

INTRODUCTORY REMARKS

Jobs, growth and globalisation

Ladies and gentlemen,

It is with great pleasure that I address this audience on behalf of EFTA. Indeed, we share a common history and more recently growing commercial and legal ties through the European Economic Area agreement; and in the case of Switzerland through bilateral treaties with the EU. In my remarks I would like to review similar approaches of the EFTA countries with regard to the issue of how to create more jobs and growth in a globalizing economy. I then discuss Iceland's experience with structural reforms similar to the Lisbon strategy of the EU countries.

EFTA now consists of four small, open and thriving economies that have certain features in common. The EFTA countries enjoy high levels of income, education, employment and welfare. Importantly, flexible arrangements in domestic markets have ensured that the EEA agreement has been a boon for Iceland, Lichtenstein and Norway. Switzerland is also working on introducing additional structural reforms to enhance its growth performance. Forward looking structural policies and well functioning labour markets combined with open markets are seen as the best policy response to the future challenges related to jobs, growth, globalization and sustainable development.

The trend GDP per capita of some EFTA countries has converged to the USA level. The gap in the GDP per capita performance can be broken down into labour-utilization and labour productivity gaps. Policy priorities in the EFTA countries aim to improve both productivity and labour-utilization. Policies to improve labour-utilisation aim to reduce work disincentives through the limitations of the duration of unemployment benefits and the lowering of benefit levels for those out of jobs for a long time; to provide extra resources for job-search assistance; consider reforms of pension and/or de facto early retirement schemes that will ultimately reduce financial disincentives to work at older ages and encourage labour participation of women. Performance is also encouraged through strengthening education systems. The result of such arrangements is high and growing labour-utilization and rising labour productivity.

In markets for goods and services, the EFTA countries have numerous policies and institutions in place aimed at improving productivity performance. Firms are encouraged to seek efficiency gains through either the adoption of technological or organizational best practices. Across the EFTA countries, barriers to entry in network industries and/or professional services are being reduced; burdens of regulation on business operations arising from price controls or administrative procedures are being eased; the extent of public ownership is being reduced and administrative burdens on business start-ups are being lowered.

Now allow me to turn to the experience in Iceland. Iceland has taken measured steps in the process of European integration. It joined EFTA in the early 1970s and the EEA agreement in 1994. These decisions were democratically arrived at, albeit after a lot of debate. The experience with the EEA agreement shows that it has been a watershed event in our further integration into European life as well as the global economy. This is all the more remarkable given the countries remote placement in Europe. A major reason for its success is that Icelandic businesses have enthusiastically embraced the idea of participating on the Single European market. The developments have occurred at a rapid pace and over two thirds of the publicly listed companies in Iceland now have the majority of their turn-over and profits in other EEA countries. This development, however, did not just occur because of the agreement. Since the early 1990s, a number of far-reaching structural reforms to the Icelandic economy have been introduced, prudent economic policies adopted and the countries participation in the global economy increased.

These efforts at market liberalization and international integration have shown impressive results. The annual growth rate of GDP has exceeded 4% on average in the past decade and the unemployment rate is currently below 2%. The reforms have also unleashed a lot of entrepreneurial dynamism. Some important changes have resulted from the EEA agreement but many important reforms have been enacted at our own initiative with the aim to increase competition and flexible adjustment in the economy. All of these changes have been accompanied by a change in the productive structure of the economy. There is a growing contribution from large-scale manufacturing, high-tech production, financial services and tourism. The reduced reliance on a dominant export sector, marine products, has also served to increase economic stability. Productivity growth in all sectors has increased and the inflation rate, which used to be high in international comparison, has fallen to international levels. In Iceland, a country with a rich natural endowment base in terms of fisheries and energy resources, the important thing was to have a clear shift away from the wasteful policies of the past into a more enlightened policy framework.

New institutional arrangements in the public sector have led to the separation of administrative functions and market-based activities. The liberalization of capital movements led to an overhaul of the regulatory framework in capital markets and was followed by the privatization of three state-owned banks, resulting in rapid growth in the financial services sector. The privatization of a state-owned telecommunications firm has also recently been finalized. The increased competition in these sectors has brought benefits to consumers in terms of better services and/or lower prices. The division of production and distribution in the electricity sector may be viewed as a precursor to privatization in that sector. In the health services sector there is a long-term tradition of public funding for health services through the social security system. Growing private sector activity in the secondary and tertiary education system has been financed with public funds but complemented by student fees. Recent private-public partnerships of new universities are seen to be increasing the supply of highly skilled labour.

In general, the labour market in Iceland has been liberal for a long time with limited need for further deregulation. Company start-ups are not burdened with red tape or restrictive hiring or firing regulations. Replacement rates in the flat rate unemployment benefit system are low. The labour market may therefore be

characterized as “easy in – easy out.” To increase the labour supply and pass on the gains from improving public finances, the state income tax rate on individuals is being reduced from 34,3% in 1993 to 21,25% in 2007, and by four percentage points in stages between 2005 and 2007. A so-called “high income surcharge,” which stood at 7% in 2003, is being reduced in stages and will be abolished in 2006. In other words, the personal income tax is a flat-rate system. Due to the EEA agreement, there has been growing inflow of foreign labour, which has contributed to reduce the risk of overheating of the economy in the current upswing

Other reforms have been enacted. The corporate income tax rate has been lowered in stages from 50% in 1989 to 18% in 2002, when also the tax on capital income and capital gain was set at 10%. The net-wealth tax is being abolished in 2005. In spite of the lower rates, revenues from corporate and capital income taxes have grown. A system of transferable fish quotas introduced in the early 1980s led to restructuring in the fisheries sector and an improvement in cost structures and profitability. The fisheries sector has shown enormous adaptability to variable fish stocks and market situations. The growth of activity in other sectors also attests to the increased private-sector dynamism of the Icelandic economy.

The adoption of increasingly prudent and well-structured economic policies has been conducive to stable and higher economic growth. A new monetary policy strategy of inflation targeting and floating exchange rates was adopted in 2001. This is seen to be enhancing the price stability and credibility of monetary policy. Fiscal policy has been counter-cyclical with surpluses achieved most years in the past decade. And along with privatization proceeds, the net debt of government has declined dramatically, and is among the lowest in Europe. Improved cost control in the central government has made fiscal policy more restrictive when it needed to be.

Based on reforms in the early 1970s, a three-pillar pension system has been established, with a basic public flat rate non-funded pension, private largely funded pension and individual pension funds. The private pensions have over time become fully funded and sustainable. Along with the sound position of public finances, population ageing is therefore not expected to be a problem for public finances in coming decades.

To sum up, I believe our experience shows that to successfully meet the challenges of globalization, a lot depends on the policies but also on the political framework. Political democracy, pluralism and the rule of law, coupled with the best that the market economy has to offer is the recipe for success. The countries of EFTA and the EU are fortunate to have peacefully developed all the necessary institutions for this. The rest is up to the policy makers and the public. Or as Alexis de Tocqueville phrased it over one and a half century ago, “...for democratic nations to be virtuous and prosperous, they require but to will it.”

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