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The Diplomacies of Small States

Between Vulnerability and Resilience

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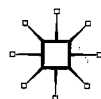
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Can Small States Choose Their Own Size? The Case of a Nordic State – Iceland

Baldur Thorhallsson

Introduction

The aim of this case study is to explain why Iceland has changed its international approach and become a more active player in the international arena since the mid- and late 1990s. Iceland's increased activity in the international system is explained by five interrelated features: a redefinition of interests; greater economic resources; greater administrative resources; a change of perception and preference by a large part of the Icelandic political elite; and an external pressure reflecting the view of international actors. All these features have led to a policy change at the domestic level. There has been a move away from an international approach built on historical bilateral relations, with a narrow focus on the concrete economic advantages to be gained from all overseas activity, to an approach based on more broadly defined interests and increased international activity within multilateral organisations. Accordingly, Iceland is moving out of Keohane's 'system-ineffectual' category, that is, being a state which simply adjusts to the international system and cannot change it. Recently, Iceland can be regarded as belonging to Keohane's 'system-affecting' category, that is, being a state that cannot influence the international system on its own but can do so together with other states (Keohane, 1969: 295–6).

The decision by the Icelandic government in 1998 to apply for a seat in the Security Council of the United Nations (UN) demonstrates the shift from a reactive international approach to greater activity in the international arena. Iceland joined most of the international organisations created after the Second World War, but unlike other Nordic states, it did not seek an active role within them. The Icelandic governments

attached importance to bilateral relations with neighbouring states in terms of trade and defence: the Nordic states, the United States and Britain (Thorhallsson, 2005). Emphasis was placed on obtaining concrete economic advantages from all overseas activity, whether these concerned the extension of Iceland's fishing zone, trade agreements or protection by the US military. The work of the UN (with the exception of the establishment and application of the Law of the Sea), the North Atlantic Treaty Organization (NATO) and the Council of Europe, were not placed high on the agenda. Governments prioritised beneficial trade deals with European states and joined the European Free Trade Association (EFTA) in 1970 and the European Economic Area (EEA) in 1994. However, as soon as market access for Icelandic fish and marine products was achieved, little importance was attached to the work of those institutions except when issues concerned Icelandic core interests and the unavoidable routine day-to-day business within them. Politicians did not engage in building a decisive civil service, including a foreign service, in order for Iceland to become actively engaged in these institutions (see detailed discussions in Thorhallsson, 2002 and 2005). Moreover, Icelandic policy-makers, have been reluctant to apply for membership within the European Union (EU) since it might jeopardise the resilience of the economy (Oddsson, 2004). This prevented Iceland from belonging to Keohane's 'system-affecting' category of states which can influence the international system with other states, as stated above. This is in contrast to the other Nordic states, primarily Sweden, Norway and Denmark, which can be said to have belonged to this category in the postwar period because of their international activity. Keohane distinguished between large and small powers by examining whether their leaders have a decisive impact on the international community. His third category is 'system-determining, or system-influencing', consisting of states that can influence the international system through unilateral or multilateral action (Keohane, 1969: 295–6).

However, since the late 1990s, the Icelandic government has become increasingly engaged in the international community, emphasising a traditional small state multilateral approach. Iceland has become more active within international organisations such as NATO, the European Council, the Organisation for Security and Co-operation in Europe (OSCE), the World Trade Organisation (WTO), the World Bank and organisations of the UN, such as the Food and Agricultural Organisation (FAO), the UN Education, Scientific and Cultural Organisation (UNESCO), and a number of UN commissions. Iceland has also taken on leadership duties in the Arctic Council and the Council of the Baltic Sea

States. Aid for development has increased substantially along with work within international organisations dealing with aid and development. In 2000 Iceland created an Icelandic Crisis Response Unit (ICRU) explicitly earmarked for possible use by NATO, the EU, the UN and the OSCE. The ICRU is a non-military 'peacekeeping force' of individuals (police, doctors, nurses, lawyers, air traffic controllers, administrators, etc.) available for rapid deployment abroad. In 2001 and 2002 it contributed to a mission in the Balkans in which all four international bodies named above were involved. Its main missions have been the management of the international airports in Pristina in Kosovo and Kabul in Afghanistan. Furthermore, since the mid-1990s, the Foreign Service has extended its activity to a number of countries and opened embassies in China, India, Japan, Canada, South Africa, Finland and Austria.

Moreover, Iceland's central administrative capabilities have increased considerably in the last two decades. In terms of number of personnel, the Icelandic Foreign Service has nearly doubled in size over the last decade. Its ability to produce detailed reports on Iceland's status and policy choices in Europe and elsewhere has changed fundamentally (see detailed discussions in Thorhallsson, 2006a). The administration is now much more capable of taking an active part in the international arena.

Yet recently Iceland's burgeoning international presence has suffered its share of setbacks. In 2008, the vulnerability of Iceland, as a small economy and a small international actor, became evident in the financial crisis as well as its campaign to become a member of the UN Security Council. The small Icelandic currency (the króna) fell rapidly while the three main Icelandic banks collapsed, forcing the Icelandic government to take over their operations. Moreover, the country came to an economic standstill as foreign trade crumbled due to the breakdown of the foreign currency market in the country. The Icelandic government, despite considerable effort, failed to get immediate loans and other economic assistance from both its neighbours and international institutions.

Internationally, Iceland had failed to guarantee the country a permanent shelter within the EU framework, including the European Central Bank, even though it took an active role in the Four Freedoms through its membership in the EEA. Iceland got into a major dispute with Britain and the Netherlands because of their demands that Iceland should honour its legal obligations within the EEA to depositors in overseas branches of the Icelandic banks. The British government used its antiterrorist law to take over the assets and operations of the two Icelandic banks in Britain, causing one of the banks to fall instantly, and substantially worsening the economic crisis in Iceland. Britain also managed to delay much needed

economic assistance promised by the International Monetary Fund (IMF) until the dispute had been settled.

Moreover, Iceland failed to get elected to the UN Security Council in mid-October 2008. This was because of a limited record of activities within the UN, a small foreign service compared to the competitive states, Austria and Turkey, and a campaign by Britain against Iceland in the week before the vote in the UN General Assembly. Accordingly, the case of Iceland in 2008 once again indicates how the fate of a small economy is tied to external conditions and the actions of larger neighbours despite rapid economic growth and a considerable increase in international activity.

Explanations

Acknowledging the setbacks that have occurred, it is still worth analysing what has led to this policy shift in Iceland. Why has Iceland moved away from its reactive international approach with its focus on bilateralism and adopted an active international approach based on multilateralism? As introduced above, Iceland's increased activity in the international system is explained by five interrelated features: a redefinition of interests; greater economic resources; greater administrative resources; a change of perception and preference by a large part of the Icelandic political elite; and external pressures reflecting the view of international actors.

A redefinition of interests

The Icelandic political elite was highly ambitious concerning domestic affairs throughout the twentieth century. Icelandic society was transformed from being a very poor undeveloped agrarian society to a rich industrial and commercial society. The prioritisation of the elite was clear: self-determination over the country's landmass and surrounding waters. Accordingly, the elite managed to gain independence from Denmark (domestic rule in 1904, sovereignty under the Danish Crown in 1918 and a republic in 1944) and full control over the 200-mile fishing zone surrounding the island in 1976 (after steady successful extensions of the zone). This was combined with an aim for a more successful economy and higher living standard – though Iceland's priorities in this respect were perhaps not always correctly focused.

Throughout the twentieth century fish and marine products were far the most important exports of goods accounting for 95 per cent in 1940 (National Economic Institute, 2001). Accordingly, Iceland's trade policy had a clear objective: to guarantee its fish and marine products access to

important markets mainly in Britain, the EU and US. On the other hand, fish and marine products have declined significantly in importance in the last four decades. In 2006 fish and other marine products accounted for just over 50 per cent of merchandise exports and roughly one-third of total exports, down from 82 per cent and 60 per cent respectively in 1991 (Central Bank of Iceland, 2007). The economy has diversified bringing into the picture exports of aluminium and medical and pharmaceutical products, a tourist industry and recently a financial sector. The export of manufactured goods has grown rapidly and accounted for 38 per cent of merchandise exports in 2008 while service accounted for almost 35 per cent of total export revenues (Central Bank of Iceland, 2007). The government has had to respond to and focus on a much wider range of interests internationally. For instance, it has extended its work within the WTO and expanded its Foreign Service to distant markets. The international work of the government now bears the hallmark of protecting the new financial sector, and its operational consequences abroad, as well as export-oriented companies such as pharmaceuticals.

There has been a shift of priorities from a narrow focus on direct benefits from overseas relations to more broadly-defined interests in terms of the importance of contributing to the work of the international community. For instance, Iceland's increased activity within the WTO is seen as contributing to better market access for Icelandic products around the globe. Also, the opening of the embassies in China, Japan and India is a response to the growing and potential importance of these markets for Icelandic companies (Ásgrímsson, 2004). The pivotal role of these states internationally is also recognised by decisions to open embassies in their capitals. Moreover, Icelandic governments did not take an active part in the work of the World Bank in the twentieth century, but attached importance to membership in the IMF due to the several economic benefits Iceland received from IMF membership¹ and not from the World Bank (International Monetary Fund, 2005; Institute of Economic Studies, 2005). In 1997 a report issued by the Icelandic Ministry for Foreign Affairs stated that Iceland had done little to increase its expertise and its level of development assistance. The consequences have been that Iceland has had difficulty in taking on duties within the group of the Nordic and Baltic states in the World Bank Group (Haralz, 1997). In a report that followed in 2003 the government was encouraged to take a more active part in the governing and the work of the Group (Ingólfsson and Haralz, 2003).² In the last decade, Iceland has increased its development aid substantially and there were plans for considerable annual increases in overseas assistance before the financial crisis. Accordingly,

Iceland has increased its international activity in order to facilitate aid in international organisations, such as the World Bank; opened an embassy in Africa, and works more closely with developing states within the UN. Increased international activity is seen as being of benefit to Iceland in the long run. For instance, Iceland's increased aid expenditure and international cooperation with small developing states was obviously linked to its bid for an elected, rotational seat on the Security Council. Membership within the Security Council was seen to benefit Iceland in that cooperation with distant countries could help to build coalitions concerning Icelandic trade interests in other international organisations.

Furthermore, the Icelandic government was forced to re-examine its defence policy after the US government decided to close down its military base in the country in 2006, leaving Iceland without a military presence. However, the defence treaty signed between the two states in 1951 – originally based on a defence and trade agreement from 1941 – is still in place. But since the withdrawal of the US military, Iceland has sought formal defence cooperation with European states, such as Norway and Denmark, as well as other NATO members based on the Atlantic Treaty. In the process that led to the military withdrawal Iceland recognised its obligations to contribute to its own defence after considerable pressure for the US – previously paid for and operated entirely by the US. In the late 1990s, Iceland became more active within NATO and started to contribute to its operations. This was a part of the government's policy to share some of the NATO burden in the hope of helping to maintain the US military presence in the country (Bailes and Thorhallsson, 2006). Since this strategy's failure, Iceland's defence policy no longer focused entirely on cooperation with the US. Iceland now works more closely with European states, emphasises its work within NATO, and has since had its first defence budget in 2008. Hence, Iceland's economic and political interests are becoming much wider in all respects.

Greater economic resources

Iceland was one of the poorest states in Europe at the beginning of the twentieth century and received development aid until 1976 (Gísladóttir, 2008); yet, its economic development over the century was remarkable, and has been so particularly since the mid-1990s. The resilience of the Icelandic economy coincides with neoliberal policies and membership in the EEA since the early 1990s. The Icelandic economy was transformed through various measures such as tax reductions, the privatisation of state-run businesses – particularly banks – and improvements in the

corporate environment. Access to common markets, aided by the compulsory implementation of EU regulations in competition and finance through EEA membership, led to greater prosperity. Accordingly, Icelandic governments managed to enhance the flexibility of the economy, labour, and product markets within the policy framework of the country and the EEA.

The liberalisation and privatisation process led towards a rapid growth of the financial sector. This growth was originally led by favourable fish prices, a global economic recovery, a rise in exports, and foreign investment in the aluminium sector. It was sustained by private consumption and investment in the non-traded goods sector mainly financed by foreign credit. Historically, Iceland's prosperity was largely built on its comparative advantages in abundant marine and energy resources. However, growth in the twenty-first century has been boosted by services located mainly in the financial services sector. From 1945 to 2006, the average annual growth rate of GDP was about 4 per cent and from the mid-1990s Iceland has experienced one of the highest growth rates of GDP among the Organisation for Economic Co-operation and Development (OECD) countries. Despite the small size of the economy, the smallest within the OECD, reflecting the 310 000 inhabitants of the country, Iceland's Gross National Income (GNI) per capita was the sixth highest among OECD countries and the eighth highest in the world, amounting to US\$36 000 in 2006 (Central Bank of Iceland, 2007). In addition, Iceland was ranked first out of 177 countries on the 2007/2008 Human Development Index published by the UN (UN Development Programme, 2007/2008).³

The economic boom beginning in the mid-1990s, and the increased revenue that has followed, has allowed governments to move from a relatively large public sector deficit in the 1980s and early 1990s to a series of budget surpluses. The fiscal balance has been well above the OECD average (Central Bank of Iceland, 2007). This has enabled the government to allocate more resources to the central administration. For instance, a decisive Foreign Service has been built and all ministries and their institutions have afforded to spend more time and resources on external relations. Besides, the government has been more affluent and politicians more willing than before to contribute to international aid and take part in international burden sharing. Accordingly, there has been less necessity to focus entirely on getting direct economic benefits from overseas activities.

That said, the vulnerability of a small economy has become evident in the case of Iceland during the credit crisis in 2008. The rapid foreign

expansion of Icelandic banks and companies, mainly based on foreign borrowing, led to major constraints on the economy and the króna. The Central Bank of Iceland has had difficulties in defending the króna due to its lack of liquidity. In mid-2008 the IMF concluded that the Icelandic economy was at a difficult and uncertain turning point: 'the long home-grown, foreign-funded boom was coming to the end. Its legacies are overstretched private sector balance sheets, large macroeconomic imbalances, and high dependence on foreign financing' (IMF, 2008). The Icelandic banks were hit hard by the credit crisis, as the cost of borrowing rose. The banks responded by slowing lending growth and rationalising balance sheets.

The króna, fell rapidly in the first half of 2008, making life somewhat more comfortable for the export-oriented industries. At the same time, export costs increased considerably due to foreign borrowing and the higher cost of imported material. In response to the fall of the króna, The Central Bank of Iceland concluded bilateral swap facility arrangements with the Central Banks of Sweden, Norway and Denmark to bolster its international liquidity. The facilities are a precautionary measure made to provide the Central Bank of Iceland with access to euros if needed. Each agreement provides up to EUR 500 million, where the Central Bank of Iceland can acquire euros against the Icelandic króna. The swap agreements are facilities that may be drawn upon by the Central Bank of Iceland when and if necessary (Central Bank of Iceland, 2008). However, the Icelandic Central Bank failed to bolster its external liquidity any further. Requests from the Central Bank and the Icelandic government to the neighbouring central banks and governments in the Nordic states, the UK and the US, to come to Iceland's rescue were declined. These states doubted the government's ability to stand by its overgrown financial sector.

Accordingly, the swap facility arrangement did not prevent a further fall of the króna, reduced to an all-time low against the euro a few weeks after the agreements were made public (Oakley, 2008). In autumn 2008 the three main Icelandic banks were nationalised by the government as they faced bankruptcy caused by 'lending stops' abroad. The foreign currency market collapsed leading the country to an economic standstill. The Icelandic government sought emergency loans and assistance from the IMF as well as from the EU emergency fund and several states around the globe, including Russia and China. The IMF came to the rescue and provided the Icelandic government with a \$2.1 billion loan. The IMF economic assistance package included a promise by several states to loan Iceland about \$3 billion in order. However, Britain and

the Netherlands turned against Iceland in order to guarantee the savings of their citizens in overseas branches of the Icelandic banks. They argued that the Icelandic government was obligated to guarantee all deposits of up to about EUR 20 000. Iceland claimed that these obligations were covered by the Icelandic Depositors' and Investors' Guarantee Fund set up by the EEA rules and if the fund is unable to fully meet its obligations, as was the case, the Icelandic government did not have to step in. The British government used its anti-terrorist law to take over the assets and operations of the two Icelandic banks in Britain, putting the banks and the Icelandic Ministry of Finance and the Central Bank on the British government's list of terrorist organisations (a list that includes al Qaeda). Britain and the Netherlands used their influence to delay the much needed emergency loan from the IMF, a loan from the EU emergency fund and loans from the Iceland's close allies, the Nordic states. In fact, they managed to block all attempts by the Icelandic government to foreign currency loans as well as other forms of economic assistance. Iceland finally gave in to this pressure in order to prevent total economic collapse – since the stock of foreign currency in the Icelandic Central Bank was rapidly coming to nothing – with the Bank providing foreign currency to only Icelandic companies importing food, medication and fuel.

The Icelandic government was 'left without friends', as the Icelandic prime minister put it, and failed to secure new friends despite several attempts at getting loans from Russia and China. Iceland's closest neighbours, the Nordic states, were all on the side of Britain and the Netherlands, fearing that if Iceland would not be obligated to stand by guaranteeing all deposits up to about EUR 20 000, the credibility of the whole financial sector within the EEA might be in danger. Iceland was faced with bilateral negotiations with the Britain and the Netherlands without access to the decision-making processes within the EU institutions. The IMF did not provide Iceland with an immediate shelter, failing to stand by its agreement with the Icelandic government and succumbing to pressure from Britain not to formally approve the agreement and put it into action until the dispute between Britain and Iceland had been settled.

The Central Bank of Iceland was simply 'too small' to defend the extensive foreign expansion of Icelandic banks and companies. Moreover, the króna did not stand a chance in the credit crisis due to the large Icelandic financial sector operating abroad. Consequently the viability of the króna has gone. Owing to the fluctuation of the króna and its collapse, the Icelandic business community is united in urging the government to explore the possibility of adopting the euro. Furthermore,

a broad consensus has developed among economic sectors in Iceland – with the exception of the agrarian and fisheries sectors – and Iceland's most influential labour union for negotiation with the EU on accession: one of the main reasons given for membership is the importance of receiving backup from the European Central Bank. Furthermore, in June/July 2008 an opinion poll indicated that about 60 per cent of voters wanted the government to start negotiations with the EU on accession and the adoption of the euro; of the remainder of respondents, equal numbers were opposed to such moves or undecided (Capacent Gallup, 2008).

The grand coalition government, consisting of the centre-right Independence Party (IP) and the Social Democratic Alliance (SDA), has been divided on the EU and the euro questions. However, the leading IP, which has traditionally fiercely opposed EU membership and the adoption of the euro, is now reviewing its European policy. The party has given in to severe pressure from the business community and decided, in the midst of the current economic turbulence, to examine in detail the pros and cons of EU membership. After one of his ministers called for adoption of the euro within the framework of the EEA (Bjarnason, 2008), the leader of the IP and prime minister, Geir H. Haarde announced that the government's committee on Europe would look into this possibility as well as tying the króna to the euro. However, Haarde has expressed doubts about these possibilities without full EU membership (Icelandic Public Radio, 2008), an option he has previously opposed. The leader of the SDA and the foreign minister, Ingibjörg Sólrún Gísladóttir agrees with Haarde that adopting the euro without joining the EU is an unlikely possibility.

Hence, the vulnerability of the small Icelandic economy has become evident in the financial crisis. Iceland benefits enormously from EEA membership (i.e. access to the common market), participation in the Four Freedoms of the EU, with the exceptions of the Common Agrarian Policy and the Common Fisheries Policy, and credibility due to the fact that Iceland has to implement exactly the same financial legislation and regulatory framework as EU member states. However, Iceland lacks the shelter of the European Central Bank and faces a massive economic downturn 'dominated by external considerations' (IMF, 2008). The IMF predictions in the summer of 2008 had all become evident by the autumn: the króna could depreciate more if the outflow of capital continues; external liquidity risk remains a key concern, caused by the foreign debt of the private sector – chiefly banks – and domestic risks such as inflation, house and equity prices, and household and corporate

indebtedness (IMF, 2008). The 'economic miracle' of the last decade is over. The volatility of a small economy is once again evident.

Icelandic governments have reluctantly sought shelter within the framework of European integration in order both to guarantee access to the European market and respond to economic downturns. This was the case with EFTA membership in 1970 and EEA membership in the early 1990s. Yet again, the government, led by the IP, is considering the EU alternative and adopting the euro. A question mark has been added to Iceland's capacity to nurture the resilient nature of its economy without the protection of EU membership.

Greater administrative resources

The increased capacity of the Icelandic central administration over the past two decades has gone hand in hand with greater economic resources, a wider range of interests, and the growing importance of international organisations and change in the priorities of politicians. The ability of the civil service to engage in information gathering and policy-making has increased enormously. It is able to form its own policies, that is, it is less dependent on interest groups and policy-making in other Nordic states, and has the ability to skilfully pursue its policy objectives. Over the last decade, the Icelandic Foreign Service has nearly doubled in size in terms of number of personnel (see Figure 7.1), and its expertise on a wide range of international affairs has also increased (Thorhallsson, 2002; Thorhallsson, 2004).

Iceland's membership within the EEA required all ministries and many of their institutions to hire experts in the field of European integration in order to engage effectively in EEA policy-making and to implement EEA regulations. Moreover, the administration's engagement in European integration has given officials greater room for manoeuvre in their day-to-day work since politicians are largely absent from the formal EEA decision-making system (Lægreid et al., 2004). This may have given officials greater confidence concerning policy-making and representing Iceland abroad since, historically, Icelandic politicians have interfered to a greater extent in the work of the bureaucracy than in the other Nordic states (Kristinsson, 1993). Membership within the EEA also forced ministers to increase expertise within their ministry by professionally hiring specialists instead of using appointments to return political favours. A wider range of economic and political interests, a more complex international system, and a greater importance of international institutions, such as the WTO, the EEA and the Arctic Council, have required

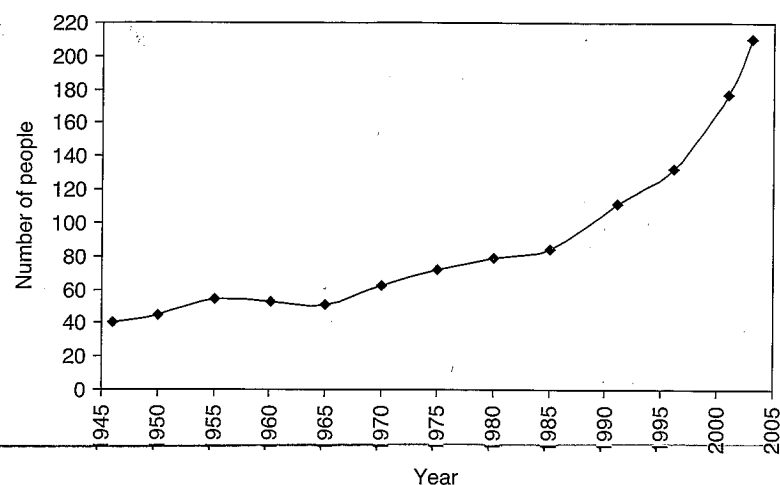


Figure 7.1 The number of people working in the Icelandic Foreign Service from 1945 to 2003, all personnel included.

Source: Based on data from Ministry for Foreign Affairs, Government of Iceland, 2003.

profound knowledge within the administration. Accordingly, the administration has been engaged in a steady and successful capacity build.

The consequences are clear; Iceland has been able to take on considerable leadership duties abroad. For instance, Iceland assumed the chairmanship of the Council of Europe for the first time in 1999 – earlier having always argued that it did not have the administrative capacity to tackle the chairmanship duties that rotate among member states. Iceland also chaired the Arctic Council from 2002 to 2004 and held the presidency of the Council of the Baltic Sea States from mid-2005 to mid-2006. It has also taken on leadership roles within the WTO, the World Bank and the FAO, UNESCO and other organisations and commissions of the UN. Moreover, the extensive operations of the ICRU at the international airports in Pristina and Kabul, mentioned above, have been acknowledged.

Furthermore, since the mid-1990s, the Foreign Service has extended its activity to a number of countries. Figure 7.2 shows the rapid rise in the number of Icelandic separate embassies/missions abroad in the last decade. Iceland opened a number of embassies/missions in the 1940s but, in the 40-year period that followed, only four new separate embassies/missions were established abroad (Ministry for Foreign Affairs, Government of Iceland, 2006). Iceland did not regard it as important to establish embassies to serve individual states abroad (Ásgrímsson, 2004).

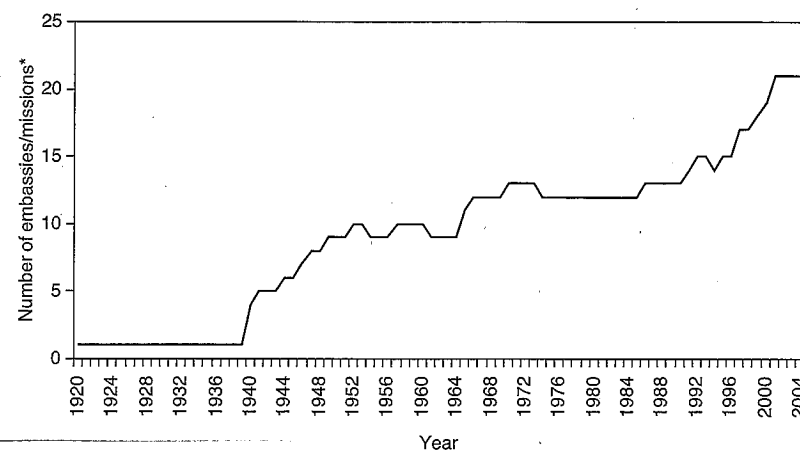


Figure 7.2 The number of Icelandic embassies/missions abroad

Note: *The number of Icelandic embassies/missions is defined as the number of separate foreign-service offices abroad, i.e. embassies, permanent missions and consulates-general with special ambassadors, permanent representatives or consuls-general.

Source: Based on data from Ministry for Foreign Affairs, Government of Iceland, 2006.

A change of perception and preference by the political elite

The opinions of relevant domestic actors, particularly political leaders, regarding the state's ability to engage in international affairs cannot be ignored. The willingness of leaders to participate in the international community is also of key importance in understanding a state's external policies. Political leaders' preferences and perceptions of their state and the international environment is a base upon which they build their state's international engagement. 'Preference size' includes three features of the domestic political elite: ambitions, prioritisation and ideas regarding the international system. 'Perceptual size' is the size of a state as viewed by domestic actors in comparison with other states (Thorhallsson, 2006b). This reflects how political discourse may determine how actors view states' sizes and capabilities (see for instance Hansen, 2002; Hálfðanarson, 2004). There are three issues here: first, the changed view of the Icelandic political elite regarding Iceland's size and external capabilities; secondly, the 'new' belief or ideology of decision-makers that Iceland has obligations in the international arena and should contribute to the well-being of individuals and international organisations; and finally, the belief that a small state like Iceland can have a say internationally.

In the last century, domestic actors in Iceland regarded the state as having considerable internal capacity in terms of the ability to build up the infrastructure and provide a decent living standard. However, until the mid- to late-1990s, the Icelandic political elite did not regard Iceland as having the external capacity needed to engage in wide-ranging international activity. Icelandic politicians lacked the ambition to play an active part in the international arena and seemed not to have believed that Iceland could have a say within international institutions (see detailed discussion in Thorhallsson, 2005).

The political discourse in Iceland was based on self-determination regarding the extension of the fishing zone, diminishing or increased dependency on the US military presence in the country and the lack of political will to transfer power from Reykjavik to the institutions of the EU (Thorhallsson, 2005). Also, it centred on the necessity of deriving concrete benefits from overseas activity (Haarde, 2006a). Policy-makers opted for a reactive international approach based on bilateral contacts with neighbouring states. Why should a state try to influence decisions taken in international organisations if its policy-makers steadily regard it as impossible for them to do so?

This view of the Icelandic political elite was in sharp contrast to the views of the elite in other Nordic states, who regarded themselves and their states as being fully capable of participating actively in the international community. Moreover, the postwar political discourse in other Nordic states was characterised by the obligation to participate in the international system (Archer, 2003). For instance, other Nordic states provided 25 per cent of all military personnel deployed in UN peacekeeping operations during the Cold War (Embassy of Norway in Copenhagen, 2005; Ministry of Foreign Affairs, Government of Denmark, 2005).

On the other hand, as has been stated above, there has been a complete turnaround in Iceland's international approach in the last ten years. Iceland has become more active in all of the international institutions, mentioned above. This policy change would not have occurred were it not for the changed views of a large portion of the Icelandic political elite concerning Iceland's priorities, role and duties, internationally. The Icelandic government also regards Iceland as having a duty to contribute to the international community (I.S. Gísladóttir, 2007; I.H. Gísladóttir, 2007; Haarde, 2006a; *Morgunblaðið*, 2003). This has led to Iceland's contribution to a number of international institutes and commissions. Iceland has not only become highly ambitious in its international activity by taking a more active part in the work of these organisations, but its prioritisation has radically changed in the last ten years. This

is manifested in the Policy Statement of the present government which states that: 'Human rights, increased development cooperation and a focus on peaceful resolution of disputes will be the new cornerstones of Icelandic foreign policy. ... Iceland should aim for leadership in the campaign against marine pollution and in global work to counter climate change' (Policy Statement, 2007).

A considerable number of politicians now seem to consider it possible for the country to influence decisions taken within international institutions. Moreover, Iceland is seen as having a role to play and the ability to contribute to the international community (Haarde, 2007). Also, the Icelandic political elite, at least the present governing elite, has changed its view regarding the international system itself. Its perception regarding the international system has changed since Iceland, despite its smallness, is seen as having a say within it.

The intensive debate in 2004 and 2005, about whether or not Iceland should continue with its application to become a member of the UN Security Council, showed two opposing camps disagreeing on Iceland's international approach. On the one hand there was the traditional camp arguing for an international approach based on economic gains, with little or no belief that Iceland could exercise influence in international institutions and in the international system generally (see Oddsson, 2002; *Morgunblaðið*, 2005a; *Morgunblaðið*, 2005h). This is founded on the notion of Iceland's smallness compared to other states, its limited administrative capacity and the conviction that membership within the Security Council would not bring Iceland any direct benefits (see *Morgunblaðið*, 2005b). The financial burden that would result from increased international cooperation also plays a part in the debate. In 2004 and 2005 the Icelandic foreign minister, Oddsson, a former prime minister for more than 13 years (1991–2004) and leader of the right of centre Independence Party, raised doubts about the continuation of the campaign for a seat in the Security Council because of the estimated high cost involved. He was supported by a number of MPs in his party (*Morgunblaðið*, 2005c; *Morgunblaðið*, 2005d; *Morgunblaðið*, 2005e). On several occasions during his premiership Oddsson questioned whether a small state like Iceland could have any say in an international organisation like the European Union.

On the other hand there was the camp that continues to regard Iceland as being capable of taking an active part in the international community and having duties towards the outside world (Haarde, 2006a; Haarde, 2007). The foreign minister, Geir H. Haarde, also from the Independence Party and who took over from Oddsson in September 2005, restated the

government's policy to campaign for a seat in the Security Council for 2009–2010. He argued that the reason for the campaign was to place Iceland in a position to be able to influence decisions which concern the international community. He stated that the administration is not too small to take on the duties associated with membership on the Council and would manage this by relocating personnel within the Foreign Ministry and having staff from other ministries work temporarily in the Foreign Ministry. He claimed that Iceland's main goals in the Council would be to promote the core values of the country's foreign policy, that is, human rights, freedom, respect for peace, and security (Haarde, 2006b). Moreover, Iceland's main aim would be disarmament and to prevent the further spread of nuclear weapons (Haarde, 2006a). This latter view prevails now under another foreign minister from May 2007, leader of the Social Democrats, Ingibjörg Sólrún Gísladóttir. She is enthusiastic about Iceland's new and more active international role and regards Iceland as having duties towards the outside world. Under her leadership Iceland intensified its campaign to get a seat in the Security Council emphasising Iceland's ability to contribute to human rights, particularly women's rights, and assist developing states, particularly small developing states (Gísladóttir, 2008). Gísladóttir has had the full backing of Haarde (now prime minister).

The prime reason for Iceland's historical absence from the Security Council is the lack of enthusiasm on the part of previous governments in Iceland to play an active part in the international community. They did not see any reason for Iceland to join the Council, since this would not provide any direct economic benefits for Iceland. In 1998 Iceland was the only Nordic state not to have applied for a seat on the Council. Moreover, Iceland has not taken on the presidency of the UN General Assembly – a post which all the other Nordic states have held, as well as Luxembourg (1975) and other countries of 'similar size' such as the Former Yugoslav Republic of Macedonia (2007), Saint Lucia (2003), Malta (1990), Lebanon (1958) and Ireland (1960–61), all of which were less economically advanced than Iceland (UN General Assembly, 2008). In autumn 2008 Iceland lost its bid for a seat on the Security Council after a humiliating defeat by Austria and Turkey. Iceland received only 87 of 192 votes for one of two rotating European seats on the Security Council. Austria got 133 votes and Turkey 152 votes, achieving the two-thirds margin needed for election in the secret balloting. The result can partly be explained by the lack of interest the Icelandic government has shown regarding UN work over the years. Also, the Icelandic Foreign Service found itself marginalised in the election campaign against the much

larger and more widespread Foreign Services of Austria and Turkey. Furthermore, Britain's campaign against Iceland's membership in the last few days before the vote, due to the financial dispute, lost Iceland many votes in the Commonwealth and the small Caribbean island states. The election defeat is a serious blow to those within the Icelandic government who have campaigned for a more assertive and active international role for the country. The defeat also indicates the fractal position of Iceland as a small state in the international community despite its effort to increase its international activities.

External pressure

The perception of international actors, such as pressure groups, firms, states and international institutions, regarding a particular state's ability to influence the international arena cannot be ignored in the new globalised system. This is because the attitudes of these actors may shape the notion of the size of the state and influence its international approach and how other actors respond to its actions (Thorhallsson, 2006b).

International organisations, governments and a number of inter-governmental organisations have put increased pressure on Iceland to contribute more to the international community in the last decade. For instance, this has been the case with NATO, the World Bank, the EEA and the UN and its member states. There has also been growing pressure from organisations working on human rights and development assistance. The US government also put considerable pressure on Iceland from the early to mid-1990s to contribute to its own defence and to shared duties with NATO member states.

Moreover, in 2005, as the debate on whether or not to continue the campaign to seek membership on the Security Council intensified in Iceland, both the prime minister and the foreign minister stated that they were under considerable pressure from their Nordic counterparts to continue the campaign (*Morgunblaðið*, 2005f; 2005g). The prime ministers of the other four Nordic states raised their concerns about Iceland's potential withdrawal of its Security Council application. They emphasised the need for a Nordic state to be represented at the Council's negotiation table and stated that they would be very disappointed if Iceland withdrew its application. Furthermore, they argued that one of them would have campaigned for the seat in the 2009–2010 period in the Council if Iceland had not decided to run in 1998 – and that it was now too late for them to start a campaign (*Morgunblaðið*, 2005b).⁴

One could argue that the views of these actors regarding Iceland's international capabilities has changed in recent years since Iceland has become more affluent and gradually more self-assertive internationally. This external pressure has had several implications for Iceland's international activity. For instance, it has led to the establishment of the ICRU (Bailes and Thorhallsson, 2006) and a considerable increase in Iceland's development aid, which has been much less, as a proportion of GDP, than that given by the other Nordic states (Haralz, 1997; Ingólfsson and Haralz, 2003).

The case of whaling provides an example of the pressure on Iceland to participate in the international scene and to follow its norms and rules. In 2002 Iceland found itself obliged to rejoin the International Whaling Commission (IWC) having left it ten years earlier in protest at not being allowed to continue whaling for commercial purposes. The decision to withdraw from the IWC was in sharp contrast to the position adopted by other whaling nations, such as Norway and Japan, which continued to work with, and promote their policies in, the IWC. This attempt to challenge the authority of the IWC can be seen in the light of the traditional view of Icelandic governments to have the right to make their 'own decisions' regardless of international rules – such as the matter of the Icelandic fishing zone – and deal with issues outside international organisations. In the 1990s Iceland made an attempt to start whaling again, having stopped whaling for scientific purposes in 1989 (after international pressure), by creating an international organisation, the North Atlantic Marine Mammal Commission, together with other whaling nations. This approach failed completely (Halldórsson and Stefánsson, 2001) and Iceland sought to rejoin the Commission in order to be able to start whaling for scientific purposes. Thus, Iceland decided to accept international rules concerning whaling, that is, to work within the IWC, which it has done since 2003. This brought Iceland into line with other whaling nations that accept the IWC's authority and co-operate with countries world-wide within its framework.

To summarise, the pressure from the international community to contribute more on the world stage is clearly felt by the Icelandic government. Iceland has felt obligated to take part in the burden sharing of the more affluent members of several international organisations. Reluctance to follow international norms and rules is neither an attractive option nor even a realistic option for a small state wishing to be taken seriously and needing to protect its wide-ranging interests internationally.

Conclusion

Iceland has become a more active international actor in the last decade, a policy change occurring at the domestic level. There has been a fundamental shift in foreign policy primarily aimed at securing direct Icelandic interests towards a much broader international approach. Iceland's increased activity in the international system has been explained by five interrelated features. First, a more diversified domestic economy and a more complex international arena have led to a redefinition of interests. The Foreign Service has had to widen its appeal in order to respond to this new environment. Second, increased economic resources based on the economic boom from the mid-1990s have given successive governments an opportunity to allocate resources to international affairs. Iceland's government was seen to be more affluent and capable of engaging in activities previously regarded as a luxury. On the other hand, the small Icelandic economy has been hard hit by the financial crisis. The massive overgrown financial sector, which was built on expansion abroad by foreign borrowing, has collapsed with severe consequences for the economy and the fall of the króna. The volatility of the small economy is evident, and the Icelandic government is once again considering seeking economic shelter within the framework of European integration, that is, by considering adopting the euro. Also, the Independence Party is reviewing its policy towards EU membership which might lead to a policy change within the government. Third, the central administration has been strengthened and the Europeanisation of the civil service has increased its expertise and independence. The human capital of the country has also increased in terms of a better educated workforce capable of engaging in international activities. Consequently, the Foreign Service and other ministries and institutions dealing with international affairs are much more capable of decisive policy-making, of carrying out their duties and taking on leadership domestically and internationally. That said, the smallness of the Icelandic Foreign Service was clearly a disadvantage in its campaign for a seat on the UN Security Council as it faced the bigger and more widespread foreign services of competing states Austria and Turkey. Also, the budget deficit which Iceland faces in the coming years due to the economic downturn will lead to a down-scaling of the Foreign Service. Fourth, Iceland has chosen to become a more active player in the international arena, a conscious choice. Most Icelandic politicians now regard Iceland capable of contributing to the international community and being able to have a say within international organisations. Governments still prioritise Icelandic core

economic and political interests internationally but their list of international engagements has become much longer. Iceland is not only seen to have a duty to protect its core interests, but also its obligations to the outside world. In other words, Iceland is becoming much more ambitious internationally, taking on duties previously unconsidered. On the other hand, Iceland's failure to get a seat in the Security Council could lead to a backlash in the country's attempt to become a more active player on the world stage. Moreover, Icelandic governments have failed to secure the country a permanent economic and political shelter. Iceland's closest allies failed it when the country faced its most serious economic crisis in decades, as did the international institutions such as the EEA, the IMF and the Nordic Council. The Icelandic government has not had access to EU decision-making despite the fact it has to implement most of the EU rules, such as concerning the financial sector, though membership within the EEA. Accordingly, Iceland implemented rules related to the free movement of capital without having any say about the rules and the shelter of EU institutions, including the European Central Bank. Thus, Iceland was left defenceless in the credit crisis. Finally, there has been considerable pressure from international actors for Iceland to take on greater international responsibility. The view of these actors on Iceland's capacity has shifted in recent years along with the increased confidence of Icelandic actors abroad. Iceland has yielded to the pressure in order to take part in the burden sharing of the international community and in the hope of securing long-term benefits for Icelandic society.

As a result, and in the light of the country's reactive approach until the mid- to late 1990s, one could say that Iceland has chosen a new role internationally based on its revaluation of its size. Accordingly, Iceland has chosen a new size based on the features discussed above. Political leaders in Iceland have transformed the country from belonging to Keohane's 'system-ineffectual' category into a country capable of influencing the international system together with other states within Keohane's 'system-affecting' category. Iceland's increased activity within the UN, NATO and other multi-lateral organisations is noticeable in this sense. That said, the reluctance of Icelandic governments to take full part in European integration by joining the EU has left the country without an economic and political shelter. This has left Iceland stranded by the EEA Agreement – only implementing its rules without having any say within the EU.

States can choose the extent to which they take part in the international community, given that they have the necessary resources and political will to carry out given tasks. Political elite in a state such

as Iceland, which has built up its internal capacity, can transform its domestic capabilities into an active international approach. This is precisely what Icelandic governments have done during the last decade. Iceland is now preparing for the next step towards greater participation in the international community by re-examining its stand towards EU membership.

Notes

1. Such as financial assistance in the form of beneficial loans; economic advice (which was very much needed owing to a lack of domestic expertise, the fluctuating economy and, more specifically, Iceland's currency, the króna), and technical assistance to its financial institutions.
2. On the other hand, Iceland has occasionally taken on duties within the World Bank Group and the IMF through its participation in the Nordic and (since the early 1990s) Baltic states' group in the past few decades (Central Bank of Iceland, 2005).
3. Iceland was in second place on this index from 2003 trailing only Norway (UN Development Programme, 2005), but moved to first place in 2007. The index compares the standard of living in 177 countries. These are assigned a Human Development Index (HDI) rating, which combines four variables: life expectancy at birth; adult literacy rate; combined gross enrolment ratio for primary, secondary and tertiary schools and GDP per capita (PPP US\$).
4. Elections to the Council, for terms of two years, are held within the UN every second year, and one of the other four Nordic states (Norway, Denmark, Sweden and Finland) has always campaigned for membership every other term, i.e. the policy of the Nordic states is to have one of their number represented in the Council every other term.

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