



Lecture

by

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OPPORTUNITIES FOR
SMALL STATES IN THE
AGE OF GLOBALIZATION:
THE ICELANDIC EXPERIENCE

At the beginning of the 20th century Iceland was a sparsely populated and impoverished nation of fishermen and farmers who for centuries had lived under foreign rule. Ever since Iceland was settled in the ninth century the population had been less than 100,000; from the Middle Ages, ordinary people's living standards were determined by the interests of colonial rulers; Iceland had most of the characteristics of countries which today are associated with the third world. The campaign for independence began around the middle of the 19th century and Iceland received home rule at the beginning of the 20th century, sovereignty in 1918, and the Republic was established in 1944. Seven centuries of foreign domination in Iceland thereby finally came to an end.

At the dawn of the new century Iceland is still one of the smallest states in the world in terms of population, with fewer than 300,000 inhabitants, and its gross domestic product is 8½ billion US dollars. But the transformation in national living standards is almost incredible. Iceland now has one of the highest average incomes in the world, and in terms of GDP per capita, within the OECD, we are outstripped only by Norway, Switzerland and the USA, and ahead of Canada, Denmark and Germany. The nation has adopted information technology in such a scale that per capita use of mobile telephones and internet connections is the highest in the world, and the same goes for access to computers. The economy has evolved from the rudimentary techniques of fishermen and farmers towards the diversity which moulds a developed economy, although the technologically advanced and market-driven fisheries sector still plays an important role in our foreign currency revenues. Globalization is leaving its mark on the Icelandic economy to a growing degree. Activities of financial institutions and businesses are increasingly being shaped by the laws that globalization ushers in.

Iceland's evolution in the 20th century and its efforts to seize opportunities that the global economy offers in the new century in many ways represent interesting material for discussing the contemporary position of small nations and their ability to provide their inhabitants with living standards which are comparable with the best anywhere in the world. Although my compatriots have a tendency to underline our unique

position in many fields – a fixation which is deeply rooted in our culture, identity and history – I nonetheless doubt that this success can primarily be attributed to the Icelandic national character. On the contrary, I feel that Iceland's experience pays fine testimony to the potential that all small nations have for taking advantage of economic opportunities, especially if they are also fortunate enough to manage their own affairs with steadfastness, discipline and vision, and can establish a balanced and stable economy.

Admittedly, Iceland has had to take the rough with the smooth in achieving an effective economic framework. Sharp swings, high inflation and devaluations were rife at various periods in the 20th century, strikes and fierce labour disputes reflected tensions within society. From the middle of the 1960s to the mid-1980s, inflation averaged 50% and was sometimes much higher.

Just over a decade ago, the government which was in office from 1988-1991 managed to bring inflation under control and create a foundation for lasting stability. Inflation was brought down from more than 20% to less than 2% in 1994, and few countries that have wrestled with such a high rate of inflation have achieved such a success. Since then, Iceland's economic policy has aimed to consolidate such balance, and has produced one of the best track records in Europe in this respect. A low rate of inflation, high economic growth, rising real wages and low unemployment are the characteristic features of the Icelandic economy during the last decade, although strong measures were sometimes needed in order to secure such results.

Iceland therefore has all the conditions in place to seize the opportunities presented by the economy of the 21st century, opportunities that new technology and the globalization of business create every single day. The transformed character of the economy and industry in recent years is much more favourable towards small states than the conditions that prevailed for most of the 20th century. A strong case can be argued that smaller states have never had opportunities on the scale witnessed today. Former obstacles to their growth have largely been abolished and replaced by an open and wide field where the talents, imagination and

creativity of individuals determine what is harvested, and not how big they are or the physical resources available to them.

We all know how the metals industry, oil resources and heavy goods manufacturing generated wealth in the last century. The industrial revolution was the era of large nations and mass production was their means towards advancement. Information technology and globalization, on the other hand, have dramatically transformed the operating environment. Innovations can now emerge from any direction, new types of market goods have appeared, individual initiative and creativity can lay the foundation anywhere in the world for companies which can establish a global presence. Technology and intellectual products, specialist services and information systems developed within a small nation can rapidly become highly lucrative products in the global marketplace. Company growth in small states is no longer subject to the same restrictions. Through globalization, they can grow to gigantic proportions in their respective fields in the space of a few years. It can definitely be said that the new economy of the 21st century has presented small nations with opportunities to flourish. Never before have they enjoyed such potential for prosperity and progress.

These claims may clash with certain prevailing attitudes and the view that integration into various kinds of international alliances is the most favourable course to take, and that small states will run into troubles if they do not align themselves in this way on a long-term basis. Such attitudes dominate the European dialogue, and are also present in many other parts of the world. However, no contradiction need be involved here. On closer examination, the possibilities available to small states are based on access to an open international business environment, and such access can be ensured and consolidated in various ways.

In many respects Iceland is an ideal example for providing this dialogue with a wide range of material, and for making a realistic assessment of the opportunities available to small states in the age of globalization. Let us begin by looking at several general features with reference to Iceland's experience and then examine clear examples of the way that Icelandic businesses have successfully taken advantage of

globalization and attained positions in global markets that would have been unthinkable only a few decades ago.

First: Economic growth and living standards. Iceland enjoys one of the highest average levels of income per capita anywhere in the world and this income is also one of the most evenly distributed. The overwhelming majority of Icelanders live in their own housing, and figures for the size of residential accommodation per family and for ownership of cars and household appliances show that the general public has reaped enormous gains from the economic growth of the past decades. Universal literacy and a high level of education created favourable conditions for growth.

Although the University of Iceland has been a strong institution and other universities have joined the field in recent years, Icelanders have benefited greatly from having to seek their further education in many fields from other countries. Students returning home passed on their knowledge to a society which in this way incorporated cultural features from many different directions. Experts who had studied at some of the world's leading educational establishments assumed leadership positions in various fields. On account of its small population, Iceland became a kind of melting pot where cultural movements from various countries engaged in a creative flux. In larger countries there is a tendency to acquire education exclusively on the home front, but small states are compelled to look farther afield. This can become a valuable resource, especially when education is an increasing precondition for economic growth, and the impact has been felt not only in the transformation of the Icelandic economy but also in the development of science, the health service, activities of financial institutions and other fields.

Despite having a population of only 100,000 at the beginning of the 20th century and just over a quarter of a million now, Iceland nonetheless managed to become one of the world's leading fishing nations. This achievement illustrates how small states, through specialization and vigorous foreign trade, can successfully take advantage of the international division of labour. Iceland is now one of the leading fishing nations in the world, ranking thirteenth in terms of catch volume and sixth in terms of net export of marine products. Our share in global seafood

trading amounts to several percent. A responsible resources management policy, based on scientific research, has been the guiding principle on which the fisheries sector has been organized, and widespread public understanding and the consensus prevailing within a small and homogenous nation have made it easier to implement such a policy. However, opinions have been divided as to the fairest way of sharing the economic rent on fisheries resources among the whole of the nation.

Icelanders have transformed fisheries into a technologically advanced sector and now trade with fish which is caught all over the world. The tough schooling afforded by being a small nation equipped us to become global businessmen in fisheries and thereby put our living standards and economic growth on a firm footing. The profits generated by fisheries and sustainable management of fish stocks gave us the scope to diversify our economy by nurturing other sectors. Through specialization, this small nation achieved a vantage point in the global marketplace. Many nations and international agencies have made efforts in recent years to learn from the way that Iceland managed to generate such high living standards by harvesting marine resources. In most parts of the world, fisheries are a problematic industry associated with underdevelopment, a way of earning a living in poorer regions. Iceland, on the other hand, has made fisheries into the backbone of economic growth and value creation, a market-based industry driven by the profit motive.

Second: A few words about the welfare system. Iceland has managed to integrate the welfare system with a flexible and strong economy. Everyone enjoys the same right to education and healthcare, both of which are financed almost entirely by central and local government taxes. The family of a manual labourer has the same access to schools and hospitals as the family of the President. Equality is the fundamental principle of the welfare state. We have managed to build up an educational system and healthcare institutions which conform to stringent Western quality standards, without impairing the competitiveness of our industries or imposing an excessive tax burden. The public sector's share in GDP amounts to only 39% in Iceland

compared with an average of 44% in the European Union and 50% or more in Denmark and Sweden. There is much to suggest that our small size has enabled us to develop such a strong and efficient welfare system at so little cost in terms of GDP because we do not have enough people to make it bureaucratic. We have had to allow people who work in the welfare system substantial scope for making their own decisions. The close contact that our small size engenders also inspires an active sense of community alongside the system itself, and when individuals and families encounter setbacks, there is almost always someone who is prepared to lend a helping hand.

The welfare system in Iceland has not hindered labour market participation, which is one of the highest in the world at almost 80%. The labour market has always been very active and flexible, as is clearly shown by the fact that measured unemployment has been well within 3% over the past five years. The retirement age is high, and there is a high labour market participation rate among older people. Coupled with the fact that the Icelanders are still a young nation compared with others in Europe, and have evolved a pension system which has compulsory membership of fully funded pension funds as one of its main pillars, this means that Iceland faces much smaller problems on account of the ageing of the population. The development of pension funds has also exerted a powerful influence on the evolution of financial markets, and it is estimated that pension fund assets will be equivalent to at least one-and-a-half times GDP by the middle of this century.

A very strong work ethic is built into the fabric of Icelandic society, perhaps because in the old society of fishermen and farmers, everyone had to help each other and hard work has always been considered a virtue. These characteristics have contributed to strong national income growth, although various social problems can also result from parents working long hours and having insufficient time to attend to their children's upbringing and development.

Third, Iceland's small population has given it an element of flexibility that proved to be an unquestionable advantage in 20th century economic developments, and will probably be even more so in the future.

Poor fish catches and price slumps in foreign markets often caused considerable difficulties for Iceland in the past, but the strong community spirit which was reinforced by its small size enabled the nation to adapt to new circumstances. A considerable degree of flexibility has always been built into the Icelandic economy and smallness has proved an advantage in this respect: everyone has perceived the need and realized that common interests are at stake.

The view that size restricts small states by denying them the benefits of the economies of scale has not turned out to give a realistic picture of the situation. Iceland's experience has shown that specialization in certain sectors and active foreign trade can provide a small nation with a strong market position, especially when knowledge and education are key factors. But inevitably various limitations accompany small size as well, both regarding competition in individual markets and the potential for developing certain sectors on a sufficient scale. Such shortcomings, however, may be countered to some extent by the benefits accompanying globalization, as Iceland has done, for example, on the basis of the integration established by the European Economic Area Agreement.

Fourth, there is the question of stability. Small countries are perhaps less stable than larger ones, for instance because shocks in one sector can transmit serious effects to the economy as a whole. The fisheries sector has often had such an impact on the Icelandic economy. This proved to be a test of our ability to apply disciplined and forward-looking economic policies and to create consensus about effective action. We Icelanders have had varying degrees of success in this respect in the course of time, but have done much better in the past decade after inflation was brought under control in 1988-1991. It has also recently been seen how concerted action by the government, labour movement and employers managed to expedite greatly the process of disinflation and prevent the need for a tight monetary stance with an accompanying negative impact on economic growth and employment. Competition, transparency and the personal contact engendered by small size doubtless made a significant contribution towards preserving stability with coordinated actions.

Disciplined economic policies thus allow small nations to achieve the balance necessary for enjoying prosperity in the long run.

Fifth, globalization has brought Iceland, like other small states, a wealth of new tasks, which we have tackled by systematically building up financial markets and switching our monetary and exchange rate framework from a fixed exchange rate regime to a floating one with inflation targeting. The core of Iceland's adaptation to globalization in recent years has been its membership of the European Economic Area, which is based on an agreement made by the EFTA nations with the European Union. Iceland thereby belongs to the EU single market for the free movement of goods, services, labour and capital, but can make independent trade agreements with states and corporations outside the Community. This arrangement brings Iceland, so to speak, the best of both worlds: it can take advantage of the benefits of the EU in many fields without any major sacrifices, and establish trade at its own discretion with nations and corporations elsewhere in the world – in the USA, Asia and Latin America – without being tied to the EU negotiating processes.

So far, this arrangement has turned out well for Iceland. We have benefited from European cooperation but at the same time can utilize the advantages of being a small state which determines for itself its relations with others. Admittedly, opinions are divided as whether this arrangement can be maintained in the long run, but so far no political party in Iceland has made EU membership its policy, although the issue is frequently discussed in Iceland.

In recent years Iceland has shown how a small state can make an organized and successful response to globalization and exploit it to boost its own economic growth and general welfare. Globalization can spell a renaissance for small states if they apply firm policies that address the requirements entailed by opening up the economy.

With the IT revolution, computerization and a wide spectrum of technological advances, world industry and business have been radically transformed, and these fundamental changes have become increasingly

widespread with the impetus given by globalization. Now, in effect, avenues have opened up for ideas and innovations from anywhere in the world. Every entity has the opportunity to profile itself. New companies can emerge regardless of where their home base is, and soon have the whole world as their market region.

Small size is no longer the obstacle it once was. The traditional sectors of the industrial revolution, which based their growth on economies of scale, are no longer decisive. Now, innovations can come from all directions and individuals and businesses in small states or in small communities within larger states can rapidly attain key positions.

In fact, there is much to suggest that, in the new economy, the small state can be an profitable basis for business innovations. In small states it is easy to see the way that different elements link up, establish cooperation between different fields, gain access to information and experience, grasp solutions to difficult tasks. Although Iceland has a small population, it has all the characteristics of developed Western societies, its market is similar and its government administration disciplined – plus the fact that the general public are ready to embrace technological innovations and eager to cooperate with experts and researchers in all fields. Experience shows that the small state can serve as a kind of laboratory or research station in precisely the sectors of industry that are increasingly dominating the economy of the new century. In this respect, the new economy can truly open up new horizons for small states.

Many examples can be cited to show how Iceland has managed to establish itself in a world market with innovations in diverse fields, and this success is to a significant extent based on research and development which has been conducted in the small home market. Something that gains a foothold in Iceland proves competitive elsewhere in the world. Iceland acts as a kind of training centre for penetrating larger national markets. Companies are no longer held back by the boundaries of the small state. The entire world is their playing field. Industrial growth is not restricted. Icelandic businesses can now become the best in their fields in the world.

This is obviously a turning point for any small state, and many examples of the Icelandic experience demonstrate without a doubt that the transformation of the global economy has given smaller players the opportunity to flourish. Let us look more closely at a few of these:

Because of the importance of fisheries and the necessary specialization that a small population engenders, talented people from engineering, technology, software and marketing have channelled their energies into this sector. The outcome has been a range of innovations that were originally developed within the Icelandic fisheries sector and have since been sold to companies in other branches of the food industry in many parts of the world, including chicken producers in Texas and other parts of the USA. Many companies with roots in Iceland's fisheries sector now sell their technology around the world and some of them have set up plants and branches in other countries to increase their production and strengthen their position.

A number of Icelandic software companies have developed products in recent years which have attracted the attention of major corporations and governments around the world. Icelanders have been engaged in such cooperation with IBM, Ericsson, INTEL, Cisco, Vodafone and Motorola, to name a few examples. On my recent state visit to Russia the authorities there showed a strong interest in Icelandic software for an emergency telephone network linking ambulance, fire, police and rescue teams. A company that last year earned the President of Iceland's Export Prize has developed a document storage application in which local government authorities, government agencies and major corporations in other countries have expressed an interest. Cooperation with the Icelandic administration played a key role in developing this software. Although Iceland's governmental apparatus is small, its scope is nonetheless sufficiently wide to reflect most of the problems that need to be tackled in larger societies, meaning that Iceland has been a promising site for developing interesting products.

While more instances of the opportunities available to Icelandic software companies in global markets could be cited, the main problem they have faced has been gaining sufficient access to venture capital. In

this sense the small size of the Icelandic economy can prove to be a temporary obstacle, but greater contact with international finance markets, more training of Icelandic experts in this field and wider knowledge of the Icelandic economy among foreign investors ought to give Icelandic software houses easier access to the capital required to put their products on the world market.

Leading Icelandic operators of food store chains and shopping malls have recently shown that such a business background in the small Icelandic market can equip them to make their presence felt in the tough home markets of large countries. They recently acquired Bill's Dollar Stores, a chain of four hundred stores here in the USA, and made a bid for the major UK retail chain Arcadia which operates well known stores such as Miss Selfridges, Top Shop, Wallis, Burtons and Dorothy Perkins, or a total of 2,000 shops. These entrepreneurs argue that the skills they have acquired in the Icelandic home market have made them capable of competing in larger markets, perhaps even more capable than others because of how tough a schooling they have been given by its close contact and transparency.

Just over a decade ago an Icelandic inventor developed new prosthetics technology which has provided the foundation for a company that is now one of the largest of its kind in the world. Two years ago the group took over the US company Flex Foot and, operating from Iceland, is even stronger now than ever. The spread of diabetes means that the prosthetics market is continually growing and this company is a classic example of how a small nation can assume a strong position globally for healthcare products. Medical services, pharmaceuticals and rehabilitation will account for an increasing share of economic activity in the future, for reasons including the growth in the oldest age group of the population.

Another example of an Icelandic achievement in the healthcare sector is the growth of pharmaceutical manufacturers, who have recorded major export successes and have also acquired pharmaceutical companies in other countries, including Central Europe, which they aim to make more profitable on the basis of the experience gained in Iceland. Iceland's small size has benefited pharmaceutical companies in various ways,

including the fact that international giants forgot “little Iceland” while they were securing patents for certain drugs. When these patents ran out in bigger countries, the Icelandic companies had already produced their own generics which they were ready to ship straight to other markets.

Nature has bestowed blessings on Iceland in more fields than fisheries. Geothermal springs not only serve as a valuable source of energy but have also created new opportunities for us in the global market. Iceland has carved out a niche with the experience we have acquired in space heating using natural hot water from the depths of the Earth, steam generation of electricity and the creation of spas and pools for relaxation and health. Certainly the most famous spot of this kind is the Blue Lagoon, which has been the choice for American television stations to set up base when they broadcast live from Iceland.

Iceland’s success in geothermal harnessing has won worldwide attention, since its engineers and technicians have needed to solve various problems in this sphere ahead of others. We have developed a vast bank of knowledge in energy utilization which in fact also extends to urban planning of communities which deploy geothermal energy for space heating. Authorities in China and California, Russia and a number of European countries have sought partnerships with Iceland on energy issues, demonstrating that the technology and experience acquired by a small state can become a valuable commodity for trading with the most powerful nations in the world.

More examples can be cited to highlight the good position that a small state can attain in the globalized economy in the new century, and Iceland’s experience shows that this can happen in very diverse fields. One area worth special mention is the genetic research initiative that has generated unparalleled publicity in the business and medical communities and worldwide media attention. In the space of a few years, one of the most important genetic research companies in the world has been built up in Iceland and its founder never tires of explaining how Iceland’s unique combination of conditions has produced a favourable environment: ready access to genealogical information stretching back many centuries, detailed medical records for everyone in the country for most of the 20th

century, a homogenous population due to its former geographical isolation from the rest of the world, and a strong public readiness to cooperate with scientists, often more on the basis of personal trust than formal agreements concerning access to private information. This Icelandic genetics company recently acquired a pharmaceutical enterprise in the USA and is now examining the possibility of transferring its operations to Iceland. Then, even more experts from various countries would move to Iceland; and it is gratifying to see how much foreign scientists like living in Iceland, their appreciation of the advantages of this small but highly advanced society, its diverse culture and unique nature.

It is also interesting to see the results that Icelandic finance companies and banks have achieved in recent years by setting up branches in other countries. Icelandic finance companies now operate in New York, London, Luxembourg and Stockholm, to name a few examples. Within a short space of time, a new generation of Icelanders, with international educational backgrounds, have been producing results in a branch of business that we previously left to others. In discussions which I set up a few years ago in Luxembourg with foreign clients of Icelandic finance companies, it emerged that they chose Icelanders to handle their trading because these young people were prepared to work in the evenings and at weekends, to buy or sell when the markets were open in New York or Tokyo, while employees of the established European banks went home at five o'clock, did not want to be disturbed before the next day and fiercely defended their weekend break from Friday evening to Monday morning. The Icelanders, on the other hand, were always ready to work. The old work ethic from the days of fishing and farming, when everyone chipped in to land the fish or bring the hay indoors without even thinking about the time, has clearly resurfaced as entrepreneurial spirit in the tough arena of global business – the roots of Icelandic culture have now spawned initiative and enterprise which are well suited to the needs of the global market. Thus our small population in the past has produced a beneficial resource for us in the global age.

There is much to suggest that culture will have a strong impact on the competitive position of nations, and the creative energy that it nourishes will produce numerous opportunities. Small states may also be well placed in this respect, because their culture and customs, heritage and history give them a unique position in competition. Icelandic culture has always respected the talents of individuals who compose poetry and tell stories, who are creative participants in their companionship with others. People who were original in their choice of words always enjoyed great respect and the nation has regarded poets as superior to officials. These attitudes have been passed on to the business community today – the Icelandic term used to describe a pioneer or entrepreneur is “athafnaskáld”, which literally means “poet of enterprise”. Admiration of creative people has been transplanted from ancient times into the new age, and originality is one resource that our small nation’s culture has handed down. Such qualities can prove decisive in the globalized economy. The culture of small states can foster talents that allow entrepreneurs and “poets of enterprise” to excel.

Uncertainty surrounds the future of small states, like all others, but there are many signs that the years to come could bring them a renaissance. Of course, a precondition is efficient economic policies. Given this assumption, the global economy opens up many new horizons for small states, releases them from bonds that once cramped their economic growth.

I have tried to shed light on the position of small states in an era of growing globalization by referring to Iceland’s experience. Although each country is special in certain ways, I feel that the Icelandic paradigm has some universal application. It shows that the IT revolution underlying globalization, and various main characteristics of the new economy, the service, software and technology sectors, can arm small states with a wealth of opportunities for enhancing their economic growth and general welfare, and that companies developing within a small state can nonetheless have the whole world as their market region.

While small states certainly need to tackle a variety of problems, they have qualities which are precious assets in the new era. I have

discussed several and more could be mentioned. Their contribution towards the evolution of democracy is also important, since the close contact and transparency engendered by smallness can boost the democratic way of life. It is interesting to note that, in antiquity, the cradle of Western democracy was Athens and Rome, which in those days were small states by modern standards with a similar population to that of Iceland today. The settlers of Iceland established their own parliament more than a thousand years ago and the Icelanders have always been proud of having the oldest national assembly in the world.

History shows that small states can serve as a creative forum for democracy, law and legal order: models for civilized society and transparent government. Although the contribution made by small states, past and present, to the advancement of democracy and political ethics is beyond the scope of this lecture, it is important to bear such factors in mind too when examining the economic position of small states.

Small states also have the great quality that they are a threat to no one and there is no risk involved in engaging in widespread cooperation with them. They have no hidden agenda and cannot deploy military might, financial power or strong political pressure to achieve their aims. They act straightforwardly and there are no problems involved in being their friends. Such qualities are also genuinely valuable at a time when complex relations underlie the coexistence of nations. Many doors are open to a small nation that remain closed to others. Other countries seek its assistance and its contribution, because they all know it will never prove a threat to its partners.

Such freedom from fear can also be a resource when globalization brings increasing ties between nations, communities and businesses. It is an advantage to be small and be able to have everyone as a friend.