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Karl Benediktsson and Anna Karlsdóttir
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Iceland: crisis and regional development – Thanks for all the fish?

Karl Benediktsson
University of Iceland, Iceland

Anna Karlsdóttir
University of Iceland, Iceland

Abstract

In this commentary, the crisis that hit Iceland in late 2008 and involved the collapse of the country's entire banking system is discussed briefly and its impact on regional employment levels is outlined. Currently, unemployment is highest in south-west Iceland, including Reykjavík. Fisheries-dependent communities have performed better, but fisheries management is yet again a major issue in the political arena. We trace the origins of the Individual Transferable Quota (ITQ) system and speculate about its role in the series of events that eventually led to the downfall of the banks. Ongoing attempts to reform the fisheries management system are discussed. These include the re-establishment of open-access coastal fishing and the gradual recall of ITQs by the state. Finally, some issues regarding the future of Iceland's economy are discussed briefly.

Keywords

banking crisis, fisheries, Iceland, ITQs, regional development

Introduction: Iceland's reflexive moment

In the afternoon of 6 October 2008, Mr Geir Haarde, then leader of the right-wing Independence Party and Prime Minister of Iceland, addressed the nation on television. His rather cryptic address was mostly about the state of the international financial system. Full of metaphoric references to stormy weather, treacherous waves, etc., it ended with the words 'God bless Iceland'. If that was meant as a reassurance, it had the opposite effect. This was indeed Iceland's day of reckoning. The entire financial system had collapsed under its own weight. After several months of stern warnings from many quarters – warnings that had not been heeded by the Icelandic government, let alone the banks themselves – a global chain of events had triggered what seemed a disintegration of an entire national economy.

Corresponding author:
Anna Karlsdóttir, Assistant Professor – Human Geography and Tourism Studies, Faculty of Life and Environmental Sciences, School of Engineering and Natural Sciences, University of Iceland, Sturlugata 7, 101 Reykjavík, Iceland
Email: annakar@hi.is

The suddenness and severity of the crash in October 2008 stunned most Icelanders. How did it come to this? Many have come to the following conclusion: a neoliberal political ideology that gained ascendancy in the early 1990s had nurtured a lethal mix of greed, hubris and political corruption that had been gnawing at the roots of society. The beginning of the 21st century saw the emergence of the super-rich in Iceland – a small elite that seemed to have appeared almost out of nowhere and that flaunted its wealth rather crassly at times. A particular form of nationalism (see Hálfdanarson, 2006; Bergmann, 2009) allowed this to go on without much critical scrutiny. Moral questions were conveniently brushed aside, together with regular news of a growing number of people living in relative poverty. These were indeed times of economic expansion, jobs in abundance, rising wages and property values, and apparently unlimited access to capital – translating into a consumerist binge by the large middle class, which acquiesced to it all with silence.

Looking behind the façade towards the reality of economic management, it is clear that Iceland's national economy had been subjected to more stresses and strains than most, albeit strains resulting largely from questionable policies and decisions made at home rather than the woes of the global economy per se. It had become severely overheated, owing to a large (and controversial) public project in hydropower development and the associated construction of a large aluminium smelter – the country's third. Easy access to lending capital had led to the Icelandic króna becoming grossly overvalued. By the time of the crash, the country's three large banks had by then amassed assets that amounted to more than nine times the GDP (Gylfason et al., 2010) during their rather questionable attempt to turn tiny Iceland into a global financial centre. Much of this expansion of the banks' portfolio, it has now turned out, was based on lending decisions that were less than prudent to put it mildly, involving cross-lending between the banks themselves as well as huge loans to the large holding companies that operated under their aegis, with little or no collateral. The country's Financial Supervisory Authority had not seriously monitored the banks' activities and the government of the time did not do anything to cap their expansion – rather the opposite. As the international financial crisis mounted, the whole edifice was a disaster waiting to happen (see Wade, 2009). The currency reserves of the Central Bank were very limited and nowhere near enough to prop up the bloated banks when the global credit crunch washed up on Iceland's shores.

The months following the prime minister's address were marked by protests that culminated in the 'pots-and-pans revolution' in the first weeks of 2009. Icelanders took to the streets as never before seen in the country. A lot of noise was made about the situation, literally. Pots, pans, spoons and forks were enlisted for the purpose. Fires were lit in the streets. Eventually the government stepped down and an interim minority government took the helm, made up of the Social Democrats (partners in the previous coalition government) and the Green Left. Elections in April 2009 gave these parties a sound majority in the Icelandic parliament, Alþingi.

Our purpose in this commentary is not to provide a detailed analysis of the roots of the Icelandic crisis or its many faces. A number of perceptive analyses of this kind are already available (for example, Wade, 2009; Gylfason et al., 2010). Instead, we want to focus on certain aspects of the crisis that have regional development implications. We will first outline the impacts of the crash on regional employment levels, before discussing the complex entanglement of the nation's market-based fisheries system in the turn of events that led to the collapse. Finally, we will discuss current ideas about reforms in the fisheries management system and some other questions about Iceland's future.

A regional turnaround?

Since the crash, Iceland has seen a great increase in bankruptcies and mass layoffs, and hence considerable unemployment (Figure 1). Although the unemployment rate (at the time of writing about 9 percent) is perhaps not that dramatic seen from mainland Europe, where double-digit numbers have been a persistent feature in economic statistics, this turn of events has come as a great mental shock to Icelanders. Large-scale unemployment was almost unthinkable

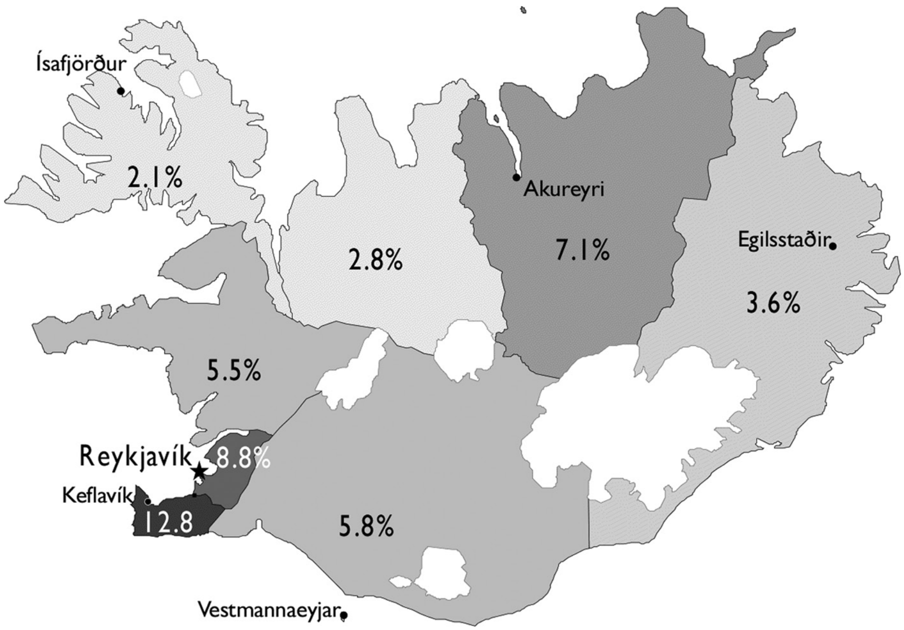

Figure 1. Average unemployment in the regions of Iceland in 2009
Source: Based on data from Statistics Iceland (2010).

for a long while. In fact, since the 1990s the demand for labour had been such that immigration on an unprecedented scale took place (see Skaptadóttir and Wojtynska, 2008), with the percentage of foreign-born residents quickly reaching levels comparable to those of neighbouring Scandinavian countries that have a much longer history of receiving immigrants.

But the scourge of unemployment has hit the regions differently. It is highest by far in the south-west, a region that has also had to cope with the sudden disappearance (in 2006) of the large US Air Force base at Keflavík. The capital region, which had benefited most from the impacts of the bloated financial sector, is also experiencing high unemployment. Localities with a high percentage of construction and service-based jobs have fared badly.

In the fisheries communities the situation is rather better. Commodity export sectors such as the fisheries are in fact performing quite well. The plummeting of the value of the Icelandic króna against major currencies – it is now worth less than half of what it was before the crash – means that exporters are more competitive. The employment level in those regions most dependent on fisheries is much higher than elsewhere in the country, and there are examples of municipalities where the local income tax has increased after the crash, owing to the much higher incomes of both vessel owners and crews (who are paid on a share basis). During the banking bubble, the fisheries had been relegated to a back seat in the minds of many Icelanders. Jobs in the fisheries were perceived as a last resort and the resource-based localities suffered from high outmigration and insecurity. In contrast, the fishing villages and towns of the Westfjords, for example, found themselves in an advantageous situation at first, comparatively speaking, but as time has passed their employment situation has worsened also.

Quota-based capital(ism)

The origins of the rise – and fall – of the financial sector, described at the beginning, can in fact be traced further back and linked to changes in the fishing industry. In 1984, a quota management system was introduced in the main fisheries in order to prevent overfishing and to enable rationalization of the fisheries sector so as to maximize the economic value of the fisheries. Quotas were allocated to those vessel owners who had happened to be in the business of fishing for the previous three years. This in effect privatized a common-pool resource that had been the mainstay of the Icelandic economy for decades. The resource harvesting rights instantly became valuable assets, and by that token a source of considerable power. In 1990, a fully fledged Individual Transferable Quota (ITQ) system was in place and restrictions on quota transfers between fisheries firms were lifted (Matthíasson, 2003).

This was a crucial step towards the era of unbridled market capitalism. In a television interview late in 2007, the main ideologue of the Icelandic political right bragged about what he (not so modestly) termed 'the Icelandic economic miracle' with these words:

> We activated capital that was dead before. . . . The fish stocks did not have a price tag, they were non-transferable and could not be used as collateral – non-tradable. Then the quotas are allocated, which creates capital. . . . Here in Iceland, capital was handed over to private owners, and then it became alive. (Hannes Hólmsteinn Gissurarson, in *Ísland í dag*, 13 September 2007)

The tying of quotas to the ownership of vessels and the transferability of the quotas under the ITQ regulatory regime led to a flurry of mergers and acquisitions. Many quota holders quickly sold their rights for windfall profits. Many smaller fisheries companies were merged with or acquired by the big ones. In the five-year period 2003–7 some 428 fishing companies ceased to exist, through some 282 mergers, or 30 percent of all mergers and acquisitions in Iceland in the period (Jónsdóttir and Knútsson, 2009). The result is a few vertically integrated fisheries companies with considerable economic power. In 2007, just 10 of the largest quota holders controlled 51.7 percent of the ITQs (Jónsdóttir and Knútsson, 2009).

These structural changes led to a situation in which the inhabitants of many fishing towns were more or less excluded from access to the marine resources, as the ITQs passed into the hands of non-local owners (see Eythórsson, 2000). The term 'creeping enclosure' could be valid in this case (McCay, 2008), a situation that has led to considerable bitterness in many parts of the country (see Figure 2). Simultaneously, technological and organizational change had a great impact on the fisheries communities. Increased processing at sea led to the closing down of many land-based plants, undermining the economy of many villages and consolidating power in the hands of vessel owners (see Karlsdóttir, 2008). Since the beginning of the 1990s, no less than 60 percent of the (land-based) jobs in fish processing have vanished (Sigurmundsson, 2008), with profound regional implications. A small number of places have grown, while others went into decline.

On the other hand, the sudden wealth that the introduction of the ITQ system 'created' was like a shot in the arm for Icelandic capitalism. It found its way quickly to Reykjavík, where it played a considerable role in the nascent neoliberal market economy. Other developments contributed to the financial bubble. Amid accusations of political cronyism, the formerly state-owned banks were promptly privatized in the early 2000s. Again, this brought formerly 'dead' capital mysteriously to life. The spoils from the ITQs immediately found their way into these private financial institutions. Large and established power blocs from the fisheries sector were able to gain considerably by forming more extensive investment networks. The end result was a financial sector that took on a life of its own. But the minuscule local market was soon considered to be too small and the main players developed an aggressive expansion strategy through takeovers and property deals abroad.

The brave new financial world was almost entirely centred on Reykjavík and neighbouring areas. The role of the fisheries communities, previously the backbone of production for commodity exports, declined when considered in relation to the national economy as a whole. A stagnant real estate market elsewhere contrasted sharply with the property boom in the capital area. The perceived glamour of urban wheeling and dealing sidelined the rural resource-based occupations even further. Existing regional inequalities were thus greatly amplified in the neoliberal regime.

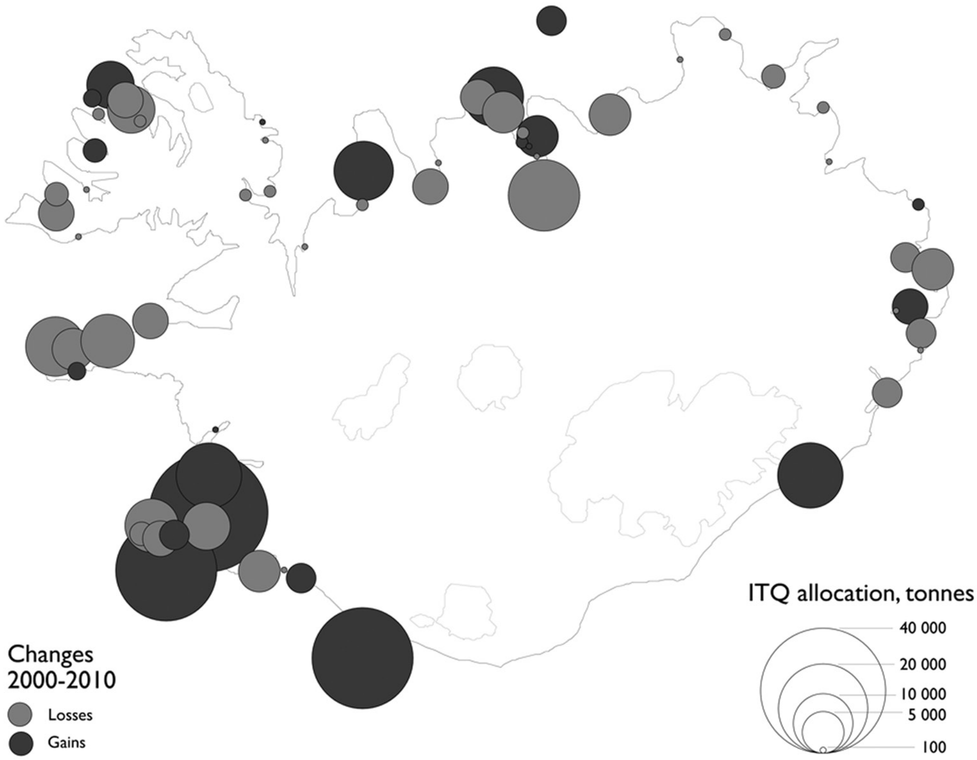

Figure 2. The geography of fishing rights: ITQs for the fisheries, management year 2009/10, allocated to vessels registered at each harbour

Notes: Quotas for all species are calculated as 'cod equivalents'. The map also shows which places gained/lost quotas from 2000/1 to 2009/10.

Source: Based on data from Alþingi (2009).

Following the collapse of the banks in late 2008, increasing attention has been paid to the precariousness of the fisheries within the financial system. The main issue is that ITQs had been handled like any other private property and used as collateral for loans – which was precisely what the designers of the system had intended (see Portes and Baldursson, 2007; Árnason, 2008). The fisheries companies, many of them embedded in corporate networks that included the banks themselves, have accumulated astonishingly high debts. Assessing the real debt of the fisheries is difficult, but in July 2009 they were estimated to be at least ISK550 billion (Hávarðsson, 2009), which is more than a third of GDP in 2008. Nearly 90 percent of the total fishery debt was owed by only a third of the fishery companies (Hávarðsson, 2009).

Rough seas: rethinking the fisheries

One of the many challenging tasks for those charged with reforming the Icelandic political economy is the revision of fisheries regulation. This revision will inevitably bring about changes not only in the technicalities of fisheries management but in the power structures that have been ingrained in the Icelandic political economy for a long while (see Gylfason et al., 2010).

Right from its instigation, the ITQ system has been one of the most divisive issues in Icelandic society. Apart from the impacts on regional development, the thorniest questions relate to the ethical implications of the state handing an extremely valuable common-pool resource over to private owners (Pálsson and Helgason, 1996). Whereas the first article of the fisheries management legislation has since 1988 stated that the fish stocks are the 'common property of the Icelandic nation' (Alþingi, 2006), the quota holders do not pay any substantial resource-use fees to the state. Several economists (for example, Matthíasson, 2001) have argued that a fee levied by the government, designed to capture the resource rent, would not only be economically sound but also go a long way towards increasing the legitimacy of the ITQ system in the eyes of the Icelandic people. Some limited steps have been taken in this direction, with the introduction of a 'catch fee' in 2004 (Matthíasson, 2008), but this has been set much lower than what the quota 'owner' can obtain on the rental market that has developed for ITQs. Accusations of neo-feudal relations between the 'quota kings' or 'sealords' (see Pálsson and Helgason, 1996) and fishermen who have to rent their access rights have been persistent.

The current economic crisis provides an opportunity to rethink fisheries regulation and management in order to achieve more equitable social and geographical outcomes, although it will not be an easy task given the fierce opposition of the current quota holders to any substantial reforms. A working group was set up in July 2009 by the Ministry of Fisheries and Agriculture to review the fisheries management system, but the powerful Federation of Icelandic Fishing Vessel Owners shunned the meetings at first and attempted to derail this work.

But some measures have already been taken. In 2009, an attempt was made to (re)introduce a coastal small-scale fishery independent of the ITQ system. The consolidation of power occurring under the previous regime had severed the links between locality and resource. The new arrangement provides for open-access coastal fishing for part of the year, using hook-and-line techniques only. Although proponents of the ITQ system often stress that it has enabled more environmentally sound management than other options – for instance the Common Fisheries Policy of the European Union (EU) – the growing concerns worldwide about the impact of industrial trawl fishing on ecological conditions have been dismissed. Likewise the ITQ regime has sidestepped questions of social equity entirely. The emphasis in the new coastal fishing scheme, on the other hand, is on sustainability in both the social and environmental sense. A survey conducted in late 2009 in order to evaluate the impact of the first round revealed that many people in fishing communities felt that this had revitalized their villages (Háskólasetur Vestfjarða, 2010). Although the sudden introduction of the scheme in 2009 resulted in some teething problems, the Minister of Fisheries and Agriculture has declared that the experiment will continue.

Even more heated debate about the regional development impact comes from the current government's intention to recall a certain percentage of the quotas from their holders every year and to reallocate them either by political or market-based means. As a part of the current government's political programme, this is meant to reassert the national ownership of the resource and open the sector up for new entrants. Not surprisingly, the current quota holders have reacted vehemently to the proposal. Ironic as it seems, given the debilitating impacts of the ITQ system on many coastal communities, the issue is portrayed as yet another attempt by Reykjavík to suck the lifeblood out of the rest of the country.

Another controversial issue is possible EU membership. In July 2009, the Icelandic government lodged an application to the EU. The process is causing great anxiety among stakeholders in the fishing industry, who argue that entering the EU would take away the possibility of Icelanders to manage their own most important natural resource. This has indeed been a longstanding concern (Bergmann, 2009).

Conclusion

Although much attention has been paid to the banks during the current crisis in Iceland, fish is yet again in focus. A resource that was very much central in the days before the banking bubble, it has assumed the role of propping up an otherwise ailing economy and preventing the worst-case scenario of complete standstill. But even if the present economic circumstances leave the fisheries-based regions in a relatively strong position, the future of the fishing communities is subject to considerable uncertainties, as has been discussed above. The high debts of the fishing companies are a frequent source of concern. What remains to be seen is how the problem of quotas as collateral will be dealt with when, and if, fisheries firms go bankrupt, which has not happened yet to any great extent. So far, it seems that the debts are being written off according to different criteria in each case. The lack of transparency is indeed one of the problems in the cleanup of the sorry mess of the Icelandic economy.

In fact, much searching for alternative development strategies is presently taking place. Apart from the fisheries, Iceland's chief sources of foreign currency are the tourism sector (which has grown very rapidly in recent years) and heavy industry. Energy-intensive industries – not least large aluminium smelters – are seen by many politicians and local authorities as a 'natural' route to growth and development (see Benediktsson, 2009). However, not only are such strategies highly contested, but there is an almost complete freeze in foreign direct investments, which are needed for large-scale developments of power stations and industrial plants. More progressive perhaps is a renewed emphasis on smaller, local initiatives and on developing new export possibilities through innovation. During the previous decade, the overvalued Icelandic currency and extremely high interest rates had made it very difficult for smaller innovative companies to establish a footing.

More fundamentally, the Icelandic nation is engaged in extensive soul-searching. The current moment provides an opportunity to learn from the past and to design a more open and transparent society. There are still very thorny problems to be solved. At the time of writing, Iceland continues to be embroiled in a struggle with the governments of the United Kingdom and the Netherlands about compensation to these countries because of the Icesave fiasco, which involved the operation of one of the Icelandic banks within these two large markets. Within Iceland itself, many highly indebted families face the prospect of losing their homes. The high level of frustration among the public surfaces every now and then, e.g. through ranting in the blogosphere or demonstrations on the ground. Overcoming the crisis will take a long time – but at least Icelanders can be thankful for all that fish.

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