UNIVERSITY OF ICELAND

Liberty in Iceland, 930–2015

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What Milton Friedman Told Me

- There’s no Austrian economics and non-Austrian economics; there’s just good or bad economics
- If the laws of economics don’t apply to Iceland, they are no laws of economics
- Let’s look at Iceland, a micro-cosmos

A Glimpse of Iceland

Settlement, 874–930

Economic Analysis Can Explain …

- How Icelanders enforced law privately
- How they managed mountain pastures
- Why they lost their independence in 1262
- Why they starved for centuries despite fertile fishing grounds
- Why they became affluent again
- How they manage their fisheries
- How the banking sector collapsed in 2008
- How the Icelanders rose again to their feet

Commonwealth, 930–1262

Remarkable Legal Order

- No kings and no aristocracy
- 39 chieftains: each ran a protective association
- Law: “the good, old law” to be discovered
- New law passed with unanimity at Althingi
- Judicial decisions made at assemblies
- Such decisions enforced privately, by families and chieftains
- Conflict resolution by price

Local communities

- About 5,000 farms in the country
- Each farmer chose a chieftain, for protection
- Also obliged to participate in local community (hreppur)
- Local community; mutual insurancy company, had to have over 20 members
- Local community administered the commons: allocated grazing rights

Iceland Commonwealth Farm

Grazing Rights

- Sheep kept in mountain pastures during summer
- Temptation for each farmer to drive too many sheep up to the mountain
- "Tragedy of the Commons": benefit of additional sheep to the farmer himself; cost imposed on whole farming community
- Solution in old Law-Book: Each farm received a quota, a given number of sheep which it could graze
- Correct economic principle: Total number of sheep set in such a way that they would return as fat as possible in autumn

Why Was Iceland Desperately Poor?

Fishing and Foreign Trade Restricted

- From 1490, foreigners forbidden to stay in winter: no foreign capital therefore invested in fisheries, only rowing-boats
- A law on service duty obliged all non-farmers to be farmhands
- Prices of export set by royal decree, favouring agriculture over fisheries
- Agriculture, on the 5,000 Icelandic farms, in effect only legal economic activity

The Mist Famine, 1784–5

Marginal, Unwanted Country

- Christian II tried twice, 1518 and 1524, to sell Iceland to Henry VIII
- Christian III once, 1535
- Christian IV to German merchants, 1645
- Zero value in 1785, proposal to evacuate
- Three proposals to U.K. to annex turned down, 1801, 1807, 1813
- Sweden not interested in including Iceland when she got Norway
- U.S. Congress laughed at proposals to buy Iceland in 1868

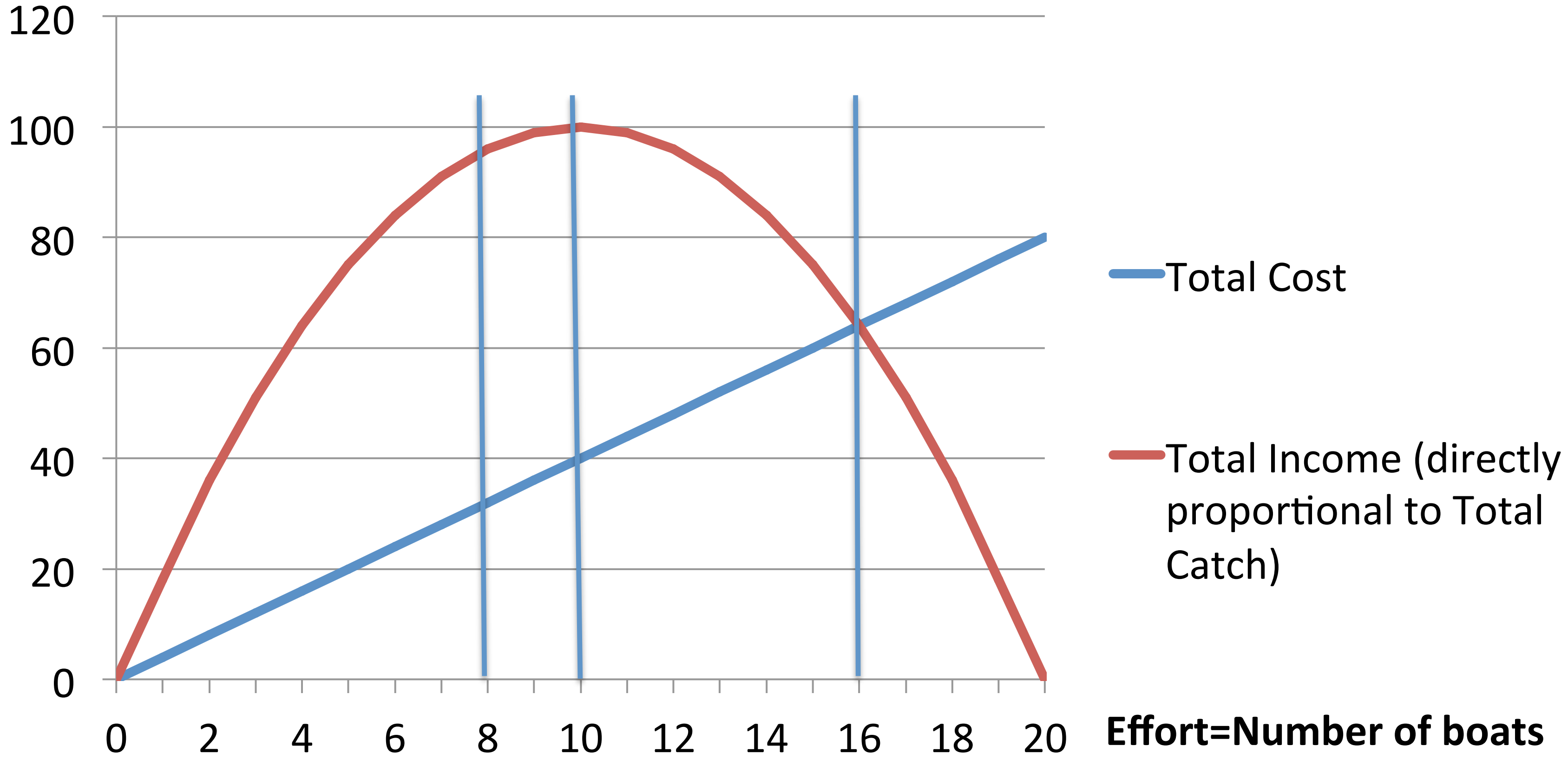
Fertile Fishing Grounds

Icelandic EEZ Since 1975

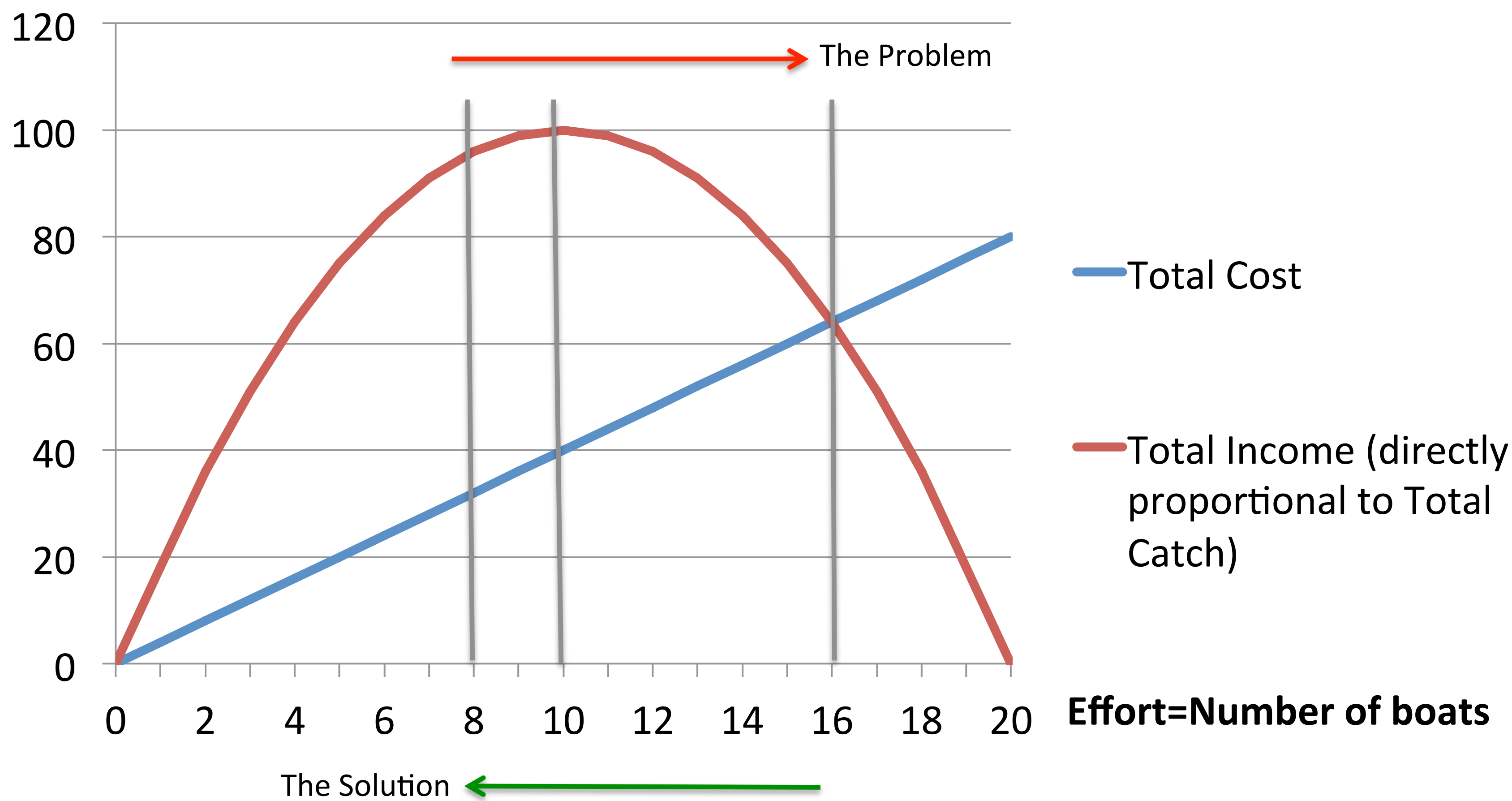
Fishing Rights

- Fishing grounds similar to mountain pastures: Open access leads to over-utilisation
- 1967–8 herring collapse taught Icelanders a lesson
- 1975 individual catch quotas in herring, later also in capelin; gradually made transferable
- 1977 warnings of cod collapse
- 1977–1983 trial-and-error process
- 1984 individual catch quotas introduced in cod
- 1990 comprehensive system of ITQs
- Sustainable and profitable; however some resentment

Which Effort is Most Efficient?



More Catch with Less Effort

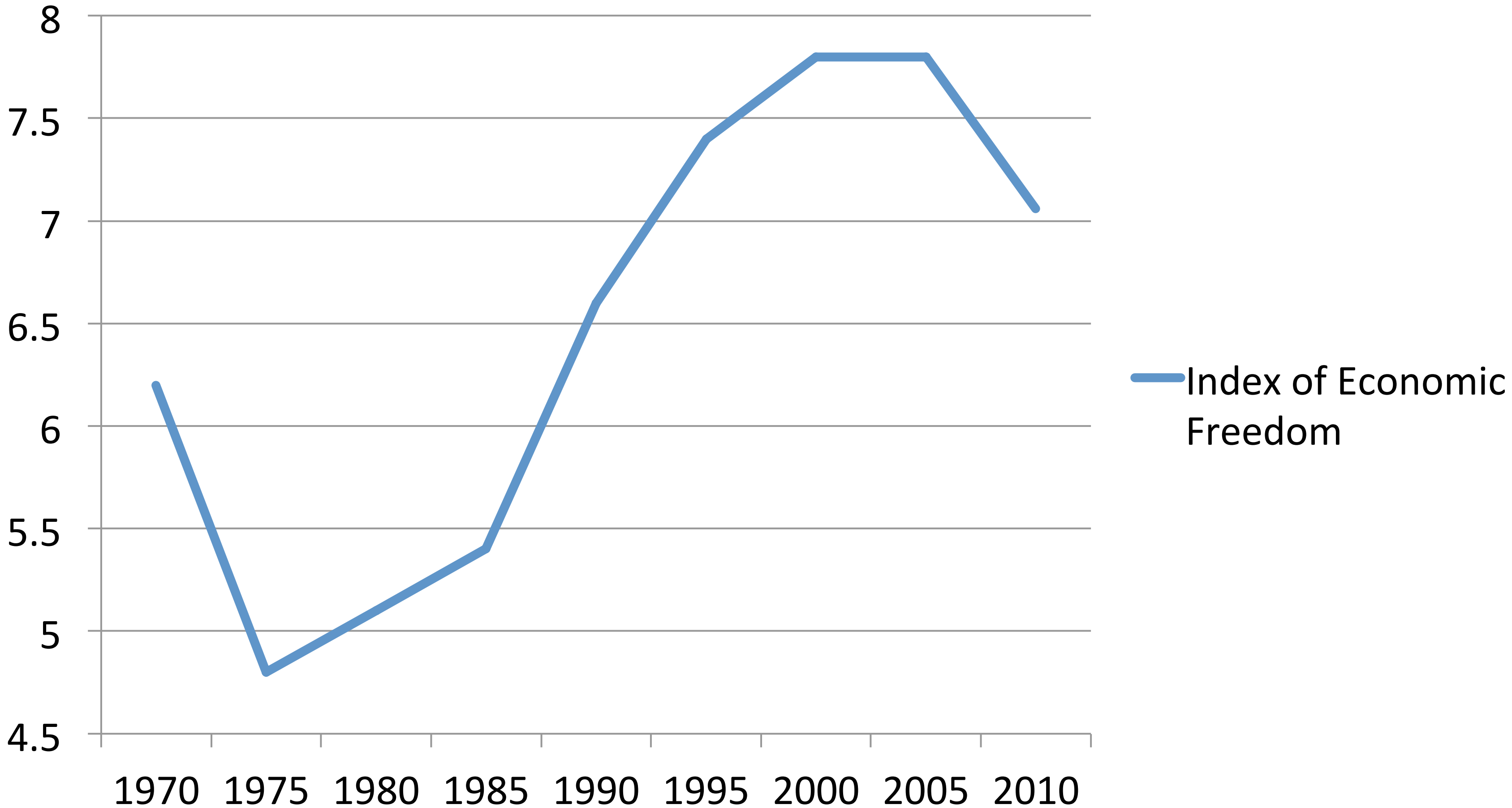


Simple, Efficient Solution

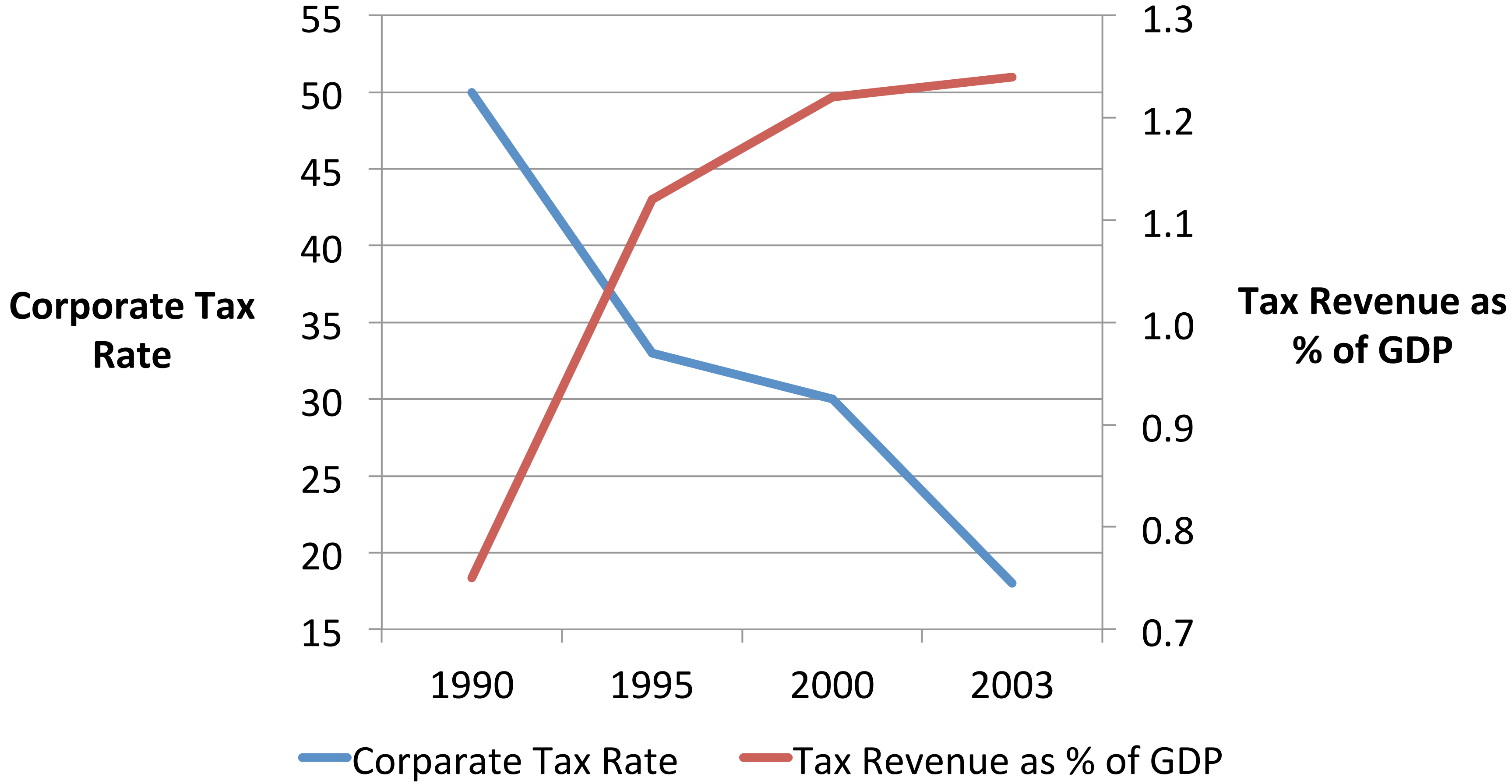
- Open access means boats added until profit zero; 16 boats harvesting instead of 8
- If transferable catch quotas issued to all, 8 more efficient will buy out 8 less efficient
- Excessive boats bought out, not driven out
- Essential to issue first quotas according to catch history: more continuity, less friction
- Parero-optimal solution: Nobody worse off
- Tax or initial auction not Pareto-optimal: Some worse off
- Only right removed: the right to operate at zero profit

30 April 1991

Economic Freedom in Iceland



More Revenue at Lower Tax Rate



Liberalisation, 1991–2004

- Stabilisation, inflation fell, government deficit disappeared, government debt reduced
- Opening of economy with membership of EEA
- Privatisation of major companies, including banks
- Comprehensive tax cuts
- Sustainable pension system
- Laws on increased protection of individuals from abuse of power (law on information and civil administration)

15 September 2004

What Then Went Wrong?

- Crony capitalism in 2004–8: handful of businessmen took power, controlled major companies and the media
- Used Iceland's good reputation, created in 1991–2004, to obtain credit abroad
- Also, Iceland lost its strategic position, became expendable for U.S.
- No support from U.S. in the financial crisis
- The U.K. imposed anti-terrorist law on Iceland and closed Icelandic-owned banks, saving all other banks

Iceland Left Out in the Cold

Why Has Iceland Risen Again?

- Because it was never bankrupt, despite Brown’s outburst
- Lack of help blessing in disguise
- Four pillars of Icelandic economy:

1. Profitable fisheries
2. Booming tourist industry
3. Considerable energy resources
4. Much human capital

- Iceland’s problems: capitalism still discredited; Icelanders very innocent; lack of moderation and self-control
- Nevertheless, a remarkable experiment of a small nation governing itself