

The Political Economy of Northern Regional Development

“...Taking the structure and functioning of the Arctic regional economies and the degree of economic dependence as a point of departure, these region's self-reliance and comparative socio-economic performance is analyzed. The fundamental problem is still the dependency Arctic regions have on their mother economies in the south”.

“...the impact from climate changes and the global economy strongly influence the self-sufficiency constraints and potentials of the Arctic societies. Traditional approaches to economic valuation may not be sufficient to capture these relationships. Neo-classical economics and the trade off model look upon nature as a good commensurable with all other goods, and henceforward there is a substitution possibility. The rational self-interest and ‘homo economicus’ is however, not the same as responsible self-interest included in ecological economics. This suggests broader approaches to environmental uncertainties, which take into account ethical values and conflicts of interest”.

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Vol. I



Gorm Winther (ed)



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7. The transnational capitalist class and the mini-Keiretzu system in Iceland⁹⁸

*Ivar Jonsson*⁹⁹

For the last twenty years, globalization as an economic policy has predominated the political discourse in most countries of the world. The worldwide globalization lobby is strong, and one gets the feeling that a fundamental change is taking place in the world economy and that a new base for worldwide prosperity is being born. This picture does not seem to reflect reality. International economic activity has increased in rather limited areas in terms of branches of industry and geography (L. Weiss 1998 and I. Jonsson 2006). However, the social and political impact of this increased trans-nationalization is relatively much greater than the changes in the economic base. In this paper we will discuss the case of Iceland. The discussion is to be considered as the first part of a research project that observes how the relative mismatch in the development of the economy and socio-political structures appear in the emergence of a new transnational capitalist class (TNCC) with roots in Iceland. The rise of the new TNCC has not only undermined the balance of power between class fractions and power blocs, but emerges as well in new forms of lifestyle within the emerging leisure class.

The final part of the research project will discuss the impact of the socio-economic structural change on social and environmental policy during recent years. The main aim of this paper is to discuss the growth of the transna-

⁹⁸ This article was finished in December 2007, before the international economic crisis set in.

⁹⁹ Professor, the Bifrost Business School, Iceland and former associate professor at "Ilisimatusarfik" (The University of Greenland).

tional sector in the economy of Iceland and describe the main features of the analysis that will follow in later parts of this research project.

7.1. Introduction

In the ideal world of capitalism as presented by Adam Smith in his book *The Wealth of Nations*, published more than 200 years ago, there is no space for economic or political privileges, or exploitation by any minority group within society. Impersonal transactions in perfectly competitive markets by free, and totally independent or “sovereign” individuals, hinders the concentration of wealth and power. As a consequence equality, law and order in society are secured. This happy state of society has never existed as there is neither an “invincible hand” nor a mechanism that secures optimal use of resources and optimal level of production through the transactions of “self loving” and competing individuals. More importantly for our discussion, it is even more unlikely that such a state of happiness will exist in very small economies (I. Jonsson 1995). Small economies suffer from greater problems of oligopoly and monopoly than larger economies, and as a consequence the underlying trend towards undemocratic governance and oligarchy is strong. Micro-economies like the Icelandic economy suffer from structural strains due to its small size, oligopoly and oligarchic trends. In recent years this situation has in many ways been intensified by intensive trans-nationalization of companies in the retailing, financial and transport sectors. Hitherto unknown levels of concentration and centralization of capital and wealth has created a new trans-national class that threatens not only democracy and sovereignty of individual citizens, but also entrepreneurship and endogenous sources of economic growth.

The core of the matter may be summarized along these lines:

- a) Following privatization of the state bank sector in Iceland in the 1990s, a kind of mini-keiretzu system developed in which three privatized banks became the core and base of the growth of three closely knitted webs of related companies in the retailing and transport sectors.¹⁰⁰ These com-

¹⁰⁰ Keiretzu, refers to families or networks that manage Japanese corporations

panies and the banks built their strong financial position on oligopoly stricken markets, which they use to exploit Icelandic consumers in order to collect oligopoly-rents on which they base their investment abroad in their original branches of industry. Having accumulated substantial investments abroad, they have a capital base and securities large enough to have foreign banks finance their further investments on top of loans from the Icelandic banks and shares bought by pension funds in the Icelandic companies. This strategy enables the companies to overcome the shortcomings of the small home market, and create new sources of capital accumulation.

- b) Icelandic consumers finance their consumption by loans from the oligopoly mini-keiretzu banks. As a consequence, indebtedness of the Icelandic population has increased tremendously along the road, so that Iceland is now the most indebted nation in the world.
- c) Since the 1990s, the governments have deregulated the financial market and helped outward foreign direct investment (OFDI)¹⁰¹. OFDI leads to a spiral of depreciation of the local money (the Icelandic krona); it leads to increasing inflation due to increasing prices of imported goods and increasing wages as a response to inflation. Moreover, it leads to decreasing investment in domestic industries as profit margins are expected to lower due to higher wages and real costs of production. The government has responded to this scenario with a strategy, that has increased demand for the krona. The government allowed the building of one of Europe's largest hydropower plants (Karahnjukavirkjun) in order to foster large increase in inward foreign direct investment (IFDI) in the aluminum industry by transnational companies. In addition, Icelandic bonds have been issued in European financial markets that have appealed to foreign investors due to their high interest rate. These bonds have stimulated considerable demand for kronas. However, in the long run this strategy is problematic, as the krona is vulnerable to the consequences of speculation and shifting mood in international bond markets. As the nominal exchange rate of the krona has tended to fall after construction periods in the hydropower and aluminum plant sectors, the central bank had to increase the interest rate level to prevent inflation from rising. The level of interest rates in Iceland is now more than dou-

¹⁰¹ Usually called "outward offensive" or "Viking offensive" by the transnational capitalist class.

ble the rate than in the other Nordic countries. Higher interest rates undermine the profitability of investment in domestic production and industries. The result is creeping stagnation in the local economy.

- d) The class system has transformed over the last 15 years, from a relatively homogeneous class system into a polarized class system – in which the social cleavage between the transnational capitalist class and the traditional capitalist class is deepening alongside the increasing polarization between wage earners and the capitalist classes.
- e) We will now discuss the development highlighted above in more detail and start with analyzing the transformation of the economic base of the class system in Iceland.

7.2. The transformation of the transnational sector in Iceland

The process of globalization and de-regulation in the world economy has changed the conditions of class formation in many countries. This development has led to an increase in a group of people that has been called “the transnational capitalist class”. Globalization is set about by forces such as mass media, corporations, global economic forces, institutions, structural policies and global marketing (L. Sklair 2001: 2). These forces or structures and networks are realized by active strategies and actions of individuals, who belong to an emerging new “transnational capitalist class” that

“...pursues people and resources all over the world in its insatiable desire for private profit and eternal accumulation. This new class is ... composed of corporate executives, globalizing bureaucrats and politicians, globalizing professionals, and consumerist elites.” (L. Sklair 2001: 4).

It is through consumerism, that globalization is legitimized and reproduced. This is an ideology, that presumes that the meaning and value of our lives are to be found principally in what we possess, which can never be totally satisfied with our possessions (a feeling that is constantly created by ever-changing fashion and style). This ideology also assumes, that the goods and services we consume are best provided by the free market driven by profit maximization (ibid: 6).

As we will discuss below, Icelandic companies that have become transnational in recent years have grown extremely fast. As a consequence, a

new transnational class appears to have emerged and grown fast. The figure below highlights our framework to analyze the development of the class system in Iceland since the 1970s.

As the framework highlights, the TNCC1 has emerged as a new actor in Icelandic society and has passed other classes in terms of income and economic power. This new class distinguishes itself from the other two fractions of the TNCC with reference to income and economic power. By economic power, we refer to power within companies and their number of employees, relations between companies regarding investment and interlocking directorship and influences on economic policy formation of governments.

As a consequence, TNCC1 has gained a hegemonic position in the Icelandic society. The different categories of classes presented in the figure refer to:

The transnational capitalist class: fraction I = main owners of shares in international companies with roots in Iceland (TNCC1); fraction II = managers of TNCs' plants located in Iceland (TNCC2); fraction III = managers of governmental bodies and state apparatuses that work on building the infrastructure of transnational capital accumulation and legitimize it ideologically (TNCC3).

The domestic capitalist class (DCC) is constituted by class fractions such as: the domestically based classes of wholesalers and retailers and fishing capitalists as well as the small group of manufacturing capitalists (DCC1); Another fraction of DCC refers to managers of governmental bodies and state apparatuses, that work on building the infrastructure of domestic capital accumulation and legitimize it ideologically (DCC2).

The state and stakeholders bureaucratic class (SSBC) consists of managers of ministries and institutions within the spheres of the welfare state, the judicial system and foreign affairs. Furthermore, this includes employees of interest groups who concentrate on societal distribution of income and life chances.

The wage earning classes (WEC) consists of scientists, specialists, skilled and unskilled labor, that work in jobs that are not part of societal power centers in which social policy formation takes place. Following the projects on building the hydropower plant, Karahnjukavirkjun, in East-Iceland, the building of new aluminum plant there and enlarging

aluminum plants in West Iceland, a large number of foreign workers have been hired by TNCs like Impreglio and Bechtel.

As a consequence to this increase in numbers, foreign workers have become a much larger group within the WEC than ever before. As the social conditions experienced by these workers are much worse than workers of Icelandic nationality, the WEC is arguably split into WEC1 (workers of Icelandic nationality) and WEC2 (foreign workers).

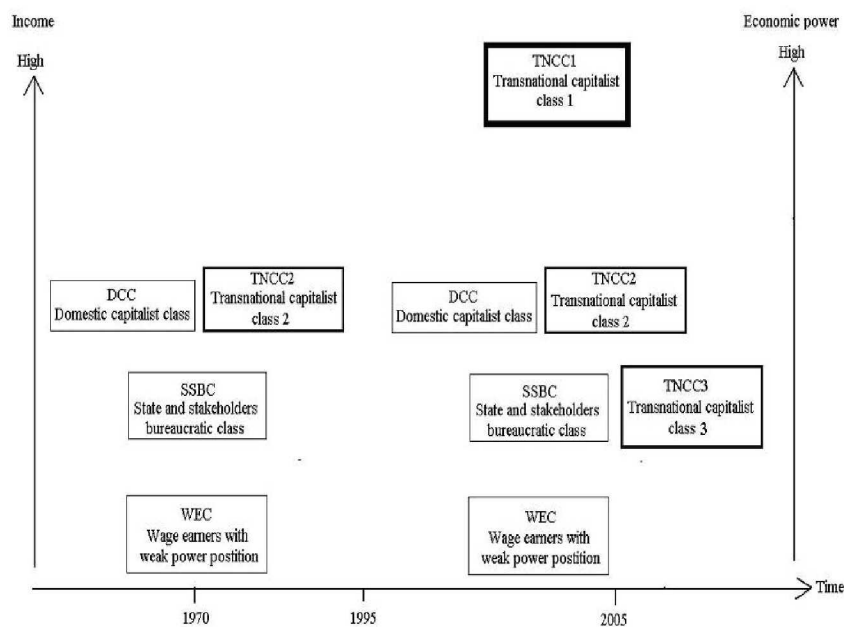


Figure 1. *The transformation of the class system in Iceland since the 1990s*

7.2.1. *The growth of the transnational sector in Iceland*

The growth of the transnational sector indicates that the transnational capitalist class in Iceland has grown in recent years. This is particularly true in terms of the new TNCC1. We will now focus on the growth of this sector in reference to the scale of production and number of employees. We will first highlight the transnational sector of inward direct investment and then observe the new transnational sector of outward direct investment

7.2.2. The transnational sector of inward direct investment

The bulk of inward foreign direct investment is in the aluminum and ferro-silicon industry. In recent years investment in this sector has increased fast, and so has its production. This development appears clearly in the export statistics as the structure of export has changed rapidly in recent years. Fish and other marine products accounted for 51% of merchandise exports and 34% of total exports in 2006. This figure was 82% and 60% respectively in 1991. Led by aluminum melting and medical and pharmaceutical products, exports of manufactured goods have been growing rapidly in importance and accounted for 38% of merchandise exports in 2006. The export of services has also soared, as the economy becomes increasingly service-oriented. Services now account for almost 35% of total export revenues while in 1990 the share was 26% (Central Bank of Iceland 2007).

Table 1. Foreign direct investment position, by type of investment

Year	Inward investment ¹⁾		Total
	Equity	Intra-company loans	
1989	7.886	-1.259	6.627
1990	7.418	710	8.129
1991	5.864	3.335	9.199
1992	5.652	2.225	7.877
1993	5.880	2.620	8.500
1994	6.610	2.045	8.655
1995	7.448	972	8.419
1996	7.719	5.616	13.335
1997	14.364	9.882	24.246
1998	24.006	8.297	32.303
1999	25.062	9.598	34.660
2000	33.177	8.959	42.136
2001	62.872	7.780	70.652
2002	56.116	8.176	64.292
2003	61.670	23.040	84.709
2004	94.152	33.293	127.445
2005	236.853	59.697	296.550
2006	413.078	125.329	538.407

¹⁾ Excluding real estate

Investments by TNCs in the electricity intensive sector of aluminum production have increased, following the strategy to build the new mega hydropower plant, Karahjukavirkjun. The large-scale investment projects in the aluminum and power sectors launched in 1997 are nearing completion. When these projects are completed in 2009, the total production capacity of aluminum melters in Iceland will be 800 thousand tonnes per year (tpy), up from 270 thousand tpy in 2005.

Power capacity needs to be stepped up by 80% to supply them with sufficient energy. The long-term impact of these investments will increase the share of aluminum in total merchandise exports so there will increase from 20% in 2005 to roughly 40% in 2009 (*ibid.*).

Table 2. Direct investment from abroad: Inflows by industrial sector

(Millions of kronur)	1998	1999	2000	2001	2002	2003	2004	2005	2006
<i>Total</i>	10.839	4.958	13.463	16.912	7.987	24.475	51.704	194.062	271.764
Metal and mechanical products	1.709	567	-74	409	1.773	1.071	20.258	41.168	64.934
Financial activities	3.268	-255	559	2.473	686	-771	93	146.898	162.206

Source: Central Bank of Iceland

Inward direct foreign investment has increased fast in recent years. This is particularly true concerning 2005 and 2006 as can be seen from table 1.

It is interesting to note that the main source of inward foreign investment in equities has not been the TNCs of the aluminum industry, but investors in the financial sector. As appears in the following table 2 (see Appendix 1 below for more details).

The development highlighted above has strengthened the power position of the TNCC2 – particularly in terms of regional policy formation as the TNCs in the aluminum sector are effective in creating jobs over short periods.

7.2.3. The new transnational sector of outward direct investment

Liberalization of cross-border capital movements has resulted in profound change in the composition of residents' financial asset portfolios. Before full liberalization in 1995, residents owned only approximately €156 million (13 b. kr) in foreign securities. By the end of 2006, this figure had increased to €12.7 billion (1,200 b.kr), or the equivalent of 105% of Iceland's GDP. In 1995, Iceland's outward investment stock was equivalent

to approximately 14.5% of GDP. Eleven years later, in 2006, it had risen more than twenty-six-fold to 396% (Central Bank of Iceland 2007).

Figure 3 and 4 below show, that there was a turning point in 2004 as outward foreign investment increased from around 4 billion Euros in 2003 to over 23 billion Euros in 2006. The main reason for this shift was the privatization of former state banks and the deregulation of financial markets. International acquisitions and internal growth led to tenfold the growth of the banks' turnover between 2000 and 2006 as acquisitions and internal growth led to tenfold the growth of the banks' turnover between 2000 and 2006.

The three commercial banks have subsidiaries and branch offices in e.g. the UK, USA, Scandinavia and continental Europe (Central Bank of Iceland 2007). Figure 5 below highlights the development of the bank system since 1990.

The transformation of the bank system and the de-regulation of the economy have had considerable impact on the class system in Iceland. The trans-nationalization of the banks and the retailing sector has created a new group of wealthy people, who have the bulk of their income stemming from investments abroad.

This development is the main reason for the polarization of Icelandic society with foreign workers on the low end of the spectrum and the new transnational class on the top end. We shall now observe the base of this new class in terms of the companies they own.

7.2.4. The size of the new transnational sector of companies leading the outward foreign direct investment

The rise of the new TNCC1 in Iceland raises the question: Who are they, and where do they come from? The TNCC1 comes from the main companies in the financial and retail sectors, but some companies in other sectors have also trans-nationalized fast in recent years¹⁰². It is worth keeping in mind when looking at the figures below, that the population of Iceland was 304.334 in 2006 and the labor force was counted at 174.600 people. The GDP in 2006 was 1.162 billion ISK, or around 9,3 billion GBP. The GNP of Iceland in 2006 amounted 1.076 billion ISK or around 8,6 billion GBP.

¹⁰² Information on the companies was collected from their respective annually reports and homepages during October to December 2007.

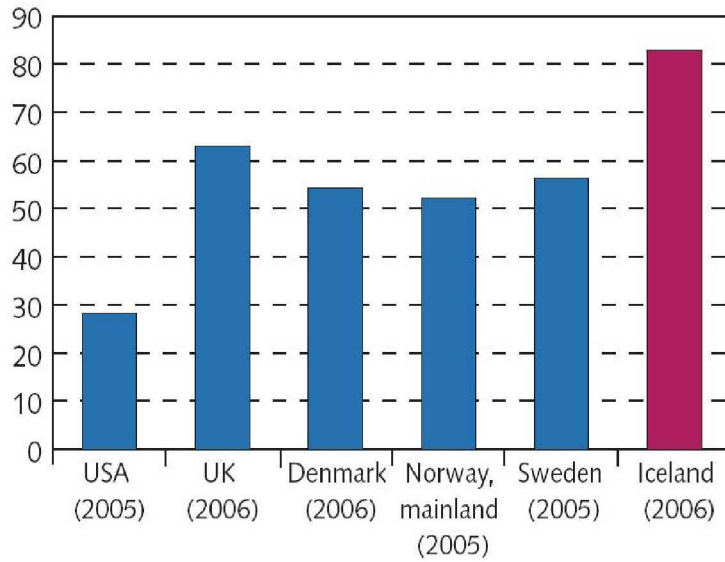


Figure 3. Outward direct foreign investments (% of GDP in different countries).

Source: Central bank of Iceland, 2007

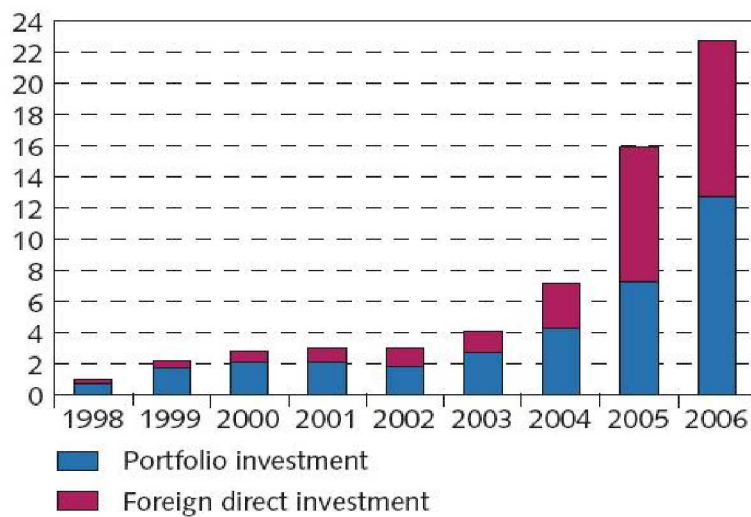


Figure 4. Outward foreign direct investments and portfolio capital owned abroad by residents (at year end) 1998 – 2006.

Source: Central bank of Iceland, 2007

7.3. The structure of the transnational sector

The sectors, where the transnational companies operate are the financial sector, the fishing and food sector, the retail and real estate sector, pharmaceutical products and sea freight.

7.3.1. The financial sector:

- Kaupthing Bank (Total assets 42,9 billion GBP in 2006 and operating income 1,4 billion GBP, 2700 employees of which 1100 in Iceland)
- Landsbankinn (Total assets 16,4 billion GBP, net operating revenue 0,7 billion GBP. Number of employees 2313 in 2006 of which 61% in Iceland, 19% in UK and Ireland, 19% in Continental Europe and 1% in USA)
Straumur-Burdaras (investment bank) (total assets 6,9 million EUR, net operating income 2006: 0,3 billion GBP, number of employees around 450 of which 112 are located in Iceland and 187 in Finland)
- Glitnir (net operating income 2006: 0,5 billion GBP)
- Pension funds (have wide range of investments in the companies in the transnational sector as well as foreign companies)
- Norvik (3000 employees worldwide in retailing of foods, furniture, sportswear and timber processing plants as well as owning banks in Latvia and Russia. By 2004, Norvik was Iceland's tenth largest company with a total turnover of over 221 million GBP).

7.3.2. Fishing and food sector:

- Samherji (Operating revenues was around 0,19 billion GBP in 2006 Owns enterprises in Iceland, Faroe Islands, Germany, Poland, U.K and Canary Islands)
Bakkavör (20000 employees in 8 countries, 55 factories, turnover 1 billion GBP in 2006).

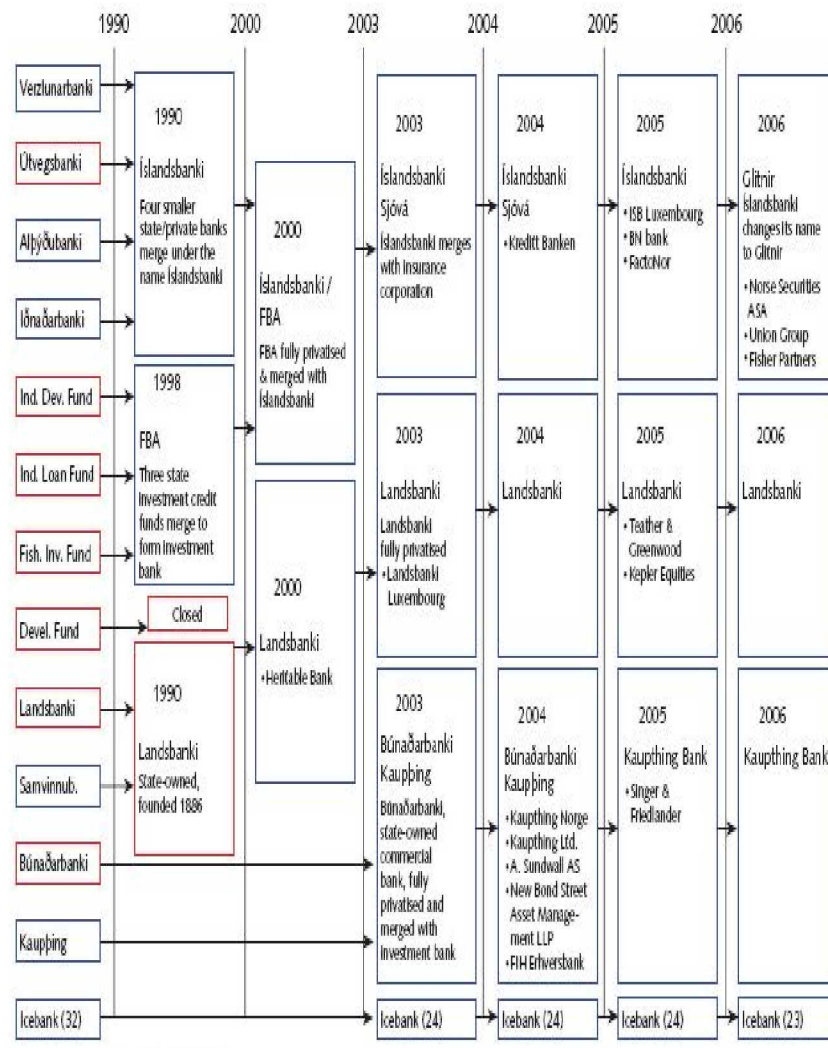


Figure 5. *The Development of the bank System of Iceland.*

Source: Central Bank of Iceland 2007

7.3.5. Retailing and real estate:

Baugur Group (75000 employees, 3000 stores worldwide, turnover 9,8 billion GBP. Baugur Group owns 27% in 365 the largest media company in Iceland)

7.3.6. Other sectors

- Actavis (pharmaceutical – Turnover in 2006 around 2,1 billion GBP with approximately 11000 employees in 40 countries, 500 in Iceland)
Eimskip (sea freight) (Total assets 0,9 billion GBP and 0,5 billion GBP in operating revenues in 2006, 9500 employees of which 8500 work abroad in 13 countries)
Samskip (sea freight) (Total assets 0,06 billion GBP and 0,17 billion GBP turnover in 2004. In 2006 the company had around 1400 employees in 14 countries)
FL-Group (Total assets 2,1 billion GBP in 2006 and investment income around 0,34 billion GBP. Among shares in companies that FL-Group had shares in 2006 are the Icelandic bank Glitnir. (30.4%), AMR Corporation.(6,0%), Finnair Oyj (22.4%), Royal Unibrew. (24.4%), Bang & Olufsen (10.4%) and Aktiv Kapital (13.3%).

7.4. Analyzing class relations – where to go from here

The discussion above is but a part of a larger research project. The main object of the research to follow will be on the economic, political and social relations of the new transnational capitalist class in Iceland. Hence, the emphasis will be on the concentration as well as the centralization of capital in the Icelandic economy. The development of concentration of capital will be approached in terms of market shares of main companies in the different branches of industry that will be analyzed. Concerning centralization of capital, the focus will be on the interlocking directorship (see I. Jonsson and F. Jonsson 1992 and J. Scott and Griff 1985) in terms of managers that are also board members of the companies within the transnational sector. Furthermore, interlocking shareholding will be analyzed in terms of intra- and inter-company ownership of shares.

As for political relations, the relations of the companies in the transnational sector and their managers with ties to political parties, interest groups and media will be observed and analyzed in terms being the “inner circle” of the transnational capitalist class (M. Useem 1984 and F. Jonsson and I. Jonsson 1992).

Concerning social relations of the TNCC, the polarization of Icelandic society will be analyzed both in terms of income distribution and the Gini-

index, as well as in terms of life-style patterns, and in particular, regarding “leisure-class” behavior) cf. T. Veblen (2007) and M. Weber’s (1974) concept of “status”.

Finally, the transformation of the Icelandic socio-economy and the role of the new transnational capitalist class will be analyzed in terms of the emerging “absentee capitalism” (I. Jonsson 2006). A development of this sort would presume, that the new transnational class would in that case move the headquarters of companies to the metropolises of the richest developed countries, and direct their companies around the globe from there. As a consequence, the new transnational capitalist class of Iceland would live abroad.

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Appendix

CENTRAL BANK OF ICELAND
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July 16, 2007

CENTRAL BANK STATISTICS
Balance of payments and external position

DIRECT INVESTMENT FROM ABROAD: INFLOWS BY INDUSTRIAL SECTOR

(Millions of kronur)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
TOTAL	10.830	4.958	13.463	16.912	7.987	25.475	51.704	194.062	271.764
Agriculture & fishing	-21	55	3	-21	-4	3	1	1	1
Mining & quarrying	165	1	23	62	-140	-8	-3	-5	-6
of which: Extraction of petroleum and gas	-	-	-	-	-	-	-	-	-
Manufacturing	1.764	2.801	11.458	1.317	5.287	5.137	25.294	43.420	85.107
of which:									
Food products	-46	2.344	1.173	-1.927	423	533	475	1.082	16.566
Textile and wood activities	-8	-	-2	-	-	-	-	-	-
Petroleum, chemical, rubber and plastic products	100	-110	4.004	2.392	1.056	3.330	2.092	2.654	3.462
Metal and mechanical products	1.709	567	-74	409	1.773	1.071	20.258	41.168	64.934
Office machinery, computers, radio, TV and communication equipment	-	-	6.355	243	2.036	133	1.570	-1.484	145
Vehicles and other transport equipment	-	-	-	-	-	-	-	-	-
Electricity, gas & water	-	-	-	-	-	-	-	-	-
Construction	529	535	165	1.308	43	-16	112	194	237
Trade & repairs	2.176	705	1.103	-462	6.093	-6.665	276	21	5.100
Hotels & restaurants	-	-	-4	-8	154	13	31	1	-16
Transport & communication	-33	-294	126	19	1054	-1095	-3089	2.095	1.638
of which:									
Land, sea and air transport	131	-138	-151	-22	2.372	-1.043	2.036	1.241	3.215
Telecommunications	-164	-156	276	41	-1.318	-52	-5.125	1.754	-1.376
Financial activities	3.268	-255	559	2.473	686	-771	93	146.898	162.206
of which:									
Monetary institutions	-	-	-	-	-	-	-	-	-
Other financial institutions	3.268	-255	559	202	655	-771	93	146.898	162.206
of which: Financial holding companies	-	-	-	-	-	-	-	-	-
Insurance & activities auxiliary to insurance	-	-	-	2.272	30	-	-	-	-
Other financial institutions and insurance activities									
Software, research, management holding, etc.	2.874	1.292	6	12.826	-5.234	28.963	28.117	620	17.527
of which: Real estate	-	-	-	-	-	-	-	-	-
Other services	119	118	23	-1.108	47	-85	873	-83	-30