Iceland's 2020 Goals
Compared to EU's 2020 Goals

by

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Summary

This paper surveys Iceland's challenges, in the short-term and more so the longer-term towards 2020, in the context of EU's 2020 reform program. We also approach the task from the framework of EU's Annual Growth Survey and the Joint Assessment Framework. Iceland is shown to share many of the EU2020 goals and some of the benchmarking indicators. Despite the present crisis Iceland is today ahead of some of the EU2020 social inclusion goals, especially as regards employment and poverty reduction. Still there are other goals where Iceland is lacking behind, the most decisive example being the high dropout rate of students from secondary education.

Iceland's main shorter-term challenges are primarily shaped by the spectacular financial collapse of October 2008 and the following deep economic recession. The recession seems now to have bottomed out and growth is expected this year and the following years. Altogether the GDP went down by about 10% and registered unemployment went up from 1-2% in 2004-7 to about 9% when it reached its highest level.

Iceland's 2020 reform program was developed partly as a part of the resurrection program of the government, aiming to mend what was felt to be wrong with the society prior to the financial crisis. The spectacular collapse of Iceland's financial system was perceived by many as a major failure of the governance, regulatory and surveillance system and the aim is thus to revitalize the society, to avoid repeating the errors of the past and to regain trust amongst the general public. Iceland's 2020 program was thus evolved in great cooperation with the main stakeholders and the general public in all major regions of the country had access formal to the process.

Iceland sets itself 20 benchmarking goals and indicators, 15 of which relate to social inclusion, education, innovation and sustainability, while 5 refer to economic and developmental issues. Some of the goals aim to correct what went off track, such as the increasing inequality of incomes during the years of the bubble economy and the growing unemployment level in the crisis.

There is good ground for a direct comparison of Iceland's goals and the EU 2020 targets, and in fact as is shown in table 2 of the report, Iceland has already reached eight of the eleven EU 2020 measuring targets. The two goals where Iceland is decisively lacking are, firstly Greenhouse gas emissions that are significantly higher in Iceland than on average in the EU countries and, secondly, Iceland has a significantly higher dropout rate from secondary schools than the EU average. On the employment, R&D and innovation, and poverty reduction and social inclusion goals Iceland does indeed have a very favourable position, already above the EU 2020 target. Despite Iceland's spectacular financial collapse and the deep economic recession in its wake the employment rate of about 80% in 2009 and 2010 (for 20-64 year aged individuals) is still the second highest in the West, following Switzerland.

A very important part of the short-term challenges has been the debt relief process for households. This has progressed stepwise during the crisis and seems now to have reached a sustainable level. With all implemented measures, outlined below, the debtors in difficulties are in effect offered to scale their debt situation to the state they were in before the crisis, i.e. to the early part of 2008. Those who overinvested in luxurious or oversized housing will not be helped to retain such assets that they cannot handle in their present situation. A modest family home is the reference for support measures. This is of course a major effort that has avoided massive personal bankruptcies and foreclosures of homes. Some families had already overreached their capacities by 2007 and nothing can save them from being relieved of their assets. Debt relief has emerged as a major issue of social inclusion and justice during the crisis.

Lastly we profile poverty rates by various social groups in Iceland in comparison to the EU27, including some indicators of inclusion in the labour market. As previously noted Iceland has a strong position on most of these issues, both in comparison to EU countries and to the EU 2020 goals.

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Part 1. Challenges: Short-term and Longer-term

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1. Shorter-term challenges in the context of EU's Annual Growth Survey

Iceland's main shorter-term challenges are primarily shaped by the spectacular financial collapse of October 2008 and the following deep economic recession. The recession seems now to have bottomed out and growth is expected this year and the following years, as can be seen from table 1. Altogether the GDP went down by about 10% and registered unemployment went up from 1-2% in 2004-7 to about 9% when it reached its highest level.[1]

The table indicates that private consumption will be increasing again from 2011 while collective consumption will continue on contraction course in 2011-2012 due to further expenditure cuts in the public sector, in order to balance the budget. Investments in the economy came drastically down during the recession but are expected to pick decisively up from 2011, and these will mainly be investments in industry. Overall national expenditures will thus increase from 2011 onwards after decisive cuts.

The IMF stand-by agreement defined the main features of the financial resurrection of the banking and monetary system along with mending the public finances, which collapsed with the extra cost of refinancing the banks (including the Central Bank which became literally bankrupt) and the general slowdown of economic activity following the crash. The government overall budget deficit topped at 13.5 in 2008 and was down to 6% in 2010 and is expected to go down to 3% in 2011 and even out in 2012. The IMF program has been very successful and it seems that the program will be finished by late 2011, as originally planned.

Table 1: Iceland's Economic fundamentals 2007 to 2010 and predictions 2011-2013

	Change from previous year (%)						
	2007	2008	2009	2010	2011	2012	2013
Private consumption	5.6	-7.9	-15.6	-0.2	2.7	3	3.2
Collective consumption	11.1	15.9	8.1	-3.2	-4.1	-2.8	0.4
Investments	-11.1	-19.7	-50.9	-4.9	15.8	16.6	8.5
National expenditures	-0.1	-8.5	-20.7	-2.1	2.9	3.8	3.5
GDP	6.0	1.0	-6.8	-3.1	2.3	2.9	2.7
Central government fiscal balance	5.4	-13.5	-10.0	-6	-3	0.1	2
Real disposable earnings	10.5	0.5	-17.7	-3.6	0.3	0.6	1.2
Unemployment rate (registered)	1.0	1.6	8.0	8.1	7.7	6.4	5.1
Inflation rate	5.0	12.4	12.0	5.4	2.8	2.7	2.5
General Gmt. net debt (yearly % GDP)	42.1	67.7	75.6	78.6	74.7	64.5	42.1

Source: Central Bank of Iceland, Monetary Bulletin, April 2011 and IMF 2011.

Real wages came down by about 10% during the recession and real disposable earnings were lowered more, in the region of 18-20% (including effects of tax rises and lower work volumes, such as reduced overtime and extra benefits). The earnings of higher income groups came significantly more down than those of median income earners, and lower income groups were partly sheltered against reductions. Thus the lowest decile of income earners got a reduction of

[1] Registered unemployment has generally been about 1 %-point higher than survey measures of unemployment during the crisis. The survey-based measure is the one comparable to the Eurostat labour market surveys.

some 7% while the overall average was closer to -15% in 2009 (Kristjánsson and Ólafsson 2010).

As the table shows the inflation rate also came down to just over 5% in 201, after having topped at 12.4% in 2008 and increased again by 12% in 2009. So the shift seems firmly to be taking place from late 2010 and 2011. But the challenges remain. We will primarily focus on challenges that relate to issues of social inclusion, but we will outline the short-term challenges with a prime reference to the EU Annual Growth Survey's (AGS) 10 key priority actions for reforms. Thus we survey these challenges and how they are being dealt with and with what success so far.

As with most EU countries setting the public budget on a sound footing has been the preeminent policy goal and it was in fact the key ingredient of the IMF stand-by agreement between the government and the IMF and other collaborating nations (the Nordic countries also provided loans in addition to the IMF package, on the same conditions as the IMF loans). Secondly dealing with the greatly increased unemployment has been the second largest challenge and the debt problems of households have also been a major challenge for government, especially since the largest part of the banking system collapsed.

Before surveying the AGS 10 key priority actions and show how they have played out in Iceland's case, we start by giving an overview of Iceland's 2020 reform plan, which was recently accepted by the government. While Iceland's plan was worked out in the last two years with detailed consultations with major stakeholders in all main regions of the country it has great similarities to the EU 2020 framework plan.

1.1 **Longer-term Challenges:** Iceland's 2020 reform program overview

In January 2011, the Icelandic government presented "Iceland 2020 – a governmental policy statement for the economy and the community", subtitled "Knowledge, sustainability and welfare". The program was a part of the resurrection goals of the present government, undertaken in the context of what is generally perceived as a failed political-economic environment in the advent of the financial crisis. The government promised wide-ranging reforms of the public administration, the banks and financial surveillance institutions. In addition to that came this reform program laying down societal visions for a roadmap to the future for the society. The document thus presents a vision for Iceland towards 2020 as well as a number of recommendations and tasks that fall under the areas of responsibility of specific ministries (Prime Minister's Office, 2011).

The reform program was undertaken with considerable consultations with stakeholders and the general public in all major regions of Iceland. For that purpose participative consultation meetings were organized, open to the general public, regional associations, local authorities, trade unions and economic interest groups, and then specialists coordinated the outcomes and wrote the resulting documents that form the core of the reform program. The program document sets forth measurable goals that are to be achieved by the year 2020 and these are to be monitored yearly (with 20 benchmarking yardsticks). It has significant similarities to the social side of the EU 2020 program (Marlier and Natali 2010)

Policies and Projects

The overall recommendation includes a strategy for the economy and society; an economic and fiscal plan until 2020; an economic activity plan and a collaborative forum on preliminary measures for employment and the labour market.

The strategy for the economy and society contains fifteen social objectives and five economic and development objectives. Thus the welfare emphasis is quite prominent. The strategy has some common goals as the Europe 2020 program, with some of the measurement indicators the same. The Icelandic ones are however more numerous than the EU 2020 headline indicators.

The *social* objectives are:

- 1. To reduce the percentage of people receiving disability pensions from 6.9% of the population to 5.7% by 2020.
- 2. To reduce the unemployment rate (> 12 months) to under 3% by 2020.
- 3. To achieve greater equality in Iceland, by lowering the Gini coefficient for disposable in-come to around 25 by 2020.
- 4. To narrow the gender gap in order to bring the Global Gender Gap Index close to 0.9 by 2020.
- 5. To improve well-being and sound mental health so that the average measurements on the WHO-5 well-being index rise from 64 in 2009 to 72 in 2020.
- 6. To reduce the percentage of Icelanders aged between 20-66 who have not received any for-mal secondary education, from 30% to 10% by 2020.
- 7. That 4% of the GDP shall be allocated to research, development and innovation by 2020. The investment by the private sector shall be 70% against a 30% contribution from the public sector through contributions to competitive funds and research programs.
- 8. That by 2020, Iceland will be in the group of the top 10 nations on the E-government development index and E-participation Index measured by the United Nations.
- 9. That by 2020, the high-tech industry will account for 10% of the GDP and 15% of the value of exports.
- 10. That a minimum of 20% of the fuels used in the fisheries industry will be eco-friendly by 2020 and that 20% of all fuels used in transport will be eco-friendly.
- 11. That by 2020 Iceland shall have made commitments comparable to those of other European nations with regard to the United Nations‟ Framework Convention on Climate Change.
- 12. That eco-innovation and its products be the main growth sector of this decade, with an annual growth in turnover of 20%, which will double between 2011 and 2015.
- 13. That by 2020, 75% of new vehicles weighing less than five tons will run on eco-friendly fuel.

- 14. That the percentage of domestic food consumed by Icelanders will have increased by 10% by 2020.

- 15. That by 2020, the skills of Icelandic elementary school pupils be comparable to those of the top 10 nations classified by the OECD Program for International Student Assessment (PISA) in the domains of reading and mathematical and scientific literacy.

The *economic* and *development* objectives are:

- 1. That Treasury debt shall not exceed 60% of the GDP by 2020.

- 2. That, by 2020, inflation shall be no more than two per cent higher than inflation in the three EU member states with the lowest inflation rates.

- 3. That, by 2020, interest rates (long-term interest rates) shall be no more than two per cent higher than the interest rates in the three EU member states with the lowest interest rates.

- 4. That the UN's Human Development Index (HDI) for Iceland shall be comparable to those of the top five nations on the index.

- 5. That the Genuine Progress Indicator (GPI) shall always remain on a level with the growth in GDP.

Integrated planning
In order to implement the priorities and objectives of Iceland 2020, changes will have to be made to the structure of the public sector and the strategic tools that have been used over the past years will need to be reviewed.

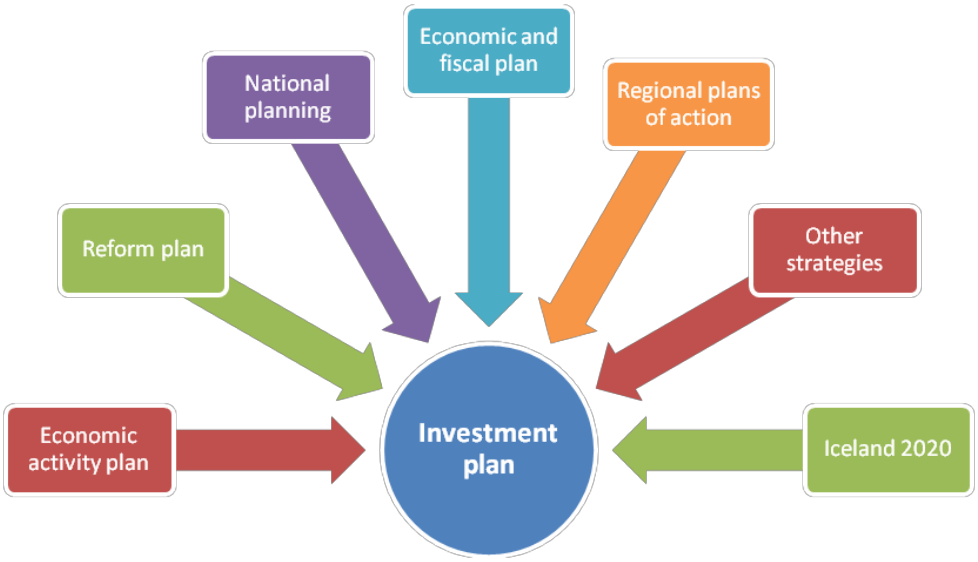

Figure 1: Interlinked aspects of the reform planning process

The idea is also that various national and regional plans will be integrated into a coherent investment plan, where money will follow words. This is to be linked with reforms in the public

administrative structure and also of regional allocations of resources and reporting systems.

Specific projects to follow up the policy statement and economic activity plan
A list of key factors underpinning the implementation of the Iceland 2020 vision including education, the knowledge economy and ICT, creation of new jobs within selected industries, strengthening of local government, increased focus on competitiveness; a review of the tax system, etc. Thus a long list of projects is visualized as a follow-up to the main reform framework.

Iceland 2020 in that way forms the basis for the Icelandic government's policy-making and planning over the coming years.

1.2 Iceland's 2020 in the context of EU 2020 – Comparison of headline goals and benchmarking indicators

As indicated above there are similarities in the Icelandic 2020 and the EU 2020 reform programs, though the Icelandic one includes many more benchmarking measures and touches on more issue projects. Still there is good ground for a direct comparison of Iceland's goals and the EU 2020 targets, and in fact as we see in table 2, Iceland has already reached eight of the eleven EU 2020 measuring targets. The red ones in the table are two goals where Iceland is decisively lacking. The first one is Greenhouse gas emissions that are significantly higher in Iceland than on average in the EU countries and secondly Iceland has a significantly higher drop-out rate from secondary schools than the EU average.

Table 2: EU 2020 and Iceland's Equivalent Goals and Present Position

	2006	2007	2008	2009	**TARGET 2020**
Employment rata -EU (27)	69	70	70	69	75
Employment rate -Iceland	86	87	85	81	86 (implied)
R&D expenditrures - EU (27)	2	2	2	2	3
R&D expenditures - Iceland	3	3	3	3	4
Greehouse gas emissions - EU (27)	92	91	89	..	80
Greehouse gas emissions - Iceland	125	132	143	..	Reduce
Share of renewable energy - EU (27)	9	10	10	..	20
Share of renewable energy - Iceland	..	..	81	..	Increase
Energy intensity - EU (27)	176	169	167	165	More efficiency
Energy intensity - Iceland	358	..	..	..	More efficiency
Early leavers from education - EU (27)	16	15	15	14	10
Early leavers from education - Iceland	26	23	24	21	10
Tertiary educ. attainment 30-34 - EU (27)	29	30	31	32	40
Tertiary educ.attainment 30-34 - Iceland	36	36	38	42	Increase
Pop. at risk of poverty or exclusion - EU (27)	25	25	24	23	Reduce
Pop. at risk of poverty or exclusion - Iceland	13	13	12	12	
Households w. very low work intensity - EU (27)	10	10	9	9	Reduce
Households w. very low work intensity - Iceland	3	2	3	2	
Pop. at poverty risk after transfers - EU (27)	17	17	16	16	Reduce
Pop. at poverty risk after transfers - Iceland	10	10	10	10	
Severely materially deprived - EU (27)	10	9	8	8	Reduce
Severely materially deprived - Iceland	2	2	1	1	

Source: EUROSTAT - EUROPE 2020 dataset. Figures refer to ages 20-64.

Regarding the former goal it needs to be explained that Iceland has such a high emission rate because of the country's ample hydroelectric resources, which are green and sustainable, and this energy is disproportionally used for energy intensive smelters, such as for aluminium and ferrosilicon. These are responsible for a sizable part of the overall emissions, but in addition to that the Icelandic fishing fleet burns oil that produces a sizable part too, and lastly car ownership is very high in Iceland. This is also related to Iceland scoring high on Energy intensity – Iceland does indeed use a lot of energy per capita, most of it renewable, due to its extensive resources in that field. As we outline below there are ambitious plans in operation now for reducing emissions in cars and possibly in the fishing fleet. Needless to say Iceland is to a much greater extent a user of renewable energy resources than most advanced nations (81% as against EU average of 10%).

The most serious deficiency that Iceland has in terms of the EU 2020 headline indicators is the relatively drop-out rate from secondary schools, particularly amongst boys. There the situation is worse than on average in the EU countries and unlike in the energy sector there is no excuse for Iceland to have that state of affairs. While the situation has improved somewhat on that front in the last decade there is still a long way to go for Iceland in that area, not just to equalize the EU average but to reach the 2020 goal of 10% (Andersen et. al. 2011).

On the employment, R&D and innovation, and poverty reduction and social inclusion goals Iceland does indeed have a very favourable position, already above the EU 2020 target. Despite Iceland's spectacular financial collapse and the deep economic recession in its wake the employment rate of about 80% (for 20-64 year aged individuals) is still the second highest in the West, following Swiss. This reflects the fact that prior to the crisis Iceland indeed had the highest employment participation rate in Europe as well as amongst other OECD countries. Hence Iceland was falling from a very favourable position in some respects and that explains that the present situation is not as dismal as might be expected, despite significant difficulties, as we reveal below.

2. Iceland in the AGS and JAF Context

Now we analyse further the position of Iceland in the light of the AGS 10 key policy priorities with some references as well to the JAF framework.

2.1 Fiscal Consolidation and **Debt Relief for Households**

After a financial collapse, as in the Icelandic case, the debt burden is heavy for government, firms and households. We showed at the beginning of this report how the public budget deficit has already been halved and is going according to the IMF plan. The deficit seems likely to be evened out by 2012, thus having been lowered from -13.5% in 2008. The consolidation of the public deficit is being achieved with about 55% coming from reduced expenditures and 45% from tax increases.

The overall net government debt level is also lower than previously expected and according to recent IMF assessment it will most likely not be outstandingly high by the period 2013-2015, in comparison to other European countries. Thus Iceland seems to be recovering rather fast in this respect.

Increased debt burden is, along with higher unemployment and cuts in real earnings, one of the main dismal consequences of the financial crisis. All housing loans in Iceland are indexed to prices (both the principal and the debt servicing payments) and due to greatly rising inflation from autumn 2008 through 2010 the debt burden was greatly raised across the board, equally

for households and firms. Some households and many firms had loans in foreign currencies and these were raised significantly more due to the collapse of the Icelandic Krona. So debt burden became one of the biggest issues of the crisis and the subject of massive public criticism and protests.

The government promised from early on to try to shelter households, particularly lower income earners, from the consequences of the crisis, as possible. Dismal public finances were an obvious hindrance but still various measures were implemented to relieve householders with heavy debt burdens. From early on there were loud calls for a flat rate cut of all household debts, by 25%. This was rationalized as necessary and fair since the basis of most peoples' loans had been eroded in the financial collapse, making them very difficult to handle or even unsustainable for many. Some of the political parties joined in on the request for a 25% flat rate cut of household debts. Such a measure was likely to hit taxpayers themselves the hardest, since the majority of mortgages came from the public Housing Loans Fund (*Íbúðalánasjóður*) and secondly from the occupational pension funds (both directly and indirectly). The pension funds are of course owned by all presently and previously employed Icelanders, since membership is mandatory for employed people and has been since 1980 (Ólafsson 1999). So a flat rate cut of these debts would have required massive injections of cash into the Housing Loans Fund and would also have greatly harmed the occupational pension funds. The government thus rejected this approach from early on and opted for a targeted debt relief program.

These debt relief measures started in a piecemeal fashion, evolving in steps as the crisis progressed. The continuous protests kept the government on its toes throughout and various measures were added through 2009 and early 2010 in a stepwise manner. Then in the autumn of 2010 the government commissioned a major review of the measures already in place and their effectiveness as well as a review of the cost of various additions and other ways of dealing with the problem (Snævarr et.al. 2010). The Central bank of Iceland had previously, from early 2009, done a major survey of the debt burden of households and firms, which had guided the early measures (Central bank 2009 and 2010).

The new survey of autumn 2010 established what had already been indicated, that the big majority of households should be able to handle their debts, even though the debt burden had increased decisively. Some 15% of households were in great difficulty in dealing with their debt burden and another 10% or so were hard pressed. Over 30% owed more on their houses than their current value (which had come down in the crisis). So the survey undertaken by the Prime Minister's task force (Snævarr et.al. 2010) strengthened the previous conclusion about the viable way of dealing with the debt problem of households (the new resurrected banks had the main task of dealing with the debt problems of firms). The targeted approach was shown to work reasonably in the sense of concentrating on those households that were in a low income position, had high debt levels on a reasonably sized home (with high negative equity) and the measures also better favoured families with children. In a way the younger families with children who had bought homes in the period from 2004 through 2008 were hit the hardest, since they bought their homes at elevated prices in the bubble economy and thus went deeper in debt than traditionally had been normal in Iceland. These oversized debts then escalated in the financial crisis and the following recession. Those who lost their jobs were of course particularly hardly hit.

Another conclusion of the new review of autumn 2010 was that still the measures were lacking and the government implemented at the beginning of 2011 an increased effort to speed up the measures already in place and to streamline the approach, as well as by raising further the tax relief on interest payments on mortgages and they also raised the child/family benefits

significantly, on top of previous rises of these benefits and reliefs. The new measures were done in consultation with major stakeholders, including representatives from a new organization called the Households' Interest Group (a strong voice in calling for more debt reliefs during the crisis). The banks, pension funds and unions were also parties to the pact.

A new office of Ombudsman for debtors was also established, with the role of supporting debtor households with financial advice and help in dealing with the banks. The prescription for the new office was to side with the debtors to increase their bargaining power *vis a vis* the banks, when working with them in the debt relief process. After this package was implemented the voices of protests over debt burden were more silent than before, yet not fully quiet.

The following main features define the debt relief process in Iceland to date:

- **General debt relief:** Debtors in difficulties with negative equity values can get their debts reduced to 110% of the value of their assets, up to the value of a modest home (taking account of family size). There is a limit to the amount that a general relief can offer (24.500 Euros for a single individual and 43.000 Euros for couples and single parents). For those in more serious trouble further debt relief can be obtained, after a more detailed examination of their finances and ability to pay. This can give a reduction of debts by up to 91.500 Euros for a single person and 183.000 Euros for couples and single parents.
- **Special debt relief:** This is a more restricted measure, open to fewer families and only to people in very serious difficulties. These can get a debt write-down to 70% of the value of their asset while the remaining 30% are frozen for up to 3 years, without any interest or repayment during that time. In those cases all debt over 100% of the value of the home will be written off.
- **Increased interest rebates through the tax system:** The special targeted tax rebate on interest payments for mortgages was raised at the start of the crisis and this last step in the debt relief process involved further increases in the sums involved. This rebate is income-tested, and also linked to the net value of the home and number of children. Hence it is directed at homeowners in greatest need. Up to 85% of families aged 25 and over are homeowners in Iceland. So households with low and average incomes and a heavy debt burden get most.
- **New temporary general subsidy on interest cost:** This is a new temporary feature, directing more aid to homeowners in financial hardships. This is universal in the sense of not being income-tested, but it is instead asset-tested, i.e. once net value of the family asset goes beyond a fixed sum it is reduced and eventually faced out. This can give an indebted family up to 1800 Euros in subsidy of their interest burden in a year. The government bargained with financial institutions and pension funds to finance this measure.
- **Special effort to aid families in arrears:** A special effort is made to reach all families who are in arrears with their mortgages before 1st of June 2011, offering advice and aid in tailoring measures that may help. The goal with this measure is to avoid foreclosures as far as possible.
- **New social measures in housing provisions:** The government organizes a special effort, in cooperation with financial institutions, local authorities and NGOs, to establish more varied options in family housing, including new renting options. **Rent rebates** were increased at the beginning of the crisis and they are to be kept at a higher rate than they were at before the crisis.

With all these measures the debtors in difficulties are in effect offered to scale their debt situation to the state they were in before the crisis, i.e. to the early part of 2008. Those who overinvested in luxurious or oversized housing will not be helped to retain such assets that they cannot handle in their present situation. A modest family home is the reference for support. This is of course a major effort that has avoided massive personal bankruptcies and foreclosures of homes. Some families had already overreached their capacities by that time and nothing can save them from being relieved of their assets.

Those who had borrowed foreign currency loans to buy cars in the years leading up to the crisis have also been awarded a significant debt relief, since most of such loans that were in effect paid out in Icelandic Kronur but tied to foreign denominations were ruled illegal in Icelandic courts last year. That means that debtors can get up to 40% of such loans written down to the value they would have had if they had been in Icelandic denomination. Since such loans are at a maximum to be paid back in eight years, and often in shorter time, the debt burden of those loans is often heavy. This measure obtained through the courts has thus also been important for relief of debt burden of Icelandic households.

Debt relief has thus emerged in this financial crisis as a very important measure of social protection, working against social exclusion. Since the debt relief measures in the Icelandic case were targeted at those in more need (in terms of income level, net asset ownership level and number of children) they have been equalizing for levels of living and avoided risks of exclusion in the field of family housing. That is of major importance and it is interesting to know to what extent similar measures have been undertaken in other countries that were heavily hit by the financial crisis.

Debt relief for households has also been important for countering contraction in the economy, maintaining general consumer demand at a higher level than otherwise possible, in the spirit of classical Keynesian demand management. Is has also proved to be a very important issue for countering a sense of injustice amongst many sections of the population. After such a dramatic experience, as the financial collapse was, that is indeed a very important concern for stability.

2.2 Correcting macro economic imbalances

This is of course only indirectly related to social inclusion issues, except as a necessary foundation for sustainable government and a thriving welfare system. As seen in the first section of this report the Icelandic economic fundamentals have been seriously addressed, in cooperation with the IMF, with considerable success. In addition to the consolidation of the public debt and refinancing of the Central Bank and the new banks the trade balance, which was heavily negative in the years of the overheated bubble economy (2003-2008) has now been reversed. The trade balance is now positive in each month, since the value of exports has increased (with the fall of the Icelandic Krona) and the volume of imports has gone down in a decisive way. That is due both to reduced purchasing power of the general public and also due to greatly reduced investment in the economy. There are hopes now that with the basic resurrection of the financial system progressing well and economic growth resuming this year (predicted to be in the region of 2.5% in 2011) that investment will increase. Energy-related investment for the aluminium industry is hoped for as well as data centres and other smaller scale projects.

2.3 Ensuring stability of the financial sector

With its particularly spectacular financial collapse Iceland can be said to face more severe tasks in this area that the average EU country. While some EU countries seem set to end at a

higher government debt level than Iceland (such as Ireland, Italy, Greece, Portugal etc., and USA and Japan in other parts of the world) the loss of trust in Iceland is particularly damaging. This involves not just loss of trust in financial institutions but also in governmental regulatory institutions as well as politics in general. The restructuring of the banking system has though progressed well and with less cost than originally estimated and new regulatory laws have been implemented.

The behaviour of bank directors and prominent business speculators prior to the collapse is presently being investigated by a new Office of a Special Prosecutor, with the aim of disclosing if unlawful activities were being undertaken in the financial system. There are widespread suspicions of that. A special investigation committee, appointed by parliament, delivered a detailed report in 9 volumes in 2010, giving cause for many such suspicions, as well as many questionable lending activities, for example from banks to their principal owners.

On the whole much has been done to uncover unlawful and immoral activities in Iceland in relation to the bubble economy and the financial collapse. The public administration has also been subject to widespread reforms and presently a special constitutional assembly is in session to draw up a new constitution that will be put to the parliament and then possibly the public may get the chance to vote on it or the main recommendations for changes. All of these measures are aimed at improving governance in the country and avoiding dangers of repeating such a drastic failure as the financial collapse proved to have been. These reform measures are also thought to be useful for increasing trust amongst the general public, both in governing structures and the financial system.

2.4 Employment – Making work more attractive

As indicated in our first section, Iceland has an outstanding long-term record on high employment levels. Prior to the crisis employment participation amongst 20-64 year olds was in the region of 86% and in 2010 is was down to about 80%, which was still the second highest in Europe, closely following Switzerland. Unemployment has typically been below 3% in the post-war period. During the crisis of the last two years it topped at around 8-9% and is now in the region of 7% (spring 2011). In a way Iceland should be a benchmarking example to many European nations, showing that significantly higher levels of employment can be reached and maintained for a long time.

Iceland's high employment level means that there is no pressing need to "make work more attractive". This achievement is reflected in a high employment participation rate amongst females, but it is also high amongst the elderly (60+) and amongst such candidates for labour market exclusion as disabled people. People with disabilities (long-term health deficiencies or sicknesses) have higher employment participation in Iceland than in any other OECD country (Hannesdóttir et. al. 2010). With high employment participation has followed a generally low unemployment rate and a relatively long working week. So the Icelander's attitude to work has been positive and conditions for work have been fertile (Ólafsson 1996; Ólafsson and Stefánsson 2005; Andersen et. al. 2011).

In the present crisis it emerged that Iceland was previously a laggard as regards active labour market policies, since there had not been felt the great need for that prior to the crisis, even after the unemployment rate was generally raised somewhat during the 1990s. But after the unemployment rate increased above 5% the awareness of the importance of ALMPs and rehabilitation was greatly raised and major efforts were set in place in the last two years, firstly aimed at younger unemployed individuals and then followed special programs on long-term unemployed and older unemployed workers (50+)(Halldórsdóttir et.al. 2009 and Directorate of Labour 2010). Rehabilitation for the sick and disabled has also been stepped up with new

varieties of measures and a new rehabilitation fund operated by the labour market partners (unions and employers' federations).

Taxes are an important part of conditions for work. While Iceland id a high tax country, yet not reaching the full height of taxation levels of the neighbouring Scandinavian countries, its taxation of personal incomes is lower than in the other Nordic countries while the VAT tax on consumption is now the highest in the Western world. So the EU recommendations in the AGS for shifting taxes from labour to consumption and environmental aspects could be aligned to the Icelandic case. The emphasis of the present government has been to shelter lower income earners against higher taxes during the crisis while the tax burden of average and higher income earners has been raised. This has facilitated consumer demand amongst low-income groups during the crisis and probably softened the contraction effect on GDP.

The high work level of Iceland has also been supported by ample facilities for childcare (pre-school facilities). Hence two earners are the norm in more than 90% of Icelandic families. That is also important when crisis hits, as at present, since the big majority of the unemployed belong to a family where another earner still has his/her job (Directorate of labour 2010). That becomes an important "security system" in crisis time.

Thus with Iceland already with a significantly higher employment rate than envisaged in the EU 2020 goals Iceland is in a good position in that field. Yet the goal in Iceland's 2020 strategy is to lower the unemployment rate again to under 3% and the employment rate should then return to pre-crisis levels, around 85-6%. That by now traditional achievement is a consequence of many things coming together, the pension and benefits' system being one of them – and to that we now turn.

2.5 Reforming pension systems

Iceland's pension system is, in accordance with the recommendations of the World Bank, a three-tiered system. The first pillar is the public tax funded social security system, which greatly equalizes the income distribution and forms the basic safety net of the society. That is generally a defined benefit pay-as-you-go system that uses income testing against other incomes to a rather high degree. The second pillar is mandatory occupational pensions run by the labour market partners. These pensions are funded and the Occupational Pension Funds now amount to about 130-140% of GDP. The funds lost about 20% of their assets in the financial crisis and many of them have cut their benefits, since they operate with a defined contribution system, aiming to compensate around 56-60% of former pay when rights are fully accumulated from a whole lifetime career. The third pillar is Individual Pension Accounts (IPAs) that have enjoyed tax favours since 1997 (for up to 4% of pay), as well as an employer contribution of up to 2% of pay. This feature had grown considerably but a part of the crisis relief measures the owners of such savings have been allowed to liquidate a part of their assets there for use in debt restructuring or for meeting other temporary needs during the crisis. This has reduced these assets for many.

On the whole the pension system is thus financially sustainable and has in fact provided an important asset for the society in the crisis, since it provides investment funds that have been increasingly important as contributors the resurrection of the economy, by funding restructured firms and some economic activities, such as construction of nursing homes and there is now being considered the possibility of financing increased road works with money from the funds in the coming years.

Icelandic pensioners retire later in Iceland than is typically found in other European and Western countries. The public age for retirement is 67 but many males work up to the ages of

69-70 and females frequently work up to ages 65-67. So early retirement is rare indeed, and in fact there is no scheme for formal early retirement. Hence those seeking early retirement from age 60 have to pass into the disability pension scheme and qualify in the capability test/disability test. Hence there is a barrier to early retirement. Relatively low public pensions were for a long time also a stimulant for late retirement but with improved replacement rates as the occupational pension system ripens that has become an issue of reduced importance. Still there are important incentives in the pension system to delay take-up of pensions. In the social security system one can delay the take-up to the age of 72 and thereby one can increase the pension rate by about 30%. The same principle applies in the occupational pension funds.

Hence the features that the AGS and the EU's Green Paper on Pensions recommended are operative in Iceland and as such they are a proof that such measures do work and produce advantages in many ways, including indirectly for government finances. They also reduce the risk of poverty amongst the elderly. An important feature of the sheltering of lower income people during the crisis in Iceland has been the raising of the minimum pension guarantee in the social security system, which has in effect pushed many pensioners above the poverty line, especially elderly widows and long-term disabled individuals (Kristjánsson and Ólafsson 2009 and 2010).

2.6 Getting the unemployed back to work

Even though Iceland's unemployment rate has remained 1-2 %-points below the EU average throughout the crisis, the present rates in Iceland are historically high, indeed unprecedented (Andersen et.al. 2011; Ólafsson and Stefánsson 2005; Jónsson and Magnússon 1997). So the unemployment problem is taken very seriously and it is in fact one of the main challenges that Iceland now faces to reduce its level. The prognose for the immediate future, i.e. the next 3-5 years, is that the unemployment level will come slowly down despite reasonable economic growth. That is indeed a common experience of countries after such financial crises and that was the experience of Finland after its deep crisis of the early 1990s. It took them up to 18 years to regain the pre-crisis unemployment level. But their unemployment rate went up to 18%, much higher than Iceland's present rates (Kalele et.al. 2001).

During the crisis the unemployment benefit was raised slightly. The cost of that and of increased numbers of benefit receivers was financed by increasing the insurance premium which is paid by employers, this was done already in 2009. The period that the unemployed can remain on benefits was also lengthened last December, from 3 to 4 years. Thus the expenditures of the unemployment benefits fund have increased drastically. The unemployment protection system has indeed reacted to the cyclicality of the economy and intensified its support during the crisis.

On the whole the tax and benefit structure in Iceland is conducive to making work reasonably attractive, even at low earnings. Still the minimum pay is relatively low by Nordic standards but not so low compared to many Continental EU countries (Ólafsson 2010). Still in-work poverty in Iceland is closer to the EU average than other forms of poverty and the risk of the unemployed of falling under the poverty line is at about 30%. Hence conditions for low paid workers are often criticised in Iceland. Still there are incentives for working, both attitudinal in the culture and in the taxation system at present, since the tax burden of low income earners had indeed been lowered in 2009 and 2010, compared to previous years (Kristjánsson and Ólafsson 2011; Kristjánsson 2011; Andersen et.al. 2011).

Unemployment benefits are of course conditioned on continued seeking of jobs amongst recipients and in-work benefits have been raised in the last two years. That should make it

reasonably feasible for the unemployed to return to work when job opportunities will be forthcoming. So the problems should primarily be those of creating new jobs rather than restructuring the benefits system and temporary support measures.

Active labour market policies have been greatly intensified in the last two years, firstly aimed at the young unemployed. Special programs have been on offer for summer time jobs for students as well and the ALMPs have been offering the young unemployed various possibilities for returning to secondary schools and to university level education. This seems likely to work for many, but further evaluation assessments are needed to establish the functioning of these efforts. The same applies to special efforts directed at older and longer-term unemployed individuals (Directorate of Labour 2010; Andersen et.al. 2011).

On the whole the prime task of getting the unemployed back to work in Iceland seems mainly to revolve around job creation (see further list of challenges and recommendations for the Icelandic labour market from a recent report, in the Appendix to this report).

2.7 Balancing security and flexibility

While the Icelandic labour market is highly organized, with one of the world's highest unionization rates and wide-ranging federal organizations both on the sides of employees and employers, the Icelandic labour market is generally deemed to be very flexible indeed (Ólafsdóttir 2010; Eðvaldsson 2003; Andersen et.al. 2011). It is also embedded in a universal social security and occupational pension systems, providing significant security in times of deviations from regular career processes. Hence the Icelandic labour market can be described as having a strong degree of security and flexibility, in many ways an enviable position. The policies of the labour market partners and the tradition of tripartite corporatism, in conjunction with ad hoc flexibility that is possible in a small-scale social environment, have all worked together to produce such favourable combinations.

On the whole one can thus say that Iceland's employment record indicates that Iceland has achieved a favourable combination of organizational features and institutional engineering of the labour market. There are however issues of low productivity that need to be faced and dealt with in a long-term perspective, increasing productivity at the same time that weekly working hours are reduced. Also issues of avoiding risk of exclusion of foreign nationals in the Icelandic labour market. The size of the immigrant population increased greatly in the years prior to the crisis and only about a fifth of those that came to Iceland during the last 5 year before the crisis have left again in the last two years. The unemployment rate amongst immigrant labourers is higher than amongst native Icelanders at present (Andersen et.al. 2011). These seem likely to be issues of great concern in the coming years and will certainly be important for effectively obtaining the wider Iceland 2020 goals. Iceland seems to have more than fully obtained the EU 2020 goals referring to employment and poverty reduction.

2.8 Frontloading growth –smart, sustainable and inclusive

The Iceland 2020 reform program involves a great emphasis both on smart growth and sustainable growth, as well as inclusive and participatory society. The emphasis on smart growth involves an emphasis on innovation and R&D and improved skill levels, as well as an emphasis on knowledge economy developments, S&M firms and ICT utilization. There is also a great emphasis on clustering and utilizing green energy for knowledge economy developments, for example for data centres. There are great resources for green energy in Iceland.

Skills: This goal tackles one of the main challenges of Iceland, in comparison to the EU 2020 plan, i.e. the goal of increasing the proportion of individuals who have secondary or higher educational level (or as it is framed in the Iceland 2020 plan, lowering the share of population with less than secondary education from 30% to 10%). This addresses one of the bigger challenges in the Icelandic labour market and educational system. The reason for the problem is a high drop-out rate from secondary schools, especially amongst boys (Ólafsson and Arnardóttir 2008; Óskarsdóttir 2000).

The main reasons for the high drop-out rate is insufficient supply of vocational and occupationally oriented course programs as well as a rather low status of such educational routs. Those who are not strongly motivated towards academic or general studies often have difficulties in finding applied courses and options that suit them. In addition the high rate of job supply has meant that there have been significant temptations for youngsters, especially boys, to leave school and take up reasonably highly paid jobs, such as in fishing, construction or services, and thus fulfil materialistic consumer goals in the short-term. This is thought to have been a particularly important factor of temptation from schools in the provincial areas. The growth of immigrant labour in the last decade threatens this low skilled Icelandic labour with increasing competition, stressing the importance and urgency of this issue.

Related to this issue is the growing concern that there may be an insufficient supply of technically skilled labour in the next years once growth has fully resumed, such as for ICT industries and software. This reflects the fact that too few of those who finish university level education do studies in technical, engineering and vocationally oriented fields. The number of students in social sciences, humanities and business and law is rather disproportional (Ólafsson and Stefánsson 2005; OECD 2010).

While there is considerable awareness of the risk and waste of too high a drop-out rate from secondary schools, both in the public administration and in the educational system, the success in dealing with the issue has been less than satisfactory to date, even though some progress has been made. This is thus a major challenge for Icelandic society and labour market in the years to come.

R&D and innovation expenditures in Iceland have already reached the EU 2020 goal, i.e. of 3% of GDP. Iceland has set itself the goal of reaching 4% by 2020, like some of the other Nordic nations, such as the Finns. The Iceland 2020 reform program places a great emphasis on increasing the efficiency of the R&D and innovation sectors and there is a continued effort on behalf of the Science and technological council to improve the organization of the system and facilitate better outcomes. The competitive research funds were partly sheltered against cuts but they are still too weak for a thriving scientific research environment. Increased synchronization with the European Research Area would be helpful, since Iceland enjoins some access to that through its affiliation to the European Economic Area zone. Tapping the potential of the Single Market thus has relevance for Iceland and Iceland's application to join the EU of course aims at enjoying the benefits of the common market in all aspects, as well as the common currency area.

The present government implemented in 2010 a new legislation on tax concessions to individuals investing in innovation start-ups or operating small innovative firms. This also provided for some tax rebates on expenditures on innovation. The Research and Development Council (RANNÍS) takes charge of assessments of the innovative role (www.rannis.is). The state also operates a Technological and Innovation Centre for aiding industries in developmental innovation and start-up. Within that organization there is also a incubator for start-ups assistance. Hence the understanding of the importance of innovation is at hand in Iceland and it is persistently being harnessed for further achievements.

Clustering has however had a slower progress than in for example Sweden and Finland of the 1990s, partly due to an overrated currency (the Icelandic Krona) before the financial crisis. That produced conditions unfavourable to high-tech and innovative SMEs aiming for exports. In the decade before the financial collapse some thriving innovative and high-tech firms actually took out their expansion abroad due to these unfavourable currency conditions. The aluminium industry is also seen as a negative competitor to knowledge economy green firms, since it consumes a lot of available sustainable energy for the smelters. Many environmentalists would like to see more emphasis on green high-tech or ICT play a larger role in the economy of the future in Iceland, at the cost of the energy intensive aluminium smelters that mainly export low-skill/low grade products. This is one of the greatly contended issues amongst environmentalists/Greens and others at present.

2.9 Attracting private capital to finance growth

In an economy having suffered a financial collapse and where many firms and households are over indebted, there remains a problem for increasing investment. As we saw above (table 1) investment in the Icelandic economy fell drastically in the crisis and has not yet picked up. There are however predictions of a recovery in that field, which will however take a few years to gain adequate levels.

Lack of trust is also an issue in this context and the present plans of government for rebuilding the financial system and strengthening the regulatory framework also aim at improving the conditions for investments. These issues only touch indirectly on social inclusion issues and hence we will not deal with them further here.

2.10 Creating cost-effective energy

Ample hydro-electric and renewable geothermal power resources are a major asset of Iceland. As emerged in table 2, comparing Iceland's and EU's 2020 goals, Iceland is a great user of sustainable energy. It presently uses about eight times the EU average of renewable energy (Iceland has 81% of its energy use sustainable as against 10% for EU on average). Hence Iceland is very favourable placed in affairs relating to energy. Energy is generally cheap, both for households (for lighting and heating) and for firms. Many of Iceland's promising opportunities for future industrial and economic developments are related to the energy sector (Porter 2010).

While Iceland is an intensive user of energy, most of it is sustainable. Iceland could however no doubt increase the efficiency of its energy use and in fact there is great interest in that. Many research project are being undertaken to use electricity for powering transportation means, from cars to light trains. Most optimism revolves around using electricity to power cars, either directly or by means of Hydrogen or Metanol. Use of geothermal energy is of course widespread for heating houses. Close to 90% of homes in the country are heated by geothermal energy, i.e. hot water from the ground, and that is of course sustainable and hardly polluting.

With massive increases in the price of petrol and oil during the crisis the interest in alternative energy sources for transport has increased greatly. Experiment in that area are active and increasing in number so widespread new uses of alternative energy on cars may increase faster in the coming decade than previously (cf. www.nmi.is).

3. Poverty profiles

In figure 1 we present a profile of poverty by various social groups in Iceland in comparison to the average for the 27 European Union Member countries. This is important for outlining where Iceland is doing well and where it is not doing so well, in comparison to the EU countries.

If we look firstly at where Iceland is not doing better than the EU27 countries on average we first stop with employed persons, where Iceland has a slightly higher rate of people at risk of poverty (60% of median equivalized incomes), i.e. about 8%. In comparison those who are not employed or registered as unemployed have a higher poverty risk rate, but not nearly to the same extent as in the EU27 (Ólafsson 2010). Thus while unemployed Icelanders have a risk rate of 29% the EU27 have a rate of 45%.

The second group where Iceland has a higher rate than the EU27 is when the household consists of one adult over the age of 65. There Iceland has 31% at risk of poverty while the EU27 have on average 27%. The majority of singles over 65 is older widows, who have a high life expectancy. They generally have less rights in occupational pension funds, due to less employment participation during their lifetime, in some cases they have been doing housework for all their career and have to rely solely on social security. In that case they will have low income in Iceland and this is more so amongst the oldest of the elderly, who often reside in nursing homes. With very high longevity amongst Icelandic women this group becomes sizable and has a large role in raising the risk rate for the 65 and older group. Growing maturity of the occupational pension funds will reduce poverty amongst this group with the very lowest earnings in Iceland's case.

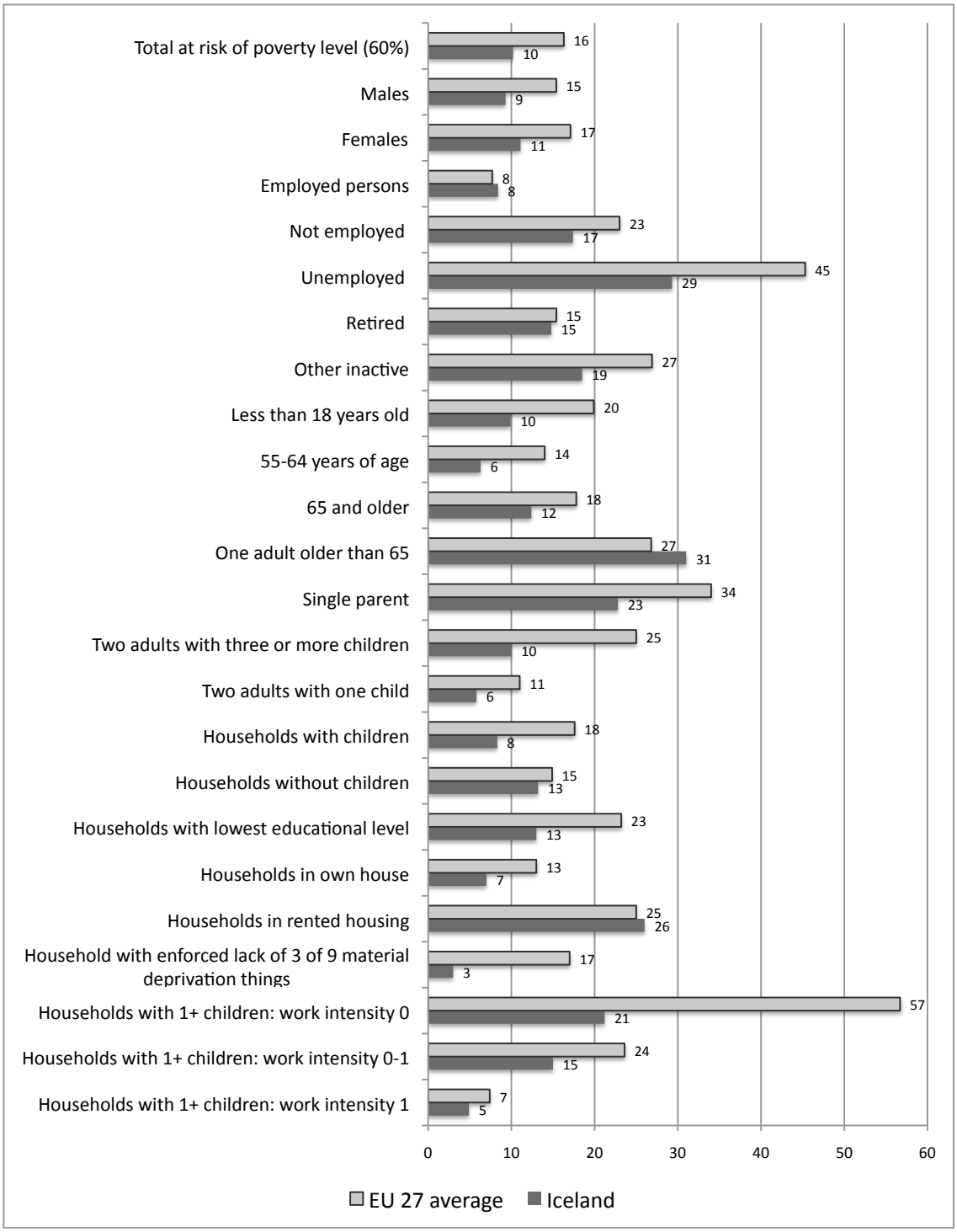

Figure 1: Poverty profiles in Iceland and EU 27 in 2009.
Source: Eurostat.

The third and last group for which Iceland has a higher risk of poverty than the EU27 is people that live in rented housing. Iceland has about 26% of them at risk of poverty while the EU27 has 25%.

In the 20 other sub-groups Iceland has a lower risk of poverty rate than the EU27 and in some cases a decisively lower rate. The overall rate (referring here to all the population while the figures in table 2 refer to the population aged 20-64) of poverty risk is 10% for Iceland while the

EU27 have 16% rate. In broad terms the patterns are similar, i.e. the same groups generally have higher poverty risk rates in both cases, yet there are also significant deviations, presumably reflecting differing characteristics of welfare states and differing effort at poverty reduction.

The highest poverty rates for the EU27 are for households with one or more children and no work participation, i.e. they are jobless households. The average poverty rate for this group is 57% in the EU. The second highest is unemployed people (45%) and then single parents with dependent children (34%). Then come single elderly adults, 65 and older (27%) and then inactive people other than the registered unemployed. So on the whole it appears that jobless households and registered unemployed individuals are generally insufficiently provided for in the welfare systems of the EU27 countries.

In Iceland's case the highest overall poverty rate is for single adults over the age of 65 (31%), then come the registered unemployed (29%), and then households living in rented housing (they include many single parents and also students). The Icelandic welfare system does not seem to care as well for single elderly adults as do the European systems on average, but the Icelandic system provides relatively better for workless households than the EU27 (with a poverty rate of 21% as against EU27's 57%). There is also a great difference for the registered unemployed, to Iceland's favour. But on the other hand Iceland has in-work poverty on level with the EU27's average, which is somewhat surprising for a Nordic Welfare state. That reflects a relative low minimum pay in the labour market and low in-work benefits, especially for couples on low incomes (Kristjánsson 2011). On the whole households with children have a significantly lower poverty rate in Iceland than in the EU27, while there is not much of a difference for households without children.

Lastly there is an interesting pattern for households with one or more children and differing levels of work participation, from workless households to fully working two breadwinners (see the bottom of the figure 1). Growing work volume clearly reduces the risk of poverty in both cases, but more so for the EU27. The difference between Iceland and EU27 for workless households is more than double while the difference for fully working households is one of 5% for Iceland and 7% for EU27.

The only indicator of subjective material deprivation in the figure ("Households with enforced lack of three out of nine material deprivation things" – fourth column from bottom) shows a very large difference between Iceland and the EU27, with 3% as against 17%. That in a sense is an accumulated indicator reflecting the fact that Iceland has quite low poverty or hardship rates for many groups that are frequently at great risks of poverty in other modern countries.

So on the whole Iceland has a relatively good record on poverty reduction, as indeed do the other Nordic nations (Marlier and Atkinson 2011). Iceland shares to a significant extent many of the more important features of the Scandinavian welfare system, despite some deviations as well (Ólafsson 1999; Fritzell, Beckmann and Ritakallio, forthcoming 2011).

We can lastly say that the goals that have been set for Iceland in the Iceland 2020 reform program are well chosen and address some of the main challenges facing the country. In the field of social inclusion the reduction of the unemployment rate as well as the reduction of drop-out from secondary schools are two of the most important challenges. Improving the welfare of heavily indebted households and reducing inequality, which grew excessively in the extreme bubble economy of the period in the 2000s (Ólafsson 2006a and 2006b; Kristjánsson and Ólafsson 2007 and Ólafsson and Kristjánsson 2010). Raising the skills levels and

strengthening the innovation features of the knowledge economy are also of decisive importance.

Another feature that is very important for inclusion-exclusion is access to work in the labour market. As has already emerged in this report Iceland has for a long time had an outstanding record in maintaining high employment participation levels. To end with we show this aspect in figure 2 with a wide-ranging comparison of the proportion of individuals that belong to jobless households in Iceland and other Western nations, around the year 2005.

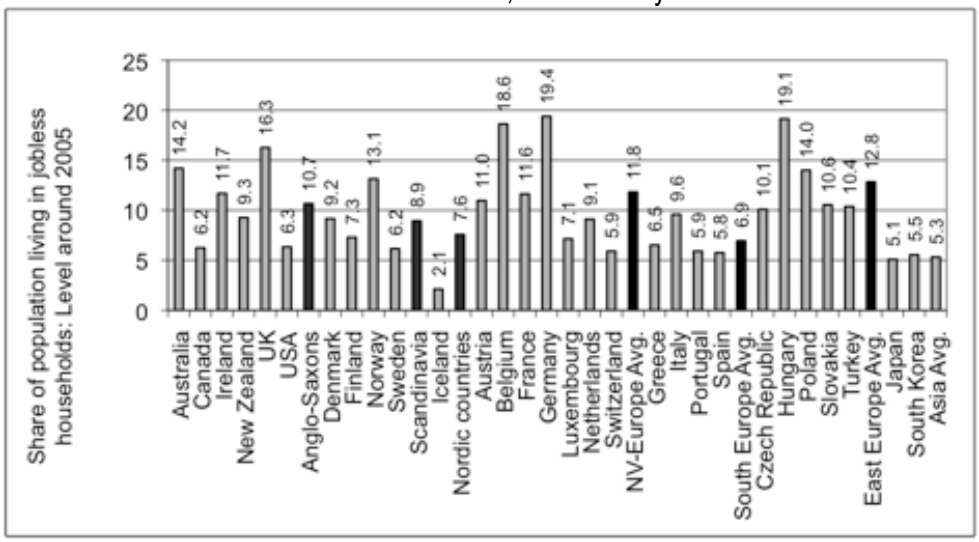

Figure 2: Share of population living in jobless households, around 2005.
Iceland and the OECD-countries Compared (Source: OECD 2008).

Here we see that Iceland had by far the lowest proportion living in jobless households (2,1%). Next in line were Japan, South Korea, Spain, Switzerland, Portugal, Sweden, Canada and then the USA. The highest proportions are to be found in Germany, Hungary, Belgium and the UK.

So Iceland starts the progress towards its 2020 goals with a rather strong position on the social inclusion front, both as regards low poverty levels for most groups and in terms of inclusion and participation in the labour market. There are still very important goals to be reached but the biggest challenges are in other areas, such as in raising skill levels and avoiding labour market segmentation for immigrant labourers.

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Appendix I

Main Challenges for the Icelandic Labour Market

(From a recent assessment of the Icelandic labour market, by Tine Andersen, Karsten Hougaard and Stefan Ólafsson, 2011).

The challenges facing the labour market in Iceland can be divided into short-term challenges con-nected to the current economic situation and long-term, structural challenges connected to Iceland‟s position in the world economy and in the global competition.

Based on our data analysis and interviews with key representatives of the labour market actors, we have identified the following key challenges:

Short term challenges

- The unusually high rate of unemployment by historical standards:
  - among young individuals, particularly at the ages of 16-29, including school leavers;
  - increasing long-term unemployment rate, which is higher than ever before;
  - very high concentration of unemployment among construction workers (unskilled and skilled), employees in commerce (shop assistants), and unskilled service workers; the majority of those concerned have low educational levels and low functional mobility;
  - specific higher level occupations are also affected, in particular occupations within the previously over-expanded financial sector; and
- Migrant workers have higher rates of unemployment than native Icelanders.
- Strengthening activation measures:
  - planning and implementing measures of the Directorate for Labour and the PES;
  - managing the use of private operators supplying labour market measures; and
  - increasing the stock of options for measures as well as resources for implementation.
- Avoiding increased flow of unemployed people onto disability pensions:
  - reorganizing rehabilitation measures and procedures; and
  - ensuring new resources and increased facilities for vocational rehabilitation (education, physical and psychiatric rehab and guidance).
- New job creation, through private and public investment.

- Gradualism in wage bargaining on the way out of the recession.
- Better social inclusion of migrant labourers.
- Avoiding a net outflow of persons in the active ages.

Long term challenges

- Increasing productivity.
- Developing policies to counter the tendencies to a dual labour market.
- Increasing the share of the population who complete a vocational or higher education.
- Developing policies and measures to tackle the growth in in-work poverty.

Recommendations

Following from the above observations made, we can make the following recommendations:

Develop and strengthen active labour market measures, taking a competence perspective
We recommend that the Directorate of Labour coordinate the efforts of the PES, the social partners and the funds at their disposal, and VIRK to ensure that resources in this field are spent more efficiently than appears to be the case at present. While the recession is felt all over the country, the capital area and the Southwest (*Reykjanesbær*) are by far the hardest hit and the measures should be concentrated proportionally more on these two areas.

Study methods used by European PES for anticipating skill needs in the labour market
The European PES have been very active in developing their ability to be able to respond to skill demands. Since 2008, the PES have undertaken joint work to contribute actively to the Lisbon Strategy and since 2010, to Europe 2020 Strategy. The outcome of this work is described in reports and good practice descriptions that should be considered by the Icelandic labour market policy makers, and in particular, by the Directorate of Labour, who is responsible for the PES.

Continue and deepen the review of the benefit systems
The current benefit systems appear to be less suited to aid flexibility in the labour market. There is already focus on the disability pension system, but we recommended a proper review of the whole system of benefits available for persons in and outside the labour market to synchronise as well as pinpoint and remove barriers in the system.

Develop criteria and procedures for quality assurance of activities carried out by private service providers to the PES and in the field of rehabilitation
It demonstrated that the quality and efficiency of activities carried out by private providers of employment services varies considerably. VIRK, the rehabilitation institute, has developed criteria for quality assessment of their providers. These should be studied by the PES. Experiences from other European PES (e.g. the Dutch PES) could also provide useful inspiration in this respect. This also applies to private providers of rehabilitation services.

Monitor migration closely with a view to react if the net outflow of persons in the labour

force threatens the sustainability of the economy
There is currently a large outflow of migrants from Iceland, and some interviewees raised concern about a possible brain drain. However, it appears that the evidence base concerning the skill levels of migrants (immigrants as well as emigrants) lacks in precision.

Facilitate a better match between supply and demand for skilled labour
There is a growing concern that there is an insufficient supply of technically skilled labour, particularly in the fields of high-tech, software and information technology.

Increase the capacity of Statistics Iceland in order to improve a timely monitoring of the labour market
The current capacity of Statistics Iceland appears to be insufficient as detailed labour market data can only be made available with a delay of more than 3 months. This means that the labour market actors are often unable to respond in a timely manner. More data appears to be available at Statistics Iceland than is readily accessible to the labour market actors and researchers. This appears to be caused by restricted manpower resources at Statistics Iceland.

Make a long-term plan for increased productivity and shorter working hours
The report shows that relative to the overall affluence level of the country, the productivity level is rather low in the Icelandic economy. This indicates that too much of the prosperity is based on heavy labour input (high work participation in conjunction with long weekly working hours), so that contrary to the situation elsewhere in Europe, increasing working hours by increasing the la-bour force is not a priority in Iceland. There are clearly great possibilities for improving quality of life and improving work-life balance by shortening working hours in conjunction with a plan for increased productivity levels.