European periphery, ed. by Henry F. Carey (Lanham ML: Lexington Books, 2014), pp. 223–244.

122 Gunnar Helgi Kristinsson, Patronage and public appointments in Iceland, 2006, p. 14.

appointment was unprofessional in that others applicants were more qualified than Thorvaldsson (even if it was uncontested that he was qualified), then the question must be whence those who say this derive this superior knowledge.

Consider the other case mentioned by Professor Kristinsson, where an appointment to the Supreme Court in 2004 was criticized. It was quite clear that some incumbent judges did not want one applicant, Jon Steinar Gunnlaugsson, a prominent attorney at law, to be appointed, even if one of them, the aforementioned Markus Sigurbjornsson, had encouraged him to apply for an earlier vacancy on the Court. Gunnlaugsson had not hesitated to criticize the Court, especially if he felt that it did down people who were not able to defend themselves properly. In their evaluation of the applicants, the incumbent judges deemed Gunnlaugsson qualified, but ranked him lower than some other applicants, on controversial grounds. (For example, they assessed his experience in arguing court cases equal to that of another applicant, Professor Eirikur Tomasson: Gunnlaugsson had in fact argued 258 cases, some very complicated and important, whereas Tomasson had argued 31 cases. Also, the criteria used in the evaluation seemed to be inconsistent with that used a year earlier where emphasis had been put on the valuable experience gathered by having practised as an attorney at law, making attorney Ragnar H. Hall better qualified than the chief justice of a district court.)[123] Many lawyers and commentators on current affairs protested publicly against this low ranking of Gunnlaugsson which they deemed unfair. Be that as it may, Gunnlaugsson was appointed Supreme Court judge by the temporary Minister of Justice, Geir H. Haarde, after Minister of Justice Bjorn Bjarnason had excused himself from the appointment process. While Gunnlaugsson was a well-known supporter of the Independence Party, his appointment was publicly applauded by many prominent leftists, including Jon B. Hannibalsson, leader of the Social Democrats in 1984–96, and Throstur Olafsson, a leading Social Democrat and for a while the Chairman of the Board of the Central Bank of Iceland. They said that Gunnlaugsson brought sound legal training and a keen sense of justice to the Court.[124]

When it was pointed out that Jon Steinar Gunnlaugsson was, and is, a friend of David Oddsson, then Prime Minister, the answer is again that it seems irrelevant, as Oddsson did not make the appointment: It was Geir H. Haarde who did this. Furthermore, why should Gunnlaugsson be singled out here? Indeed, at the time three recent applicants for seats on the Supreme Court were in a small group of old law school friends who used to play bridge with David Oddsson once a week: Arni Kolbeinsson, appointed to the Court in 2000, Jon Steinar Gunnlaugsson, appointed in 2004, and Professor Eirikur Tomasson, who unsuccessfully applied for a seat on the Court both in 2003 and 2004.[125] Why was the appointment of Kolbeinsson not criticized on the same ground? It is also true that Geir H. Haarde and Jon Steinar Gunnlaugsson used to participate in a luncheon club of old friends which met fortnightly.[126] But another member of the same luncheon club was Gunnlaugur Claessen who was appointed Supreme Court judge in 1994, and who vehemently opposed the appointment of Jon Steinar Gunnlaugsson in 2004.[127] This illustrates yet again one of Professor Sibert's points, that there are many interpersonal relationships between people in a small society. "Old boys' networks" are not only formed at Eton, Harrow, Oxford and Cambridge. But it is clear that the acting Justice Minister, Geir H. Haarde, felt that Jon Steinar Gunnlaugsson was the best qualified applicant for the judgeship. He made his appointment on the professional model, and neither the bureaucratic nor the political ones. It is therefore hardly plausible, to say the least, to regard this appointment as an example of party patronage: Perhaps the controversy surrounding it was rather an example of how the "insiders" in the Supreme Court tried to protect themselves from the "outsiders" that they considered troublesome and non-pliant. There can be institutional as well as political patronage. •

123 Jon Steinar Gunnlaugsson, I krafti sannfaeringar (Reykjavik: Almenna bokafelagid, 2014), pp. 267–289.

124 Jon B. Hannibalsson, Ad njota sannmaelis [Fair Judgements], Morgunbladid 27 September 2004; Throstur Olafsson, Tilgatur radi ekki for [Innuendos Should Not Control Discussion], Morgunbladid 29 September 2004.

125 David Oddsson i myndum og mali, p. 146.

126 David Oddsson i myndum og mali, p. 96. It was called "The Locomotive Group" because it had, in 1972–5, revived an old magazine, Eimreidin (The Locomotive), which had started in 1895 to fight for Iceland's modernisation.

127 Jon Steinar Gunnlaugsson, I krafti sannfaeringar, pp. 267–289.

14

CAUSES OF CORRUPTION

To return to the main topic of this paper: In general there does not seem to be any positive connection between tiny populations and political corruption. Quite the opposite: The seven countries where there is least corruption in 2015 according to the Corruption Perception Index would all count as small: Denmark, Finland, Sweden, New Zealand, the Netherlands, Norway, and Switzerland. On the other hand, corruption is rampant in very populous states like Russia (no. 119 on the Index), China (no. 83), Brazil and India (both no. 76). As a consequence of human frailty, there will always be some corruption in society. The spirit may be willing, but the flesh is weak. But perhaps a few comments might be in order here on why there is there more corruption in some societies than others.

One important answer is that "Opportunity makes the thief". It seems plausible that the more power there is in the hands of politicians to distribute divisible goods, the more opportunities there are for political patronage. Therefore political patronage should be expected to be more prevalent in societies where government is large and economic and political controls extensive than in less politicized societies. This may explain, for example, why political patronage in Iceland decreased after 1960, when the system of import and currency controls was abolished, and yet again after 1991, after special government investment funds were abolished and banks and other companies were privatised.

Another important answer is a strong civic culture. The least corrupt societies on the Corruption Perception Index all have a strong civic culture. This may be related to them being homogeneous. A relatively homogeneous society is likely to generate a stronger consensus, more of an accepted framework for conducting affairs, than a society with great divisions in terms of class, race, or wealth. This may explain the relative lack of corruption in the Nordic countries, the Netherlands, New Zealand and Switzerland.

Moreover, small states would normally be more transparent than bigger ones, and if they are free and democratically governed, their transparency will increase. Independent investigation authorities and courts and free media will pursue cases, and politicians also have to face the risk of their opponents replacing them and finding out what they were doing while in office. Again, *pace* Professors Sibert and Thorhallsson, the case for small states seems to be strengthened rather than weakened by considerations about corruption. It also seems somewhat disingenuous of Thorhallsson to invoke "widespread corruption" in Iceland as a reason to join the EU and to transfer power from Reykjavik to Brussels. A 2016 study by the Rand Corporation, commissioned by the European Parliament, estimates the cost of corruption in Europe to be up to €990 million annually.[128] In the past, disillusioned accountants and officials who have worked for the European Commission have also accused it of irregular book-keeping and even corruption.[129] Indeed, in 1999 the whole Commission, under Jacques Santer, resigned after charges of incompetence, cronyism, nepotism and fraud.[130] Some would say, that in term of corruption, moving from Reykjavik to Brussels would be like jumping out of the frying pan into the fire. •

128 The Cost of Non-Europe in the area of Organised Crime and Corruption. Annex II: Corruption (Brussels: European Parliament Research Service, 2016). http://www.europarl.europa.eu/RegData/etudes/STUD/2016/579319/EPRS_STU%282016%29579319_EN.pdf

129 Paul van Buitenen: Blowing the Whistle: One Man's Fight Against Fraud in the European Commission (London: Politicos Pub, 2000); Marta Andreasen, Brussels Laid Bare (London: St. Edward's Press, 2009). Some examples are discussed in Urs Steiner Brandt and Gert Tinggaard Svendsen, Why does bureaucratic corruption occur in the EU? A principal-supervisor-agent model, Public Choice, Vol. 157 (3–4: 2013), pp. 585–599.

130 Committee of Independent Experts, First Report (15 March 1999), http://www.europarl.europa.eu/experts/report1_en.htm

15

POLITICAL PATRONAGE IN THE NORDIC COUNTRIES

As already noted, "hard" corruption, such as bribery, embezzlement, theft, fraud and extortion, is perceived as being quite rare in the Nordic countries, including Iceland. "Soft" corruption, such as nepotism, favouritism, clientelism and party patronage, may however exist there, even if not to the same extent as in many bigger countries. But it is difficult to see why Professor Wolfgang Müller in his 2006 paper puts four Nordic countries, Sweden, Denmark, Finland and Norway, in the first category of virtually no party patronage, and Iceland in the third category of a medium level of party patronage. It would seem that Professor Müller both overestimated party patronage in Iceland and underestimated it in the other Nordic countries.

Here a relevant factor has to be that in Sweden and Norway Social Democrats had almost sole control of government for forty years or more: In Sweden, with the exception of a few months in 1936, the Social Democrats formed the government from 1932 to 1976, occasionally in coalition with other parties (in 1936–1939 with the Farmers' Union, in 1939–1945 with all major parties in a national unity government, and in 1951 with the Farmers' Union, renamed the Centre Party). In this respect, Sweden was quite different from Iceland where government power rotated between the parties in a series of coalition governments. From 1930 to 1995, the Independence Party governed with the Progressive Party for 23 years and without it for 15 years. It was in government for 38 years and in opposition for 22 years. However, the Progressive Party was longer in government, for 39 years in the same period, sometimes with the left.

In 1976, Law Professor Erik Anners published a book, much-discussed in Sweden at the time, about the Social Democratic power machine, describing how they had placed their members almost everywhere in public administration.[131] Examples abound of how the dominance of the Social Democrats in Swedish politics was reflected in the public sector. In his memoirs, the chief of Swedish counter-intelligence tells the story of how a colleague was dismissed because he did not belong to the right party:

> To be regarded as a reliable person one had to carry the flag; otherwise one was blacklisted and driven out as soon as possible. At that time, Sweden had been ruled by the same party for decades. The Social Democrats had grown into the state. All large and important authorities were led by people who carried the flag in one way or another. To give an example: When the Social Democrats lost the 1976 elections, the new Minister of Education, Jan-Erik Wikström, from the Liberal Party [Folkpartiet] called a meeting of all the department chiefs of the Ministry. They all turned up with a red pin stuck to the lapel, a signal at that time that one was a follower of the Party.[132]

Indeed, the Swedish Social Democrats controlled the Swedish military intelligence service IB (Information Bureau) and used it to spy on communists who often challenged their dominant position in labour unions. Its director, a card-carrying Social Democrat, reported directly to Olof Palme, leader of the Social Democrats. When this was discovered, it caused a huge uproar in Sweden. The close relationship between the Social Democrats and the military intelligence service in the 1950s and 1960s was described in detail in a government report issued in 2002.[133]

131 Anners, Den socialdemokratiska maktapparaten (Stockholm: Askild & Kärnekull, 1976).

132 Olof Frånstedt, Spionjägaren, 2: Säpo, IB och Palme (Stockholm: Ponto Pocket, 2014), p. 98. Translated here from the Swedish.

133 Lars Olof Lampers, Det grå brödraskapet. En berättelse om IB (Stockholm: SOU, 2002), http://www.regeringen.se/rattsdokument/statens-offentliga-utredningar/2002/01/sou-200292/

The Norwegian case was somewhat similar. The Norwegian Labour Party, the Social Democrats, governed Norway, from 1935 to 1945 with allies, on its own from 1945 to 1965, with the exception of a few weeks in 1963. It was again in power in 1976–1981. During its years in power, the Labour Party appointed a lot of its members to prominent positions in public administration. A joke which the leader of the Conservative Party (Høyre), Kåre Willoch, once used at a meeting illustrates this. "The Labour Party Secretary has characterised his party as the eagle amongst Norwegian political parties. But if it is time for metaphors, then I should like to draw attention to another remarkable animal in the abundant fauna which the globe can still offer us," Willoch said. His audience listened in anticipation. "I should like to draw attention to the elephant which has the unique quality that it never forgets its own." The audience burst into laughter. Everybody knew to what he was referring.[134] In 1963, one of Norway's most distinguished historians, Professor Jens Arup Seip, gave a famous lecture, "From Officialdom to a One-Party-State" (Fra Embedsmannsstat til ettpartistat), where he described how the 19th century state ruled by high civil servants had been replaced, since 1945, by a state ruled by one political party:

> We can either say that through the party voters have brought the bureaucracy under control: the evolution into democracy, the rule of the people, has been completed. Or we can say: through the party apparatus, a bureaucracy has gained control over the voters. The first statement is in accordance with the myth we all entertain; we surely do entertain it. The second statement I would unhesitatingly put forward as a plausible working hypothesis.[135]

In a comment on Seip's lecture, the distinguished Swedish political theorist Herbert Tingsten wrote:

> No empirical research on this is known to me, but much indicates that public administrators, if active and ambitious, tend to support or at least to accommodate themselves to the dominant party. Partly this is because the government favours the well-disposed, for example by moving them from the party bureaucracy to the government bureaucracy. And partly it is because strivers seek out the party which provides them with the best prospects for good jobs and easy promotions.[136]

134 Daniel Heggelid Rugaas, Stat og parti: Det vanskelige skillet, Civita-notat, nr. 25/2013, p. 1.

135 Jens Arup Seip, Fra embedsmannsstat til ettpartistat og andre essays (Oslo: Universitetsforlaget, 1963), p. 26. Translated here from the Norwegian.

136 Herbert Tingsten, Det norska mönstret och demokratin, Från idéer till idyll. Den lyckliga demokratin (Stockholm: P. A. Norstedt & Söner Förlag, 1966), p. 174. Translated here from the Swedish.

Tingsten also pointed out that such a career choice was facilitated by the fact that the Social Democrats in Sweden and Norway seemed to stand for a consensus. This suggests, also, a methodological problem in using surveys of experts to draw conclusions on the level of party patronage in any given country: They may regard the appointments of people who share the prevailing consensus as somehow more "natural" than those of individuals with different views.

In Norway, like in Sweden, even the secret services cooperated with the Labour Party, as was documented in a report by a special investigation commission, the Lund Commission.[137] Party patronage has not disappeared in Norway, as a 2013 survey demonstrates. It was of 265 appointments to high positions in 1997–2010 during which period four different governments were in place. Taking into account how long each government lasted and how many appointments each minister made, and only counting appointees with publicly known party allegiances, it turned out that the Labour Party made the most appointments of known party members or supporters, or 13%, while the corresponding numbers for the Centre Party and the Conservatives were 8% for each. The numbers were considerably lower for the other three parties, the Christian Democrats, the Left Party and the Socialist People's Party.[138]

In Denmark, the Social Democrats were dominant in the second half of the 20th century, but perhaps not enjoying the same hegemony as in Sweden and Norway. Finnish politics were somewhat more complicated, with some rotation of power between parties, but not to the extent of Iceland. Be that is it may, it is fair to say that in and after the 2000s party patronage has significantly decreased in all five Nordic countries and that Iceland is now at least on the same level as the other four countries in that respect. This is confirmed by a comparative survey of party patronage done in 2008 of 15 European countries, including Iceland, Denmark and Norway. The conclusion was that party patronage was least common in the UK, the Netherlands, Denmark, Iceland, and Norway, with the Index of Party Patronage going up from 0.09 in the UK to 0.26 in Norway. Party patronage was most common in Greece, Austria, Italy, Germany and Hungary, with the Index going down from 0.62 in Greece to 0.43 in Hungary.[139] These findings are a dramatic refutation of Professor Wolfgang Müller's 2006 assessment of Iceland as having much more extensive party patronage than the other four Nordic countries. They are also totally at odds with Professor Baldur Thorhallsson's assertion about "widespread corruption" in Iceland, requiring the country to join the EU as soon as possible. Again, these findings suggest that Professor Gunnar Helgi Kristinsson's previous survey of appointments in Iceland in 2001–2005 may have exaggerated party patronage in Iceland, possibly because of the biases briefly discussed here. •

137 The report is available online in Norwegian, https://www.stortinget.no/no/Saker-og-publikasjoner/Publikasjoner/Dokumentserien/1995-1996/Dok15-199596/

138 Daniel Heggelid Rugaas, Stat og parti: Det vanskelige skillet, Civita-notat, nr. 25/2013, p. 4.

139 Petr Kopecký and Peter Mair, Conclusion: Party Patronage in Contemporary Europe, Party patronage and party government in European democracies, eds. Petr Kopecky, Peter Mair and Maria Spirova (Oxford: Oxford University Press, 2012), p. 367. The authors give a website where the data are said to be available, but they are not to be found there: https://www.universiteitleiden.nl/en/social-behavioural-sciences/political-science/research

16

FAVOURITISM IN THE NORDIC COUNTRIES

There is a different kind of "soft" corruption which should also be mentioned here, favouritism. During the 2008 Icelandic bank collapse, cases of favouritism may perhaps be identified in the other Nordic countries, even if they were said by Professor Wolfgang Müller to be much less corrupt than Iceland. Two of the cases were found in Norway. Glitnir Bank owned and operated two medium-sized companies there, Glitnir Bank and Glitnir Securities, both registered and paying taxes in the country. As a result of the Icelandic bank collapse, in October 2008 those two basically sound companies had to deal with a sudden liquidity problem. However, the Norwegian Central Bank refused to provide these two firms with liquidity. It referred Glitnir Bank to the Norwegian Depositors' and Investors' Guarantee Fund which decided to provide Glitnir Bank with short-term liquidity, a credit line of 5 billion Norwegian kroner. The loan was refinanced by the Norwegian Central Bank.[140] Thus, the two institutions practically forced a fire sale of Glitnir Bank, because it was made clear in oral communication that the short-term credit would not be renewed unless there was a change of ownership. A consortium of saving associations led by Finn Haugan, Chairman of the Board of the Norwegian Depositors' and Investors' Guarantee Fund, bought Glitnir Bank for 300 million Norwegian kroner, less than 10% of its book value of equity. The credit line was then immediately extended and the name of the bank changed to its old Norwegian name, and in January 2009 the bank was registered with the book value of 2 billion Norwegian kroner. It was not surprising that in 2009 Finn Haugan received a special bonus of 540,000 Norwegian kroner for his activities in 2008.[141]

140 Evaluering av håndteringen av krisen i Glitnir Bank ASA og Kaupthing Bank hf NUF (Oslo: Bankernes sikringsfond, 9 November 2009). This report in Norwegian was on the website of the Norwegian Depositors' and Investors' Guarantee Fund, http://www.bankenessikringsfond.no/no/Hoved/Nyheter/Evaluering-av-krisenhosten-2008/ But it seems to have been removed.

141 Bankdirektør får bonus. NRK Trøndelag, 6 April 2009. http://www.nrk.no/trondelag/bankdirektorfar-bonus-1.6557551

The fate of the other Icelandic-owned financial firm in Norway was similar. Immediately after the bank collapse, the Norwegian management team of Glitnir Securities bought it for 50 million Norwegian kroner, one fourth of its book value of equity. A week later, the new owners sold the company for double this amount of money to a financial company located in the same building. In both cases, because of the unhelpfulness of the Norwegian Central Bank to two Norwegian companies, registered and paying taxes in Norway, albeit owned by Icelanders, individuals pocketed huge profits.

In Finland, Glitnir Bank owned and operated a bank, Glitnir Pankki. After the Icelandic bank collapse, the Finnish Financial Supervisory Authority pressed hard for an immediate sale of the bank. The management staff bought the bank for €3,000, even if the book value of equity in 2007 was €180 million. The bank immediately adopted its old Finnish name. At the end of 2009, the book value of equity was €49.8 million, and in 2013 the bank was sold for €200 million.[142] The buyers had made an enormous gain. The Finnish Financial Supervisory Authority has refused to answer any questions about its role in the transfer.[143]

In Denmark, after the collapse, the CBI took over a subsidiary of Kaupthing, the Danish FIH Bank, which had been collateral for an emergency loan from the CBI to Kaupthing. The loan was for €500 million, but the book value of equity was about €1 billion. At first, FIH received the same liquidity provisions as other Danish banks. But in the autumn of 2010, the Danish Central Bank made it clear that it would not receive more assistance, unless it changed hands. The new CBI Governor, Mar Gudmundsson, bowed to pressure and sold the bank to a consortium led by some well-connected Danish businessmen, including a friend of the Danish Royal Family.[144] The price was €670 million, a little lower than the book value at the time, but there was also a stipulation that only a part of it, €255 million, would be paid immediately, and possible losses would be subtracted from the total price in a span of a few years. The managers immediately set out to realize all their losses and basically to liquidate the bank. At the end of 2014, the bank's book value of equity was €769 million. In the end, it seems that the buyers will only have paid the initial payment for the bank and that they will be tripled their investment in 4–5 years.[145]

These four examples seem to be cases of favouritism where the opportunity was used to transfer significant assets owned by Icelanders to local well-connected people. The Norwegian Central Bank and the Norwegian Depositors' and Investors' Guarantee Fund, the Finnish Financial Supervisory Authority and the Danish Central Bank all exerted pressure on the managers of the estates of the fallen Icelandic banks to sell assets at prices far below market value, thus enriching local businessmen. It is interesting to compare the treatment of Icelandic-owned local companies in Norway, Finland and Denmark on the one hand and in Sweden and the UK on the other hand. The Swedish Central Bank provided the Kaupthing subsidiaries in Sweden with liquidity and facilitated the sale of their assets in an orderly way. In the UK, after an initial period of distrust, the British authorities realized that the UK branch of Landsbanki should not be forced into a fire sale of its many valuable assets, so the Bank of England provided it with a loan of £100 million which enabled it to maximise the value of the estate.[146] •

142 T. Kinnunen, Finland's S-Pankki to buy financial group FIM. Reuters 26 May 2013. http://www.reuters.com/article/2013/05/28/finland-spankkiidUSL5N0E912E20130528

143 Email from Terhi Lambert-Karjalainen to Hannes H. Gissurarson 25 July 2014.

144 He is Fritz Schur. Cf. Niels Sandøe, Hanne Sindbæk and Thomas Svaneborg, Kammerherrens nye klæder (København: Jyllands-postens Forlag, 2012).

145 Hannes H. Gissurarson, Thrir erlendir bankar i eigu Islendinga: Hvad gerdist? [Three Foreign Banks Owned by Icelanders: What Happened?] Thjodmal, Vol. 11 (3: 2015), pp. 69–80. The sale and liquidation of FIH Bank was followed with interest by the Danish business journal Borsen which realized all the time what the game was. The dealings in Norway and Finlands have not received the same attention. See references in Gissurarson's article. Retrieved from http://www.thjodmal.is/2015/12/03/thrir-erlendir-bankar-i-eigu-islendinga-hvad-gerdist/

146 Interviews with Mark Durrant-Sismey 28 November 2014 and with Lilja B. Einarsdottir 3 March 2016.

17

LACK OF EXPERTISE IN SMALL STATES

Professor Sibert gives two examples of how very small countries may suffer "because of their high degree of interpersonal relations":

> In Iceland, it has been alleged that personal animosity may have played a role in the central bank denying Glitnir a loan in October 2008 and that the Independence Party played an unseemly role in the privatisation of Landsbanki with agreements made to offer plum executive positions to Independence Party members. Even if such suspicions are untrue, the widely held belief that they might be is damaging to social cohesion and the state's legitimacy.

Unfortunately, Professor Sibert provides no evidence that these allegations are true or that they are even widely held. Some would however say that it was reprehensible to repeat accusations (without any attribution) and then simply to add the *caveat* that even if they were untrue, the belief that they might be, was damaging to social cohesion. What is really damaging to social cohesion is rather to throw out untrue accusation and to have them widely believed, thus creating distrust, anger and resentment.

The facts of the Glitnir case are as follows. At the end of September 2008, it was a unanimous decision of the two government parties, the Independence Party and the Social Democrats, supported by representatives of all the opposition parties, that Glitnir Bank should not receive a requested emergency loan of €600 million from the currency reserves of the CBI (the bulk of the reserves, as it were), but that instead the government should purchase 75% in the bank for €600 million, thus providing it with new equity. Governments in other countries did similar things at the same time, recapitalising ailing financial institutions and writing down shares of their co-owners. Professor Gylfi Magnusson, often a critic of the CBI, said in a television interview 30 September 2008 on Station Two that this action was "in fact just by the textbook".[147] It is therefore hardly plausible or even relevant to say that "personal animosity" played a role in this decision. This was however what business tycoon Jon Asgeir Johannesson publicly asserted after the decision had been made.[148] His assertion was not widely accepted. Indeed, after initial protests, the Glitnir Board of Directors wanted the deal to go through, but then the bank was falling and it was too late.

Professor Sibert's other allegation, that "the Independence Party played an unseemly role in the privatisation of Landsbanki with agreements made to offer plum executive positions to Independence Party members", is unclear and therefore hard to evaluate. When Landsbanki was fully privatised at the end of 2002, Halldor J. Kristjansson was the sole chief executive officer of the bank. He continued in this capacity after the event. Any secret agreements in connection with the privatisation of Landsbanki would therefore surely not have applied to him. In the spring of 2003, Sigurjon Th. Arnason who had been working at Bunadarbanki was hired as a

147 Evening news, Station Two, 30 September 2008; Gudni Johannesson, Hrunid (Reykjavik: JPV, 200), p. 54. The economists publicly supporting this measure included Nobel Laureate Paul Krugman, hardly motivated by "personal animosity" towards the Glitnir bankers.

148 Staersta bankaran Islandssogunnar [Biggest Bank Robbery in Icelandic History], Frettabladid 30 September 2008 (an interview with Jon Asgeir Johannesson).

second chief executive officer. It is unlikely that this move—which came as a surprise to most people—had been decided before the banks were privatised. Apparently, Arnason decided to change jobs because he realised that the new owners of Bunadarbanki were not going to offer him a leading role in Bunadarbanki's management.[149] Whereas Professor Sibert speaks about "executive positions" and not about board memberships, it should be pointed out that the Chairman of the Board of the privatised bank, Bjorgolfur Gudmundsson, was the representative of the biggest shareholder in the bank and that the Vice Chairman of the Board, Kjartan Gunnarsson, was the second biggest shareholder. Gunnarsson was the only one of these four men with close ties to Prime Minister David Oddsson, but after privatisation he sat on the Board as a private shareholder in Landsbanki. It should also be noted that the HSBC Investment Bank oversaw the sale of shares in Landsbanki and that the sale was twice investigated by the Icelandic National Audit Office which found that it had been in accordance with good practice.[150] Professor Sibert's allegation is therefore directed against HSBC Investment Bank and the Icelandic National Audit Office no less than against the Icelandic Privatisation Commission or the government at the time.

Professor Sibert concludes her analysis of the problem of tiny states by a suggestion: "A sensible policy solution to the problem of filling sufficiently important posts when there is limited local talent or to filling a politically sensitive post where the independence and impartiality that is required cannot be found at home is to hire foreigners." She gives two examples from Iceland, that a Norwegian expert had been hired to be acting central bank governor, after David Oddsson and his two colleagues had been ousted by law, and that a Norwegian-born French magistrate had been hired to investigate possible criminal activities by the Icelandic banks.

Here, some additional comments are in order. Svein Harald Oeygaard [Øygaard in Norwegian], the CBI governor mentioned by Sibert, took office immediately after the positions of the three governors had been abolished by law 27 February 2009. A graduate of Oslo University in economics, he had been an active member of the Norwegian Labour Party, working briefly in the Central Bank of Norway, for the Norwegian Parliament and for the Ministry of Finance before getting a job at the management consultants McKinsey & Co. where he was Managing Director for Norway in 2005–7.[151] He could therefore hardly be regarded as an expert on central banking. Moreover, his appointment, even if temporary, seemed to be in breach of the Icelandic Constitution which explicitly prohibits the appointment of foreign citizens as public officials, as law experts immediately pointed out. The Constitution does not make any distinction between temporary and permanent appointments: Under Icelandic law, temporary appointments could be made for a maximum of two years, and permanent appointments usually for five years, and in the case of the CBI governors for seven years.[152] Icelandic and Norwegian are not mutually intelligible, so the governor communicated in English with his staff. On the recommendation of the Norwegian Labour Party leadership, Oeygaard had been secretly hired before the Parliament passed the necessary changes to the law on the Central Bank of Iceland. He was kept hidden in a hotel room in Reykjavik for five days until the changes were passed. Oddly, he told reporters that he could not remember when he had been offered the governorship.[153] Oeygaard served as governor until August 2009 when an Icelander, Mar Gudmundsson, was appointed governor. Only serving in the CBI for five months, Oeygaard can therefore hardly be said to have made an impact. Moreover, his political past, the doubts about the legality of his appointment and the strange circumstances concerning it—his not remembering when he was first offered the job and being kept hidden for five days in a Reykjavik hotel room before he took it up—are not typical of the non-partisan and professional civil servant.

Eva Joly, the Norwegian-born French magistrate mentioned by Professor Sibert, became well-known when she investigated French politicians, banks and companies, in particular Elf Aquitaine.[154] She published a book about her activities and was invited by television host Egill Helgason to discuss it on his show Sunday 8 March 2009, her travel expenses being paid by anonymous donors.[155] She told her audience that the Icelandic authorities had to investigate possible criminal behaviour by the bankers. Money had been concealed, if not abroad, then in Iceland. In the following days Joly met with some government ministers and also with the Special Prosecutor investigating economic crimes in connection with the bank collapse and with the State Prosecutor. The Minister of Justice decided to hire Joly as a consultant in the investigation of the bankers. In a lecture in Iceland Tuesday 10 March, Joly said that the bankers should be treated like criminals, pursued with arrests and search warrants. She also said that the Special Prosecutor needed more resources. Some Icelandic lawyers criticized however that a person who had already made up her mind that crimes had been committed, and said so publicly, should be a part of the investigation team on possible crimes.[156] Shortly after her visit to Iceland, in June 2009, Joly was elected to the European Parliament for a small Green Party in France. In an interview on Icelandic television 10 June 2009 she said that if more resources were not devoted to the investigation of bankers' crimes, then she would quit as an adviser. She also said that the State Prosecutor should leave office. (He had already excused himself from all cases concerning the bank collapse, as his son had been director of a financial company.) Prime Minister Johanna Sigurdardottir publicly said that she agreed with Joly on the State Prosecutor. Some criticized this because the office of the State Prosecutor was supposed to be independent.[157] A decision was made however to increase the budget of the Special Prosecutor.

In total, Eva Joly and her associates received around 128 million Icelandic kronur for their advice to the Icelandic authorities. This is equivalent to approximately US$ 985,000, or a little less than a million dollars.[158] A careful reading of the reports on the Icelandic banks that Joly delivered to the Special Prosecutor reveals however that they add virtually nothing significant to the sections in English in the comprehensive 2010 report by SIC, the Special Investigation Commission on the bank collapse. The one million dollars paid for foreign "expertise" was a waste. In 2012, Joly stood in the French presidential election as candidate of the Greens, receiving 2.31% of the votes. Whatever people may think about Joly, her career at least demonstrates that she was not a typical professional as Professor Sibert seems to suggest: Joly was and is a highly motivated participant in political battles, albeit with marginal support in her own country. But when Professor Sibert mentions Oeygaard and Joly as examples of how important posts could be filled by foreigners where there was limited local talent, she leaves out a third example: Herself. In March 2009, Professor Sibert was appointed by Prime Minister Johanna Sigurdardottir as a member of the Monetary Policy Committee of the Central Bank of Iceland.[159] She received around £2,000 a month for being a member of the Committee where she served for three years, so her total income from Iceland must have amounted to £76,000. The Icelandic government also paid for her airfare and accommodation, which was around £8,000 a year, or £24,000 for three years.[160] In total, Professor Sibert cost the tiny Icelandic nation around £100,000 in 2009–12. •

149 Several interviews with Bjorgolfur Gudmundsson and Kjartan Gunnarsson in 2015 and with Sigurjon Th. Arnason 15 November 2011.

150 Greinargerd um utbod a fjordungshlut rikisins i Landsbanka Islands hf. [Investigation of the Tender for One-Fourth of the Government Share in Landsbanki] (Reykjavik: Rikisendurskodun, Oktober 2002); Einkavaeding helstu rikisfyrirtaekja arin 1998–2003 [Privatisation of main government companies 1998–2003] (Reykjavik: Rikisendurskodun, December 2003).

151 Acting Governor and Deputy Governor of the Central Bank of Iceland appointed, https://eng.forsaetisraduneyti.is/news-and-articles/nr/3441

152 Embaettismenn seu innlendir [High Officials Have to be Icelandic], Frettabladid 27 February 2009 (interview with Professor Sigurdur Lindal); Setning stenst stjornarskra [Temporary Appointment Not in Breach of Constitution], Frettabladid 28 February 2009 (interview with Professor Bjorg Thorarensen). Lindal thought the appointment might be in breach of the Constitution, Thorarensen disagreed. The matter was not pursued further. An illustration of one of Professor Sibert's points, that there is a high degree of interpersonal relations in a small country like Iceland, is that Professor Thorarensen had been offered a position as a government minister in the minority government taking office 1 February 2009. She chose instead to work for the government on constitutional revisions, so she was a government adviser at the time (Bjorg kaus ad vinna ad nyrri stjornarskra [Bjorg chose to work on a new constitution], Morgunbladid 3 February 2009; an interview with Professor Thorarensen). It may complicate matters even more that she is married to Supreme Court judge Markus Sigurgeirsson, as pointed out earlier.

153 Apparently, Oyegaard said this at a press conference 27 February. He is quoted by Bjorn Bjarnason, Politiskir umbrotatimar, Thjodmal, Vol. 5 (1: 2009), p. 8.

154 Eva Joly, Justice Under Siege: One Woman's Battle Against a European Oil Company (London: Arcadia Books, 2006).

155 Eggert Skulason, Andersen-skjolin: Rannsoknir eda ofsoknir? (Reykjavik: Almenna bokafelagid, 2015), pp. 32–33.

156 Brynjar Nielsson, Sakamalarannsokn stefnt i haettu, Morgunbladid 15 April 2009.

157 Rikissaksoknarinn hyggst ekki vikja [State Prosecutor not to resign], Morgunbladid 12 June 2009.

158 Eggert Skulason, Andersenskjolin (Reykjavik: Almenna bokafelagid, 2015), p. 148. Exchange rate 1 June 2010, http://www.sedlabanki.is/default.aspx?PageID=bdce8efa-fe0a-11e4-93fa-005056bc0bdb A Norwegian law firm associated with Joly, Lynx Advokatfirma AS, received 28.3 million kronur in 2009 and 52.9 million in 2010. Cofisys, another company associated with Joly, received 13.8 million kronur. According to an answer from a government minister, Joly personally only received approximately 11 million kronur, or $84,400. Althingi, 144th Session, 2014–15, Document 580, Case 328 (Question to Minister of Justice from Ossur Skarphedinsson). But for some reason the minister was misinformed, so he omitted other personal payments to Joly, approximately 13 million kronur, and her travel and office expenses, 3.3 million kronur. Her assistant, an architect by the name of Jon Thorisson, received 5 million kronur.

159 Prime Minister appoints Dr Anne Sibert and Dr Gylfi Zoega members of the Monetary Policy Committee of the Central Bank of Iceland, at https://eng.forsaetisraduneyti.is/news-and-articles/nr/3464

160 Sibert med 2.000 pund a manudi [Sibert gets 2,000 pound per month], Frettabladid 25 February 2010.

18

THE "SHELTER" THEORY

Professor Baldur Thorhallsson agrees with Professor Sibert that the 2008 bank collapse revealed that Iceland cannot stand on her own, that she needs a shelter and that this shelter is to be found in the European Union. But unlike Sibert, Thorhallsson is not only a teacher and writer, but also a politician: He was an alternate member of parliament for the Social Democrats in 2009–2013, occasionally attending meetings there and voting. His party has however been in rapid decline. The Social Democrats received 29.8% in 2009, 12.9% in 2013 and 5.7% in 2016. Professor Thorhallsson can therefore hardly be regarded as being in the mainstream of Icelandic politics or speaking for a large segment of the Icelandic population, although this does not necessarily invalidate his arguments. Thorhallsson also has close ties to the European Union as the Jean Monnet Professor of European Studies at the University of Iceland. According to *The Times Higher Education*, each such chair is worth up to €50,000 over three years.[161] The arguments of Professors Sibert and Thorhallsson against the feasibility of small states share the same defect: They are not all of them necessarily completely wrong, but they are inadequate in proving that Iceland needs to join the European Union in order to safeguard her interests. Sibert and Thorhallsson both make the obvious point that small states are vulnerable and that there are costs attached to smallness. But small states have ways of dealing with their vulnerability, and the benefits of smallness may outweigh the costs.

Professor Thorhallsson argues that globalisation, or as he calls it, the "experience of the neo-liberal international economy of today, characterised by free flow of capital," makes small states even more vulnerable than before. In a world of risk and uncertainty, small states had constructed "buffers" to protect themselves, mainly corporatism and the welfare state, as described by Peter Katzenstein. But now these "buffers" were not sufficient.[162] If the analysis in this paper is correct, then Thorhallsson is doubly mistaken: He uses the plausible arguments for economic integration, large markets, as if they are arguments for political integration, large states. Small states certainly need economic integration, free trade, global markets, open economies, to benefit from the international division of labour. It is increased globalisation which has indeed made the proliferation of small states possible, as has been emphasised here. In the second place, the "buffer" of small states—their increased ability to respond to external challenges, especially economic crises—is not corporatism or the welfare state, but flexibility, openness, short decision-making chains, transparency, homogeneity, social cohesion and respect for the rule of law. Corporatism and the welfare state are the consequences of those characteristics of many small states rather than their causes. The social cohesion found in the Nordic countries has made the welfare state there possible, not been brought about by the welfare state.[163]

A clear example of the flexibility enabling Iceland to recover surprisingly quickly from the grave repercussions of the 2007–9 international financial crisis was that she was not a part of the euro system and could therefore allow her currency sharply to depreciate. The depreciation of the currency brought about increased competitiveness in the export sectors of the economy, especially the fisheries and tourist services, while Icelandic consumers bought less and saved more. American economist and Nobel Laureate Vernon Smith argues that a flexible currency regime may be crucial for a quick recovery from a crisis and uses Iceland as one of his examples.[164] This stands in marked contrast to some of the small states in the euro zone which in fact went through greater difficulties than Iceland, and were not as quick to recover. They include the Baltic states—which Thorhallsson regards as having obtained adequate "shelters"—and Ireland.

Professor Thorhallsson's use of the word "shelter" is somewhat strange. According to the *Oxford University Dictionary,* shelter is used in two senses, "a place giving temporary protection from bad weather or danger" and "a shielded or safe condition; protection". The dictionary lists two special uses of the word in the former sense, "a place providing food or accommodation for the homeless" and "an animal sanctuary". An example of the word's use in the latter sense is that somebody is "welcome to take shelter from the storm".[165] Thus, the word always refers to temporary rather than permanent arrangements: A shelter is never a home. When Professor Thorhallsson speaks about "the enormous annual fiscal transfer to the Baltic states from the EU Structural Funds" as an argument for Iceland joining the EU,[166] his readers must be reminded of the original meaning of a shelter as "a place providing food or accommodation for the homeless". Rarely have direct transfers from one government to another benefited the general population or stimulated economic growth, as the failure of so-called development aid has amply demonstrated.[167] Again, it is somewhat disingenuous to mention EU funds, because Iceland, as a relatively rich country despite the 2008 bank collapse, would definitely have been a net contributor to such funds rather than a beneficiary from them.

Professor Thorhallsson takes the word "shelter" out of its natural context and uses it in a very wide sense, not only about military protection sought from a big state by a small one, where it seems most appropriate, but also of mutually beneficial trade and of fruitful cultural exchanges between nations. He writes, for example, that in the 14th, 15th and 16th centuries "Iceland had some economic shelter from European sailors and merchants, who provided important trade links with Europe in times of a limited or non-existent domestic fleet."[168] Certainly the foreign sailors and merchants of the time were not doing the Icelanders a favour: They were simply providing a service against a payment. If anything, they themselves found shelter in Iceland while they were harvesting fish and trading goods. Using the concept of shelter in such a wide sense serves to obscure the hard and uncontested core of truth in Professor Thorhallsson's analysis which is that small states have very limited military power and can therefore be occupied and annexed by larger and mightier states, as history has shown over and over again. One survival strategy of small states in the face of their weakness is to find a somewhat distant and powerful ally that can protect them against the perceived threat from a powerful neighbour:[169] Portugal sought and obtained protection against Spain from the UK; otherwise she would most likely have shared the fate of the Basque Country and Catalonia, as she indeed did for a while, in 1580–1640. Israel and Taiwan still enjoy protection against their neighbours from the US. The small states in post-communist Central and Eastern Europe regard their membership of NATO and, to a lesser extent, the EU as a guarantee against any attempts by their former masters to reconquer them. Another survival

161 EU-funded professors deny claims of bias from Brexit campaigners, Times Higher Education 31 May 2016, https://www.timeshighereducation.com/news/european-union-eu-funded-professors-deny-claims-of-bias-from-brexit-campaigners

162 Baldur Thorhallsson, Domestic buffer versus external shelter (2011), p. 324.

163 Nima Sanandaji, Scandinavian Unexceptionalism (London: Institute of Economic Affairs, 2015), p. 5.

164 Steven Gjerstad and Vernon L. Smith, Balance Sheet Crises: Causes, Consequences, and Responses, Cato Journal, Vol. 33 (3: 2013), pp. 437–470.

165 https://en.oxforddictionaries.com/definition/shelter

166 Baldur Thorhallsson, Domestic buffer versus external shelter (2011), p. 332.

167 Peter Bauer, From Subsistence to Exchange and Other Essays, with an Introduction by Amartya Sen (Princeton: Princeton University Press, 2004); William Easterly, The White Man's Burden: why the West's efforts to aid the rest have done so much ill and so little good (New York: Penguin, 2006).

168 Baldur Thorhallsson, Domestic buffer versus external shelter, 2011, p. 330.

169 For other examples, see Donald E. Nuechterlein, Small States in Alliances: Iceland, Thailand, and Australia, Orbis, Vol. 13 (1969), pp. 600–623.

strategy of small and weak nations has been to try and rely on international treatises and institutions. This has until recently largely been a failure, as the League of Nations and the many non-aggression pacts signed between states before the Second World War demonstrate. For example, Denmark signed a non-aggression pact with Germany in 1939, only ten months before the German Army invaded Denmark.[170]

As noted earlier, the world-wide triumph of democracy, especially after the 1989–1991 collapse of communism, may impose constraints on governments of big states to use their military might against small states. Examples abound, nevertheless, of the basic precariousness of small states and political units: China invading and annexing Tibet in 1950, India invading and annexing Goa in 1961 and Sikkim in 1973, Indonesia invading East Timor in 1975, Argentina invading the Falkland Islands in 1982, the US invading Grenada in 1983 and Panama in 1989, Iraq invading Kuwait in 1990, Russia invading and annexing Crimea in 2014, and so on. As the Athenians said to the Melanians more than two thousand years ago in a famous exchange, the rule in international relations has often been that "the strong do what they can and the weak suffer what they must."[171] In a narrow sense, therefore, Professor Thorhallsson's "shelter" thesis is true, but trivial: Of course, small states try to ally themselves with more powerful states to get the protection they are not able to provide on their own. In a wide sense, however, the "shelter" thesis is implausible. Mutually beneficial trade in world markets and fruitful cultural exchanges between nations have little if anything to do with shelters where people huddle together for temporary relief. People are not taking refuge from a storm by freely engaging in trade or cultural exchanges. Sometimes small states can even be cultural centres in their own right, like Athens and Florence.

However, Professor Thorhallsson neatly protects his thesis from any refutations. Admitting that seeking a "shelter" may impose costs on the small state, he observes that "this price may never be higher than the gains it receives: otherwise one cannot refer to this as shelter."[172] In other words: any large-scale interaction of a small state with a big one is a "shelter" if its benefits outweigh the costs; otherwise it is not a "shelter". The thesis is like the proverbial customer of whom César Ritz spoke: It is never wrong. But a theory which explains everything, explains nothing. Perhaps Professor Thorhallsson is unwittingly presenting as a general theory the utter helplessness, sense of rejection and even desperation that many Icelanders felt in the autumn of 2008, in the midst of the financial crisis, when they were not only refused help from their traditional allies, whereas small countries like Sweden and Switzerland received such help (without ever having been allies of the West), but they were also for a while cut off from international trade and money transfers by the brutality of the UK Labour government that needlessly invoked a special anti-terrorism law against both the Icelandic authorities and one of the three Icelandic banks. As Thorhallsson himself writes: "Iceland was stranded on its own in the mid-North Atlantic without economic and political shelter."[173]

In Professor Thorhallsson's account of the dramatic Icelandic bank collapse in 2008 there are some outright errors or misleading statements. He writes, for example: "Therefore, the Americans simply expressed relief when the Russian government hinted that it was willing to bail Iceland out with a substantial loan after the crisis hit (information from the US Embassy in Reykjavik, 2009)."[174] This goes totally against what could be expected from the US government in the circumstances: Of course it would not be "relieved" if Russia was to gain a foothold in Iceland. More importantly for our purposes, it also goes totally against the evidence available. It so happens that a secret cable from the US Embassy in Reykjavik to the State Department, sent in the midst of the crisis, was intercepted and published on the Wikileaks website. In the cable, Ambassador Carol Van Voorst describes statements by Prime Minister Geir H. Haarde and other Icelandic politicians that they had been abandoned by Iceland's traditional allies so that they had turned to Russia for help. She adds:

> American bankers here tell us that U.S. support is badly needed, that the Icelandic bank assets are not toxic, and that their problem is short term liquidity worsened by a crisis of confidence. The U.S. has strategic interests in the high north and a sturdy security relationship with post-Keflavik Iceland that both sides have labored to develop. Today the Embassy urged senior reps in the PM's office and elsewhere to at least explore what confidence-building cooperation (other than the credit swaps the Fed turned down) may be possible to develop. We doubt that it would be in the interest of the U.S. or NATO for the Icelanders to be beholden to Russia, however "friendly" the loan terms may be.[175]

Thorhallsson must have misunderstood the person to whom he spoke at the US Embassy in Reykjavik. He seems to have been carried away by his own strongly held belief that the EU had to replace the US as a "shelter" for Iceland.

It is also highly misleading how Professor Thorhallsson describes the position on EU membership of the Independence Party under David Oddsson in the 1990s and early 2000s: "its leadership stifled all discussion of a possible application for EU membership in order to prevent an outright split of the party."[176] It is by no means correct that the leadership of the Independence Party tried to avoid a debate on a possible application for EU membership. In fact, David Oddsson discussed it several times, and so did other leading members of the Independence Party, in particular Bjorn Bjarnason, Minister of Education and later of Justice.[177] It was obvious from Oddsson's speeches that he had not been unsympathetic to EU membership in the early 1990s, but that he had slowly changed his mind for three reasons: first, Iceland gained access to the European market by membership of the European Economic Area so that there were no compelling reasons for her to seek membership of the EU. In the second place, as a shrewd politician Oddsson realized that there was strong opposition in Iceland to EU membership, just as in Norway where it was rejected twice by the voters. In Norway, opposition was in fact strongest in the Northern part of Norway, Finnmark, which is most similar to Iceland economically and socially. No more than the Norwegians did the Icelanders want to transfer control of their fertile fishing grounds to Brussels. Thirdly, during this period the EU was developing from a common market to some kind of superstate; political integration seemed to be replacing economic integration as the main objective.

Both Oddsson and Bjarnason criticized the repeated assertions by supporters of EU membership that the Icelanders could obtain special and permanent exemptions from EU principles. They stressed that there was no such thing as a negotiation between an applicant state and the EU: there was only an adjustment process in which the applicant changed its laws and statutes in accordance with EU principles. Nevertheless, at the end of 1999, Oddsson wrote that "EU membership cannot be categorically excluded. Therefore it is positive that discussion on it continues, as the EU itself develops and changes."[178]

Of course the leadership of the Independence Party had no power or ability to stifle discussion of Iceland's possible EU membership. Professor Thorhallsson seems to be complaining, rather, that the leadership did not agree with him and other advocates of membership and that it contributed to the discussion on its own terms instead of being dictated to by Thorhallsson and his soulmates. On the other hand, the supporters of EU membership certainly had a lot of resources at their disposal to promote discussion on the subject. The EU did not only provide Professor Thorhallsson with a Jean Monnet Chair, but also financially supported courses on European integration at the University of Iceland and several series of lectures on European affairs organised by the Institute of International Studies at the University. Many of Thorhallsson's colleagues at the University also enjoyed EU grants. It would be sufficient material for a special research paper to describe the informal network, or even propaganda machine, which was funded by the EU in Iceland in order to influence public opinion in favour of the EU. •

170 Erik Brüel, The Danish-German Non-Aggression Pack, Nordisk Tidsskrift for International Ret, Vol. 10 (1939), pp. 157–163.

171 Thucydides, History of the Peloponnesian War, Book V, 5.89.

172 Baldur Thorhallsson and Tómas Joensen, Iceland's External Affairs from the Napoleonic Era to the Occupation of Denmark: Danish and British Shelter, Stjornmal og stjornsysla, Vol. 11 (2: 2015), p. 189.

173 Baldur Thorhallsson, Domestic buffer versus external shelter (2011), p. 325.

174 Baldur Thorhallsson, Domestic buffer versus external shelter (2011), pp. 328–329.

175 Carol van Voorst to State Department, Icelandic economic crisis, time for USG to get involved? 8 October 2008. http://wikileaks.org/plusd/cables/08REYKJAVIK225_a.html

176 Baldur Thorhallsson, Domestic buffer versus external shelter, 2011, pp. 330–331.

177 See Bjarnason's collections of articles on the EU, Bjorn Bjarnason, Hvad er Islandi fyrir bestu? Tengsl Islands og Evropusambandsins (Reykjavik: Ugla, 2009).

178 David Oddsson, Aramotagrein, Morgunbladid 31 December 1999. http://www.forsaetisraduneyti.is/radherra/raedur-og-greinar/nr/25

19

IMPLAUSIBLE ACCOUNT OF THE COMMONWEALTH'S DOWNFALL

In addition to his strange description of small states as some kinds of vagrants who have to huddle together in shelters, hoping for hand-outs from bigger states or from the EU, Professor Thorhallsson offers a new interpretation of Icelandic history where the main theme is the search by the nation (putting 'the nation' within inverted commas to show his disdain, just like Marx had done with 'the Icelanders') for a shelter. "Iceland started as an independent entity and then was voluntarily moved to a dependency relationship with Norway," he writes.[179] The reasons why the Icelanders decided in 1262 to subject themselves to the authority of the Norwegian King were, according to Professor Thorhallsson, that they wanted to end the domestic violence amounting almost to a civil war and that they sought the general protection of the Norwegian Realm, including access to markets and a guarantee of transport to and from their remote island, at least six ships a year, as stipulated in the Old Covenant of 1262.

This is implausible. First, the violent conflicts between a few families or "clans" had ceased before 1262. Gissur Thorvaldsson whom the Norwegian king had in 1258 made Earl of Iceland had already emerged as a victor in the conflicts. If anything, by advocating the subjection of the Icelanders to the King he was trying to reinforce his victory and to strengthen his position.

In the second place, it was the Norwegian King who wanted to extend his rule to Iceland, and he was forcefully resisted by many Icelanders who had a deep seated distrust of kings, not least because they feared an increased tax burden. This was eloquently brought out in *Heimskringla*, a chronicle of the Norwegian kings written by Icelandic statesman Snorri Sturluson (who was in 1241 killed at his farm in Iceland on the order of the Norwegian king). In 1024 King Olav "the Fat" Haraldsson of Norway sent an Icelandic courtier to Iceland to inform the inhabitants that the king was willing to be their sovereign if they wanted to be his subjects. The emissary, Thorarinn Nefjolfsson, arrived when Parliament was in session at Thingvellir. He delivered the king's greetings to the Icelanders and his tentative offer of becoming their sovereign, but also more concretely he asked the Icelanders to give the island of Grimsey north of Iceland to the king, and then the king would reciprocate their generosity. The farmers of the North held a special meeting to discuss this. One of them, Einar Eyjolfsson from Thvera, was asked why he kept silent about the matter. He replied that nobody had asked him for his opinion. He thought that the Icelanders should remain friends of the king, but that they should not become his subjects, undertaking to pay the same heavy taxes as the Norwegians:

> [T]his heavy burden we will lay not only upon ourselves, but on our sons, and their sons, and all our race, and on all the community dwelling and living in this land, which never after will be free from this slavery. Now although this king is a good man, as I well believe him to be, yet it must be hereafter, when kings succeed each other, that some will be good, and some bad. Therefore if the people of this country will preserve the freedom they have enjoyed since the land was first inhabited, it is not advisable to give the king the smallest spot to fasten himself upon the country by, and not to give him any kind of tax or service that can have the appearance of a duty. On the other hand, I think it very proper that the people send the king such friendly presents of hawks or horses, tents or sails, or such things which are suitable gifts; and these are well applied if they are repaid with friendship.[180]

This speech probably owes more to Snorri Sturluson writing in 1225 than to the farmer from Thvera speaking in 1024. Nevertheless, it illustrates a clear awareness by the Icelanders of their separate collective identity and their suspicion of kings, especially the royal propensity to lay heavy taxes on the people.

In the same spirit, Icelandic farmers later responded to attempts by various local chieftains to become their rulers, as can be read in *Sturlunga*, a compilation of stories from the 12th and 13th century. When Thorgils Bodvarsson from the Sturlungar family in 1255 asked a meeting of farmers at Vallalaug in Skagafjordur for acceptance as their ruler, one of them, Broddi Thorleifsson from Hof, wearily said: "If I have to serve a master, then I would choose Thorgils Bodvarsson, but it would be best to have no master if that were possible." When another chieftain, Thorvard Thorarinsson from the Svinfellingar family, and supported by the Sturlungar, the same year asked an assembly of farmers at Djupadalsa in Eyjafjordur for acceptance as their ruler, one of them, Thorvard Thordarson from Saurbaer in Eyjafjordur, said: "I find the present ruler acceptable, but it would be best to have no rulers at all."[181] According to a contemporary account, after Icelandic farmers learned in 1261 that Earl Gissur Thorvaldsson had committed himself to make Iceland a Norwegian tributary, they "promised the Earl a huge amount of money in order to relieve them of the payment that was demanded". When Earl Gissur was persuading the farmers to swear allegiance to the king, "he called it a plot against his own life if they did not accept."[182]

The Icelanders reluctantly yielded their country to the Norwegian King and became his subjects for two main reasons: Earl Gissur Thorvaldsson who had more or less gained control of the whole country strongly urged them to do so because he wanted to maintain his earldom; and the King had the power to isolate the country, far up in the North Atlantic. Iceland was

179 Baldur Thorhallsson, Iceland's external affairs in the Middle Ages: The shelter of Norwegian sea power, Stjornmal og stjornsysla, Vol. 8 (1: 2012), p. 10.

180 Snorri Sturluson, Saga of King Olaf Haraldsson the Saint, Heimskringla, Vol. II, Ch. CXXXIV (London: Longman, Brown, Green and Longmans, 1844), p. 188. Translated by Samuel Laing.

181 Thorgils saga skarda, Sturlunga, Ch. 452 (Reykjavik: Svart a hvitu, 1988).

182 Sturla Thordarson, Hakonar saga Hakonarsonar (Oslo: Forlagsentralen, 1977), Ch. 311, pp. 189–90. Translated by Gunnar Karlsson. Here after Karlsson's History of Iceland, p. 85.

dependent on trade with Norway, and the King could at any time stop transport of goods and people to and from the country. Therefore, the Icelanders stipulated in the 1262 Old Covenant that at least six ships should sail from Norway to Iceland in the next two summers and after that as many as the king "and the most judicious farmers in Iceland" believed to be in the best interest of the country. But their deep seated distrust of kings expressed itself in the stipulations that the king would let them "enjoy peace and the Icelandic laws" and that they would be free of all obligation if the king broke the Covenant.[183] Professor Thorhallsson turns the explanation for the Old Covenant upside down: He asserts that the Icelanders accepted the Covenant because they feared isolation, but in fact they reluctantly accepted it because the Norwegian king threatened to isolate them if they would not become his subjects. In 1262, there was no immediate internal or external crisis which required the Icelanders to take "shelter" in the Norwegian realm.

In his account of the end of the Icelandic Commonwealth, Professor Thorhallsson glosses too easily over the opposition of the Icelanders in the 13th century to yield the country to the Norwegian king, not only expressed in *Heimskringla* and *Sturlunga*, but also in the Icelandic sagas which take place roughly from the settlement of Iceland in 874–930 to the 1020s, but which are mostly composed in the 13th century. The best-known saga was is that of Egil Skallagrimsson, probably written by Snorri Sturluson: It is all about a feud between an Icelandic family of hardy individualists and the Norwegian royal family. Two anecdotes from other sagas also illustrate this anti-royal attitude. In *The Saga of the People of Vatnsdalur*, two Norwegians are discussing the newly discovered island out in the North Atlantic. One of them, Grim, announces his intention to settle there, because the climate is, he says, ideal for rearing sheep, the lakes and rivers are full of fish, there is plenty of wood there, and "men are free from the assaults of kings and criminals".[184] In Grim's mind, kings and criminals belonged in the same category.

Another telling example is found in *Grettir's Saga*. An old Viking, Onund the Tree-foot (so named because he had lost one foot in a battle), is reluctant to return to Norway. "He added that he had no inclination to become the slave of a king and to beg for his own property."[185] Here the idea of independence and autonomy is quite clear: Onund did not want to beg for what was rightfully his; he was a free man, not the king's slave. Professor Thorhallsson seems not to have any sympathy with, or indeed awareness of, the position of Snorri Sturluson in *Heimskringla*, put into the mouth of Einar Eyjolfsson, of the two farmers in the 13th century, Broddi and Thorvard, about whom *Sturlunga* tells us, or the two settlers, Grim and Onund the Tree-foot, as quoted in the sagas.

Perhaps more surprisingly, Professor Thorhallsson does not mention the yearly tribute which the Icelanders eventually agreed, in the 1262 Old Covenant, to pay to the Norwegian king. It was not an insubstantial sum for a poor country, 20 ells a year from each financially independent farmer. 20 ells were one-sixth of the value of a cow,[186] so it would amount to US$250–300 in today's money from each farmer, or in total, since the financially independent farmers in Iceland numbered around 4,000, perhaps up to a million dollars a year. "This would not be called heavy taxation nowadays, but by medieval standards it may have been considered quite severe," History Professor Gunnar Karlsson writes.[187] Furthermore, the crown derived some income from various fees and fines. In the 14th century, responding to severe financial difficulties, the Norwegian king increased taxation of the Icelanders. He subjected goods from the country to a 5% tariff and the ships sailing to and from the country had to provide the crown with a quarter of their space. The king also started to rent out Iceland as a tax province.[188] Imposing reformation in 1540–1550, the crown also appropriated much of the Catholic Church's substantial holdings, coming to own almost 20% of all land, on which it collected rent.[189] Against this has to be counted the expenses of collecting taxes and maintaining what little control the king had over Iceland. It is likely that the king's net revenue from Iceland in her first centuries as a tributary was around $300,000 a year.[190]

What did the Icelanders get in return? They did not really get any protection, as became obvious in the early 15th century when English fishing fleets started to frequent Icelandic waters after innovations in shipbuilding technology. The English could easily take control of the country; in 1467 they even killed the king's governor. The only real defence the country had was the great distance from other countries, but even this was not sufficient to prevent pirate raids from Algeria and Morocco in 1627, although they obviously did not prove lucrative enough for the pirates to return: they captured around 400 Icelanders whom they sold into slavery in their homelands.

By now, the king of Denmark had become king of Norway as well. He offered to sell Iceland to the English king, Henry VIII, not once, but thrice: in 1518, 1524 and 1535. The price the Danish king was willing to accept was 50,000 gold florins which is something like 6.5 million dollars in today's money.[191] In 1645 the Danish king tried yet again to sell Iceland, this time to merchants in Hamburg. Now the price was 500,000 silver thalers which is something like 6.4 million dollars in today's money. The price had obviously not changed much over a century. But there were no buyers, probably because fishermen and merchants from England and Germany had all the access they wanted to Iceland, especially to her fertile fishing grounds. The defencelessness of the country was demonstrated once again in 1809 when Danish and British adventurers, claiming to act on behalf of the UK government, briefly took power. •

183 The Covenant is reprinted in Gunnar Karlsson, A History of Iceland (Minneapolis: University of Minnesota Press, 2000), pp. 83–84.

184 Vatnsdaela saga (The Saga of the People of Vatnsdal), Ch. 10. The Sagas of Icelanders, (Harmondsworth, Middlesex: Penguin, 2000), p. 205.

185 Grettir's Saga, tr. by Denton Fox, ed. by Hermann Palsson (Toronto: University of Toronto Press 1974), Ch. 3, p. 5.

186 The value of a cow in Iceland in 2016 is more or less US$1,600.

187 Gunnar Karlsson, A History of Iceland, p. 84.

188 Baldur Thorhallsson, Iceland's external affairs in the Middle Ages: The shelter of Norwegian sea power, p. 18; Bjorn Thorsteinsson and Bergsteinn Jonsson, Islandssaga til okkar daga (Reykjavik: Sogufelag, 1991), pp. 141–142.

189 Helgi Thorlaksson, Fra kirkjuvaldi til rikisvalds, Saga Islands, Vol. IV, ed. Sigurdur Lindal (Reykjavik: Hid islenska bokmenntafelag, 2003), pp. 99–107.

190 Jon Sigurdsson calculated that the king initially received around 10,000 rigsdaler (the Danish currency in mid-19th century) from Iceland a year, which amounted to 20,000 kroner (the new gold-based currency introduced in 1875). If the value of the gold backing the currency is converted into today's prices, with $37 for 1 gramme, and with 1 rigsdal worth 2 kroner and 1 krone worth 0.403 grammes of gold, as was the case, then the outcome is that 10,000 rigsdaler were worth $298,000. This is plausible since the king was willing to sell Iceland in 1518 and 1645 for $6 million, as I have calculated: It would be like a principal of $6 million with an interest rate of 5%, or $300,000. A social discount rate of 5% would not have been unlikely in the period 1300–1800.

191 Hannes H. Gissurarson, Proposals to Sell, Annex or Evacuate Iceland, 1518–1868, Rannsoknir i felagsvisindum, Vol. XVI (Reykjavik: Felagsvisindastofnun Haskola Islands, 2015).

20

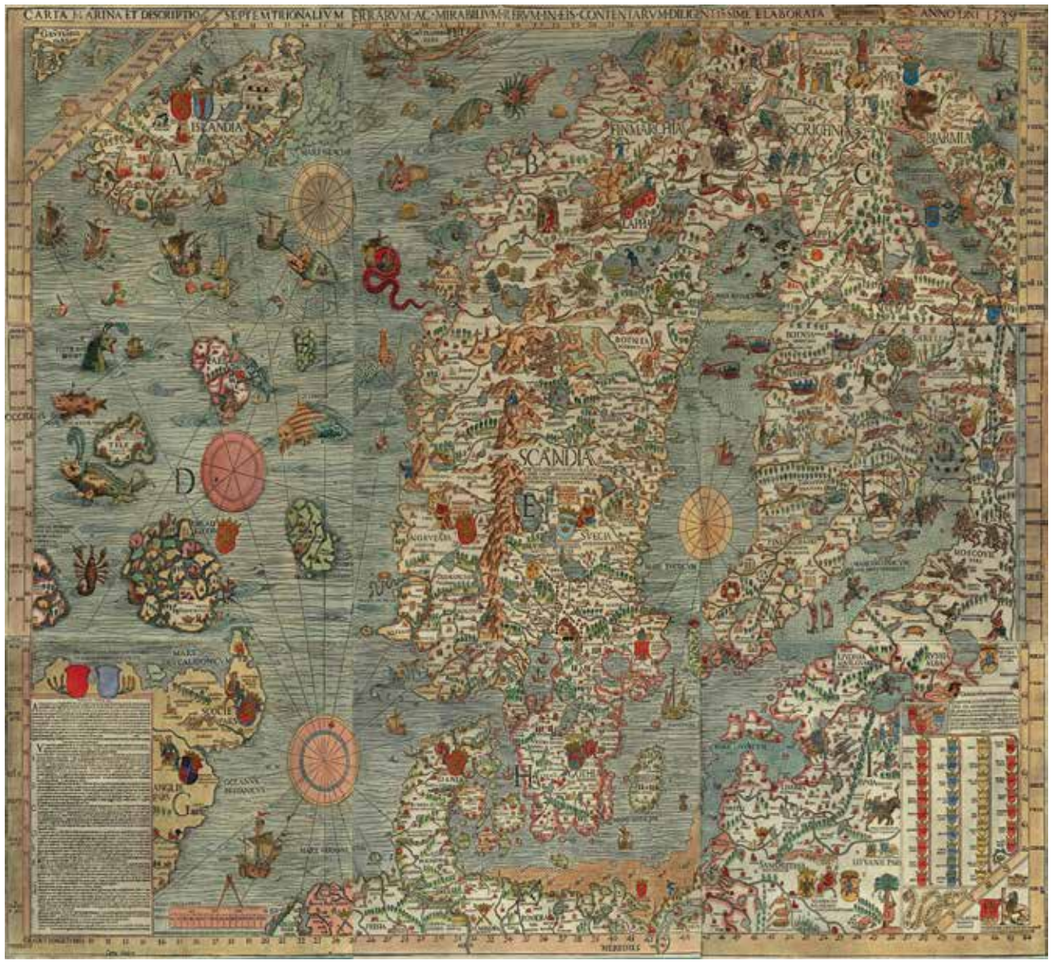
WHEN A SHELTER BECOMES A TRAP

THE CASE OF ICELAND

Not only was Iceland left defenceless: the "shelter" Iceland may have found in the Danish-Norwegian crown turned into a trap, as History Professor Gisli Gunnarsson and Economics Professor Thrainn Eggertsson have cogently described. When in late 14th century the fertile fishing grounds off Iceland became accessible to Europeans through improved technology, the Danish king was faced with two alternatives. One of them was to encourage the fisheries and foreign trade of Iceland which would have made the Icelandic economy more productive. This would presumably have increased the total tax revenue from the island. But this strategy carried the risk of losing control of the island altogether, as the unhindered activities in the 15th and 16th centuries of English and German fishermen and merchants in Iceland showed. The alternative strategy was to discourage all relations between Icelanders and foreigners, even if it meant that no profitable fisheries would develop in the country and it would remain impoverished. This is what the king chose to do: He preferred the certainty of low tax revenues to the risk of no tax revenues.

Essentially, over a period of time, roughly in 1450–1600, in a series of statutes and ordinances, the king made a pact with the ruling elite of landowners in Iceland that agriculture should be the only legal full-time profession of the population; that everybody had to be registered in one of Iceland's 4–6,000 farms, as a farmer, a member of his family, or a farmhand; and that foreigners were forbidden to stay in Iceland during winter. This meant that the fisheries could only be a part-time activity, with the Icelanders operating primitive open rowboats and staying close to the coast while foreign fleets of decked vessels were harvesting immense amounts of fish. Moreover, in 1602–1787 the Danish king imposed a total monopoly on all trade with Iceland. The Icelanders were strictly prohibited, under the threat of severe punishment, to trade with anyone except a designated Danish merchant in each region, and more importantly, at prices decided in royal decrees, where the prices of agricultural products were set far above market prices and the prices of marine products far below them.[192] These measures stifled the growth of the fisheries and explains the paradox pointed out by Professor Eggertsson that the Icelanders suffered one famine after another even if they lived close to some of the most fertile fishing grounds in the world.[193] The Greenlanders who had pledged allegiance to the Norwegian king at the same time as the Icelanders did not benefit, either, from it. The king never ensured transport to and from them, and the colonies there disappeared.

The unholy alliance between the Danish crown and the Icelandic landowners broke down in the 1780s when Iceland had become so impoverished that the Danish authorities seriously thought of relocating the whole nation, then only numbering around 35,000 people, to other Danish territories, perhaps to the Jutland moors.[194] Following the demise of the old landowning class and the public sale of most farms previously owned by the crown and the church, a class of independent farmers came into being. The monopoly trade was abolished in 1787 and full freedom to trade introduced in 1855. As soon as



Iceland escaped the "shelter" in which she had been entrapped for centuries, the fisheries started to develop and the population to grow. A new class of merchants, fishermen and urban workers emerged. Professor Thorhallsson makes much of the fact that now Danish authorities started to spend money on Iceland, especially on education and health, abandoning their previous project of extracting as much tax revenue out of the country as they could. "Accordingly, despite its peripheral location, Iceland enjoyed considerable societal shelter provided by Denmark."[195] But as the leader of Iceland's struggle for independence, Jon Sigurdsson—not mentioned once by Professor Thorhallsson—argued, the Danish crown was simply reimbursing the Icelanders for the land unlawfully expropriated and the taxes violently extracted from the country for centuries.[196] It is true that in the 19th and early 20th century, Danish authorities generally treated the Icelanders decently, never trying for example to impose Danish on them and displaying genuine interest in, and respect for, Icelandic culture. The democratic and peaceable Denmark of 1904—when Iceland got home rule—was quite different from the predatory Danish crown of past centuries. But this does not mean that a small nation should just be grateful for hand-outs from a bigger nation that had previously ruined her, as Professor Thorhallsson seems to suggest. Arguably, it would also have been more fruitful for the Icelanders to have cultural exchanges with a wider range of nations than the Danes alone, however sympathetic and well-meaning they were. •

192 Gisli Gunnarsson, Monopoly trade and economic stagnation: studies in the foreign trade of Iceland, 1602-1787 (Lund: Ekonomisk-historiska föreningen, 1983).

193 Thrainn Eggertsson, No experiments, monumental disasters: Why it took a thousand years to develop a specialized fishing industry in Iceland, Journal of Economic Behavior & Organisation, Vol. 30 (1996), pp. 1–23.

194 Anna Agnarsdottir, Scottish plans for the annexation of Iceland 1785–1813, The Scottish Society for Northern Studies, Vol. 29 (1992), p. 87.

195 Baldur Thorhallsson and Tomas Joensen, Iceland's External Affairs from 1550–1815: Danish societal and political cover concurrent with a highly costly economic policy, Stjornmal og stjornsysla, Vol. 10 (2: 2014), p. 207.

196 Jon Sigurdsson, Um fjarhagsmalid, Ny felagsrit, Vol. 22 (1862), pp. 22–99.

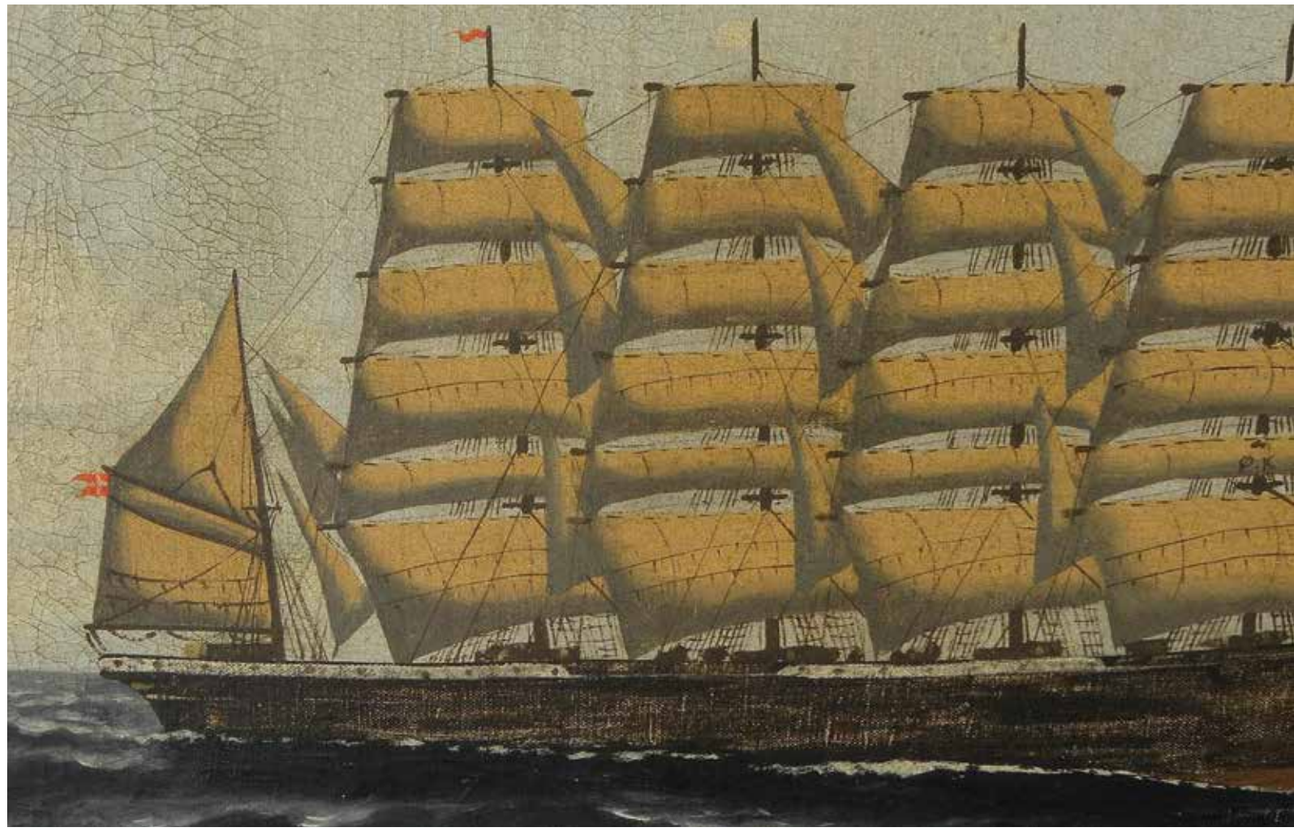
21

ENTRAPPED BY ALLIES

While small states certainly need protection, they always run the risk that their protectors suddenly abandon them if they decide that this is in their own best interests. Iceland is no exception. Two incidents, in 1864 and 1901, showed the inherent vulnerability of this small and expendable country. In the 19th Century, the Danish realm had suffered one setback after another, losing in 1814 the Kingdom of Norway to Sweden (when the Swedes did not even bother to make a claim to the old Norwegian dependencies in the North Atlantic, Iceland, the Faroe Islands and Greenland) and in 1864 the two duchies of Schleswig and Holstein to a German alliance. While Holstein was German-speaking and a member-state of the German Federation, the Northern part of Schleswig was populated by Danish speakers. Almost in despair, after a humiliating military defeat, the Danish government discussed the possibility of offering Iceland to the Prussians who led the German alliance, if Northern Schleswig (or Southern Jutland, as the Danes preferred to call it) could remain under Danish rule. The Danish emissaries in peace talks with the Prussians were instructed cautiously to enquire whether there would be any possibility of such an exchange. It turned out that Otto von Bismarck, the Prussian chancellor, had no desire of acquiring Iceland, so the offer was never made formally. Perhaps this idea would never have been implemented anyway, but it is still telling that it should have been seriously considered by the Danish government.[197]

The second incident was a treaty that Denmark made in 1901 with the UK, after much pressure, that for the next fifty years Iceland's territorial waters should only be limited to three miles, thus abandoning the traditional Danish claim that Iceland's territorial waters should be 16 miles (which had actually later been reduced to four miles in the hope that this could be more easily patrolled). This change was quite important to the UK: British catches in Icelandic waters in 1919–1938 were more than twice the total catch of the British distant-water fleet in all other waters combined.[198] The 1901 treaty was unfavourable to the Icelanders. They could only begin to take sole control of the fertile fishing grounds in their waters after 1951 when the treaty expired, extending the territorial waters to 4 miles in 1952, 12 miles in 1958, 50 miles in 1972 and 200 miles in 1975, each time against the opposition of the UK government which thrice sent in the Royal Navy to protect British fishing vessels from the tiny Icelandic patrol boats. The 1901 treaty illustrated that for the Danish government the Danish interest in maintaining good relations with a powerful neighbour (and customer of Danish exports) overrode the Icelandic interest in excluding others from the Icelandic waters.

Certainly small states seek military protection from bigger states whereas Professor Thorhallsson implausibly wants to call this "shelter". It is clear, however, that Iceland did not enjoy any real military protection from Denmark in the 18th and 19th centuries, notwithstanding that she was formally ruled from Copenhagen. The Danish connection was even a liability in the Napoleonic Wars when the UK and Denmark were enemies and the UK put an embargo on Denmark, but fortunately Iceland had friends in the UK and was exempted from the embargo, with some conditions.[199] Iceland's real protection was her distance from other countries combined with the unwillingness of the UK, with her powerful navy, to see any other significant power take control of this North Atlantic island, while the British themselves had no desire to annex it. In the First World War, the UK immediately took control of Iceland, if not formally: A career diplomat, Sir Eric



Cable, was dispatched to Iceland, and during the war he made all important decisions about trade between Iceland and other nations. Even if Iceland was then a Danish dependency, Iceland and the UK made trade agreements directly between themselves without Danish participation.[200] The requirements of the powerful country swept away all formalities. The same happened in the Second World War, except then the UK occupied Iceland directly, disregarding her declaration of perpetual neutrality.[201]

It was however an important milestone in the history of Iceland when she, as a sovereign state, signed an agreement with the United States in the summer of 1941 by which the US took over the country's defence for the remainder of the war. The US military force left Iceland in 1946, but as the Cold War was beginning the US had great interest in a military base in Iceland. Already in 1920, communist leader Vladimir Lenin had pointed out to the Icelandic delegates at the Comintern congress in Moscow that after the introduction of airplanes and submarines Iceland was becoming strategically important in potential military conflicts in the North Atlantic.[202] The German geopolitician Karl Haushofer had said in the same vein, as Winston Churchill observed, that whoever possessed Iceland was holding a pistol firmly pointed at the UK, the US and Canada.[203] Any military cooperation with the US was fiercely resisted by the strong Icelandic communist movement, closely connected to and financed by Moscow, but nevertheless Iceland joined NATO in 1949 and made

197 Sverrir Kristjansson, Skjol um skipti a Islandi og Nordur-Slesvik arid 1864, Andvari, Vol. 89 (1964), pp. 62–74.

198 Jon Th. Thor, British Trawlers and Iceland (Gothenburg: University of Gothenburg Press, 1995), p. 56–107.

199 Anna Agnarsdottir, The imperial Atlantic system: Iceland and Britain during the Napoleonic wars, Atlantic history. History of the Atlantic system 1580–1830, ed. H. Pietschmann (Göttingen: Vandenhoeck & Ruprecht, 2002), pp. 497–512.

200 Solrun B. Jensdottir, Anglo-Icelandic Relations during the First World War (New York: Garland, 1986).

201 Winston Churchill writes, The Second World War, Vol. III, The Grand Alliance (Boston: Houghton Mifflin, 1950), p. 120, that UK forces occupied Iceland "with the concurrence of its people". This is not entirely accurate: The Icelandic government protested against this violation of Iceland's declared neutrality. However, some leading Icelanders were secretly relieved that it was the UK and not Nazi Germany that occupied Iceland. Independence Party leader Olafur Thors said as much to the British Ambassador on the day of the occupation. On Icelandic foreign policy, Thor Whitehead, The Ally Who Came In From the Cold (Reykjavik: University of Iceland Press, 1998).

202 Hendrik S. Ottosson, Fra Hlidarhusum til Bjarmalands (Akureyri: Palmi H. Jonsson, 1948), p. 230. Ottosson was one of the two delegates.

203 Winston S. Churchill, The Grand Alliance, p. 120.

a defence treaty with the US in 1951 by which the US established a military base in Iceland. The British interest in Iceland had, almost from the time of Henry VIII, been mostly negative: the UK was not interested in controlling the country, but she did not want any other major European power to control it, either. The American interest in Iceland was more positive. The US wanted a military base in Iceland, but she wanted it with the full consent and cooperation of the Icelanders. This meant that suddenly Iceland found herself, for the first time in history, in a strong bargaining position against a major power, to boot a friendly one. She used it to obtain favourable trade agreements and even financial support from the US, and most importantly the US put pressure on the UK, behind the scenes, not to use force to prevent Iceland's four extensions of her territorial waters, enabling her to take sole control of the fertile fishing grounds off the island.[204]

Again, however, Iceland, like other small states, ran the risk that her designated powerful ally suddenly abandoned her if and when this ally decided that protecting her was not in its own best interests. With the end of the Cold War, Iceland's strategic importance seemed to be greatly reduced. In 2006, the US unilaterally withdrew her military force from Iceland, leaving the island practically defenceless. In 2008, as the international financial crisis caused a massive liquidity shortage in foreign currency in the Icelandic banks, the US Fed resolutely refused to make the same currency swap deals with the CBI as it did with the central banks of the three Scandinavian countries (including Sweden, never a US ally) and of Switzerland (also never a US ally). It was described earlier that the three Scandinavian central banks had only very reluctantly made currency swap deals with the CBI. Now, not only the US Fed, but also both the Bank of England and the European Central Bank refused to make such deals. The refusal of the US Fed to make the deal was justified by the excessive size of the Icelandic banking sector which might have required a liquidity facility of US$10 billion. But in the Cold War this would not have been an obstacle: This was anyway a much lower credit facility than the three Scandinavian central banks obtained from the Fed.[205]

Moreover, as a fully committed ally of Iceland, for her own reasons, the US would probably not in the past have allowed the British Labour government to behave to the Icelanders as it did in the fateful first week of October 2008 when the whole Icelandic banking sector collapsed: first, at the same time as the Labour government announced a rescue package of £500 billion for British banks (mainly aimed at two big and ailing Scottish banks, RBS and HBOS), it closed down only two British banks, those owned by Icelanders. When these two banks, Heritable and KSF, went into resolution it emerged that they had been solvent, unlike some of the banks which were rescued. By closing down KSF the British government brought about the downfall of its Icelandic parent company, Kaupthing, the biggest of the three main banks. In the second place, the Labour government froze Icelandic assets in the UK by invoking an anti-terrorism law against not only Landsbanki, one of Iceland's three main banks, but also against Icelandic institutions such as the CBI, the Ministry of Finance and the Icelandic Financial Supervisory Agency. For a while, these public institutions and Landsbanki found themselves on the same list of terrorist organisations at the Treasury's website as Al-Qaida, the Talibans and the governments of Sudan and North Korea.[206] Iceland was a NATO ally of the UK, and did not even have her own military force! The purpose was supposedly to block the same last-minute transfers of immense assets out of the UK as had happened in the collapse of Lehman Brothers three weeks earlier. But the British Financial Services Authority had already issued a confidential order to Landsbanki's UK branch whereby it could not transfer money out of the UK without prior knowledge and consent by the UK authorities, while the bank which administered such transfers had been informed of the order.[207] Invoking the anti-terrorism law was therefore unnecessary, but it had serious consequences for the Icelandic economy which found itself cut off from the international financial markets. It is also hard to imagine that the UK Treasury would have put the US Fed and the US Treasury on its list of terrorist organisations because of some last-minute transfers of assets, however immense, from a bankrupt British financial firm to its US parent company. •

204 Gudni Th. Johannesson, Sympathy and Self-interest: Norway and the Anglo-Icelandic Cod Wars (Oslo: Forsvarsstudier, 2005).

205 Federal Reserve System, Report to Congressional Addressees (Washington DC: U.S. Government Accountability Office, July 2011).

206 SIC Report, Vol. 7, Ch. 20, p. 153. There is a screen shot of the website, after the names of Icelandic institutions had been removed, but with Landsbanki still there.

207 Financial Services Authority, First Supervisory Notice, Landsbanki, 3 October 2008. https://www.fca.org.uk/publication/supervisory-notices/landsbanki.pdf

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ENTRAPPED BY MULTI-NATIONAL ORGANISATIONS

In her hour of need, Iceland's traditional allies abandoned her. This is indeed Professor Thorhallsson's main argument for introducing his "shelter" theory. The 2008 bank collapse and the country's isolation showed, he says, that Iceland needs membership of the EU. There she can find a "shelter". It should be noted, however, that the EU fully supported the UK in her harsh treatment of the Icelanders (in closing down British banks owned by Icelanders while rescuing all other British banks, in needlessly invoking an anti-terrorism law and in demanding a government guarantee from Iceland for outlays concerning the banks). It should also be noted that the European Central Bank, ECB, joined the US Fed and the Bank of England in refusing to make currency swap deals with the CBI, making the collapse of the Icelandic banking sector inevitable. Probably, however, as Thorhallsson would argue, the EU would have behaved differently towards Iceland if she had been a member state. But the record shows that the EU has not been very helpful to small member states which found themselves in a situation similar to that of Iceland. Consider the cases of Ireland and Cyprus.

In Ireland, the ECB told the Irish government in September 2008 that it should rescue the banks but that it would have to do it on its own.[208] When it became clear in November 2010 that this was beyond the powers of the Irish government, the ECB and the European Commission, in cooperation with the IMF, or "the troika", imposed a restructuring programme on Ireland, involving loans with high interest rates and strict conditions. The objective of the programme did not seem to be as much to control public spending, as was admittedly necessary and prudent to do, but rather to avoid the transfer of any losses to bondholders on the one hand (which meant that Irish taxpayers continued to be saddled with them) and to limit the tax advantages which Ireland had in previous years offered to corporations and capital. For decades, the EU has strongly discouraged the tax competition in which Ireland had successfully engaged: The controversial 2016 Apple case where the European Commission ruled that Ireland's application of her tax law to a US company, Apple, violated European antitrust rules is only the latest example. Perversely, the European Commission regards low tax rates as subsidies. In 2011, the State secretary at the German Finance Ministry, Jörg Asmussen, said: "The general feeling here among many Germans is that if you need financial assistance you cannot keep your corporation rate at the lowest in the EU."[209]

Basically, membership of EU and of the eurozone made it impossible for Ireland to respond to the crisis in the way Iceland did, depreciating the currency to encourage export-led recovery and ring-fencing the economy so that the bank creditors, with the exception of depositors, shared the risk of their own activities.[210] In 2015, government debt in Iceland was 68.5% of GDP, whereas in Ireland it was 93.8%.[211] Despite the many advantages which Ireland has enjoyed by being member of the common European market and by participating in economic integration, in her hour of need Ireland found herself in a trap rather than a shelter. "Iceland did the right thing by making sure its payment systems continued to function while creditors, not the taxpayers, shouldered the losses of banks," says US economist and Nobel laureate Joseph Stiglitz. "Ireland's done all the wrong things, on the other hand. That's probably the worst model."[212]

Did Cyprus, as a member of the EU, find a plausible lender-of-last-resort in the ECB, as Professors Sibert and Thorhallsson would argue Iceland needed? On the contrary. The ECB or the European Commission did not rescue the Cypriot banking sector. In cooperation with the IMF, in March 2013 this "troika" imposed a restructuring programme on Cyprus, again involving loans with high interest rates and strict conditions. The country's second-largest bank was closed down, uninsured deposits in Cypriot banks (above €100,000) were to a large extent expropriated, and capital controls were imposed. Again, the objective seemed to be not so much to control government spending, but rather to make it difficult for Cyprus to offer tax advantages to foreign corporations and capital.[213] "Among Cypriots, the feeling is widespread that as a country of fewer than one million people, geographically closer to the Middle East than to Europe and with a reputation as a haven for Russian cash, they were used as lab rats to test new and poorly conceived policies."[214] In her hour of need, Cyprus found herself in a trap rather than a shelter.

Professor Thorhallsson argues that multilateral "shelters" in international organisations are even more important for small states than bilateral "shelters" with powerful allies. According to him, scholarly research on small states showed that they "have a stronger negotiating position within multilateral organisations than in bilateral negotiations with a large state". He adds: "Small states benefit from clear procedures, rules and regulations within international organisations—making it more difficult for large states to use their greater power resources, such as a large administration, economic and military power, to press their interests single-handedly." Thorhallsson concludes: "Accordingly, international organisations provide small states not only with economic shelter but also more secure political shelter."[215] While Iceland was not a member state of the EU and therefore could not expect the same "shelter" there as Ireland and Cyprus, she was a member state of the IMF. How did her experience with the IMF in the Icesave dispute between Iceland and the UK fit in with Thorhallsson's description of a multilateral "shelter"?

It should be recalled that the dispute arose during the 2008 bank collapse because the UK government unilaterally decided to compensate all depositors in the UK branch of the Icelandic bank Landsbanki and then demanded that the Icelandic government would accept these outlays, immense by Icelandic standards, as a loan to the Icelandic Treasury, with high interest rates. (The Dutch government did the same and was a party to the dispute on the UK side.) The Icelanders protested that their government was not liable for bank deposits. First, the liability was that of the estate of Landsbanki, and then, if its funds would not be sufficient, since the deposits were in a branch of an Icelandic bank, but not in a foreign subsidiary with the Icelandic bank as a parent company, it was the liability of the Icelandic Depositors' and Investors' Guarantee Fund which had been set up in full compliance with European law and regulations. When Iceland could not obtain credit facilities anywhere to help her through the bank collapse, she applied for assistance from the IMF. But it was made clear that she would only obtain such assistance if she would submit to the UK demands. It seems that the other Nordic countries were persuaded by the UK government to make it a condition of any credit facilities to Iceland in addition to that of the IMF that Iceland would accept the UK demands. Now, as before, their interest in maintaining good relations with the powerful UK overrode any feelings of friendship towards the Icelanders.

Only in June 2009 when a deal in the Icesave dispute had been negotiated, did the UK revoke the anti-terrorism law against Landsbanki (other Icelandic institutions and organisations, such as the CBI, had, at the request of the Icelandic government, been removed earlier from the Treasury's list on the website). The Icesave deal was controversial in Iceland, as mentioned earlier, with Professors Thorvaldur Gylfason, Gunnar Helgi Kristinsson, Baldur Thorhallsson and others supporting it, while former CBI governor David Oddsson and many others bitterly opposed it.[216] Only in November 2009 when the Icesave deal (with some amendments) had been confirmed by the Icelandic Parliament, did the IMF initiate a stand-by credit arrangement in support of its programme. In January 2010, the President refused to sign the Icesave deal into law and it was rejected by 98% of the votes in a subsequent national referendum (the UK and Dutch government having made it known in the meantime that they would offer more favourable terms). After the deal had been rejected, the IMF halted the implementation of its programme again, only to continue with it after a new deal had been reached. While the terms of the new deal were much more favourable to Iceland than those of the first one, it was also controversial. Its supporters included Professor Thorhallsson, whereas former CBI governor David Oddsson led the opposition, as before.[217] In February 2011, the President also refused to sign this deal into law, and again, it was rejected by 59% of the votes. After this, the case was taken to the EFTA Court which delivered its judgement in January 2013. As noted earlier, it accepted the Icelandic argument that the government of Iceland was not financially responsible for business transactions between individuals, let alone immense amounts of money for a tiny nation.[218]

The EFTA Court decision was a full victory for the Icelanders in the Icesave dispute. However, the dispute shows that contrary to its stated purpose, the IMF acted against a member state as some kind of a hand collector for the UK and Dutch governments, with the perhaps uneasy connivance of the Nordic countries. UK Prime Minister Gordon Brown did not bother to hide this when he was asked about the Icelandic bank collapse: "The first responsibility is for the Icelandic authorities to pay up, which is why we are in negotiations with the International Monetary Fund and other organisations

208 Misjudging risk: Causes of the Systemic Banking Crisis in Ireland, Report of the Commission of Investigation into the Banking Sector in Ireland (Dublin: March 2011), §4.7.4, p. 78.

209 Dan O'Brien, Banking on Europe: the true story behind Ireland's bailout, The Irish Times 23 April 2011.

210 This is partly recognised by Professor Baldur Thorhallsson in a working paper jointly written with Irish Professor Peader Kirby, Financial crises in Iceland and Ireland: Does EU and Euro membership matter? (Reykjavik: Centre for Small State Studies, November 2011).

211 http://www.tradingeconomics.com. Figures from Iceland from the Central Bank of Iceland; figures from Ireland from Eurostat.

212 Iceland shows Ireland Did 'Wrong Things' Saving Banks, Politico 5 February 2011, http://politico.ie/world/iceland-shows-ireland-did-%E2%80%98wrong-things%E2%80%99-saving-banks

213 Interview with Athanasios Orphanides (governor of the Central Bank of Cyprus 2007–2012), The Economist 28 March 2013, http://www.economist.com/blogs/freeexchange/2013/03/interview-athanasios-orphanides Orphanides has also written much about the mismanagement of the Cypriot economy before the crash by the ruling communists.

214 Jack Ewing, As Cyprus Recovers from Banking Crisis, Deep Scars Remain, New York Times 16 March 2015.

215 Baldur Thorhallsson, Domestic Buffer versus External Shelter (2011), p. 326.

216 On Thorvaldur Gylfason, Loglegt? Sidlegt? [Legal? Ethical?], Frettabladid 25 June 2009; On Gunnar Helgi Kristinsson, interview on television Station Two 10 August 2009, http://eyjan.pressan.is/frettir/2009/08/10/gunnarhelgi-kristinsson-stjornarkreppa-ef-althingifellir-icesave/ Baldur Thorhallsson was of course an alternate member of parliament for the Social Democrats who all supported the first deal. On the whole debate the book by an investigative journalist, Sigurdur M. Jonsson, Icesave-samningarnir: Afleikur aldarinnar [The Icesave-Deals: the Blunder of the Century?] (Reykjavik: Almenna bokafelagid, 2011).

217 Eins og ad deila vid domarann [As if quarrelling with the judge], Frettabladid 31 March 2011.

218 Judgement of the EFTA Court, 28 January 2013, http://www.eftacourt.int/uploads/tx_nvcases/16_11_Judgment_EN.pdf

about the rate at which Iceland can repay the losses that they are responsible for."[219] Professor Thorhallsson however turns the case on its head, commenting: "These events raise the question of whether the Icelandic government failed to guarantee its citizens sufficient economic and political shelter."[220] He blames Iceland for the fact that in a dispute with Iceland the UK abused the IMF in ways contrary to its purpose. The IMF had turned out to be a trap, not a shelter.

Professor Thorhallsson's "shelter" theory is not a plausible argument for Iceland's eventual membership of the European Union. His account of Iceland's present circumstances and of her history rather seems to confirm the traditional view that small states are likely to be better off than bigger states, but also more vulnerable. As the Athenians said to the Melanians, "the strong do what they can and the weak suffer what they must."[221] Several times, Thorhallsson seems to turn history upside down. When the Icelanders reluctantly succumbed to the Norwegian king as they feared his power to isolate them, Thorhallsson argues that they became subjects of the king to seek "shelter" from isolation. When the Icelanders found themselves entrapped by an alliance of the Norwegian-Danish crown and the landowners against the development of fisheries, so they had to go hungry near a sea of plenty, Thorhallsson admits that there were costs attached to their "shelter", but adds that there may also have been benefits such as increased economic security. When the Danish king could not defend Iceland, Thorhallsson sees this as a "shelter" provided by British fishermen and traders. When the Danish king supported the education of some Icelanders, thus giving back a fraction of the assets he had forcibly seized before, Thorhallsson sees this as a "cultural shelter". Thorhallsson seems to have adopted the method of Mephistopheles:

> Denn eben, wo Begriffe fehlen,
> Da stellt ein Wort zur rechten Zeit sich ein.
> Mit Worten läßt sich trefflich streiten,
> Mit Worten ein System bereiten,
> An Worte läßt sich trefflich glauben.[222]

Or in the English of George Madison Priest:

> For at the point where concepts fail,
> At the right time a word is thrust in there.
> With words we fitly can our foes assail,
> With words a system we prepare,
> Words we quite fitly can believe.

Where arguments fail, Thorhallsson thrusts in a word: "shelter."

It would however be unfair to assume that Professor Thorhallsson overlooks so much of the relevant evidence and arguments because he is a Jean Monnet Professor, supported by the EU, or because he is active in the pro-EU Social Democrats, backed by 5.7% of the voters. Thorhallsson is not pleading a cause as a courtier, like Thorarinn Nefjolfsson in 1022 or Gissur Thorvaldsson in 1262. His error seems to be not to distinguish properly between two concepts of European integration, economic and political. If it is economic integration, many would support it, employing the arguments of Adam Smith about the extent of markets. As has been emphasised here, economic integration in the sense of a common market is essential to small states, because it enables them to enjoy the benefits of the international division of labour. This common market should however not be only European, but international, encompassing China, India, the US, Canada, Australia and other countries. Those who want to build bridges between nations instead of walls cannot be in favour of Fortress Europe. Political integration is however much more problematic, simply for the reason that it is not based on a clear collective and generally accepted European identity, let alone a common will of the many nations of Europe to form a superstate, a United States of Europe. A small elite of Platonic Guards, professional politicians, bureaucrats and intellectuals, is trying to impose this project on the European electorates, without much success and with the danger that there will be a backlash against beneficial economic integration. The admirable determination of the largest states on the continent, especially Germany and France, to turn swords into ploughs should not mean that the smaller European states have to lose control over their own affairs or that they cannot continue to cooperate with the North Atlantic powers, especially the US and UK. •

219 Gordon Brown, Speech in the House of Commons 6 May 2009. Hansard 6 May 2009, Column 172. http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm090506/debtext/90506-0003.htm

220 Baldur Thorhallsson, Domestic Buffer versus External Shelter (2011), p. 328.

221 Thucydides, History of the Peloponnesian War, Book V, 5.89.

222 Johann Wolfgang von Goethe, Faust, Part 1, Scene IV: Studierzimmer.

23

STATES AND NATIONS

The case for small states is not necessarily a case for nation-states. They have different weaknesses. The chief weakness of small states is their political and military vulnerability.[223] Milan Kundera put it eloquently:

> What distinguishes the small nations from the large is not the quantitative criterion of the number of their inhabitants; it is something deeper. For the small nations, existence is not a self-evident certainty but always a question, a wager, a risk; they are on the defensive against History, that force which is bigger than they, which does not take them into account, which does not even notice them.[224]

However, small states are not totally helpless against History. They can be flexible, alert, resourceful, even cunning, although Stanley Kubrick's famous remark is of course grossly unfair, that in international relations the "great nations have always acted like gangsters, and the small nations like prostitutes."[225] Small nations can exchange favours with bigger states. They can concentrate on certain issues, whereas the greater powers have to spread their efforts thin. Small states can seek allies, of which the United States has been the most useful and least intrusive one for many of them, including Iceland, in the 20th century.[226] Small states can also try to play bigger powers off against each other. They can even form alliances between themselves. If in 1939 the three Baltic countries had been united in a strong military alliance, then they might jointly have put up as fierce a resistance to a Soviet invasion as the Finns did, with the result that Stalin abandoned the idea of annexing Finland.[227]

Big states do not necessarily have a strong interest in subduing small states, and they operate under several kinds of constraints. Small states can also take comfort in the fact that risks go both ways. They present opportunities as well as dangers. In a speech which Prime Minister David Oddsson gave for the three foreign ministers of the Baltic countries at a dinner party in August 1991 when Iceland became the first country to resume diplomatic relations with them, after the failed coup in Moscow, he quoted Shakespeare:

> There is a tide in the affairs of men,
> Which, taken at the flood, leads on to fortune;
> Omitted, all the voyage of their life
> Is bound in shallows and in miseries.
> On such a full sea are we now afloat,
> And we must take the current when it serves,
> Or lose our ventures.[228]

Small nations have to engage in active diplomacy, seizing the moment when it presents itself, using "windows of opportunity", taking the current when it serves.

Whereas the chief weakness of small states is their political and military vulnerability, that of nation-states is usually that they are not fully homogeneous: They usually have a dominant nation, and some national—and occasionally hostile or at least restless—minorities. The nation is therefore often simply the majority group. Even the peaceful and civilised Nordic countries, except Iceland, have within their borders minorities which used to be oppressed or at best ignored. In the north of Norway, Sweden and Finland (as well as in the Russian Kola peninsula) live the

223 David Vital, The Inequality of States: A Study of Small Powers in International Relations (Westport CT: Greenwood Press).

224 Milan Kundera, Die Weltliteratur, New Yorker 8 January 2007, http://www.newyorker.com/magazine/2007/01/08/die-weltliteratur

225 Quoted in Guardian 5 June 1963.

226 Robert O. Keohane, The Big Influence of Small Allies, Foreign Policy, Vol. 2 (1971), pp. 161–183.

227 Erling Bjøl makes the same point about the Scandinavian countries against the Nazi attack in 1940. p. 11. The Power of the Weak, Cooperation and Conflict: Journal of the Nordic International Studies Association, Vol. 3 (2: 1968), p. 157.

228 William Shakespeare, Julius Ceasar, Scene 4, Act 3, 217. Vikverji skrifar, Morgunbladid 27 August 1991.

Sami, a Finno-Ugric ethnic people traditionally called Lapps, numbering perhaps around 100,000. Until recently, they were denied education in their own language. Now, they have limited self-rule and form a cultural, non-territorial community, recognised and supported by the Nordic states.[229] Finland also has a sizeable Swedish-speaking minority, around 5% of the population, that suffered some discrimination in the past, but not any longer. The three Baltic countries all have sizeable Russian-speaking minorities that mostly immigrated, or were brought there, during the long Soviet occupation, in 1940–1991. The two European nation-states that rose on the ruins of the Habsburg and Ottoman empires, Czechoslovakia and Yugoslavia, both had a dominant nation and many national minorities.

This weakness of the nation-state has led many liberals and conservatives to be suspicious of it. In a trenchant treatise on nationalism, Elie Kedourie, a British historian born in Baghdad as an Iraqi Jew, described how a new style of politics had been introduced in the French Revolution. Politics had become a fight for principles, not the endless composition of claims in conflict.[230] One of these principles, Kedourie submitted, was that nations should establish their own states. He observed that multi-national empires like the British empire and the Ottoman and Habsburg empires had allowed different peoples to live together in peace, whereas their disintegration had led to conflicts where nationalists strove for dominance. Ludwig von Mises, an Austrian economist born into a Jewish family in Lemberg in Galicia (later Lwów in Poland and now Lviv in Ukraine), pointed out that classical liberals like himself urged self-determination. "The principle of nationality is an outcome of the interpretation which people in Central and Eastern Europe," von Mises added, "gave to the principle of self-determination. It is a distortion, not a perfection, of liberal thought."[231]

Even if Kedourie's and Mises' opposition to nationalism may be based partly on their personal experiences of suddenly finding themselves belonging to unpopular minorities previously enjoying protection within multi-national empires, their criticisms are certainly cogent. Sometimes, a nation seems to be no more than "a group of people united by a common error about their ancestry and a common dislike of their neighbours".[232] But a clear and indeed crucial distinction has to be recognised between two kinds of nationalism. One is an aggressive, coercive nationalism which seeks to use the powers of the state to construct conformity, conquer new territories and subdue minorities: in the distant past, French was imposed on Bretons, English on Irishmen and Swedish on Samis, and in the 20th century, Poles replaced Austrians as oppressors of Ukrainians, Czechs insisted on including Germans and Slovaks in their state and Serbs assumed control over Croats and Slovenes. The other kind of nationalism is non-aggressive and spontaneous and expresses a common desire and will to preserve and develop the cultural community which a nation in Renan's sense is, and if feasible, to establish an independent state based on this cultural community, realizing that it may need protection and support: As has been pithily observed, a language is a dialect with an army and a navy.[233] Hebrew replaced Yiddish as the language of the Jews, because it was backed by a state. Respect for minorities, and the rights of emigration and secession are the necessary conditions for this concept of a nation: its legitimacy is derived from a "daily plebiscite", as Renan put it. This is the idea behind Norway's secession from Sweden in 1905, Iceland's declaration of sovereignty in 1918, the independence of the three Baltic countries before and after Soviet occupation, and the secession of Slovakia from the Czech Republic, and Slovenia and Croatia and other former Yugoslav republics from Serbia. If Belgium was allowed to secede from the Netherlands in 1830, why should Flanders not be allowed to secede from Belgium in 2017? This is in essence the same distinction as British philosopher Sir Isaiah Berlin makes between nationalism proper which he considers malign and a national feeling which is, according to him, not only benign, but probably necessary for human beings, a sense of belonging.[234]

While open-minded and moderate nationalists would agree that secession and voluntary emigration should always be possible, under certain rules such as a substantial majority for secession, other means have been used to cope with the fact of heterogeneity of a state. Two of them would not only be unacceptable to civilised people of modern times, but would also be considered catastrophic: They are the two forms of ethnic cleansing, extermination and deportation (including enforced mass migration). These are gruesome realities, not figments of a febrile imagination. During the Second World War, the Nazis tried to exterminate European Jewry, and many consider the 2015 massacres of Armenians in Turkey a pre-meditated attempt to exterminate them. In 1923, Greece and Turkey exchanged, or mutually deported, approximately two million people. After the Second World War, more than ten million Germans were deported from Poland, Czechoslovakia and other countries in Central and Eastern Europe to Germany, while Polish speakers were forced to migrate from Ukraine to Poland.[235] Needless to say, Stalin deported many nationalities from one end of the Soviet Union to the other.

The coercive construction of conformity, using the powers of the state to silence and subdue minorities, is of course also unacceptable to moderate nationalists. But there are two other means of coping with heterogeneity which could be called the Swiss

229 Else Grete Broderstad, The Promises and Challenges of Indigenous Self-Determination: The Sami Case, International Journal, vol. 66 (4: 2011), pp. 893–907.

230 Elie Kedourie, Nationalism (London: Hutchinson, 1960), p. 18.

231 Ludwig von Mises, Omnipotent Government (Indianapolis IN: Liberty Fund, 1974), p. 102.

232 Karl Wolfgang Deutsch, Nationalism and its alternatives (New York: Random House, 1969), p. 3.

233 Max Weinreich, Der YIVO un di problemen fun undzer tsayt, YIVO Bleter, Vol. 25 (1: 1945).

234 David Miller, Crooked Timber or Bent Twig? Isaiah Berlin's Nationalism, Political Studies, Vol. 53 (2005), pp. 100–123.

235 Raymond M. Douglas, Orderly and Humane: The Expulsion of the Germans after the Second World War (New Haven CT: Yale University Press, 2013).

and the Danish solutions: decentralisation and division. The Swiss solution is to accept the existing borders of the state and to renounce secession, but to implement and ensure mutual recognition of cultural communities within the country, both linguistic and religious, combined with extensive decentralisation, in Switzerland through the cantons. This enables speakers of the four recognised languages of Switzerland and members of different religious denominations to live together in peace and to constitute one nation. In some ways, the positions of the German speaking majority in South Tyrol, a part of Italy since the First World War, and of the Swedish speaking majority in the Åland Islands, a part of Finland, are now on the Swiss model. Initially, both nationalities were largely opposed to the annexation of their territory by a nearby nation-state, but through a process of reconciliation and mutual recognition there is little interest any more in secession, or in joining either Austria or Sweden. Perhaps Czechoslovakia would have been a more feasible political unit, if she had been organised on the Swiss model, as many semi-independent cantons. Perhaps, also, Belgium could be divided into semi-independent cantons, with the German-speaking minority constituting one canton, the city of Brussels one, and Flemings and Walloons forming several cantons, depending on circumstances, history and consensus.

The Danish solution, on the other hand, is to move the borders of the states involved in a peaceful way by referenda in contested border regions with the consent and cooperation of the states involved. As already mentioned, an alliance of German states had in 1864 conquered the duchy of Schleswig which had until then been a part of the Danish realm and not a member of the German Federation. In North Schleswig (South Jutland) the majority spoke Danish, but in South Schleswig the majority spoke German and identified with Germany. After Germany's defeat in the First World War, the right of self-determination was given to the people of Schleswig. The duchy was divided into three regions. In the southernmost region, almost solely German, no referendum took place, at the wish of the Danish government. In February 1920, 75% of the inhabitants in the northernmost region voted for rejoining Denmark. In March 1920, 80% of the inhabitants in central Schleswig voted for remaining in Germany. Consequently, the northernmost region, in its entirety, was transferred to Denmark, although in a few towns and parishes a majority had voted for remaining in Germany, not all of them on the border. The transfer to Denmark was however widely accepted. The Danish king and some politicians did not want to respect the outcome of the referendum in the central region, but they were overruled by Danish moderates.[236] The Danish solution is not without its problems, of course—such as who should determine the size and shape of the different border regions and who should administer the referenda—but nevertheless it worked in Schleswig.

Thus, leaving aside emigration, there are basically six means of responding to heterogeneity within a state: the two totalitarian tools of extermination and deportation, an authoritarian domination of one group over others, and the three libertarian processes of secession, decentralisation and division. At the moment, in Europe and North America there are possibly several unresolved issues of nationalities and states: Quebec in Canada, Flanders in Belgium, Scotland again in the future (if the Scottish Nationalists are to be believed), Catalonia and the Basque Land in Spain, and Crimea and Eastern Ukraine. In addition, there is the question of independence for the Faroe Islands and Greenland. In general the evidence shows that secession on the model of the nation-state is not bound to become a disaster, and it is certainly better than the enforced coexistence of nationalities hostile to one another. Secession can actually benefit both the original country and the new one. Each case is however different. Both in Flanders and Catalonia the inhabitants are more affluent than the rest of the country, and they do not all identify sufficiently strongly with their fellow citizens to accept redistribution to them. In Quebec and Scotland, however, the inhabitants are receiving more from the united state than they contribute so that secession may be costly in the short run, even if subsidies usually do not benefit the recipients in the long run.

The situation in Ukraine is also special. When the Russians seized Crimea from Ukraine in 2014, they broke the first principle of international law, according to the Stimson doctrine, that changes of borders should take place peacefully and by mutual consent.[237] On the other hand, the inhabitants of Crimea should have a right to self-determination. The question is then who should be defined as holding this right, since the Russians deported a lot of Crimeans in Soviet time. Be that as it may, this change of border did not take place in a just and fair process and should therefore not be recognised. *Ex injuria jus non oritur*, unjust acts cannot create law. Many Ukrainians want to be a part of the West for which they would see membership in NATO and the EU as essential. Other Ukrainians feel more affinity for Russia that is also adamantly opposed to Ukraine moving westwards. Ideally, in the interest of long-term stability, Ukraine has to pursue good relationships both with Russia and the West. A possible compromise or middle road might be that Ukraine becomes a member not of the EU, but of the EEA, like Norway, Iceland and Liechtenstein (and, effectively, Switzerland), all countries at the margin of Europe. Then Ukraine would enjoy the benefits of an open market without strong political commitments one way or another. In East Ukraine Russian-speaking rebels who want to join Russia control some regions. With Russian support, they are still fighting against the Ukrainian Army. Again, the right to self-determination has to be taken into consideration. Possibly, if the Swiss solution of decentralisation and peaceful co-existence of cultural communities within one state is not feasible, the Danish solution could be applied. In free and fair elections, the border regions would choose in referenda whether they want to belong to Russia or Ukraine.

In discussions about the key concepts of the nation and the state, many philosophers and political scientists seem to be obsessed with the need to define the two words accurately, to find their essence. But perhaps such essentialism is misplaced. It is possible that the Wittgensteinian notion of family resemblances is more applicable to them than a strict definition.[238] They may resemble one another instead of all sharing some set of characteristics. The concept of the state is hybrid, fluid and multi-layered. Some entities have elements of statehood without being proper states. For example, the Icelandic Commonwealth which was in place in 930–1262 consisted of 39 chieftainships which could be regarded as micro-states, as it was the task of each chieftain to uphold the law for his "clients" or "constituents".[239] Another example is the Swiss cantons which have considerable autonomy, usually reserved for proper states. Some territories are not states themselves, and are attached to other states without being proper parts of them, for example the British Virgin Islands, Puerto Rico, Greenland and the Faroe Islands. At another level, the EU has gradually taken over some functions of its member states without being a state itself. In NATO, the member countries have put their military forces under a common command (with some exceptions and reservations).

The concept of the nation is no less hybrid, fluid and multi-layered. This can best be observed in the border regions of Europe where one nation blends softly into another. The inhabitants of South Tyrol have long since abandoned the idea of seceding from Italy. They are Italians. But they are also Tyrolians, and they are members of the Tyrolian community: Representatives from the parliaments of Austrian Tyrol, South Tyrol and Trentino (with a sizeable German-speaking minority) meet regularly and cooperate on cultural affairs. Thus, a Tyrolian can call himself Italian, German and Austrian at the same time.[240] The Nordic countries have cooperated in many fields, as Friedrich Engels learned to his dismay. They delegated monetary authority, normally reserved to individual states, to the Scandinavian monetary union in 1873–1914: The currencies of the three Scandinavian countries were on parity and circulated freely in all of them. (It facilitated the union that all three currencies used the gold standard.)[241] The Nordic Council was founded in 1952 by the parliaments of four of the Nordic countries, Sweden, Denmark, Norway and Iceland, with Finland joining in 1955. The Nordic countries agreed to a common labour market and the abolition of passport requirements in travel between them. While attempts at forming a Nordic

236 Troels Fink, Da Sønderjylland blev delt, 1–3 (Aabenraa: Institut for grænseregionsforskning, 1978–1979).

237 Robert Langer, Seizure of Territory: The Stimson Doctrine and Related Principles in Legal Theory and Diplomatic Practice (Princeton NJ: Princeton University Press, 1947).

238 Ludwig Wittgenstein, Philosophical Investigations (New York: Macmillan, 1953), §66.

239 David Friedman, Private Enforcement and Creation of Law: A Historical Case, Journal of Legal Studies, Vol. 8. (1979), pp. 399–415; Birgir Thor Runolfsson, Institutional Evolution in the Icelandic Commonwealth, Constitutional Political Economy, Vol. 4 (1: 1993), pp. 97–125; Sigurdur Lindal, Law and Legislation in the Icelandic Commonwealth. Journal of Scandinavian Law, Vol. 37 (1993), pp. 53–92.

240 Rolf Steininger, South Tyrol: A Minority Conflict of the Twentieth Century (New York: Transaction Books, 2009).

241 Axel Nielsen, Den skandinaviske møntunion: et historisk rids (København: Børsens forlag, 1917).

military alliance or a customs union failed, extensive cultural cooperation between the Nordic nations demonstrates a strong feeling of a common collective identity. It is also telling that Greenland, the Åland Islands and the Faroe Islands are associate members and that the three Baltic countries and the German state of Schleswig-Holstein have observer status in the Nordic Council. Sometimes, also, Estonia has been called the "sixth Nordic country": Her language and Finnish are mutually intelligible, and most of Estonia was for a long time under Danish and then Swedish rule.[242] Another well-known example, similar in some ways, different in others, is the British Commonwealth, established in 1949. This is now a cultural community, with a shared history of some association with the British Empire of the not-so-distant past, and with some shared traditions such as the English common law and English sports. Thus, it has elements, although quite weak, of a nationhood.

However fluid and hybrid the concept may be, the nation is nevertheless not a romantic fantasy, but real, combining the cultural identity and the democratic will of a people.[243] Nations bear family resemblances to one another because they are indeed related; they are not related because they resemble one another. Nations are real and they fulfil a strong need in most human beings, as some liberal thinkers have grasped, for example Sir Isaiah Berlin who writes:

> To belong to a given community, to be connected with its members by indissoluble and impalpable ties of common language, historical memory, habit, tradition and feeling, is a basic human need no less natural than that for food or drink or security or procreation. One nation can understand and sympathise with the institutions of another only because it knows how much its own mean to itself. Cosmopolitanism is the shedding of all that makes one most human, most oneself.[244]

Harvard philosopher Robert Nozick also explains why he abandoned the "hard" libertarianism of his celebrated *Anarchy, State, and Utopia*, recognising that it "ignored the importance to us of our joint and official serious symbolic statements and expression of our social ties and concern".[245] Instead, Nozick did not embrace egalitarianism, but rather "soft" libertarianism or what could be called conservative liberalism which unites conservative insights into the human condition and classical liberal principles.[246] For Nozick, "hard" libertarianism was not wrong, but inadequate, precisely because it lacked the communitarian attachments which non-aggressive, spontaneous nationalism can provide. How can a cosmopolitan for example explain nostalgia, when people wither in exile? And what was it that Quisling betrayed in Norway, so serious that the death sentence was reintroduced there to make his execution possible? When St. John's Church in Viljandi in Estonia was consecrated again in 1992, having been used during Soviet occupation as a warehouse, a member of the congregation told a moving story. She and her family had been deported to Siberia more than fifty years earlier. In their small cottage, they hid the Estonian national flag in a closet, under layers of stuff. Each year, in the evening of 24 February, Estonian independence day, they carefully shut all the doors and windows of their cottage, lit some candles, took out the flag and put it on the simple table, and sitting around it, they sang softly together the Estonian national anthem.[247] •

242 Speech by Toomas Hendrik Ilves, Minister of Foreign Affairs [later President of Estonia], to the Swedish Institute for International Affairs, 14 December 1999, http://www.vm.ee/et/node/42622

243 Hedva Ben-Israel, The Nation-State: Durability Through Change, International Journal of Politics, Culture, and Society, Vol. 24 (1–2: March–June 2011), pp. 65–74.

244 Isaiah Berlin, The Counter-Enlightenment, Against the Current: Essays in the History of Ideas (Oxford: Oxford University Press, 1991), p. 12.

245 Robert Nozick, The Nature of Rationality (Princeton NJ: Princeton University Press, 1993), p. 32. See also Robert Nozick, The Zigzag of Politics, The Examined Life (), p. 292.

246 Edmund Burke, David Hume, Adam Smith, Alexis de Tocqueville and Friedrich A. Hayek can all be regarded as proponents of such conservative liberalism.

247 This was a story told to me by a guide when I visited St. John's Church in June 2016. Estonian historian Toomas Hiilo tells me that such clandestine ceremonies were not uncommon under the Soviet occupation, especially amongst the deported.

24

RECOMMENDATIONS

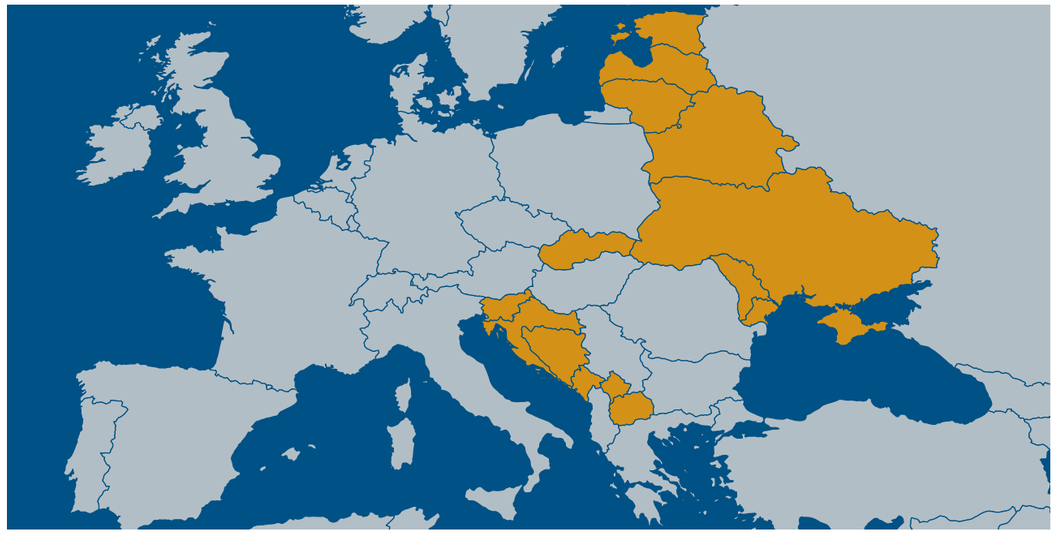
Perhaps the main lesson to be learned from the analysis presented in this paper is that the politics of Procrustes—the Greek villain who made his guests fit his bed by either cutting off their legs or by stretching them forcibly—is misconceived. One size does not fit all. On the basis of this analysis, some practical recommendations can be made:

1. The recently established small states in Europe, the three Baltic states, Estonia, Latvia and Lithuania, as well as Slovakia, Slovenia, Croatia, Montenegro, Bosnia-Herzegovina, Macedonia, Kosovo and Moldova, are a welcome addition to the colourful tapestry of Europe. None of them is too small to be sustainable. While Belarus and Ukraine may not count as small states, their independence was also desirable.

2. Contrary to what Professors Anne Sibert and Baldur Thorhallsson would suggest, there is strength in smallness. This is shown by several studies which show small states to be relatively wealthy. The main reason is that they maintain open economies and thus are able to benefit from the international division of labour. Thus, international (not only European) free trade is vital to small states. Economic integration enables political disintegration. Larger markets make smaller states feasible.

3. Small states also tend to be more flexible, resilient, transparent and cohesive, with considerable accumulated social capital and trust, so the production of some public goods such as law and order are actually cheaper per capita than in larger and more heterogeneous societies. Because of their cohesion and sense of solidarity, they may also be better at coping with sudden economic or natural disasters and catastrophes than bigger and more heterogeneous states.

4. The recent increase in the number of small states also can have two desirable side-effects: such states are usually less aggressive and less inclined to go to war over disputes than bigger countries; and they provide a wider choice for people who are for some reason, for example



exorbitant taxes, dissatisfied in their own country. Thus they create a constraint on the abuse of power. Tax competition should indeed be encouraged, not fought against, as is now the case in the EU and OECD.

5. The chief weakness of small states is their military vulnerability: "The strong do what they can and the weak suffer what they must," as the Athenians said to the Melanians. But small states can often cope with this. They find a powerful ally that is willing to protect them, usually at a price, or form alliances, play bigger states off against one another and quickly seize opportunities when they present themselves. At present, the best protection the small states of Europe can however find is in a military alliance over the North Atlantic, with the United States, UK and Canada, NATO.

6. The history of Iceland, invoked by Professor Thorhallsson in support of his "shelter" theory—that the traditional strategies of small European states in international affairs do not suffice and that they have to seek a "shelter" in the EU—is on the contrary a refutation of that theory. When the Icelanders, under pressure from the Norwegian king and his Icelandic allies, reluctantly accepted in 1262 to abandon their three centuries' old independent Commonwealth, to recognise the king and to pay tribute to him, they did not enter a shelter, but were caught in a trap. The king extracted as much money from the country as he could, renting it out regularly to tax collectors and monopoly merchants. He sought to isolate Iceland from other countries, even if he could not defend her from a pirate raid in 1627 or a brief British occupation in 1809. The king tried thrice to sell Iceland to Henry VIII and once to German merchants, and in 1864 he and his ministers seriously thought of offering Bismarck Iceland in exchange for the newly-lost North Schleswig.

7. The lesson Iceland can learn from her experience in the 2008 bank collapse is that states do not have friends, only interests. The reasons why Iceland did not receive the same liquidity support as other European small states, both from the US Fed and the ECB, are however still not clear. Even less clear is why the British Labour government chose to close British banks owned by Icelanders and to invoke an anti-terrorism law against Icelandic institutions and companies. A partial explanation for the refusal of the US Fed to help Iceland was undoubtedly that the US had lost strategic interest in Iceland. A partial explanation of the brutality of the British Labour government in dealing with Iceland may have been the Scotland factor. While there were undoubtedly many other explanations why Iceland was left out in the cold, if she becomes strategically important again, as is likely, then she should use the opportunity in possible military agreements with the US and the UK and try and provide for lender-of-last-resort facilities from those countries. Generally speaking, she should choose the North Atlantic option, seeking allies and protectors in Canada, the US, the UK and Norway.

8. While the case for nation-states is not necessarily the same as for small states, nationality seems to fulfil a human need for meaning, ties and attachments and to create a sense of belonging and recognition which adds to or reinforces the social cohesion observed in many small states. The non-aggressive, spontaneous nationalism of small countries like Iceland and Estonia, based on a shared language and history, common meaningful memories, and symbols of national pride, is totally different from the aggressive and coercive nationalism of some bigger nations that used at best to ignore, but often even to subdue nationalities within their borders. In a small nation-state basic, thorough and carefully planned education in the language, literature and history of the nation should therefore be encouraged, while other nations are also respected.

9. The chief weakness of a nation-state is the existence of hostile or dissatisfied nationalities within its border in addition to the dominant nation. Totalitarian regimes have dealt with this by extermination or deportation. Authoritarian regimes have usually oppressed such minorities or at best ignored them. These options are not, and should not be, open to European or North American conservative liberals. This problem has three kinds of acceptable solutions: peaceful secession, Norwegian or Slovakian style; the Swiss model of decentralisation and mutual respect for different minorities or groups; and the Danish model of moving borders by mutual consent.

10. States with a dissatisfied national minority within their borders should try the Swiss model, as was successfully done in South Tyrol and the Åland Islands besides Switzerland herself, but they should not resist secession by all means at their disposal. However, secession requires a firm commitment of the nationality that wants to leave and form its own independent state or to join another state (75% in North Schleswig in 1920, 88% in Slovenia in 1990). Sometimes the separate identity of the national minority may not be strong enough to sustain secession, as seems to be the case in Scotland that may have, over the centuries, come to share too much of an identity with England and Wales to be really willing to leave the United Kingdom. One possibility for Scotland would be to acquire the same status as the old British dominions, Canada, Australia and New Zealand, becoming an independent state, but in a personal union with England and Wales and with close ties to this neighbour and friend. But in most cases there are no conclusive economic or political arguments against secession.

11. The best international strategy for Ukraine, the only real battleground left in Europe, may be to try and become a member state of the EEA, European Economic Area, cultivating close economic cooperation with the rest of Europe without making many political commitments. She should try the Swiss model in Crimea and her Eastern regions which is to respect the rights of the Russian-speaking minorities to their own language and to grant them some autonomy. If this is not feasible, then the borders should be revised on the Danish model, by mutual consent, region by region. It is surely better to move borders than to kill people, deport them or oppress them. A stable Ukrainian state needs trade with the West and peace with Russia. While in the interest of peace there has to be a strong presumption in favour of the *status quo*, a similar revision of some borders might be possible in other parts of Europe, if carefully planned and negotiated, for example if a national minority inhabits a border region with a nation-state which it would like to join.

12. The European Union fits some, even most, European countries, but it does not fit them all. Whereas it was US nuclear arms, and not the strength or good will of European nations which ensured peace on the continent after the Second World War, it was a move for the better when Germany, France and Italy set aside their old grievances in 1957 by establishing the European Economic Community, with three smaller nations, and when Germany fully accepted her new borders. But economic integration does not imply political integration. The nations on the North Atlantic islands, Great Britain and Iceland, and possibly Ireland, and in other margins of Europe, up in the far north or up in the Alps, Norway, Switzerland and Liechtenstein, are not a part of the project of the elites in control of some major continental powers to create a federal state, even if they still misleadingly call it a federation of states. Even within the EU, there is not a sufficiently strong European identification for the peoples of Europe to accept such a development, as events clearly show.

13. The exit of the United Kingdom from the EU is no disaster. She has not only a strong national identity, but also close ties to countries outside Europe, the "special relationship", to the United States, and to the Commonwealth countries, especially Canada, Australia and New Zealand, where the Queen is still monarch: all those countries came to the help of the UK when she fought alone against Nazi Germany (then in an alliance with Stalin's Soviet Union) between the collapse of France and Hitler's attack on the Soviet Union.[248]

A few final remarks may be directed to those countries which would see their territories reduced not because they have lost a war, but because they honourably are accepting a demand of a dissatisfied national minority for a secession or an adjustment of borders. Those countries, Russia, perhaps Ukraine, even Spain or Canada, should bear in mind the example of Denmark. In the Middle Ages and after, she was a powerful country, controlling besides Denmark proper the whole Norwegian Realm, including Iceland,

248 Daniel Hannan, How We Invented Freedom and Why It Matters (London: Head of Zeus, 2013).

the Faroe Islands and Greenland, parts of what are now Sweden and Estonia, the two duchies of Schleswig and Holstein, some other German territories and a few overseas colonies. Gradually she lost some of her territories, Southern Sweden in 1658, Norway in 1814 and Schleswig and Holstein in 1864. The loss of the two duchies was a heavy blow to the Danes and changed their sense of identity, while strengthening it at the same time. They accepted that they formed a small and vulnerable nation, abandoning the pursuit of glory on the battlefields of Europe and concentrating instead on agriculture, industry and trade. "Hvad indad tabes, det må udad vindes," What is lost outwards, shall be regained inwards, a Danish poet wrote, expressing an informal consensus which was being formed since 1864.[249] The Danish became ardent free traders, exporting mainly agricultural products to their neighbours, not least to the United Kingdom.

As a result, Denmark prospered in late 19th century and early 20th century. In 1943, an Irish historian, James Beddy, asked why she had become much more prosperous than Ireland, even if she had fewer natural resources and a less favourable climate: the GDP per capita was almost 50% higher in Denmark than in Ireland. His answer was that Denmark relied more on market forces.[250] Beddy's conclusions were reinforced more than a half century later by Irish historian Kevin O'Rourke. He attributed Denmark's success to her cultural homogeneity and political stability, whereas Ireland was culturally and politically divided. The Danes enjoyed a high level of trust and much accumulated social capital which in turn contributed to the formation of real capital becoming available in small savings associations all over the country, whereas Irish farmers had little access to capital. Denmark was also independent over all this period, so that liberal reforms came from within, and not from the outside, as in Ireland: "a lack of social and political cohesion, uncertain property rights as well as cultural factors all help explain why Ireland lagged behind Denmark during this period."[251] What is lost outwards, shall be regained inwards.

A similar idea was eloquently expressed much earlier by Joseph Addison writing about the Royal London Exchange:

> Nature seems to have taken a particular care to disseminate her blessings among the different regions of the world, with an eye to this mutual intercourse and traffic among mankind, that the natives of the several parts of the glove might have a kind of dependence upon one another, and be united together by their common interest. Almost every degree produces something peculiar to it. The food often grows in one country, and the sauce in another. The fruits of Portugal are corrected by the products of Barbados: the infusion of a China plant sweetened with the pith of an Indian cane. … For these reasons there are not more useful members in a commonwealth than merchants. They knit mankind together in a mutual intercourse of good offices, distribute the gifts of nature, find work for the poor, add wealth to the rich, and magnificence to the great. Our English merchant converts the tin of his own country into gold, and exchanges his wool for rubies. The Mahometans are clothed in our British manufacture, and the inhabitants of the frozen zone warmed with the fleeces of our sheep. … Trade, without enlarging the British territories, has given us a kind of additional empire: it has multiplied the number of the rich, made our landed estates infinitely more valuable than they were formerly, and added to them an accession of other estates as valuable as the lands themselves.[252]

When large nation-states lose territory by secession or border adjustment, they may gain new friends and customers in their new neighbours. They should seek the "additional empire" about which Addison writes, given by international free trade. The Modern European needs both a home, in the nation, and a market, in the world. •

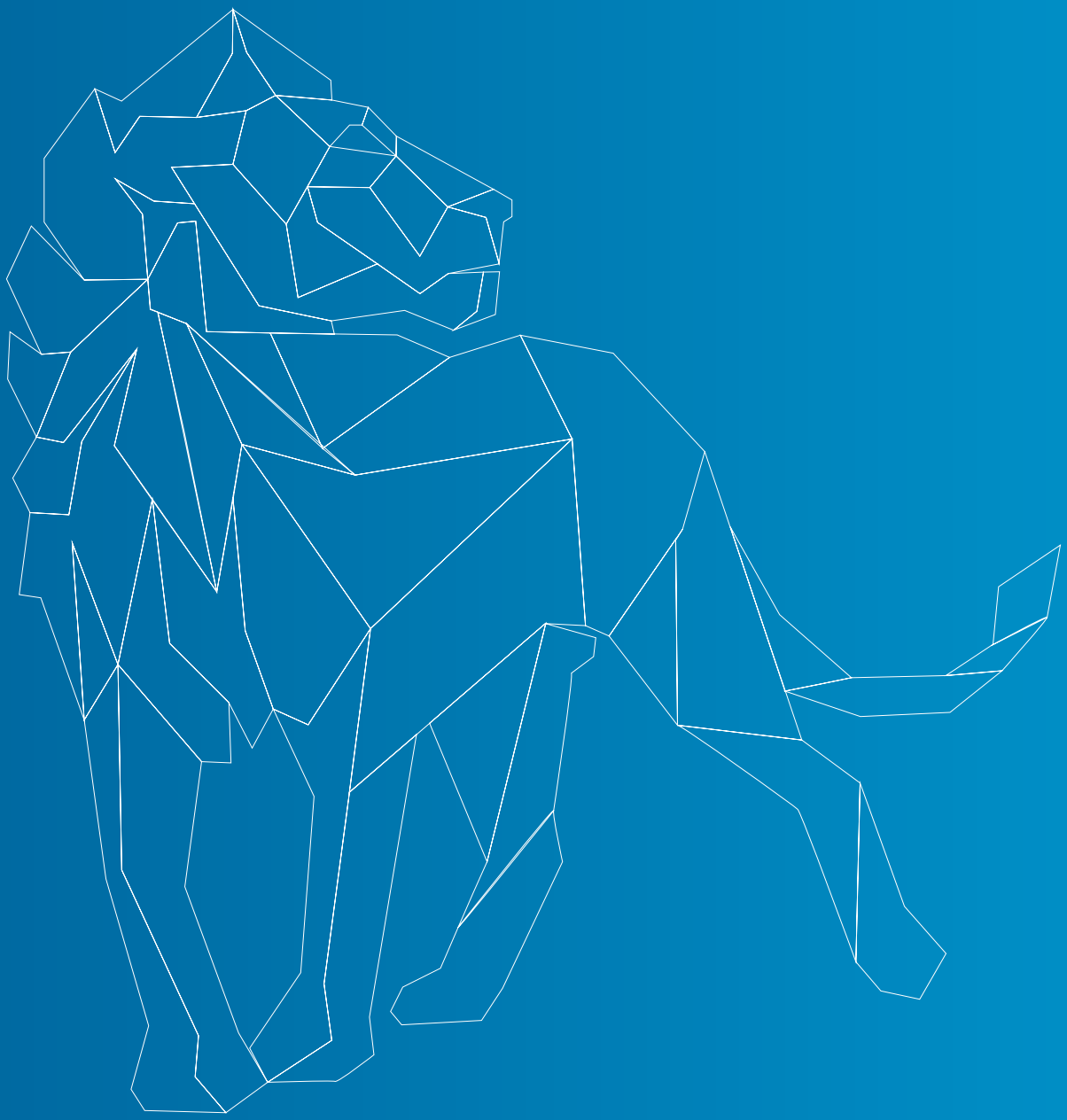
249 Composed by Hans Peter Holst on a memorial coin issued in connection with an exposition of industry and art in Copenhagen in the summer of 1872.

250 James P. Beddy, A comparison of the principal economic features of Eire and Denmark, Journal of the Statistical and Social Inquiry Society of Ireland, Vol. 27 (1943), pp. 189–220.

251 Kevin H. O'Rourke, Property righs, social cohesion and innovation: evidence from the creamaries, Mimeo (Dublin: Trinity College, 2003), p. 1. Cf. Kevin H. O'Rourke, Late Nineteenth-Century Denmark in an Irish Mirror, National Identity and the Varieties of Capitalism: The Danish Experience, ed. by John L. Campbell, John A. Hall and Ove K. Pedersen (Montreal: McGill-Queen's University Press, 2006), pp. 159–198.

252 Spectator, No. 69, May 19, 1711.

NOTES



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