Iceland Has a Winning Policy!

by Michelle Rasmussen

On the sidelines of the bankers' get-together in Davos, Switzerland Jan. 25, Icelandic President Ólafur Ragnar Grimsson gave a highly instructive interview on the positive developments in his country, after refusing to bail out the banking system in 2008. Contrary to the European Union and the United States, which are still throwing money at the banks, Iceland has experienced real economic growth and a decrease in unemployment.

Stephen Cole of al-Jazeera first asked Grimsson why Iceland has survived, while the rest of Europe has failed. His reply: "I think it surprises a lot of people that four years ago, we were exhibit number one of a failed financial system, but now we are back on recovery, with economic growth and very little unemployment; and I think the primary reason is that we were wise enough to realize that this was also a fundamental social and political crisis.... We introduced currency controls, we let the banks fail, we provided support for the poor, we didn't introduce austerity measures of the scale you're seeing here in Europe. And the end result, four years later, is that Iceland is enjoying progress and recovery very different from the other European countries that suffered from the financial crisis."

He was then asked whether Iceland's policy of letting the banks fail could have worked for the rest of Europe. Grimsson replied: "I think so. As I have often asked people, why do they consider the banks to be the holy churches of the modern economy? Why are private banks not, like airlines and telecommunication companies, allowed to go bankrupt, if they have acted in an irresponsible way? The theory that you have to bail out banks, is a theory about bankers enjoying for their own profit the success, and then letting ordinary people [pay for their] failure, through taxes and austerity. And people in enlightened democracies are not going to accept that in the long run."

The last question was: "It wouldn't work for the U.K., with their reliance on the financial sector, would it?"

Grimsson answered: "This is an interesting question, because one thing we learned after the collpase of the banks in Iceland, is that the Icelandic, like the British and American and other banks, had in fact become high-tech companies, hiring engineers, mathematicians, computer scientists, and when they failed, the innovative sectors of our economy, the IT sector, the high-tech sector, in fact, blossomed, and have been doing much better in the last three years than ever before.

"So the lesson of that is, if you want your economy to be competitive in the innovative sector of the 21st Century, a strong financial sector that takes the talent from these sectors—even a successful financial sector—is in fact bad news, if you want your economy to be competitive in the areas which really are the 21st-Century areas."

A Victory in Court

In addition to its economic success, Iceland just won a case at the Luxembourg-based European Free Trade Association court (EFTA), brought by the British and Dutch governments. The court affirmed, on Jan. 28, the validity of the Icelandic government's decision not to fully compensate British and Dutch bondholders in 2008, after the bankruptcy of the bonds of the IceSave online bank, which had branches in the U.K. and the Netherlands. When the Icelandic banking system collapsed in October 2008, the combined nominal indebtedness of Iceland's three largest banks, Kaupthing, Landsbanki (IceSave's parent), and Glitnir, was more than five times the country's gross national product.

The EFTA court, which handles cases concerning three countries in the European Economic Area, but not belonging to the EU (Iceland, Lichtenstein, Norway), found that, given the magnitude of the systemic crisis, Rekjavik was not obliged to come up with the minimum compensation for IceSave's branches abroad.

The British and Dutch governments decided to bail out those bondholders themselves, and then demanded the money back from the Icelandic government. While the Parliament voted to do so, twice, the President refused to sign on, took the issue to the people, organizing instead two referenda, in which Icelanders rejected the bailout.

Now, Iceland may become the first nation to adopt a Glass-Steagall-style bank separation. A bill is now pending before the Economic Affairs and Trade Committee of Parliament, and is expected to be voted on before national elections in April.