

Box IV-1

The economic impact of the US military withdrawal from Iceland

On March 15, Washington announced its decision to withdraw the bulk of its military capability from the Keflavík base this autumn. After the jets and helicopters have left, only a skeleton presence will be maintained in Iceland. Much still remains unclear as to how defence and security capability will be built up after the US withdrawal and how the accompanying expenses will be shared out in the short and long term.

The US-manned Iceland Defense Force (IDF) has been a significant provider of both employment and currency earnings in Iceland. Its importance has been waning, but is still substantial. In 2005, Iceland earned more than 8 b.kr. from work for the IDF – equivalent to 0.8% of GDP. Of this figure, 3.2 b.kr. was compensation to (all civilian) employees and 1.3 b.kr. payment to contractors, while others accounted for 3.6 b.kr. Icelandic employees of the IDF number around 850.

Revenues from the IDF are entered on the export side in the national accounts. In 2005, these revenues amounted to 131 m. US dollars and had increased by 9% in dollar terms since 2001. This increase reflects the depreciation of the US dollar over the period: measured in Icelandic krónur, revenues were 30% lower in 2005 than in 2001. Revenues from the IDF amounted to 2.3% of Iceland's export revenues in 2005, but more than 7% in the early 1990s.

The US military currently pays part of the basic operating costs of Keflavík international airport. If the IDF ceases to pay this cost, it will have to be borne by the Icelandic state, airport users or both. Military helicopters have been used on air-to-ground rescue operations in and around Iceland. Iceland's own Coast Guard helicopter fleet is expected to need to be expanded when the US helicopters are deployed elsewhere. What needs to be done for Iceland's defences is a much vaguer issue. Presumably this will depend on the outcome of negotiations with the US authorities. Activities under the auspices of the Icelandic authorities are also likely to be built up over a longer period. Thus it is uncertain that the cost of such activities will increase massively over the coming years. On the other hand, defence capabilities are very expensive and commonly account for the equivalent of 1-2% of a country's GDP.

At a rough estimate, the impact of a complete withdrawal by the US military before October 1, 2006 would be as follows, per year: i) Export revenues will decrease by 8 b.kr. (130 m. US dollars); ii) Domestic expenses on the operation of Keflavík airport will increase by 1.5-2 b.kr.; iii) Treasury expenditures will increase due to the purchase and operation of helicopters; and iv) Treasury expenditures will increase due to the development of local defence capability.

The contraction in export revenues is known. It could be offset by a grant from the US authorities, conceivably phasing to zero over a transition period of some years.

Both the volume and timing of Treasury expenditures are more uncertain, partly because of possible US participation during a transition period. It appears unlikely that large-scale defence capability will be built up in the immediate future.

The Central Bank's macroeconomic forecast assumes that export revenues will shrink by 8 b.kr. as of next year on account of the military withdrawal. The Treasury is expected to shoulder an additional 3 b.kr. in operating costs for Keflavík airport and helicopter rescue operations. These costs are bracketed as an increase in public consumption. A further 1 b.kr. in public sector investment is also assumed, for example on helicopter purchases. Naturally these figures are highly uncertain but a clearer picture of the impact of the military withdrawal can be expected to emerge in the coming weeks and months.