DEBATE

the corporatist model and its value in understanding small european states in the neo-liberal world of the twenty-first century: the case of iceland

baldur thorhallsson
University of Iceland, 101 Reykjavík, Iceland
E-mail: baldurt@hi.is
Website: http://notendur.hi.is/baldurt/indexenska.htm

doi:10.1057/eps.2010.27

Abstract
Iceland's neo-liberal laboratory ended in economic crash and political chaos. The business-oriented sectoral corporatist structure in Iceland created an ideal framework for the neo-liberal agenda. A comprehensive democratic corporatist framework, including the conditions for economic flexibility and political stability, was missing. The culture of consensus did not prevail. The paper shows how Iceland does not fit Katzenstein's theory. At the same time, the case of Iceland shows the value of the corporatist model in analyzing the process of change in a small society and its successes and failures.

Keywords small states; corporatism; Iceland; sectoral corporatism neo-liberal; international economy

Small States in World Markets maintained that the choices of seven small European states are conditioned by two sets of interlinked forces, that is historically shaped domestic structures and the constraints of the international economy. This is also evident in the case of Iceland – our test case. Past decisions and reliance on international trade still have a profound influence on present political and economic choices. However, not all small European states are the same. As the Icelandic case illustrates, historical decisions vary widely, despite domestic similarities.

Katzenstein also claimed that small European states were better equipped than large states to deal politically with the economic dislocations and uncertainties of the 1980s. Small European states were not only able to cope with economic openness; they were able to use it to their advantage and become politically and economically more successful than their larger neighbours (Germany, Britain and France) and also the United States and Japan. Achievements were generated by historical choices where 'economic flexibility and political stability are mutually contingent' (Katzenstein, 1985: 191). The key to success is flexible domestic adaptability. Democratic corporatism, enhanced by an extensive domestic consensus, creates conditions for these achievements and 'builds strong political links between the proponents of efficiency and those of equality: indeed, the corporatist formula for success is to restrain the unilateral exercise of power' (Katzenstein, 1984: 257). This was the reality in all of Katzenstein's seven cases, that is the Netherlands, Belgium, Switzerland, Austria, Denmark, Norway and Sweden.

The argument is convincing and seems to capture the reality in the prosperous years of the 1990s, and the first decade of the twenty-first century. It may also still be the case. That said, no one can doubt that the international financial crisis of 2008 hit several other small European states worse than the large European states. This is clearly evident in the economic, political and societal chaos that broke out in Iceland – a country not used to public uproar and crises of confidence. In light of Iceland's recent experience, we might wonder whether Katzenstein's argument needs some revision; whether the democratic corporatist structures and flexible strategies of adjustment in other small European states are up to the challenges of the twenty-first century. Katzenstein's thesis is of great value for understanding the rapid transformation of Iceland from a protectionist community to a neo-liberal laboratory.

'Katzenstein's thesis is of great value for understanding the rapid transformation of Iceland from a protectionist community to a neo-liberal laboratory.'

Katzenstein argues that size facilitates particular political outcomes and should be dealt with as a variable rather than a constant. He states that 'size affects, in particular, both economic openness and the characteristics of the political regime' (Katzenstein, 1985: 80). The difference between small and large states will ensure that for 'the foreseeable future the small European states will remain much more open to and dependent on the world economy' (Katzenstein, 1985: 87). However, economic openness has created opportunities, rather than constraints, for small European states. The case of Iceland indicates that the emphasis which Katzenstein places on size and its consequences is as important, if not more so, in the new globalized economy: Iceland's economic collapse can be partly blamed on its smallness and the inadequate measures taken to overcome the weaknesses associated with it in the credit crunch of 2008.

To test Katzenstein's corporatist model, it is important to find a test case that is as comparable as possible to the countries already analyzed. This will ensure we are loyal to the importance of the domestic structure of decision-making and the role it plays in the countries' responses to external events. Iceland provides an interesting insight into the framework, its applicability and relevance in the new globalized economy. Not only is Iceland one of the Nordic states, sharing most of the same domestic characteristics as Katzenstein's three Nordic cases; but it is also domestically comparable to his other four cases. Just as importantly, Iceland experienced the stress of the world economy when its entire banking sector collapsed in the international financial crisis of 2008. This collapse came quickly on the heels of rapid economic growth since the mid-1990s.

The aim of this paper is to analyze the applicability and relevance of Katzenstein's *Small States in World Markets* to the case of Iceland. After a period of twenty-five years, when the international economy was dominated by a neo-liberal surge, it is interesting to test the relevance of Katzenstein's framework on a small European state. Accordingly, the paper shows how Iceland, despite sharing so many of the same characteristics as its neighbouring countries, does not fit Katzenstein's theory. At the same time, the case of Iceland shows the value of the corporatist model in analyzing the process of change in a small society and its successes and failures. To show this, Iceland's most influential political party in the past twenty-five years – the conservative Independence Party's (IP)[1] – will be scrutinized, particularly in its implementation of the *laissez-faire* agenda and its engagements with Katzensteiń's key concepts, that is those of corporatism, consensus, sharing and adaptability.

CONTINUING CONSEQUENCES OF ECONOMIC OPENNESS AND VULNERABILITY FOR SMALL STATES

Iceland came to an economic standstill with the collapse of its financial sector and the free fall of its currency, the króna, in the credit crunch of 2008. The consequences were bankrupt companies and households, record levels of registered unemployment, weeks of violent protests in the streets of Reykjavik for the first time in its history, the fall of the government led by the IP, and a general election. Iceland's neo-liberal laboratory had not only undermined the economy but also the country's political system, social consensus and the core functioning of the society itself. The IP's ideology created an alternative to Katzenstein's model of democratic corporatism based on cooperation and sharing, and the resulting policies were a failure.

Iceland was the only European country in which the entire financial system collapsed in the credit crunch. This is no coincidence, though: 'Iceland is in part a victim of the international crisis' (OECD, 2009: 8) exacerbated by the country's smallness in terms of its 'small' currency, Central Bank and the national bureaucracy. The OECD concluded: 'Iceland's supervisors were unable to keep up with the complexity and size of the system as it grew rapidly and applied rules in an excessively legalistic manner' (OECD, 2009: 8). Clearly, the size of the state is, as Katzenstein claims, an important variable.

That said, there is a danger of overlooking the national circumstances which led to 'Icelandic banks' aggressive expansion strategies in an atmosphere of ineffective supervision' (OECD, 2009: 8). It is this strategy of unsupervised expansion that rendered not only the banks, but also the county itself, highly vulnerable. The quest for rapid economic gains, combined with misgivings about the norms of consensus-building, cooperation and sharing (the key concepts that Katzenstein associated with democratic corporatism), created an atmosphere of individualism and 'aggressive *expansion*' without limits. According to the same rhetoric, EU regulations (many of which have been adopted under the European Economic Agreement) and supervisory duties of the national bureaucracy were seen as restricting the free market, at large, and the expansion of Icelandic banks and corporations. Consensus-building, close cooperation of all relevant interests, tough rules and strict practices

… all these things stood in the way of individual freedom.

The expansion of Iceland's banks and companies, along with greater economic openness, created vulnerability on a scale previously unknown to the small society. This would have been clear to Katzenstein's readers. The state did not respond to this vulnerability with relevant measures. After all, the state might have substantially strengthened the Central Bank's foreign currency reserves and/or given greater powers to supervisory bodies. On the contrary, supervisory institutes were expected to get out of the way of the government's neo-liberal agenda: 'the first big mistake made was to allow local investor groups (with major expansion plans) to gain controlling stakes in the banks when they were privatized. The Financial Supervisory Authority in Iceland was not satisfied with this decision, which it considers to have been political, but acquiesced after lengthy deliberations' (OECD, 2009: 11). Discretionary best judgement became a secondary objective to the quest for rapid economic gains.

APPLICABILITY OF THE CORPORATISM MODEL IN UNDERSTANDING SMALL STATES' CHOICES

According to Katzenstein, the historical origin of democratic corporatism dates back to the economic and political crisis of the 1930s and 1940s. Iceland's sectoral corporatism, like the corporatism in other countries, emerged when agricultural interest groups gained 'a representational monopolicy and privileged access to government' (Lehmbruch, 1984). Lehmbruch claims that it is easier for societal corporatism to occur if sectoral corporatism exists in a country. However, the Icelandic sectoral corporatism, despite extending itself to other economic sectors of importance, never developed and incorporated and/or tamed labour (see, for instance, Guðmundsdóttir, 2002). Hence, it fundamentally differs from the social corporatism in Scandinavia and Austria, as well as the liberal corporatist variants found in Switzerland, the Netherlands and Belgium.

'However, the Icelandic sectoral corporatism, despite extending itself to other economic sectors of importance, never developed and incorporated and/or tamed labour.'

Still, Katzenstein's historical approach shines a light on the nature of Icelandic sectoral corporatism. The Right in Iceland was not weak and divided. Katzenstein notes that a weak and dived right is an important component of societal corporatist regimes. Also, the substantial over-representation of the rural coastal areas in the national parliament, the Althingi, created conditions for the dominance of agrarian interests and later the fisheries lobby (at the cost of representatives from the Greater Reykjavík area). Hence, the traditional leading sectors – farming and fishing – could sideline other interests, and gained blocking power within the united Right (the IP), and the agrarian Progressive Party. Rural costal interests still prevail partly due to late industrialization (arriving only at the beginning of twentieth century), export specialization and Iceland's social structure. In Iceland, the aluminium sector (from the late 1960s) and the privatized financial sector (in the first decade of the twenty-first century) were granted the same status and influence as the fisheries and agricultural sectors, within the Icelandic sectoral corporatism framework. This pattern is consistent with Katzenstein's explanation of the relationship between labour, business and the state.

In addition, Iceland's sectoral corporatism has never been characterized by 'the voluntary, cooperative regulation of conflicts over economic and social issues through highly structured and interpenetrating political relationships between business, trade unions, and the state, augmented by political parties' (Katzenstein, 1985: 32). Accordingly, the conditions for economic flexibility and political stability were missing. In other words, the culture of consensus did not prevail. Just as important were the political factors. Social Democrats predominated in Scandinavia: they created the corporatist and consensus decision-making framework and included both labour and business.

The IP's successful slogan, 'solidarity of classes' (*stétt með stétt*), dates back to the economic structures of the 1930s, and refers to the essence of societal consensus. It is these norms that contributed to the party's broad popularity among voters of all classes (Harðarson, 1995). Indeed, the IP is the only conservative party in the Nordic states to have succeeded in becoming the largest political party. However, the idea of class solidarity (and the universal appeal of the party to the traditional classes) has made it difficult for the party leadership to break ranks with what are, historically, the core economic sectors of Icelandic society and, in fact, the core backers of the party: the agricultural and fisheries sectors. The solidarity of Iceland's economic sectors and, actually, the solidarity of the party itself, would be threatened by breaking ranks with its protectionist policies in the agricultural and fishing sectors.

In short, the needs of Iceland's dominant agriculture and fisheries sectors made it difficult for the IP to embrace an open, free trade, economy. Accordingly, protectionist policies regarding these sectors prevailed within the party and hindered the creation of a democratic corporatist system. In the absence of such a system, it was incapable of dealing with challenging issues such as increased pressures resulting from Europeanization and globalization (including, in particular, the free movement of capital). Hence, in the 1990s, when the IP started to implement its neo-liberal policies, it kept agrarian and fisheries interests intact by means of a sectoral corporatist structure and its compensation mechanism. The business-oriented sectoral corporatist structure, in fact, created an ideal framework for the neo-liberal agenda.

In 1990, the left-of-centre government in Iceland reached an historical agreement with the main labour federations and employers' associations. The resulting Social Pact laid the foundation for economic stability in the county. Before then, the Icelandic labour market had been characterized by conflict rather than the traditional Scandinavian consensus (Guðmundsdóttir, 2002). The main labour-market organizations were in close contact with the government, despite the lack of a corporatist framework where they could all gather at the same table and resolve their disputes (Kristinsson *et al*, 1992). The corporatist framework initiated by the Social Pact was not maintained when the IP took office a year later. Sectoral corporatism continued to flourish, but there was less tension in the labour market because of greater cooperation between the main labour federations and employers' associations. However, Iceland continued to have the highest level of strikes among the OECD countries (Aðalsteinsson, 2006). Occasionally, the government stepped in with economic or welfare measures in order to settle disputes, but some scholars argue that inequality increased considerably (Ólafsson, 2006). The domestic decision-making structure could not be described as a culture of consensus, as we see in the other Nordic states. Instead, it continued to be characterized by conflict – both in the labour market and in the Althingi.

With the IP in government, the structure of the Icelandic government's decision making is more in line with what Katzensteiński describes as the American trend toward exclusion (rather than the inclusionary nature of the small European states' corporatism). Social movements, such as the new environmental movement, were explicitly, and deliberately, sidelined in governmental decision-making processes. This was the perception of most, it not all, social movements, such as the Organization of the Disabled, which became openly very critical of the government's policies. Furthermore, those government agencies and supervisory bodies that questioned the government's policies were penalized by outright closure (e.g., the National Economic Institute) or given inadequate budgets to carry out their duties (e.g., the Competition Authority, the Financial Supervisory Authority and the Consumers' Association). Katzenstein's 'typical' method of decision-making by consensus in small European states, which is supplemented by majority rule, is nowhere in sight in the Icelandic case.

Furthermore, the IP's government worked closely with selected employers' groups, largely excluding labour groups, either to implement its neo-liberal agenda or to strengthen its electoral base. For instance, Iceland's transferable fisheries quota system was designed and implemented in close cooperation with the leading fisheries corporations in accordance with the sectoral corporatist system. Basically, the fishing quotas were given, free of charge, to the operators of fishing vessels that had been fishing in Icelandic waters over a certain period of time. At the same time, foreigners were kept out of the fishing industry – being forbidden to own fishing quotas and shares in fishing corporations. The Icelandic fishing industry demanded this, in order to maintain full control over the sector. The Icelandic government and the fishing industry were also unified in their opposition to granting foreign fleets access to Iceland's Exclusive Economic Zone. However, owners of fishing quotas – all of them being Icelandic – are allowed to rent or sell their quotas, with limited restrictions – and often receive gigantic sums of money for doing so. This has led to fierce opposition to the quota system by the general public, as fish-factory workers, seamen, as well as rural communities have sometimes lost their livelihoods as a result. Some opponents of the IP claim that it has 'privatized' what was presumed to be a common good: the Icelandic fish stocks.

Also, the agrarian sector benefited from its historical ties to the IP and the agrarian Progressive Party, the second-largest political party in the country until the end of the twentieth century. Accordingly, the powerful fisheries and farmers' lobbies have been in such close contact with the government that it has been difficult to observe where their influence ends and the role of the government begins. The state's engagement with these interest groups differs from Katzenstein's corporatist states' engagements. The Icelandic labour movement and consumer groups are either absent or mostly without influence in the state's decision-making process. Hence, the Icelandic sectoral corporatist structure of decision-making only secures flexible adjustment for the key stakeholders within its framework, that is fisheries corporations and the farmers' lobby. What is more, these interest groups have largely created their own regulatory framework. Not only are all important changes to their working environment approved by the interest groups, but the changes are often initiated or created by them in one way or another (for instance, see Jónsson, 1990; Hugason, 2002).

Katzenstein's thesis is highly valuable for understanding the rapid transformation of Icelandic society from a protectionist country to a neo-liberal laboratory. One could argue, following Katzenstein, that a lack of democratic corporatism made it easier for the IP to implement its neo-liberal agenda, since '[t]he political logic inherent in the corporatist structures of the small European states … enhances political predictability and incremental adjustment' (Katzenstein, 1985: 198). This is because 'corporatist structures encourage flexibility, collaboration, and the absorption of the political consequences of economic dislocations' (Katzenstein, 1985: 198). Hence, 'alternative political coalitions are not easily found. … These structures narrow power differences and link state and society intimately. They thus succeed in capturing potential coalitions among changing political forces and in channelling political energies into the relegitimizing of corporatist arrangements' (Katzenstein, 1985: 198).

HOW TO COPE WITH CHANGE?

In the early and mid-1980s, small European states were under a considerable 'squeeze' from changes in the international economy. Katzenstein identified a number of new problems, which small states were facing, internally and externally, due to these changes. He speculated whether the pressure on business to adopt neo-liberal arrangements might be overwhelming and affect the corporatist structure of decision-making. Moreover, he wondered whether 'corporatism may then be viewed by business and labour as part of the problem' (Katzenstein, 1985: 193).

The case of Iceland, at least, indicates that the neo-liberal policies prevailed and that corporatist tendencies became part of the problem. From the early 1990s, the IP's governments interpreted the

'The case of Iceland, at least, indicates that the neo-liberal policies prevailed and that corporatist tendencies became part of the problem.'

pressure for close consultation and consensus-building (with all relevant stakeholders from the labour market and in society at large) as standing in the way of the sort of structural changes they were determined to implement, and which they believed would deliver economic prosperity. They missed the essence of the corporatist framework: 'Democratic corporatism is not an institutional solution to the problems of economic change but a political mechanism for coping with change' (Katzenstein, 1985: 198).

Historically, the IP was slow to adopt the liberal economic and trade policies of its counterparts in Western Europe (Ásgeirsson, 1988). The state's common economic means was to drastically devalue the currency, the króna, to the benefit of marine exports. This not only badly affected households (due to higher prices on all imported goods) but also undermined the potential of new manufacturing industries that relied on imported material. Hence, manufacturing industry has never prospered in the country. Also, an important side effect of the currency devaluation policy has been an improved market position for the domestic agrarian sector, without it having to structurally adjust to global changes and consumer demand.

It is also interesting to note that Iceland's closeness to the other Nordic states throughout the centuries – its engagement with Switzerland within the EFTA from 1970, and later with other small European corporatist states through a free-trade agreement with the European Community, membership in the EEA since 1994, and other European institutional bodies – bears little evidence of the influence of corporatism. The same trend seems evident in the Baltic states, as well as in other small states in Europe. The corporatist idea seems to travel slowly – if at all – and is based, as Katzenstein claims, on historical political choices by each and every state in question.

Hence, Iceland did not have the democratic corporatist means to adjust to structural changes in the international economy – like adapting to the free flow of capital. It kept its protectionist policies in the traditional economic sector intact, hindering their adaption to the new global economy. Moreover, the state did not have the long-term capacity to pre-empt the cost of change by structural transformation of the economy (as indicated by costly attempts to pursue fish-farming and mink and fox breeding in the 1980s).

Originally, the IP leadership sought ideas and policies from the other Nordic states. American influences became evident later; since the 1980s, the party has been highly influenced by the neo-liberal policies of the Reagan and Thatcher era. It developed relations with the British Conservative Party and was influenced not only by its liberal economic and trade polices but also by its scepticism of the EU's supra-national institutions. The party's opposition to EU membership became fiercer and was based on several arguments: Iceland's fisheries sector would be seriously damaged by EU membership; Iceland would not be able to conduct its own economic policy; adopting the euro would be fatal to the economy; as a small state, Iceland would be powerless within the EU and unable to defend its interests; corporate taxes might rise due to membership; and regulations from Brussels would place a burden on businesses and the community at large (Independence Party, 1995, 1999, 2007; Oddsson, 2001, 2002a, b; Gissurarson, 2001). The EU was seen to stand in the way of the government's agenda – forcing it to make more domestic and international compromises of the type it had already been obliged to make within the EEA framework. In other words, EU membership would oblige the government to develop 'consensus through cooperation' as Katzenstein might say.

Icelandic governments headed by the IP became gradually more neo-liberal. In 1995, the IP formed a government with the Progressive Party, with which it had a better chance of implementing its neo-liberal agenda (in particular, the privatization of the state-run banks). The liberalization of the economy, which the IP had launched with the small Social Democratic Party in 1991, now reached new heights with the Progressive Party in government – a government coalition lasting for twelve years, that is until 2007. Several government enterprises were privatized, including two commercial banks, Landsbankinn and Búnaðarbankinn – (later named Kaupthing Bank), large investment funds and large fish-processing plants. Also, the government improved the corporate environment through various measures including tax reductions (for a detailed discussion, see Thorhallsson, 2008). For instance, corporate income tax was cut from 48 to 18 per cent, and a turnover tax was abolished. Price and exchange controls were abolished, as were restrictions on capital transfers (Gissurarson, 2001). In 2007, these neo-liberal policies were kept intact despite the fact that the IP formed a new coalition government with the recently formed Social Democratic Alliance.[2]

At first glance, this seemed an enormous success, and was hailed as such worldwide. Nevertheless, when the crisis hit, the proper decision-making channels were not in place to deal with it, or its consequences. Hence, the main decision-making bodies lost the trust of the people. This was not only the case of the government, its institutions and supervisory bodies. Confidence in the media, labour federations and employers' associations was also placed in jeopardy. They simply did not have the means to deal with the catastrophe.

Iceland's neo-liberal laboratory ended in chaos – weeks of protests in the streets of Reykjavik, and the fall of the government. In the general election of April 2009, the Left gained a majority in the Althingi, for the first time. The Social Democratic Alliance became the largest party and IP support plummeted to 23 per cent – a record low. However, a year later, at the time of this writing, there seems no end to the economic and political crisis and/or disputes over how to establish economic recovery. Yet again, no framework of the type identified in Katzenstein's small-states model is in place, where these disputes can be discussed and settled. Icelandic decision-making processes continue to be characterized by conflict rather than consensus. The greatest lesson of Katzenstein's thoughtful analysis of the seven small European states is probably that there exists a model in which small states can cope with international economic challenges and develop a sustainable long-term growth and prosperity. It is not merely a pity that other small states have not adopted the corporatist framework; it seems to have been catastrophic for those who have not done so. This is, at least, the case in Iceland.

CONCLUSION

The universality of the small European democratic corporatist model is in question. It is for this reason that *Small States in World Markets* is highly relevant twenty-five years after it was first published: because it focuses on historically shaped domestic structures and the pressure exerted by the world economy. This is also true of its focal point on smallness and its consequences for international engagement. Katzenstein's emphasis on the risks associated with a lack of democratic corporatism, and the threat of uncontrolled liberal economic policies in small states, is also immensely value. His core focus on the political and social consequences of economic openness and vulnerability is still at the heart of 'Realpolitik' in small states.

'... Katzenstein's corporatist framework does not fit the case of Iceland.'

Still, Katzenstein's corporatist framework does not fit the case of Iceland. Although Iceland was chosen as a test case on the basis of its broad comparability to Katzenstein's seven cases, this must be the conclusion. Further studies are needed to evaluate other small European states, such as the Baltic states, Ireland, Greece, Hungary and Rumania, and the applicability of *Small States in World Market* to the circumstances found there. Interestingly, they seem to have followed a different domestic path than that which Katzenstein depicted twenty-five years ago, despite their engagement in the European project and ongoing globalization. That said, Katzenstein's small-states framework may still be applicable to his original cases. At least, they seem to have coped much better with the current international economic crisis than the other small European states mentioned above. One wonders whether they are a collection of seven special cases in Europe.

More importantly, though, Katzenstein's analytical framework facilitates our understanding of the processes of transformation in small states. The framework identifies causes of success and failure, which are of immense value in analyzing a process of change. The unilateral exercise of power by the Icelandic government failed to build a bridge between the advocates of a free market economy and the advocates of egalitarianism. The closeness between the state and particular interests (agrarian, fisheries, aluminium and finance) helped to enforce their policies by sidelining others. Also, importantly, the compensation mechanism which was in place for interests embedded within the sectoral corporatist framework helped to enforce the neo-liberal agenda. According to Katzenstein, the success of the corporatist model is achieved by restraining a 'unilateral exercise of power'. Small states may prosper by a strict uncompromising policy implementation and the population, at large, may obey. However, the unpredictability of the international market and its consequences for small economies may result in a swift turn from a peaceful society to troubles on the streets as soon as the decline is felt. Iceland bears this hallmark.

Furthermore, and more than ever, small states need economic and political shelter in order to cope with the neo-liberal international economy. Small vulnerable EU member states, such as the Baltic states, Hungary, Rumania, Ireland and Greece, got EU backing after the 2008 credit crunch. On the other hand, Iceland, as an outsider, experienced outride hindrance by some of the EU member states in its attempt to seek IMF assistance due to the so-called Ice-save dispute with Britain and the Netherlands. It was only after the crash that the Icelandic government sought external shelter, for example through membership in the European Union, in order to withstand international challenges.

Katzeinstein's thesis has its greatest value when it concerns the consequences small (European) states may encounter if they do not shield themselves, by domestic arrangements, from an unpredictable and fluctuating international economy. The economic, political and social chaos, which Iceland has experienced in the current international economic turmoil is a striking example of this. This may also well be the case for Greece and other small European states, though to differing degrees depending on economic, political and social factors.

Katzenstein identified important features of seven small European states twenty-five years ago. He convincingly related their success to their engagement in consensus-building, sharing and corporatism. The failure of other small European states to follow their path is currently evident in their economic and political difficulties. The stresses they have suffered have been magnified by their exposure to the international economy, as Katzenstein's model predicted. Unlike the seven states in his study, however, these small states have been affected in different ways.

The case of Iceland shows that not all European small states are the same. Small states do have a choice as to how they respond to the liberalization of the international economy and to European integration (Katzenstein, 1997), despite their greater vulnerability compared to larger states when faced with international economic and political pressure. The Icelandic case also shows that historical choices determine present responses to pressures from the international economy. Governments may decide to conduct their domestic decision making according to their own wishes, drawing lessons from the international environment. However, it is of fundamental importance that they be aware of their limitations and vulnerability – because of their smallness – and create a domestic framework capable of responding to and softening the economic, political and social consequences of the fluctuating international economy. That is the real hard-core lesson of *Small States in World Market,* which many small European states have yet to learn.

Notes

1 The IP was in government for twenty-one of the twenty-five years (and continuously from 1991 to 2009). Moreover, the IP was in government for fifty-two of the sixty-five years from 1944 (when Iceland became a republic) to 2009, and arguably for longer, since for three of the remaining thirteen years a splinter group from the party, under the leadership of its vice-chairman, formed a government with the left-of-centre parties.

2 The Social Democratic Alliance (SDA) had been formed eight years previously by three left-of-centre parties in order to oppose the IP dominance of Icelandic politics.

References

Aðalsteinsson, G.D. (2006) 'Verkföll og verkfallstíðni á íslenskum vinnumarkaði 1976–2004', *Stjórnmál og stjórnsýsla veftímarit (fræðigreinar)* 2(2): 175–196; http://stjornmalogstjornsysla.is/images/stories/fg2006h/gylfi.pdf.

Ásgeirsson, J.F. (1988) *jóð í hafti*, Reykjavík: Almenna bókafélagið.

Gissurarson, H.H. (2001) *Hvernig getur Ísland orðið ríkasta land í heimi?*, Reykjavík: Nýja Bókafélagið.

Guðmundsdóttir, Á.E. (2002) *Íslenskur vinnumarkaður á umbreytingartímum: Sveigjanleiki skipulagsheilda, stjórnun og endurskipulagning efnahagslífsins*, Háskólinn í Reykjavík: Reykajvík.

Harðarson, Ó.Þ. (1995) *Parties & Voters in Iceland. A study of the 1983 and 1987 Althingi Elections*, Reykjavík: Social Science Research Institute, University of Iceland.

Hugason, K. (2002) *Markmið og árangur í stjórnun fiskveiða*, Reykjavík: Faculty of Social Sciences, Department of Political Science, University of Iceland.

Independence Party. (1995) *Framboðslisti Sjálfstæðisflokksins í Reykjavík*, Reykjavík: Sjálfstæðisflokkur.

Independence Party. (1999) *Kosningayfirlýsing Sjálfstæ∂ísflokksins 1999*, Reykjavík: Sjálfstæðisflokkurinn.

Independence Party. (2007) 'Ályktun um utanríkismál', http://xd.is/?action=landsfundur_nanar&id=603, accessed 12 August 2008.

Jónsson, H. (1990) 'Ákvarðanataka í sjávarútvegi', *Samfélagstíðindi* 10: 99–141.

Katzenstein, P. (1984) *Corporatism and Change: Austria, Switzerland, and the Politics of Industry*, Ithaca; London: Cornell University Press.

Katzenstein, P. (1985) *Small States in World Markets: Industrial Policy in Europe*, Ithaca; London: Cornell University Press.

Katzenstein, P. (ed.) (1997) *'The Smaller European States, Germany and Europe' Tamed Power: Germany in Europe*, Ithaca: Cornell University Press, pp. 251–304.

Kristinsson, G.H., Jónsson, H. and Sveinsdóttir, H.Þ. (1992) *Atvinnustefna á Íslandi 1959–1991*, Reykjavík: University of Iceland Social Science Research Institute.

Lehmbruch, G. (1984) 'Concentration and the Structure of Corporatist Networks', in J. Goldthorpe (ed.) *Order and Conflict in Contemporary Capitalism*, Oxford: Oxford University Press, pp. 60–80.

Oddsson, D. (2001) 'Ávarp Davíðs Oddssonar forsætisráðherra á fundi Samtaka um vestræna samvinnu og Varðbergs', http://www.forsaetisraduneyti.is/radherra/raedur-og-greinar/nr/355, accessed 21 August 2008.

Oddsson, D. (2002a) 'Áramótagrein forsætisráðherra í Morgunbla∂inu 31. desember 2002', http://www.forsaetisraduneyti.is/radherra/raedur-og-greinar/nr/378., accessed 2 February 2004.

Oddsson, D. (2002b) 'Ávarp forsætisráðherra á aðalfundi Samtaka atvinnulífsins', http://www.forsaetisraduneyti.is/radherra/raedur-og-greinar/nr/365, accessed 18 August 2008.

OECD. (2009) *OECD Economic Survey: Iceland*, Paris: OECD.

Ólafsson, S. (2006) 'Aukinn ójöfnuður á Íslandi. Áhrif stjórnmála og markaðar í fjölþjóðlegum samanburði', *Stjórnmál og stjórnsýsla veftímarit (fræðigreinar)* 2(2): 129–156; , http://stjornmalogstjornsysla.is/images/stories/fg2006h/stefan.pdf.

Thorhallsson, B. (2008) 'Evrópustefna íslenskra stjórnvalda: Stefnumótun, átök og afleiðingar', in V. Ingimundarson (ed.) *Uppbrot hugmyndakerfis. Endurmótun íslenskrar utanríkisstefnu 1991–2007*, Reykjavík: Hi∂ íslenska bókmenntafélag, pp. 67–96.

About the Author

Baldur Thorhallsson is Jean Monnet Professor, Faculty of Political Science and Chair of the Institute of International Affairs and the Centre for Small State Studies, University of Iceland, and author of several papers on European integration, small European states and Iceland's foreign policy and books entitled *The Role of Small States in the European Union* and *Iceland and European Integration: On the Edge*.