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# Exit Costs and Conflict Dynamics: Lessons from the Third Cod War

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# Abstract

This thesis examines how exit costs influence a target state's decision to comply with a challenger state's demands, focusing on the Third Cod War between the United Kingdom and Iceland. Testing Mark J. C. Crescenzi's exit model, the study aims to delve into the details of the causal mechanism leading to the UK's decision-making process. The central question driving this study is: How do exit costs influence a target state's decision to comply with a challenger state's demands?

The research employs a qualitative causal process-tracing method with the selection of a least-likely case. The analysis is based on primary sources such as policy discussions and official government documents from the British Houses of Parliament, alongside secondary sources including academic articles and historical reviews. Triangulation of these data sources is utilized to enhance the reliability and validity of the findings.

The analysis reveals that while economic exit costs were considered by the UK, they were not the primary factor driving compliance. Instead, the reassessment of the economic value of the issue at stake, which diminished over time, significantly lowered the exit cost threshold. Additionally, broader geopolitical and strategic concerns, such as the potential for diplomatic fallout and risks to NATO cohesion, emerged as crucial factors in the UK's decision-making process.

The findings support Crescenzi's exit model, demonstrating that compliance is influenced by the relative comparison between exit costs and the exit cost threshold. However, the study also identifies significant non-economic factors that were not fully accounted for in the original model, suggesting that a more comprehensive framework is needed to understand state compliance in low-level conflicts. This research contributes to a deeper understanding of state-behavior in low-level interstate conflicts and offers insights for refining the exit model by considering stronger and diverse interdependence the world knows today.

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# 1. Introduction

Conflicts between states can arise from various sources, including territorial disputes, economic rivalries, and historical or cultural grievances. Understanding the behavior of decision-makers in these contexts and uncovering patterns in their decision-making processes, represents a crucial aspect of research in international relations. The causal relationship between economic interdependence and interstate conflicts has been a long-standing subject of scholarly debate. Within this academic discourse, the concept of exit costs, as presented by Mark J. C. Crescenzi (2003), offers a compelling framework for analyzing the dynamics of interstate conflict and state decision-making processes. Crescenzi defines exit costs as the opportunity costs that arise when a state breaks off its economic relationship with a partner. These costs depend on how far the ties are cut and how difficult it is for the state to find alternative economic partners (Crescenzi, 2003).

The Cod Wars, a series of confrontations between Iceland and the United Kingdom (UK) over fishing rights in the North Atlantic, serve as an ideal setting for exploring the influence of exit costs on compliance decisions. Spanning from the late 1950s to the 1970s, these conflicts consistently resulted in British compliance and Icelandic "victory," despite the significant asymmetry in economic dependence between the two states (Steinsson, 2016). Among these, the Third Cod War (1975-1976) stands out due to its heightened tensions, diplomatic fallout, and clashes between Icelandic coast guard vessels and British trawlers. Central to this conflict was Iceland's assertion of exclusive fishing rights extending to 200 nautical miles from its coastlines (Steinsson, 2016). The unexpected outcome of this conflict makes it a "crucial case" and a "least-likely case," providing a strong test of the exit model framework (Gerring, 2007).

The significance of this research extends beyond the immediate conflict over fishing rights. It aims to explore the role of economic interdependence in interstate conflicts and examine the specific mechanisms within Crescenzi's exit model that explain a state's decision to comply with another state's demands. While existing research has explored the relationship between economic interdependence and the likelihood of armed conflicts, the focus has primarily been on full-scale military conflicts (Kinne, 2012). In contrast, the influence of economic interdependence in low-level, or diplomatic conflicts has not been extensively analyzed.

Crescenzi's meso-approach, which incorporates various scenarios such as status-quo, high-level, and low-level conflicts, argues for a higher likelihood of low-level conflict between economically interdependent states. Central to this framework is the concept of economic exit costs—the potential costs incurred by a state when exiting a trade relationship (Crescenzi, 2003). However, existing studies, including Crescenzi's quantitative analysis, fall short in providing an in-depth exploration of the causal pathway between economic exit costs and state decision-making processes, and their impact on conflict intensity.

This thesis seeks to bridge this gap by examining how exit costs influence state compliance. Through a causal-process-tracing analysis of the Third Cod War, this paper aims to uncover the detailed mechanisms through which exit costs shape the decision-making process of the target state. By focusing on this aspect of interstate relations, the research deepens our understanding of low-level conflicts and informs policymakers on strategies for conflict management.

The central question of this thesis is: How do exit costs influence a target state's decision to comply with a challenger state's demands?

In order to answer this research question, the paper begins with a literature review that addresses various theoretical perspectives on the causal relations of economic interdependence with interstate conflicts, and on coercion in diplomatic negotiations, while also identifying the gap this research aims to bridge. Following the literature review, the theoretical framework introduces Crescenzi's exit model, detailing the moves of both the challenger and target states to establish the theoretical foundation for the study. The methodology chapter outlines the research design and method, addressing limitations, explaining the operationalization process with a flowchart, and detailing the criteria for case and data selection.

The analysis chapter provides an in-depth examination of the Third Cod War, following the theoretical causal chain of the exit model and focusing on the British government's decision-making process that led to compliance. Subsequently, the discussion chapter interprets the empirical findings, exploring their implications for existing theories and suggesting paths for further research. Finally, the paper concludes by directly answering the research question and summarizing the study's contributions.

## 2. Literature review

Economic coercion, in the form of threats or sanctions, has long been recognized as a tool in international relations and is often employed by states to achieve their interests. The concept of economic exit costs, referring to the perceived costs incurred by a target state should it refuse to comply with the demands of a challenger state, is a significant aspect of this topic (Crescenzi, 2003). Understanding the role of exit costs in the decision-making processes of states is therefore important for outlining diplomatic negotiations and state behavior.

This literature review examines the broader discourse surrounding economic coercion within existing scholarly works, focusing on the role of exit costs in the target state's compliance decision-making process. This review addresses the relationship between economic interdependence and conflict, as discussed in both liberal peace theories and realist perspectives. It also explores recent insights on trade composition and coercion in diplomatic negotiations. In doing so, it highlights the significance of Crescenzi's exit model theory in deepening our understanding of economic coercion, state decision-making processes, and interstate conflicts.

This literature review begins by focusing on liberal peace theories, followed by newer dimensions within the liberal debate. Next, the review scrutinizes realist perspectives. Finally, it discusses more recent academic works, focusing on the role of trade composition in conflict as well as coercion in diplomatic negotiations.

### 2.1 Liberal Peace Theories

The dominance of liberal peace theories in the literature underscores the strong influence of the Kantian notion of "perpetual peace". Central to these theories is the belief that economic interdependence fosters peace between states by creating mutual interests and incentives for cooperation. Oneal and Russett (1997) in their work "The Classical Liberals Were Right: Democracy, Interdependence, and Conflict" support the classical liberal view that democracy and free trade lead to peace. Drawing on empirical evidence from the Cold War era, they suggest that higher levels of economic openness between countries are often associated with a reduced likelihood of militarized conflict. They argue that nations act through the consideration of consequences that armed conflicts would have for their economic relations with third countries. Moreover, they focus their analysis on the difference in states' relations to peace depending on their autocratic or democratic nature.

Gartzke et al. (2001) build on the classical liberal perspective and provide a comprehensive review of the relationship between economic interdependence and conflict. They argue that economic interdependence can act as a pacifying element, reducing the likelihood of conflict between states by fostering mutual economic interests. However, Gartzke et al. introduce the idea that economic interdependence may not eliminate the potential for conflict, but rather change its form or nature. While economic interdependence may decrease the likelihood of militarized conflicts, it may still lead to other forms of conflict and disputes that involve diplomatic strategies: “opportunity costs associated with economic benefits generally cannot deter disputes. Instead, interdependence creates the means for states to demonstrate resolve without resorting to military violence” (Gartzke et al., 2001: 392). In fact, they deduce that while trade partners are less likely to engage in militarized conflicts, they are more likely to engage in non-militarized conflicts (Gartzke et al., 2001). Gartzke and Westerwinter’s (2016) work called “The Complex Structure of Commercial Peace: Contrasting Trade Interdependence, Asymmetry, and Multipolarity” also represents this perspective, as they further discuss how asymmetry in trade relationships contributes to reducing the likelihood of conflict. The theoretical argument by Gartzke resonates with Crescenzi’s exit model, which incorporates a clear differentiation between high-level and low-level conflicts. Crescenzi (2003), argues that militarized conflicts or high-level conflicts become less likely with higher economic interdependence, whereas low-level conflicts, encompassing diplomatic conflicts, economic sanctions, and trade barriers, become more likely.

Gartzke et al.’s (2001) work contributes to the literature by emphasizing the importance of trade in promoting peace between states through the analysis of numerous empirical studies. However, there are some limitations to their study. For instance, they fail to differentiate between different types of economic ties and mainly look at trade instead of other variables such as asset specificity or investments. Additionally, their research primarily focuses on the direct effects of economic interdependence on conflict, overlooking the crucial in-depth analysis of how economic factors influence state behavior and decision-making.

Also anchored in Kantian theory, Gelpi and Grieco (2008) argue that the effects of trade and democracy on conflict outcomes are not independent of each other. They suggest that there is a combined influence of democracy and interdependence that leads to a strong incentive for peace among democracies, but that this effect may not hold for nondemocratic



states. Their study highlights the importance of considering the interactions between different variables rather than treating them separately when studying conflict processes.

In conclusion, liberal peace theories provide a good framework for understanding the potential pacifying influence of economic interdependence, drawing from the Kantian notion of perpetual peace. While the empirical support aligns with the classical liberal perspective, linking democracy and free trade to peaceful relations, insights from scholars such as Gartzke et al. call for a re-examination of the dynamics between economic ties and conflict, encouraging a more nuanced and comprehensive approach.

## 2.2 New Dimensions within the Liberal Debate

James D. Morrow's study (Mansfield et al., 2003) "Assessing the Role of Trade as a Source of Costly Signals" challenges the classical liberal argument on trade and war, arguing that the relationship between these variables is not as straightforward as depicted by classic liberals. He introduces the concept of costly signaling, which refers to actions involving significant costs or risks to communicate determination and seriousness about a policy or stance, thereby reducing the likelihood of military escalation. This concept aligns with Crescenzi's exit model, which emphasizes the use of economic measures, including threats and sanctions, to influence state behavior. Crescenzi conceptualizes these elements as the variable "economic exit threats". This exit threat is used by challenger states when issuing a demand to a resistant target state. (Crescenzi 2003).

While Morrow's study expands the theoretical framework and thematizes the complex mechanisms surrounding state responses to economic incentives and threats, it also raises questions about the practical implementation of costly signaling and the potential unexpected consequences. Thus, Crescenzi's model (2003) provides a bridge to addressing these gaps, as it offers different scenarios after the issuance of a demand with an economic exit threat by a state and considers variables leading to this issuance, and the subsequent decision-making processes. In his framework, target states may comply with or reject the demand in the first step after the issuance of the demand with an economic exit threat.

In "The Classical Liberals Were Just Lucky: A Few Thoughts about Interdependence and Peace," Gartzke (Mansfield et al, 2003) presents a critical analysis of classical liberal perspectives on economic interdependence and peace. He questions the prevailing notion that economic ties inherently deter political violence and argues that the reality is far more nuanced. According to Gartzke, classical liberal explanations fail to fully capture interstate

bargaining and decision-making. Instead, Gartzke emphasizes the important role of diplomatic means and bargaining positions in shaping outcomes and highlights the need for a more holistic understanding of the factors driving peace and conflict.

Gartzke's critique showcases the limitations of classical liberal theories. By highlighting the importance of diplomatic strategies and bargaining theory in shaping outcomes, he incentivizes scholars to reevaluate traditional assumptions about the pacifying effects of economic interdependence. However, Gartzke's analysis also leaves room for further examination of the specific mechanisms through which economic factors contribute to bargaining positions in the context of diplomatic negotiations. This further reinforces the relevance of Crescenzi's framework in understanding the role of economic coercion in state decision-making processes, as his model emphasizes the target state's assessment of its exit cost threshold, which it compares against potential exit costs when evaluating its bargaining position.

In "Trade and Conflict: Uncertainty, Strategic Signaling, and Interstate Disputes," Stein (Mansfield et al., 2003) states that several factors have been overlooked in the literature. He argues that trade decreases the escalation of disputes by increasing the costs of conflict and providing states with a means of coercion, resonating with the costly signaling concept presented in Morrow's work (Mansfield et al., 2003). Nonetheless, Stein acknowledges the challenges of demonstrating a clear causal relationship between trade and conflict. His work therefore shows the need for further empirical research to depict the relationship between trade, conflict, and coercion.

In conclusion, the consideration of costly signaling by scholars such as Morrow within the liberal discourse on economic interdependence and conflict offers an additional research dimension to the subject matter. Gartzke specifically highlights the aspect of the bargaining position of states and diplomatic means as important factors in the analysis of the relationship between economic interdependence, and peace or conflict. Stein joins Morrow's emphasis on costly signaling, underscoring the significance of coercion in interstate relations.

## 2.3 Realist Perspectives

Among realists, Barbara Barbieri's work (1996) stands out as a prominent voice challenging the classical liberal argument of economic interdependence leading to peace. Through a quantitative analysis that spans from 1870 to 1938, Barbieri (1996) presents findings that contest the prevailing notion that trade inherently fosters peace between states.

She suggests that while low to moderate levels of economic interdependence may indeed reduce the likelihood of dyadic disputes, strong economic ties might actually increase the likelihood of militarized conflicts between countries.

Furthermore, Barbieri and Schneider (1999) amplify Barbieri's perspective by advocating for a broader conceptualization of globalization, that encompasses a wider range of factors influencing the occurrence of conflict. They highlight the conflict-exacerbating relationship between trade and militarized conflicts, further opposing themselves to the classical liberalists.

However, Barbieri's operationalizations have not been without critique. Authors like Gartzke et al. (2001) question her methodology, particularly her measurement of interdependence based on the salience of trade. Gartzke et al. (2001) express skepticism about Barbieri's findings, suggesting that her operationalizations of interdependence may be responsible for the observed outcomes. Furthermore, the article "Measure for Measure: Concept Operationalization and the Trade Interdependence-Conflict Debate" by Gartzke and Li (2003) argues that the discrepancies in findings can be explained by differences in variable construction and highlights the need to review indicators and the reconceptualization of interdependence. Despite this criticism, Barbieri's work remains influential in shaping discourse on the realist perspective regarding the relationship between economic ties and conflict.

A few scholars such as Buzan (1984) and Waltz (1970) similarly question the notion that economic interdependence reduces the likelihood of conflict (Barbieri, 1996). However, contrary to Barbieri (1996) or Barbieri and Schneider (1999), they suggest that economic interdependence does not affect interstate conflicts at all. Buzan in his work "Economic Structure and International Security: The Limits of the Liberal Case", argues that economic structures are not enough alone to guarantee security and peace, as he highlights cases where economic ties have failed to prevent conflicts. Waltz argues that national interests and power dynamics are more significant in interstate relations and questions the idea that economic interdependence inherently reduces the likelihood of conflict (Barbieri, 1996).

Crescenzi's exit model includes realist perspectives, as it encompasses scenarios where economic interdependence leads to militarized conflict. However, Crescenzi stresses that the likelihood of that is rather low in contrast to a higher likelihood of low-level conflicts (Crescenzi, 2003).

## 2.4 The Role of Trade Composition in Conflict

Recent academic research has focused on the relationship between trade composition and interstate conflict outcomes, questioning the thought that all forms of economic interdependence promote peace similarly. Dorussen (2006) sheds light on this topic by reflecting on the nature of traded goods, arguing that it significantly influenced the likelihood of conflict. Certain types of trade, such as those of advanced manufactured goods, tend to have a pacifying effect, whereas primary goods or food products may increase tensions due to their vulnerability to appropriation by force. This differentiation between traded goods indicates limitations when analyzing the relationship between economic interdependence and conflict on a state-only level, and as such encourages the consideration of additional variables.

Akoto, Peterson, and Thies' (2019) study, "Trade Composition and Acquiescence to Sanction Threats", further enriches the discourse by addressing the role of trade composition in influencing states' responses to sanction threats.

They argue that the asset specificity of certain traded goods plays a significant role in determining a state's vulnerability to sanction threats. This study reflects similarities to Dorussens's (2006) findings, as it argues that compliance with sanction threats is more likely when it involves intra-industry trade, where countries exchange similar types of goods.

This study enriches our understanding of how states respond to economic coercion by incorporating insights on trade composition into academic discussions about sanctions and threats. These insights resonate with elements in Crescenzi's theoretical framework (2003) including the notion of exit cost threats and asset specificity in Crescenzi's (2003) model.

Peterson and Zeng's (2021) research offers additional insights into the variations in conflict and cooperation with trade partners. They find that states tend to engage in both cooperation and conflict more frequently with their major trade partners. However, as countries become more exposed to the global economy, the link between trade partners and conflict or cooperation weakens. Their analysis of recent events between the US and China shows that while there is a political conflict, the intensity would have been much stronger if either country were less exposed to the global economy. Challenging opportunity cost and signaling theories, this study emphasizes the existence of both positive and negative impacts

between major trade partners, further complicating our understanding of the relationship between trade and conflict.

Overall, recent scholarship has highlighted the importance of trade composition in shaping interstate conflict outcomes. Authors such as Dorussen (2006), Akoto et al. (2019), and Peterson and Zeng (2021) insist on considering the nature of traded goods and trade relationships and their vulnerability to coercion. This common theme shows the need to look beyond state-level analyses and include additional factors when analyzing the relationship between economic interdependence and conflict. Additionally, these elements align with Crescenzi's conceptualization of exit costs, at the heart of its causal mechanism between economic interdependence and conflict, as it includes the variable of asset specificity.

## 2.5 Coercion in Diplomatic Negotiations

The role of coercion in diplomatic negotiations has been the subject of increasing attention in recent years among scholars within the field of international relations.

Peksen and Peterson's study (2016) "Sanctions and Alternate Markets: How Trade and Alliances Affect the Onset of Economic Coercion" contributes to this discussion by offering insights into the decision-making process of states regarding the imposition of economic sanctions. This process is strongly influenced by factors such as trade dependence and the target state's capacity to redirect lost trade to alternative markets. Therefore, the study expands our understanding of the specific process involved in the decision-making of imposing economic sanctions. Furthermore, it broadens the scope of dyadic analyses by incorporating the influence of third-party alliances and potential alternate markets, complementing Crescenzi's exit model and offering a more holistic perspective.

Similarly, Ferguson et al.'s research (2023) on "Market adjustments to import sanctions: lessons from Chinese restrictions on Australian trade, 2020-2021" contributes to our understanding of the mechanisms through which target exporters respond to import sanctions. Through a case study on Australian export-oriented markets impacted by Chinese import sanctions, the analysis identifies three different mechanisms: reallocation, deflection, and transformation. This represents an extension of the causal variable "market structure" appearing within Crescenzi's framework (2003). Specifically, market structure is part of the operationalization of economic exit costs in Crescenzi's model, along with asset specificity and significance of the economic activity with the relevant state. These findings indicate the

existence of multiple alternatives in the hands of target exporter states facing import sanctions.

Furthermore, Lee's study (2017) on the Russia-Ukraine gas conflict provides a qualitative case study applying a theoretical framework that combines Armstrong's model on dependence-political compliance and Crescenzi's exit model to explain the causal mechanisms leading to the conflict. Specifically, the research aims to explain the causal mechanism leading to the gas conflict, particularly emphasizing the significance of the issues at stake in shaping state behavior. By incorporating Crescenzi's theoretical framework into the analysis, Lee's work enhances our understanding of state decision-making processes in conflict settings and reinforces the validity of Crescenzi's theoretical framework. However, a limitation of Lee's study is the lack of explicit detail in the operationalization of the combined theoretical framework, suggesting a need for further clarity and transparency in future research on the matter.

Additionally, Peterson's study (2013) on "Sending a Message: The Reputation Effect of US Sanction Threat Behavior" focuses on the importance of reputation in shaping state decision-making processes. He argues that the effectiveness of these threats is not only influenced by immediate circumstances but also by past behavior patterns. By considering reputation alongside variables directly related to economic partnerships and the issue at stake, Peterson's work offers a broader outlook on state decision-making processes, contributing to a more comprehensive understanding of exit cost assessment and compliance decision-making within the context of Crescenzi's exit model.

The discussed studies address the significance of coercion in diplomatic negotiations, and emphasizes factors including trade dependence, market adjustments, and reputation effects. While this paper's research does not directly encompass all these elements, it aligns with Crescenzi's exit model, which encompasses key aspects such as economic exit threats, market structure, and the value of the issue at stake. By focusing on the target's compliance decision-making within this framework, this paper aims to contribute a nuanced analysis of how states react to economic coercion.

## 2.6 Summary and Discussion

Economic coercion, a significant tool in international relations has become an important topic of discussion and extensive research in the field of international relations. The concept of economic exit costs, at the center of Crescenzi's exit model theory (2003),

adds depth to our understanding of the decision-making processes of states in response to demands and coercion. This literature review explored various theoretical perspectives and recent academic works to contextualize the significance of Crescenzi's framework within the broader discourse on economic coercion and the relationship between economic interdependence and interstate conflicts.

Despite economic coercion being topical in the academic debate, several gaps persist. Firstly, while liberal peace theories provide arguments promoting the pacifying effect of economic interdependence, more recent studies have highlighted the need for a more differentiated approach. Scholars such as Gartzke et al. and Morrow emphasize the importance of considering diplomatic strategies and bargaining positions in shaping outcomes of interstate relations, suggesting that economic ties alone may not guarantee peace. Crescenzi's exit model addresses this gap by introducing a clear separation between high-level and low-level conflicts and offers a framework that includes economic coercion or "economic exit threat" in the decision-making processes of states.

Secondly, realist perspectives on the matter seem less convincing than liberal ones. Indeed there is a divide within the school of thought about the effect of economic interdependence. Some, such as Barbieri, argues that it increases the likelihood of conflicts, while others argue that it does not have any significant influence on conflict and that other factors like power dynamics and national interests are more relevant. Additionally, Barbieri's work faced criticism for its methodology and operationalization of interdependence. However, these arguments and critiques have encouraged more research on the topic and Crescenzi's model accommodates these perspectives by acknowledging the potential for economic interdependence leading to militarized conflicts.

Thirdly, recent academic papers on trade composition and coercion in diplomatic negotiations highlight the need to consider additional factors beyond economic ones. Dorussen, Akto, et al., and Peterson and Zeng emphasize the importance of trade composition and market adjustments in shaping state responses to demands with coercion. While not directly referring to these factors, Crescenzi's framework provides a theoretical lens through which to analyze the role of economic exit threat in state decision-making by incorporating variables such as market structure, asset specificity, the value of the issue at stake, and the likelihood of escalation of conflict.

In light of these considerations, this thesis aims to contribute to filling some of these gaps by focusing on the target state's compliance decision-making within Crescenzi's model. As Crescenzi's model is very comprehensive and includes different scenarios, this paper will allow an in-depth analysis of the steps regarding how a target state assesses its exit costs and exit cost threshold that will lead to compliance decision-making. In other words, this study seeks to enhance our understanding of how economic coercion influences state behavior.

Lastly, the specific topic of compliance decision-making during the Third Cod War is still relevant today as economic coercion has become increasingly employed in interstate relations. As there is a lack of case studies using Crescenzi's framework, this work would contribute to the literature by presenting an adoption of the model. Moreover, Crescenzi mentions the Cod War briefly in his work but does not analyze this case study. By exploring this case in detail, my thesis aims to provide further validation and insight into Crescenzi's framework.

### **3. Theoretical Framework**

This section establishes the theoretical framework for examining the relationship between economic interdependence and the target state's decision-making. It examines Crescenzi's exit model theory and introduces the theoretical focus that this thesis follows.

#### **3.1 Theory: Crescenzi's Exit Model**

Crescenzi contributes to the debate on the relationship between economic interdependence and conflict by providing a theoretical model that reveals the causal mechanism between the two elements. He identifies three effects of economic interdependence on the conflict in the existing literature: peace, neutrality, or increased conflict (Crescenzi, 2003). Most recent narratives in academic literature point towards the former outcome. Crescenzi's model emphasizes the distinction between high-level and low-level conflicts and concludes that while economic interdependence reduces the likelihood of high-level conflict, it increases the likelihood of low-level conflict (Crescenzi, 2003). Conflict intensity in this research is conceptualized dichotomously following Crescenzi's differentiation of conflicts, it can be high-level, manifesting through militarized conflict or it can be of low-level, encompassing different types of economic sanctions. Moreover, Crescenzi recognizes the asymmetrical nature of economic integration, where certain states may have more leverage than others.



According to Crescenzi, economic interdependence is “a function of economic activity within the context of available alternatives” (Crescenzi, 2003: 811). Central to this model is the concept of exit costs, which represent the costs incurred when severing economic ties and choosing the next best alternative partnership. These costs are influenced by factors such as asset specificity, market structure, and the level of economic activity (Crescenzi, 2003).

Asset specificity refers to the degree to which assets can be redeployed without loss of value, while market structure influences access to alternative partnerships (Crescenzi, 2003). The level of economic activity also influences economic interdependence and consequently, economic exit costs. The interdependence between two states is strongest in situations where alternative economic partnerships are limited, adaptation is expensive, and the economic relationship is important (Crescenzi, 2003).

States choose their response by evaluating and comparing their exit costs to their exit cost threshold. The exit cost threshold encompasses the value of the issue in question in the challenger’s demand, the costs associated with the potential escalation to militarized conflict, and the likelihood of being successful in the case of such conflict.

### 3.1.1 Challenger’s First Move

Crescenzi presents a game theory model between a challenger state (State A) and a target state (State B), where State A seeks change while State B aims to maintain the status quo. The game begins with the challenger’s first move, where it decides whether to issue a demand to the target or maintain the status quo. This decision is influenced by factors such as the value of the issue, costs associated with conflict escalation, and the likelihood of success in conflict.

The challenger evaluates the potential benefits of issuing a demand against the exit costs it may incur. Market structure, asset specificity, and economic activity levels play significant roles in this assessment. The challenger’s decision also considers the bargaining power equilibrium, where the costs of exit for the target allow the challenger to induce compliance. Ideally, for the challenger state, its exit costs fall beneath its exit cost threshold, while the target’s exit costs surpass the target’s threshold.

Ultimately, the challenger must evaluate the risks, benefits, and drawbacks of issuing the demand before arriving at a decision. The theory suggests that if the target wants to keep

the status quo, the challenger – if choosing to make the demand - must combine his demand with a threat of economic exit if the target does not comply directly. (Crescenzi, 2003)

### 3.1.2 Target's First Move

The second move is taken by the target state. This stage is marked by the decision-making process between rejecting the challenger's demand and complying with it. If the target complies, the game ends, and the challenger benefits and gains from its demand, while the target suffers losses. The target weighs the potential losses of compliance, such as economic or political costs, against the risk of rejection, which may lead to loss of economic benefits or risk of conflict escalation. Asset specificity and market structure play a role here, as higher asset specificity and limited alternative partners may increase the costs of economic exit. In addition, it also compares the perceived potential costs of exit in case of rejection with its exit costs threshold, determining whether it can afford to reject the demand or if compliance is the more feasible option. Specifically, the relevant factors in this comparison are: the value of the issue at stake, the likelihood of conflict resolution influence the target's decision

### 3.1.3 Challenger's Second Move

If the target rejects the demand, the game proceeds with the challenger's second move. During this phase, the challenger must weigh the decision whether to follow through with its threat of economic exit or retract it and face audience costs. Besides the potential audience costs, the choice is influenced by two factors: the perceived likelihood of achieving its demands and the potential costs associated with conflict escalation. Crescenzi's theory highlights the significance of the level of interdependence between states in shaping these factors. Specifically, market structure, asset specificity, and level of economic activity serve as crucial variables, providing insight into the degree of interdependence. These determinants impact the perceived costs of conflict escalation and the incentives for the challenger to negotiate or resort to economic exit.

### 3.1.4 Target's Second Move

The outcome and the intensity of the interstate conflict depend on the target's response to the threat of economic exit. If the target accepts the threat, the challenger gains the value of its demand minus the costs of economic exit. However, if the target rejects the demand, demonstrating the failure of the economic threat, the possibility of militarized conflict becomes a reality. In the decision-making process, the target evaluates whether the

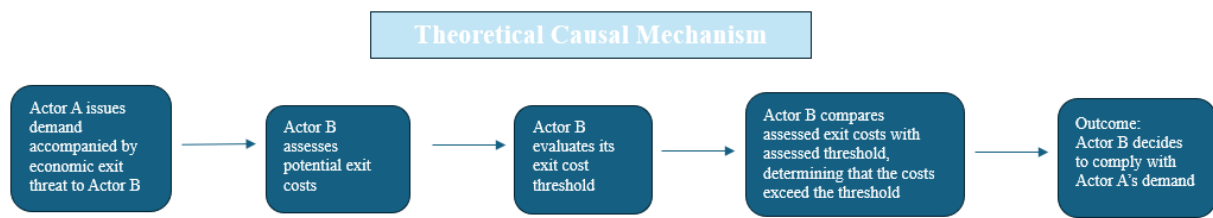
costs of escalated/full-scale armed conflict outweigh the benefits of maintaining the status quo. The market structure and asset specificity also inform this decision, as they influence the feasibility of finding alternative trade partners and the adaptability of assets in the face of economic exit threats.

### 3.2 Theoretical Focus of the Research

While Crescenzi's exit model theory is a comprehensive framework for understanding the dynamics of interstate conflicts and the role of economic exit costs, this thesis focuses on a specific aspect of the causal mechanism within his model. Rather than attempting to explore the entirety of Crescenzi's framework or all possible scenarios outlined within it, this research zooms in on a particular facet of the causal mechanism.

Specifically, this thesis centers on investigating how economic exit costs influence the target state's decision to comply with the challenger state's demands during the Third Cod War. By narrowing the focus to this specific scenario, the research aims to provide a detailed understanding of the mechanisms through which economic exit costs shape state behavior in the context of low-level conflicts. This focused approach allows for a deeper exploration of the causal pathways between exit costs and state compliance.

The following visual representation showcases the focused and studied causal mechanism. First, the challenger state, here named "Actor A", issues a demand accompanied by an economic exit threat to a target state or "Actor B". Secondly, Actor B assesses its potential exit costs, followed by the evaluation of its exit cost threshold. Then, Actor B compares these two costs and determines that the exit costs exceed the threshold, leading to its compliance with Actor A.



## 4. Methodology

### 4.1 Research Design

The research design is constructed to effectively address the research question by employing an explanatory research approach suited to the positivist nature of the thesis topic. The primary aim is to explore the causal relationship between economic exit costs and state compliance decisions, focusing on analyzing states' decision-making processes in response to demands accompanied by economic exit threats.

This study is grounded in Crescenzi's exit model theory, which outlines a clear causal chain leading to a state's compliance decision. This framework supports a qualitative, deductive analysis, allowing for a detailed examination of the causal variables influencing state decision-making.

To empirically test Crescenzi's exit model, the study applies Blatter et al.'s causal-process tracing method (2018) to a single case study of the Third Cod War. While Crescenzi's quantitative analysis identifies key variables, it does not fully capture their intricate interactions. Causal-process tracing offers a qualitative approach that provides a more comprehensive explanation and reinforces the theory's validity if successfully applied in the case study. The fisheries conflicts between the UK and Iceland, documented in Crescenzi's work (2003), present a distinct target and challenger state dynamic, making the Third Cod War an ideal case for detailed examination. By focusing on the UK's decision-making process, the research aims to uncover the exact mechanisms that led to British compliance, including the role of economic exit costs. Each step in Crescenzi's causal chain is empirically tested to verify the presence and influence of expected variables while also exploring other relevant factors affecting the UK's decision.

The Third Cod War is selected as a crucial case according to Gerrings's definition (2007) due to its unexpected outcome. Despite the UK's lower economic dependence on Iceland, it complied with Iceland's demands. This case is ideal because it tests the explanatory power of the exit model under conditions that seemingly contradict its predictions.

The scope of the study is delimited to the timeframe of the conflict, from October 1975 to June 1976, with a secondary expanded scope starting at the First Cod War. The analysis incorporates information from both parties, with a focus on the UK's decision-making process.

The objectives of this research include understanding the applicability of the Exit Model, testing its explanatory power, and delving into the specific processes that form Crescenzi's causal chain. By choosing a single-case study analysis of the Third Cod War and utilizing causal-process tracing, this research aims to contribute to the existing scholarly literature, providing empirical evidence and insights into state behavior during international disputes.

## 4.2 Research Method

This research adopts causal-process-tracing as the method to analyze the causal pathway between economic exit costs and compliance decision-making within the Iceland-UK case study. This method enables a within-case analysis, which involves examining in-depth how influencing factors interact within a specific case (Blatter et al., 2018). Blatter et al. (2018) mention different possibilities as to how to apply this method in one's research. He talks about four different objectives where the process-tracing analysis techniques are applied, though one, in particular, represents the ideal research design of process-tracing analysis. This goal involves the identification of intricate conditions that must be in place for particular events or outcomes to occur. Indeed, this research seeks to uncover the factors contributing to the target state's compliance decision-making, with economic exit costs being the key causal factor. Focusing on one of Crescenzi's scenarios of low-level conflict, this research design allows the understanding of specific events or outcomes (referred to as Y-centered) (Blatter et al., 2018). In such analysis, the researcher aims to uncover how various causal factors interact to explain the observed outcomes, collectively forming a "causal configuration" (Blatter et al., 2018: 247).

For instance, in Crescenzi's research, economic exit costs are framed as the primary factor influencing the level of conflict and its development. This variable is further broken down into components such as market structure, asset specificity, and significance of economic activity. Moreover, the threshold for economic exits is influenced by factors such as the value of the initial demand, escalation costs, and the likelihood of being successful in case of conflict. This suggests that multiple variables must interact to determine the level of conflict between two countries. However, Crescenzi's quantitative analysis does not fully capture the intricacies and interactions of these variables. Adopting the causal-process tracing

method offers a qualitative approach to the theory, providing a more comprehensive explanation and potentially reinforcing its validity if successfully applied in the case study.

Blatter et al. (2018) highlight two significant aspects of an ideal causal process tracing. Firstly, causal heterogeneity acknowledges that the causal effect of an influencing factor varies on its interaction with other causal factors. Secondly, equifinality recognizes the existence of multiple causal pathways leading to the same or similar outcome.

### 4.3 Limitation of Generalization

Blatter et al. (2018) apply Charles Ragin's recipe concept, highlighting the importance of determining essential "ingredients" and their sequential arrangement. Particularly, he insists on the significance of understanding how these ingredients must be interconnected to achieve the desired outcome. Thus, an effective application of causal-process-tracing analysis provides an overview of the necessary conditions leading to a particular outcome. Moreover, it offers a comprehensive understanding of how factors interact to enable that outcome, providing deeper and more detailed insights into their constellation.

In the context of this paper's case study, the empirical analysis allows for a comprehensive understanding of the factors contributing to the target state's compliance decision-making. By identifying various causal factors and their interactions, the study can provide insight into the specific conditions leading to compliance with the other state's demands in the face of economic exit threats. However, it is important to acknowledge a limitation of causal-process-tracing: it does not allow for concluding that the effect of a causal factor will be the same in other similar cases or that a variable influencing the outcome in this study's case would have the same effect in another case with a similar or same outcome (Blatter et al., 2018).

### 4.4 Operationalization

Following the causal-process-tracing method, the focused theoretical framework introduced in [section 3.2](#) is operationalized to elucidate the factors influencing the compliance of the British government with the Icelandic government's demands during the 3<sup>rd</sup> Cod War conflict. This method enables the identification and analysis of variables necessary and sufficient for understanding compliance behaviors in low-level conflicts such as the Cod Wars.

Drawing from the definition of causal variables provided by Blatter et al. (2018), a variable is deemed necessary if its absence would have prevented the outcome and sufficient if its presence directly contributed to the outcome. Each causal element is evaluated within the sequence of events, considering scenarios both with and without that specific element. In examining the sequence of events in the 3<sup>rd</sup> Cod War conflict, the causal mechanism derived from Crescenzi's exit model theory is adopted. Subsequently, the plausibility of each causal variable addressed in the analysis is assessed.

The configuration of causal variables must adhere to the principle of sufficiency for a valid causal-process-tracing analysis. As previously noted, in process-tracing analysis, other potential pathways cannot be eliminated; thus, conclusions can only be drawn regarding sufficiency rather than necessity (Blatter et al., 2018).

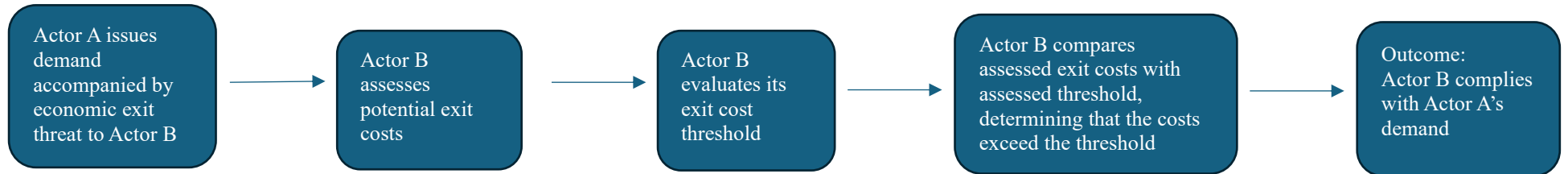
Economic exit costs, as defined by Crescenzi (2003), are determined by asset specificity, market structure, and the level of economic activity. Asset specificity refers to the degree to which a state's asset invested in the economic relationship with another state can maintain its productivity when utilized for different purposes or by other entities if economic ties are severed (Crescenzi, 2003). For the sake of the analysis, the asset specificity can be either high or low. Market structure dictates the ease of finding substitute trade partners (Crescenzi, 2003), presenting either a framework in which the state can easily find substitute trade partners or a high market concentration framework in which the state struggles to do so. The level of economic activity is represented by the salience of an economic relationship between two states for one of the states (Crescenzi, 2003).

Given that states evaluate economic exit costs relative to their exit cost thresholds, it is important to deconstruct this element into causal conditions to be considered within the analysis framework. These conditions encompass the value of the issue at stake, which may be political, strategic, or economic, as well as the likelihood and potential costs of conflict escalation (Crescenzi, 2003). Conflict escalation, as conceptualized by Crescenzi, entails the transition from a low-level to a high-level conflict, characterized by militarization.

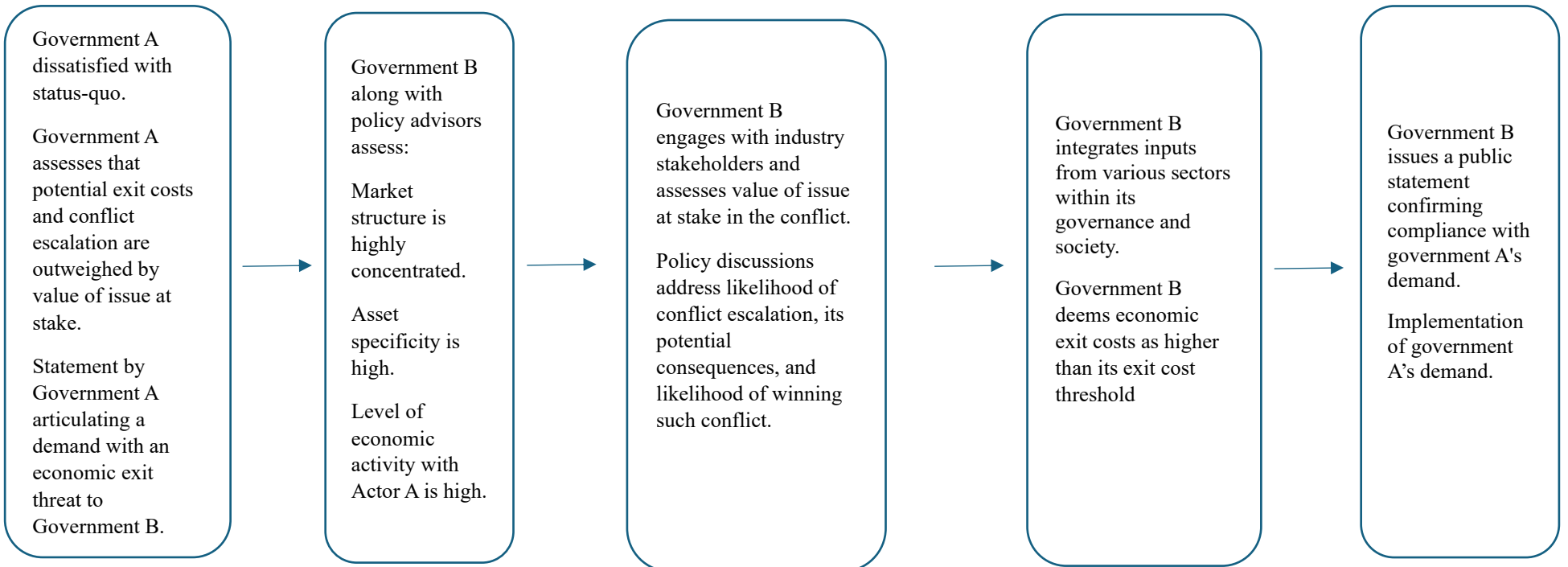
#### 4.4.1 Flowchart

The following flowchart offers a visual representation of the causal mechanism underlying compliance behavior, outlining each step along with observable implications derived from the theoretical framework.

## Theoretical Causal Mechanism



## Observable Implications





#### 4.4.2 Explanation of Flowchart

The first step in the theoretical causal mechanism involves Actor A (the challenger state) issuing a demand accompanied by an economic exit threat to Actor B (the target state). According to Crescenzi's theory (2003), the observable implications of this stage include Government A's dissatisfaction with the status quo, an assessment by Government A that, its potential exit costs and the risk of conflict escalation are outweighed by the value of the issue at stake, and a formal statement by Government A to Government B articulating the demand and the economic exit threat.

In the second step, Actor B assesses the potential economic exit costs if ties with Actor A are severed. This stage has three observable implications: Government B assesses a highly concentrated market structure, Government B assesses high asset specificity, and Government B assesses a high level of economic activity with Actor A. According to Crescenzi's exit model (2003), these factors contribute to higher exit costs, implying that for a state to comply, its exit costs must exceed its exit cost threshold.

The third stage involves Actor B assessing its exit cost threshold. Although Crescenzi does not specify the decision-making agencies involved, the theory suggests rational actors which would imply the government's consideration of different factors before assessment. Therefore, this paper interprets Government B's evaluation as shaped by consultations with affected stakeholders and comprehensive policy discussions. Based on this interpretation of Crescenzi's theory and exit model, the observable implications include the engagement with industry stakeholders followed by the evaluation of the issue at stake in the conflict. Additionally, this stage encompasses policy discussions of Government B, addressing the likelihood of conflict escalation, its potential consequences, and the likelihood of winning such a conflict.

In the fourth stage, Actor B compares the potential economic exit costs with its exit cost threshold. According to Crescenzi (2003), compliance occurs if Actor B assesses that the exit costs exceed its threshold. Therefore, observable implications in this stage include Government B's consideration of inputs from various sectors within its governance and opinions about the importance of previously evaluated variables, leading to the second observable implication of this stage: the conclusion that exit costs are higher than the threshold. The first observable implication of this stage represents an interpretation of the comparison and evaluation process of the state, as it is not specified in Crescenzi's theoretical framework.

Finally, the last stage is Actor B's compliance with Actor A's demand. This is observable through an official statement from Government B confirming compliance and the implementation of Government A's demand.

## 4.5 Case Study Selection

This section explains the selection of the Third Cod War as the case study to investigate the relationship between compliance decision-making and exit costs.

The primary objective of the research is to uncover the causal processes linking exit costs and compliance decision-making in the context of interstate conflicts and economic exit threats.

Considering the range of Crescenzi's theoretical framework, which includes various scenarios, it was necessary to choose a case that represented one of these scenarios, either through a clear rejection of the demand or a clear compliance. Additionally, the research question aims to analyze a low-level conflict, aligning with the specific context of Crescenzi's work and narrowing the range of applicable interstate conflicts.

The Third Cod War was chosen as a crucial case study, following Gerring's (2007) concept of crucial cases. Gerring defines a crucial case as one that is "most or least likely to fulfill a theoretical prediction," thus providing a stringent test of the theory, offering strong evidence if the theory applies (Gerring, 2007: 232). The Third Cod War is considered a least-likely case because, despite the UK's limited economic dependence on Iceland and Iceland's high economic dependence on the UK, the British government ultimately complied with Iceland's demands. This research aims to explain this counterintuitive outcome using Crescenzi's exit model, which argues that a state will comply with demands when the potential economic exit costs exceed its exit cost threshold. As Gerring states, a least-likely case is "one that, on all dimensions except the dimension of theoretical interest, is predicted not to achieve a certain outcome and yet does so. It is confirmatory" (Gerring, 2007: 232).

Moreover, despite historical analyses of the Cod Wars, they have not been extensively analyzed through the lens of theories, especially meso-theories, such as the exit model.

## 4.6 Data Selection

When analyzing the causal pathway between economic exit costs and compliance decision-making of the target state, the research scope is limited to the period from October 1975 to June 1976. This focused timeframe allows for a thorough analysis of the specific

events and evolutions of the conflict. However, understanding the contextual framework surrounding the conflict is significant. Therefore, considering the events leading up to the third Cod War, including the first and second Cod wars, as well as potential diplomatic discussions or economic policies is important. These preceding events may be relevant to the factors influencing the decision-making of the UK and their exit costs during the third Cod War. Consequently, while the primary scope of the research is October 1975 to June 1976, the extended scope is the period from 1958 to shortly after the conclusion of the third Cod War in June 1976.

Data for this research is drawn from both primary and secondary sources. Primary sources mainly include policy discussions and debates within the British Houses of Parliament, as well as information from official government websites. Secondary sources comprise academic articles and historical analyses of the dispute. Given the nature of conflict research, assessing the reliability and potential biases of sources is essential. Triangulating policy discussions with secondary data enhances the validity and credibility of the empirical results. It is also important to note that this research primarily focuses on one party in the conflict, the British Government, meaning that most primary data will originate from the UK.

## **5. Analysis**

### **5.1 Demand Issuance and Economic Exit Threat by Iceland**

Firstly, to address the research question concerning the compliance decision-making process of the target state in response to the challenger's demand accompanied by an economic exit threat, it is essential to begin by analyzing the process surrounding the issuance of demand and the subsequent economic exit threat. In the case of the third Cod War, Iceland acted as the challenger state, while the UK represented the target state.

#### **5.1.1 Icelandic Government's Dissatisfaction with Status Quo, Considering Historical Context**

According to Crescenzi's theory (2003), the issuance of a demand from the challenger state to the target state is a crucial element necessary before an interstate conflict occurs. This demand arises from the challenger state's dissatisfaction with the status quo (Crescenzi, 2003). To understand the Icelandic government's discontent and the variables underpinning the issuance of a demand accompanied by an economic exit threat, it is essential to

historically contextualize UK-Iceland relations regarding fishery disputes after the Second World War.

Iceland's dissatisfaction with the UK regarding fishing activities in the North Atlantic developed over decades. Marked by strong tensions, conflicts over fishing limits in the North Atlantic have defined Iceland's relationship with the UK throughout the second half of the 20th century. Preceding the Third Cod War, the Proto Cod War, the first, and the second Cod Wars highlight the longstanding disagreement over fishing rights between the two countries (Steinsson, 2016). Each dispute led to a British defeat and an Icelandic victory.

The First Cod War, initiated in September 1958, with Iceland extending unilaterally its fishing limits from 4 to 12 miles, concluded in early 1961 with a British defeat. The Second Cod War, marked by an Icelandic extension of limits to 50 miles in September 1972, ended in late 1973 with a temporary agreement favoring Iceland. This period was particularly tense, as Iceland came close to following through on its threat to expel US forces from their country (Steinsson, 2016). The Third Cod War began when Iceland unilaterally imposed a new fishing limit of 200 nautical miles, against the UK's and other nations' will (Steinsson, 2016).

Iceland's dissatisfaction with the status quo stemmed from economic, political, and nationalistic factors, particularly within the fishing industry. Historically, Iceland's economy thrived on fishing, with herring catches driving the country's prosperity following the 1961 agreement. However, a crisis ensued in 1967 when herring stocks disappeared, leading to economic difficulties until 1969. Iceland's reliance on cod fishing intensified, however, by 1971, cod catches declined significantly – 25% compared to the previous year (Ingimundarson, 2008).

A central issue was the substantial foreign presence in Icelandic waters, with British and West German vessels accounting for half of the total catch (Ingimundarson, 2008). The fishing industry represented 80 percent of Iceland's exports in the 1970s, reflecting the importance of this industry sector for the Icelandic economy (Ingimundarson, 2008). Despite efforts to extend fishing limits to 50 miles in 1973, the temporary agreement was expiring. Moreover, Iceland was facing additional economic challenges due to diminishing fish stocks, a concern underscored by British and Icelandic scientists' confirmation of deteriorating fish stocks: "...the steadily deteriorating state of the fish stocks, especially, cod, in Icelandic waters was confirmed by a team of British and Icelandic scientists, strengthening the

Icelandic position on conservation” (Ingimundarson, 2008: 92). This economic vulnerability enhanced Iceland’s discontent with the status quo, as foreign fishing activities, particularly by the UK, threatened its economic stability.

Beyond economic considerations, Iceland’s dissatisfaction concerned also political and nationalistic factors. Divisions within Iceland’s political landscape over NATO membership and the presence of US military forces further complicated matters. While some parties advocated for NATO withdrawal and expulsion of US forces, others, such as the right-right and pro-American Independence party that won the 1974 elections, were pro-western and prioritized expanding the fishing limits. Despite these political divisions, Iceland’s stance on foreign fishing remained coordinated, driven by economic grievances (Ingimundarson, 2008).

This persistent discontent over foreign fishing activities spanned decades, punctuated by conflicts such as the Proto Cod War, the First, and Second Cod Wars, and eventually the Third Cod War. This first observable implication within Crescenzi’s theoretical causal mechanism highlights a gradual process beginning in 1958 and becoming particularly significant by the 1970s when cod stocks became scarce and scientists warned about overexploitation. While political and nationalistic factors shaped Iceland’s divided stance on Western influences, economic losses from foreign fishing, notably by the UK, were the primary drivers of Icelandic dissatisfaction in 1975. In summary, Iceland’s dissatisfaction with the status quo was the expression of its economic vulnerability and commitment to safeguard its fishing resources.

### 5.1.2 Iceland’s Assessment of Exit Costs and Value of Issue at Stake

The dissatisfaction with the status quo is a necessary element for the demand issuance by a state, however, the government has to also weigh the potential exit costs and the likelihood of escalation with the issue at stake. According to Crescenzi’s (2003) theoretical framework, if the exit costs outweigh the object of demand and the likelihood for escalation is high, then the state would most likely decide against the demand issuance. However if the value of the issue at stake outweighs the exit costs, the state will proceed with its action.

With constant resistance from the British during previous instances when Iceland unilaterally expanded its fishery limits, it was natural for Iceland to anticipate similar pushback from the UK. However, the Icelandic commitment to win the dispute is clear among scholars, underscoring the economic value of the issue at stake – the expansion of

Iceland's fishing limits. For the Icelandic government, this issue was at the top of its agenda, given the heavy dependence of its economy, including GDP, wages, and employment, on the fishing industry sector (Steinsson, 2016). The Icelandic Prime Minister expressed himself on the matter just before its official decision to expand the fishery limits highlighting publicly the government's strong position on the matter: "We shall not enter into any agreements which do not fully conform with our interests, and we shall either negotiate for full victory or, if such is our fate, fight until victory is won" (Tomasson, 1976: 156).

Considering potential exit costs in the event of conflict escalation, Iceland faced substantial risks. Scholars widely acknowledge Iceland's significant reliance on UK trade, as it represented the largest export market for the UK (Steinsson, 2015), a dependency that characterized the Cod Wars as risky and potentially costly for Iceland (Steinsson, 2016; Steinsson, 2018). Before 1970, up to 90% of Iceland's economy relied on fish product exports, declining to 75-80% in the 1970s with the inclusion of aluminum and ferrosilicon exports. While Iceland included new types of goods in its exports, the fishing industry remained central, particularly in its bilateral trade with the UK.

However, despite this dependence, the assets involved in the fish trade, particularly with the UK, were not highly specific to the bilateral relationship. As a matter of fact, Iceland exported fish to various other countries, including Germany, Portugal, Spain, Italy, and African nations (Government of Iceland, n.d.). Moreover, Iceland's 1972 free trade agreement with the European Community enhanced its competitive position for fisheries products within Europe (Steinsson, 2015). This meant that adaptability costs were relatively low, indicating a lower level of asset specificity.

Furthermore, the richness of Icelandic waters and high-quality fish allowed for flexibility in seeking alternative trading partners if the relationship with the UK weakened. In other words, the market structure favored Iceland, mitigating potential exit costs.

The issue at stake - the expansion of Iceland's fishery limits - directly impacted the country's fish catch volumes, market structure, exports, and, consequently, exit costs. Without the expansion, Iceland would face a persistent shortage of fish, impacting export capabilities and intensifying competition with other nations, particularly Germany and the UK, for Icelandic-specific fish species such as cod. This heightened competition would be challenging as it would also suggest a market structure with higher concentration, potentially limiting Iceland's ability to export fish. In addition, despite tensions, the likelihood of

escalation to a full-scale war remained low due to both countries' NATO membership and the broader context of the Cold War.

In summary, following Crescenzi's theoretical framework, Iceland issued its demand ultimately leading to the Third Cod War, conflict due to the immense economic value of the issue at stake – expanding fishery limits to 200 miles. Despite its dependency on UK trade, the relatively low asset specificity and advantageous market structure favored Iceland's position leading to the unilateral imposition of the 200-mile limits against the UK's will. Moreover, considering potential exit costs related to Iceland's ability to export fish to the UK, it is noteworthy that since Iceland could not catch enough fish to meet demand, the threat of losing access to the UK market could not have diminished significance tremendously. Therefore, Iceland's risk assessment weighed in favor of expanding fishing limits, even if it entailed potential exit costs. Iceland's decision-making process for the issuance of demand and subsequent threats was explained by the economic benefits of expanding fishing limits outweighing the perceived risks of escalating tensions with the UK.

### 5.1.3 Iceland's Demand Issuance and Economic Exit Threat

The issuance of a demand followed by an economic exit threat is an important step within Crescenzi's exit model. This step is empirically illustrated by a statement of the Icelandic government articulating a demand with an economic exit threat to the British government.

Negotiations between Iceland and the UK over fishery limits began in June 1975 (Guðmundsson, 2006). Iceland demanded that the UK limit its annual catches to 65,000 tons within the proposed 200-mile limit (Hattersley, 1975). However, the UK strived for a higher quota of 110,000 tons (Steinsson, 2015). This initial demand from Iceland represents the formal issuance of a demand to the British government, fitting into Crescenzi's framework.

The British government's rejection of Iceland's demand led to Iceland's unilateral decision to extend its fishing limits to 200 miles. This decision was officially announced on October 15<sup>th</sup>, 1975 (Government of Iceland, n.d.; Tomasson, 1976; Anand, 1976). The Icelandic Prime Minister Geir Hallgrímsson addressed himself to the nation one day before Iceland's official extension of fishery limits. He expressed his determination to fulfill this objective, underscoring the urgency and necessity of this action due to declining fishing stocks: "The answer is that the fish stocks in the waters adjacent to Iceland are in such danger

of extinction that it would, indeed, be a matter of heavy responsibility to wait any longer..... Our livelihood is at stake” (Geir Hallgrimsson cited in Tomasson, 1976: 156).

Following this unilateral extension, British vessels continued their fishing activities within the new Icelandic fishing zone. In response, Iceland undertook actions that amounted to economic and physical threats, such as sabotaging British vessels and equipment (Steinsson, 2015). These actions resulted in significant financial costs for the UK, aligning with Crescenzi’s conceptualization of economic exit threats.

Furthermore, Iceland issued broader threats, including the potential withdrawal from NATO and the rupture of diplomatic relations, in reaction to the UK's deployment of the Royal Navy into the contested fishing limits (Steinsson, 2017; Steinsson, 2018; Hattersley, 1976). While these threats are strategic and political rather than economic, they form part of the sequence of events and are considered in the broader analysis.

## 5.2 UK’s Assessment of Exit Costs

The next stage of Crescenzi’s exit model involves the target state assessing its potential exit costs, which includes evaluating market structure, asset specificity, and the level of economic activity. This section details how the British government, with the help of policy advisors, conducted these assessments during the Third Cod War.

### 5.2.1 Market Structure

The British government’s assessment of the market structure surrounding the UK’s trade relations with Iceland, particularly focusing on fish imports, which were the main economic tie between these two states (Steinsson, 2017). Crescenzi's theory suggests that high market concentration, indicating difficulty in finding substitute partners, increases the likelihood of compliance with another state’s demand. This theoretical expectation is tested in the context of the Third Cod War, where the UK ultimately complied with Iceland's demands.

The British government’s evaluation primarily involved understanding the importance of fish found in Icelandic waters. Although the UK had extensive trade relations globally, with the third-highest export share among G7 economies and China in 1970 (Kent, 2016), its dependence on Icelandic cod within the UK market presented significant challenges. The richness and high quality of fish in Icelandic waters (Jóhannesson, 2005) were not easily substitutable by other fishing grounds due to increased competition and overexploitation of waters in the North Sea (Kerby et al., 2012).



Furthermore, the British government was aware of the cultural and economic significance of cod in the British culinary tradition, notably in the iconic dish of fish and chips. Following the Second World War, this dish gained popularity, becoming a staple among the British middle class (Walton, 1992). The UK needed a steady supply of white fish like cod, which is “firm in texture, bland in taste, suitable for frying with little or no preparation and possessing few or no bones” (Laing, 1977: 535). Consequently, British consumers gave “primacy to demersal fish – fish which live at or near the bottom of the sea – such as cod, haddock, saithe, whiting, plaice and sole” (Laing, 1977: 534). As Icelandic waters provided 40 percent of all British cod landings, the dependency on Icelandic cod was evident (Laing, 1977).

However debates within the British Parliament revealed that the potential termination of fish imports from Iceland was not a significant topic. The discussions focused more on the loss of access to Icelandic waters for fishing rather than the negative consequences of losing Iceland as a trade partner (Jopling, 1975; Peart, 1975; Hattersley, 1975). This suggests that while the British government recognized the challenges presented by a highly concentrated market structure, it did not seriously consider alternative fish exporters. Instead, the government prioritized maintaining access to Icelandic waters.

In conclusion, the British government’s recognition of the difficulty in finding substitute fishing grounds aligns with the theoretical expectation of high market concentration. However, the primary concern was maintaining access to Icelandic waters for fishing activities rather than focusing on fish imports. This indicates that while the assessment of a highly concentrated market structure may be a sufficient variable in explaining the UK's eventual compliance, it is not a necessary one.

### 5.2.2 Asset Specificity

This section examines the British government’s assessment of the asset specificity surrounding its economic relationship with Iceland. Asset specificity, as defined by Crescenzi (2003), refers to the degree to which an asset can maintain its productivity when utilized for different purposes or by different entities. In the context of the UK’s assessment of potential exit costs, the concept of asset specificity is important in determining the feasibility and costliness of ending imports from Iceland, particularly of codfish, if ties are severed.

British fishing ports engaged in the importation of fish from Iceland, primarily Grimsby, Hull, and Fleetwood (Kurlansky, 1997), were specialized facilities designed

specifically for handling seafood. These ports have dedicated infrastructure for unloading, processing, storing, and marketing seafood products, as well as for maintaining and servicing the fishing fleet. (Scheffczyk, n.d.) For instance, the port of Hull specialized in stern freezer trawling and strongly relied on access to distant water grounds (Kerby et al., 2012).

These ports included secure docking facilities for fishing vessels, refueling, and repairs, as well as accessibility to water, electricity, and waste management facilities. They importantly supported the development of fish processing industries by providing the high hygienic standards (Scheffczyk, n.d.). Cold storage facilities associated with seafood imports were specialized to maintain precise temperature and humidity levels required to maintain the freshness and quality of seafood products. These facilities were essential for ensuring the quality of the imported fish during transit and storage. Fish and seafood had to be stored at -1 to 2 degrees Celsius, a different standard than for other types of foods such as meat and poultry (n.a, 2023). Before reaching consumers, fish undergo processing, including filleting and freezing, before being delivered to the market. This process begins with pre-treatment, involving the cleaning and cutting of the fish. Next, the fish is filleted using specialized machinery, followed by the removal of the skin and trimming with the use of specific machines, then the removal of the skin followed by trimming (Nielsen, 2003). Processing plants are equipped with specific equipment and infrastructure tailored for seafood processing, highlighting the high asset specificity inherent in the fishing industry. Therefore, numerous assets involved in the UK's trade relationship with Iceland, particularly fishing ports that receive seafood imports, exhibit high asset specificity due to their specialization in handling seafood. These ports are specifically designed to meet the unique needs of the fishing industry, making them less adaptable to alternative import sources and commodities.

However, these assets are also utilized for processing fish caught by British fishermen, suggesting low asset specificity. Fish caught by British trawlers constitute the majority of the fish processed in these ports (Kerby et al., 2012). These ports' dependence is stronger on fish caught by British trawlers, particularly from Icelandic waters, highlighting the vulnerability of the British fishing industry in the context of the Third Cod War. The core issue was the UK's ability to fish within the 200-mile zone claimed by Iceland. The Guardian's report on the decline of British fisheries emphasizes that Iceland's unilateral decision to expand its fishing limits jeopardized the UK's access to prime fishing grounds, leading to job losses and port obsolescence (Nelsson, 2018). For the British Trawlers Federation, the concern over the loss of utility of fishing ports was not linked to the loss of

imports from Iceland if ties were severed, instead, discussions revolved rather around the impact of the inability to fish in Icelandic waters, including job losses, loss of utility of processing facilities, with even the risk of obsolescence of entire fishing ports (Jopling, 1975; Reid, 1988).

The specificity of fishing ports and related assets was recognized in parliamentary discussions but was associated with British access to Icelandic fishing grounds, not the fish trade with Iceland. This suggests, that these assets had multiple purposes indicating low asset specificity. The loss of utility of assets involved in the economic relationship with Iceland did not constitute an apparent part of the government's assessment of exit costs, overshadowed by the stronger impact of non-access to Icelandic waters. Although the economic exit threat made by Iceland of the continuation of attacks on British vessels, leading to equipment damages and loss of catches did represent a significant issue in the UK, these sanctions and threats alone did not incite the British to comply.

In conclusion, asset specificity concerning trade relations with Iceland appears to be low and does not emerge as a significant part of the British government's assessment of exit costs. However, the specificity of fishing ports and related assets involved in British fishing activities in the North Atlantic was assessed as high. This analysis reveals that although British assets in the economic tie were specific to the fishing industry, this sector was driven more by British catches than by Icelandic imports. This empirical result challenges the theoretical expectation of high asset specificity in explaining the UK's compliance decision-making, suggesting this theoretical variable was not necessary. However, this analysis uncovers why the UK did not comply immediately, leading to clashes at sea between British vessels and Icelandic coast guards (Steinsson, 2017). In fact, it is important to note that, the dependency on fish caught by British trawlers in Icelandic waters represented a significant vulnerability for the British ports and the only response to this situation seemed to be the contestation of Iceland's unilateral expansion.

### 5.2.3 Level of Economic Activity

Evaluating the potential economic exit costs of the conflict for the UK involves assessing the level of economic activity with Iceland. As highlighted by Crescenzi (2003:821): "the degree to which one state involves another in its economy provides additional information about how costly it would be for the first state to endure an exit from this economic relationship".

Despite eventual compliance by the British, the economic activity between the UK and Iceland appeared relatively low from the UK's perspective. The primary economic link was the importation of fish from Iceland. However, much of the cod arriving at British fishing ports came from British trawlers operating in Icelandic waters, as mentioned earlier.

Furthermore, the British economy showed minimal dependency on fishing. The fishing industry, particularly fishing ports such as Hull and Grimsby, was the primary beneficiary rather than the broader economy (Steinsson, 2016). In 1970, manufacturing was the main driver of the British economy, contributing 30.1% of total output and 25.1% in 1975 (Qayyum et al., 2019). This was followed by the sectoral group of financial services, business services, rent, and real estate (Weston, 2024), with services overall accounting for 60.3 % of the UK economy in 1975 (Qayyum et al., 2019). In contrast, "fish accounted for less than 1 per cent of Britain's exports..." (Ingimundarson, 2008: 88), and the fishing sector was included under "other sectors" which represented 5 % of the UK economy in 1975 (Qayyum et al., 2019). This underscores the limited significance of economic activity with Iceland, for the UK during that period.

Additionally, discussions in the Houses of Parliament merely mentioned trade activity with Iceland as a bargaining advantage for the UK, noting Iceland's strong reliance on these exports (Steinsson, 2015). Iceland's economic activity level with the UK was indeed high, making the UK one of Iceland's biggest export markets (Steinsson, 2015). The Icelandic economy depended heavily on the fishing industry, with fish products accounting for 75% of Iceland's exports (Steinsson, 2015; Steinsson, 2018; Government of Iceland, n.d.) and 90 % before 1970 (Government of Iceland, n.d.). Alongside Germany, the UK was a main importer of fresh fish from Iceland (Government of Iceland, n.d.; Steinsson, 2015). This dependency increased Icelandic exit costs, making it clear to the UK that Iceland's economic reliance on the British market was substantial.

The reliance had been a significant point of discussion in previous Cod Wars, where the British government even considered imposing sanctions on Icelandic imports if necessary (Steinsson, 2015). For instance, during the First Cod War, British trawlers imposed a ban on Icelandic imports, leading to a critical economic agreement between Iceland and the Soviet Union in 1953. Given the Cold War context, the UK likely wanted to avoid a similar situation, which weakened its bargaining position in the Third Cod War.

The assessment of the level of economic activity between the UK and Iceland reveals that, from the British perspective, economic ties were not as significant as Crescenzi's theoretical framework would predict. The UK's decision-making process was more influenced by the strategic need to maintain access to Icelandic waters rather than the broader economic impact of losing fish imports from Iceland. This understanding highlights that the level of economic activity was not the primary driver in the UK's compliance decision during the Third Cod War, thereby challenging the theoretical expectations.

### 5.3 UK's Assessment of Exit Cost Threshold

The exit model theory suggests that states will evaluate their exit cost threshold following an assessment of potential exit costs during their decision-making process regarding compliance with another state's demand and threats. Should the UK's exit cost threshold surpass its potential exit costs, it would contribute to elucidating its decision to comply with Iceland's demands. The exit costs threshold represents the maximum level of costs a country can tolerate in a conflict, influenced by factors such as the value of the issue at stake, the likelihood of escalation, and the potential consequences of the escalation.

#### 5.3.1 The British Government engages with industry stakeholders to assess the significance of the issue

This section delves into the British government's assessment of the value of the issue at stake during the Third Cod War, focusing on its engagement with industry stakeholders in this evaluation process. This analysis highlights the factors influencing the UK's exit cost threshold and subsequent decision-making regarding compliance with Iceland's demand.

The British government actively engaged with relevant stakeholders in the fishing industry to assess the significance of access to the North Atlantic fishing grounds, which Iceland had unilaterally expanded (Steinsson, 2016). This expansion represented a significant economic challenge for the British fishing industry, which was already facing difficulties. Michael Joplin, MP of Westmorland and Shadow Minister for Agriculture, Fisheries and Food (MAFF) at the time, was influential within the UK government as he served as Assistant Whip in the early 1970s, becoming Minister of State of MAFF in 1983 (UK Parliament, 2024). He described the situation of the fishing industry in June 1975 (a few months before the start of the Third Cod War) as the "most serious crisis" since World War II. Fishermen and industry actors, such as boat owners, were suffering immense financial losses due to reduced fish stocks, rising costs of operations, and lower fish prices, exacerbated by

escalating oil prices and the expenses of new trawling boat technology. The Scottish Trawling Federation reported average losses of £16,000 per boat in Scotland alone.

Throughout 1975 and 1976, numerous parliamentary sessions focused on the “fisheries dispute” and the broader challenges facing the fishing industry. Notably, the Ministry of Agriculture and Fishery and Food (MAFF) was a prominent advocate for assertive actions against Iceland’s actions. The ministry’s stance on protecting the UK’s fishing interests had considerable influence in the early stages of the conflict, having led to interventions such as the deployment of the Royal Navy in Icelandic waters (Steinsson, 2016).

Minister of Agriculture, Fishery and Food, Fred Peart, and the Minister of State actively engaged with fishing communities by visiting ports, acknowledging the strong impact of the conflict over fishing limits on the industry. Peart (1975) recognized the conflict as contributing to the industry’s struggles, alongside broader economic difficulties and concerns over overexploitation and conservation.

The British Trawler Federation, representing fishermen’s interests, played an important role in shaping government discourse. During the Second Cod War, the British distant-water trawling industry, represented by the British Trawler Federation, exerted substantial influence within the MAFF. The trawlermen, having earned national respect for their contributions during World War II, leveraged their influence to advocate for the protection of fishing interests. (Jóhannesson, 2004) While the stance of the MAFF and the British Trawler Federation was influential over government decision-making during the early stages of the conflict, a gradual shift occurred as the government reassessed the issue’s value and the industry’s significance to the national economy (Steinsson, 2016).

This paper’s empirical analysis reveals that while the fishing industry was important within fishing communities, its overall economic contribution to the national economy was relatively low (Weston, 2024). In 1975, the services sector accounted for 60.3% of the UK economy, and manufacturing contributed 25.1%, while fishing and other smaller sectors together represented only 5% (Qayyum et al., 2019). This disparity in economic contribution highlights the relatively low economic value attributed to the fishing industry during the Third Cod War. Government responses to the fishing industry’s difficulties prior to the conflict already indicated a lack of action (Jopling, 1975). This evidence underscores the limited economic significance of the fishing industry in the eyes of the British government

during the 1970s, and consequently, the relatively low economic value assigned to the issue at stake during the Third Cod War, particularly when the economic efforts involved in the Third Cod War did not seem to improve UK's position in the conflict (Marriott, 1976; Goronwy-Roberts, 1976).

Furthermore, legal opinions and considerations were sought in policy discussions, influencing the value of the issue at stake. The legal aspects surrounding the conflict, such as Iceland's unilateral decision and attacks on British vessels in the North Atlantic, and the broader implications of the 200-mile fishery limit in the context of international law of the sea, were subjects of discussion within the British government (Hattersley, 1975). Legal aspects played a significant role in evaluating the bargaining power of the UK within the conflict. The "traditional law of the sea or, rather, that version of the law that has been accepted by the countries of northern Europe" (Tomasson, 1976: 155) stems from Hugo Grotius's statement *Mare liberum* (1609) that "high seas cannot be possessed and must therefore belong to all mankind" (Tomasson, 1976: 155), highlighted the legitimacy of British trawlers' activities in Icelandic waters, contrasting with the perceived illegitimacy of Iceland's unilateral actions. This analysis provided British decision-makers with a strong argument to reinforce their position in negotiations and potentially influence the conflict's outcome. However, despite the UK's perceived legitimacy, Iceland's actions were not sanctioned by the international community as Iceland leveraged strategic interests over Western countries. (Hellmann and Herborth, 2008). In addition, Iceland viewed its actions as justified in the context of evolving international law, particularly as more countries adopted the 200-mile limit such as Chile and Peru in 1947 (Tomasson, 1976; Steinsson, 2016). Developments in international law regarding extensions of territorial and fishing limits significantly influenced the bargaining dynamics during the Third Cod War. By March 1976, it had become evident to all parties that the UN Conference on the Law of the Sea (UNCLOS III) would likely establish a 200-mile economic jurisdiction for all coastal states, as a consensus had emerged on this issue (Tomasson, 1976; Hellmann and Herborth, 2008). Additionally, the US and Canada had already announced their intention to expand their economic zones to 200 miles, regardless of the conference's progress (Ingimundarson, 2008).

The difference in legal interpretation between the conflicting parties illustrated further evidence for the commitment of Iceland to achieving its goal, which came to be increasingly evident to the British government. In addition, the transitional period of the international sea law led to a lack of international support for the UK in this conflict. Discussions within the

UK government acknowledged the inevitability of legal changes concerning the generalization of the 200-mile limit (Croy, 1976). This awareness underscored the need to adapt to evolving legal frameworks and influenced the country's compliance strategy. The limited time the British would have had access to the contested waters if winning the conflict therefore also diminished the economic value of the issue at stake.

In conclusion, the assessment of the value of the issue at stake during the third Cod War highlights the UK government's engagement with industry stakeholders and its reassessment of the issue's economic value. As theoretically expected, the government consulted stakeholders within the fishing industry, with the MAFF being particularly engaged. The evaluation by the British government of the low economic value of the issue at stake was a gradual process with the intensification of the conflict and legal developments playing an important role in the reassessment of the significance of the conflict. The assessment acknowledged the limited contribution of the fishing industry to the UK, which diminishes the importance of this conflict considerably for the UK. This aligns with Crescenzi's theoretical framework which underscores the importance and the sufficiency of the variable "assessment of the value of issue at stake" within the government's assessment of its exit cost threshold.

### 5.3.2 Likelihood of conflict escalation, Potential Consequences, and Likelihood of Winning such Conflict

The assessment of the likelihood of conflict escalation (low-level conflict to high-level conflict), its potential consequences, and the likelihood of winning such conflict constitute the remaining variables influencing the exit cost threshold according to Crescenzi (2003).

#### 5.3.2.1 *Status at the Time of Assessment*

This section examines the status of the conflict at the point of the British government's compliance decision-making process. Understanding the conflict's progression up to this point is essential for assessing the likelihood of further escalation and its potential consequences.

The conflict had already undergone several stages by the time of the decision-making process. Clashes between Icelandic patrol ships and British trawlers had significantly raised tensions in the North Atlantic. Reports of attacks on British trawlers by Icelandic fishermen and the British coast guards led to reduced catches and increased expenses for the British. In



response, the UK deployed civilian vessels and the Royal Navy to protect its trawlers (Hattersley, 1975; Rodgers, 1976). However, the situation reached a critical point on February 19th, 1976, when Iceland broke off diplomatic relations (Anand, 1976) after the UK sent its Royal Navy back into the contested waters (Steinsson, 2017), despite the clear threat of rupturing diplomatic ties in January 1976 (Hattersley, 1976), the threat of closure of Keflavik airport and of withdrawing from NATO (Ingimundarson, 2008: 92; Anand 1976). The conflict resumed with renewed intensity, leading to damages to Royal Navy ships (Rodgers, 1976). The increased tensions of the conflict forced the British Government, to reassess the likelihood of the conflict escalating further and to evaluate its potential consequences.

#### *5.3.2.2 Policy Discussions on Conflict Escalation Likelihood*

The evaluation of the likelihood of conflict escalation during the Third Cod War involved extensive deliberations within the Commons and Lords Chambers. Discussions centered on the evolving dispute, potential ramifications, and the interests of British fishermen. Key actors in these discussions included notably the Minister of State, Foreign and Commonwealth Office (Lord Goronwy-Roberts), the Minister of State for Foreign Affairs (Roy Hattersley), the Minister of State for Defence (Mr. William Rodgers) the Minister of Agriculture, Fisheries, and Food (Mr. Fred Peart), and Parliamentary Private Secretary (Mr. John Prescott). These figures proposed various steps and highlighted the risks associated with the conflict (Goronwy-Roberts, 1976; Hattersley, 1976; Rodgers, 1976; Peart, 1976; Prescott, 1976).

Geopolitical factors played a significant role in assessing the likelihood of conflict escalation, as observed in previous Cod Wars (Steinsson, 2016). Given that both the UK and Iceland were NATO members, the prospect of a full-scale war was deemed improbable. This argument is supported by the absence of discussions regarding such a possibility in the UK's policy meetings analyzed during this research. The principle of Article 5 of the Washington Treaty, which stipulates: "an attack against one Ally is an attack against all – is at the core of the Alliance, a promise of collective defense" (US Mission to the NATO, n.d.), underscores the collective defense commitment within NATO. Despite Iceland's credible threat of leaving NATO, the asymmetry in military capabilities between the two nations significantly reduced the likelihood of military confrontation. Iceland, was the smallest nation in the world with no military capabilities – lacking an army, air force, or navy (Tomasson, 1976; Anand, 1976) – whereas the UK had one of the most powerful naval bases and military strength (Anand, 1976). Furthermore, Iceland's economic dependency on the Free Trade Agreement with the

European Economic Community since 1972, and its reliance on trade with EU member states provided additional reasons for Iceland to avoid military conflict with the UK (DG NEAR, European Commission, n.d.).

However, while the UK did not anticipate a declaration of war by Iceland, concerns persisted over continued harassment by the Icelandic Coast Guard, which led to economic losses for the British Fishing industry (Marriott, 1976). The potential for Iceland to withdraw from NATO added pressure on the UK, with concerns voiced by the US and other NATO allies (Marriott, 1976). The breakdown of diplomatic ties in February 1976, between the two countries further complicated direct communication, making a diplomatic resolution difficult as Iceland showed no interest in negotiating. The possibility of mediation by third parties was also limited, contributing to the uncertainty surrounding the conflict's evolution. The British government acknowledged "that continuing with the third Cod War and its "certainty of dangerous escalation" did not make sense in the face of these international moves" (Bennett, 2012: 2).

In summary, the evaluation of the likelihood of conflict escalation towards a militarized conflict was not a relevant part of British policy talks due to the low probability linked to geostrategic and economic interdependencies and the asymmetry in power between the two conflicting nations. This analysis showcases the "likelihood of conflict escalation" variable as a non-necessary conditional variable within Crescenzi's exit model to explain the compliance decision-making process and as not significant within this case study. Crescenzi (2003) defines escalation of conflict as transitioning from a low-level conflict to a high-level conflict, which did not enter policy discussion within the UK. However, concerns over economic losses, the diplomatic rift, and potential risks to NATO were significant factors that could have led to increased tensions and negative developments for the UK. The identification of these empirical observations represents the new variables contributing to the causal mechanism of the compliance decision-making process in this case study. The likelihood of increasing tensions within the low-level conflict, specifically geostrategic, economic, and political factors emerges as sufficient variables within the causal configuration.

### *5.3.2.3 Potential Consequences of Conflict Escalation*

This section focuses on the potential consequences of conflict escalation during the Third Cod War, specifically on the implications within the limits of a low-level conflict.

Given the low probability of escalation to a high-level conflict, as defined by Crescenzi (2003), British policy discussions did not address the potential consequences of a full-scale militarized conflict. Instead, the focus was on the consequences of escalation within the context of low-level conflict.

Iceland's threats were taken seriously, particularly regarding its potential withdrawal from NATO. According to Ingimundarson (in Steinsson, 2017), Iceland had only reluctantly joined NATO and agreed to a US military presence, both highly contentious issues in Icelandic politics. Although attitudes towards NATO and the US improved throughout the Cold War, the withdrawal of membership from NATO and the removal of the US base were probable scenarios for further intensification of the conflict (Steinsson, 2017; Goronwy-1976), particularly given its proximity to implementation during the Second Cod War (Steinsson, 2016).

Scholarly literature highlights the pressure exerted on the UK by NATO member states, notably the US. Consequently, the British government weighed the implications for the security alliance and the strategic positioning of Western countries in the context of the Cold War. The potential diplomatic fallout and strategic repercussions of losing Iceland's support were magnified by US influence.

Iceland's strategic significance as a NATO ally cannot be overstated, given its control over the critical North Atlantic shipping lane (Steinsson, 2016). American policymakers regarded Iceland as one of the six most crucial bases for defense against Soviet threats, later adopting a monitoring role of Soviet submarine movements (Steinsson, 2016). The loss of Iceland as a NATO ally would have had huge strategic ramifications for the Western block in the context of the Cold War, weakening inherently NATO, as well as its cohesion, losing one member state and potential diplomatic tensions between the UK and other member states (Steinsson, 2015).

Beyond strategic concerns, there were economic considerations within the British government. The Third Cod War was costly for the UK, and the conflict did not seem to improve (Marriott, 1976). While direct economic dependence on Iceland was limited, the escalation of the conflict could have severely disrupted communication and transport routes to Europe, resulting in significant challenges. Iceland served as an important link in these routes and had a Free Trade agreement with the European Economic Community (EEC) since 1972, of which the UK was a member (Steinsson, 2016). The potential disruption of these

connections and pressure from EEC member states further lowered the UK's economic exit cost threshold.

In summary, this empirical analysis suggests that the conditional variable “assessing consequences of potential conflict escalation” was not necessary, as a militarized conflict was improbable and its consequences were not a point of discussion. Despite this, the UK examined potential negative developments that could impact its interests, as well as those of the EEC and NATO. The geostrategic and diplomatic ramifications, particularly the potential withdrawal of Iceland from NATO and the threat of closing the US military base, were significant factors in the UK's compliance decision-making process, substantially influencing the UK to comply. Furthermore, Iceland's economic interdependence with the EEC illustrated the risk of additional indirect impacts on the UK, reinforcing the importance of these broader geopolitical and economic considerations in shaping the UK's response. These factors constitute new variables not considered in Crescenzi's theory, contributing to the decision-making process of the UK.

## 5.4 UK Compares Assessed Exit Costs with Assessed Exit Cost Threshold

### 5.4.1 Consideration of Inputs from Different Government Sectors and Preference Expression

There were notable discrepancies in opinions and influence on policy between departments within the British government during the Third Cod War, with the different influences evolving throughout the conflict.

The Ministry of Agriculture, Fisheries and Food (MAFF) was the department advocating strongest for “aggressive and extreme actions” (Steinsson, 2016: 264). Advocating for the British Trawlers Federation's interests, the MAFF prioritized the economic interests of British fishermen and the fishing industry. Scholars such as Ingimundarson (2002), Guðmundsson (2006), and Jóhannesson (2007) noted that the MAFF's policy approach was driven by the significant economic reliance on Icelandic waters and the necessity to protect British fishing interests (Steinsson, 2016).

In contrast, the Foreign Office, which encompassed the British department most concerned with the UK's long-term security interests and international position, adopted a more cautious and diplomatic approach. The Foreign Office was particularly reluctant to deploy the Navy and was inclined towards meeting Icelandic demands. Diplomats recognized that resolving

the disputes through negotiation and being ready to meet Icelandic demands would better maintain the UK's long-term security interests and international reputation (Steinsson, 2016). This discourse is notably visible within the discourse led by Lord Goronwy-Roberts, minister of State for Foreign Affairs and Commonwealth Affairs, raising concerns about the deployment of the British Navy in this conflict (Goronwy-Roberts, 1976). This department's stance was strongly characterized by the consideration of the strategic implications of the conflict, notably regarding the NATO alliance.

At the early stages of the Cod Wars, empirical evidence suggests that the UK's fishing interests preceded security interests. This prioritization was partly due to the dominance of the Ministry of Agriculture and Fisheries at that time (Guðmundsson, 2006). The immediate economic importance of the fishing industry led to a strong initial focus on maintaining fishing rights in Icelandic waters. However, increasing pressure from NATO and the US and the economic unsustainability of prolonged conflict led the UK to reconsider its position. Notably, the amount of fish caught was not more than the 65,000 tons limit Iceland offered during negotiations, which meant pursuing this conflict did not make economic sense (Goronwy-Roberts, 1976).

The British government faced continual pressure from the Ministry of Defence, emphasizing that British warships were required for NATO support. Indeed, the “operational efficiency of the fleet was suffering” (Marriott, 1976: 50), due to its involvement in the Cod War (Marriott, 1976).

Consequently, the UK eventually aligned more closely with the Foreign Office's position, recognizing that the broader implications for national security and international diplomacy outweighed the immediate economic interests of the fishing industry. The pressure from NATO and the practical need to maintain operational efficiency of the fleet highlighted the strategic necessity of a diplomatic resolution.

#### 5.4.2 Exit Cost Threshold Exceeds Exit Cost According to British Government

This section analyses the British government's comparison between its assessments of economic exit costs and exit cost threshold during the Third Cod War.

Throughout the Third Cod War, the British government's assessments and positioning evolved, explaining its initial non-compliance position until May or June 1976 (Steinsson, 2016). Discussions and debates within the British government and Parliament concerning

conditional variables of the compliance decision-making process had occurred earlier in the conflict. However, the government initially favored other factors, notably those defended by the MAFF (Steinsson, 2016). Consequently, it is essential to include data from the period preceding the reassessment of the government's position on the conflict.

The British government's assessment of economic exit cost highlighted a low asset specificity and a low level of economic activity from a British perspective, both of which significantly reduced exit costs. While the analysis indicated a highly concentrated market that would typically increase the UK's exit costs, this factor did not feature prominently in the government's assessment. This suggests that the trade relationship with Iceland held minimal significance in the UK's cost-benefit analysis, making this variable's negative impact on exit costs negligible.

Regarding the assessment of the exit cost threshold, the value of the issue at stake emerged as a crucial and sufficient component. The government, eventually, attributed low economic value to the issue at stake, which significantly lowered the threshold. The likelihood of conflict escalation and its potential consequences were not prominent variables in the government's assessment, however, the low value of the issue at stake can plausibly explain the compliance decision on its own. Nonetheless, other variables not included in Crescenzi's conceptualization of exit cost threshold have influenced the decision-making process. The potential for intensified low-level conflict leading to diplomatic, geostrategic, and economic costs appeared during the causal-process tracing as influential and sufficient variables.

All these factors revealed as particularly significant in the British government's decision-making process, lowering its exit cost threshold significantly are highlighted in the Secretary of State for Foreign and Commonwealth Affairs, Anthony Crosland's speech after the end of the conflict, on the 7th of June 1976: "What were the alternatives? There was in fact only one. That was to continue to pursue the cod war, with the certainty of dangerous escalation, with international and especially NATO opinion moving sharply against us, at a mounting cost in terms of naval protection, with our moral position steadily eroding as nation after nation accepted the principle of 200 miles..." (Anthony Crosland, 1976).

In conclusion, the government's assessments reveal that the exit cost threshold was lower than the potential exit cost by the British government. The significant variables influencing the government's decision to comply were not those related to economic exit

costs, which were either low or irrelevant in the government's evaluation. Instead, the decisive factors were those related to the exit cost threshold, which was assessed as extremely low. The low economic value attributed to the issue at the end of the conflict appears to have shifted the UK's attitude. Although the likelihood of conflict escalation and its costs were deemed irrelevant, other variables sufficiently contribute to explaining the outcome.

## 5.5 Outcome: UK Complies with Iceland's Demand

The outcome of the Third Cod War was the British government's compliance with Iceland's demand for a 200-mile expansion of their fishery limit. This decision was formalized through an agreement signed on June 1st, 1976, in Oslo, leading to the resumption of diplomatic relations between the two countries (Anand, 1976). The agreement was highly favorable to Iceland, granting the British only temporary and very limited fishing rights. Specifically, the British were allowed to keep only 24 trawlers within 200 nautical miles, with a maximum catch of 50,000 tons (Steinsson, 2018). The new regulations mandated that fishing within Iceland's EEZ be based on scientific assessments of fish stock conditions (Olivert-Amado, 2008).

On June 7th, 1976, the Secretary of State for Foreign and Commonwealth Affairs delivered a speech addressing the agreement reached with the Icelandic Foreign Minister. He acknowledged that the adoption of the 200-mile limit was inevitable, noting that several countries, including the US, Canada, and Norway, had already implemented it. He also expressed gratitude to the Norwegian Foreign Minister for his mediating role and to the NATO Secretary General for their efforts in facilitating the agreement (Crosland, 1976).

## 5.6 Summary of Empirical Results

This section summarizes the empirical findings of the analysis. It highlights the main factors influencing the UK's decision to comply and sets the stage for the subsequent discussion of broader implications and interpretations.

Firstly, the British government's assessment of high market concentration was in line with theoretical expectations. However, it was not included as a significant part of the British government's evaluation, thus not significantly increasing the exit costs. Asset specificity and the level of economic activity showcased a negative causal effect on the outcome, thus, both did not contribute to the decision-making process of compliance. These findings within the evaluation of potential economic exit costs suggest that the British government assessed low

economic exit costs, with the market structure being the only variable slightly increasing these costs, but not enough to be a strong influencing factor.

Secondly, the evaluation of the exit cost threshold reveals that the British government's reassessment of the issue's economic value was crucial in shaping its compliance decision. Legal developments and the continued economic impact of the dispute played a significant role in this re-evaluation. Despite the low likelihood of escalation in Crescenzi's sense, concerns over more economic losses, diplomatic rifts, and risks to NATO were significant. These geopolitical and economic considerations emerged as new influential and sufficient variables within the decision-making process.

Ultimately, the significant variables influencing compliance were related to the exit cost threshold, which was assessed as very low. Economic exit costs, while relevant, were not the main determinants of compliance. Instead, geostrategic concerns, the concerns of economic losses produced by this conflict, and diplomatic implications contributed to the decision-making process. However, the empirical findings confirm the core argument of Crescenzi's model: that exit costs must be higher than the exit cost threshold for a state to comply with another state's demand.

## **6. Discussion**

### **6.1 Summary of Results**

This section summarizes the key empirical findings on how exit costs influenced the British government's decision to comply with Iceland's demands during the Third Cod War.

The British government prioritized maintaining access to Icelandic waters over trade ties, indicating that market structure, while theoretically increasing exit costs, did not significantly influence compliance. Asset specificity was low, as fishing assets were not highly dependent on Icelandic imports. Moreover, economic activity between the nations was not a major factor in the decision-making process. The findings suggest low economic exit costs, with market structure being the only slightly increasing factor but not decisive.

In contrast, the reassessment of the issue's economic value lowered the UK's exit cost threshold significantly, contributing significantly to the UK's decision-making process to compliance. Additionally, other factors such as geostrategic and diplomatic concerns and



intensification concerns, as well as economic costs of the conflict emerged as significant variables within the decision-making process of the UK.

Overall, the assessment of the low economic value of the issue at stake combined with the concerns about negative strategic and geopolitical developments, their potential worsening, and the economic losses the engagement in the conflict was incurring was sufficient in their causal configuration to explain the compliance of the UK. The UK's threshold was lower than the minimal exit costs it faced by not complying because of the very low economic value attributed to the issue at stake. However other variables also constituted sufficient variables to explain the outcome.

## 6.2 Interpretation of Results

The assessments of economic exit costs through the variables of market structure, asset specificity, and level of economic activity were found to be either weak in significance in the British government's evaluation or a negative causal effect on the compliance decision. This phenomenon can be explained by the direct economic stake of the conflict's issue. The economic interdependence between the UK and Iceland was primarily in the fishing industry, which was also the sector at stake in the Third Cod War. For the UK, the economic value of the conflict itself was higher than the economic value of the trade relationship with Iceland. Consequently, factors defining economic exit costs did not significantly increase the overall economic exit costs for the UK. Perhaps a case with no overlap between the nature of interdependence of the two states and the issue of the conflict would lead to a different expression of the economic exit costs.

Another factor contributing to the weak or negative causal effect of variables within economic exit costs is the limited economic dependence of the UK on Iceland. Crescenzi's paper (2003) acknowledges an asymmetry in state interdependence, which justifies the selection of this case. This recognition underscores the need to consider asymmetries in economic dependencies when analyzing state behavior in conflicts. However, the evaluation of low economic exit costs meets the initial expectations of this paper given the much stronger economic dependence of Iceland on the UK.

In contrast, the evolving perception of the value of the issue at stake plays a central role within Crescenzi's framework for explaining compliance decision-making in this case study. Initially deemed relatively high, the assessment of the issue gradually decreases over the conflict's duration, eventually reaching a very low value according to the British

government. This diminishing value becomes a primary factor in the decision-making process within Crescenzi's exit model. This empirical finding reinforces the pivotal role of the "value of issue at stake" variable in evaluating the exit cost threshold and broader cost-benefit calculations in interstate conflicts.

Indeed, the initial non-compliance and subsequent low-level conflict can be attributed to the British government's assessment of the issue's high value, with the MAFF exerting significant influence during this period. This assessment elevates the exit cost threshold above potential economic exit costs, further reinforcing the exit model's validity (Crescenzi, 2003).

Moreover, newly identified variables during the analysis, such as concerns over NATO cohesion due to Iceland's potential withdrawal, diplomatic relations fallout between the two countries, and the costly deployment of the Royal Navy in the Third Cod War, significantly influenced the UK government's compliance decision-making process. These findings suggest potential vulnerabilities in the theoretical framework.

While the research reveals additional significant variables, not foreseen in the exit model, the strong expression of the "low value of the issue at stake" variable sufficiently lowers the threshold, so it finds itself below exit costs. This analysis unveils additional elements and their closeness with existing variables in the exit model, specifically, the likelihood of conflict escalation and its consequences. These newly identified variables align with the category of conflict intensification and its potential ramifications within the low-level conflict arena.

## 6.3 Implications

This paper's application of causal process tracing, a qualitative methodology, to a quantitative theoretical model, enriches our understanding of decision-making processes within interstate conflicts. By delving into the details of the causal mechanisms and observing the interconnectedness and interactions of variables, this study uncovers insights beyond the scope of quantitative analysis. For instance, while a quantitative approach might have stopped analysis after categorizing market structure as high, the causal process tracing method reveals the variable's low significance for the UK's decision-making process, providing a more accurate assessment of the concrete factors influencing the UK's decision.

The selection of a crucial case (Gerring, 2007), where the UK complied despite being less dependent on Iceland, is a strong test of the theoretical model. Despite uncovering additional variables that contribute to explaining the UK's compliance decision, identifying the very low value of the issue at stake underscores the sufficiency of this core variable. This challenges conventional assumptions and reinforces the validity of the exit model, highlighting the importance of nuanced understanding in evaluating compliance dynamics.

Within the existing literature, the findings of this paper enhance the argument that economic interdependence lowers the risk of a militarized conflict, aligning with newer liberal arguments (Gartzke et al, 2001; Gartzke and Westerwinter, 2016). By avoiding militarized conflicts, both Iceland and the UK employed alternative tactics and threats, illustrating Crescenzi's theoretical argument of a high likelihood for low-level conflicts and bargaining dynamics between states. However, to better explain the outcome, a broader conceptualization of interdependence including institutional interdependence would be more adequate. For instance, Keohane's (1977) conceptualization of "complex interdependence" suggests that societies are connected through various channels, including formal and informal ties between governments and transnational organizations. In this interconnected system, issues lack a clear hierarchy, leading to blurred distinctions between domestic and foreign policy. Military force is typically not used in relationships within a region or on certain issues, but may still be important in relations with external actors or on different issues (Keohane, 1977). Alternatively, a refinement of the variables composing the exit cost threshold that refer to escalation within low-level conflicts would allow for a more comprehensive analysis through this theoretical model.

This study initially challenges the findings of previous literature, such as Gartzke and Westerwinter (2016), which argue that asymmetrical dependence between states tends to increase the likelihood of militarized conflict, particularly when the less dependent state has fewer trade ties outside the main relationship. Despite the asymmetrical dependence between Iceland and the UK, and Iceland's other trading partners, the conflict did not escalate to militarized conflict. What emerges as particularly relevant in this case study is the presence of economic interdependence among Iceland's trade partners, notably within the European Economic Community (EEC). This suggests that including multipolar interdependence is necessary, especially when analyzing asymmetrical bilateral interdependence. By expanding the analysis beyond the dyadic relationship, and considering the broader network of trade relationships, facilitated by international organizations like the EEC, the analysis will allow

for a comprehensive understanding of the factors influencing conflict dynamics. Indeed, the role of international organizations has become increasingly significant since the conflict in 1975. Their influence in shaping economic interdependence and facilitating diplomatic relations highlights the need to incorporate such dynamics into theoretical frameworks explaining interstate conflicts.

## 6.4 Limitations of Research

Despite the contributions and insights provided by this study, several limitations warrant acknowledgment.

One limitation arises from the lack of precision in Crescenzi's theory regarding the agency within the causal chain of the government's decision-making process. As a result, operationalizing the theory for this research necessitated a certain degree of interpretation, which may have introduced some subjectivity into the analysis. However, the core of each operationalized variable is directly derived from the theoretical model, which makes the process of the research and its results reliable.

Furthermore, a single-case study inherently restricts the generalizability of the results (Toshkov, 2016). However, by selecting a least likely and crucial case – the compliance decision of the British government during the Third Cod War – this research serves as a strong test of the exit model, and therefore its results have high validity. Its confirmation contributes to the validity certain degree of validity to the findings. Despite this limitation, the study offers valuable insights into the non-necessity of certain variables and contributes to the refinement of the theory.

Another limitation stems from the assumption of rational decision-making within the theoretical framework. While this assumption aligns with the dynamics of the conflict studied, it may not always reflect reality. Additionally, the theory assumes transparency of information. This is not always empirically given, indeed, scholars have argued that a lack of transparency of the Icelandic government's intentions and internal political dynamics led the British government to confusion and miscalculation, explaining their initial non-compliance (Steinsson, 2016)

Moreover, a limitation of the study is the lack of access to certain information that could be relevant to further contextualize the government's decision-making process. The primary data sources, mainly from the Houses of Commons and Lords, are triangulated with

historical and secondary literature. However, internal conversations and confidential information may not be publicly available, consequently limiting the available data accessed for this research. Additionally, the temporal distance of the conflict in 1975 further limits the availability of data.

Despite these limitations, this research provides valuable insights into the compliance decision-making process during the Third Cod War and contributes to the ongoing scholarly discourse on economic interdependence and interstate conflicts.

## 6.5 Recommendation for Further Research

Crescenzi himself acknowledges that his model is only a preliminary step and emphasizes the need for refinement and additional research (Crescenzi, 2003).

Building upon this insight, our study suggests the refinement of exit cost threshold variables to incorporate the likelihood of escalation within low-level conflicts, thus capturing the complexity of decision-making processes more accurately.

Moreover, Peterson's work (2013) the role of "reputation" in interstate conflicts presents an intriguing avenue for further research. Considering Iceland's resolute implementation of its threat to expel US forces from its territory during the Second Cod War, the credibility of its threats in the Third Cod War could be analyzed through the lens of Peterson's work. This theoretical perspective could reinforce the validity of variables that influenced the UK's decision to comply and provide additional insights into compliance dynamics.

Lastly, exploring economic dependency asymmetries in conflict outcomes by including the impact of international institutions in analyzing state's bargaining positions and decision making presents a path of research.

## 7. Conclusion

This paper aimed to understand how exit costs influence a target state's decision to comply with a challenger state's demands by analyzing the Third Cod War between the United Kingdom and Iceland. The study identified several factors contributing to the UK's decision to comply with Iceland's demands.

Firstly, while the UK's market concentration theoretically increased exit costs, the practical impact was minimal due to the low economic significance of trade ties with Iceland.

The asset specificity of fishing-related assets in the UK-Iceland trade relationship was also low, as these assets were not highly dependent on Icelandic imports. Additionally, the level of economic activity between the two nations did not significantly influence the UK's decision-making process, suggesting that economic exit costs alone were not decisive factors.

A reassessment of the economic value of the issue at stake heavily influenced the UK's decision to comply. Initially deemed high, the importance of maintaining access to Icelandic waters diminished over time, significantly lowering the exit cost threshold. This reassessment played a central role in shaping the UK's compliance decision. As the economic value decreased, the threshold for exit costs also lowered, making compliance a more viable option.

Moreover, broader geopolitical and strategic concerns emerged as critical factors in the decision-making process. The diplomatic fallout, risks to NATO cohesion, and the economic costs of continued conflict were significant variables that outweighed purely economic considerations. These findings highlight that non-economic factors can substantially influence a state's exit cost threshold and, consequently, its decision to comply.

The study confirms that exit costs are relevant in a state's decision-making process, but their impact is mediated by the exit cost threshold, which is shaped by both economic and non-economic factors. As stipulated by Crescenzi's exit model, the relativity between exit costs and the threshold explains state behavior. This was observable in the earlier stages of the conflict when the British government assessed the economic value of the issue as high, resulting in a higher exit cost threshold that exceeded the level of exit costs, correlating with a period of non-compliance.

Furthermore, the research identified geopolitical factors, including the influence of third parties and international institutions, as significant variables in the decision-making process. These could be conceptualized as part of a refined exit model within the exit cost threshold, considering the likelihood of escalation and its potential consequences in low-level conflicts.

In conclusion, the analysis of the Third Cod War demonstrates that while economic exit costs are significant, their influence on state compliance decisions is contingent upon a broader range of factors that determine the exit cost threshold. This comprehensive understanding of compliance behavior in international conflicts highlights the need to consider both economic and non-economic variables to accurately predict and explain state

decision-making. This research contributes to refining the exit model and enhancing our understanding of state behavior in low-level interstate conflicts.

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