



UNIVERSITY OF ICELAND

Explanations of Icelandic Collapse Neoliberalism or Government Intervention?

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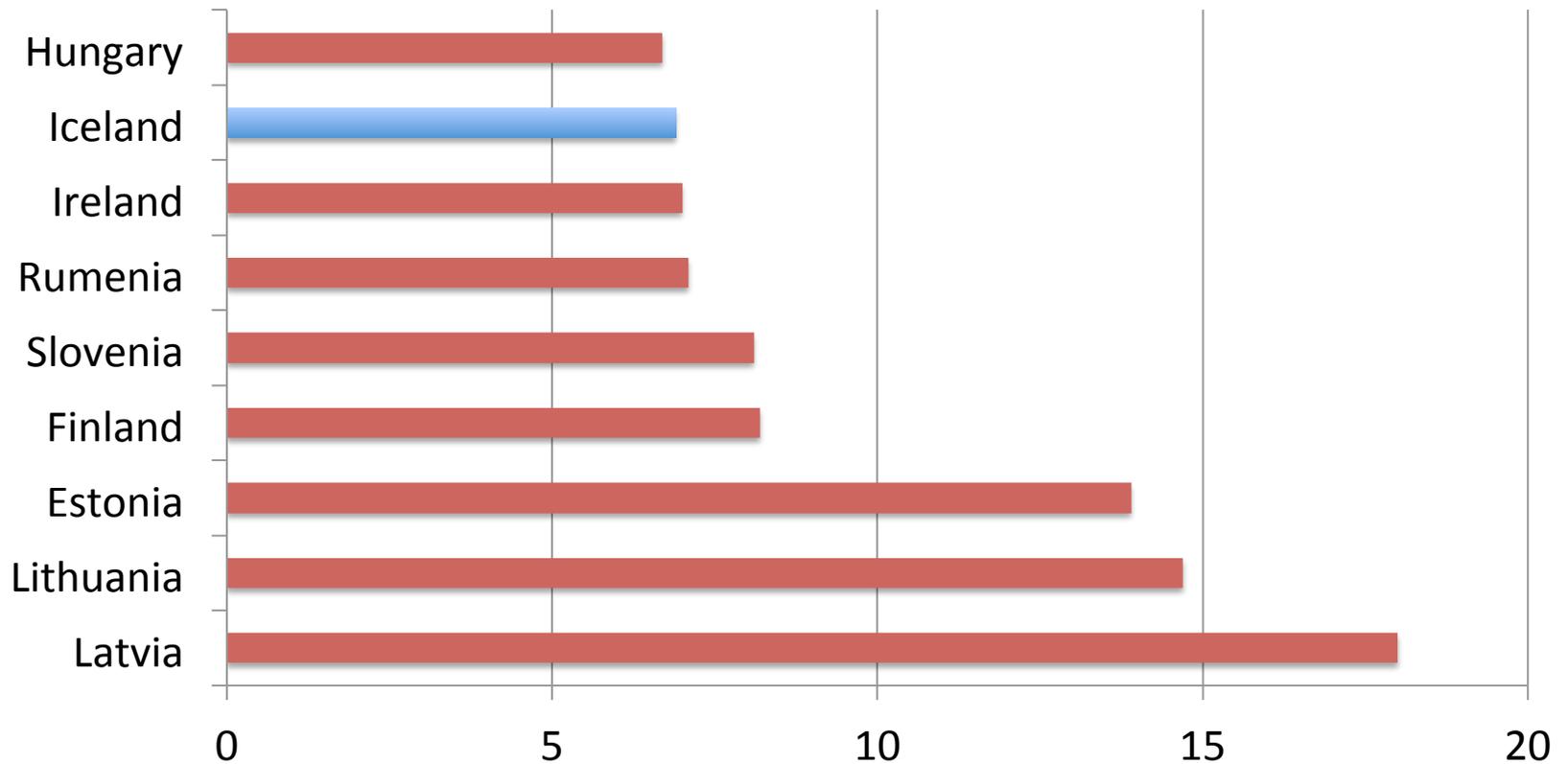
APEE, Las Vegas 14 April 2014

What Happened in Iceland in 2008?

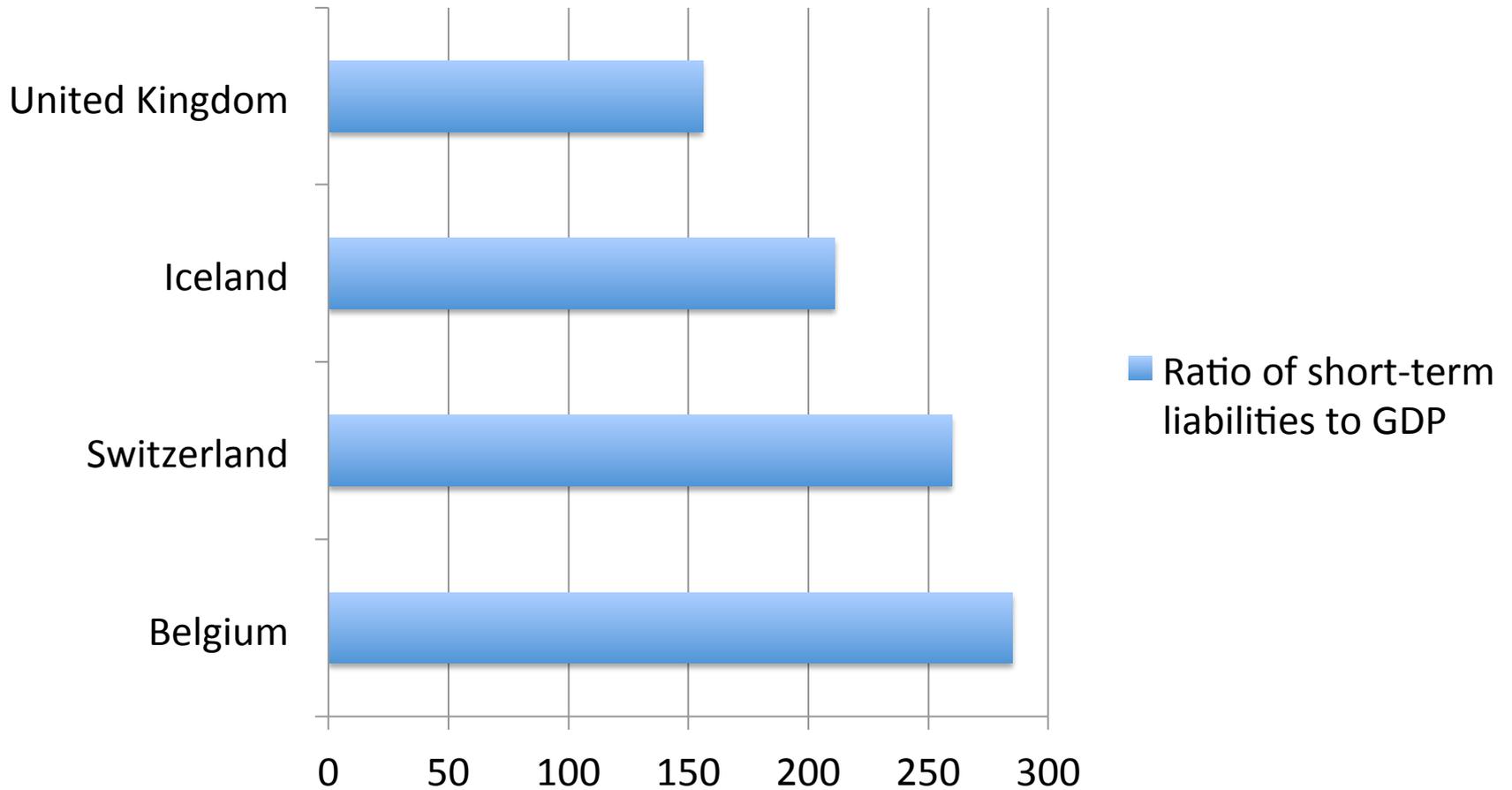
- Icelandic bank collapse no worse a crisis than in many other European countries
- Icelandic banking sector big, but so were such sectors in Switzerland and the UK
- Icelandic bankers reckless, but not more so than in other countries
- Worked under same regulatory framework as in other EEA countries
- Real explanations: Vulnerable situation, crucial decisions

Seven EU countries hit harder

GDP Contraction 2009 in %



No more “oversized” than others



No more “reckless” than others

- UBS bailed out: fined \$1.25 bn for destroying documents on Jews; \$780 mn for assisting in tax evasion; \$1.5 bn, for rate rigging
- Danske Bank bailed out (with dollars from Fed)
- RBS bailed out, £45 billion in capital, £275 in liquidity: fines for rate rigging, money laundering for Iran and Sudan
- ING bailed out, €10 billion in capital: fines for money laundering

Others Needed Help: Currency swaps

- Aggregate transactions with CBs: \$10,057 bn
- ECB \$8,011 (79.7% of total)
- CB of the UK \$919 bn
- CB of Switzerland \$466 bn
- CB of Denmark \$73 bn
- CB of Sweden \$67 bn
- CB of Norway \$30 bn
- Also CBs of Japan, Korea and Mexico

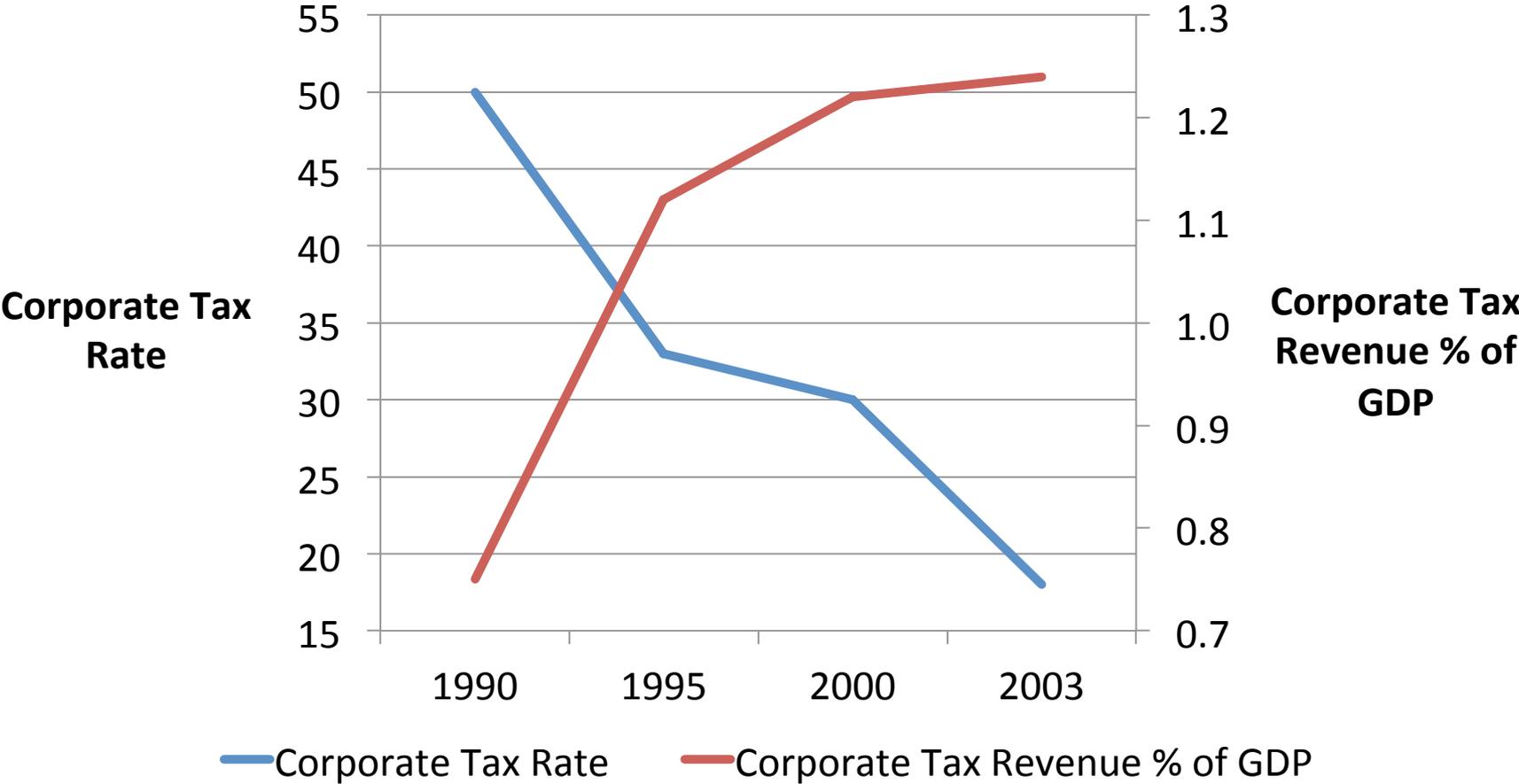
No less regulated than others

- Iceland joined EEA in 1994 and operated under same financial regulation as other member-states (including 27 EU countries)
- Reserve requirements same as in other EEA member-states; reduced, only to make them equal to those of competing European banks
- Free market reforms in 1991–2004, but only to bring Iceland into line with neighbours

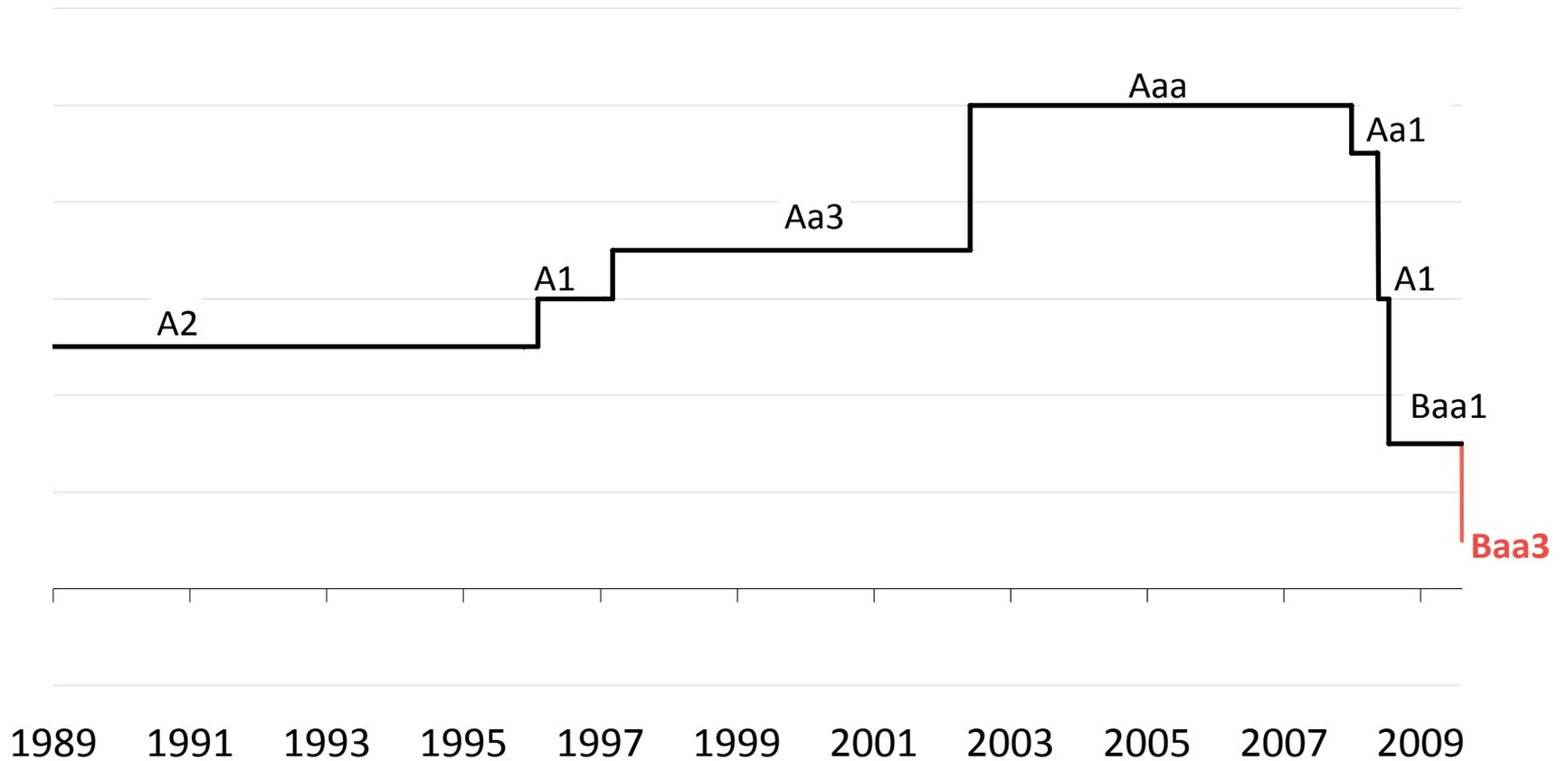
1991–2004 Reforms

- Corporate subsidies cut
- Tax reductions: corporate tax from 45% to 18%, other taxes simplified and reduced
- Privatisation, revenue used to pay up public debt
- Stabilisation, inflation brought down, ITQ system in fisheries further developed
- Pension reforms, pension funds made sustainable
- Legal reforms: public administration, information
- Consequence: Good reputation, high ratings

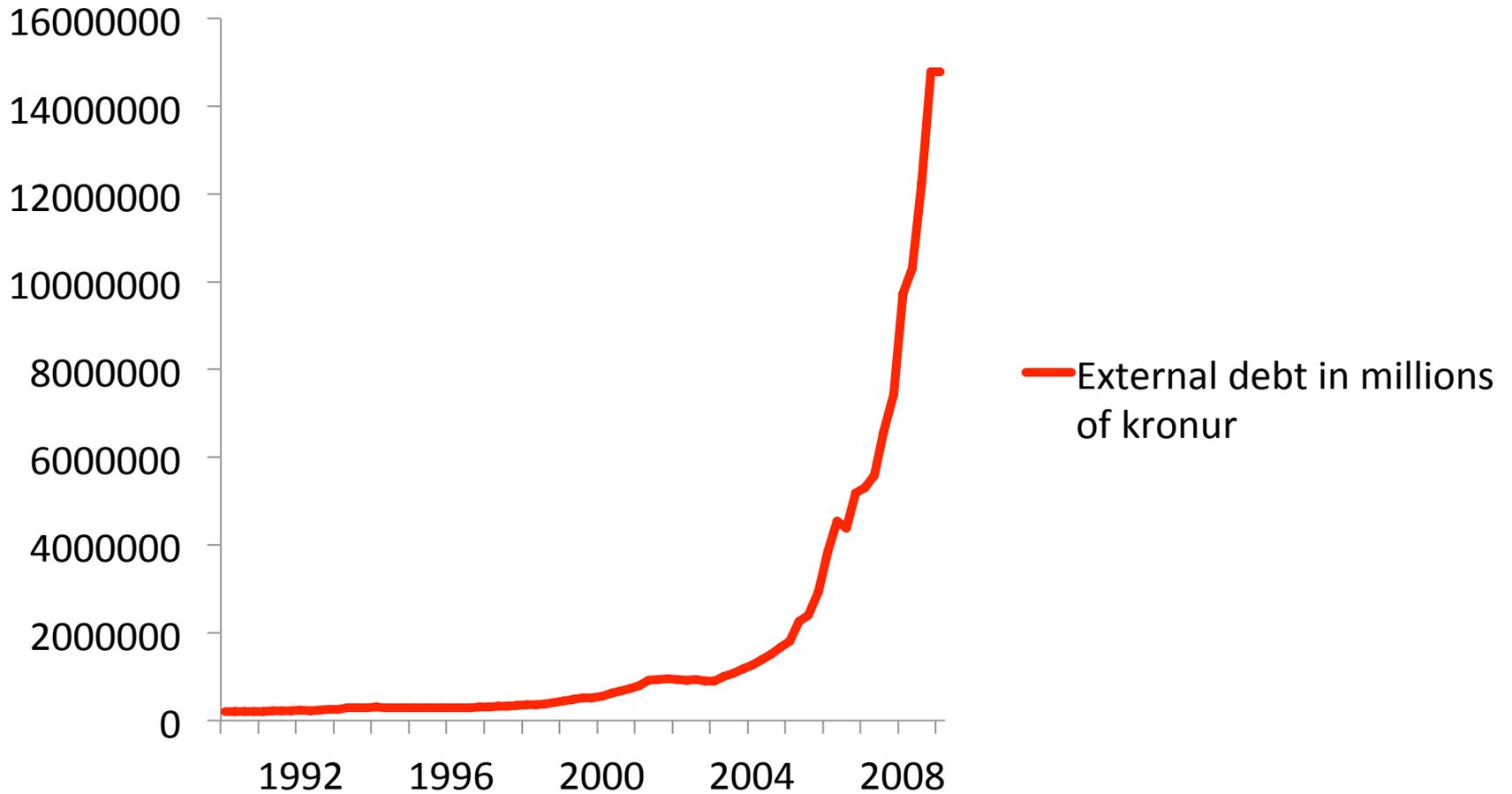
More Revenue with Lower Rate



Irony: High Ratings Led to Bubble



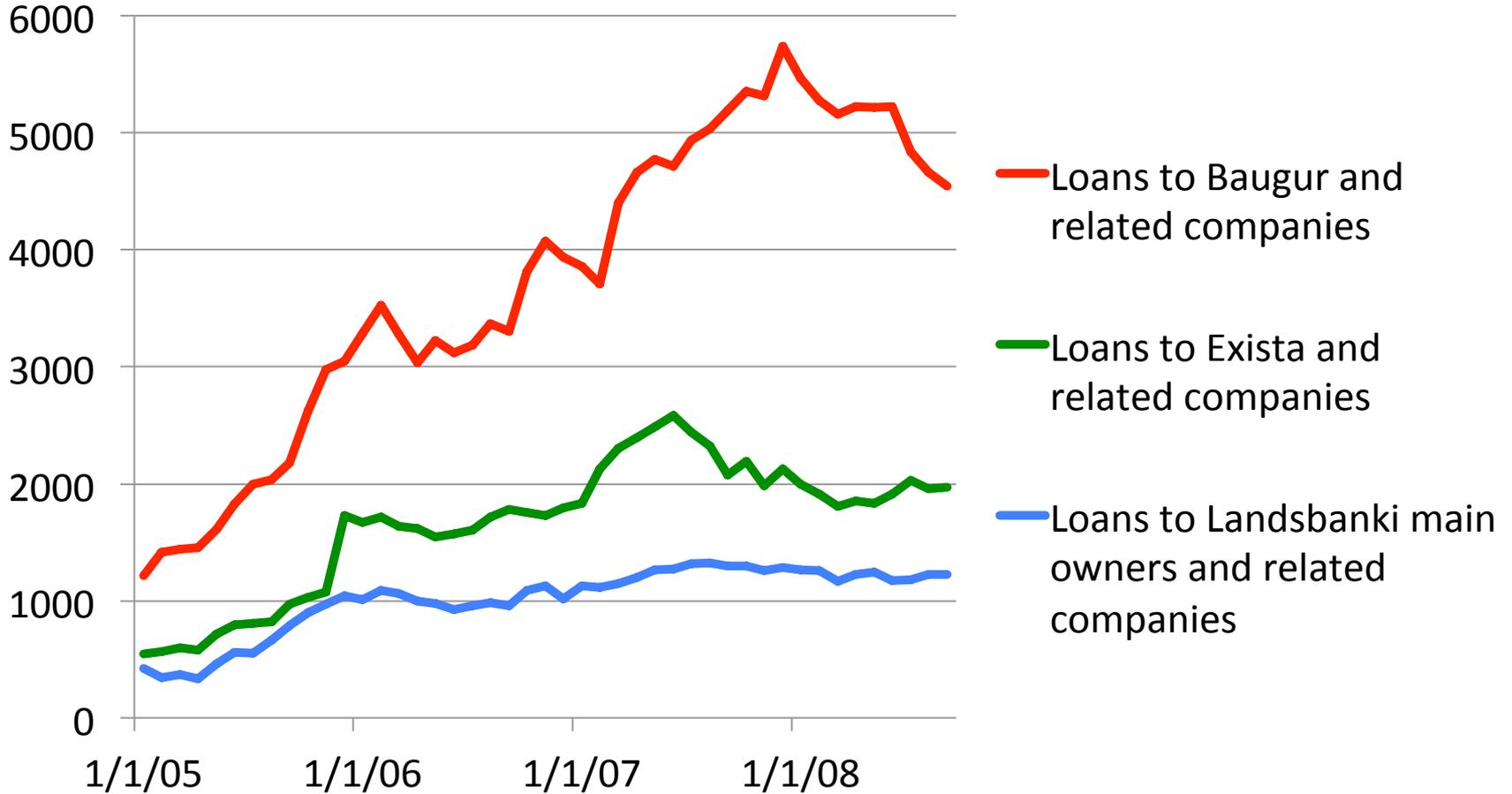
External Debt: 2004 Crucial Year



From Market to Crony Capitalism

- 1991–2004 market capitalism: competition, independent judiciary, free media, economic power separate from political power
- 2004 battle about media law, Oddsson loses, Jon Asgeir Johannesson of Baugur wins
- 2004–2008 crony capitalism: Johannesson owned media, supported by politicians (and supporting them), cooperative judiciary

Baugur Bubble



Hence, additional systemic risks

- General international risks: moral hazard; government mistakes; difficulty of pricing risk with new techniques
- One additional risk for Iceland, SIC: too much cross-ownership, overvalued assets, Jon Asgeir Johannesson and his cronies
- Another additional risk for Iceland: field of operations all of EEA; field of institutional support Iceland alone

Three crucial decisions abroad

- 24 September 2008, Fed refuses to make dollar swap deals with Iceland, makes them with Scandinavia at same time
- 7 October 2008, British Labour government closes the two Icelandic-owned banks in England, bails out all other banks at same time
- 8 October 2008, British Labour government uses anti-terrorism law against Icelandic companies, stopping all transfers to or from Iceland, making recovery impossible

Unnecessary losses

- Asset management section of Singer & Friedlander sold for £5 mn, real value £30 mn
- Glitnir Norway sold for NOK 300 mn, had been bought year before for 3.1 bn
- Finn Haugan, chairman of Norwegian Guarantee Fund, also leader of savings banks buying Glitnir Norway! Valued month later NOK 2 billion
- Glitnir Sweden sold for SEK 60 mn, had been bought 4 years earlier for SEK 380 mn
- Glitnir Finland sold for €3,000, shareholder value above €40 mn, sold 2013 for €200 mn

Lessons from Bank Collapse

- Bail-out not possible: Blessing in disguise
- Banks did not bring down Iceland: governments
- Extensive regulation did not hinder crisis
- Strictly regulated financial sector creates false security
- Harmonisation creates additional systemic risk
- Necessary: more correct pricing of risk, if competition and diversity in markets, also smaller units (not too big to fail)

