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Buttressing the West in the North:
The Atlantic Alliance, Economic Warfare, and the
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A NEW LEFT-WING GOVERNMENT in Iceland precipitated a crisis in NATO in 1956 by demanding the abrogation of Iceland's bilateral treaty of defence with the United States. Given Iceland's importance as a strategic outpost between North America and Western Europe, the decision shocked the Eisenhower administration and its European allies. Although the Icelandic government – the so-called Leftist Government – made it clear that Iceland's membership in NATO would not be affected by demilitarization, its foreign-policy agenda nonetheless represented the first political challenge to the presence of US troops in Iceland since their arrival, in 1951, as part of the Western military build-up following the outbreak of the Korean War.

The decision was rooted in both domestic and international developments: the left-wing realignment in Icelandic politics, which strengthened the groups protesting against the US military base, and the growing popular perception that the thaw in Soviet-American relations – the Spirit of Geneva – made US troops in Iceland unnecessary. The perception also reflected the disunity within the Western alliance as the United States and its Western European allies clashed over trade, NATO's nuclear strategy, and European neocolonialism. But the Icelandic case was unique in two ways: first, during the mid-1950s the Soviet Union suddenly became Iceland's biggest trading partner, and second, the Icelandic government included the pro-Soviet Socialist Party, which was adamantly opposed to Iceland's Western alignment. No other member of NATO came close to being economically dependent on the Eastern bloc or allowed Communists to join the government.

Traditionally, historians have focused on the impact of the Suez débâcle and the controversy over the nuclearization of NATO to explain the malaise that gripped the Western alliance in the mid-1950s.¹ The purpose

¹ See, e.g., M. H. Armacost, *The Politics of Weapons Innovation: The Thor-Jupiter Controversy* (New

here is to widen the scope of the inquiry by focusing on another, if largely overlooked, cause of dissent.¹ The Icelandic challenge to the United States was not only a blow to the political cohesion of NATO and Western military plans in the North Atlantic, it also threatened to hand the Soviet Union a propaganda victory in the cold war. Ultimately at stake was the continuation or reversal of Iceland's political, military, and economic integration into the Western alliance.

The article puts the crisis of 1956 in its historical context by sketching the history of Iceland's alignment with the West after the Second World War, and by evaluating the effects of events such as the Communist coup in Czechoslovakia, the Korean War, the Geneva summit, and the Hungarian Revolution on Iceland's security and its ties with the United States and Western Europe. Similarly, it explains how the Left's ascendancy in the 1950s led to the decision to revoke the treaty with the United States and to the formation in 1956 of the Leftist Government.

Second, the article analyses the United States and NATO's response to the left-wing challenge, emphasizing the link between politics and economics – between the Icelandic government's need to finance its modernization programme and the United States and NATO's need to defend their strategic interests.² The escalation of the crisis in 1956 initially seemed to leave open only two possibilities: either a breakdown in Iceland's relations with the Western alliance or the downfall of the Icelandic

York, 1969); D. N. Schwartz, *NATO's Nuclear Dilemma* (Washington, 1983); J. Melissen, *The Struggle for Nuclear Partnership: Britain, the United States, and the Making of an Ambiguous Alliance, 1952-9* (Groningen, 1993); P. Nash, 'Jumping Jupiters: The US Search for IRBM Host Countries in NATO, 1957-9', *Diplomacy & Statecraft*, vi (1995), 753-86; *Das Nordatlantische Bündnis, 1949-56*, ed. K. A. Maier and N. Wiggershausen (Munich, 1993); F. H. Heller and J. R. Gillingham, *NATO: The Founding of the Atlantic Alliance and the Integration of Europe* (New York, 1992); D. Kunz, *The Economic Diplomacy of the Suez Crisis* (Chapel Hill, 1991).

¹ Little has been written on the topic in English, but several publications are available in Icelandic. See V. Ingimundarson, *Í eldlinu kalda stríðsins. Samskipti Íslands og Bandaríkjanna 1945-60* (Reykjavík, 1996) and 'Áhrif bandaríks fjármagns á stefnubreytingu vinstri stjórnarinnar í varnarmálum árið 1956', *Saga*, xxxiii (1995), 9-53. See also T. Whitehead, 'Leidin frá hlutleysi 1945-9', *Saga*, xxix (1991), 105-20, 'Lydveldi og herstöðvar 1941-6', *Skrtnir*, cl (1976), 126-71, and 'Stórveldin og lydveldid 1941-4', *Skrtnir*, cxlvii (1973), 202-41; E. Loftsson, 'Ísland í NATO partíerna och försvarsfrågan' (dissertation, Gothenburg, 1981) and 'The Disguised Threat: Iceland during the Cold War', *Scandinavian Journal of History*, x (1985), 226-38; F. H. Hallsson, *Herstöðin: Félagslegt umhverfi og íslenskt thjóðlíf* (Akureyri, 1990). On other issues touching on some aspects of Iceland's relations with the United States and NATO, see W. Heinemann, 'Die NATO und Island: Kommunistische Regierungsbeteiligung und Stützpunktfrage', *Militärsgeschichte*, iii (1993), 6-13; M. Berdal, *The United States, Norway, and the Cold War, 1954-60* (London, 1997); R. Tamnes, *The United States and the Cold War in the High North* (Oslo, 1991); G. Lundestad, *America, Scandinavia, and the Cold War* (New York, 1980).

² For Scandinavian works on this relationship, see, e.g., 'Leon-Jensen: NATO og danske økonomisk-politiske interesser, 1949-56', in *Danmark, Norden, og NATO, 1948-62*, ed. C. Due-Nilsen, J. P. Noack, and N. Petersen (Copenhagen, 1991); T. E. Førland, 'An Act of Economic Warfare? The Dispute over NATO's Embargo Resolution, 1950-1', *International History Review*, xii (1990), 490-513.

government. Not until after the Hungarian Revolution and the Suez débâcle was the crisis diffused, when the Icelandic government, reversing its decision to revoke the treaty, made a supplementary agreement with the United States that confirmed the status quo ante.

Third, the article focuses on the intense cold war struggle that took place in Iceland between 1956 and 1959 over the future orientation of its political economy, and demonstrates that the United States, NATO, the Soviet Union, and Iceland all turned to economic warfare to achieve political and military goals. The irony of the episode was unmistakable: the United States and NATO propped up a left-wing government with Communist members. Allowing strategic interests to override anti-Communist ideology proved effective: it contributed to the reaffirmation of Iceland's Western alignment and a sharp reduction in the barter trade with the Soviet bloc.

* * *

After the Second World War, Iceland's Western alignment became the most hotly contested topic in Icelandic politics. Four decisions, in particular, marked the end of Iceland's traditional policy of neutrality: the Keflavik Agreement of 1946, which granted the United States transit rights for military aircraft; participation in the Marshall Plan between 1948 and 1953; entry into NATO in 1949; and the arrival in 1951 of US forces in Iceland following the outbreak of the Korean War. Although the centre-right Independence Party, the centre Progressive Party, and the Social Democratic Party were basically pro-Western, there were divisions, both among the parties and within them, over the nature and scope of Iceland's ties with the United States and Western Europe. The Independence Party, the largest, which traditionally captured about forty per cent of the vote, was pro-business, but moderate on social and economic issues, and with supporters spanning class lines. The Progressive Party, which appealed to farmers and captured about twenty-five per cent of the vote, had disproportionate influence owing to a distribution of seats that favoured the countryside over the towns. Despite its influence within the trade union movement, the Social Democratic Party, surprisingly small compared to its Scandinavian counterparts, was unable to rely on capturing more than fifteen per cent of the vote. Two reasons for this were the centrist platform of the Independence Party and the conservative bent of the Social Democratic leadership. More important, however, was the strength of the Socialist Party – which usually captured about twenty per cent of the vote – among workers and intellectuals. Only the Socialist Party was openly sympathetic to the Soviet Union, though it couched its criticism of a Western alignment in nationalist and neutralist language. It had gained

respectability during the Second World War, owing to the Soviet Union's role in the anti-Hitler coalition and to its success in breaking the Social Democratic Party's monopoly within the trade union movement. It had its greatest success in 1944, however, when it ended its isolation by joining a coalition government – the so-called Innovation Government – with the Independence Party and the Social Democratic Party.

Strategic considerations explain the US interest in Iceland. After US troops replaced the British occupation force in 1941, the United States used Keflavik airfield as a stopover for bombers and fighters on their way to the European theatre. In addition, the US military based in Iceland played a vital role in the war against U-boats in the North Atlantic and in keeping open the sea lanes to Britain and the Soviet Union. Although, by 1945, US military planners saw the extension of the United States's defence perimeter to Iceland as the logical outgrowth of the Second World War, the Truman administration's attempts to extend its military rights failed on account of the political opposition in Iceland. A revival of nationalism, spurred by the decision in 1944 to sever the remaining constitutional ties with Denmark, reinforced the widely held view that the presence of US troops in Iceland would threaten its sovereignty.¹

Yet, apart from the Socialists, most Icelandic politicians were keen to preserve friendly relations with the United States, not least because of the political and economic benefits brought by US troops during the Second World War. Iceland, northern Europe's poorest country in 1939, had become by 1945 one of the richest in the world (only the United States may have enjoyed a higher per capita standard of living). Thus parliament approved a compromise – the Keflavik Agreement of 1946 – that gave the United States the landing rights in Iceland it needed to meet its obligations in Germany. Even though the Truman administration was refused permission to station troops in Iceland, the agreement proved to be extremely controversial and broke up the Innovation Government: the Socialists and left-wing Progressives and Social Democrats objected to it because it implied the abandonment of the main tenet of the country's foreign policy, permanent neutrality.

The coalition government formed in 1947 by the Independence, Social Democratic, and Progressive Parties, decidedly pro-Western, turned into an anti-Communist bulwark with the beginning of the cold war. But despite a huge parliamentary majority, the government proved weak. The deteriorating economic situation, caused by successive seasons of bad herring catches and growing competition in European markets for Iceland's

¹ See Whitehead, 'Lydveldi og herstöðvar 1941-6', pp. 126-71 and Ingimundarson, *Í eldinni kalda stríðsins*, pp. 17-75.

fish products, forced it to introduce stern austerity measures, including rationing and foreign-exchange and import controls. Second, although the Socialists had condemned themselves to political isolation by their decision to leave the government, they kept control of the trade union movement.

Not until the Communist coup d'état in Czechoslovakia in February 1948, coupled with the Berlin Blockade in June, did the political climate in Iceland begin to change. The Socialists' support for both undermined their popularity, enabling the government to strengthen Iceland's ties with the United States and Western Europe. As Iceland had profited from the Second World War, the government had decided not to seek Marshall Aid, until the economic downturn in 1947-8 forced it to change its mind. Similarly, although reluctant to give the United States a military foothold in Iceland, it made tentative attempts to turn the Keflavik Agreement into a bilateral defence treaty.

Although, by 1948, the United States had made no plans to defend Iceland, it did foresee its occupation as soon as possible after the outbreak of war, with or without the government's consent, both to prevent the Soviets from exploiting the strategic location and to ensure that if the Soviets destroyed the Strategic Air Command (SAC) bases in Britain, a counter-offensive could be launched from Iceland using medium-range bombers.¹ The Icelandic government did not have precise knowledge of these plans, but was aware of Iceland's potential offensive value. Hence, its caution about entering into a defence pact with the United States.

When the negotiations leading to the North Atlantic Alliance began, the United States was keen that Iceland should join,² for, like the Azores and Greenland, it provided a stepping stone across the Atlantic. The government was reluctant, however, owing to internal divisions, domestic political opposition,³ and its uncertainty about the participation of Iceland's closest allies, Norway and Denmark. It eventually agreed to join, on condition that military forces would not be stationed in Iceland in peacetime;⁴ here Iceland followed Denmark and Norway, both sensitive to the Soviets'

1 See memo for chief, air force planning staff [College Park, Md. and Washington, DC, United States National Archives], R[ecord] G[r]oup 341 [Air Force – Plans Projects DF], box 837; see also memo of con[versation], Benediktsson and Butrick, 26 Aug. 1948 [Reykjavik, Bjarni] Benediktsson Papers.

2 Memo of con., Benediktsson and Butrick, 7 Dec. 1948; Thors to Benediktsson, 8 Jan. 1949 [Reykjavik, Thjóðskjalasafn Íslands [IS], S[kjalasafn] S[endiráds] Í[slands] W[ashington], NATO 1948-52, B/135 [folder: Dec. 1948-Dec. 1950], 8.A.2.

3 See Whitehead, 'Leidin frá hlutleysi', pp. 97-8; Baxter to F[oreign] O[ffice], 5 Jan. 1949 [Kew, Public Record Office], F[oreign] O[ffice Records] 371/77423; M. Johannessen, *Ólafur Thors. Ævi og Störf* (Reykjavik, 1981), ii. 88, 97-8.

4 Johannessen, *Ólafur Thors*, ii. 88, 97-8; see also, S. J. Stefánsson, *Minningar Stefáns Jóhanns Stefánssonar* (Reykjavik, 1967), ii. 47-8; Butrick to acting sec. state, 12 Jan. 1949, *F[oreign] R[elations] of the U[nited] S[tates]*, 1949: IV (Washington, 1976), 12.

fears owing to their proximity to the Soviet Union. Although Norway and Denmark, unlike Iceland, were not urged to accept military bases,¹ their decision to join NATO did much to persuade the Icelandic government to follow suit. The decision led to protests from nationalists and the Socialists that culminated in the most serious post-war riots in Iceland;² the parliament building was stoned and government ministers attacked. Ironically, Iceland, which had made its unarmed tradition the precondition for joining NATO, witnessed the most serious disturbances.

Despite the government's refusal to accept Allied troops in peacetime, the United States and NATO made no secret of their wish to send troops to Iceland to protect the airfields at Keflavik.³ Not until the Korean War,⁴ however, did a new centre-right Icelandic government composed of the Independent and Progressive Parties decide, on its own initiative, to ask NATO⁵ and the United States to strengthen Iceland's defences.⁶ However surprising the reversal may seem, the Korean War triggered a war scare in Iceland as in Western Europe and Scandinavia, partly owing to the presence off Iceland of a large Soviet fishing fleet. Although the Truman administration did not expect the Soviet Union to invade Iceland, it was quick in the spring of 1951 to conclude a defence pact with Iceland.⁷

Surprisingly, the defence pact and the arrival of US troops caused less controversy than the Keflavik Agreement and the decision to join NATO. Nationalists failed to co-operate with Socialists because the left-wing of the

¹ N. Petersen, 'Britain, Scandinavia, and the North Atlantic Treaty, 1948-9', *Review of International Studies*, viii (1982), 251-68.

² See Stefánsson, *Minningar*, ii, 52; Johannessen, *Ólafur Thors*, ii, 85; British embassy (Reykjavik) to Bateman, 26 April 1949, FO 371/77423; memo of con., Benediktsson, Jónsson, Jónsson, Andersen, Thors, Bohlen, Hickerson, and Hulley, 14 March 1949, *FRUS*, 1949, iv, 204, 206; memo of con., Benediktsson, Jónsson, Jónsson, Andersen, Thors, Bohlen, Hickerson, Anderson, Woolridge, and Bream, 15 March 1949, *ibid.*, pp. 227-8; Benediktsson to cabinet, 17 March 1948, IS, SSfW, NATO 1948-52, B/135, 8.A.2.

³ Embassy to foreign minister, 30 Jan. 1949, IS, SSfW, NATO 1948-52, B/135, folder: Dec. 1948-Dec. 1950, 8.A.2.

⁴ US embassy (Reykjavik) to state dept., 7 Aug. 1950 [RG 59], S[tate] D[eartment] D[ecimal] F[ile] 740B.5/8-950, box 3503.

⁵ Memo (Benediktsson), 29 Aug. 1950, IS, S[ögusafn] U[tanríkisráðuneytisins (Ministry of Foreign Affairs, Historical Records)], varnarmál og NATO, 1950-1, box 15; see also memo of con., Benediktsson and Lawson, 4 Sept. 1950, *ibid.*; Lawson to state dept., 1 Sept. 1950, SDDF 740B.5/9-150, box 3503; British embassy (Oslo) to FO, 7 Sept. 1950, FO 371/8650; Thorsteinsson, *Útanríkishjónusta Íslands og utanríkismál*, i, 361.

⁶ Report, extract from records of meeting of the standing group North Atlantic Military Committee, 16 Jan. 1951, IS, SSfW, NATO 1952-3, B/137, NATO. 8.A.1, 2.

⁷ See US embassy (Reykjavik) to state dept., 1 July 1950, SDDF 740B.00/7-150, box 3502; US embassy (Reykjavik) to sec. state, 26 June 1950, SDDF 740B.22/6-2750, box 3502; memo (Benediktsson) 4, 5 July and 14 Aug. 1950, IS, SU, varnarmál og NATO, 1950-1, box 15; Thors to state dept., 10 July 1950, IS, SSfW, NATO 1948-52, B/135, NATO 1951-2, 8.A.1, 2; Harrison to Price, 17 July 1950, FO 371/86501; Baxter to FO, 20, 28 July 1950; British embassy (Washington) to FO, 19 July, 1 Aug. 1950, FO 371/86501.

Progressives and all the Social Democrats voted for the treaty owing to the unstable international situation. By blaming the West for the war in Korea, the Socialists further isolated themselves. Nonetheless, public reaction to the US military presence was mixed: Icelanders remembered the social tensions caused by the US troops during the Second World War, when the number of foreign troops at one time exceeded the male population. Despite their first-hand experience of Icelandic nationalism, both dormant and active, the Americans were slow to grasp the importance many Icelanders gave to avoiding fraternization.¹

* * *

Apart from protecting Keflavik airport, the few thousand US soldiers stationed in Iceland were to facilitate air and sea patrols in the North Atlantic. With an improved Distant Early Warning system, the United States would be able to counter a surprise attack by deploying the fighter planes stationed in Iceland against Soviet bombers en route to the United States.² The US air force, however, which criticized the defence pact for prohibiting the use of Iceland for offensive purposes, pressed hard for an additional base in Iceland to support a heavy strategic mission by SAC in wartime and to conduct training exercises in peacetime. Worried that the British might deny them the use of SAC bases in Britain, the United States planned to use the Icelandic bases for counter-attacking the Soviets.³ At first, the Icelandic government seemed likely to agree, partly owing to the potential economic benefits of a second airfield and because a Norwegian general, Bjarne A. Øen, asked for an independent opinion, concluded that the airfield would strengthen Iceland's defences. Nonetheless, the government postponed negotiations with the United States because of the parliamentary elections due in the summer of 1953.⁴

¹ US embassy (Reykjavik) to state dept., 25 May, SDDF 740B.00/5-2551, box 3495 and same to same, 27 July 1951, 740B.00/7-2751, box 3495; Iceland Post Report, March 1951, RG 469 [Records of the US Foreign Assistance Agencies, 1948-61], mission to Iceland, office of the director, subject files, 1948-53, Legislation – NATO, box 9; 'Sources of tension between military and civilians in Iceland: suggestions for ameliorating such tensions', 26 Sept. 1951, RG 84, Classified General Records, 1950-2, box 19.

² See report, Strategic Importance of Iceland, 27 Sept. 1955, RG 319, General Staff, asst. chief of staff (G-3), 1955, box 13.

³ See Ramey to SAC, 29 Aug. 1951, RG 341, Air Force – PPDF, folder: OPD 091 Iceland, sec. 6, box 834; memo (Maddux), 9 Oct. 1951; CINCLANT [commander-in-chief, Atlantic] to CNO [chief of naval operations], 24 Oct. 1951; memo for Vandenberg, 14 Nov. 1951, sec. 3, box 834; Thorsteinsson, *Utanríkisþjónusta Íslands*, i. 376-9; S. Duke, 'US Basing in Britain, 1945-60', in *US Military Forces in Europe: The Early Years, 1945-70*, ed. S. Duke and W. Krieger (San Francisco, 1993), p. 132.

⁴ Lawson to Raynor, 17, 27 March 1953, SDDF 740B.5/3-1753, box 3504; memo of con., Benediktsson and Lawson, 12 March 1953, IS, SU, varnarmál og NATO, 1952-3, box 15; fundargerdir midstjórnar [executive committee minutes] (18), 16 Jan. 1953, S[kjalasafn] F[ramsóknarflokksins] [Political Archives of the Progressive Party]; memo of con. with Benediktsson, Thors, and others, 17 May 1950, RG 59 [Bureau of European Affairs, Subject Files Relating to European Defence Arrangements, 1948-54], lot file no. 55D 258, box 4; memo of con., Raynor and Thors, 3 April 1953, SDDF 740B.00/4-353,

Opposition to the US military presence grew slowly but steadily in 1952 and early 1953. The founding of a new party, the National Defence Party, solely for this purpose signified the revival of organized nationalism among intellectuals and left-of-centre political groups mostly dormant since Iceland's entry into NATO. Simultaneously, the Social Democrats moved to the left under new leaders who opposed granting additional rights to the United States. Most important, the Soviet Union suddenly joined the top rank of Iceland's trading partners.

Although the Soviet Union had been one of Iceland's biggest trading partners in the years immediately after the war, since 1947 there had practically been no trade between the two: the Soviets had severed all economic ties in riposte to Iceland's closer political alignment with the West. But in 1952, they decided to fill the vacuum created by a British ban on Icelandic fish owing to Iceland's decision to extend its exclusive fishing zone from three to four miles.¹ The barter trade with the Soviet Union strengthened the Socialists, as it proved beneficial to Iceland's economy: the Soviets supplied raw materials such as oil and cement and paid above world prices for fish products.

The shift to the left paved the way for major changes in Iceland's stance towards the United States and NATO. True, in the 1953 elections the Independence Party consolidated its position as the largest party, but the Progressives lost ground to the National Defence Party, which emerged victorious with six per cent of the vote and two parliamentary seats.² When the Progressives reluctantly agreed to revive the centre-right coalition with the Independence Party, they did so in order to change the pro-American course charted by the Independence Party foreign minister from 1947 to 1953, Bjarni Benediktsson. One of the first acts of the new foreign minister, the Progressive Kristinn Gudmundsson, was to demand the revision of the defence pact.

The Progressives wanted to seal off the NATO base at Keflavik by building a fence around it and by restricting movements off base. They demanded to replace all foreign workers with Icelanders and to revoke the business licence of the US contractor, whose labour practices had provoked criticism. Finally, they sought to prevent the US military from hiring construction workers from other parts of the country to ease the labour shortages in the fish-processing industry. The Eisenhower administration

box 3499.

¹ See T. Thórarinnsson, *Sókn og sigrar: Saga Framsóknarflokksins* (Reykjavik, 1986), ii. 244-5; see also state dept., office of intelligence research, 14 Oct. 1953 report, 'Outlook for additional base facilities in Iceland', IR 6425.

² See *Hagstofa Íslands, Kosningaskýrslur* (Reykjavik, 1988), ii. 556-8, 612-15; Johannessen, *Ólafur Thors*, ii. 228, 231; executive committee minutes (20), 9 Sept. 1953, SF.

was reluctant to agree, but when the Progressives threatened – indirectly – to revoke the treaty, gave way. In return, the United States was allowed to raise the number of troops stationed in Iceland from 3,900 to 6,200, but was denied the request for a second airfield.¹

Owing to the emergence of the National Defence Party and the Soviet economic offensive in Iceland, the Americans recognized by mid-1954 that they had to respond to the growing opposition to the military base. When the Socialists joined forces in 1954 with Social Democrats to defeat the previous majority, made up of the non-Socialist parties, in elections to the all-powerful board of the Federation of Labour,² the Eisenhower administration first tried to counter the left-wing trend with propaganda: sending world-famous artists to Iceland and inviting Iceland's political leaders, artists, trade unionists, and journalists to visit the United States. And they sought to combat Communism within the trade union movement by encouraging the non-Socialist parties to co-operate.³ It was clear that they were facing an uphill battle, however, when the Geneva summit in the summer of 1955 only buttressed the Socialists' claim that the US troops at Keflavik were superfluous because of the relaxation in East-West tensions.

The Eisenhower administration knew, of course, that propaganda alone would not swing over Icelandic public opinion. Ironically, the slide in American popularity from 1953 to 1955 coincided with enormous economic benefits to Iceland from the US base. The suspension of Marshall Aid in 1953 had no effect on Iceland's economy because of the military construction programme at Keflavik: purchasing power in Iceland may have risen as much as thirteen per cent in 1953-4 because of the money the base injected into the economy. What amounted to a new industry was created, one that the Icelanders profited from without having to invest a penny.⁴

Beneath the surface, however, there were serious problems. The base economy increased inflationary pressures, leading to easy credit, excessive investment, and an unstable labour market. Although the government was partly to blame for the lax economic policies – it would have been possible

1 Raynor to Merchant, 25 Nov. 1953, *FRUS*, 1952-4, iv. 1523-15; Gudmundsson to Lawson, 4 Dec. 1953, pp. 1526-7; Lawson to state dept., 11 May 1954, pp. 1531-3; Dulles to Lawson, 14 May 1954, pp. 1533-5; Thorsteinsson, *Utanríkisþjónusta Íslands og utanríkisráðgjafi*, i. 386-7, 389-91; meeting minutes (18), 24, 27 Jan., 11 May 1954, SU, NATO, box 15; embassy (Washington) to for. min., 2 June 1954, IS, SSÍW, B/137, 8.A.2. NATO I, 1954-8; memo, negotiations on the implementation of US-Icelandic defence agreement of May, 1951, 28 Jan. 1954, RG 59, lot file no. 59 D 233, box 26.

2 See Thórarinnsson, *Sókn og sigrar*, ii. 254-5; see also US embassy (Reykjavik) to sec. state, 24 Sept. 1954, SDDF 740B.00/9-2454, box 3502; T. Fridriksson, *Undirheimar íslenskra stjórnmála* (Reykjavik, 1988), p. 44.

3 Chief, MSA special mission, Iceland (Lawson), to SRE/Paris, chief, information div., 23 Feb. 1953, RG 469, mission to Iceland, office of the director, subject files, 1948-53, Funds-Labor, box 8.

4 See I. Sigurpálsson, 'Herinn og hagkerfid: Efnahagsleg áhrif varnarliðsins', *Fjármálattíðindi*, xxxiii (Jan.-June 1976), 35.

to isolate the base economy from the Icelandic one – Icelanders were predictably not keen on losing the income from construction at the base, even if they wanted to control the pace. The result was a general strike in the spring of 1955, which ended the Progressives' co-operation with the Independence Party in the government, a political reconfiguration unwittingly facilitated by the United States, which refused to slow the construction programme at the base. Although state department officials knew what might happen, the Pentagon ignored everything but the military aspects of the base economy.¹

In a last-ditch effort to reverse the decline in its fortunes in Iceland, the United States offered two sorts of economic help. First, on the initiative of the secretary of state, John Foster Dulles, the Eisenhower administration decided to sidestep US laws stipulating the imposition of countervailing duties on fish products from subsidized industries such as Iceland's.² Dwight Eisenhower himself even suggested that the United States should buy Iceland's entire fish production to give it away to poor countries as a humanitarian gesture. The suggestion was not taken up lest it should open a floodgate to similar requests from other countries.³ Second, the United States offered to finance the construction of a cement factory in Iceland, which the International Bank of Reconstruction and Development (World Bank) had refused to do, partly to forestall the acceptance of a similar offer from the Soviet Union.⁴ Although Iceland received most of the money in the spring of 1956, the scheme was too modest and came too late to stabilize the coalition between the Independence and Progressive Parties.

* * *

Since the late 1940s, the Progressive Party's chairman, Hermann Jónasson, had wanted to form a left-of-centre electoral alliance with the Social Democrats, in order to counterbalance the Independence Party led by Ólafur Thors.⁵ The personal feud between the two men helped to destabilize

¹ Progress report on Iceland by the operations co-ordinating board, 7 Sept. 1955 [Abilene], D[wight] D. E[isenhower] L[ibrary, White House Office of the special assistant for] N[at]ional S[ecurity] A[ffairs], policy papers, NSC 5426, box 12, folder: policy toward Iceland, 9/755 (8).

² See embassy (Washington) to for. min., 6 May 1955; aide-mémoire, 6 April 1954; Thors to Thors, 20 May; Thors to Gudmundsson, 23 May; memo of con., Gudmundsson and Dulles, 15 June 1955, IS, S[kjalasafn] F[orsætisráðuneytis], B-64, efnahagsmál, 1955-65; memo of con., Raynor, Stanford, and Thors, 2 May 1955, RG 59, lot file no. 59 D 233, box 26.

³ Memo of discussion, NSC meeting, 22 July 1954, DDEL, A[nn] W[hitman] F[ile], box 5, folder, 207th meeting of the NSC; progress report NSC 5426, 7 Dec. 1954, *FRUS*, 1952-4, iv. 1543.

⁴ Thors to for. min., 6 March 1954, IS, SSÍW, B-127, ECA, 1949-60; progress report NSC 5426, 7 Dec. 1954, *FRUS*, 1952-4, iv. 1546; Muccio to Dulles, 16 Dec. 1954, SDDF 740B.00/12-1654, box 3502; memo, 'International Co-operation Administration and State Department', 17 Nov. 1955, SDDF 840B.332/11-1755, box 4421.

⁵ Executive committee minutes (16), 19 Nov. 1949, SF.

Icelandic politics, and their refusal to join the coalition government of the Independence, Progressive, and Social Democratic Parties in 1947 undermined its authority at a crucial period. Although they made a temporary truce in 1950 when the Independence and Progressive Parties formed their first coalition government, Jónasson refused in 1953 to serve under Thors in their second.

Not until the autumn of 1955 were the Progressives and Social Democrats strong enough to combine forces, which set the stage, in the spring of 1956, for an electoral alliance dubbed by its opponents the Alliance of Fear. By exploiting the flaws in the electoral system, the Progressives and Social Democrats hoped to obtain a parliamentary majority with little more than one-third of the popular vote. Sensing the growing opposition to the US base, the alliance placed the cancellation of the defence pact at the top of its foreign-policy agenda, and after the Progressives withdrew from the coalition government in March 1956, they and the Social Democrats introduced a sweeping resolution in parliament calling for the removal of US troops and for the reversion to the policy of no military presence in peacetime, while confirming Iceland's adherence to NATO.

Although the resolution was supported by all parties except the Independence Party, its implementation would hinge on the outcome of the parliamentary elections in June.¹ The Alliance of Fear was not the only cause of the uncertainty about the future of the US base; together with a group of left-wing Social Democrats, the president of the Federation of Labour, Hannibal Valdimarsson, formed an electoral alliance with the Socialists known as the Popular Alliance. They, too, promised to carry out the resolution should they join the new government.

Eisenhower and Dulles's first public response was surprisingly mild: they hinted that the number of US troops in Iceland could be reduced: according to Eisenhower, the 'Icelanders were our friends' and the problem 'can probably be worked out'.² But behind the scenes, the administration tried to prevent the abrogation of the treaty. To drive home the point, it halted construction at Keflavik pending the outcome of the negotiations, a decision bound to have major economic consequences because the revenues from the base accounted for almost ten per cent of Iceland's national income and between fifteen and twenty per cent of its foreign-currency earnings.³ Understandably, such tactics angered the Progressives

¹ *Althingistíðindi*, 1955, D (Reykjavik, 1956), A, pp. 662-3.

² State dept. to embassy (Paris), 6 April 1956, SDDF 740B.00/4-656, box 3174; *New York Times*, 5 April 1956.

³ See report, 'Analysis of internal security situation in Iceland and recommended action', 2 May 1956; report, 'Importance of the Icelandic action to US and NATO security plans', 18 April 1956: USNA, RG 59, Records Relating to State Department Participation in the Operations Co-ordinating Board

and Social Democrats. Guðmundsson accused the United States of interfering in Iceland's domestic politics by supporting the Independence Party:¹ although there was no collusion between the Eisenhower administration and the Independence Party,² it was bound to favour the only party that supported the treaty. But the United States's indirect efforts to determine the outcome of the election were unsuccessful. It failed to persuade the World Bank to approve Iceland's application for a loan to finance a hydro-electric project on the river Sog,³ and the British to rescind their ban on Icelandic fish, partly because the British feared that such an action would be interpreted as interference and partly because nothing was offered in return to British trawler-owners. The only direct offer of aid to the Independence Party came from West Germany. When the chancellor, Konrad Adenauer, personally offered Thors a \$20 million loan to pay for the Sog power plant, Thors nonetheless declined, lest he should be accused of too-close ties with a foreign government.⁴

The election result proved inconclusive: the Independence Party took 42% of the vote; the Progressive-Social Democratic alliance 34%; and the Popular Alliance 19%. With only 4.5%, the National Defence Party lost both of its seats. US relief over the Alliance of Fear's failure to obtain a majority, and over the defeat of the National Defence Party, quickly turned into disappointment, for, despite its impressive showing, the Independence Party was isolated, and the Popular Alliance's strong third-place finish enabled Jónasson to form a left-wing government of Progressives, Social Democrats, and the Popular Alliance.

The news from Iceland jolted the Eisenhower administration: for the first time, the government of a member of the Atlantic Alliance included pro-Soviet Socialists. At US bidding, NATO headquarters at Paris immediately stopped circulating confidential documents to Iceland, on the grounds that they might end up in Socialist hands. The decision caused a crisis in Iceland's relations with the Western alliance. Claiming that ministers from the Popular Alliance had no influence on Iceland's foreign policy and were prohibited from reading NATO documents, the Progressive and Social Democratic members of the Leftist Government demanded

and the National Security Council, 1947-63, box 19.

¹ Muccio to Dulles, 7 April 1956, SDDF 740B.00/4-656, box 3174.

² Elbrick to Hoover, 11 July 1956, SDDF 740B.00/5-3056, box 3174.

³ See memo, 11 June 1956, FO 371/1224918; Aldrich to Dulles, 14 June 1956, SDDF 840B.254/6-1456, box 4421.

⁴ See report, West German embassy (Reykjavik) to for. min., 25 May 1956, [Koblenz, Bundesarchiv] band 122, no. 546; see also memo of con., 18 April 1957, SDDF 840B.00/4-1857, box 4418; Scherpenberg to West German embassy (Washington and Reykjavik), 16 Aug. 1956 [Bonn, Politisches Archiv des] A[uswärtigen] A[mtes], Abt[eilung] 4, 410, band 88; Adenauer to Thors, 22 June 1956, signed by Hallstein, AA, Abt. 4, 410, band 88; Jónsson to for. min., 22 June 1956, IS, SSfW, B-163.

unrestricted access to them. When NATO – again at US bidding – refused to resume the document transfers, Jónasson threatened to leave NATO ‘in one hour’.¹ Under duress, NATO gave in at the end of September. But as Iceland had no adequate system for protecting classified information during the 1940s and 1950s, it did not receive any important strategic-military plans.

Although NATO urged Iceland to allow the American troops to stay, the Leftist Government, bent on an independent foreign policy, looked likely to demand their withdrawal. From the US perspective, one hope rested with the new foreign minister, Guðmundur Í. Guðmundsson, and other right-wing Social Democrats, including the president of Iceland, Ásgeir Ásgeirsson, who was very influential despite holding a ceremonial post. All of them wished to compromise with the United States, partly because Danish and Norwegian Social Democrats opposed the demand for withdrawal.² The other US hope was Canada’s foreign minister, Lester B. Pearson, keen as always to raise his country’s international profile, who offered to mediate. According to one plan, US forces would leave Iceland, to be replaced in rotation by forces drawn from NATO members, including the United States.³

At first, the United States, hoping to avoid dealing with the Leftist Government, did not respond.⁴ In September, however, the United States gave ground after sensing a willingness on the part of the Social Democrats to find a solution acceptable to both sides. Its hand was also strengthened because Iceland had failed to obtain foreign loans to finance its ambitious economic development plan.⁵ The Progressives and Social Democrats had not asked the United States for loans owing to the unpopularity in Washington of Iceland’s foreign-policy agenda; instead, they placed their bets on Adenauer’s offer to Thors before the election.

However, as Adenauer had offered to reward the Independence Party for its pro-Western course, Germany now turned the new government down. So did France. Most NATO governments shared the US view that the dispute over the base should be settled before economic aid to Iceland

1 Memo of con., Jónasson and Gilchrist, 18 Sept. 1956, FO/371/22492.

2 Muccio to Dulles, 16 July 1956, SDDF 740B.00/7-1656, box 3175; US embassy (Oslo) to sec. state, 31 July 1956, SDDF 740B.15/7-3156, box 3178; British ambassador (Oslo) to FO, 30 July 1956, FO 371/124888.

3 US embassy (Oslo) to sec. state, 31 July 1956, SDDF 740B.15/7-3156, box 3178; Muccio to Dulles, 5 Aug. 1956, SDDF 740B.11/8-456, box 3178; Muccio to sec. state, 8 Aug. 1956, SDDF 740B.15/8-756, box 3180.

4 See memo for Melbourne, 3 Aug. 1956, DDEL NSA, NSC Staff April–Nov. 1956, box 36, folder: Iceland no. 4 (6); memo, ‘Northern European chiefs of mission conference’, London, 19–21 Sept. 1957, summary of proceedings, *FRUS, 1955-7: IV* (Washington, 1986), 621.

5 Memo of con., Thór, 26 Sept. 1956, SDDF 740B.00/9-2656, box 3175; Muccio to Parson, 10 Sept. 1956, SDDF 740B.00/9-1956, box 3175.

was discussed.¹ Despite this setback, the Progressives and Social Democrats resisted the Socialists' call to seek aid from the Soviet Union: as the barter trade with the Soviet bloc was approaching thirty-five per cent of Iceland's total volume of trade, they feared that Iceland would become too closely tied to it. As the only possibility left was US aid, they reluctantly recognized that economic and defence questions were inseparable.²

When Iceland agreed to hold exploratory talks with the United States early in October in Washington, it aimed to obtain a *modus vivendi* on the defence question and to secure economic aid. At the first meeting with Dulles on 1 October, the acting foreign minister, Emil Jónsson, offered to compromise, and requested that the governor of Iceland's Central Bank, Vilhjálmur Thór, be allowed to explain Iceland's economic problems before defence talks continued. The Eisenhower administration, keen to tie defence and economic questions together, happily agreed. At the second meeting, on 3 October, the assistant secretary of state, Herbert Hoover, offered a \$5 million loan to finance the Sog hydroelectric plant, provided that it supplied power to the US base. The purpose, of course, was to ensure the continued presence of US forces in Iceland.³

No decisions were made during the Washington talks, but it was agreed to begin the formal negotiations about the base in November. In the interim, the Socialists' leader, Einar Olgeirsson, tried to obtain a Soviet loan to buttress the Popular Alliance's position in the government. When the Soviets verbally promised a large loan on advantageous terms, the Progressives and Social Democrats tried to use it to lever the United States, claiming that if refused US aid, they would have to accept the Soviet offer.⁴ Although the Eisenhower administration was sensitive to attempts to play off the United States and the Soviet Union against each other, it recognized that Iceland's economic dependence on the Soviet Union could weaken

¹ Elbrick to Hoover, 30 July 1956, SDDF 740B.00/7-3056, box 3175; see also US embassy (Paris) to state dept., 11 Sept. 1956, SDDF 840B.10/9-1156, box 4418; Gudmundsson and Briem to for. min., 10 Aug. 1956, IS, SF, B-163; memo of con., Gudmundsson and Scherpenberg, 8 Aug., memo (von Lupin), 3 Sept., Oppler to for. min., 31 Aug., Meseck to von Lupin, 26 Oct., memo of con., Scherpenberg and O'Shaughnessy, 10 Aug., memo, West German embassy (Washington) [Heinz Krekeler], 21 Aug. 1956, AA, Abt. 4, 410, band 88.

² Memo of con. with Thór, 26 Sept. 1956, SDDF 740B.00/9-2656, box 3175.

³ Fundargerdir, 1, 3 Oct. 1956, IS, SSÍW, NATO 1958-62, 1990 B/138, NATO 1958 1, 8.A.2; see also memo, 'Informal-confidential discussions between the sec. state and under-sec. and Jónsson', 1, 3 Oct. 1956, RG 59, US N[ational] S[ecurity, 1955-9] 711.56340B/10-256, box 2887; memo, 'Discussions between the under-secretary and Thor', 25 Oct. 1956, SDDF 611.40B/10-256, box 2477; memo, 'Iceland Upper Sog Hydroelectric Project', 23 Oct. 1956, SDDF 840B.2514/10-2356, box 4421; Elbrick to Hoover, 2 Oct. 1956, RG 59, USNS 711.56340 B/10-256, box 2887.

⁴ See memo, 'Recent reports concerning possible Soviet loan to Iceland', n.d., RG 59, Records Relating to State Department Participation in the Operations Co-ordinating Board and the National Security Council, 1947-63, box 19; see also Jónasson to Thór, 12 Oct. 1956, IS, SF, efnahagsmál, 1955-65, B-64.

US influence in Iceland. Therefore, on 25 October, Hoover handed Thór an aide-mémoire, offering a quid pro quo: economic aid in exchange for continued military rights. The United States was prepared to grant an emergency loan of \$3 million before the conclusion of the defence negotiations, depending on a 'satisfactory' outcome of the bilateral talks. It promised more, if the Icelanders would be forthcoming on defence:

At an appropriate time and in the light of the economic measures taken by Iceland to stabilize its economy the United States would be willing to consider on their economic merits the financing of specific projects. A further consideration that will weigh heavily with the United States Government in these subsequent discussions will be the actions which will have to be taken by Iceland to demonstrate its willingness to continue to contribute effectively to the defense of the Free World.¹

Since September, the Leftist Government had moved away from its hardline stance. Gudmundsson hinted late in October that the question could easily be settled, and Jónasson was leaning in the same direction.² The Social Democrats and Progressives hoped to persuade the United States to reduce the number of troops stationed at Keflavik, instead of closing the base, in order to prevent the Popular Alliance from withdrawing from the government in protest. Thanks to the Hungarian Revolution, which provoked a storm of protest in Iceland and severely undermined the Socialist Party, a bargain with the United States would not break up the government. Thus, with the Socialists' acquiescence, the Leftist Government abandoned its plan to abrogate the treaty, citing the precarious international situation after the Hungarian Revolution and, for formality's sake, the Suez Crisis.³

The defence negotiations that took place in late November merely ratified the status quo ante and the US offer of economic aid. The leaders of the opposition Independence Party, Thors and Benediktsson, criticized the government for bartering Iceland's security and the United States for bolstering a government that included pro-Soviet Communists.⁴ Although the Eisenhower administration had been deeply divided over whether to offer economic aid, strategic considerations outweighed ideological ones.

¹ Memo, 'Discussions between Hoover and Thor', 25 Oct. 1956, SDDF 840B.10/10-256, box 4418; see also Elbrick to Hoover, 22 Oct. 1956, SDDF 740B.5-MSP/10-2256, box 3182; Thór to Jónasson, 26 Oct. 1956, IS, SF, efnahagsmál, 1955-65, B-62.

² Muccio to Dulles, 25 Oct. 1956, SDDF 840B.00/10-2556, box 4417.

³ Memo of con. with Olgeirsson, 28 Feb. 1957 [Berlin, Stiftung Archiv der Parteien und Massenorganisationen der DDR im Bundesarchiv] Z[entralkomitee] der S[ozialistischen] E[inheitspartei] D[eutschlands], IV 2/20/286 and V. Ingimundarson, *Lidsmenn Moskvu. Samskipti íslenskra kommúnista við austantjaldsrákin* (Reykjavík, 1992), pp. 127-8; Gilchrist to FO, 14 Nov. 1956, FO 371/122492.

⁴ See Gilchrist to state dept., 2 Jan. 1957, FO 371/128761.

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Although the Leftist Government disingenuously denied the link between defence and economic aid, it was determined to make the United States keep its promise. In January 1957, Thór asked for a \$40 million loan, a much larger sum than the \$3 million Hoover had offered, plus \$5 million to cover the foreign-exchange costs of the Sog project and a modest loan to finance the buying of US agricultural surplus goods. The United States had tied more substantial economic aid to the soundness of Iceland's economic policies.¹

When the Social Democrats and Progressives learned that Iceland could only expect a fraction of the US economic aid it sought, they had great difficulty in figuring out their next move. Ignoring advice from Olgeirsson, they were still opposed to turning to the Soviet Union: it could spoil their chances of receiving Western loans and stymie efforts to modernize an economy whose reliance on export subsidies, barter trade, currency controls, and import restrictions resembled the command economies of Eastern Europe. On the other hand, they could hardly turn down the Soviet offer, renewed in the spring of 1957, of \$25 million to be repaid in fish, if the West would not come to the rescue.²

The Social Democrats and Progressives preferred to try all the other possibilities before turning to the Communist bloc. After talking of inflationary financing, they appealed to West Germany and Britain for aid, but although both were willing to give government guarantees for short-term loans at market rates of interest, Iceland was seeking long-term loans at preferential rates – in short, political loans. Only the United States had taken a small step in this direction with its \$5 million loan for the Sog project and a \$2.2 million PL-480 loan on generous terms.³

Although Hoover's aide-mémoire was meant to facilitate the negotiations on the base question, it was also meant to forestall Iceland's acceptance of a Soviet loan. In late spring 1957, however, the Eisenhower administration decided that the Sog and PL-480 loans were not enough to prevent Iceland from slipping further into the Soviet economic orbit. For one thing, Olgeirsson was trying to persuade the government to accept a Soviet offer to pay for twelve fishing vessels to be built in East Germany with a \$3 million loan. East Germany's prime minister, Otto Grotewohl, had invited the Socialist minister of fisheries, Lúdvík Jóseppsson, to sign the

¹ Memo of con. with Thór, 1 Feb. 1957, SDDF 840B.2614/2-157, box 4421; Hollister to Dulles, 8 Feb. 1957, SDDF 840B.10/2-857, box 4418; Elbrick to Murphy, 11 Feb. 1957, SDDF 840B.14/2-1157, box 4420; Dulles to US embassy (Reykjavik), 13 Feb. 1957, SDDF 840B.10/2-557, box 4419.

² Hirschfeld to for. min., 9 April 1957, AA, Abt. 4, 410, band 88.

³ Gilchrist to FO, 15 March 1957, FO 371/128761; memo of con. with Thór, 18 April 1957, SDDF 840B.00/4-1857, box 4418 and 3 May 1957, SDDF 740B.00/5-357, box 3175.

agreement in East Berlin. Both sides would benefit: Soviet economic aid would bolster the standing of the Popular Alliance within the government, while signing the agreement in East Berlin would constitute an important step towards the de jure recognition of the German Democratic Republic, a move adamantly opposed by West Germany.¹

Sensing that the loan question might turn into a Soviet victory in the cold war, the Eisenhower administration persuaded the Progressives and Social Democrats that Iceland's economic problems should be discussed at NATO. On 1 July 1957, Iceland's permanent delegate to NATO wrote to the secretary-general, Paul-Henri Spaak, asking for economic aid. Citing the Soviet offers, Iceland argued that the West should counter the Soviet attempts to take advantage of Iceland's economic woes to undermine its commitment to the Western alliance.²

Spaak replied that the request served the useful purpose of extending NATO's responsibilities to its members beyond security, its intention in setting up in the spring of 1956 its committee of Wise Men. The United States offered to provide part of the loan on the condition that Iceland stabilize its economy and reduce its dependence on the Soviet market. Denmark, Norway, Italy, and Canada also responded favourably to Iceland's request, but Britain objected that NATO was not meant to act as a bank and that Iceland should not receive any favours refused to others. West Germany was also hesitant to provide direct economic aid.

Although Spaak conceded that there was no economic rationale for giving economic aid to Iceland, he added that NATO should anticipate Soviet attempts to exploit Iceland's economic problems:

He [Spaak] explained that he had come to the conclusion that, quite apart from the longer-term task of reorganising the Icelandic economy (a task for which OEEC should primarily make itself responsible) it was necessary for NATO to carry out in the immediate future a short-term rescue operation of a strictly political character. He believed that unless NATO were to intervene rapidly there was a very real danger of the Russians being able to exploit Iceland's present financial difficulties to the point of seducing Iceland from its allegiance to NATO.³

In an unprecedented move, he recommended a long-term loan of \$9

¹ Gilchrist to FO, 8 April 1957, FO 371/128750; memo of con., Benest and Mayer, 24 April 1957, SDDF 740B.00/4-2457, box 3175; see also, memo of con., Walkow, Handke, Astawin, 24 May 1957, Berlin, Politisches Archiv des Auswärtigen Amtes, A13159; memo, Kredit an Island, 20 May 1957, A313159; Handelsvertretung Island to East German for. min., 21 May, memo, 27 May, Handke to Oelbner, 3 June 1957, A13159.

² Andersen to Spaak, 1 July 1957, FO 371/128756.

³ Permanent British delegation, NATO to FO, 9, 10 July 1957, FO 371/128756; permanent British delegation, NATO to FO, 12, 16, 17, 25 July 1957, FO 371/128756; Spaak to representative of NATO member states, 8 Aug. 1957; British embassy (Washington) to FO, 10 Aug. 1957 and memo (Brimelow), NATO aid to Iceland, 8 Aug. 1957, FO 371/128756.

million at a low rate of interest. The United States and several Continental states immediately supported him, and Britain, alone in objecting, did not oppose. The United States, West Germany, Denmark, Norway, and Canada agreed to share the loan between them.¹

Iceland's own actions, however, threatened to unravel the deal. The Progressives and Social Democrats insisted that no more than three NATO countries should share the loan: as the agreement would require parliamentary approval in several NATO countries, they wanted to avoid widespread discussion of Iceland's economic problems. They also feared that the Independence Party would renew its charge that the government was using Iceland's security as a bargaining chip.² In the end, the United States and West Germany shared the loan between them, when the other NATO countries backed away for budgetary reasons. The US loan of \$5 million was granted in December 1957;³ the West German loan of \$2 million in April 1958. The political price was a promise by Iceland to reject the Soviet loan as a sign of good faith.⁴

For strategic reasons, the United States and NATO had decided to strengthen a left-wing government to maintain their own military presence and reduce Soviet influence in Iceland. The first test of Iceland's Western alignment came in late 1957 and early 1958, when the Soviet premier, Nikolai Bulganin, proposed a moratorium on nuclear testing, a nuclear-free zone in Central Europe, and a non-aggression treaty between the Atlantic Alliance and the Warsaw Pact. These proposals were a response to NATO's decision in December 1957 to create a joint nuclear stockpile and to consider stationing intermediate nuclear missiles in member countries.

In his first letter to Jónasson, Bulganin offered to guarantee the neutrality of Iceland on the condition that all foreign troops be withdrawn. In a second letter, he intimated that Iceland was in grave danger, owing to the United States's capability of storing atomic weapons in Iceland. Jónasson replied that the US base in Iceland was defensive and that there were no plans to store nuclear weapons there.⁵ This forceful response, welcomed by the United States, showed how far the Leftist Government had moved from its stance in 1956.

1 British embassy (Washington) to FO, 10 Aug. 1957, FO 371/12856; see also permanent British delegation to NATO to FO, 11 Sept. 1957, FO 371/12857; permanent rep., NATO, to FO, 3, 8 Oct. 1957, FO 371/12858.

2 Permanent rep., NATO, to FO, 3 Oct. 1958, FO 371/12858.

3 Memo of con. with Thór, 19 Dec. 1957, SDDF 740B.5-MSP/12-1957, box 3182; see also US embassy (Reykjavik) to sec. state, 3 Feb. 1958, SDDF 840B.10/2-358, box 4419.

4 See memo (Curtius), 28 March 1958, and tel. con., Curtius and Mittendorff, 29 March 1958, AA, Abt. 4, 410-85.00-9411, band 254.

5 See Thórarinnsson, *Sókn og sigrar*, ii. 17-20; US embassy (Reykjavik) to state dept., 19 Dec. 1957, SDDF 740B.00-/12-1957, box 3176.

The United States, however, was less convincing when it came to cementing Iceland's ties with the West. In May 1957, the defence department, with Eisenhower's approval, recommended the withdrawal of the US army units from Iceland to save money,¹ and proposed to replace them with NIKE and HAWK anti-aircraft missile systems armed with nuclear warheads. Although the proposal would not have meant a major reorganization – four thousand air force and navy personnel would remain – it was bound to be sensitive because the army contingent was the core of the Iceland Defence Force responsible for Iceland's defence. Fearing the political repercussions, the US ambassador, John Muccio, warned the state department that the proposal might be interpreted as a signal that the United States had lost interest in Iceland, contradicting its own arguments in 1956 for the need of a base.² The Supreme Allied Commander, Atlantic (SACLANT), Jerauld Wright, just as critical, argued that apart from Scotland, Iceland was the most important key to the defence of the Atlantic.³

The Eisenhower administration decided nonetheless to pull out its troops in 1958. To make the measure more palatable, they talked of describing the NIKE and HAWK air-defence units as a replacement,⁴ but gave up the idea when it became clear that the US army would be unable to deploy air defence units to Iceland. They also seem to have ignored the possibility of opposition in Iceland to the stationing of nuclear warheads; perhaps US embassy officials in Iceland believed that the missiles would have conventional warheads (these were dual capability weapons). In any case, it is unlikely that Iceland would have agreed to the arrival of NIKE missiles, for it would almost certainly have led to a political crisis and the fall of the government.

At this time, Iceland had no firm policy on nuclear weapons. Jónasson, in replying to Bulganin, had not ruled out the acceptance of them but, like Denmark and Norway, which expressed their dislike of the United States's and NATO's increasing reliance on nuclear weapons by refusing to allow them to be stored on their territory, Iceland was worried about their

¹ NSC minutes, US policy toward Iceland, 16 May 1957, DDEL, AWF, NSC series, folder: NSC, 32 meeting, 16 May 1957 (4), box 8.

² Murphy to Quarles, 18 Aug. 1957 and Murphy to Dulles, 3 Oct. 1957, SDDF 711.56340B/8-1657, box 2888.

³ See memo for Radford, 1 July 1957, USNA, RG 218 [Records of the Joint Chiefs of Staff] Geographic File, 1957, chairman's file, Admiral Radford, 091, 1953-7, Iceland, box 9; see also Wright to the sec. def., 11 Oct. 1957, RG 469, mission to Iceland, office of the director, subject files, 1948-53, NATO Programme, box 10.

⁴ See memo of con. with McElroy on withdrawal of ground troops from Iceland (Boster), 28 March 1958, RG 59, Records of the Policy Planning Staff, 1957-61, box 140; see also Dulles to US embassy (Reykjavik), 11 April 1958, RG 59, USNS 711.56340B/4-1158, box 2888.

potential use. As the United States never discussed the plan to send the NIKE and HAWK systems to Iceland, it had no effect on US-Icelandic relations. But the United States had stored NIKE missiles at its base at Thule in Greenland between 1958 and 1965; this violation of Denmark's non-nuclear policy, revealed only in 1995, had been approved by the prime minister, H. C. Hansen, but kept secret from the cabinet.¹

Although the Eisenhower administration arranged to deploy special ground forces to Iceland in an emergency instead of air defence units, to compensate for the withdrawal of the army units, the decision to pull out was postponed twice, owing to political developments that could reopen the defence question: the escalating cod war between Iceland and Britain and the parliamentary elections of 1959.² Not until 1959 did the troops leave, without any adverse publicity in Iceland.

A more serious test of Iceland's Western alignment was provided by the cod war with Britain. Only a month after Iceland received the West German loan, it triggered off another crisis within the Atlantic Alliance by announcing its plan to extend unilaterally its fishing limit from four to twelve miles. NATO had persuaded Iceland to wait for the outcome of the Law of the Sea conference at Geneva in the spring of 1958 before resorting to any unilateral measures,³ but when the conference proved unable to agree on a formula for territorial waters and fishing zones, the minister of fisheries, Lúdvík Jóseppson, persuaded his cabinet colleagues to act. When the decision took effect on 1 September 1958, Britain not only refused to honour it but sent warships to protect its fishing boats within the twelve-mile zone.

The dispute caused the United States, which tried to stay neutral, considerable embarrassment. Gripped by nationalistic fervour, Icelanders of all stripes were enraged when the Eisenhower administration prevented the adoption of a proposal at the Law of the Sea conference that would have sanctioned Iceland's action.⁴ If the British used force within the twelve-mile zone, Iceland might withdraw from NATO and abrogate the defence pact with the United States; after all, the Americans were supposedly in Iceland to defend it.⁵ When US attempts to resolve the

1 See Dansk Udenrigspolitisk Institut: *Grønland under den kolde Krig: Dansk og amerikansk sikkerhedspolitik, 1945-68* (Copenhagen, 1997). See also Berdal, *United States, Norway, and the Cold War*, pp. 80-1.

2 Memo for Murphy, 7 July 1958, RG 59, USNS 711.56340B/7-758, box 2888; Elbrick to Sprague, 13 Sept. 1958, *ibid.*, 711.56340B/9-155, box 2888; Muccio to state dept., 22 Dec. 1958, *ibid.*, 711.56340B/12-2258, box 2888.

3 See memo, 'British views and plans with regard to Iceland', 24 April 1957, SDDF 740B.00/4-2457, box 3176.

4 See US embassy to state dept., 17 April 1958, SDDF 740B.00/4-1758, box 3176.

5 See state dept. to US embassy (Reykjavik), 9 May 1958, SDDF 740B.0022-/5-958, box 3176 and same

dispute within NATO failed in 1958, every political party considered the option of leaving NATO because of the British show of force. Britain agreed as a gesture of good-will to cease fishing inside the twelve-mile zone before the Law of the Sea conference in 1960. When it threatened to resume fishing after the failure of the conference, the minister of justice, Bjarni Benediktsson, who as foreign minister in 1949 had been instrumental in securing Iceland's NATO membership, made it clear that Iceland would withdraw from the alliance as a result. It is not certain whether this threat made the difference, but Britain refrained from entering the twelve-mile zone and, in February 1961, signed a deal which clearly favoured Iceland: Britain recognized the zone in return for fishing rights within it for three years.

The solution was facilitated by the downfall of the Leftist Government in 1958; disagreements over economic policy destroyed the first experiment in Icelandic left-wing politics since the founding of the state. Despite a verbal commitment to NATO in 1957 to reform the economy in line with recommendations from the International Monetary Fund (IMF) and the Organization of European Economic Co-operation (OEEC), the Leftist Government had continued to subsidize exports and failed to halt the inflation caused by wage rises and a high level of consumer demand coupled with deficit-financed investment and inadequate credit controls. Although the Progressives and Social Democrats had tried to explain to the public the shortcomings of a system characterized by disguised multiple exchange rates and bilateral barter trades, they failed to persuade the Federation of Labour of the need for wage cuts. Jónasson saw no alternative in December 1958 but to resign.

After a brief Social Democrat minority government, the Independence Party and the Social Democrats formed a coalition government late in 1959 – the Reconstruction Government – which stayed in power until 1971. Its main domestic political goal was to relax controls on imports, abolish export subsidies, and devalue the currency. The plan was made possible by \$30 million in stabilization aid from the OEEC, the IMF, and the United States; its success was ensured by record fish catches. The government marked the beginning of a new stable phase in Iceland's relations with the United States and NATO that lasted throughout the 1960s and confirmed Iceland's alignment with the West. The economic reforms led to a shift in trade towards Western Europe away from the Eastern bloc.

For the West, the outcome was highly advantageous: Iceland, while strengthening its ties with the Western bloc, became less dependent on the Soviet Union. Equally important, the new economic policies eliminated

to same, SDDF 740B.022-/6-558, 5 June 1958, box 3178.

Iceland's need for Western aid to support its economy and drastically reduced its dependence on revenues from the US base. To be sure, following a similar domestic political reconfiguration as in 1956, a Leftist Government renewed in 1971 the demand for the withdrawal of US forces but, as in 1956, it failed to make good on its promise and was brought down by internal squabbling.

The outcome was a second period of stability in Iceland's relations with the United States and NATO, despite the escalating East-West tensions in the early 1980s, the fall of Communism in Eastern Europe in 1989, and the break-up of the Soviet Union in 1991. After the cold war, the United States substantially reduced its forces in Iceland, and although the Keflavik area still benefits economically from the base, in contrast to the 1950s it plays no major part in Iceland's economy. The domestic political function of the US military presence has also changed. During the 1950s, it reflected deep ideological divisions and polarized the electorate; now the defence pact is seen more as evidence of Iceland's continued commitment to NATO.

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Given the strategic importance of Iceland during the cold war, it is not surprising that the United States and NATO were keen during the 1950s to prevent any change in Iceland's Western alignment. The dual strategic role of Iceland in Western military planning remained constant from the end of the Second World War to the mid-1950s. It had greater offensive potential for the United States than any other area except the British Isles, North Africa, and the Middle East, and was second only to Greenland for defence. In Soviet hands, Iceland would pose a direct threat to the security of the United States and the North Atlantic. Although US military planners envisioned the use of Iceland for strategic air operations in wartime, they were never able to set up a SAC base there. The introduction in the late 1950s of intercontinental ballistic missiles and sea-launched intermediate missiles reduced the strategic importance of Iceland for SAC, but it continued to be a key link in air and sea communications between the United States and Europe as well as in the Early Warning System. By the end of the decade, Iceland had also become an important base for anti-submarine operations,¹ one arm of the sea-air barrier stretching from Greenland by way of Iceland to Britain.²

1 Report, 'Transfer of Keflavik airport and support of Iceland defence force to US navy', 15 April 1960, RG 218, central decimal file, folder: 9191.2/3410, Iceland (12 Oct. 1959), box 151.

2 See memo, 'State-defence examination of future defence requirements in Iceland', 21 April 1960, SDDF 740B.56311/4-2160; see also CINCLANT to sec. state, 7 Jan. 1961, SDDF 740B.56311/1-661, box 1655; state dept. to US embassy (Reykjavik), 24 Feb. 1961, SDDF 740B.56311/2-2461, box 1655; review of United States, military bases, April 1960, RG 273, Mill Papers.

Cold war battles over Iceland's foreign policy had no visible impact on the priorities of the Icelandic modernization programme. All parties, from the Independence Party to the Socialist Party, agreed on the need to finance the projects discussed here. To be sure, business interests, for example the Co-operation Movement and the Icelandic Main Construction Company at Keflavik airport, had powerful political connections within the Independence Party and the Progressive Party. Vilhjálmur Thór, a former head of the Co-operation Movement, had tremendous influence as the governor of Iceland's central bank. But business interests did not determine Iceland's policy on the defence question: given the harsh political climate, no government party could take the chance of following the dictates of Icelandic business. The parties that formed the Leftist Government wanted to reap the political benefits of the modernization programme, which enjoyed support across the political spectrum.

Iceland was extremely skilful at extracting economic aid from the United States, receiving over \$70 million in grants and loans between 1948 and 1960. In addition, the annual revenue from the base amounted to \$12-15 million from 1954 to 1960, about 15-20% of Iceland's foreign currency earnings. Despite record fish catches, Iceland would never have experienced an average annual rise in national income of about 11% between 1952 and 1957 without these two sources of revenue. The same applies to the modernization effort: domestic savings accounted for only a small part of an investment programme that equalled about 35% of GNP in 1957. This was the price the United States and NATO paid for political and economic stability, for their military presence, and for limiting the influence in Iceland of the Soviet Union and its supporter, the Socialist Party. Despite Iceland's huge profits from the war, it received \$38 million in Marshall Aid between 1948 and 1953, in relative terms more than any other European country. And after a hiatus lasting two years, the United States granted Iceland another \$34 million between 1956 and 1960. This aid served the same purpose as the Marshall Plan: to ensure economic and political stability and head off Communist encroachment. In addition, the OEEC gave Iceland substantial loan guarantees to buttress its currency reserves, enabling the Reconstruction Government to enact its market reforms.

True, the Icelanders themselves, by pursuing an economic course that favoured barter trade, were partly responsible for inviting Soviet influence. But Iceland's Western allies understood the dilemma facing the Icelanders: because of a lack of economic diversification and overwhelming dependency on fishing, there was a strong temptation to engage in barter trade with the Soviets, because they paid higher prices for Icelandic fish. The Soviets were interested in Iceland because of its strategic importance, the US military presence, and the success of the Socialist Party.

The West's 'double' containment strategy worked both in the military and economic fields: first, Iceland abandoned its policy of disengagement, renewed its commitment to the defence pact with the United States, and did not renew the demand for the evacuation of the US forces. Nor did it object to NATO's controversial decision in 1957 to permit the stationing of medium-range nuclear weapons in Europe. Second, Western economic aid prevented the Leftist Government from accepting Soviet loans and Iceland from becoming more dependent on the Eastern bloc. It also contributed to the success of the economic reforms of the Reconstruction Government. The net result was the reaffirmation of Iceland's alignment with the West and the reduction in Soviet influence in a strategically vital region.

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