TOURISM BOOM IN ICELAND MAKES ECONOMIC ‘MIRACLE’ POSSIBLE

Iceland’s small and volatile economy has been marked in recent decades by experiencing economic cycles far distinct than the rest of the European economies: intense growth booms (with cumulative commercial imbalances) followed by major recessions.

Recently, a new element seems to have changed the situation regarding the country’s past. The Icelandic economy has been steadily growing for almost eight years; however, external (and domestic) imbalances have surprisingly disappeared, and Iceland now enjoys a strong current account surplus, accompanied by a low and stable inflation. The secret of this positive change lies in the tourism boom.

Tourism has radically shifted the historical pattern in Icelandic economy, to the extent that the European Commission has released a document highlighting this novel position: “The economy of Iceland is going through a peculiar situation, a combination of an elevated growth, a strong fiscal position coupled with low inflation and current account surpluses.”

Just in 2012, tourist arrivals doubled. The numbers of travelers who enter the country every year have increased six times the total population of Iceland.

As the report highlights, tourism has been one of country’s main pillars for growth and to maintain a current account balance (roughly, exports minus imports). The expenditure of tourists in Iceland counts as exports, since visitors bring money from their countries to spend in goods and services on the island. Although many of the products that tourists purchase are made with imported goods, the services (hotels, trips, activities…) are completely Icelandic. This favorable situation has had a remarkable influence on the tourism boom, while at the same time, offsetting the fiscal deficit in the balance of goods, permitting the current account surplus that keeps indebtedness at bay.

The country accumulates over seven years with an average GDP growth of 3.6%, an employment rate that surpasses 87% (the highest in Europe by far), an unemployment rate of 2.7%, a surplus public sector of 1.2% of the GDP and more importantly, a current account surplus of 3.7% of GDP, a figure that contrasts with Iceland’s 2008 deficit of 22.7% (the largest in the world in terms of GDP).

“Tourist arrivals have doubled in the last five years, reaching over 2 million visitors in 2017, a huge amount in comparison to the 340,000 citizens of the country,” explains the European Commission report.

This beneficial increase in visitors has skyrocketed “the tourist’s average expenditure, which is now an important source of income… the purchases of these visitors went from representing 2% of GDP in 2005 to 10% in 2016,” adds the report. Additionally, tourism's direct contribution to GDP is nearly 9%, compared to 3.5% in 2009.

The tourism boom hasn’t resulted in large imbalances due to the appreciation of the Icelandic króna (which has prevented inflation from running wild) and the flexibility of the country’s labor market.

Iceland is now leading the OECD (Organization for Economic Co-operation and Development) labor market flexibility rankings. This time however, even more than that actual labor flexibility, the arrival of immigrants has been the decisive factor, by increasing the supply of workers when the country needed them the most.

In 2008, during the country's crisis, thousands of Icelanders left the island to explore the labor markets of Sweden, Norway and Denmark. At present, Iceland has 'opened' its borders and the number of immigrants arriving in the country is the largest in decades, which is complementing the local workforce and preventing an accelerated and uncontrolled wage growth. Moreover, the country's gross domestic savings rate registers historically high levels, currently amounting to 25% of GDP.

The accelerated growth of tourism also poses risks for the country. The strong demand of Icelandic krónur by visitors has helped to increase the value of this currency, which has accumulated a rise of 44% compared to the euro since 2009. This appreciation of the currency has already raised a number of complaints from other sectors of the economy, which have seen more difficulties when exporting their goods and services.

Another negative effect is the alarming increase in housing: As a result of the strong demand in housing, the prices of real estate market in the capital have progressed rapidly. There is growing evidence that the real estate sector is experiencing a crowding out effect that, for example, is making it difficult for young families to find affordable housing near the capital.

Lastly, and perhaps the most important risk to consider, **is that this 'magical' source of income derived from tourism boom can end just as quickly as it started.** EC economists emphasize that "the cause of Iceland's popularity boom as a tourist destination is hard to determine." One may consider the curiosity awakened by the eruption of the volcano located under the Eyjafjallajökull glacier, or the difficult and unstable situation in the Arab countries; but both conditions could change and modify tourism's perception about destinations and trends.

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