

Small states in international health crises: Iceland's response to the global COVID-19 pandemic

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Abstract: This paper analyses Iceland's macroeconomic policy responses to the COVID-19 pandemic during the first phase of virus contagion in Western Europe (January-June 2020). The country's smallness, as evidenced by trade openness and economic specialisation, provided for acute crises in Reykjavík's fight against the virus as a lack of local manufacturing forced the government to procure medical supplies, equipment, and pharmaceuticals from a crowded and competitive international market. The country's reliance on tourism resulted in massive economic loss as North Atlantic economies implemented travel restrictions and closed national borders. However, the Icelandic government's massive welfare and economic rescue packages kept the national economy afloat, earning praise from world markets. The intervention of the Icelandic Central Bank into currency markets, in particular, proved sufficient in stabilising the value of the national currency. Reykjavík's skilful macroeconomic governance during spring and summer 2020 allowed the government to access revenue independent of taxation. This paper finds that although Iceland was disadvantaged by its size during critical phases of virus spread, the country's smallness and control of an independent national currency enabled a robust macroeconomic response to stabilise wages and the national economy, mitigating the impact of the concurrent global recession.

Keywords: Iceland, macroeconomic policy, trade openness, tourism

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Introduction

Pandemics comprise a type of international security crisis that often prompt further economic and financial crisis dynamics as populations around the world close businesses, consumer markets, and international borders in order to stymie virus spread. Although there is a rich scholarship on small state responses to international security crises including armed conflicts (Jesse & Dreyer, 2016; Kacowicz, 1998), international recessions (Verdun, 2012; Hilmarsson, 2014), security crises prompted by strategic rivalries (Thompson & Dreyer, 2012), and global financial crises (Jónsson, 2009; Boyes, 2009), we know less about how small states cope with “soft” crises such as regional or global pandemics, environmental disasters and humanitarian crises (Thorhallsson, 2018).

This paper seeks to contribute to the growing literature on small state responses to ‘soft’ security crises by examining the macroeconomic policies of Iceland during the first phases of the COVID-19 pandemic. It argues that Iceland's smallness, as expressed through economic openness and economic specialization, provided for a number of critical obstacles to engaging in effective virus mitigation. For Iceland, economic specialisation translated into a lack of domestic manufacturing and production of medical supplies and equipment, which forced Reykjavík to compete with larger, wealthier states in international markets for personal

protective equipment (PPE) and pharmaceuticals. Iceland's reliance on tourism exposed the country to massive economic shocks and the country's smallness prohibited the Katrín Jakobsdóttir government from persuading the European Union and the United States to keep international travel open, adding further pressure to the crumbling tourist economy. However, the Icelandic government was successful in drafting and implementing large social welfare and economic rescue packages which effectively kept the national economy afloat. The Central Bank of Iceland skilfully intervened in international currency markets to maintain the value of the Icelandic national currency, the króna.

This paper is divided into four parts. Part I provides an overview of the trajectory of virus contagion in Iceland during the first phase of the pandemic (January-June 2020). Part II offers an overview of the theoretical literature on small state behaviour in international affairs, paying close attention to the kinds of economic responses we might expect from a small state to international health and economic crises. This section considers three key literatures: (1) small state economic specialisation; (2) small state openness and international trade exposure; and (3) the macroeconomic policies of small states, including monetary and exchange rate policies. The goal of this section is to parse out explicit expectations for small state behaviour during a pandemic. Part III then examines the degree to which Iceland fits the theoretical expectations provided by scholars of international relations and small state studies as outlined in the literature review. Part IV offers concluding remarks.

The first wave of virus contagion in Iceland

Iceland reported its first confirmed case of COVID-19 in late February 2020 (Hilmarsdóttir, 2020). An immediate investigation led by the Icelandic Directorate of Health (Embætti Landlæknis) ensued into the patient's movements from Northern Italy to the Infectious Disease Department at the National University Hospital (Landspítali) in Reykjavík. After the identification of this initial infection, the case count across the island began to rise. These earliest cases were among individuals who had recently travelled to Central or Southern Europe; by 2 March, the Icelandic government had placed 300 individuals under home quarantine orders (Gunnarsson, 2020). Widely circulated reports suggested that many of the quarantined individuals were venturing out of their homes, increasing the likelihood for community spread (Gunnarsson, 2020). Within a matter of days, the case count spiked as COVID-19 infections in the country reached a total of 40, with an additional 400 individuals ordered to sequester at home under government-enforced quarantine orders (Jónsson, 2020). By this time, daily press briefings were held by leaders and ministers in the Icelandic national government (Ríkisstjórn Íslands) including the head of the Directorate of Health, Alma Möller, Chief Epidemiologist at the Directorate of Health Þórólfur Guðnasson, Minister of Health (Heilbrigðisráðuneytið) Svandís Svavarsdóttir, leaders of government security services and local police, in addition to Prime Minister Jakobsdóttir (Grettisson, 2020).

By midweek the following week, the Icelandic national government began to mount a more concerted response to halt virus spread. First, the government worked with local airlines and foreign governments to secure travel for Icelanders living, studying or working abroad, especially for those in Europe, the emergent epicentre of the COVID-19 pandemic at that time (Ragnarsdóttir, 2020). Second, the Directorate of Health, in conjunction with the Prime Minister's Office (Forsætisráðuneytið), announced plans to begin the widespread screening of the population for the virus through a program designed and implemented by deCODE Genetics (Íslensk efðargreining), a Reykjavík-based medical research laboratory (Fontaine, 2020). Third, on 10 March, in a joint press briefing, Jakobsdóttir and Minister of Finance and

Economic Affairs (Fjármála- og efnahagsráðuneytið) Bjarni Benediktsson announced plans to engage in massive government intervention into the national economy to mitigate the negative economic repercussions of business closures, mandatory quarantine measures, wage loss, and the sudden and dramatic collapse in tourism upon which much of the Icelandic workforce depended (Guðmundsson, 2020). This would be the first of two major economic relief packages implemented in spring and summer 2020. By the end of March, the Icelandic national parliament had suspended debate and dialogue over all issues not related to the global COVID-19 pandemic (Sigurðsson, 2020).

Throughout spring 2020, the number of infected men and women continued to rise across the country as well as the total number of individuals under mandatory quarantine orders. The first phase of the pandemic peaked in Iceland in early April 2020 as infection rates followed a downward trend after 2 April (Reuters, 2020). The Icelandic national government faced challenges in sourcing medical equipment and personal protective equipment (PPE) and acquiring drugs and other medicines from international markets. The Jakobsdóttir government faced significant battles, both with the Trump administration and the European Commission as both the United States and European Union largely ignored the Icelandic government's petition to keep international borders open. By early June 2020, with the help of the deCODE Genetics virus screening program and other efforts from the National University Hospital and Ministry of Health, the government reopened national borders to tourist entries after lifting the State of Emergency on 25 May 2020 (Ingavarsdóttir, 2020). By October 2020 (the time of this writing), there had been 3,757 cases (<0.01% of the population) of COVID-19 in Iceland as the country moved into the fall wave of the virus, yet the death rate in the country remained substantially below that of other European nations (<0.00003%) (Reuters, 2020).

Table 1: COVID-19 Infections in Iceland (May 2020).

Region	Infections
Höfuðborgarsvæði	1,314
Suðurnes	77
Suðurland	178
Austurland	8
Norðurland eystra	46
Norðurland vestra	35
Vestfirðir	97
Vesturland	43

Source: COVID-19 á Íslandi Tölfræði.

Efforts of the national government to control or contain virus spread were helped by the relatively limited geographic scope of the virus across the country. The capital city region (Höfuðborgarsvæði), comprised of the major population centres of Reykjavík, Kópavogur, Hafnarfjörður, Garðabær, and Mosfellsbær, remained the hardest hit, followed by the densely populated Suðurnes/Reykjanes Peninsula region and the relatively isolated and less populated West Fjords region (Vestfirðir). The rest of the country experienced much lower rates of COVID-19 infections and community spread including Iceland's northernmost urban area of Akureyri in the Northwest region of the country (Norðurland vestra). The particular geographic pattern of virus spread (see [Table 1](#)) allowed the national government greater freedom in the

mobilisation of services and resources given that virus spread was more geographically limited to three of the eight regions. The regions most impacted by the virus are among the most heavily populated; these wealthier, resource rich regions (Höfuðborgarsvæði, Suðurnes, Suðurland) have a more developed public health infrastructure when compared to the less populated or more rural regions of the Northwest (Norðurland vestra), Northeast (Norðurland eystra), and East (Austurland).

Literature review

Economic specialisation and trade openness

In the North Atlantic region, small states often carve out niches in the international economy and create and maintain prosperity and stability through trade openness and strong macroeconomic governance (Thorhallsson, 2017). Small states tend to structure national economies around the production of a small handful of highly valued goods and opt for the production of goods that generate high profits in international markets, yet remain sufficiently labour intensive as to maintain high levels of employment (Thorhallsson, 2007). The key to small state prosperity is the ability to access foreign markets and small states often lead international efforts to promote trade and political liberalisation (Ingebritsen, 2006). Because only a small handful of goods or services dominate the national economy, the political and economic systems of many small, European states are typically marked by high levels of corporatism (Katzenstein, 1985; 2003).

In corporatist economies, economic specialisation and trade openness go hand in hand with corporatist political and economic decision-making structures (Katzenstein, 1985; 2003). Corporatism is a term used to describe power-sharing agreements or arrangements between labour, industry, and government in democratic countries (Thorhallsson, 2007). Under such arrangements, government often serves as an independent mediator between labour and industry: labour and industry work together to establish wages, working conditions, access to specialised training programs, and to determine production levels; government supplies welfare state goods and services including healthcare, wage replacement programs, child care programs, and a tailored national educational/vocational training system (Thelen, 2013; Mares, 2013; Estevez-Abe, Iversen & Soskice, 2013).

Although corporatist structures are characteristic of many small states in Europe, corporatism is not the only path to economic openness, as the case of Iceland illustrates. Rather, 'sectoral corporatism' can produce similarly high levels of economic or trade openness without incorporating deeper levels of consensus decision-making into national economic governance (i.e., 'societal corporatism') (Thorhallsson, 2010; Thorhallsson & Kattel, 2012). Iceland stands out from its Central and Northern European counterparts on this measure. Post-war Icelandic political history is one dominated by conservative and agrarian political parties which formed close alliances with key economic sectors such as metal production, farming, and fishing. Iceland's political history constitutes a marked departure from that of other small states such as Austria, Denmark, Norway, and Sweden, that is from political systems which remain heavily conditioned by Social Democracy (Thorhallsson, 2010). Thus, trade openness in Iceland is the by-product of the sectoral favouritism of the conservative Icelandic Independence Party (Sjálfstæðisflokkurinn) and the more right-wing populist Icelandic Progressive Party (Framsóknarflokkurinn) rather than the result of power sharing agreements between labour organisations and the national government (Thorhallsson & Kattel, 2012).

Although trade openness and economic specialisation produce high levels of economic growth for many small states, this economic orientation offers both promises and pitfalls for coping with the health and economic crises produced by a pandemic. On the one hand, the tightly-knit relationships between government and industry allow for higher levels of policy manoeuvrability and some degree of flexibility (Campbell & Hall, 2009). For instance, a government can increase social welfare spending to cope with a decline in production by offering social transfers to employees suffering from a reduction in hours whereas labour and industry can agree to temporary wage freezes. Such moves allow for industry and manufacturing to remain afloat for a longer duration, creating a higher level of resiliency in weathering an economic storm. On the other hand, however, trade openness and economic specialisation can prove to be perilous. If a global pandemic is severe enough to impact international trade, a small state may experience difficulty in acquiring essential goods not manufactured at home. Iceland may prove to be more vulnerable to these dynamics given that country's particular export-oriented economy which has made the import of raw materials more expensive thus limiting the growth of domestic manufacturing (Thorhallsson, 2010; Thorhallsson & Kattel, 2012).

A downturn in global trade flows will produce difficulties for small state manufacturers or firms dependent upon foreign markets (Katzenstein, 1985). Specialisation in only a small number of goods or commodities may spell trouble for a small state during a pandemic if medical supplies, medical equipment, drugs or pharmaceuticals and personal protective equipment (PPE) are not among those specialised goods produced in the national economy. A lack of local medical supply production combined with a tightening of international trade provides for obstacles in virus mitigation or containment. If an international pandemic produces a short- or long-term contraction in the national economy, (semi-)corporatist dynamics may prevent the kinds of internal labour mobility or flexibility necessary to redirect economic activity toward other sectors. In corporatist arrangements, the national labour force is highly inflexible and such industrial relations provides for disincentives for men and women to switch industries as the (semi-)corporatist structure encourages firms to retain employees for as many years as possible (Hall & Soskice, 2001).

A final theoretical observation on the economic challenges facing small states during a pandemic centres on state economic planning which corresponds, in large part, to the level of control a small state has over its own macroeconomic policies. Small states are restricted in terms of public administration and the provision of welfare goods given the smallness of the national tax base. This provides for challenges in increasing state spending without relying on printing money, engaging in deficit spending, increasing the money supply, or borrowing from foreign countries. For this reason, we find that many small states have high national debt-to-GDP ratios, a trend exacerbated by large trade deficits and small state tendencies toward "big" government (OECD, 2019; Jahan & Wang, 2013). Small states also differ from large states with regard to monetary policy. Although all open economies remain exposed to balance of payments-related problems, small states tend to be more exposed to tumult in the global economy, more prone to vulnerability to external shocks, and more reliant on monetary policy to promote the price stability necessary to maintain economic activity (Jayaramann, Boodhoo & Tari, 2015). Because fiscal policy has monetary policy consequences – government deficit financing through public borrowing results in upward pressure on market interest rates – small state governments coordinate extensively with a national central bank to harmonise policy (Jayaramann, Boodhoo & Tari, 2015).

Small state exchange rate policies also differ from those of large states inasmuch as exchange rate policies are developed relative to both geopolitical considerations (Guðmundsson, 1999) and small state economic needs (Birchwood & Goto, 2011). Small states are more likely to use fixed exchange rate systems by which the national currency is set to the value of a major global reserve currency and we find that many small states do not use a nationally-produced currency at all. Of the 50 small states identified by the World Bank in 2018, 22 of these (or 48%) either use the currency of a regional power or the currency of a regional bloc. For many small states, maintaining a national currency is either too expensive or impractical given that many small states are recently independent former colonies and are yet to fully develop national financial and banking sectors. Twenty-eight of the 50 small states (52%) identified in 2018 by the World Bank maintain a national currency. This means then that the majority of small states in the international system are responsible for managing independent exchange rate policies.

Most of the 28 small states which make use of an independent national currency rely on fixed exchange rate systems of various designs. According to data gathered by the IMF, most small states (69%) opt for an intermediate form of fixed exchange rates or what we might call a “soft peg” as opposed to a “hard peg” (31%) in which there is no bilateral agreement achieved through a currency board (IMF, 2013). Small states use fixed exchange rates to achieve and maintain price stability, to exercise more control over foreign currency reserves, and to allow space and manoeuvrability to engage in exchange rate adjustments (IMF, 2013). On the one hand, the macroeconomic policies described above – fiscal, monetary and exchange rate policies – pursued by small states often prove effective in producing domestic economic stability. Maintaining control over a national currency through a national central bank is advantageous in times of crisis as governments are able to use financial instruments to increase government revenue independent of taxation; a government of a small state can manipulate the value of the national currency for ostensibly political ends by removing the national currency from its “peg” and allowing it to float on international markets. A small state can also intervene in currency markets to prop up the value of a national currency or sell sovereign bonds to increase short-term state revenue. On the other hand, however, using monetary tools in a time of crisis also poses substantial risk for inflation or currency devaluation on international markets. Monetary and exchange rate tools used by small states to mitigate crises must be wielded in such a way as not to provoke a future currency crisis or a foreign currency reserve crisis. In the case of Iceland, as I will show, control over a national currency, the Icelandic króna, allowed the government to use monetary and exchange rate policy to bolster domestic economic stability during the pandemic. However, this resulted in inflationary pressures on the króna, raising the prospects of compounding economic and currency value issues in the medium- and long-terms (Icelandic Chamber of Commerce, 2020).

Analysis

Impact of specialisation and trade openness on the Icelandic economy during the pandemic

The economic specialisation of small states often focuses on the production of highly valued goods or services (Katzenstein, 1985). Small states carve out trade and production niches in the global economy, attempting to capture markets for expensive and labour-intensive trade items. Trade openness allows for business opportunities at home and abroad. Looking to the case of Iceland, we find the patterns of trade openness associated with small states, with the caveat that such openness is not necessarily the by-product of corporatist structures (Thorhallsson & Kattel, 2012). According to data published by the OECD in 2020, imports of

goods and services to Iceland accounted for 44% of total GDP whereas exports from the country accounted for nearly 55% of GDP in 2018 (OECD, 2020). According to data published by the United States Department of Commerce in 2017, 42% of total Icelandic exports in goods and services originated from the tourism sector whereas marine and aluminium products accounted for an additional 34% of total exports. Trade accounts for over 90% of total Icelandic GDP (World Bank, 2018). The bulk of Icelandic exports are sent to markets across North America and Europe. Although the United States is Iceland's largest single country trading partner, the member states of the European Union collectively account for about 72% of total exports and 67% of all imports to the island country (Department of Commerce, 2019).

Iceland's trade openness and exposure to the global economy, otherwise counted among the nation's strengths (Central Bank of Iceland, 2016), became an economic handicap for the country as the onset of the COVID-19 crisis in Europe and North America prompted a drastic decline in the trade of goods and services and brought the Icelandic tourism sector to a standstill. Internationally, the economic fallout from the spread of the virus resulted in a nearly 10% decrease in international trade, an economic decline on par with the 2008-2009 financial crisis (World Trade Organisation, 2020). In Europe, the total value of exports to third parties outside the EEA market fell by 24 billion €, from 228 € in January 2020 to 252 billion € by March 2020 (Eurostat, 2020). The blow to Iceland was severe and sudden, as the Icelandic economy contracted by eight per cent GDP only weeks into the pandemic (Central Bank of Iceland, 2020).

In the initial weeks of virus spread in the North Atlantic, governments began to discourage citizens from international travel. As the spread of the virus marched on, leaders began to strategise how best to defend public health and plans for border closures and travel restrictions materialised in North America and Europe. In March, the Trump administration halted foreign travel between the United States and Europe, initiating a period of international travel chaos as thousands of American students, workers, and tourists across EEA states attempted to fly home before the travel ban on entries from Schengen Area countries went into effect (White House, 2020). Shortly before the 21 March agreement between Washington and Ottawa to close the United States-Canada border (Department of Homeland Security, 2020), the European Union announced a 30-day travel ban on entry on third party nationals from non-Schengen Area countries to the EEA (Jónsson, 2020), prompted, in part, by developments in North America.

Already suffering from the economic impact of a drastic decline in the number of foreign visitors during the first weeks of March, the bans on trans-Atlantic and international travel issued by the U.S. and the EU dealt a further blow to Iceland's tourism-based economy. As noted above, tourism accounts for over 40% of total Icelandic GDP and, along with aluminium production and marine product exports, forms the backbone of the Icelandic national economy. Iceland was listed specifically among those countries under the American travel ban, prompting Jakobsdóttir to request a phone call with U.S. President Donald Trump within hours of the White House statement to voice objections and request an exemption for Iceland (Kolbeinsson, 2020). From the perspective of the Icelandic national government, Iceland should have been exempted from the American travel ban given that the island is more geographically proximate to North America than to Europe (Kolbeinsson, 2020). Foreign Minister (Utanríkisráðuneytið) Guðlaugur Þór Þórðarson and Justice Minister (Dómsmálaráðuneytið) Áslaug Arna Sigurbjörnsdóttir voiced similar objections to the proposed Schengen Area travel ban initiated by the European Commission (Jónsson, 2020).

The rebukes of American and European policy by the Icelandic national government reflected the view of officials at the Directorate of Health, the Prime Minister's Office, and the Foreign Ministry that travel bans are ineffective at preventing virus spread. From the perspective of Icelandic officials, testing, contact tracing, masking, and quarantine efforts proved to be more effective at containing virus spread than bans on international travel (Jónsson, 2020). Speaking to journalists, Foreign Minister Guðlaugur Þór Þórðarson stated that the EU travel ban was, in particular, “not based on the best possible health information” (“*þetta er ekki byggt á bestu mögulegu heilbrigðisupplýsingum*”) (Jónsson, 2020). Icelandic officials also argued that the country should be exempt from the European and American travel restrictions because the virus appeared to be spreading at a much slower rate in Iceland when compared to other European countries. Yet, the diplomatic push back against travel restrictions was also aimed at preventing further losses to the Icelandic tourist economy. A decline in tourism translated into a decline in revenues and profits for private businesses in the tourism industry. Fewer incoming tourists also impacted wages and earnings given that 10-15% (or about 20,000-33,000 individuals out of a total workforce of about 200,000) of the workforce in the country was employed in the tourism sector of the national economy at that time. A decline in tourism also translated into a decline in tax revenues and a concurrent decline in foreign currency reserves.

By the afternoon of 26 March, the first day of registration, the Icelandic Ministry of Social Affairs (Félagsmálaráðuneytið) had received 9,670 applications for reduced rate of employment benefits (Icelandic Ministry of Social Affairs, 2020). By that time, 48 companies had reduced working hours for at least 20 employees and three companies had reduced working hours for at least 100 employees. Nearly 50% of the companies engaged in working hours reductions catered directly to international tourism. The decline in tourism also devastated the Icelandic air travel industry led by Iceland-based carrier Icelandair. Within weeks of the onset of the pandemic, stocks in Icelandair dropped by 23%, prompting the company to fire hundreds of workers. Within a month, by 29 April, Icelandair would begin the most massive layoff program in the company's history, letting go of 95% of its total workforce (Harðarson, 2020), prompting discussions among members of the Social Democratic Alliance (Samfylkingin jafnaðarmannaflokkur Íslands) in the national parliament (Alþingið) to consider nationalising the airline carrier (Halldórsson, 2020). In sum, the pandemic provided for a massive blow to a central pillar of the Icelandic national economy.

Small state economic specialisation also leads to fewer companies in small state economies and a less diversified national economic base which results in pressure to procure many consumer and manufactured goods from overseas (McIntyre, et al., 2018). Given that Iceland is home to a major international commercial airline company, the Foreign Ministry and Directorate of Health coordinated plans to use Icelandic commercial aircraft to ship supplies directly from China that spring (Ministry of Foreign Affairs, 2020). The national government brokered deals with pharmaceutical companies in developing countries for the acquisition of medicines as well. Toward the end of March, for instance, the Icelandic pharmaceutical company Alvogen purchased 50,000 packages of hydrochloroquine from producers in India. Although the managing director of Alvogen, Guðrún Ýr Gunnarsdóttir, cited difficulties in obtaining various drugs given heightened global competition over medical supplies, the company was able to work with the Icelandic Foreign Ministry, the Indian Embassy in Iceland, and the Icelandic Ambassador to New Delhi to secure both purchase and shipment of the drug (Bjarnasson, 2020). The Icelandic government also partnered with its core allies in Europe for the acquisition of medical supplies. Although both the European Union and the European Free Trade Area issued export bans on a range of medical supplies to third parties including face masks and respirators, neither the EU nor the EFTA excluded the other in the ban, allowing

countries within both organisations to purchase medical goods and supplies across Europe, independent of organisational membership (European Commission, 2020). The Icelandic government planned to coordinate further with other European nations, looking to Stockholm, in particular, to lead a partnership to procure any future COVID-19 vaccine (Olsson, 2020).

Nonetheless, the reliance of the Icelandic national government on foreign suppliers is also the by-product of market specialisation and those dynamics seen among small states which trend toward an economic focus on comparative advantage. As an advanced industrialised society, the Icelandic economy is home to some medical supply producers and companies, many of which participated in virus testing or mitigation operations. For instance, during the onset of the pandemic, the Iceland-based medical supply company Össur, contracted by the national government, supplied 20,000 nasal swabs to be used for COVID-19 testing operations (Markúsdóttir, 2020). However, local manufacturers were largely unable to produce the bulk of medical equipment, pharmaceuticals, and personal protective equipment necessary to maintain a robust virus containment strategy. It is true that much larger economies also struggled to procure the supplies necessary to provide the population with adequate access to face masks, hand sanitiser, soap, or other forms of personal protective equipment. During March and April, the United States federal government led efforts to airlift supplies from China to hard-hit areas of virus spread in California and New York (Holland, 2020). Large European countries also engaged in similar actions, chartering planes to fly to manufacturing centres in China in order to obtain critical supplies, including face masks (Flemming et al., 2020). However, large economies were able to take advantage of national economic diversification in ways small states like Iceland could not: Brussels, Ottawa, and Washington DC called for a ramping up of medical supply production by medical supply companies and encouraged other sectors of the economy to convert manufacturing operations to the production of medical supplies (see, for instance, U.S. Chamber of Commerce, 2020).

Icelandic macroeconomic governance and Central Bank interventions during the pandemic

The national government sought to stabilise certain sectors of the economy through financial, economic, and exchange rate policies. Foreign governments and international financial markets praised the government's economic response to the crises, even if overall levels of national economic growth severely contracted in the first half of 2020. In order to mitigate the negative social, financial, and economic impact of the international health crisis, the national government drafted and implemented multiple economic relief packages. The first of these, announced in mid-March by Jakobsdóttir and Benediktsson (Guðmundsson, 2020), constituted a type of stop-gap program aimed at mitigating the most immediate financial and economic hardships caused by the pandemic at a total cost of Icelandic króna (ISK) 230 billion (1.3 billion €) or about 8% of total Icelandic GDP (Icelandic Ministry of Finance and Economic Affairs, 2020). The March package contained a mix of direct social transfers to individuals and macroeconomic measures focused on increasing corporate access to capital, decreasing tax rates, providing public investment in infrastructure, and keeping the tourism sector afloat. Social transfers and welfare payments remained centred on wages, child care, and access to pensions. Through the new legislation, Icelandic workers were effectively guaranteed up to 75% of unemployment benefits (Icelandic Ministry of Finance and Economic Affairs, 2020).

The government also allowed for the withdrawal of a monthly sum from voluntary pensions savings to a maximum of ISK 800,000 (5,000 €) in addition to reimbursing for value-added tax (VAT) in certain sectors such as construction, maintenance, and charities. The Ministry of Finance and Economic Affairs also provided a one-off child benefit payment to be

disbursed on 1 June 2020 to all families with children under the age of 18. The new program stipulated that parents with an average monthly income below ISK 925,000 (6,100 €) in 2019 are to receive ISK 40,000 (260 €) per child and those families with a higher average monthly income are to receive ISK 20,000 (130 €) per child. In total, the package provided ISK 3 billion (18 million €) for child benefits payments; ISK 3 billion (18 million €) for the tourism sector; ISK 50 million (300,000 €) to promote innovation in climate science; an additional ISK 1.4 billion (8.5 million €) to the Infrastructure Development Fund; ISK 350 million (2 million €) to hospitals in Akureyri and Reykjavík; ISK 400 million (2.4 million €) directed toward national COVID-19 testing programs; ISK 140 million (850,000 €) to fight homelessness and promote mental health; along with an authorisation for the national treasury to borrow an additional ISK 95 million (600,000 €) from foreign countries through the selling of sovereign bonds (Askham, 2020).

Macroeconomic policymaking at this time focused on taxation, liquidity, access to loans, and exchange rate policy. The national government, in conjunction with the Central Bank of Iceland (Seðlabanki Íslands), postponed corporate and business taxes for 12 months and abolished hotel taxes until 2021. The program stipulated increased access to government-backed loans for Icelandic corporations in addition to reductions in bank taxes with the goal of helping corporations and businesses to keep workers on the payroll. Demand-side spending also included proposed partnerships with municipal governments for investment in infrastructure development projects including transportation, public construction projects, and technology-related infrastructure. The goal here would be to use infrastructure projects as a means to bolster employment and create high wage jobs. Prior to the formulation of this first financial rescue package, Governor of the Central Bank of Iceland Ásgeir Jónsson reported that the national currency had lost 10% of its value on international markets since the onset of the crisis and pledged to reduce interest rates (Halldórsson, 2020). The deterioration in the value of the króna prompted a number of interventions into foreign currency markets by the Central Bank beginning on 2 March when it purchased ISK 430 million (2.5 million €) in foreign currency to bolster the króna's value (Icelandic Ministry for Finance and Economic Affairs, 2020).

Despite the investments made by government in social spending and despite the efforts of financial institutions including the Central Bank to increase loans and liquidity, the Icelandic economy continued to deteriorate through much of April 2020. According to data published by the Directorate of Labour (Vinnumálastofnun), unemployment in Iceland rose dramatically from 7.5-8% in March to 12-13% in April (Government of Iceland, 2020). By this time, the financial and economic crisis produced by the pandemic was now far worse than the economic and currency crisis in 2008 after the collapse of the Icelandic banking system (Jónsson, 2009; Boyes, 2009). After implementing the new program for wage recovery in the March financial relief package, the Directorate of Labour reported applications for unemployment insurance had reached 25,000; 50% of these were applications for reduced employment benefits from workers in the tourism sector. The further decline in national economic fortunes prompted the creation of additional financial and economic relief packages in the coming weeks.

The national government created an additional ancillary package in April 2020, constituted by a mix of welfare spending and social transfers in addition to macroeconomic interventions to alleviate pressures on corporations and the national currency in the amount of ISK 58 billion (350 million €) (Icelandic Ministry of Finance and Economic Affairs, 2020). Welfare spending included establishing funding for summer school terms and the creation of 3,000 summer jobs for students in Iceland, an effort to bolster youth employment and

reinvigorate economic growth as virus transmission appeared to be on a path toward decline by summer (Kjartansson, 2020). The government pledged continued financial support for low-income families with children. Macroeconomic policies pursued that this time fell in line with the spending and economic relief priorities established by the March package. The Jakobsdóttir government pledged to support corporations through fiscal policy, allowing companies to carry 2020 losses back to offset 2019 income taxes. Demand-side spending would also include packages to protect the national food supply by enhancing production and other investments in technology infrastructure development. During March and April, the Central Bank intervened in foreign currency markets 10 times total, purchasing over ISK 17 billion (104 million €) in foreign currency to shore up the value of króna (Ministry of Finance and Economic Affairs, 2020); over the course of 2020, the króna would weaken by 17% against the Euro (Rangeley-Wilson 2020). Toward the end of that same month, the government would announce extensions on the provisions of the March financial packages, guaranteeing income, in particular, and widening government responsibilities for securing wage replacement through direct transfers.

Conclusion

The behaviour of the Icelandic government during the first wave of the COVID-19 pandemic (January-June 2020) illustrates some of the weaknesses posed by state smallness in the development of successful virus containment and mitigation strategies. For instance, Iceland's economic openness, economic specialization, and high exposure to trends in the global economy, created a dynamic in which the Icelandic national economy did not itself produce the medical equipment, personal protective equipment, and pharmaceuticals necessary to combat the virus. This forced Reykjavík to compete with much larger and wealthier states in an increasingly crowded international market. The government's virus mitigation policy was also helped by the serendipitous strength of the island's genetics and genomics research infrastructure, housed at the University of Iceland and deCode Genetics. At the same time, however, Iceland's smallness was also an asset during the pandemic. Through the patterns of multilateral and bilateral cooperation and diplomacy characteristic of Reykjavík's post-WWII foreign policy, Iceland was able to acquire supplies, equipment, and medicines from its global partners, in Europe and beyond. The country's position in the economic architecture of the North Atlantic, combined with the Central Bank's control over an independent national currency, allowed the government to mitigate the negative consequences of its smallness during the global economic downturn through generous and expansive state spending.

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