

The effectiveness and failure of the small public administration in Iceland relating to the 2008 economic crash

**Speech by
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Chair - and distinguished guests

First of all, I would like to thank for opportunity to talk about my two favorite subjects: Iceland and small states.

The aim of this talk is to discuss whether a small state, like Iceland, encounters, purely or partly, structural problems associated with its smallness, in the international system.

I think it is important to examine the role of public administrations in the new globalized world - and the pros and cons of their engagement with regional and international organizations.

Let's try to answer three key questions:

1. Does Iceland's small size in terms of its economy and bureaucracy provide a better understanding of the economic collapse and its responses to the crisis than do factors regarding economic management and administrative competence?
2. How can a small public administration cope with increased demands posed by domestic and international actors?
3. Are small states more or less in a need of an external shelter - an alliance - in order to cope with the new globalized economy?

The original focal points in the small-states literature were the variables associated with states' capabilities in term of numbers of inhabitants, the size of the economy, military strength and territorial size.

The influence of having a small central bureaucracy and small diplomatic corps was also mentioned early in the development of the literature

- Though this was never properly dealt with or taken fully into account.

Small states were said to be more economically vulnerable due to the size of their GDP, their small domestic markets, reliance on external trade and exposure to international economic fluctuations.

- Small entities were even regarded as not being economically sustainable or viable.

It is obvious that the small size of public administrations posed constraints on small states internal and external policy-making.

In the 60s, at the height of the decolonization process, doubt was even cast on small states' ability to govern themselves.

It was argued that they had less capacity for exposure to risk - due to the small size of their bureaucracy and less margin for error.

They were said to rely on their larger neighbours for basic survival and engagement with the outside world.

Alliance formation was a must for their success.

Later in and after the mid-80s, small states began to be seen as economically and administratively smart, salient, resilient and faster and more fit to adjust to global competition and other challenges.

They were no longer seen as being constrained by their small administrations and the smallness of their economy.

Instead, the informality and flexibility of their bureaucracy and the small domestic market were seen as providing them with opportunities, domestically and internationally.

In other words, the small-states literature gradually shifted its focus from the mere vulnerability consequences of the size of the economy and the central bureaucracy to opportunities associated with smallness.

On the other hand, the question which remains unanswered is whether good economic management and administrative competence are more relevant than the opportunities and constraints associated with smallness.

Let's start with the role of the public administration in our case, Iceland and the economic collapse:

Iceland's small administration did not have the resources needed to engage fully in comprehensive policy-making and legislation concerning the financial sector.

The size of staff and lack of expertise within the administration led to a fundamental lack of supervision of the financial sector and assessment of the risks entailed in its expansion for the small community.

The small bureaucracy was unable to deal properly with the complexity of the massive expansion by the banks; their operations in the new globalized international economy were too demanding.

That said, governments could have prioritized the building of a coherent and competent administration. They did not do so and the small administration was given insufficient resources to deal with the demanding task of supervising the banks.

The governments' firm belief in the free market and limited interference in its operations - including those of the banks - was manifested in politicians' official and unofficial pressure not to restrain the 'outvasion'.

A small administration cannot be expected to engage in policy formation in as decisive manner as larger administrations.

Icelandic policy makers need to take account of the fact that the scope of the Icelandic administration will always be more limited than that of most other administrations in Europe.

This does not mean that nothing can be done to make the administration better capable of engaging in complex supervision of the financial sector or other complicated matters. (For example, Caroline Gron covered in her lecture today how Denmark and Sweden have found ways of having a say within the EU institutions in Brussels and the importance for small states to invest in resources. Also, Christian Frommelt told us, in his lecture, how Liechtenstein has found a special way to manage with the flow of EEA rules. Moreover, as Roderick Pace covered in his lecture, it has been very interesting to follow the transformation of Maltese public administration since Malta joined the EU in 2004).

I will leave it up to the experts in the field of public administration to explain what can be done domestically to compensate for the smallness of the public administration.

That said, I would like to mention that we could look outside our borders for an administrative shelter in order to build competence.

For instance, we can be compensated for the smallness of the public administration by seeking advice and assistance from other states and by close engagement with supervisory bodies such as the EFTA Surveillance Authority (ESA) and its sister organization, the European Commission.

Instead of expressing annoyance over alleged interference by ESA, Icelandic politicians and public bodies should welcome its efforts at supervision.

Moreover, the absence of Icelandic politicians from the EEA/EU decision-making processes concerning financial rules left them unaware of their implications for the small economy and capacity of the small state entity.

Small actors need to be fully aware of their external surroundings and opportunities and challenges posed by the international environment.

We need awareness and - we need a decisive public administration to deal with these opportunities and challenges.

A doubt has to be cast on the ability of small public administrations to stand on their own in the new globalized economy - without external administrative assistance.

In addition, traditional features of the Icelandic administration, which professor Gunnar Helgi Kristinsson, has identified, such as little emphasis on long term policy-making, a general lack of professionalism, outsourcing of projects and political interference, led to insouciance about the threat posed by the so-called 'outvasion' to state and society. (It is not all about smallness or the size of the public administration as Per Lærgreid's lecture indicated. For instance, trust is an important feature or

variable which we need to take account of when considering the development of public administrations).

That all said, we need to consider the original small-states literature regarding the small size of the public administration and the economy in order to understand fully the reasons for the Icelandic economic meltdown.

The small domestic market, the small state budget and the small national currency could not sustain the Iceland 'outvasion'.

The financial sector outgrew the domestic market's ability to defend it. The Icelandic authorities did not have any external back-up such as they had enjoyed from the United States during the cold war and, previously, under the Danish umbrella.

Economic size did not pose any constraints during the economic boom; - however, size constraints gradually emerged as the warning signals about the state's capacity to stand by its banks started to pile up.

The fall in the exchange rate and, later, the currency shortage, further weakened the system.

Iceland was without a buffer in responding to the crisis event, and in the midst of the crisis it was faced with Britain's closure of an overseas branch of its only functioning bank.

Moreover, the country had great difficulty in obtaining IMF assistance.

One of the most important lessons to be learned from the crash is the restricted scope of small economies to engage in the international global economy without a proper alliance.

We are back to the established observation in the small state literature that a small state needs to form an alliance in order to limit the risk exposure involved in engagement with the international community.

To conclude:

Small states can overcome many of the obstacles associated with the small size of their economy and public administration.

First, we need a public acknowledgement of inbuilt weaknesses.

Small states need to acknowledge their limitations and take notice of it in their economic planning and the structuring of their public administration.

- Icelandic policy-makers did not acknowledge the limited capacity of the public administration and the inbuilt vulnerability of the small domestic market.

Second, we need sound economic management and administrative competence.

Third, Constraints imposed by having limited personnel and small domestic markets may be compensated for by closer engagement with relevant regional and international organizations.

Seeking advice and assistance from the others can compensate for limited domestic administrative capacity.

Instead of expressing annoyance over alleged interference by organizations such as the IMF and ESA small states should welcomed their efforts at supervision.

These may provide an important administrative shelter.

- having recourse to protection may ease economic burdens and provide important political, diplomatic and administrative assistance in times of need.