



# Anti-Liberal Narratives About Iceland, 1991–2017

Hannes H. Gissurarson<sup>1</sup>

[LINK TO ABSTRACT](#)

Iceland is a tiny country, with less than 330,000 inhabitants, so she can hardly be expected to have made major contributions to economic liberalism. Nevertheless, two original and relatively efficient institutions were developed in this remote North Atlantic island, those being the system of private law enforcement during the Commonwealth period, 930–1262, and the modern system of individual transferable quotas in the fisheries. Moreover, as related in my previous paper in this journal, in the 19th and 20th centuries Iceland saw a liberal tradition develop (in the classical sense of the word ‘liberalism’), with Jon Sigurdsson, Arnljotur Olafsson, Jon Thorlaksson, Benjamin Eiriksson, Olafur Bjornsson, and others defending free trade and limited government (Gissurarson 2017). In the 1980s, a strong liberal movement arose in Iceland, influenced not only by those native liberals, but also by Friedrich A. Hayek, Milton Friedman, and James M. Buchanan, who made inspiring visits to the country. Many members of this new liberal movement belonged to the Independence Party which had been founded in 1929 to defend the tradition of Jon Sigurdsson against encroaching socialism and interventionism. In 1991 the Independence Party leader David Oddsson formed a coalition government with the Social Democrats which set about opening up the economy and transferring power from politicians and bureaucrats to taxpayers and consumers. This ambitious liberal programme was continued in coalition governments of the Independence Party and the rural-based Progressive Party in 1995–2007, with Oddsson stepping down as Prime Minister in 2004 and accepting a position as governor of the Central Bank of Iceland (CBI) a

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1. University of Iceland, 101 Reykjavik, Iceland. An earlier version of this paper formed a part of the author’s 2016 report for the think tank New Direction in Brussels on “The Nordic Models.”

year later.

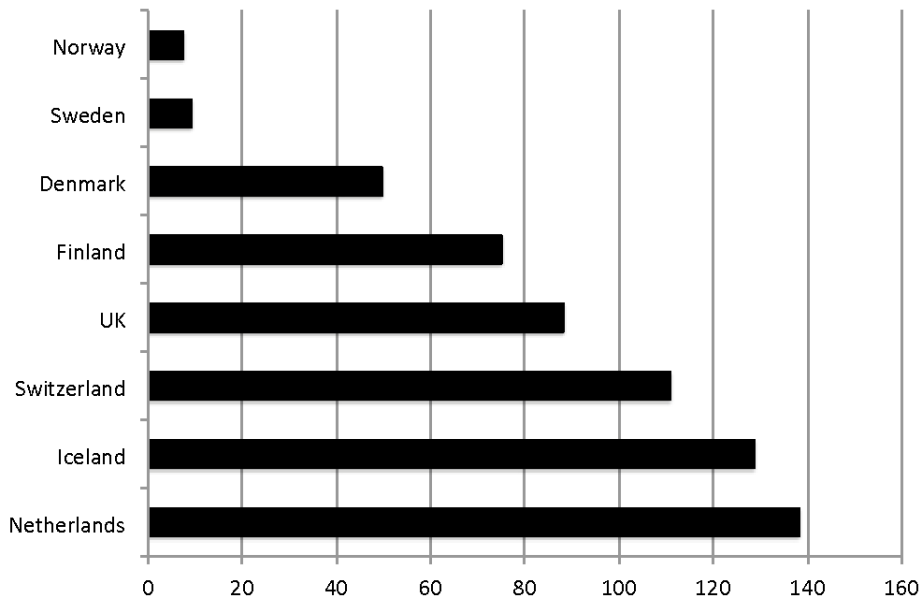
The liberal reforms were comprehensive: The system of individual transferable quotas in the fisheries was not only maintained but reformed, by removing various exemptions from it and facilitating quota transfers; the pension funds were strengthened; inflation was tamed; public companies were privatised; taxes were cut. The result was an unbroken period of economic growth from 1994 to 2007 (Statice 2017a). But for reasons that will be explained, Iceland became a victim of her own success, and during the 2007–2008 international financial crisis the Icelandic banking sector collapsed. This in turn gave some credence to anti-liberal narratives in Iceland and abroad about both the 1991–2004 reforms and the 2008 collapse. A Nobel Laureate in economics wrote that Iceland’s economy “was in effect hijacked by a combination of free-market ideology and crony capitalism” and that thus it was brought down (Krugman 2010). In this paper, it will be argued that these narratives are without sound basis in fact. Translations from Icelandic sources are the author’s own.

## Reforming the pension funds

While 1991 was certainly a turning point in Icelandic politics, in many ways the Oddsson governments up to 2004 continued and reinforced reforms that had already been initiated. This applied not only in the fisheries, but also to the pension funds which were now however greatly strengthened. A public pension fund for all had been established in 1936, and occupational pension funds in 1969, becoming mandatory in 1974. The public pension, financed by taxes, was basic and low, while a supplementary pension was paid to low-income pensioners, and payments were reduced for those receiving adequate pensions from occupational pension funds or other sources of income. A pensioner who had made no provisions for old age and therefore with no other source of income than the basic pension would receive roughly what amounted to the minimum wage. The occupational pension funds were self-financed, by a contribution for each employee of at least 12 percent of his or her wage, 4 percent paid by the employee, and 8 percent by the employer. In 1998, the pension system was reformed, replacing wherever possible defined-benefit pension plans (pay-as-you-go schemes) with defined-contribution benefit plans, to make the system sustainable in the long run. The reforms also included facilitation of additional private pension schemes by exempting from taxation payments of up to 6 percent of wages into special accounts with recognised and registered pension funds. These accounts were heritable, unlike the pension rights of the public fund and the occupational funds. The occupational pension funds have become financially very strong. In 2005, pension payments

from them for the first time exceeded payments from the state-financed public fund (Jonasdottir 2007). The total assets of the non-government pension funds (both mandatory and voluntary) amounted to more than GDP, and in 2004, at the end of the Oddsson era, they had become the second-largest relative to GDP in the OECD. Even after the 2008 bank collapse, they remain financially healthy, as illustrated in Figure 1 with numbers from 2012.

**Figure 1.** Independent pension funds in 2012, assets as percent of GDP



*Source:* OECD (2013).

When pension funds are made sustainable, as happened in Iceland under the leadership of Oddsson and the liberal Finance Minister Fridrik Sophusson, a kind of invisible and involuntary taxation on future generations is abolished: The burden of sustaining old people is not transferred any longer from present to future taxpayers.

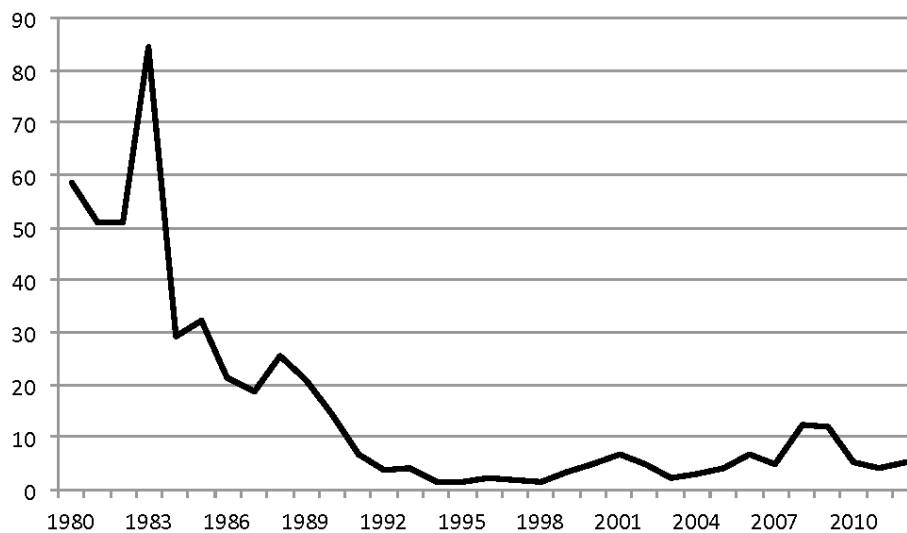
## Taming inflation

During the 1960s, 1970s, and 1980s, Iceland had much more inflation than did neighbouring countries. There are three main reasons for this: (1) an economy based on fisheries and therefore prone to great fluctuations, both in harvests and prices; (2) a militant labour movement, then dominated by radical leftists, receiving

advice and financial support from Moscow and using force regularly to dictate excessive wage increases (Gissurarson 2011); and (3) a relatively weak state which was not able to finance all its obligations by taxes (especially indirect obligations like full employment and cheap credit to businesses).

Circumstances changed in the 1980s and early 1990s. A general indexation of credit, both bank loans and deposits, introduced in 1979, had removed many of the incentives for excessive credit creation or money printing. The ITQ system in the fisheries had a stabilising influence on the economy, as fish catches became predictable. Even before the collapse of the Soviet Union the unions had abandoned their former militancy. In 1990 they entered into a “National Pact” with the employers and the government about moderate wage increases provided inflation was kept down. With the formation of the first Oddsson government, the old policies of providing generous subsidies to businesses, especially in rural areas, were also abandoned. Several public investment funds (which had made enormous losses) were abolished, and others were reined in by stricter rules on lending and investing. It was said that one of Oddsson’s greatest achievements in his first few years as prime minister had been to empty the waiting room at Government House: There were no more favours to be handed out. It was also important that the Treasury was not allowed to carry on having an overdraft at the Central Bank of Iceland, as had been customary. In the 1990s, as a result of increased monetary and fiscal discipline, inflation went down to what it was in the neighbouring countries, as illustrated in Figure 2.

**Figure 2.** Inflation, in percent



*Source:* Statice (2017b).

## Privatisation and the public debt

When the first Oddsson government took power in 1991, the public deficit was 3.3 percent of GDP (Stacice 2017c). It was decided to try and bring it down gradually, both by cautious cuts in expenditure and by reducing the public debt and thus interest payments. By 1997, the deficit had disappeared. In the following years deficits and surpluses interchanged roughly equally. The proceeds from the extensive privatisation which started in 1992 were partly used to reduce the public debt with the result that net public debt went down from 25.3 percent of GDP in 1992 to 3.9 percent in 2006 (Ministry of Finance 2006; 2012).

Privatisation took place in various stages. First, in 1992–1993 relatively small firms, like the government printing, shipping, and publishing companies, and a travel agency, were sold. Then, in 1993–1998 more important companies were put on the market, such as a series of fishmeal factories, a share in a ferrosilicon factory, and an investment bank, Fjarfestingarbanki atvinnulífsins (FBA) which had been established by a merger of four public investment funds. Subsequently, FBA merged with a bank which had been privatised already in 1990 on the initiative of the Social Democrats, Islandsbanki (earlier called Utvegsbanki). The biggest companies were however sold in 1998–2005, including two commercial banks, Landsbanki and Bunadarbanki, a construction company which had mainly served the U.S. military forces based in Iceland and the Icelandic Telephone Company. In total, the proceeds of the 1992–2005 privatisations were 141.2 billion Icelandic kronur, or €1,9 billion at the 2005 rate (Privatisation Committee 2007).

**TABLE 1. Privatisation in Iceland, 1992–2005**

Company	Year sold	Percentage of shares sold by government	Price (millions) for the holding sold off
Gutenberg printing	1992	100	129.1
Alcohol production ATVR	1992	100	28.5
Shipping (asset sale)	1992	100	528
Travel agency	1992	33.3	28.1
Drilling	1992–95	50	140.3
Publishing	1992	100	39.2
Development company	1992	29	196.1
Reinsurance (Isl. endurtrygging)	1992	36.5	244.4
Fishing firms surveyor (Ryni)	1993	100	5.8
Fishmeal factories (SR-Mjöl)	1993	100	1,050.8
Fishing firm (Thormodur rammi)	1994	16.6	127.7

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Company	Year sold	Percentage of shares sold by government	Price (millions) for the holding sold off
Medicine import and production	1994-95	100	574.1
Seaweed factory	1995	67	23.2
Computer services (Skyrr)	1997	28	109
Car inspection agency	1997	50	121.4
Ferrosilicon factory, 1st part	1998	26.5	1,370.6
Investment bank (FBA), 1st part	1998	49	6,189.2
Computer services (Skyrr)	1998	22	186.8
Construction company (IA), 1st part	1998	10.7	353.3
Fish farms (Stofnfiskur, to staff)	1999	19	16.2
Fertiliser factory	1999	100	1,612.4
School equipment shop	1999	100	46.8
Salmon farm (Holalax)	1999	33	11.5
Investment Bank (FBA), 2nd part	1999	51	12,455
School Internet Web	1999	100	15.5
Bunadarbanki, 1st part	1999	13	2,865.6
Landsbanki, 1st part	1999	13	4,211.1
Internet registry (Intis)	2000	22	78.2
Diatomite factory	2001	51	71
Fish farms (Stofnfiskur)	2001	33	305.7
Icelandic Telephone	2001	2.69	1,244.6
Mineral fiber factory (Steinull)	2002	30.11	240.4
Landsbanki, 2nd part	2002	20	5,174.3
Ferrosilicon factory, 2nd part	2002	10.49	143.7
Landsbanki, 3rd part	2002	45.8	13,438.4
Bunadarbanki, 2nd part	2003	45.8	12,766.1
Landsbanki, 4th part	2003	2.5	723.1
Bunadarbanki, 3rd part	2003	9.11	2,672.3
Construction company (IA), 2nd part	2003	39.86	2,208.9
Cement factory	2003	100	72.9
Forestry (Barri)	2004	22.39	4.3
Icelandic Flight Academy	2005	21.9	7.1
Icelandic Telephone (Landssimi)	2005	98.8	66,700
Agricultural Fund (loan collection)	2005	100	2,654
<b>Total</b>			<b>141,185.2</b>

The main purpose of privatisation was not, however, to improve the finances of the Icelandic state, but rather to reform the economy by transferring resources from politicians and bureaucrats to private owners. Many of the companies sold had rarely or never shown profit but now became lucrative enterprises. Others were wound up instead of being kept up with taxpayers' money. The idea behind the 1992–2005 privatisation in Iceland was that government should take on fewer tasks, but perform them better, and that it should leave the production of private goods to individuals and their associations. The idea was to create a strong private sector, just as in other Nordic countries, where, for example, banks were privately run. For some of the companies sold, listed in Table 1, it seems in retrospect strange that they had ever been operated by government, such as fish farms, a printing press, and a travel agency. There is also little doubt that the two measures of abolishing all kinds of subsidies to business, mostly in the form of cheap and easy credit, and of selling off all kinds of companies, small and large, changed the outlook, expectations and even temperament of Icelandic businesspeople and entrepreneurs. They realized that they had to stand on their own feet, and that they could not seek government assistance whenever there was a problem.

## **Tax reform**

At the same time as the Oddsson governments were reducing unfunded public pension obligations, inflation and the accumulation of public debt, they started to simplify and reduce taxation. A turnover tax on businesses and the wealth tax were abolished. Both were considered to be inefficient and unjust: The turnover tax was based on size, not profitability, and the wealth tax was double taxation, since taxed income had been used to create the wealth then being taxed. A special surcharge on houses used for trade or manufacturing was also abolished. The only reason for that tax had been that merchants and manufacturers were not as politically powerful as some other groups such as farmers and fishermen. The inheritance tax was simplified and lowered so that in most cases it did not go beyond 5 percent of the estate in question. A 10 percent capital income tax was introduced: Before, some income from capital had not been taxed at all, such as interest, while other such income, such as rent, had been taxed as ordinary income and therefore at a much higher level. Most importantly, the corporate and personal income taxes were significantly reduced. The corporate income tax, 50 percent in 1990 and 45 percent in 1991, was gradually lowered to 18 percent in 2001 and finally to 15 percent in 2007.

Describing changes in the personal income tax is somewhat more complicated. In the years after 1991 the personal income tax that went to the

central government was lowered while that which went to municipalities was raised, because some tasks were being transferred from central government to municipalities. But these changes had been completed by 1997. In the next eleven years, the personal income tax which went to central government was lowered from 30.41 percent in 1997 to 22.75 percent in 2007. A special surcharge on high incomes that was introduced in 1993 at the insistence of the Social Democrats was gradually phased out and had disappeared by 2007. This meant that the marginal tax rate for personal income tax (with both parts included, those of central government and the municipalities) went from 46.84 percent in 1994 to 35.72 percent in 2007 (Gissurarson 2009).

The lower tax rate, both for corporate and personal income tax, generated more tax revenue. In Figure 3 the corporate tax rate is plotted against corporate tax revenue as a proportion of GDP, for the period 1985–2003 (and therefore before the credit bubble preceding the 2008 bank collapse).<sup>2</sup> The new capital income tax also generated much additional tax revenue. In general, the tax structure changed in such a way that the three kinds of income tax—corporate, personal, and capital income taxes—became a much more important source of revenue than before, while border taxes, such as customs, were abolished or greatly lowered and became an insignificant source of revenue.

The abolition and reduction of border taxes was not least because in 1994 Iceland joined the European Economic Area (EEA), comprised of her, Norway, Liechtenstein, and the European Union countries, with Switzerland making similar arrangements without being formally a EEA member. EEA can best be characterised as a free-trade area, or a common market, but without Iceland, Norway, and Liechtenstein having to accept the same political obligations as if they had been inside the EU. For example, the EEA Treaty did not apply to natural resources like the fertile Icelandic fishing grounds or to tax issues. But the EEA countries outside the EU have to adopt many EU laws and regulations, for example concerning financial markets. While undeniably EEA membership was important in transforming the Icelandic economy, especially with the introduction of the free movement of capital, it should be emphasised that most of the economic reforms undertaken by the Oddsson governments were not dependent on, or a result of, EEA membership, such as tax reductions, privatisation, and the strengthening of the ITQ system and the pension funds. Also, of course, if Iceland needed cheaper goods from abroad, she could lower her customs unilaterally. Membership in the

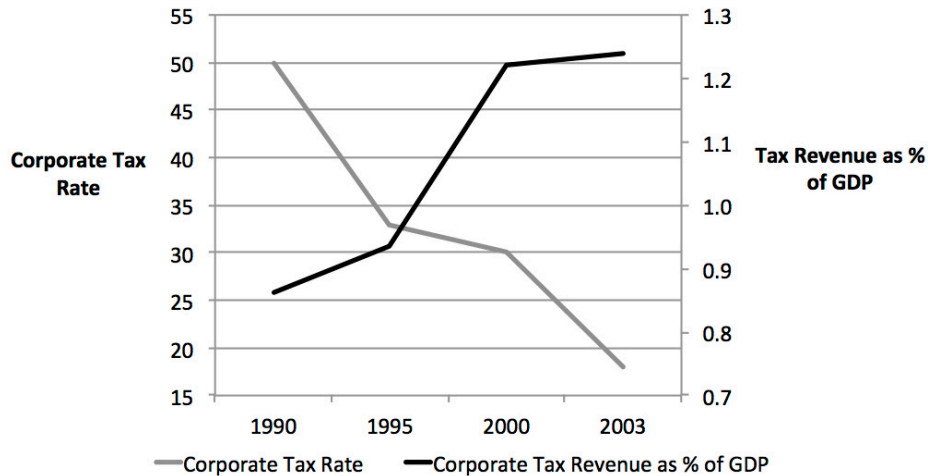
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2. The result is a striking confirmation of Arthur Laffer's insight that tax revenue can sometimes actually increase with a lower tax rate (Wanniski 1978; Laffer 1981). Incidentally, that insight was well-known to the liberal Icelandic politician Jon Thorlaksson, who wrote in 1925: "It is a general principle, recognised by taxation experts for more than a century, that there is a limit to how much taxes can be raised. When we arrive at this limit, then a higher rater does not lead to an increase in tax revenue, but to a decrease."



EEA however opened up a lucrative market to the Icelandic export industries.

**Figure 3.** Corporate tax rate, in percent, and corporate tax revenue as percentage of GDP



*Source:* OECD (2017).

## The Oddsson reform years were contentious

In hindsight, it may seem as if the Oddsson governments of 1991–2004 were smoothly implementing a liberal master plan. This was however hardly the case. Iceland suffered an economic recession until 1994, and each and every of the measures undertaken met fierce resistance. Sometimes the liberals in the government were forced to retreat, as when they accepted the special surcharge on high income, even if that was later phased out, and when they had to postpone the privatisation of some companies. Oddsson and his associates also put much emphasis on good relations with the labour unions and often compromised accordingly. Nevertheless, the Oddsson governments were successful in increasing economic freedom in Iceland: In 1980, the internationally recognised index of economic freedom showed 5.1 for Iceland, which then had the 64th-freest economy in the world of the 105 economies measured; in 1990 the index showed 6.6; and in 2004 the index showed 7.9 for Iceland which then had the 9th-freest economy in the world of the 130 economies measured. In 2004, Iceland had the freest economy among the Nordic countries and it was one of the countries in the

world where economic freedom had increased the most in the preceding ten years (Gwartney and Lawson 2006).

## **Endeavors in liberal discourse**

In my previous paper (Gissurarson 2017), Icelandic liberalism in the 19th century and up to the late 1980s was described, including the activities of the Locomotive Group, the Libertarian Alliance, and the Jon Thorlaksson Institute. During the Oddsson era, Icelandic liberals were no less active in promoting their ideas than before. The present writer published biographies of Jon Thorlaksson and Benjamin Eiriksson, and books on political economy and political philosophy (Gissurarson 1992; 1994; 1996; 1997; 2001). Professor Ragnar Arnason and other liberals including myself held conferences and edited books on the ITQ system and on taxation, usually working through the University of Iceland, where Arnason and I were both based, rather than through the Jon Thorlaksson Institute, which gradually became defunct. We were not only defending past or present achievements, but also discussing new reform ideas, such as that Iceland should further simplify and lower her taxes in order to attract foreign corporations and capital (Gissurarson and Herbertsson 2001; 2007) and that the ITQ system in the fisheries should become self-governing by transferring both the authority to set TACs (total allowable catches in each fishery over the season) and the responsibility for marine research from government agencies to the association of fishing firm owners (Arnason and Gissurarson 1999; Arnason and Runolfsson 2008). We also encouraged translations, producing the first part of Adam Smith's *Wealth of Nations* (1997) and books by Henry Hazlitt (2000), Frédéric Bastiat (2001), and Hernando de Soto (2005). In 2005 Reykjavik welcomed a regional meeting of the Mont Pelerin Society.

David Oddsson was one of the speakers at the Mont Pelerin meeting. He had formed a coalition government of his Independence Party and the Progressives in 1995, after the Social Democrats had split in 1994. The coalition government lasted for 12 years, until 2007, but after the 2003 elections Oddsson and the leader of the Progressives agreed that Oddsson would be Prime Minister until the autumn of 2004, and then the leader of the Progressives would take over and Oddsson would become Foreign Minister.

## **Big trouble in little Iceland**

The reader should recall that Iceland has a small population, mostly concen-

trated in the capital region of Reykjavik. In such a tiny country, personalities and factions can really drive events. In what follows my narrative naturally flows from my personal interpretation of events. I try however to provide documentation for its factual basis.

What made the last years of Oddsson's governments somewhat troublesome was that a group of powerful businessmen led by retail magnate Jon Asgeir Johannesson was turning against the Prime Minister, even if they were flourishing in the now much freer Icelandic economy. The origin, it seems, was that, in early 2002, Oddsson expressed his agreement with leading social democrats that increased concentration in the retail market was not desirable. Apparently, Johannesson took great offence at this. When later in the year a disgruntled former business associate of Johannesson's reported him to the Icelandic police for breaking bookkeeping rules, Johannesson blamed the action on Oddsson. Subsequently the police started an investigation into Johannesson's business affairs. Oddsson categorically denied any involvement in the case. Both Johannesson's original accuser and police investigators also rejected Johannesson's allegations.<sup>3</sup> Be that as it may, after a frantic and costly struggle for several years before the courts, Johannesson was finally convicted on the original charge and given a suspended prison sentence of three months.

While Johannesson was never a left-winger, and indeed supported Oddsson's early liberalisation efforts, in his battles he enlisted many of Oddsson's old opponents, including professed left-wingers. In 2002 he bought the newspaper *Frettabladid*, which relied on advertisements (not least from his own numerous companies) and was distributed free of charge to every home in Iceland.<sup>4</sup> In the 2003 parliamentary election campaign Johannesson used his newspaper against Oddsson, who thereupon publicly revealed that Johannesson had indirectly, through one of his associates who had previously worked for Oddsson, broached the possibility of transferring secretly a huge sum of money to Oddsson if he would relent in what Johannesson saw as his fight against him. Oddsson commented that he was not conducting any fight against Johannesson, but that he wondered whether any other Icelandic politicians had been tempted in a similar way and whether they had been able to resist it. Oddsson's account of this incident was furiously denied by Johannesson who in the autumn of 2003 bought the only

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3. The whistleblower, Jon Gerald Sullenberger, insisted (2005) that he did not know David Oddsson at the time. He made no secret of the fact that his reason for reporting Jon Asgeir Johannesson to the police was personal as well as professional: He was convinced that Johannesson had made improper advances to his wife (Thorvaldsson 2009, 75; Tryggvason 2010, 133, 150). Sullenberger also realized that he was accusing himself as well as Johannesson, since he had participated in the bookkeeping irregularities of which he was accusing Johannesson.

4. His ownership of the newspaper was not revealed until 2003 (Egilsson 2003).

private television station in Iceland as well as a tabloid, *DV*, and some magazines.<sup>5</sup>

In 2003, then, Johannesson owned not only a retail empire (by Icelandic standards) and several other companies, but also most of the private media in Iceland. He used his media clout to the utmost against Oddsson and his other critics, as former Justice Minister Bjorn Bjarnason documents in a book about Johannesson's various maneuvers during the police investigation and court case against him (Bjarnason 2011). When Oddsson in 2004, shortly before stepping down as Prime Minister, proposed a law against media concentration—a law that would have limited the possibility of market-dominant enterprises in other economic sectors, and of newspaper owners, to receive broadcasting licenses—it was approved by parliament. Admittedly, such a law goes against the presumptions of economic liberalism. But even many economic liberals, including myself, accepted Oddsson's argument, that the usual remedies against market concentration—open borders and free trade—did not apply to the Icelandic media market, since it was confined to the tiny community of Icelandic-speaking consumers (Gissurarson 2004). Others however saw the proposal as a personal vendetta against Johannesson. For the first time in Icelandic history, the president, Olafur R. Grimsson (who had in 1984, as a left-wing intellectual, debated Milton Friedman on Icelandic television), refused to put his signature to a law passed by parliament. As Oddsson pointed out, Grimsson had close ties to Johannesson: Grimsson's 1996 election manager was director of Johannesson's television station, while Grimsson's daughter occupied a managerial position in one of Johannesson's companies.

Instead of holding a national referendum on the media law, the government decided to withdraw it. Probably it expected the law to be voted down. But the outcome was seen as a defeat for Oddsson and a victory for Johannesson, changing in many ways the general attitude towards aggressive businessmen like him who suddenly seemed invincible, going from one success to another. A factor in the course of events in Iceland over the next four years, in my estimation, was a public opinion favourable to businessmen like Johannesson, wheeling and dealing, tirelessly expanding and taking high risks. Television host Egill Helgason admiringly spoke about “these adventurers of the marketplace, these men of opportunities, exuding audacity and relentless drive. They are like circus acrobats when they jump from one country to another with their treasures” (2004). Economics Professor Thorvaldur Gylfason (2005) alleged that the police investigation of Johannesson's

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5. From various private accounts of the incident related to the author it is clear that such a secret transfer was mentioned in a discussion between Johannesson and Oddsson's former associate, who subsequently told Oddsson about it. But Johannesson and the former associate both maintain that this was only a joke, not a serious proposal. What is certain, however, is that Oddsson did not regard this as a joke.

companies was politically motivated. Novelist Hallgrímur Helgason, then a fierce defender of Jóhannesson against Óddsson, later wistfully observed: “Deep down inside we idolised these titans, these money pop-stars. Awestruck we watched their adventures” (2008).

## **The anti-liberal narrative on the 1991–2004 reforms**

By the year 2004, the two most active and vocal critics of David Óddsson’s liberal reforms had become Professors Þorvaldur Gylfason and Stefan Ólafsson. Jointly they constructed an anti-liberal narrative which is widely accepted abroad, at least by left-wing intellectuals. Paul Krugman, for example, has cited both of them on his blog (2010; 2015). Both professors had connections to Jóhannesson: Gylfason was a columnist for Jóhannesson’s newspaper *Frettablaðið*, and Ólafsson’s wife was and is the anchorwoman of the evening news on Jóhannesson’s television station. The two professors clearly disagreed with Óddsson’s political agenda. Also, Óddsson seemed to provoke the hostility of left-wing intellectuals in somewhat the same fashion as did Margaret Thatcher in the UK. Both Gylfason and Ólafsson criticized the ITQ system in the fisheries; they expressed dismay that owners of fishing firms had made considerable gains from the initial allocation of quotas on the basis of catch history, and suggested that government seize the quotas from the fishing firms and then rent them back to the firms at public auctions (Gylfason 2000; Ólafsson 2011).

In the years leading up to the 2008 Icelandic bank collapse, Professor Ólafsson mainly concentrated on the development of the Icelandic welfare state, arguing that Óddsson and his “neoliberal” associates were transforming it from a Scandinavian to an Anglo-Saxon model, such as that prevailing in the U.S. and the UK. “Inequality and poverty levels seem to be slightly higher in Iceland than in the Scandinavian welfare states,” Ólafsson wrote (2005, 233). “On the whole, the average Icelander enjoys as high a living standard as prevails in the more affluent western societies, but the typical low-income groups and pensioners relying primarily on the public social security system have worse living conditions than similar groups in the Scandinavian welfare states.” His claims about poverty and income distribution have been subjected to much scrutiny in Iceland. In the midst of the campaign before the 2003 parliamentary elections, Ólafsson had presented his findings (and those of his students) that the poverty level was higher in Iceland than in the Scandinavian states (Ólafsson 2003a). Already then some economists had raised objections, and in early 2007 Eurostat published a comprehensive report

on poverty in Europe, using data from 2003 and 2004, according to which the poverty level was lower in Iceland than in every other European country except Sweden (Eurostat 2007; Statrice 2007, Figure 1).<sup>6</sup>

Before the 2007 parliamentary elections, Olafsson had changed his focus from poverty to income distribution, and he presented his calculations purporting to show that during the latter part of the Oddsson years, in 1995–2004, inequality, as measured by Gini coefficients, had significantly increased relative to the Scandinavian countries (Olafsson 2006). Gylfason publicly concurred (2006). It turned out, however, that the data were not accurate. In his calculations on income distribution in Iceland in 2004, Olafsson had included capital gains from shares, whereas they were excluded in data from other countries. If the Gini coefficients for 2004 were calculated in the same way in Iceland as in other European countries, then income distribution in Iceland did not significantly differ from that among her Nordic cousins: It was less equal than in Sweden and Denmark, and more equal than in Norway and Finland (Eurostat 2007; Statrice 2007, Figure 3). Olafsson did not publicly acknowledge the error, but quietly made the correction when he later extended his frame of reference to the years 2007–2008 (Olafsson and Kristjansson 2010). Thus he obtained the desired results, because inequality did indeed increase somewhat in Iceland between 2004 and 2007, compared to the other Nordic countries.

Olafsson's claim that in Iceland low-income groups and pensioners faced worse conditions than in the Scandinavian countries was also implausible, and probably partly the result of a statistical illusion. First, Olafsson ignored that fact that because unemployment was negligible in Iceland, the level of social exclusion could be expected to be lower than in most European countries. In the second place, there was an important difference in the arrangement of welfare benefits in Iceland and the Scandinavian countries. In Iceland—whose population appears tiny even compared to Sweden's—they were means-tested, but relatively generous to those in need. For example, in Sweden child benefits were regarded as rights of the children and did not vary according to the means of parents. The rich received the same payments per child as the poor. In Iceland, however, child benefits for the rich were low, whereas they were higher for the poor than in Sweden. This is illustrated in Table 2 which shows child benefits for a single parent in Iceland and Sweden in 2006 in current U.S. dollars:

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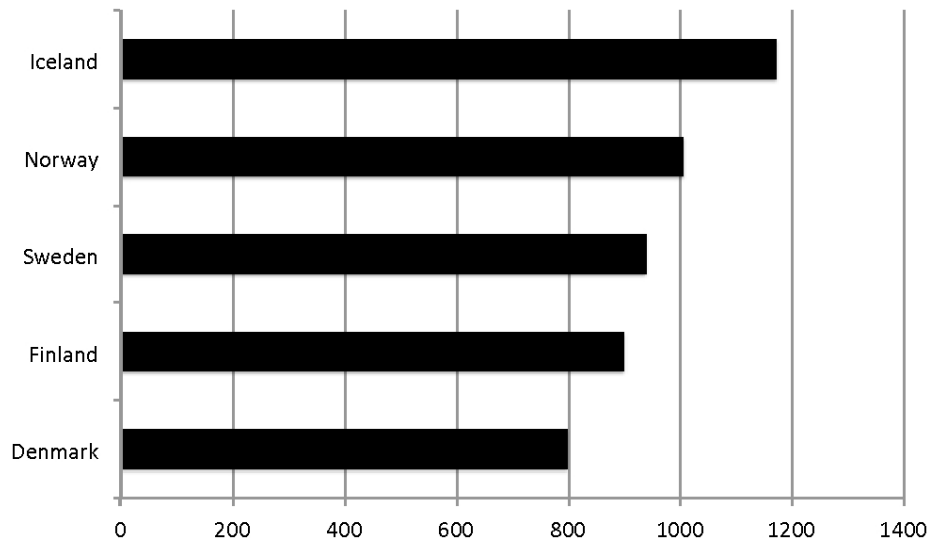
6. The original Eurostat report (2007) seems no longer to be available online. Statrice (2007) summarizes the Eurostat findings.

TABLE 2. Child benefits in Iceland and Sweden in 2006

Annual parent income	IS: 1 child younger than 7	SE: 1 child younger than 7	IS: 2 children, 1 younger than 7	SE: 2 children, 1 younger than 7
\$13,281	\$3,991	\$1,823	\$7,399	\$3,819
\$28,571	\$3,532	\$1,823	\$6,329	\$3,819
\$57,143	\$2,675	\$1,823	\$4,329	\$3,819
\$71,429	\$2,246	\$1,823	\$3,329	\$3,819
<i>Source:</i> Gissurarson (2009).				

The statistical illusion was that on average, less was spent on child benefits in Iceland than in Sweden (if the total amount spent on child benefits were divided by the total number of children), but that which was spent went directly to those in need, and not to all.

Similar considerations applied to Icelandic pensioners. If they received significant pensions from private arrangements, then their government-funded basic pension was reduced. Moreover, people usually retire rather late in Iceland, often at age 70, so poverty and social exclusion in the ranks of the elderly are at lower levels than in most other countries. In 2007, the Icelandic Ministry of Finance proudly reported, referring to data from 2004, that in Iceland average pension income was higher than in all the other Nordic countries. Olafsson was quick to protest: "Pension outlays per pensioner were in 2004 the next but lowest on average" in Iceland of the five Nordic countries (Arnason, O. Olafsson, and S. Olafsson 2007). But what Olafsson had done to reach this conclusion, it emerged, was to divide total pension outlays by the number of people of pension age, disregarding the fact that in Iceland many people continued to work even if they reached pension age and therefore did not take pensions. For example, in 2004 Icelanders of pension age were 31,000, whereas of them 26,000 took pension; the rest, around 5,000 people, were working. What the Ministry of Finance had originally reported was true: Average pension income in 2004, for pensioners, was higher in Iceland than in the other Nordic countries (Nososco 2006). This was unsurprising, given the strong pension funds and the late retirement age in Iceland. In Figure 4, the average monthly pension income in the five Nordic countries in 2004 is shown.

**Figure 4.** Average pension income/month, in euros (PPP), in Nordic countries

*Source:* Nososco (2006).

Thus, Olafsson's (and Gylfason's) anti-liberal narrative about the 1991–2004 reforms in Iceland rested on statements that were not justified by the available evidence: Poverty was not at a higher level in Iceland than in the Scandinavian countries; and inequality in income distribution was not, until 2004, greater; the Icelandic welfare system did not leave behind vulnerable groups, such as the unemployed, single parents or the elderly; on the contrary, unemployment was negligible, while child benefits were more generous to the poor than in the Scandinavian countries, and average pension income was higher. In the Oddsson years, the 'Icelandic model' of benefits generous but limited to those in need, was maintained and indeed strengthened.

At the same time that Olafsson asserted that Oddsson was implementing "neoliberal" reforms in Iceland he also claimed that Oddsson and colleagues were in fact raising taxes while pretending to be reducing them. This was, he argued, because "the government failed to let the tax-free bracket and the personal allowance sum follow general price increases and hence the effective tax rate on the lowest incomes was significantly raised." He concluded that "the share of burdens shifted from the higher end of the income ladder to the middle and lower end" (Olafsson 2003b). But Olafsson had overlooked or ignored the fact that even if the tax-free bracket had not, in this period, altogether followed the price level, payments into occupational and private pension funds had been exempted from taxation. If this was included in the calculations of the tax-free bracket, it turned out that it remained almost the same in real terms during this period (Agnarsson



et al. 2008). Olafsson had also omitted two facts: The tax-free bracket had actually been lowered much more in real terms during the tenure of his old comrade-in-arms Grimsson as Finance Minister in 1988–1991 than in the “neoliberal” era; and the tax-free bracket was much higher in Iceland than in most other European countries, including her Scandinavian neighbours (Gissurason 2009).

Moreover, it is only true in a trivial sense that the tax burden of low-income groups increased during the Oddsson years: It increased because the income of these groups significantly increased. Consider a business enterprise which is operated at a loss. It does not pay any corporate income tax. Now, in a sudden turnaround it starts to make a profit. Consequently, it also starts to pay corporate income tax. Thus, it is an undeniable fact that its tax burden has increased, but this is a fact to be applauded, not lamented. The same applies to individuals. With the range of tax-free income remaining more or less the same in Iceland, but income increasing in real terms, relatively more of a person’s income was subjected to taxation. Thus, it was an undeniable fact that the person’s tax burden had increased, but, again, this should be welcomed rather than lamented. It should be noted, also, that this may have tended to reduce social exclusion, as greater earnings tends to reflect greater social involvement and contribution.

## **The anti-liberal narrative on the 2008 Icelandic banking collapse**

Before the 2008 Icelandic bank collapse, Professors Gylfason and Olafsson did not find a large audience for their anti-liberal narrative. That suddenly changed with the collapse. Economic liberals seemed discredited by events, and longtime critics of the liberal reforms vindicated. The Economics Faculty at the University of Iceland became radicalised.<sup>7</sup> Olafsson helped organise a series of lectures at the University of Iceland under the headline “Autopsy of Neoliberalism.” Now,

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7. An example was the hitherto soft-spoken Economics Professor Gylfi Magnusson, who had been sympathetic to economic liberalism, for example welcoming the publication in Icelandic of Henry Hazlitt’s *Economics in One Lesson* (Magnusson 2000). After the collapse, Magnusson started speaking at street manifestations, and reproduced on his personal website a speech he gave at one of them, where he said: “Much has to change. First the mindset. The ideology which brought us into the present situation is intellectually bankrupt. Those who were in its forefront have immediately to quit and leave the reconstruction to others. Whether they are in politics, public administration, business, leading interest groups, or just being part of the cheerleaders. The first step to forgiveness is that these people extend a hand of reconciliation and accept their responsibility by quitting. Unfortunately, we have seen very little of this hand of reconciliation yet. We have only been given the glimpse of the middle finger upright” (Magnusson 2009).

Gylfason and Olafsson added to their old narrative a new one on the collapse. “How did the Icelandic banks manage to sink so fast and so deep? The answer lies not least in the corrupt manner of their privatization,” Gylfason writes (2014, 9). His main explanation of the collapse is “the massive failure of policy and institutions in the absence of checks and balances” (Gylfason 2010, 51). His more general observation is that Iceland is “a clan-based society more heavily permeated by politics than any other in Northern or Western Europe” (Gylfason 2009). In the same vein, Olafsson writes: “Clientelism and nepotism also characterized Icelandic politics and political administration to a very large extent” (2011, 21). He adds: “At the beginning of 2003, the former state banks were fully owned by private interests, handpicked from the ranks of favorites of the reigning political parties (the IP [Independence Party] and the PP [Progressive Party]). That privatization process had all the hallmarks of a corrupt interlinking of politics and business” (Olafsson 2016, 65). Gylfason and Olafsson describe David Oddsson as the main culprit of the collapse, both by creating the conditions for it during his tenure as Prime Minister in 1991–2004 and by not reining in the banks as CBI Governor in 2005–2009. In support of their narrative on the bank collapse, Gylfason and Olafsson frequently quote other intellectuals who previously had relied on the two of them for information about the Icelandic bank collapse, and in turn the two of them are quoted by others.<sup>8</sup>

In their narrative, Gylfason and Olafsson omit some important facts. First, as Prime Minister (until 2004), Oddsson was the most prominent critic of the excesses of the Icelandic banks. For example, in protest against generous share deals that the Kaupthing managers had made with themselves, in the autumn of 2003 Oddsson went to a branch of the bank and closed his private savings account there. On that occasion, Oddsson publicly expressed dismay at the behaviour of the bankers, quoting a famous passage on greed from a 17th-century religious poet. Oddsson’s action sent shock waves through Icelandic society: Some depositors immediately followed the prime minister in withdrawing money from the bank, while important shareholders became uneasy. Subsequently, and grudgingly, the bank leadership backed out of the share deals (Einarsson 2003).

Another important fact is that Oddsson, as CBI Governor 2005–2009, repeatedly warned the government, and, more cautiously, given his position, the public, against the recklessness of the Icelandic bankers, as is documented in the 2010 Report delivered by the Special Investigation Commission (SIC) into the bank collapse (Hreinsson et al. 2010 vol. 6, 102, 117–124, 136–137, 143, 148, 152, 173). According to the SIC, both Prime Minister Geir H. Haarde and Foreign Minister

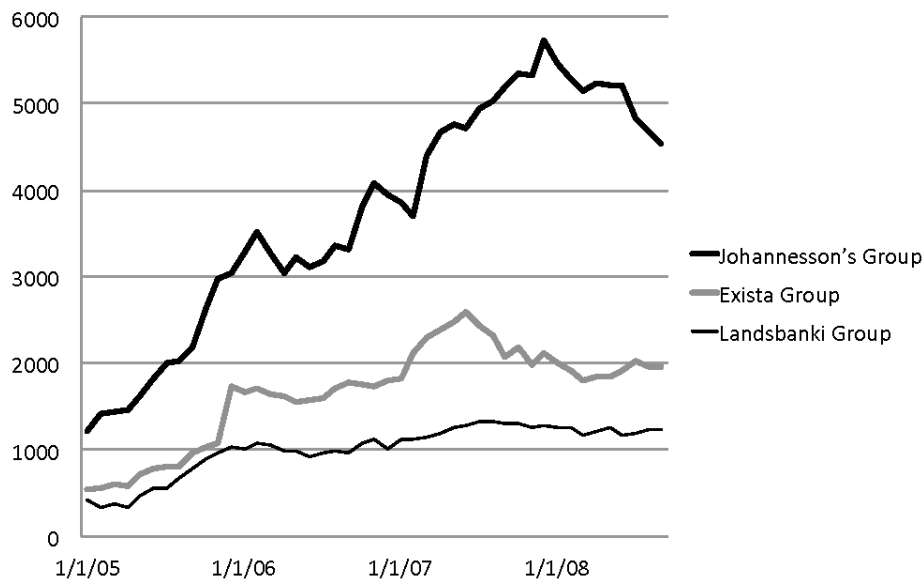
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8. Besides papers by Gylfason and Olafsson themselves, a striking example is Wade and Sigurgeirsdóttir (2009).

Ingibjörg S. Gísladóttir registered more uneasiness about Oddsson's choice of (unflattering) words about the bankers than about his warnings (Hreinsson et al. 2010 vol. 6, 118, 119, 137). The CBI did not however have any regulatory powers over the banks, unlike the Icelandic Financial Supervisory Authority (IFSA). The CBI could therefore only warn and advise. Indeed, Oddsson suggested that Kaupthing should move its headquarters abroad, that Landsbanki should transfer its so-called Icesave accounts from a branch to a subsidiary, and that Glitnir should sell its Norwegian bank (Hreinsson et al. 2010 vol. 6, 122, 124, 256–257). But after his defeat in the 2004 conflict with Johannesson, Oddsson's words did not carry the same weight as before. He had turned into an Icelandic Cassandra—doomed to utter warnings that people did not heed.

Another fact that Gylfason and Olafsson omit is that before the bank collapse Johannesson was not only Iceland's greatest business mogul and her only real media magnate, but that he was also, with his group, by far the biggest debtor of the Icelandic banks, as is brought out in the SIC Report and illustrated in Figure 5. The SIC had identified three intricately linked business groups, accumulating massive debts in the banks (which the groups partly controlled by owning shares in them), and it had concluded that their various interrelationships had constituted a major risk for the Icelandic economy.

**Figure 5.** Total debt of main business groups, in millions of euros



*Source:* Hreinsson et al. (2010 vol. 7, 6–8).

Johannesson's dominance of Icelandic society in 2004–2008 cannot be

ignored in an account of the prelude to the bank collapse. His group showed its great influence, and its willingness to use it, in the primaries of the Independence Party before the 2007 parliamentary elections when it conducted an advertisement campaign against Justice Minister Bjorn Bjarnason, managing to bring him down by one seat on the eventual list of candidates. Moreover, it has been disclosed, in a report by the National Audit Office (2010), that Johannesson's group was the biggest single contributor to the Social Democrats in 2006, the last year when there were no limits under Icelandic law on corporate donations. The second biggest contributor to the Social Democrats that year was Kaupthing, Iceland's biggest bank.<sup>9</sup> This was perhaps to be expected because the leader of the Social Democrats, Ingibjorg S. Gisladdottir, had alleged, just as Professor Gylfason had, that the police investigation of Johannesson's companies starting in 2002 was politically motivated. She had also defended Kaupthing against Prime Minister Oddsson's criticisms (Gisladdottir 2003). In her testimony before the SIC, Gisladdottir noted however that before the bank collapse she had often sought Gylfason's advice on economic policy and that he had never mentioned the possibilities of such a collapse (Hreinsson et al. 2010 vol. 8, 140).

Besides omitting numerous important facts, the narrative presented by Gylfason and Olafsson is based on some half-truths. It is true that in 2002–2003 a controlling share in Bunadarbanki was sold to the so-called S-Group, which had close ties to the Progressive Party leadership: A member of the S-Group, Finnur Ingolfsson, had even been government minister for the Party. Evidence has since been produced that the S-Group misled the Privatisation Committee about its financial position (Bjorgvinsson et al. 2016). Be that as it may, it is not true that the Samson group which bought a controlling share in Landsbanki at the same time had close ties to the Independence Party leadership. One of the three members of the Samson group, Bjorgolfur Gudmundsson, certainly had been an active member of the Party before he moved abroad in the early 1990s, but he had then been a supporter of the popular former soccer player Albert Gudmundsson, Oddsson's main rival in Reykjavik. Indeed, in the hotly contested Independence Party primaries before the 1982 municipal elections, when Albert Gudmundsson and Oddsson fought for the first seat on the Party's list, Bjorgolfur Gudmundsson had been Albert Gudmundsson's election manager and thus worked against Oddsson, even if they were by no means personal enemies and certainly on talking terms. Another member of the Samson group, Bjorgolfur Thor Bjorgolfsson,

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9. As the only Icelandic political party defending free enterprise, the Independence Party normally received much more in corporate donations than the parties to its left. But according to the aforementioned inquiry conducted by the National Audit Office (2010), in 2006 the Social Democrats received almost the same total amount of money from corporate donors as the Independence Party, 102 million kronur against 104 million.

Gudmundsson's son, did not belong to, nor did he want to associate himself with, any political party; he had also been abroad for most of his adult life. The third member of the group, Magnus Thorsteinsson, was actually a member of the Progressive Party (Björgolfsson 2014, 100).

Yet two more relevant facts omitted by Gylfason and Olafsson should be mentioned. First, the government's main adviser in the bank privatisations was HSBC, which had made attempts in 2001 to find buyers for the two banks in the international market but had turned up little or no interest. HSBC had also advised that the offers by the S-Group for *Bunadarbanki* and by the Samson group for *Landsbanki* were on the whole preferable to other offers. In the second place, the Icelandic National Audit Office conducted two thorough inquiries into the sale of the banks, not finding any major flaws in them (National Audit Office 2002; 2003). Gylfason's and Olafsson's allegations about the bank privatisations are, it seems to me, targeted against HSBC, one of the largest and most-respected financial companies in the world, and against the Icelandic National Audit Office.

Again, it is true, and generally acknowledged, that Iceland was, in the period between 1930 and 1960, characterised by party patronage, clientelism, and favouritism. The chief cause of this, I would surmise, was the politicisation of society initiated by a minority government of the Progressive Party (supported by the Social Democrats) in 1927–1932. That government nationalised a bank, and in a series of political appointments it broke with the traditions of Danish public administration, hitherto prevalent in Iceland.<sup>10</sup> Furthermore, the left-wing government of the Progressives and Social Democrats in 1934–1937 greatly extended the economic controls which had been imposed in response to the Great Depression. This begot greater opportunities for clientelism and favouritism, as economic liberal Olafur Björnsson tirelessly pointed out at the time (e.g., Björnsson 1953; see Gissurarson 2016a). But it should be noted, though omitted by Gylfason and Olafsson, that at the same time Social Democrats in the Scandinavian countries practised extensive party patronage, leading a left-wing Norwegian historian to speak of “the one party state” (Seip 1963). Indeed, so intertwined did party and state become that the Swedish and Norwegian Social Democrats even enlisted the secret services of their respective countries in the interest of their parties (Lund Commission 1996; Lampers 2002). Iceland was therefore by no means unique in the Nordic community. But with the abolition of most of the economic controls in 1960, the opportunities for party patronage diminished considerably. And with the liberal reforms of the Oddsson era, including the

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10. The role played by the 1927–1932 government is recognised by Professor Gylfason (2008), although he omits to mention that in 1927–1931 it had the support of the Social Democrats, while also mistakenly saying that the Progressives then had a majority in parliament.

abolition of special government investment funds, the sale of government companies, and tax reductions, the opportunities for party patronage diminished considerably further, while new laws on public administration and the right of information created new constraints on politicians. Indeed, in the early 2000s Iceland was perceived as one of the least corrupt countries in the world: According to the corruption perceptions index of Transparency International (2003; 2004; 2005), she was at the top of the list: 2nd out of 133 in 2003, 3rd out of 145 in 2004, and 1st out of 158 in 2005.

Olafsson quotes a survey made by his colleague at the University of Iceland, Professor Gunnar H. Kristinsson (2006a; b), which shows, Olafsson claims, that in 2001–2005, when a coalition government of the Independence Party and the Progressives was in power, more than 40 percent of appointments of high officials were political. The claim misinterprets the survey, however. The researchers interviewed 17 people about 111 appointments of high officials in 2001–2005. The real results were that 68 percent of the appointments were deemed compatible with a professional model (based on merit), 57 percent with a bureaucratic model (based on previous rank and other hierarchical considerations) and 44 percent with a political model (based on party membership). Of the appointments that could have been deemed partly political, only 16 percent were only political, or not explicable also in terms of the professional or the bureaucratic model.

Moreover, even if Professor Olafsson misinterprets the survey, it seems itself to have serious flaws. Its supervisor, Professor Kristinsson, is a strident opponent of the Independence Party, publicly stating that it is controlled, or heavily influenced, by “monsters” (Kristinsson 2009). Why was the particular period 2001–2005 selected and not others, when different political parties were in power, at least for comparison? Which were the 18 appointments deemed to be solely political? On what basis were the 17 interviewees selected? Kristinsson has not answered such queries (Gissurarson 2016b). But perhaps these questions are moot, because in a 2008 comparative survey of party patronage in 15 European countries in which Kristinsson himself participated, the results were that Iceland was one of the five countries where party patronage was at the lowest level, in a group with the UK, the Netherlands, Denmark and Norway, whereas party patronage was at a higher level in for example Greece, Italy and Hungary (Kopecký and Mair 2012, 367). There is no disagreement that ‘hard’ corruption such as bribery, extortion, and embezzlement is practically nonexistent in Iceland (and in the other Nordic countries as well). But it also turns out that ‘soft’ corruption such as party patronage is also at a low level there, at least after the liberal reforms of 1991–2004.

## The real causes of the 2008 bank collapse

The problem with ascribing the 2008 Icelandic bank collapse to “free-market ideology” or a decision to “liberalize” as Paul Krugman (2010), Ha-Joon Chang (2010, 232–234), and some other prominent left-wing intellectuals do, echoing Gylfason and Olafsson in Iceland, is that there is no causal connection between the two. It is true that economic freedom significantly increased during Oddsson’s tenure as Prime Minister. But with the Icelandic economy in 2004 being the 9th-freest in the world, eight other economies were freer. In 2007, the year before the collapse, the Icelandic economy had in fact fallen to 15th place, because economic freedom had decreased somewhat in Iceland while increasing in other countries (Fraser Institute 2017). If the collapse was caused by economic freedom, then why was there no banking-sector crash in the 14 countries ahead of Iceland? In 2007, the Swiss economy, for example, was the 4th-freest in the world, and the Swiss banking sector was as big or even bigger relatively than that of Iceland, with balance sheets amounting to about tenfold GDP. Why did this huge banking sector not crash?

It is also true that by joining the EEA in 1994, the first Oddsson government (a coalition of the Independence Party and the Social Democrats) had created a necessary precondition for the rapid growth and subsequent collapse of the banks. But because Iceland was a member state of the EEA, financial firms operated under the same laws and regulations as financial firms elsewhere in the EEA. The legal framework of the financial market was no more and no less free than in other EEA countries. It is therefore difficult to ascribe the collapse to the liberal policies pursued between 1991 and 2004, although it is certainly true, as noted earlier, that after Johannesson’s 2004 epic victory in the struggle with Oddsson, public opinion in Iceland became remarkably uncritical of aggressive, risk-taking businessmen and bankers. It is also true that by completing in 2003 the privatisation of the banks which had been begun by the Social Democrats in 1990, the Oddsson government (now a coalition of the Independence Party and the Progressives) had created another precondition for the collapse of the banks. (If they had been small government banks, confined to the domestic market, then they would presumably not have crashed.) But what the Oddsson government did was simply to introduce the same arrangements in Iceland as in other European countries where banks were privately owned and did not collapse. Why did private banks in Denmark and Scotland not collapse?

There is however one significant factor which contributed to the collapse: During the Oddsson years, Iceland acquired a good reputation for fiscal and



monetary stability which was reflected in the country's good credit ratings, and which in turn brought up the credit ratings of the Icelandic banks. Thus, ironically, Oddsson helped to make Johannesson's debt accumulation possible. Johannesson and his associates were trading on Iceland's good name, as was indeed recognised by the SIC (Hreinsson et al. 2010 vol. 1, 1).

The crucial question remains: Why did the banks in Switzerland, Denmark, and Scotland, such as UBS, Danske Bank, and RBS, and banks in many other countries, not crash in 2008 like the Icelandic banks did? Many of them would indeed have crashed, if they had not received liquidity, for example in Switzerland and Denmark from the U.S. Fed (GAO 2011) and in Scotland from the Bank of England.<sup>11</sup> Thus we see the exceptional nature of the Icelandic bank collapse. Certainly, one necessary precondition was the rapid growth of the banks, made possible by their access to the EEA and Iceland's good reputation. Another precondition was the recklessness of the bankers. Partly it was a consequence of the moral hazard that bankers everywhere face. In a boom, they expect to pocket the profit, whereas in a bust they think they are able to pass some of the bill on to taxpayers, because their banks are systemically important, "too big to fail" (Sorkin 2009). In Iceland, the ubiquitous and almost inbuilt recklessness of bankers was further exacerbated by a public opinion, promoted by Johannesson's media empire, strongly in favour of risk-takers.

While the rapid growth of the banks and the recklessness of the bankers were perhaps necessary preconditions for the collapse, they were not sufficient to explain it. Because of their rapid growth, the Icelandic banks were hit hard by the credit crunch starting in late 2007: Like other banks, they had borrowed short-term and lent long-term. Now they suddenly found themselves short of liquidity. Into Iceland's now vulnerable situation came a set of decisions made elsewhere.<sup>12</sup> First, foreign hedge funds decided to go after Iceland, first the currency and then the banks, with the consequence that the krona fell and the CDSs (credit default swaps, or insurance on their possible failures) on the banks rose to unprecedented

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11. UBS in Switzerland indeed had to be bailed out twice, before and during the financial crisis. The US government, by providing liquidity to the Swiss National Bank, was able to force the Swiss authorities to relent on their strict procedures of bank anonymity and secrecy (Hässig 2009; UBS AG 2010). Danske Bank was near collapse when it received government assistance (Danish Broadcasting Corporation 2012; Sandøe and Svaneborg 2013). The big Scottish banks, RBS and HBOS, would certainly have collapsed if they had not received government assistance (Hancock and Zahawi 2011; Brummer 2014; Fraser 2014).

12. After the Icelandic bank collapse, some economists claimed to have foreseen and even predicted it, as can be gathered from a collection of reports and papers published three years later (Aliber and Zoega 2011). But the reports and papers collected there are basically about macroeconomic imbalances in the Icelandic economy which would eventually have to be corrected, perhaps at a significant cost to the public. They are not about the extraordinary sequence of events, brought about by a set of decisions made abroad, which turned a foreseeable downturn or even depression in Iceland into a national disaster.



levels (Jonsson 2009, 118–120). In the second place, after the strategic importance of Iceland had almost disappeared at the end of the Cold War, the U.S.—which had given more Marshall aid per capita to Iceland than to any other country, and which quietly supported Iceland in her conflicts with the UK over fisheries limits (Johannesson 2004)—had lost interest in the country. The U.S. Fed refused to make the same dollar-swap deals with the CBI as it made with the central banks of the Scandinavian countries, the UK, and Switzerland (Bernanke 2015, 349). Thirdly, the European Central Bank and the Bank of England also refused to make currency swap deals with the CBI, citing (as had the U.S. Fed) the excessive size of the banking sector.

In addition, at the height of the crisis, the British Labour government made two crucial decisions about Iceland. At the same time as it publicly presented a £500 billion rescue package for all other British banks, it closed down the two British banks owned by Icelanders, Landsbanki's Heritable and Kaupthing's KSF. Because of stipulations in credit contracts, the close-down of KSF brought down the parent company in Iceland, Kaupthing, while the two other major banks had already been taken over by government. Also, the British government imposed an anti-terrorist law on Landsbanki and some Icelandic institutions, including the CBI (Treasury 2008). This was allegedly done to hinder illegal transfers of money from the UK to Iceland, but in fact the British Financial Services Authority (FSA) had already a few days earlier issued a Supervisory Notice to Landsbanki which made it impossible for the bank to transfer money to Iceland (FSA 2008). The risk of illegal money transfers from the UK was therefore an excuse, not a reason. Incidentally, no evidence has been found of any such transfers, or attempts to make them.

Besides the possibility of illegal transfers from the UK to Iceland, the British government claimed that a further reason for imposing an anti-terrorist law against Iceland was that she had discriminated between domestic and foreign depositors in the Icesave accounts of Landsbanki. The problem arose because in the UK these accounts were kept in Landsbanki's London branch and not in its British subsidiary. This meant that they were insured by the Icelandic Depositors and Investors Guarantee Fund, which was however tiny and clearly unable to fulfil its obligations in the case of Landsbanki's failure. When the British government concluded that Landsbanki was about to fail, it decided to step in and fully to compensate British depositors in the Icesave accounts, but it insisted that Iceland should reimburse the UK Treasury, and it protested against the Emergency Act which the Icelandic Parliament passed 6 October 2008 as the banks were falling. The Act gave the Icelandic government power to take over the banks and to establish new banks on their ruins, confined to domestic operations. At the same time, the government announced that all domestic deposits were guaranteed.

The British government had however misread the Emergency Act: It gave

the claims of all depositors, foreign as well as domestic, priority over the claims of other creditors. The only difference in treatment between domestic and foreign depositors was that all domestic accounts were smoothly transferred to the new government banks, whereas foreign accounts became unavailable for a while. But foreign depositors eventually received all their money back from Landsbanki's estate. The treatment of the Icelandic banks in the UK may be contrasted to that in Sweden and Germany where the situation was identical: There, deposit collection by Kaupthing had been, like that of Landsbanki in the UK, through a branch and not a subsidiary. But the governments of Sweden and Germany quietly provided loans to the estate of the fallen bank which enabled it to compensate all depositors, and the two governments were in turn paid back quickly as the bank's assets in those two countries were sold off. The only real discrimination authorised by the 2008 Emergency Act was between all depositors, foreign and domestic, on the one hand and other creditors, including most importantly the CBI and German banks on the other hand. The justification offered by the government for such discrimination was the urgent need to maintain a functioning banking sector in Iceland and thus to avert a total collapse of the whole economy.

While the British government mistakenly complained of a discrimination between foreign and domestic depositors in Landsbanki's Icesave accounts, it was itself guilty of discrimination between the banks within the UK and owned by the Icelanders which were closed down and all other British banks (including banks mainly owned by companies in Spain or the Middle East) which were rescued. Moreover, it was brought out in the resolution process of the two Icelandic-owned banks, Heritable and KSF, that they were both clearly solvent: Despite the immense costs of lawyers and accountants, their recovery rates for unsecured creditors were respectively 94 and 87 pence on the pound (Ernst & Young 2014; 2017). HM Treasury may however end up having lost considerable sums from its rescue of other British banks, such as RBS. A further irony about the imposition of the anti-terrorist law against Iceland, and Landsbanki in particular, was that some of the banks which were rescued have later had to pay large fines to UK and U.S. authorities for money laundering and violations of economic sanctions.

Be that as it may, Icelanders were shocked to find their CBI, Ministry of Finance, and Landsbanki on the list which the British Treasury kept on its website of terrorist organisations and rogue governments, such as Al-Qaida and the Taliban and the governments of North Korea and Sudan. After a few days, and vehement protests by the Icelandic government, the CBI and the Ministry of Finance were removed from the list, and later Landsbanki was moved down to a special list. But the imposition of the anti-terrorist law had an immediate effect on Iceland: Almost all financial transactions, which usually went through London, were halted, and for a while it seemed as if Iceland would also run out of essential medicine and food

supplies. Under Governor Oddsson's leadership, the CBI staff worked day and night to keep the payments system up and going, and the bank was able to transfer vital resources to and from the country with the assistance of the financial firm JP Morgan. The present writer was member of the Board of Overseers of the CBI 2001–2009 and witnessed many of Oddsson's strong warnings against the excesses of the banks (some of which were also recorded by others; see Hreinsson et al. 2010 vol. 6, 102, 117–124, 136–137, 143, 148, 152, 173). I also watched the heroic efforts of the CBI staff during and after the bank collapse. Despite all, the CBI staff succeeded: The journalists who flocked to the country in search of drama found a functioning society, even if the nation was shocked and bewildered over Iceland's isolation and its financial collapse.<sup>13</sup>

It is a matter of speculation what caused the United States and Europe to be so unhelpful, and the British government to be downright brutal. One possible cause was the widely shared conviction that the Icelandic banking sector was unsustainable in the long run. This could not be because it simply was too big, as the examples of Switzerland and Cyprus show, with their relatively big banking sectors. It was rather because of its means of financing. Switzerland and Cyprus were offshore financial centres whereas the Icelandic banks, borrowing short-term and lending long-term, were bound to have grave difficulties in a credit crunch. Possibly the Icelandic banks would have survived the 2007–2009 financial crisis if the CBI had obtained liquidity abroad, but then most likely they would have had to have been reorganised, somewhat in the same manner as Swedish banks were during the financial crash in Sweden in the early 1990s. Another cause may have been resistance to the idea that Iceland could become a financial centre on the model of Switzerland, Cyprus, Ireland, the Isle of Man, and the Channel Islands; this is suggested by recently released minutes of meetings in the Bank of England (2008). A third possible cause was the competitive and sometimes aggressive behaviour of the Icelandic bankers and businessmen abroad, offering higher prices for companies and higher rates to depositors than others. While it can hardly have been a crucial factor, Iceland's good reputation acquired in 1991–2004 may have been tarnished in the next few years by self-styled 'modern vikings.'

As to the brutality of the British government, the Scottish Prime Minister Gordon Brown and the Scottish Chancellor of the Exchequer Alistair Darling may have wanted to divert attention away from their costly rescue of two large Scottish banks, RBS and HBOS, at the same time as they could demonstrate to Scottish voters the perils of independence. Indeed, in his memoirs Darling gleefully wrote: "Iceland, along with Ireland, was part of what Scotland's nationalist first minister,

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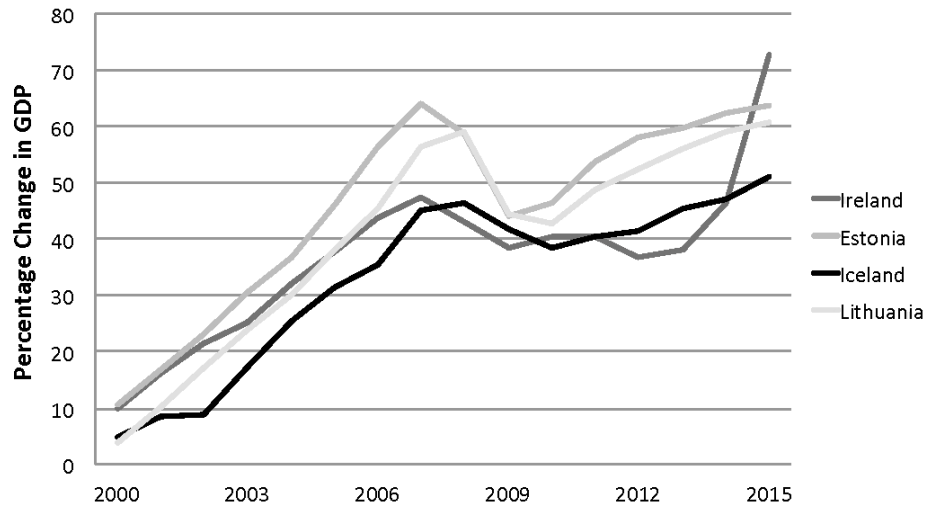
13. Space does not permit a detailed rebuttal of the widely read but totally inaccurate description of post-collapse Iceland by Michael Lewis (2009), reprinted in a best-selling book (2011, 1–39).

Alex Salmond, liked to refer to as an ‘arc of prosperity’, to which he yearned to attach Scotland. It was now an arc of insolvency” (2011, 138).

## The recovery of Iceland

Certainly, neither Iceland nor Ireland are now part of any “arc of insolvency.” Both countries have recovered remarkably, as illustrated in Figure 6 where the annual percentage changes in the growth of GDP in four countries since 2000 are shown. In retrospect, the Irish and Icelandic crises were actually not as grave as those in Estonia and Lithuania, whose economies grew much more rapidly before the international crisis while they also contracted much more rapidly as a result of the crisis. It is therefore somewhat surprising that Professor Gylfason (2014) contrasts bank privatisation in Estonia, which he deems to be a success, to that in Iceland, which he considers a clear failure. It is also clear that the Icelandic recovery cannot be attributed to the IMF programme which the country was forced to adopt at the end of 2008: The measures required by the IMF were the same which any sensible government would have undertaken anyway, the only difference being that Iceland was also required to take out an immense loan from the IMF, which lay idle in a New York bank account, but bearing high interest. While the export sectors of the Icelandic economy were greatly helped by the depreciation of the krona, the data also suggest that other countries without monetary discretion, such as Ireland, inside the Eurozone, can adjust to a recession and start to grow again.

The real reason for Iceland’s recovery is that she was never bankrupt. It was not an economy that “was in effect hijacked by a combination of free-market ideology and crony capitalism,” as Krugman (2010) asserted. Iceland recovered quickly because she was never really sick. She was only temporarily left out in the cold, and she survived it as she had done the many ravages of past centuries. The economy was and is essentially sound, with four main pillars: the sustainable and profitable ITQ system in the fisheries; ample energy resources, both hydroelectric and geothermal, with previous investments in power plants being fully financed and now starting to bear fruit; a tourist boom, caused both by the depreciation of the currency and by an increased international awareness of Iceland as a unique, strange, but also peaceful and safe country; and significant human capital, with a relatively young, well-educated, and healthy population.

**Figure 6.** Larger post-crisis GDP drops in Baltic states than in Iceland and Ireland

Source: World Bank (2017).

After the bank collapse, a minority government of the Social Democrats and the Left Green was formed, winning a resounding victory in the 2009 parliamentary elections, and continuing as a majority government. The most votes the two leftwing parties combined had previously received was 44.9 percent; now they got 51.5 percent. Instead of trying to unite the nation behind a programme of reconstruction, the government drove Oddsson and his two colleagues out of the CBI and indicted Geir H. Haarde for negligence. Haarde was eventually acquitted of all charges except the minor, even trivial, one that he had not held enough meetings with his ministers about the impending crisis (Landsdomur 2012). The case has been referred to the European Court of Human Rights which has decided to hear it, even if it has not yet delivered a decision. Perhaps the greatest cost of the bank collapse consisted indeed in the erosion of social capital: Before the collapse, Iceland had been a civilised country of trust and social cohesion, which now however suddenly saw street manifestations and even occasionally violent riots, abusive language in public discourse, and a marked loss of trust.<sup>14</sup>

14. For example, four of the left-wing intellectuals writing in English about the 2008 Icelandic bank collapse have had to withdraw false or offensive statements. Professors Robert Wade and Sigurbjörg Sigurgeirsdóttir (2010) had invented a quotation from the present author. Professor Thorvaldur Gylfason (2012) had made unsubstantiated allegations against Supreme Court judge Jon Steinar Gunnlaugsson. Professor Gisli Pálsson (2016) had made unsubstantiated allegations against Professor Ragnar Arnason. After complaints by the targets, the statements have all been removed from online versions of their papers or books. But unlike Wade, Sigurgeirsdóttir, and Pálsson, Gylfason did not apologise for his statement but only had it removed.

Strangely, the 2009–2013 left-wing government felt that Iceland’s old constitution was somehow at least partly to blame for the bank collapse, so it decided to hold elections in 2010 for a constitutional assembly. There was little interest in the project: The turnout was only 36.8 percent. Several irregularities were found in the election process which led the Supreme Court, responding to complaints about it, unanimously to invalidate the elections. In unprecedented defiance of the Supreme Court, the government decided to appoint the 25 people who had received the most votes in the now invalidated elections, including Professor Thorvaldur Gylfason, to a ‘constitutional council.’ This new body, without any legal mandate, and starting each of its televised sessions by singing together, drafted a bill for a constitution, with wide-ranging stipulations about various aspects of life, essentially a wish list, as the European Commission for Democracy through Law, the Venice Commission, declared (2013) in a blistering critique of the proposals. The bill was put to the vote in 2012. Again the turnout was small, only 48.4 percent. Of those who voted, 64.2 percent voted in favour of the bill as a guideline for a new constitution while 31.7 percent rejected it. This meant that only 31 percent of all eligible voters voted for the bill. After this obvious lack of interest, the project was abandoned. By comparison, in the plebiscite on the 1944 constitution, when Iceland became a republic, the turnout was 98.4 percent, and of those who voted, 98.5 percent were in favour of the constitution and only 1.5 percent against it. Gylfason however founded a party campaigning for the constitutional bill and ran for parliament in 2013. His party received a little over 2 percent of the vote.

In the 2013 parliamentary elections the two left-wing parties suffered a heavy defeat, only receiving 23.8 percent of the vote. Their government was replaced by a centre-right coalition of the Progressives and the Independence Party. The main reason for the 2013 debacle of the Icelandic left was however not the failed constitutional project but that the government was seen as having been feeble in negotiations with the British government, which had not only closed down British banks owned by Icelanders and imposed an anti-terrorist law on Icelandic institutions and enterprises, but which had also demanded that Iceland as a country would take on the obligations of the failed Landsbanki in the UK, immense by Icelandic standards, instead of doing what the Swedish and German governments did, which was to lend the estates of the fallen Icelandic banks enough money to compensate depositors, being repaid after the sale of bank assets. The Icelandic government had twice made deals with the UK on this so-called Icesave dispute, giving in to British demands, and both times the deals had been overwhelmingly rejected in national referenda. Finally, after the deals had twice been rejected, the dispute was brought before the EFTA Court, which found in early 2013, perhaps unsurprisingly, that Iceland as a country was not under any obligation to compen-

sate parties to a private transaction for their potential losses (EFTA Court 2013). The 2013–2016 government took important steps to abolish the capital controls introduced after the bank collapse and to resolve issues connected with the estates of the failed banks. In the parliamentary elections of 2016, the Independence Party won a victory, regaining some of its former strength, and its leader, Bjarni Benediktsson, formed a coalition government with two small parties of the centre.

## Renewed endeavors in liberal enlightenment

During the 2009–2013 left-wing resurgence, the government raised taxes and re-regulated the economy. For a while after the bank collapse, economic liberals were not vocal in Icelandic public discourse. In 2012, young entrepreneurs who were creating a small research institute to counter the resurgence of statism asked the present author to become its academic director. The institute is called **RNH** (Rannsóknarsetur um nyskopun og hagvöxt, Icelandic Research Centre for Innovation and Economic Growth). Professor Ragnar Arnason is chairman of the Academic Council, of which Birgir Thor Runolfsson and I are also members. Asset manager Gisli Hauksson is chairman of the board of the Institute, while Jonas Sigurgeirsson is its manager. RNH collaborates with the Alliance of Conservatives and Reformists in Europe. The Institute has organised many international conferences and lectures in Iceland. The group behind RNH revived the Public Book Club (Almenna bokafelagid), which has commissioned translations of classical and timely works such as *The Rational Optimist* by Matt Ridley and *Civilisation* by Niall Ferguson, and republished anti-totalitarian writings of Bertrand Russell, Valentín González, Jan Valtin, Ants Oras, and others. RNH also works on the feasibility of tax cuts and the private production of public goods.

Liberalism in Iceland is alive and kicking, building on the heritage of the ancient settlers as well as that of Snorri Sturluson, Jon Sigurdsson, and Jon Thorlaksson, and being stimulated and encouraged by liberal thinkers abroad.

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## About the Author



**Hannes H. Gissurason**, born in 1953, holds a B.A. in philosophy and history and a cand. mag. [M.A.] in history from the University of Iceland, and a D.Phil. in politics from the University of Oxford. The author of more than fifteen books on politics, history and current affairs, in English, Swedish, and Icelandic, he has been professor of politics at the Department of Politics at the University of Iceland since 1988. He has been a Visiting Scholar at the Hoover Institution, Stanford University, at UCLA, at LUISS in Rome, and at several other universities. In 1998–2004 he served on the board of the Mont Pelerin Society and in 2001–2009 on the board of overseers of the Central Bank of Iceland. He is director of academic studies at an Icelandic think tank, [RNH](#), Rannsóknarsetur um nyskopun og hagvoxt (Research Centre on Innovation and Economic Growth). His email address is [hannesgi@hi.is](mailto:hannesgi@hi.is).

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