



# Liberalism in Iceland in the Nineteenth and Twentieth Centuries

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[LINK TO ABSTRACT](#)

Iceland is a remote country with a tiny population, so a sophisticated Icelandic liberal tradition is hardly to be expected.<sup>2</sup> Nevertheless, Icelanders have developed two remarkable and original institutions facilitating individual choice and responsibility: the system of private enforcement of law during the Commonwealth period of 930–1262<sup>3</sup> and the system of individual transferable quotas in offshore fisheries since the late twentieth century. A few liberal intellectuals have also been active in public debate, first and foremost the leader of Iceland's struggle for independence, economic historian Jon Sigurdsson (1811–1883), but also the authors of the first three books in Icelandic on economics, pastor Arnljotur Olafsson (1823–1904), civil engineer Jon Thorlaksson (1877–1935), and economist Benjamin Eiriksson (1910–2000), and some more recent writers, including economics professors Olafur Bjornsson (1912–1999) and Ragnar Arnason (b. 1949), and the present author (b. 1953). Moreover, comprehensive liberal reforms were implemented in Iceland in 1991–2004, with remarkable success, even if the

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1. University of Iceland, 101 Reykjavik, Iceland. An earlier version of this paper formed a part of the author's 2016 report for the think tank New Direction in Brussels on "The Nordic Models."

2. In this paper, liberalism is used in the original political sense, as a political position in favour of individual choice and limited government, shared, despite many differences, by John Locke, Adam Smith, Alexis de Tocqueville, Lord Acton, Herbert Spencer, John Stuart Mill, Karl Popper, Friedrich Hayek, Milton Friedman, and Robert Nozick. In Icelandic, the word *friðalsbyggja* is used about liberalism in this sense by people sympathetic to it, whereas those hostile to it prefer the term *nyfriðalsbyggja* ('neoliberalism').

3. For economic and legal analyses of the Icelandic Commonwealth see Friedman 1979; Eggertsson 1992; Lindal 1993; Runolfsson 1993.

subsequent 2008 bank collapse came as a shock to the nation, though it quickly recovered.

The present piece only takes the story to about 1991. In a second piece to appear in a future issue of the present journal I will resume the narrative but in a somewhat different mode. Whereas the present paper is more strictly historiographical, the second piece will, while being historical in part, pick up in 1991 and enter the battlefield of ideas itself, as I critically analyse the widely circulated anti-liberal narrative about Iceland 1991–2017. The present piece begins around 1840, with the story of Jon Sigurdsson.

Before commencing, I should remind the reader of how small Iceland is. In a historiography of any country's trends, it is appropriate to focus on the most prominent individuals, and to suppose that, by their prominence, individuals and their decisions actually influenced the course of history. But in a tiny country like Iceland the influence of active and outspoken individuals is immediately palpable. Though Iceland has about the land area of Kentucky, her population is minuscule and highly concentrated in the capital region of Reykjavik. In 1840, the entire national population was just 57,000 people. In 1900 it was 78,000. In 2013 it was 323,000. The country today has a population approximately equal to that of the United States' 58th largest city, Corpus Christi, Texas, and much less than that of the least populated state, Wyoming.

## **The first Icelandic liberal: Jon Sigurdsson**

Iceland was settled over the period 874–930, mostly from Norway, and the Commonwealth was in place between 930 and 1262 when the Icelanders, trying to obtain security and avoid isolation, in a Covenant with the Norwegian king recognised his sovereignty (Karlsson 2000, 83–84). If, after 1262, the Icelanders thought however that they had obtained security by yielding their country to the Norwegian crown, then they would be greatly disappointed because they found themselves in a trap. As a result of innovations in shipbuilding technology, in the early 15th century English fishermen started to harvest fish in the Icelandic waters and to trade with the Icelanders. This should have opened several possibilities for Iceland of developing her fisheries and trading with foreigners. But now the Norwegian and Danish crowns had been united, and the Danish king was quick to prohibit all trade with foreigners, although it proved difficult to uphold his authority in the remote island. In 1467, English fishermen and traders even killed the crown's governor of Iceland. On three occasions in the sixteenth century the Danish king offered to sell Iceland to his English counterpart, Henry VIII, who was however not interested (Thorsteinsson 1957–61). I have calculated that the price

the king wanted for the country was approximately six million dollars in current prices (Gissurarson 2015b).

Slowly the Danish king re-established his authority in Iceland and imposed a total Danish monopoly of foreign trade. In alliance with the domestic landowning class, the Danish crown outlawed fishing and trade as full-time occupations: Every able-bodied person had to be a farmer, or the dependent of a farmer, or a farmhand, and registered with one of the roughly 5,000 farms in the country. As a consequence, the paradox arose that the Icelanders often went hungry even if surrounded by some of the world's most fertile fishing grounds (Eggertsson 1996). In mid-sixteenth century, the Danish king imposed the Reformation on Iceland and seized many church properties, and in 1662 he forced the Icelanders to accept the absolute power that he had already assumed in Denmark. Those were dark centuries for the Icelanders. The country was ravaged by cold spells, volcanic eruptions, earthquakes, epidemics, famines, and economic isolation, with the population declining to around 35,000 in 1785 and the Danish government seriously considering evacuating it to another Danish territory (Agnarsdottir 1992, 87).

The severe economic crisis in late eighteenth century marked however the downfall of the old landowning class and consequently the passing of its stranglehold over the economy (Gunnarsson 1980). Under the influence of liberal ideas, the Danish government abolished the monopoly trade in 1787, and farms belonging to the church and the crown were sold, creating a new class of independent farmers, alongside a few intellectuals, officials, merchants, and even full-time fishermen. It was into this emerging new society that in 1811 Iceland's first liberal leader, Jon Sigurdsson, was born. A pastor's son from the Western Fjords, in 1833 he went to Denmark to study philology at the University of Copenhagen. He soon became an unrivalled expert on Icelandic history and literature, and he worked for most of his life at an institute established by the Danish authorities to keep old Icelandic manuscripts. Well-read in economics and politics, Sigurdsson was influenced by the liberalism of John Locke, Adam Smith, and John Stuart Mill (Olason 1929, 364–370). In 1841 Sigurdsson started a magazine, *New Social Review* (*Ný félagsrit*), where he expressed his political views: He was a firm believer in progress, economic liberty and national self-determination. "Individual liberty should not be limited unless where society as a whole (the nation) would be harmed by it," he wrote (1841, 73).

Jon Sigurdsson was untiring in preaching that Icelanders should and could learn from other nations without having to sacrifice their pride and identity. "We have advanced the most when we have travelled widely and traded with other countries, but with many countries, not only with just one," he observed (1842, 146–147). He was a strong advocate of free trade, and he argued for it in the spirit of Adam Smith:

Our trade is confined to just one country, and we are not allowed to do business with any other countries. This goes against the nature of exchange and evolution, because progress and prosperity depend on trading what is necessary, so that people in fact support one another. When a nation disregards this rule and this law of nature, it will be punished, and the punishment will be its own humiliation and loss. No country in the world is completely self-sufficient, even if human foolishness has tried to make it so. Neither is any country such that it cannot contribute something and thus obtain what it needs. But when a country has obtained what it needs, which is what trade brings about, then it is as if itself had possessed these necessities. When trade is free, then every nation offers what it has in surplus, to those who have what it needs (Sigurdsson 1843, 52–53).

Sigurdsson pointed to England as the example the Icelanders should follow. Its rapid progress could, he wrote, without doubt be attributed to its great freedom of enterprise and association (1844, 10).

Sigurdsson's most influential paper, "An Exhortation to the Icelanders," was published in 1848, when the Danish king, under pressure to renounce his absolute power, was preparing a constitution for the Danish Realm which included not only Denmark, Iceland, Greenland, and the Faroe Islands, but also the two duchies of Schleswig and Holstein. The king was keen on retaining his duchies, but Holstein was to all purposes a German territory, whereas Schleswig was mixed. Therefore many Danes wanted to abandon Holstein and annex Schleswig to Denmark, while both the leaders of Holstein and of the German states were adamantly opposed to that idea. In his



Sigurdsson

"Exhortation" Sigurdsson argued that the 1262 Covenant had been made between the Icelanders and the Norwegian king, not the Norwegian nation. Later, the Danish king had replaced the Norwegian king, so the Covenant was between the Icelanders and him. In 1662, the Covenant had been annulled when the Icelanders had recognised the absolute power of the Danish king. This was also a treaty just between them and the monarch. With the Danish king now renouncing his absolute power in Denmark and appointing a representative government in that country, this meant for the Icelanders that the 1262 Covenant between them and the monarch became valid again. The government of Denmark therefore had no right to govern Iceland.

The logical next step, Sigurdsson argued, was to establish a legislative parliament in Reykjavik and to appoint a government with a representative in Copen-

hagen. It should be emphasised, however, that Sigurdsson did not solely base the claim to national self-determination on an old document, the 1262 Covenant. His two other arguments, perhaps more convincing to foreigners, were from identity and prudence. He pointed out that Icelanders were a separate nation with their own history, literature and language. Moreover, it was prudent to assume that they knew better than Danish officials far away what was necessary for the country: Self-rule was, Sigurdsson submitted, a prerequisite for the progress which Iceland desperately needed (Sigurdsson 1848).

In 1848, Sigurdsson became the recognised leader of the Icelandic independence movement. Most Icelanders accepted his three arguments for national self-determination, from legality, identity, and prudence, even if the motive of some of his supporters, especially conservative farmers, may paradoxically have been resentment at the attempts by enlightened Danish authorities to liberalise Icelandic society, with measures such as the stipulation of freedom of the press and of religion and the abolition of labour bondage (*vistarband*), the old requirement that everybody should be registered and employed at a farm (Halfdanarson 2012). From 1845, Sigurdsson was a member of a consultative parliament which had been established by royal decree two years earlier and which convened every other year in Reykjavik. In 1849 he was elected Speaker of the Parliament. In the summer of 1851, the Danish government summoned a National Assembly in Reykjavik to decide on Iceland's future political arrangements. The Danish Governor introduced a bill on the status of Iceland within the Danish Realm, stating essentially that Iceland should be governed as a Danish province with some self-rule. While the Assembly was deliberating, a Danish warship with a troop of twenty-five soldiers was kept in the harbour. The Assembly decided to reject the government bill and presented another bill which amounted to a constitution for an independent Iceland, in a personal union with Denmark, with provisions for some cooperation with the Danish government. The Governor rejected the Icelandic proposal and dissolved the Assembly. Sigurdsson stood up and protested, and then almost all the members of the Assembly rose and said as if with one voice: "We all protest!" (Karlsson 2000, 212–213). Thus, the attempt failed to find an arrangement for conducting Icelandic affairs which would be agreeable both to the Danish government and the Icelanders.

Most of Denmark's leaders were by now well-disposed towards Iceland, which they not only recognised as a country with a distinct identity, but which they also respected as a guardian of the ancient Nordic cultural heritage. They wanted to maintain control of Iceland, however, for three reasons. First, the question of Schleswig and Holstein was still unresolved. If Iceland was allowed to leave the Danish Realm, then the two duchies might do the same. Secondly, it may have been a matter of prestige to some Danes to include Iceland in the Realm, because at that

time it certainly was not a matter of profit: In the 1850s, the Danish Treasury paid about double the amount of money to Iceland that it derived in revenue from the country. Thirdly, many Danes were afraid that Iceland—a poor, stagnant, remote country with a tiny population—could hardly survive on her own. One of them was Carl Emil Bardenfleth, who had been Governor of Iceland for a few years before he became Danish Minister of Justice. The “young generation’s fantasies about the golden fruits of Icelandic autonomy would show themselves to be nothing but illusions,” Bardenfleth wrote in his autobiography. He was convinced that self-government would only lead to “long-lasting stagnation in Iceland’s progress towards culture and civilization” (quoted in Halfdanarson 2012, 260). Iceland needed Denmark, he thought.

Sigurdsson may have agreed, up to a point. He was a practical man, realizing that Iceland needed economic progress to be sustainable as an independent country, and economic progress required foreign capital which could probably only come from Denmark. But Sigurdsson thought that Icelanders also needed self-respect and dignity, especially because they were so few and poor. Therefore he put forward the argument from the 1262 Covenant, for even though many would think the argument absurd, it enabled the Icelanders to approach the matter as not asking for a favour but as insisting on a right. Sigurdsson adopted the same approach when he in the early 1860s was a member of a committee appointed by the Danish government to prepare the fiscal separation of Iceland and Denmark. The committee members were unanimous in proposing that the finances should be separated and that the Danish Treasury should transfer a sizeable sum annually to the Icelandic Treasury. The transfer was partly regarded as compensation for the landed properties of the Icelandic church; initially, revenues from them had been used to finance schools in Iceland, and when the properties had been sold the money had been paid into the Danish Treasury. All the committee members except Sigurdsson agreed that this sum should be about 42,000 rigsdaler (or ‘realm dollars’), the Danish currency at the time. Sigurdsson however tried to calculate what the Danes really owed the Icelanders, not only for the landed properties they had acquired and then sold, but also for Iceland’s share in the profit of the monopoly trade. He concluded that Iceland had a reasonable claim on Denmark for an annual transfer of about 120,000 rigsdaler, from which he subtracted 20,000 rigsdaler as Iceland’s contribution to the Royal House and central government: Thus, he proposed an annual transfer from Denmark to Iceland of 100,000 rigsdaler (Karlsson 2000, 219). Needless to say, Danish leaders remained unconvinced by Sigurdsson’s calculations. His chief purpose may also have been to define the contribution from the Danish treasury in a manner consistent with the self-respect of the Icelandic nation: not as poverty relief, but as rightful compensation for past wrongs.

Tall, handsome, with snow-white hair from middle age, friendly, but uncompromising, for thirty years Sigurdsson was not only the leader of Iceland's struggle for independence, but also the central figure in the Icelandic community in Copenhagen. He and his wife entertained regularly, and their house was always open to Icelanders passing by. In addition, Sigurdsson was a tireless informal facilitator in Denmark, assisting the mighty and the humble back home in various tasks that had to be undertaken on their behalf in the distant capital. He kept his strong belief that Iceland needed above all economic freedom, writing in 1866 to his brother:

You think that someone will absorb us. Let them all absorb us in the sense that they trade with us and do business with us. Freedom is not about living alone and not having anything to do with others. I doubt that Simeon Stylites or Diogenes were freer than any other unfettered people. True enough, freedom comes mostly from within, but no freedom relevant in society is realized except in exchanges, and they are therefore necessary for freedom. (Sigurdsson 1866)

Sigurdsson was however no radical. In Reykjavik in 1875, young students organised a celebration for him, one of them, Gestur Palsson, composing a poem on the occasion. When Sigurdsson thanked them, he took issue with a statement in the poem that he was “the leader who never knew any restraints.” He rejected the notion that he had never known any restraints. Discipline and restraints were needed for human development, he observed. Restraints were necessary both within and outside, both for individuals and for nations. Unrestrained freedom, without any limits, was no freedom, but simply turmoil and disarray (Jakobsson 1933, xxi). Thus, Sigurdsson may be characterised as a practical liberal. After he passed away, Thorlakur O. Johnson, a Reykjavik shopkeeper, led a movement to make his birthday, 17 June, a day of celebration. The first such celebration was held in 1886, becoming a tradition in early twentieth century. The Icelandic republic was established 17 June 1944, and since then Sigurdsson's birthday has been the national holiday.

## **In the spirit of Bastiat, Mill, and Cassel**

Even those few Icelandic intellectuals who disagreed with Sigurdsson's historical and legal arguments tended to share his liberal views. One of them was Arnljotur Olafsson, who in 1880 published the first book on economics in Icelandic, *An Inquiry into Wealth*. Olafsson had gone to Copenhagen in 1851 and studied economics for a few years at the University. Lacking the means to complete

his studies, he had taken on various odd jobs, including that of being private tutor in the household of a Danish baron, Blixen-Finecke. Olafsson accompanied the baron and his son on tours to Southern Europe. He eventually returned to Iceland, married, and completed in 1863 a degree in theology, which was then the most practical line of study. Subsequently, he became a pastor in Northern Iceland and was also elected several times to the Icelandic Parliament, but there he was too independent, and perhaps also too obstinate, to become influential. In his first years in Parliament, he argued for the establishment of an Icelandic bank and against the labour bondage. Olafsson became a prosperous farmer as well as a respected pastor, and he maintained a lively interest in economics and statistics, publishing several learned papers on Iceland's economic history. His well-stocked library included books by Herbert Spencer and John Stuart Mill.

Olafsson's book *An Inquiry into Wealth* was a vigorous defence of economic freedom, mainly based on Frédéric Bastiat's *Economic Harmonies*.<sup>4</sup> Everybody had an interest in competition because it induced producers to serve their fellow beings: "Competition is initially guided by self-interest, because competition is liberal, it is liberty itself; but it reins itself in, by reins which are in fact non-coercive, and thus it leads self-interest against its will to work for the general good." Olafsson observed that the free market set prices much more efficiently than any institution: "Competition is the invisible setter of prices in every free economy. It prices human goods,



Olafsson

and it does it more effectively than the old Icelandic chieftains priced the goods of Norwegian merchants, or the later royal sheriffs priced the goods of the Hansa merchants and the English sailors" (Olafsson 1880, 81, 79). By no means a mere translation or summary of *Economic Harmonies*, Olafsson's book was well-written and abounding with Icelandic allusions and examples. The author also translated an extract of Bastiat's *Laws*, published in two parts in an Icelandic magazine in 1890. As Olafsson grew older however, he became more conservative, opposing like some other affluent farmers the complete abolition of labour bondage against which he had campaigned as a young man (Olsen 1906).

It should also be noted that in 1886 an Icelandic journalist and adventurer, Jon Olafsson, translated Mill's *On Liberty*. At about the same time an Icelandic student in Copenhagen, Sigurdur Jonasson, translated Mill's *Subjection of Women*.

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4. An extract of one of Bastiat's most famous papers, "What Is Seen and What Is Not Seen," was also published in Icelandic (1880).



Even though that translation was only published in 1900, it had a strong impact on the Icelandic movement for the equal rights of women.

In the second half of the nineteenth century, the backward, poor Icelandic society underwent a transformation. A vibrant spirit of enterprise came to the island. In 1855, foreign trade became totally free, having previously been confined to Danish subjects, even after the abolition of the monopoly. In 1886, the first Icelandic bank, Landsbanki, was established by the government. It put into circulation Icelandic kronur, interchangeable with the also circulating Danish kroner. In 1904, a private bank, Islandsbanki, was established by Danish and Norwegian investors, being given the right to issue kronur and explicitly backed by gold. The two banks provided the capital necessary to replace the old open row boats with modern fishing vessels, first decked sailships and then trawlers. The fisheries replaced agriculture as the most important sector of the economy, owners and captains of fishing vessels prospered, and—to the chagrin of many farmers—poor people from the countryside flocked to the fishing towns on the coastline, mainly to Reykjavik.

The Danish government granted Iceland home rule in 1904, the governor being replaced by an Icelandic minister who, while a member of the Danish Council of State, was only answerable to the Icelandic parliament. But Icelandic enterprise had its opponents, not least in intellectuals who identified a potential political constituency in the rapidly expanding class of urban labourers as well as in farmers, who resented seeing their former farmhands leave for the towns and were unhappy that the banks were mainly providing capital to fishing firms. Since Iceland had gained home rule and was approaching full sovereignty, the old parties of the struggle for independence gradually became obsolete. Political ideas or collective identities guided the formation of new parties within Iceland's multiparty system, which was based on proportionality. In 1916 was founded the Social Democratic party (Althyduflokkurinn), which tried to gain the support of urban labourers and cooperated closely with the Icelandic Confederation of Labour and with its Danish sister party. The same year some farmers in parliament established the Progressive Party (Framsoknarflokkurinn) which was backed by the Cooperative Movement and had much support in rural districts.

After peaceful and friendly negotiations, Iceland in 1918 became a sovereign state in a personal union with Denmark, which undertook to represent Iceland internationally and to protect her fisheries limit in cooperation with the Icelandic Coast Guard (Halfdanarson 2000). Jon Sigurdsson's political programme had finally been implemented, seventy years after he had published his "Exhortation to the Icelanders." But his political heirs were split into several factions, challenged by the Social Democrats on the one hand and class-conscious farmers on the other hand.

It fell to Jon Thorlaksson, a civil engineer and successful businessman, to try and organise a conservative-liberal or centre-right party in the spirit of Sigurdsson. A farmer's son from the North of Iceland, Thorlaksson was a brilliant student who completed grammar school with the highest marks ever given. In 1903, he graduated as a civil engineer from the Technical University in Copenhagen (then Polyteknisk Lærestalt, later Danmarks Tekniske Universitet) and two years later he became Iceland's Chief Government Engineer, in the following years building many roads and bridges around the country (Gissurarson 1992). He later said that as a young man, his strongest desire was to use technology to bring his poor and backward country into the modern age (Thorlaksson 1923, 9).<sup>5</sup> A longtime member of Reykjavik City Council, he strongly supported the 1906 construction of the city aqueduct and the 1913 construction of the Reykjavik harbour, both crucial for modernisation in the capital. He left his government position in 1917, devoting himself after that to independent engineering projects and to his business firm which imported various kinds of building materials. Thorlaksson was also one of the pioneers in harnessing Iceland's many waterfalls, rivers and geysers to produce hydroelectric power. In 1921, on commission, he built the first power plant serving Reykjavik. In 1926 he presented a well-developed plan of using warm springs to heat up the houses of Reykjavik (Thorlaksson 1926a); this plan was gradually implemented in the 1930s and 1940s. While left-wing intellectuals sat in Reykjavik coffeehouses eloquently lamenting the inadequate living conditions of the Icelandic working class—sometimes in moving poems—Thorlaksson sat in his office designing projects that would greatly improve the living conditions of all Icelanders, including common workers, providing them with heat, light, and water, and roads, ports, and bridges.

When elected to parliament in 1921, Thorlaksson immediately started to try and bring the remainder of the old parties of the independence struggle together into a centre-right party. In early 1924, under his leadership, most members of parliament for the old parties founded the Conservative Party (Ihaldsflokkurinn) which became the largest group in parliament, almost commanding a workable majority. Thorlaksson explained that the name was chosen because the new party wanted to defend the values of economic freedom, private property rights, and fiscal and monetary stability, which had been firmly in place before the Great War and which now were



Thorlaksson

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5. All the works by Thorlaksson quoted are reprinted in his collected speeches and papers (1985).

being threatened by the emerging left. He wrote: “Our ideal is that society should consist of as many independent and free individuals as possible, and that each and every one of them should have as many opportunities as possible to increase the welfare of their families and thus the welfare of society, without harming anyone” (1926b, 18). Thorlaksson distinguished between four political dispositions. One was the liberal one, “the absence of an urge to control other people” (ibid., 5). Another disposition was conservative: it was to be cautious and want to maintain useful traditions. A third disposition was authoritarian, an urge to control other people. A fourth disposition was radical, the desire to break down the established order and to build something new on its ruins. Thorlaksson said that these four dispositions could exist in various combinations. In backward countries, liberals had for example to be radical. But in the 1920s Iceland, liberal and conservative people had a common cause: the defence of the liberty gained in the 19th Century. Their chief adversaries were the socialists who combined authoritarian and radical dispositions.

Thorlaksson’s party was not modelled on the Danish Conservative People’s Party, which derived its support mostly from the old establishment of landowners, high government officials, industrialists, and businessmen, but rather on the free-trade wing of the British Conservative Party. Like Sigurdsson, he admired the Anglo-Saxon political tradition. In a 1927 speech in parliament, Thorlaksson said: “Experience here in Europe shows that those countries have fared the best where the written statutes are the fewest, and where the constitutional customs are the firmest. Here I am referring to Great Britain.”

While Thorlaksson was universally respected for his intelligence, unflinching honesty and capacity for hard work, he lacked charisma, and in early 1924 another member of his party, more amenable to the centre, formed a Conservative government. Thorlaksson became Finance Minister, and in the autumn of 1924 he authored what was only the second book on economics published in Icelandic, *Currency Depreciation (Laggingid)*, where he tried to explain why the Icelandic krona had sunk in value in the preceding years and what should be done about it. Thorlaksson’s analysis of monetary affairs closely followed that of Swedish economist Gustav Cassel, then one of the best-known economists in the world. Thorlaksson’s answer to the first question was that the krona had sunk in value because too much of it had been produced during and after the Great War. Thorlaksson did not give a direct answer to his second question, but he proceeded as though monetary stability could only be reintroduced by returning to the gold standard and becoming a full participant in the Scandinavian Monetary Union, as Iceland had indirectly been when she was under Danish rule. The choice, as he presented it, was between returning to the gold standard at the pre-war rate or at the present rate. It

was clear that he personally favoured a return to the gold standard at the pre-war rate, like Churchill in the United Kingdom.

In 1924–1925, there was a boom in Iceland and the krona was allowed to appreciate, from around 47 per cent of its pre-war value in gold, to around 82 per cent. But Thorlaksson did not have sufficient support to carry his monetary stabilisation any further, and in the 1927 parliamentary elections his party was defeated. A minority government was formed by the Progressive Party with the support of the Social Democrats. Feeling that traditional liberties were under threat, in 1929, the last remaining members of parliament for the old parties of the independence struggle joined Thorlaksson's Conservative Party, which subsequently changed its name to the Independence Party. Thorlaksson was elected its first leader.

During the five years of his leadership, Thorlaksson set out the position of the Independence Party in almost purely liberal terms. His opponents conceived of unfettered competition in the free market as a battle in which the weakest lost. It was, they said, a race in which the devil took the hindmost, a modern Colosseum. Thorlaksson considered this to be a grave misconception. In schools, he argued, competition was between students for grades; it was about them developing their individual talents, not about harming others. Likewise, in sports, competition was between athletes for prizes; it was about them training to perform to the best of their individual abilities, and again not about harming others. Similarly, in the marketplace competition was between providers of goods or services for profit; it was about satisfying the needs of customers in the best way, either by quality or price, and not about harming others. The case for competition, Thorlaksson submitted, echoing Adam Smith and other classical liberals, was that it led people who were only working for their own interest to seek to serve the needs of their fellow beings. In a paper read to the last general meeting of the Conservative Party (and the first meeting of the Independence Party) in 1929, Thorlaksson said:

The purpose of economic activity, to satisfy human wants, cannot be better served than by allowing the human instinct for self-preservation to lead everyone to serve others to their best ability. In the self-regulating machinery of free trade, the pursuit of self-interest is the power engine which drives everything forward, while the great accomplishment of the machine is the production to satisfy everybody's wants. (Thorlaksson 1929, 25–26)

Thorlaksson's ideas on the competitive economic order were directly derived, as was his monetary analysis, from Cassel, who in Sweden was very active in popularising economic liberalism. In 1928, Cassel had published a series of articles under the name *Socialism or Progress*, and one of them, "Capital and Progress" was obviously the inspiration for Thorlaksson's exposition. Some of Cassel's newspaper

articles were indeed translated into Icelandic and published in the magazine of the Young Independents (Cassel 1930a–d; 1932).

Thorlaksson firmly rejected the idea that political parties should be based on classes. Instead, different ideas about the common good and how to attain it should divide them.<sup>6</sup> However, in the Great Depression of the early 1930s, classical liberal ideas lost their credibility with many. While people continued to respect Thorlaksson, his Independence Party did not do as well as hoped in two out of three elections fought under his leadership. Even if the Independence Party received most of the votes, the Progressive Party commanded the largest parliamentary group, as the rural districts where it had its main support were vastly over-represented in parliament.

## Iceland's road to serfdom: economic controls

In the early 1930s strict economic controls were imposed in Iceland, which enabled government commissions to shunt a lot of business from private merchants, usually supporters of the opposition Independence Party, to the cooperative movement, closely aligned with the ruling Progressive Party (Asgeirsson 1988). Islandsbanki collapsed and was nationalised under a new name, Utvegsbanki. The Progressive Party government established a third bank, Bunadarbanki, whose main task was to provide capital to agriculture. Moreover, in the 1930s a strong communist movement emerged, enjoying political and financial support from Moscow. Protesting against wage cuts, the communists showed their strength in a fierce street riot in Reykjavik on 9 November 1932 when they managed to overpower the tiny Reykjavik police force and bring about the withdrawal of the cuts (Gissurarson 2011). From that point on, wages in Iceland were regarded as 'sticky' or 'rigid': If wage cuts became necessary, then they were achieved indirectly, either through controls or inflation. The idea of providing monetary stability by returning to the gold standard became moot. In bad health, Thorlaksson resigned in 1934 as Independence Party leader. A year earlier, he had however been elected as Mayor of Reykjavik, an Independence Party stronghold. During his short tenure as Mayor, before his premature death, he was very active, encouraging the opera-

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6. Thorlaksson shared many traits with Thomas Madsen-Mygdal, the robust leader of the Danish liberal party Venstre and Prime Minister of Denmark in 1926–1929. The differences between them were less in their views than in their situation. In Iceland, there was no conservative party competing with the liberal one, and Thorlaksson was not as narrowly focused on any one sector of the economy as Madsen-Mygdal was on agriculture. Thorlaksson's Independence Party was to some extent what a merger in Denmark between the Conservative People's Party and Venstre would possibly have looked like, or one in Sweden between the Folkpartiet and the Moderate Unity Party.

tions of small privately owned boats from Reykjavik and starting to build for the city both a big hydroelectric power plant and a geothermal system for heating up houses.

The third book in Icelandic on economics dealt with the economic controls imposed in the 1930s. Its author was Benjamin Eiriksson, who well illustrated Leon Trotsky's remark that anyone wishing to live a quiet life did badly to be born in the twentieth century. The son of a poor fisherman in a village near Reykjavik, Eiriksson soon showed himself to be an excellent student, and his brother, a taxi driver, financed his education. Graduating in 1932 from Reykjavik Grammar School, Eiriksson started reading economics at Humboldt University in Berlin (then called the Friedrich-Wilhelms-Universitaet). Eiriksson as a student was a committed communist, and when he went to meetings of left-wing students it was not uncommon that Nazi gangs tried to break them up, even by shooting at them. When the Nazis took power at the end of January 1933 Eiriksson decided to move to Stockholm, where one of his teachers was the radical social democrat Gunnar Myrdal.

Still a communist, Eiriksson decided in 1935 to accept an offer to train at one of the clandestine schools which the Comintern operated in Moscow, the so-called Western University (KUNMZ), where his code name was Erik Torin. In Moscow, Eiriksson fell in love with a German girl, Vera Hertzsch, who had moved to the Soviet Union, married and separated, and was working as a journalist and a part-time student. But now Stalin's purges were beginning, and Hertzsch's nominal husband was denounced as a Trotskyite. When the Western University was closed in 1936, Eiriksson could not stay much longer in Moscow. He decided to return to Stockholm where he received a degree (fil kand, roughly comparable to an M.A.) in economics and Slavic languages. When Eiriksson left, Hertzsch had become pregnant, and she bore their child in March 1937. A year later, in March 1938, Hertzsch was however arrested as the wife of a Trotskyite, in the presence of an Icelandic writer, Halldor Kiljan Laxness, a Stalinist who was travelling in the Soviet Union. She was sent to a prison camp where her child apparently soon perished, and she herself died of malnutrition after five years. Laxness told Eiriksson about the arrest, but kept otherwise quiet about it for 25 years, continuing staunchly to defend Stalinism (Gissurarson 2004).

In the summer of 1938, Eiriksson returned to Iceland as an economist and, not immediately finding a job, he wrote his book *Causes of the Economic Problems and Currency Shortage*. He pointed out a contradiction in the policies of the Icelandic government: At the same time as it wanted to reduce imports in order to save foreign currency, it was stimulating demand for imports by offering loose credit through the three government banks. Moreover, whereas the strict import and currency controls were ineffective, they were harmful to the economy, distorting

it and stifling entrepreneurship. The overvalued krona was a great burden to the export sectors, especially the fisheries. The only feasible way out, Eiriksson argued, was to devalue the currency, to abolish the strict import and currency controls, and to reintroduce free trade with other countries.

The economic analysis in Eiriksson's book was plausible, but nevertheless he did not get much of a reception. His comrades in the Communist Party and the social democrats were adamantly against currency devaluation, because it would reduce labour's purchasing power, while the leaders of the Independence Party and the Progressive Party were wary of the young communist recently arrived from Moscow. However, in early 1939 the krona was devalued, even if extensive economic controls remained; Eiriksson's analysis had not brought this about, but it may be argued that it correctly predicted it. In that year, Eiriksson however left the Socialist Party, which had been formed in 1938 as a merger of the Communist Party and a radical faction of the Social Democrats. He could not accept the Party's slavish devotion to Stalinism. In 1942 Eiriksson left Iceland, going to the United States to pursue graduate studies in economics (Gissurarson 1996).

In the spring of 1938, Benjamin Eiriksson was not the only Icelander to graduate in economics from abroad. In Copenhagen, Olafur Bjornsson finished his studies after six years at the University. A pastor's son from the North of Iceland, as a young man Bjornsson had briefly flirted with socialism, in the midst of the Great Depression, but his views changed when during his last winter in Copenhagen he came across two books, *Socialism* by the Austrian economist Ludwig von Mises and *Collectivist Economic Planning*, a collection of papers edited by another Austrian economist, Friedrich A. Hayek. In his book, originally published in German in 1922, Mises argued that collectivist economic planning such as socialists traditionally envisaged was bound to fail because the planners could not price resources and other goods according to their relative scarcity. They could not make rational decisions about whether to build a road or a railway between two places, or whether to use a plot of land to grow corn or wine, or about thousands of other matters. In a free-market economy, such decisions were however made spontaneously by individual agents on the basis of prices and rational calculations. "And then we have a socialist community which must cross the whole ocean of possible and imaginable economic permutations without the compass of economic calculation," Mises wrote (1936, 122). Hayek added several important considerations to Mises's critique of socialism, arguing that decentralisation of knowledge required decentralisation of decisions. He also observed that owners and entrepreneurs performed a necessary role in a dynamic economy: Their acquisition and transmission of knowledge through trial and error could never be simulated by government experts and bureaucrats (Hayek 1935).

Bjornsson was probably also influenced by some of his teachers at the University of Copenhagen. One of them, Laurits Birck, rather conservative and elitist, offered many economic insights and had some impact in Denmark, not least because of his biting wit and ability to appeal to a wide audience. Bjornsson often recalled Birck's remark that under the gold standard a central bank only needed a parrot as governor for it to function properly. Axel Nielsen was an able, but non-ideological monetary economist. Jens Warming, who taught statistics to Bjornsson, was at that time a somewhat underestimated economist. It was only later that his peers fully realized that he had written original studies in the economics of non-exclusive resources. He had as early as 1911 analysed overfishing as the necessary consequence of unlimited access to a limited resource such as a fishing ground.<sup>7</sup> His work anticipated some important points made by Arthur C. Pigou in his welfare economics, and his analysis of overfishing was almost identical to that of the two English-speaking economists who are usually regarded as the pioneers of fisheries economics, H. Scott Gordon (1954) and Anthony Scott (1955). Bjornsson's supervisor at Copenhagen University was an economic liberal, Professor Carl Iversen. However, Iversen hardly ever publicly expressed his liberal views, and he became, somewhat like the liberal economist Lionel Robbins in the United Kingdom, an establishment figure, serving for many years as rector of the University of Copenhagen (Kurrild-Klitgaard 2015, 402).

Back in Iceland, Bjornsson first worked at the Statistical Bureau, and then in early 1939 he started teaching at the newly-established High School of Commerce which was a year later merged with the University of Iceland. Bjornsson was appointed Associate Professor (*dosent*) at the University in 1942. He published textbooks on his teaching subjects and wrote many articles where he restated Mises's and Hayek's argument that socialism was not economically feasible and that it would lead to tyranny. In 1944 he joined the Independence Party, and in 1945, on the initiative of young Independence Party members, he translated into Icelandic an extract of Hayek's *Road to Serfdom* that had been published in *Reader's Digest*. The translation was serialised in the leading Icelandic newspaper *Morgunblaðid*. It provoked angry reactions from both the social democratic newspaper *Althyðubladid* and the socialist newspaper *Thjodviljinn*, the latter one complaining about the "international freak" Hayek and the "national freak" Bjornsson (quoted in Gissurarson 2011, 208).

A young and clever socialist who had just graduated in economics and politics from Stockholm University, Jonas H. Haralz, responded in *Thjodviljinn* that Hayek was making unrealistic assumptions about competition and the free market, as technology required bigger units of production. Hayek was also attacking a

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7. Warming returned to the subject in 1931. See also Kærgård et al. (1998).



strawman, Haralz said; Western socialists had no intention of introducing central economic planning; they just wanted to nationalise a few key industries in order to ensure rational investment. Haralz added that the Independence Party should listen to more relevant prophets than Hayek, for example William Beveridge or John Maynard Keynes. Bjornsson replied that Hayek's book should not be interpreted as a scientific prediction, but rather as a warning against the possible consequences of power concentration. Moreover, it was by no means obvious that new technology was making competition obsolete. For example, the common concern about transport monopoly in the age of railways had disappeared with the private car. Bjornsson pointed out that often monopolies were created or maintained by governments. He added that the Independence Party did not need a prophet, but that it was sensible to try and learn from eminent scholars.

In a rejoinder, Haralz wrote that government officials, backed by democratic assemblies, could, with the assistance of experts, make and administer comprehensive national plans. Bjornsson replied yet again, recalling the danger which the concentration of economic and political power in the hands of a few posed for individual freedom. "Even if all members of a society had a formal right to employment, it would be easy to implement it in such a way that the life of those whom government regarded as its opponents would be as if in a prison camp." But whereas Bjornsson may have won the argument, the socialists had their say. In 1944–1947, the Socialist Party was in a coalition government controlling the Ministry of Education. The Minister, Brynjolfur Bjarnason, flatly refused to appoint Bjornsson a professor of economics, as tradition prescribed. Bjornsson therefore served unusually long as associate professor, for five years. But as soon as the socialists left office, he was appointed professor, in 1947 (Gissurarson 2016).

In early 1939, the Icelandic export industries, mainly the fisheries, had been on the brink of bankruptcy because of the overvalued krona. This changed, not only with the devaluation of the krona that year, but also during the Second World War when the Icelanders were the only nation to harvest fish in the fertile fishing grounds off the island and when they could sell as much fish as they wanted to in the United Kingdom and the United States. But when the War ended, this demand suddenly fell while harvests diminished as foreign vessels re-entered Icelandic waters. It was difficult to reduce nominal wages because militant socialists and communists, backed by Moscow, controlled many labour unions. Therefore, the first post-war governments reintroduced strict import and currency controls.

While the leadership of the Independence Party reluctantly went along with the controls, they also sought a way out of them. They found an economic expert who shared their concerns: Benjamin Eiriksson, the ex-communist who had in 1946 completed a doctorate at Harvard University under the supervision of Austrian economist Joseph Schumpeter. Eiriksson was now working for the Interna-

tional Monetary Fund in Washington, D.C. When the Independence Party formed a minority government in late 1949, its leadership invited Eiriksson to Iceland and asked him and Professor Olafur Bjornsson to prepare a programme for abolishing the economic controls. Their programme, which required a substantial devaluation of the krona, was accepted and implemented in 1950 by a coalition government of the Independence Party and the Progressives. However, because of sudden and unexpected economic difficulties, including the Korean War and failed harvests in the fisheries, the controls were only partly abolished then; the remainder was repealed in 1960, by a coalition government of the Independence Party and the Social Democrats.

In the 1950s and 1960s, Professor Bjornsson and Dr. Eiriksson were prominent spokesmen for free trade. Bjornsson was a respected member of parliament for the Independence Party in 1956–1971. Eiriksson however suffered a nervous breakdown in 1965 and was promptly released from his job as the director of a development fund. Whether or not there was a connection, two years earlier, Halldor Kiljan Laxness—who received the Nobel Prize in literature in 1955—had published a well-written and moving account of Vera Hertzsch’s arrest that he had personally witnessed in Moscow twenty-five years earlier (Laxness 1963).<sup>8</sup>

## An Icelandic libertarian movement

The 1960s in Iceland were characterised by a common belief that the world had seen the end of ideology. The traditionally free-market Independence Party had moved towards social democracy, and the Social Democrats had abandoned their old calls for nationalisation of key industries and a steeply progressive income tax. But the radicalisation of many young people at the end of the decade changed this and posed a challenge for those who supported liberty under the law, especially economic freedom. In 1972, a group of young people in the Independence Party took over the editorship of an old magazine called *The Locomotive* (*Eimreidin*), which had been published since 1895. The name had been chosen by the first editor and publisher to emphasise the necessity for Iceland of modernising. The ‘Locomotive Group,’ as the publishers were called, now wanted to rejuvenate the Independence Party and to make the Icelandic economy at least as free as the other Nordic economies. It was also strongly anti-communist. The leader of the group was a businessman, Magnus Gunnarsson, and it included three later prime ministers, Thorsteinn Pálsson, David Oddsson, and Geir H. Haarde, and two later Supreme Court judges as well as the present writer. While the magazine *Locomotive* folded in

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8. A book has been written in Icelandic about the tragic fate of Vera Hertzsch (Olafsson 2012).

1975, as a result of a conflict among its owners, the group of editors and writers (who had not been involved in the conflict) continued as an informal luncheon club. It had an impact on them and other Icelanders interested in economic liberty when the Nobel Prize in Economics was awarded to Hayek in 1974 and to Milton Friedman in 1976.

Younger people also became aware of, and interested, in liberal ideas. When Professor Olafur Bjornsson published a book on libertarianism and totalitarianism in 1978, he found a receptive audience. For example, I interviewed him on a radio programme and wrote a series of newspaper articles about his book. Written in a clear and accessible style, Bjornsson's book closely, and perhaps somewhat uncritically, followed works on similar issues by Mises, Hayek, and Karl Popper.

On Hayek's 80th birthday, 8 May 1979, the Icelandic Libertarian Alliance (LA) was founded by the present writer and a few other young people interested in classical liberal, libertarian, and conservative ideas. When Hayek was informed of the foundation of the LA, he expressed his delight and said that he was willing to visit Iceland in the spring of 1980. This offer was eagerly accepted, and I translated *The Road to Serfdom* into Icelandic before his arrival (Hayek 1980). Hayek gave two lectures in Iceland, on 2 April at the University of Iceland on competing currencies and on 5 April at a meeting of the LA on "The Muddle of the Middle," whereby he meant John Stuart Mill's controversial distinction between principles of production and rules on distribution. Both papers were published in my translation in a journal, *Liberty (Freisid)*, that the LA started publishing in 1980, and later reprinted in a book (Hayek et al. 1994). Hayek's message was widely discussed in Iceland. He was interviewed on television, and in a television programme a debate over his ideas took place between two economists, a liberal and a socialist. Ironically, the liberal economist who was now arguing for Hayek's ideas was Jonas H. Haralz (1919–2012), his vehement critic 35 years earlier, in the 1945 debate on the *Road to Serfdom*. Haralz had abandoned socialism and become a bank director and one of the most eloquent spokesmen for the free market, although more on grounds of efficiency than individual choice. He was also an influential adviser to the Independence Party. In 1981, the Libertarian Alliance published a collection of Haralz's essays, *Ill Fares the Welfare State*.

During his visit to Iceland Hayek was personally agreeable and intellectually alert despite being almost 81 years old. Tall, slim, whitehaired, moving with quiet dignity, speaking elegant English but with a German accent, he seemed to be precisely what he was: a scholar from the ranks of the old nobility in the Habsburg Empire. He was intrigued that in 1945 there had been a heated debate about the *Road to Serfdom* in Iceland, and he met and chatted with the chief protagonists, Bjornsson and Haralz. While in Iceland, Hayek invited me to attend the upcoming meeting of the Mont Pelerin Society, in Stanford in late 1980, and I became a

member of the Society four years later, frequently running into Hayek at the meetings. On those occasions, he was always friendly and gracious. When I went in the autumn of 1981 to Oxford to write a doctoral dissertation on Hayek's combination of conservative insights and classical liberal principles, and founded, with others students also interested in Hayek's ideas, the Hayek Society, he visited us once in Oxford, and a few of us also had dinner with him in London, in the spring of 1985.

The latter occasion was particularly memorable. Hayek was in a good mood. We were at the Ritz, and there was a group of musicians moving from one table to another, playing songs at the behest of the guests. When the band approached our table, one of us, Chandran Kukathas, who was writing a doctoral dissertation at Oxford on Hayek's theory of justice (Kukathas 1989), whispered to them to play "Vienna, City of My Dreams." When Hayek heard the tune start, his eyes lit up, he smiled broadly and started softly to hum the text of the song. Hayek also told us how Margaret Thatcher had once completely disarmed him. Soon after she became prime minister, she heard that he was in London and invited him to 10 Downing Street. She greeted him at the entrance, saying: "Professor Hayek! I know precisely what you are going to say. You are going to say that I have not done enough. And you are absolutely right!" At the end of the dinner Hayek expressed his pleasure that young people were taking interest in his ideas, but he added that he had one favour to ask us, for our own sake as much as his: It was that we would not become Hayekians, as he had observed that the Marxists were much worse than Marx and the Keynesians much worse than Keynes!

Our group in the Icelandic Libertarian Alliance was not only interested in the Chicago School's resolute use of price theory or in the Austrian conception of an economic process in which the agents slowly, and erratically, coordinated their pursuits of different aims. It was also fascinated by the public choice approach to politics, where it was deromanticised and analysed as the interplay of individuals promoting their own interest. A member of the group, Fridrik Fridriksson, in 1981 started doing postgraduate work in economics at Virginia Polytechnic Institute and University where James M. Buchanan and Gordon Tullock taught. Through Fridriksson, in the autumn of 1982 Buchanan visited Iceland and spoke about the economic analysis of politics at a meeting which was well-attended and widely discussed. His lecture was published in *Frelsid* and later reprinted in a book (Buchanan 1983; Hayek et al. 1994). During Buchanan's stay, David Oddsson who had in the spring become Mayor of Reykjavik gave a dinner in his honour at Hofdi House (which was four years later to become famous as the meeting-place for Ronald Reagan and Mikhail Gorbachev at their Reykjavik summit). Even if Oddsson was first and foremost a practical politician, he listened carefully to new ideas,

not least if they fitted in with his robust, old-fashioned individualism mixed with deep scepticism about arrogant elites.

The same year, in 1982, I published my translation of Milton Friedman's *Capitalism and Freedom*. Two years later, in the autumn of 1984, Friedman visited Iceland with his wife Rose. It is fair to say that he, like Caesar long ago, came, saw, and conquered. Small of stature, but thoughtful, witty, and totally in command of his subject, he made a strong impact. When he met the press during his first day in Iceland, a reporter asked whether he could sum up his recipe for Iceland in just one word, he replied: "Yes, I can!" Slightly surprised, the reporter asked what that word would be. "Freedom," Friedman said with a broad smile. At a luncheon given by the Minister of Trade, I introduced a Central Bank of Iceland governor to him with the words: "Here is a man, Professor Friedman, who would lose his job if your ideas were implemented in Iceland: a governor of the Central Bank." Friedman was quick to reply: "No, no. He would not lose a job; he would just have to move on to a more productive job." The Chamber of Commerce gave a dinner for Friedman, and one of the businessmen present asked him what he thought was the greatest danger to capitalism. "Look into a mirror," Friedman answered. "The greatest danger to capitalism is the capitalists themselves. They are always ready to ask for small and big favours from government. They do not like competition."

Friedman gave a lecture 1 September 1984 at a luncheon meeting organised by the Faculty of Economics and Business Administration at the University of Iceland on cooperation the Libertarian Alliance. He spoke about the "tyranny of the status quo," by which he meant the unholy alliance of three groups, politicians, bureaucrats and recipients of government transfers, whether imaginary or real. This alliance resisted all reforms and could only be reined in, Friedman submitted, by constitutional limits on the powers to tax and to print money. His lecture was published in *Frelsid* and later in a book (Friedman 1984; Hayek et al. 1994). Even if admission to the luncheon meeting cost a little less than \$40 per person (in current prices), the house was packed.

The night before, the government broadcasting service had televised a lively debate between Friedman and three left-wing intellectuals. At the close of the debate, one of the three, sociology professor Stefan Olafsson, pointed out that this was probably the first time an admission fee had been charged for a lecture at the University of Iceland (even if the lunch was included in the price). This was not his idea of freedom, Olafsson wistfully said; while he found Friedman's ideas stimulating, he could not afford to attend the lecture. Friedman was quick to reply that he thought this was not a correct use of the word 'freedom.' He had nothing against charging admission fees to guest lectures at universities. When other guests had been invited in the past to give lectures at the University of Iceland, it could not have been costless. Their travel costs and accommodation had to be paid;

meeting rooms had be rented; advertisements had to be taken out; and so on. What Olafsson meant to say, obviously, was that he wanted those who did not attend a lecture to pay for it and not only those who did attend. Icelandic television viewers all understood Friedman's message: There is no such thing as a free lecture. It should be pointed out, in addition, that the admission fee was roughly what a university student would then have spent on a jolly night out in Reykjavik. Also, although it has not been disclosed before, the reason why the Libertarian Alliance charged an admission fee was that it wanted to pay Friedman a fee for his lecture, even if he had not mentioned, let alone requested, any payment when he offered to visit Iceland. The net revenue from the luncheon meeting was used to pay him. To his great surprise, I gave him the cheque at the airport when he was leaving.

In the 1980s, gradually economic liberals, not only from the Locomotive Group and the Libertarian Alliance, but also others, gained influence. The visits by Hayek, Buchanan, and Friedman undoubtedly contributed to this, but also a stream of publications from the Libertarian Alliance and later from a small research institute, the Jon Thorlaksson Institute, which operated for a few years with the present writer as director. Those publications included collections of papers by Bjornsson (1982), Thorlaksson (1985) and Eiriksson (1987) and translations of the lectures by Hayek, Friedman, and Buchanan (Hayek et al. 1994). In 1983, Thorsteinn Palsson from the Locomotive Group was elected chairman of the Independence Party. However, under Palsson's leadership, the Party split, after he managed to offend a popular party member, and it suffered a thunderous defeat in the 1987 parliamentary elections. Palsson formed a coalition government of his Independence Party and the Progressives and the Social Democrats, but that only lasted a year because he managed to offend the leaders of the other two parties. In 1988, the present writer, having completed a doctorate at Oxford University and published it in a book (Gissurarson 1987), was appointed Professor of Politics at the University of Iceland, against vehement protests by most of the generally left-wing faculty.<sup>9</sup>

In 1989, the group which had founded the Libertarian Alliance ten years earlier decided to dissolve it, as its job of promoting classical liberalism or libertarianism in Iceland had been done. Meanwhile, liberals were also active on the political front. After the break-up of Palsson's government, many prominent members of the Independence Party felt that there was need for a more decisive leadership. The forceful and popular Mayor of Reykjavik, David Oddsson, was encouraged to stand against Palsson and in 1991 was elected leader of the Independence Party. Oddsson was like Palsson a member of the Locomotive Group, and

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9. Two other applicants for the job (neither of whom had by then completed a doctorate) complained to the Ombudsman of the Icelandic Parliament, who in his written opinion (1989) found however no fault with the appointment.

there was no basic disagreement between the two that Iceland needed comprehensive liberal reforms. In the 1991 parliamentary elections, the Independence Party won a victory, and Oddsson formed a coalition government with the Social Democrats.

## The ITQ system in the Icelandic fisheries

While the formation of the first Oddsson government certainly can be regarded as a turning point in the economic history of Iceland, in some fields reforms which had started earlier were mostly consolidated and continued. This applies in particular to the fisheries, by far the most important sector of the Icelandic economy. Iceland had extended her fishing limit four times, until it finally reached 200 miles in 1975 which meant that Icelanders became the sole users of the fertile fishing grounds in the territorial waters; earlier, around half the total catch or more had been harvested by foreigners. But at the same time, it seemed that the most valuable fish stock, the cod, was in danger of depletion, as had happened to herring some years before. Moreover, it was clear that too much capital had been invested in the fisheries, as economists would have predicted about any non-exclusive resource.<sup>10</sup> The fishing fleet had grown much faster than the total catch. The government decided to try and limit effort, defined as fishing days out at sea, but this did not seem to be successful, at least not in reducing over-investment.

In the autumn of 1980 when I was still a student of history at the University of Iceland, I was invited to a conference at Thingvellir, the site of the old Icelandic parliament, on "Iceland in 2000." One speaker after another asserted that capitalism could not deal with environmental problems such as overfishing. Instead, judicious government planning was needed. From my reading of Mises and Hayek, I had drawn the conclusion that individual property rights and their free transfer in a market were necessary to bring about the most efficient utilisation of resources. In the general discussion at the conference, I therefore stood up and innocently suggested that property rights be defined either to particular fish stocks or to particular fishing grounds, and then the problem spontaneously would be solved by the owners. Needless to say, my suggestion was derided, and a journalist from the socialist newspaper *Thjóðviljinn* who was present at the conference wrote ironically in his paper that "he had found a solution to the problem of utilising fishing grounds. It was either to entrust the fisheries to a public company which would charge an admission fee to them, or to hand over to fishing firms the full ownership of the fishing grounds previously held in common" (Bergmann 1980).

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10. See the papers already cited by Jens Warming, H. Scott Gordon, and Antony Scott.

Something like that, however, is what happened, not because people started to listen to me, but because groping for solutions, in a process of trial and error, the Icelandic fishing community, in cooperation with government agencies, developed a feasible system in the fisheries. After the collapse of the herring stock in the late 1960s, a complete moratorium on herring was imposed. In 1975, harvesting of herring started again, governed by catch quotas which each herring boat received. In 1979, the herring quotas were made transferable to make the system more flexible. A similar system was also introduced for capelin, a pelagic fish similar to herring. But in the far more important demersal fisheries it proved difficult to solve the problem of overfishing.<sup>11</sup> After attempts to limit fishing effort failed, the government decided to try and limit catch instead, as had been done in the pelagic fisheries. In 1984, it allocated catch quotas to fishing vessels according to their catch history in the previous three years. If a vessel had for example harvested 1 per cent of the total catch in cod during this period, then it received a quota consisting in a permit to harvest 1 per cent of the total allowable catch in cod over the fishing season. First, the catch quotas were only allocated for a year, and then for two years, and then without a time limit. They were also gradually made transferable.

The experience with the individual transferable quotas (ITQs) was generally positive, and in the spring of 1990 the system was made comprehensive, as I strongly supported in a book which I published during the deliberations of the parliament on the issue (Gissurarson 1990). The Ministry of Fisheries sets a total allowable catch (TAC) in each fish stock, and it allocates catch quotas—a proportion of the TAC—to each fishing vessel. The quotas are freely transferable, which means that overinvestment could be reduced. The more efficient fishermen bought quotas from the less efficient, who left the fisheries, and subsequently the buyers combined the new quotas with their own quotas better to utilise their fishing vessels. The quota holders also gained a vested interest in maximising the long-term profitability of the resource of which they regarded themselves as being partial residual claimants. Their behaviour changed: They wanted the Ministry of Fisheries to set the TAC cautiously, and they invested in research and development (Arnason 2008; Gissurarson 2000; 2015a). It amounted to a quiet revolution: The owners of fishing firms accepted the great reductions of TACs in various fish stocks that turned out to be necessary in the early 1990s.

From the outset, the ITQ system was nonetheless controversial in Iceland. Initially its opponents argued that catch quotas were not as effective in hindering overfishing as effort limits (such as fishing days), but those voices fell slowly silent as the efficiency of the system was amply demonstrated. However, the very success

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11. Pelagic fishes roam around close to the surface of the sea and migrate over long distances, whereas demersal fishes like cod tend to stay in the same deep underwater locations.



of the system has given occasion to harsh criticisms. Some people resent that the fishing firms have become profitable unlike their counterparts in most other countries. These critics point out that the owners of the firms initially received the quotas on the basis of catch history, and not in a government auction. Friedman's former opponent on Icelandic television, Stefan Olafsson, writes, for example: "This form of original allocation was by many seen as unfair, closing the formerly open access to the commons that the fishing grounds had been and producing privileges in a more closed industry" (2011, 18). But it is difficult to see who was being unfairly treated by the introduction of ITQs: According to fisheries economists, from Jens Warming to H. Scott Gordon, under open access to a fishery fishing effort will inevitably increase to the point when there is no more profit to be gained in the industry—when access becomes worthless. It was this state of affairs which was being corrected by the introduction of ITQs.

Two interesting and often overlooked points can be observed from the simple but generally accepted economic analysis of overfishing. First, under open access, there is enormous waste. This waste consists in utilising many more boats than necessary to harvest the total catch. The special profit captured by the initial quota holders consists in the elimination of waste within their sector of the economy, and not in a transfer of a good from some to others. A second point, particularly important in discussions of initial allocation, is that the only right of which others are deprived with this enclosure of a commons is the right to become the last fisherman in and to harvest fish at no profit. This is by definition a worthless right. Nothing of any value is really taken from others when the fishing grounds are enclosed. Nobody is therefore being unfairly treated.

It is true that the ITQ system is still a source of conflicts in Icelandic politics, paradoxically not because of its failure, but because of its success. But it should be observed that the alternative method of initial quota allocation which some Icelandic intellectuals suggested, a government auction, would have caused much graver conflicts.<sup>12</sup> The idea would have been to reduce the number of boats in the Icelandic waters by government auctioning off the quotas in such a way that only the more efficient boat owners would have been able to rent the quotas and to continue harvesting fish. But the more efficient boat owners would not have been better off, because they would simply have paid to government for the quotas what they previously spent on their boats, fishing gear and acquisition of fishing skills. They would not therefore have had any incentive to support the enclosure of the Icelandic fishing grounds. More importantly, the less efficient boat owners

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12. The following objections would also have applied to the idea of imposing a special tax on the fishing firms in order to reduce fishing effort, and keeping the tax high enough that only half of the fishing fleet could have continued in operation.

would have had to leave the fisheries because of their inability to buy the quotas. They would have lost in just one day, at the stroke of a pen, all their investment in boats, fishing gear and fishing skills. They would therefore indeed have had a strong incentive to oppose this change—generating great conflict. The only agent that would have been better off by the change would have been government.

The difference between the two alternatives can be put differently. A social change is said to be Pareto-improving if all or at least some benefit by it, while nobody is worse off (Buchanan 1959). Initial allocation on the basis of catch history is Pareto-improving in this sense. Initially, the boats receive the right to harvest the same amount as they had previously. Then some buy new quotas, while others sell theirs and leave the fishery, quite content with their money. But initial allocation by a government auction is not Pareto-improving. Government is much better off. Those remaining in the fishery are no better and no worse off. Those who suddenly have to leave the fishery because of their inability to pay for the quotas are much worse off. They are suddenly being deprived of their livelihood. These considerations may explain why Icelandic politicians chose allocation by catch history (sometimes called grandfathering) rather than by government auction. It was not because they knew anything about Pareto optimality, but because they did not want to lose votes.

Now, in 2017, catch quotas have been in place for 42 years in the herring fishery and for 33 years in the much more important demersal fisheries, such as cod. Most of the quotas held by individual fishing firms have been bought at market prices. Nevertheless, Professor Olafsson, economics professor Thorvaldur Gylfason (2000), and some other intellectuals still think it is feasible for government to seize the quotas from the fishing firms and to auction them off. The present writer has however not been the only university professor defending the ITQ system. Professor Ragnar Arnason has for decades been a forceful advocate of the system. Originally a socialist, he changed his view when he studied resource economics, obtaining a doctorate from the University of British Columbia in fisheries economics in 1984 and becoming professor in fisheries economics at the University of Iceland. Even if the ITQ system was mainly developed by stakeholders, cooperating with government agencies in a process of trial and error, Arnason made an important contribution to its development as an adviser to various government bodies, encouraging transferability, and also by publishing several scholarly works on the issue (1990; 2008; Neher et al. 1989; Arnason and Gissurason 1999; Arnason and Runolfsson 2008).

In debating the ITQ system, Professor Arnason identifies three fallacies in the argumentation of those who want now to seize the quotas from the fishing firms. First, it is not correct that the fisheries' profit (or resource rent) is derived from the resource alone and is not created in any way by the fishing firms. If it

were true, why then was the income from the fisheries not much higher in the past when much more was harvested from much bigger stocks? In the second place, it is not correct that the quota holders are the only ones to benefit from the system of exclusive rights. In the end, everybody benefits when a sector of the economy becomes profitable. The fishing firms pay taxes and employ people, and since they export most of their products they keep the exchange rate for the krona higher than it otherwise would be. Their owners use their profits for consumption or investment. Thirdly, it is not correct that a resource tax, imposed directly or indirectly on the fisheries, would not reduce the total fisheries profit. It would reduce the international and domestic competitiveness of the Icelandic fisheries, discourage research and development in the fisheries, and weaken the incentives the fishermen have to try and maximise the long-term profitability of the resource, for example by a cautious setting of the total allowable catch (Arnason 2012; 2013; 2016). Moreover, by creating a new source of income for the politicians, political rent-seeking would be encouraged (Runolfsson 1999).

Three of Arnason's colleagues at the Faculty of Economics at the University of Iceland have also publicly defended economic liberty, including the ITQ system. Professor Thrainn Eggertsson (b. 1942) is internationally known for his contributions to institutional economics, which he has applied to several Icelandic subjects (Eggertsson 1990; 1992; 1996; 1998). Professor Birgir Thor Runolfsson (b. 1962) wrote his doctoral thesis under Buchanan and Tullock on the Icelandic Commonwealth and has published papers on that subject as well as on the fisheries (Runolfsson 1993; 1999). Professor Asgeir Jonsson (b. 1970) mainly writes on finance (Jonsson 2009; Jonsson and Sigurgeirsson 2016), but he has also explored Icelandic economic history in the spirit of Sigurdsson. Two other well-known economists have often publicly supported liberal ideas, Dr. Vilhjálmur Egilsson (b. 1952), as Director of the Icelandic Chamber of Commerce, and Dr. Tryggvi Th. Herbertsson (b. 1963), as Director of the Institute of Economic Studies at the University of Iceland. Both Egilsson and Herbertsson were for a while members of parliament for the Independence Party.

## Concluding remarks

The ITQ system is an important part of the story of liberalism in Iceland because the fisheries are such a large part of the Icelandic economy. Whether the creation of the ITQ system is credited to liberal individuals or to a small, relatively cohesive society simply groping its way to an efficient arrangement—which seems much more plausible—it represents a major success for liberalism in Iceland. Building upon this achievement, the governments led by Oddsson between 1991 and

2004—when I was his informal adviser—embarked upon a comprehensive programme of privatisations and tax cuts, while abolishing special investment funds, ceasing to subsidise loss-making enterprises, reducing inflation to the same level as in the neighbouring countries, strengthening the occupational pension funds, and practically eliminating the public debt. When Iceland in 2004 celebrated 100 years of home rule, the country seemed, like New Zealand or Thatcher’s Great Britain, to be a poster child for economic liberalism. But this abruptly changed with the 2008 bank collapse, about whose nature and causes an influential anti-liberal narrative has been constructed, not least by Icelandic left-wing intellectuals such as Stefan Olafsson and Thorvaldur Gylfason. Indeed, for some Iceland has even become the poster child of ‘neoliberal’ folly (Chang 2010; Peck 2010; Hine and Ashman 2010; Wade and Sigurgeirsdottir 2010; Loo 2011; Pálsson and Durrenberger 2016). One of the prominent foreigners who accept the anti-liberal narrative is Nobel laureate Paul Krugman, who wrote regarding Iceland that an “economy that produced a decent standard of living for its people was in effect hijacked by a combination of free-market ideology and crony capitalism” (2010). The anti-liberal narrative on Iceland in the years 1991–2017 merits a detailed discussion which will be provided in a second article.

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