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THE NORDIC MODELS

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1

INTRODUCTION

The five Nordic countries, Sweden, Denmark, Finland, Norway, and Iceland, are rightly regarded as successful societies. They are affluent, but without a wide gap between rich and poor. They provide social security, but without a significant erosion, it seems, of their freedoms. They are small, but they all enjoy a good reputation around the world as peaceful, civilised democracies. The Nordic nations are healthy and well-educated and the crime rate is low. But what is it that other nations can learn from the Nordic success story? Harvard economist and UN development expert Jeffrey D. Sachs is in no doubt about the answer. He recalls Friedrich A. Hayek's warning against socialism, 'Road to Serfdom', and argues that he was wrong and that the Nordic countries prove it. 'In strong and vibrant democracies, a generous welfare state is not a road to serfdom but rather to fairness, economic equality and international competitiveness.'¹ In this report, it will be argued that this is a misunderstanding, not only of Hayek but also, more importantly, of the Nordic success story. The system of high taxes, extensive redistribution, and general and generous welfare benefits without any means-testing that Scandinavian social democrats

introduced in the 1950s to the 1970s turned out to be untenable. Moreover, there is in fact no one Nordic model, even if there are some resemblances between the three Scandinavian societies, Sweden, Denmark, and Norway, with Finland and Iceland being different in various respects. Indeed, because the 'Swedish model' is frequently invoked, a distinction can be made between at least three Swedish models, the liberal one of 1850–1970, the social democratic one of 1970–1990, and the present model of a liberal, restrained welfare state. It is also not true that social democracy captures any essence of the Nordic nations. They, especially the Swedes, have strong liberal traditions. What has made the Nordic countries successful is their combination of open economies, free trade, competitive export industries, protection of property rights and the rule of law on the one hand and social cohesion, transparency, strong traditions, respect for hard work, a high level of trust and homogeneity on the other hand.

In particular, this report focuses on liberalism in the smallest Nordic country, Iceland, analysing three aspects of it: institutions like the private enforcement of law in the old

Commonwealth and the present system of individual, transferable quotas in the fisheries; the individualist tradition in Icelandic history and literature, stretching back to the original settlement of the island in 874–930; and the writers, activists, and political leaders who have defined, defended, and practised freedom in Iceland, Jon Sigurdsson, the leader of the struggle for independence, Prime Minister Jon Thorlaksson, and others. A special emphasis is put on the comprehensive liberal reforms of 1991–2004, when David Oddsson was prime minister, and the many flaws in the anti-liberal narrative widely presented abroad by his critics. Finally, the dramatic 2008 Icelandic bank collapse is discussed and explained. It has frequently been interpreted as the failure of liberalism, or as left-wing intellectuals prefer to call it, 'neoliberalism'. For example, in a 2015 book two academics – one of them Icelandic – assert: 'Iceland was the canary in the global coal mine, a warning of danger,' adding:

“ In Iceland, the mine has exploded and the canaries are dead. Iceland was the first to fall. The most dramatic. The warning to others. The people have survived to learn that neoliberal meltdowns have nothing to do with genetics and everything to do with neoliberal economics and the political cronies who promote corruption, engineer multinational corporate cooptation of governments, and orchestrate massive propaganda assaults on news, on literature, and, most insidiously, on common sense.²

At the end of 2016 two other academics write: 'Iceland is the only existing advanced economy counterfactual to the inevitability of neoliberal orthodoxy.'³ In this report it will be argued that the rapid recovery of Iceland shows that the foundations laid with the liberal reforms of 1991–2004 were sound: 'neoliberalism' was not the cause of the bank collapse. The Icelandic model, neither Anglo-Saxon nor Scandinavian, has withstood the test of time. •

² E. Paul Durrenberger and Gisli Palsson, Introduction, *Gambling debt: Iceland's Rise and Fall in the Global Economy*, eds. E. P. Durrenberger and G. Palsson (Boulder CO: University Press of Colorado, 2015), pp. xiv and xxix.

³ Kevin Farnsworth and Zoë Irving, *The limits of neoliberalism? Alternatives to Neoliberalism: Towards Equality and Democracy*, eds. Bryn Jones, Mike O'Donnell and Theo Papadopoulos (Bristol: Policy Press, 2017), p. 110.



2

ECONOMIC LIBERALISM IN SWEDEN AND FINLAND

In an accessible and thorough history of Swedish liberalism, historian Johan Norberg points out that the ancient Swedish farmers were sturdy individualists who insisted on their rights against their kings. He quotes a story of the Swedish Law-man Thorgnyr told by Icelandic chronicler Snorri Sturluson. In early 11th century, when the Swedish king Olof wanted to wage war against Norway, Thorgnyr, on behalf of the farmers, spoke against the king at an assembly, praising past kings who had, unlike the present one, listened to the people. 'He wants to have the Norway kingdom laid under him, which no Swedish king before him ever desired, and therewith brings war and distress on many a man,' Thorgnyr said. Instead, he should marry a Norwegian princess and pursue peace. The Law-man then addressed the king directly and bluntly: 'But if thou wilt not do as we desire, we will now attack thee, and put thee to death; for we will no longer suffer law and peace to be disturbed.'⁴ The king relented. Norberg also quotes a modern namesake of the old Law-man, Torgny Segerstedt, who said more than nine hundred years later that individuality was deeply ingrained in the self-reliant and industrious Swedes. 'When a Nordic person says "This is not right", one has collided with a block of granite.'⁵

In the 18th century, both Sweden and Finland were ruled from Stockholm and there was a sizeable Swedish-speaking minority in Finland. The first committed liberal of this vast Nordic territory was the Swedish-speaking theologian Anders Chydenius (1729–1803). As a young pastor in Nedervetil, a small town in Ostrobothnia in the central part of Finland, close to the sea, Chydenius became interested in medicine, modern farming, and other ways of dealing



with the poverty he saw among the peasants in his parish. In 1763 he participated in an essay contest on the question: 'Why do so many people leave Sweden?' He argued that there was nothing wrong with emigration. If the Swedes wanted to reduce it, then it was necessary to reform the Swedish economy and to make it more open and agreeable. Chydenius detailed the abuses, regulations, and taxes which made it difficult to escape poverty in Sweden. 'Fatherland without freedom and merit is a big word with little meaning,' he wrote. In 1765, Chydenius was elected to the Swedish Diet which was then divided into four estates. He successfully campaigned for the abolition of trade restrictions which in his home district of Ostrobothnia were particularly harmful as the towns there had to trade with Stockholm alone. Chydenius also managed to have a greater freedom of the press passed into law.

⁴ Snorri Sturluson, *Saga of King Olaf Haraldsson the Saint*, Heimskringla, Vol. II, Ch. LXXXI (London: Longman, Brown, Green and Longmans, 1844), pp. 93–94. Translated by Samuel Laing.

⁵ Johan Norberg, *Den svenska liberalismens historia* (Stockholm: Timbro, 1998), p. 10. In the following account I rely heavily on Norberg's book and also on a short version of it in English, quoted below.

In 1765, Chydenius wrote a short treatise, 'The National Gain', where he, eleven years before Adam Smith published his celebrated 'Wealth of Nations', gave a succinct outline of a liberal economic theory, explaining how individuals seeking their own gain could thereby benefit others, if operating in a free, competitive market and not in a political race for power. He argued that 'every individual spontaneously tries to find the place and the trade in which he can best increase National gain, if laws do not prevent him from doing so.'⁶ The pursuit of National gain

“weighs everybody in the same scales, and gain is the right measure that shows who should have the preference. relieves the Government from thousands of uneasy worries, Statutes and supervisions, when private and National gain merge into one interest, and the harmful selfishness, which always tries to cloak itself beneath the statutes, can then most surely be controlled by mutual competition.”⁷

He also displayed a keen understanding of the division of labour. 'If ten men produce goods to the value of 100 Daler a day in one trade, but in another to a value of not more than 80, it is obvious that in the latter eventuality the Nation will lose 20 Daler a day on those ten men's work.'⁸

Chydenius was tireless in trying to limit the power of the state to tax, observing that the old commandment, 'Thou shalt not steal,' applied to the state as well as to its citizens. But he proved too radical for some of the Swedish nobles and after an eventful year he was thrown out of the Diet. His influence continued however to grow and later he drafted a bill for the Swedish king on religious freedom which gave Jews the right to settle in Sweden. It was not least because of Chydenius' arguments that farmers gained more control over their land and agricultural trade was liberalised. In 1770, Chydenius became rector, a combination of pastor and church administrator, in Gamlakarleby (Kokkola in Finnish) in Ostrobothnia, on the coast of the Gulf of Bothnia, living there to the end of his life. In 1778–1779 Chydenius again sat in the Diet, championing the rights of farmhands and domestic servants amongst other things. He sat for the last time in the Diet in

⁶ Anders Chydenius, *The National Gain*, §5 (London: Ernest Benn Ltd., 1939), http://www.chydenius.net/historia/teokset/e_kansallinen_johdanto.asp

⁷ Ibid., §31.

⁸ Ibid., §8.

1793 and was active in promoting many economic reforms with the aim of modernising Sweden. One of his most original ideas, presented in his old age, was to establish a kind of free-market zone in Lapland, the northern parts of Sweden and Finland, also stretching to the most northern part of Norway.

The army officer Count Georg Adlersparre (1760–1835) was perhaps not as original a thinker as Chydenius, but he was even more influential. He translated parts of Adam Smith's 'Wealth of Nations' for a magazine he published and was the first Swede to call himself 'liberal'. After the hapless Swedish king Gustav IV Adolf had in 1809 lost Finland to the Russians, Adlersparre led a successful revolt against him. The king's old and childless uncle became king, and restrictions on the freedom of the press that the two previous monarchs had reintroduced were abolished again. A constitution was adopted which in a perhaps typical Swedish way was the result of a compromise between the liberals and the conservatives. Freedom of the press, of religion, and of assembly and the protection of property rights were guaranteed, while the nobility retained some of its privileges.



Adlersparre was however disappointed when his candidate to succeed the old king suddenly died, and he then retired from politics. One of Napoleon's generals, Jean-Baptiste Bernadotte, calling himself Carl Johan in Swedish, was elected king. He allied himself with Russia and Great Britain against Napoleon and in 1814 as compensation for Finland received Norway from Napoleon's defeated ally Denmark. To placate the unruly Norwegians, he had however to accept a much more liberal constitution there than in Sweden. Carl Johan turned out to be an authoritarian king, supporting the conservatives. The liberals were in opposition. One of them was the distinguished legal scholar Johan Gabriel Richert (1784–1864). As a young man, he had read the Icelandic sagas and he was greatly influenced by their account of arbitration by mutual consent instead of commands from above.⁹ He proposed several legal reforms in order to liberalise Swedish society, but his proposals were only slowly adopted.

Another liberal in opposition to the authoritarian king was the nobleman Lars Johan Hierta (1801–1872). At once a successful entrepreneur and a political activist, in 1830 he founded 'Aftonbladet' which became a bastion of liberalism and the growing middle class, fighting against class privileges and economic controls. Hierta had a copy of a famous painting of the American revolutionaries of 1776 on the wall in his office, and he strongly believed that no group should be allowed to 'take money out of others' pockets'. His liberalism was eclectic, bringing together utilitarian arguments and ideas of natural rights. 'Some would argue that this is characteristic of the Swedish mentality', Johan Norberg remarks.¹⁰ Hierta and other liberals were convinced that the only way to bring Sweden out of poverty was to liberalise the economy and to create new opportunities both for the peasants remaining in the countryside and for the poor masses flocking to the cities. After King Carl Johan's death in 1844, the government became more sympathetic to liberal ideas. An ardent disciple of French writer Frédéric Bastiat, the cautious and clever Johan August Gripenstedt (1813–1874) was in 1848 appointed minister without portfolio, and in 1856 finance minister. In the following decade, he used his considerable political skills to implement many liberal reforms, especially after he was in 1858 joined in the government by another convinced liberal, Baron Louis



De Geer (1818–1896). 'It is no exaggeration to say that Sweden experienced a nonviolent liberal revolution between 1840 and 1865,' Norberg notes. The old Diet of the four Estates was replaced by a bicameral Parliament; the guilds were abolished; entry into business was facilitated; regulations on the important timber and iron industries were lifted; tariffs were

lowered; a law was passed on joint-stock companies; banks were established and interest rates deregulated; public education was improved; freedom of the press and of religion were expanded; women won rights to own and inherit property, receive education, and make a career. Together, Gripenstedt and De Geer also resolutely pursued a foreign policy of non-intervention. They for example stopped plans by the king to intervene in a war between Denmark and the German Federation over Schleswig and Holstein. In 1865, Sweden joined the free-trade treaty between France and the UK. Two years later, when the new bicameral Parliament convened for the first time, Lars Johan Hierta, as its oldest member, gave the welcoming speech, celebrating recent liberal reforms and warning his fellow parliamentarians not to devise new ways of taking money from the people.

Gripenstedt sometimes quoted the Swedish poet Tegnér that Sweden could within her own borders 'regain Finland', meaning that she could grow inwards instead of outwards, thus compensating for territory losses. She could engage in trade rather than warfare. When Gripenstedt said that Sweden, one of the poorest European countries at the time, could become one of the richest through free trade and modernisation, his opponents tried to ridicule him and his 'flower paintings'.¹¹ But Gripenstedt was proved right. Liberalism transformed Sweden. In 1860–1910, real earnings of male industrial workers increased by 25% per decade; life expectancy increased by 12 years. It is interesting that in the fifty years from 1860 to 1910, real earnings increased by 170%, whereas in the next fifty years, from 1910 to 1960, they increased by 110%.¹² The living standards of ordinary people improved not only as a result of higher earnings, but also because they got running water, sewerage and electric lights installed in their homes, and access to other material goods. During this period, government remained small: at the turn of the century, central public expenditure was only about 6% of GDP. New companies were founded to produce goods out of the 'green gold', as timber was called, and out of iron and other resources. Entrepreneurs and capitalists flourished. Lars Magnus Ericsson invented an automatic telephone exchange and founded L. M. Ericsson. Alfred Nobel invented dynamite and established Nitroglycerin AB. Swen Wingquist invented the self-regulating ball bearing and created

SKF. Gustaf Dalén invented a flashing apparatus for lighthouses and set up AGA. Axel Wenner-Gren built up Electrolux by introducing vacuum cleaners and refrigerators into Swedish homes. André Oscar Wallenberg founded Stockholms Enskilda Bank and Albert Bonnier started a publishing company. In Swedish intellectual life, liberals were prominent, for example the pioneer of academic economics, Count Gustaf Knut Hamilton (1831–1913), who contrasted spontaneous associations possible in the market to enforced associations envisaged by socialists.

The new Swedish Parliament did not altogether heed Hierta's advice to serve only the common good instead of special interests. In the 1880s tariffs on grain were raised, and conservatives took power. In 1889, the Social Democratic Party was founded with the explicit goal of gaining power and using it for the benefit of only a segment, albeit a large one, of the population. The Social Democrats were however against 'hunger tariffs', realizing that they reduced the living standards of the poor. Slowly, liberalism ceased to be a new and attractive idea and seemed to become merely a defence of the status quo. Great Britain had long been the model for many Swedes, but now Bismarck's new state south of the Baltic Sea, the vigorous German Empire, was viewed with admiration, not least Bismarck's introduction of government-funded welfare benefits and of tariffs to protect domestic industry. But both the German and the Russian empires collapsed in the First World War, and Sweden's old sister country, Finland, gained her independence. Since 1809, Finland had been a Grand Duchy within the Russian Empire, with some autonomy. The liberal tradition in Finland was not strong. Finns certainly claimed Anders Chydenius as their countryman, but it complicated the development of liberal movements and ideas in Finland in the 19th century that the population was divided between a large Finnish-speaking majority and a small Swedish-speaking minority which had formerly constituted most of the ruling elite of the country. Nationalism, both Finnish and Swedish, played a much more important role in Finland than liberalism, even if the Young Finns, prominent at the end of the 19th century, were at once nationalists and liberals. Nonetheless, the Finnish republic established in 1917 was built on the liberal principles of constitutional democracy and protection of human rights. Its constitution was

⁹ Johan Norberg, *Den svenska liberalismens historia*, p. 81.

¹⁰ Johan Norberg, *How Laissez-Faire Made Sweden Rich*, <https://www.libertarianism.org/publications/essays/how-laissez-faire-made-sweden-rich>

¹¹ Johan Norberg, *Den svenska liberalismens historia*, p. 147.

¹² Johan Norberg, *How Laissez-Faire Made Sweden Rich*.

written by the distinguished legal scholar Kaarlo Juho Ståhlberg who served as President of Finland in 1919–1925. But the Soviet Union, established after the Bolshevik Revolution, cast a long shadow over Finland until its dissolution in 1991.

In Sweden, during and after the First World War the old differences between conservatives and liberals were gradually replaced by differences between on the one hand conservative-liberals in a broad sense, split into many political parties, and on the other hand socialists, organised in one large party, the Social Democrats, with a small communist party to their left. Two respected and renowned economists became outspoken critics of advancing socialism, Gustav Cassel (1866–1845) and Eli Heckscher (1879–1952). As young men, both had been rather sceptical about liberalism, but by their studies and reflections they had become convinced that socialism would not have the beneficial consequences intended or at least advertised. Cassel, a merchant's son and a mathematician by training, was Economics Professor at Stockholm University. He was a world famous monetary economist who developed the idea of purchasing power parity and was internationally influential in the 1920s. He was also an excellent writer who contributed a stream, almost a torrent, of articles, in lucid, powerful prose, to Swedish newspapers in the 1920s and 1930s on the virtues of competition and the free market. Heckscher, the son of a Jewish-Swedish bank manager, was Economics Professor at the Stockholm School of Economics. He mainly argued for economic liberty on consequentialist grounds. He held that income distribution ought to be as equal as it could be without harming the process of wealth creation,¹³ in a clear anticipation of John Rawls' theory of justice.¹⁴ Heckscher was like Cassel adamantly opposed to protectionism: 'Either an economic sector is profitable, and then it does not need tariff protection; or it is not profitable, and then it does not deserve tariff protection.'¹⁵ As a scholar, Heckscher contributed to the theory of international trade and wrote a comprehensive history of mercantilism as well as a monumental economic history of Sweden. But to their chagrin, Cassel and Heckscher saw the Social Democrats assume power in 1932, although neither of them probably imagined that they would keep it for 44 years.



Besides Cassel and Heckscher, the best-known Swedish liberal intellectual in the 1930s and 1940s was Torgny Segerstedt (1876–1945), a newspaper editor, known for his uncompromising hostility towards the German national socialists, even at their heyday, when many of his fellow-countrymen thought it advisable to refrain from criticizing them. 'Herr Hitler is a nuisance,' Segerstedt defiantly wrote.¹⁶ Other liberals felt that they had to compromise, or perhaps rather to adjust their views, before the advancing tide of socialism. Blessed with a brilliant mind, good looks and an engaging personality, Bertil Ohlin (1899–1979), Economics Professor at the Stockholm School of Economics, argued for 'social liberalism' which would not envisage such a restricted role for the state as 'old liberalism'. According to Ohlin, government had to try to level out economic fluctuations, work actively against monopolies, and ensure that income distribution did not become too unequal. In many ways, Ohlin and other members of the so-called Stockholm School in economics were Keynesians before Keynes. Ohlin also made important contributions to the theory of international trade. In 1944 he was elected leader of the People's Party (*Folkpartiet*), most often the largest non-socialist party in Sweden. He served briefly as minister of trade in the Swedish wartime unity government, until 1945 when the Social Democrats formed

¹³ Johan Norberg, *Den svenska liberalismens historia*, p. 229.

¹⁴ John Rawls, *A Theory of Justice* (Cambridge MA: Belknap Press of Harvard University Press, 1971).

¹⁵ Johan Norberg, *Den svenska liberalismens historia*, p. 232.

¹⁶ *Ibid.*, p. 257.



their own government. Although he kept his professorship, after the war Ohlin devoted himself to his political career, stepping down as party leader in 1967.

Immediately after the war, the Social Democrats adopted a new and radical programme calling for comprehensive economic planning. Swedish businessmen looked with apprehension on this development and welcomed the translation of Friedrich A. Hayek's 1944 book, 'Road to Serfdom', where he argued that national socialism and communism were of the same ilk and that despite the undoubtedly good intentions of many social democrats, the extensive economic planning they craved would, if consistently carried out, lead to despotism. In Sweden, as in many other countries, a lively debate took place about Hayek's dire warnings. One of Sweden's best-known social democrats, Herbert Tingsten (1896–1973), Professor of Politics at Stockholm University, even changed his mind after reading Hayek's book. In June 1945 Tingsten said in a famous radio debate on central planning, echoing Hayek:

¹⁷ *Ibid.*, p. 267.

¹⁸ It was Hayek himself who told the present author about his disappointment with Ohlin.

“ The problem is whether one can, in a state which directs, leads, plans, and owns most things, preserve freedom in some designated sectors which are then highly taxed. Will such small oases not soon be destroyed by the desert storm which central planning really is?¹⁷

When economist Torsten Gårdlund, editor of the Social Democrats' magazine, expressed doubts about nationalisation, he was fired from his position. He took up a position as Economics Professor at Lund University, but became more of a foe of totalitarianism in all its forms than a fully committed economic liberal. Tingsten however left his professorship and became editor of one of Sweden's largest newspapers where he used his eloquence and wide learning to promote liberal principles, but displayed more interest in politics than economics. When Hayek founded an international academy of liberal thinkers, the Mont Pelerin Society, in 1947, he invited Bertil Ohlin, Eli Heckscher, and Herbert Tingsten to become members. To Hayek's great disappointment, Ohlin declined, as he did not want to associate himself with the 'old liberals'.¹⁸ Heckscher and Tingsten accepted. Tingsten only attended the first meeting of the society. He did



not find himself in agreement with Austrian economist Ludwig von Mises and some other founding members of the Mont Pelerin Society on redistribution. 'If this is liberalism, then I am still a socialist,' he said at the meeting.¹⁹

The lively and even fierce debate in Sweden on central planning at the end of the war was an intellectual victory for the anti-socialists. In order to keep power, the Social Democrats retreated somewhat from their most radical positions. The next two decades saw a new consensus forming in Sweden whereby the state refrained from nationalisation and comprehensive economic planning, but instead levied high taxes on the more well-off, while mostly avoiding to impair the competitiveness of the export industries. This was the time of 'Harpund Democracy', named after a country manor that a rich industrialist left the Swedish state in 1952 as the prime minister's summer house. Regular meetings were held there between leaders of the Social Democrats, the business community, and the trade unions. It sometimes felt, critics said, like Sweden was not ruled by her taxpayers and consumers, but by an unholy alliance of Big Government, Big Business, and Big Labour. The Social Democrats cautiously started extending welfare benefits to the middle class both to enlarge their own electoral basis and to strengthen support for the welfare state, just like Bismarck had introduced welfare benefits in Germany to try and capture the working-class vote. Nonetheless,

a few Swedish intellectuals criticized the prevailing collectivist and corporatist trends in their country. Johan Hansson (1879–1973) ran a publishing house, *Natur och Kultur*, which brought out translations of some of the more accessible works by Ludwig von Mises and Henry Hazlitt and also books on current affairs in Sweden, including Hansson's own 'Liberty under the Law instead of Social Liberalism' in 1950 and 'Revolt Against the Welfare State' in 1958.²⁰ One of Sweden's best-known novelists, Vilhelm Moberg (1898–1973), was unafraid to take up the causes of individuals whose rights had been violated and also, unlike many other Swedish commentators, to criticize totalitarianism in Nazi Germany and the Soviet Union. A social democrat drily commented: 'Moberg should write drama, not create drama.' Indeed, Moberg wrote drama, a series of celebrated novels about Swedish emigrants to North America where nobody was interested in one's origins, only in one's abilities. Before the First World War, more than one million Swedes emigrated, mostly to the US upper Midwest.²¹

In the 1960s and 1970s, the welfare state seemed to have become firmly entrenched in Sweden, the old liberals quietly falling silent and leaving the scene without younger thinkers or activists replacing them. A rare exception was economist Sven Rydenfelt (1911–2005). Suffering from bad health as a young man, he came late to economics and was already fifty years when he was appointed Associate Professor of Economics at Lund University. Because of his controversial views he was never made full Professor, although the Swedish centre-right government in 1991 bestowed the title on him years after his retirement. Rydenfelt published many books applying classical price theory to economic problems, noting for example that rent control reduced supply of housing relative to demand and that the welfare state was like a knight in armour: the heavier the protection, the less the mobility. Under the influence of Joseph Schumpeter and Friedrich A. Hayek, he stressed the role of entrepreneurs in a dynamic economy and even wrote books about some of them, the Åkermans of Eslöv and Ruben Rausing of Tetra Pak. He also argued against monopoly in education and broadcasting. Independent of mind like his forefathers, the sturdy Swedish farmers, Rydenfelt did not confine himself to economics: one of his books, co-written with a



journalist, was a critique of the Swedish Security Police for its close surveillance of individuals allegedly holding controversial views, mostly radical leftists. Indeed, the Security Police investigated whether Rydenfelt was an extreme leftist! Its informant in Lund assured the agency that this was far from being the case.²²

Long before the Soviet Union collapsed, Sven Rydenfelt predicted that it would. He also expressed doubts about the European Union, observing that customs unions are not necessary to lower tariffs and stimulate free trade; countries benefit from unilaterally lowering or abolishing tariffs. Besides his books, Rydenfelt wrote many

articles for Swedish and Norwegian newspapers and journals, including the business magazine *Farmand* in Norway, whose editor, Dr. Trygve Hoff, was one of the founders of the Mont Pelerin Society. Hoff brought Rydenfelt into the Society where he found other intellectuals with similar views.²³ Rydenfelt became a good friend of Milton and Rose Friedman, and in 1984, Friedman contributed a foreword to an English edition of one of Rydenfelt's books, on the failure of centrally planned food production.²⁴ Polemical and uncompromising, Rydenfelt certainly was not a prophet in his own country, often being dismissed as a mere reactionary. But this and much else was to change in the fourth quarter of the 20th century. •

¹⁹ Herbert Tingsten, *Mitt liv*, Vol. 3 (Stockholm: Norstedt & Söner, 1963), p. 334.

²⁰ In Swedish, *Rättsliberalism i stället för socialliberalism, and Revolt mot välfärdsstaten*.

²¹ Johan Norberg, *Den svenska liberalismens historia*, p. 285.

²² Lars Olof Lampers, *Det grå brödrskapet. En berättelse om IB* (Stockholm: SOU, 2002), p. 374, <http://www.regeringen.se/rattsdokument/statens-offentliga-utredningar/2002/01/sou-200292/>

²³ There are two chapters on Rydenfelt in Mats Lundahl, *Seven Figures in the History of Swedish Economic Thought* (Basingstoke: Palgrave Macmillan, 2014).

²⁴ Sven Rydenfelt, *A Pattern for Failure: Socialist Economies in Crisis* (New York: Harcourt Brace Jovanovich, 1984).

3

THE THREE SWEDISH MODELS



In 1976, the Social Democrats had been in power for 44 years (with only a brief break in the summer of 1936). Sweden seemed to be a prosperous, successful country. Left-wing intellectuals around the world looked on her as a role model. Books were written about ‘the middle way’ or ‘the third way’ where Sweden seemed to be located. A charismatic and radical leader, Olof Palme, who had in 1970 become leader of the Social Democrats, was determined to carry further the social reforms started by his predecessors, even if it would mark a departure from the post-war consensus. The emphasis was changing from lifting up the poor to bringing down the rich. Pragmatists were replaced by ideologues. Ambitious plans were made to transfer private enterprises gradually into the hands of the trade unions by means of special wage earner funds. Swedish society was to become as

socialised and equalised as would be possible. But as sometimes happens, the time of a movement’s greatest triumph is also the time when it may have over-extended itself, gone too far, and has to start a retreat. The ‘Swedish model’ which left-wing intellectuals animatedly discussed in the 1960s and 1970s was not to last. Indeed, a distinction can be made between three Swedish models. The liberal model was developed in the mid-19th century, when liberal principles of free trade and unfettered competition were generally accepted and implemented in Sweden. The years between 1970 and 1990 were the heyday of the social democratic welfare model, although it had of course started its development much earlier and was to last for a few more years. The third model emerged in the 1990s after the experience of the social democratic model: this was the liberal welfare model.²⁵

²⁵ The present writer wants to acknowledge his use of the analysis of the three Swedish models presented by Nils Karlson in a lecture in Iceland 2013, <http://www.rnh.is/?p=2642>

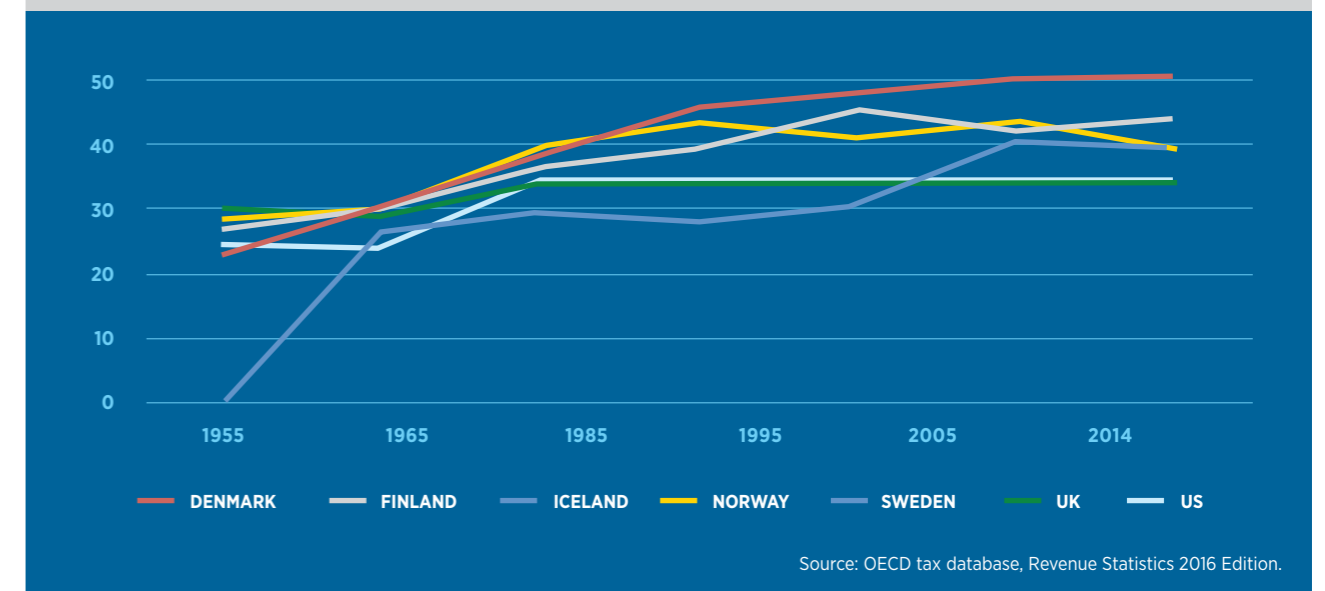
It was the liberal model which made Sweden wealthy, as Swedish economist Nima Sanandaji has well documented. Between 1870 and 1936, Sweden enjoyed the highest growth rate in the industrialised world whereas between 1936 and 2008, the growth rate was only 13th out of 28 industrialised countries.²⁶ What produced the astonishing growth after 1870 was the introduction of economic freedom into a relatively poor society, but with strong traditions of self-reliance, hard work, thriftiness, and respect for the law and a high level of education. Money was sound, with the Swedish *krona* being on the gold standard and Sweden being the leading member of a Nordic monetary union since 1873. The infrastructure, such as railways and schools, facilitated economic progress. Swedish entrepreneurs and engineers also rose to the challenge of modernisation. It helped, of course, that Sweden escaped almost all the destruction occurring

in other European countries during two world wars. It was in the hundred years between 1870 and 1970 that almost all the internationally known Swedish companies were founded, such as IKEA and Volvo. The environment was friendly to business and taxes were relatively low, even after the Social Democrats took over. In 1955, for example, tax revenues in Sweden, as a proportion of GDP, were the same as in the US, 24%. After this, however the paths of the two countries diverged. In 1975, tax revenues, as a proportion of GDP, had risen to 39% in Sweden, but was still only 25% in the US, as shown in Table 1. It did not make much of a difference that a non-socialist government was voted into office in 1976. The three non-socialist parties could not agree on coordinated policies to reduce the tax burden and reform the welfare state. The juggernaut seemed unstoppable.

²⁶ Nima Sanandaji, *Scandinavian Unexceptionalism* (London: Institute of Economic Affairs, 2015), p. 16. The account here of the demise of the social democratic model is largely based on his informative book.

TABLE 1 DEVELOPMENT OF TAX TAKE (% OF GDP)

	1955	1965	1985	1995	2005	2014
Sweden	24	31	45	46	47	43
Denmark	23	30	45	48	50	50
Finland	27	30	39	45	42	44
Norway	28	30	43	41	43	39
Iceland	N.D.	26	28	31	40	39
UK	30	29	36	32	34	32
US	24	24	25	27	26	26



Source: OECD tax database, Revenue Statistics 2016 Edition.



The Social Democrats seemed to aim for capitalism without capitalists. The tax system was becoming ever more distortionary. Examples abound. In 1980 a private person owning a business could pay an effective marginal tax of 137% on the return of capital raised by new share issues. Thus, he could lose money by making a profit. If his business was financed by debt, on the other hand, the marginal tax was high, but not expropriatory. If the business was tax-exempt, as some institutions and insurance companies were, then it might face a negative effective taxation, a net benefit, mainly because of inflation.²⁷ The predictable consequence of the social democratic policies was that entrepreneurship diminished. In 2004, 38 of the largest companies in Sweden were entrepreneurial which means that they had been started as privately owned enterprises within the country. Of these 38 firms, 21 were founded before 1913 and 15 between 1914 and 1970. Only two had been formed after 1970.²⁸ While the public sector grew, the private sector stagnated. Between 1950 and 2000, the Swedish population grew from seven to almost nine million. Incredibly, the net job creation in the private sector during this period was close to zero. All the new jobs were in the public sector.²⁹

In 1982, the Social Democrats returned to power and decided to carry out their plans for the gradual

transfer of private enterprises to wage earner funds. They ran, however, into great opposition, and the feeling became widespread that they were going too far. The leadership of the Social Democrats was greatly weakened by the assassination of Olof Palme in 1986 – which shocked the Swedish nation – and by the resignation in 1990 of Finance Minister Kjell-Olof Feldt, who later reflected on his time in office:

“ The negative inheritance I received from Sträng [a long-serving Finance Minister for the Social Democrats] was a strongly progressive tax system with high marginal taxes. This was supposed to bring about a just and equal society. But I eventually concluded that things do not work that way. This tax system created instead a society of wranglers, cheaters, strange manipulations, mistaken ambitions and new injustices. It took me at least a decade to convince a part of the party of this.³⁰

Many entrepreneurs left the country, including the founders of IKEA, Tetra Pak, and H&M. Sweden seemed to be becoming more and more like the dystopia Russian-American novelist Ayn Rand describes in ‘Atlas Shrugged’: the people who create wealth go on strike, not caring to continue working for others without payment – whereas on the free market

people work for one another according to mutually agreed contracts.³¹ But even if Swedish capitalists and entrepreneurs bore a large share of the tax burden, they were not the only ones paying taxes. What may have facilitated the steady increase in taxation, as Nima Sanandaji observes, was that much of it was invisible to the general public. Indirect taxes such as VAT, value added tax, to some extent replaced direct taxes, such as the personal income tax, and many taxes were collected by enterprises even if the final payer was the ordinary wage earner.³²

It was not only entrepreneurship which was eroded as a result of the overgrown Swedish welfare state, but also the traditional Swedish virtues of hard work, self-reliance, thriftiness, civic participation, and social inclusion. As the nation was becoming ever more affluent and healthy in the 20th century, common sense would have told observers to expect fewer sick-days, fewer people with disabilities and also fewer old people needing financial assistance. In a sense, the point of the welfare state should be to make a welfare state unnecessary. But in 1990, for example, 5% of GDP was spent on sickness and disability programmes in Sweden, 2.3% in Iceland and 2.2% in Switzerland.³³ It is difficult to believe that the explanation was that Swedes were less healthy to this extent than the Icelanders or the Swiss. Shirking has a self-reinforcing effect, both spatially and temporarily. Once some people get away with shirking, the stigma attached to it fades, and their contemporaries start shirking as well. It becomes a way of life. Again, children growing up in a family of shirkers do not learn the skills and practices necessary for self-reliance; they become shirkers as well. As Swedish economist Assar Lindbeck points out, there is, in addition, considerable evidence of explicit benefit fraud in Sweden, for example by people who receive unemployment benefits or sick-pay at the same time as they work, often in the black labour market. The erosion of traditional values is demonstrated in the World Value Survey. In the 1981–84 survey, 82% of Swedes agreed with the statement that ‘claiming government benefits to which you are not entitled is never justifiable’. In the 1999–2004

survey, the number had gone down to 55%.³⁴ It should not therefore come as a great surprise that during the 2002 FIFA World Cup, sickness absence among men increased by 41% as compared to women.³⁵ As a result of this ‘drift of norms’, social inclusion diminished. Whole groups in society became dependent on the state for their livelihood, such as the long-term unemployed and those on disability benefits and state pensions. They were in such a situation that they did only receive, and not contribute, which had to be detrimental to their dignity and self-esteem.

It is true, as Jeffrey D. Sachs and many other commentators have pointed out, that Sweden is a success story. But it was not the social democratic welfare state which produced better social outcomes than in most other countries. In 1960, for example, the total tax take in Sweden was 29% as compared to 27% in the UK and 34% in Germany. But then life expectancy at birth was the 3rd highest in the OECD nations. In 2005, after the welfare state had been greatly expanded, in Sweden life expectancy at birth was gone down to the 6th place. Clearly, high life expectancy is not created by an extensive welfare state, as Nima Sanandaji observes. He also stresses the fact that Iceland, with a much more moderate welfare state, produces as good or better health results in terms of life expectancy at birth and infant mortality as Sweden.³⁶ Before the welfare state became big, Sweden already had less poverty and a more equal income distribution than most other countries. Studies show that in Sweden inequality dropped sharply in the first 80 years of the 20th century, before the impact of the extensive welfare state would have been felt. Already in 1920, Sweden had a relatively equal income distribution. It is true that redistributive taxation may contribute something to a relatively equal income distribution, but it may also contribute something to social exclusion by creating groups who become dependent on welfare and consequently find themselves locked out of the labour market. In the Swedish case the culture of hard work and social cohesion was crucial to the relatively equal income distribution of the early 20th century.

²⁷ Ibid., pp. 22–3.

²⁸ Ibid., p. 23.

²⁹ Ibid., pp. 33–4.

³⁰ Thomas Sjöberg, Intervjun: Kjell-Olof Feldt [Interview: Kjell-Olof Feldt], Playboy Skandinavia, Vol. 1 (5: 1999), pp. 37–44, <http://www.thomassjoberg.com/wp-content/uploads/Kjell-Olof-Feldt.pdf>

³¹ Ayn Rand, Atlas Shrugged (New York: Random House, 1957); Swedish translation Och jorden skälvt (Stockholm: Timbro, 1986).

³² Nima Sanandaji, Scandinavian Unexceptionalism, pp. 44–50.

³³ Ibid., p. 69.

³⁴ Ibid., p. 75. The proportion rose slightly in the next survey, but was 55% in the 2010–14 survey.

³⁵ Assar Lindbeck, Prospects for the Welfare State, IFN Working Paper No. 731 (2008), p. 10. <http://www.ifn.se/Wfiles/wp/wp731.pdf> Lindbeck quotes a study by Malin Persson.

³⁶ Nima Sanandaji, Scandinavian Unexceptionalism, pp. 54–5.

The data suggest that it is more the homogeneity of a nation than government programmes that explains a relatively equal distribution of income. While the Czech Republic and Slovenia, for example, do not have the same high taxes or generous welfare benefits as Sweden and the other Nordic countries, income distribution there is also relatively equal.³⁷

Thus, the Swedish success story had its roots in a combination of economic freedom and a national culture which encouraged hard work, self-reliance, mutual trust, and social inclusion. This conclusion is strengthened by not focusing on Sweden alone, but comparing the living standards of Swedes in Sweden and people of Swedish origin in the United States, the descendants of the more than one million Swedes who emigrated before the First World War. This can be done because the US Census asks people to identify themselves in terms of origin. It turns out that Swedish-Americans enjoy a higher standard of living than Americans on average, and a much higher standard of living than the Swedes in Sweden. It should be recalled that the Swedes who emigrated in late 19th century were not an entrepreneurial elite like some of the rich Swedes that moved to Switzerland in late 20th century: they were people who were trying to escape poverty at home. The difference in living standards, as measured by GDP per capita, is shown in Figure 1, with data from 2008.³⁸ More recent data show the same. According to the 2010 US census, the median household income in the US is \$51,914, whereas the corresponding figure for Swedish-Americans is \$61,549. It has also been calculated that absolute poverty (in dollars or *kronor* rather than as a proportion of total income) is less in Sweden, 9.3%, than in the US, 11%. But it has been consistently found for decades that the Nordic descendants in the US have roughly half the poverty rate of average Americans which means that they have lower poverty rates than Nordic citizens.³⁹ In other words, Swedish-Americans are more affluent and less poor than Swedes in Sweden. The main explanation for this has to be culture: the strong tradition in Swedish society of hard work, self-reliance, trust, and civic participation.



The argument for the social democratic model was that it could combine security and prosperity, provide generous welfare benefits without any significant harmful effects for economic growth. But it became obvious in the 1970s and 1980s that Sweden was materially declining relative to some other rich countries, in particular the US, as shown in Figure 2.⁴⁰

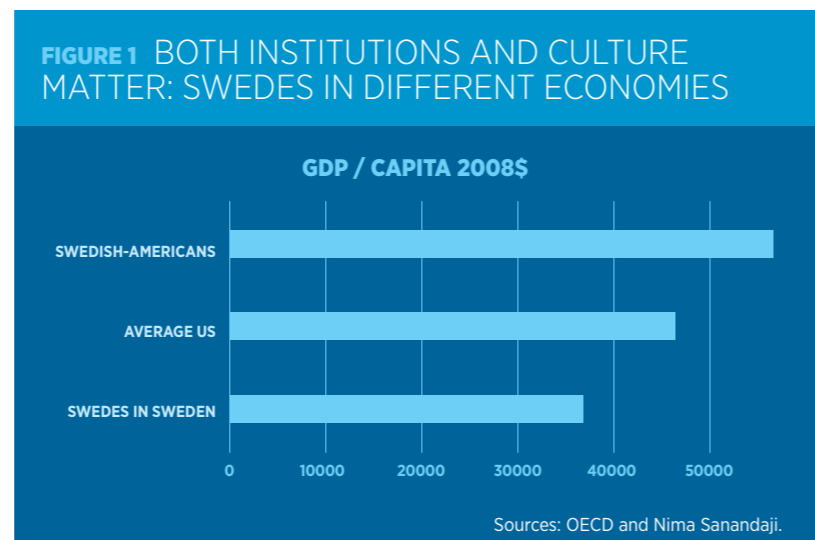
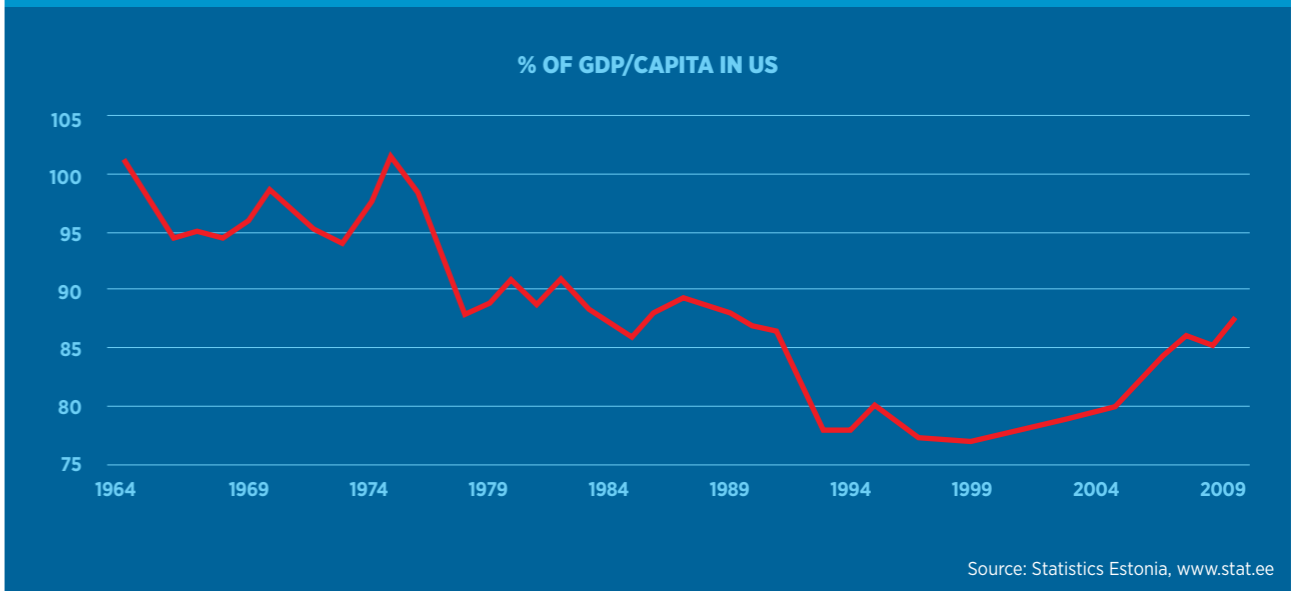


FIGURE 2 SWEDISH DECLINE AND RISE RELATIVE TO THE US



It can also be seen there that the position of Sweden started to improve at the turn of the century. Moreover, another significant comparison could be made – between North America and Europe. There are 50 states in the US and 10 provinces in Canada, whereas there are 56 sovereign states in Europe, 50 of them internationally recognised and 28 of them EU member states. Where would Sweden be ranked in terms of GDP per capita if it suddenly left the EU and became the 51st state of the US? When Swedish economists Fredrik Bergström and Robert Gidehag provided an answer in 2004, using data from 2000–2001, it may have surprised many Swedes. In fact, Sweden would have been one of the poorest states of the US. It would have had a little less GDP per capita than Alabama, ranking slightly above Mississippi and West Virginia, the two poorest states in the US. Bergström and Gidehag also point out that the living standards of the poor in the US, in terms of material benefits such as household appliances and access to modestly priced restaurants, are better than in Sweden.⁴¹ The present writer has made another comparison, using data from 2010, between the five Nordic countries and six North American states and provinces, three in the US and three in Canada, all located in the northern part of the continent and inhabited to some extent by Nordic

immigrants. It turns out, as shown in Figure 3, that the North American countries in the sample are all wealthier than the four Nordic countries and that the oil-rich Canadian provinces are wealthier than oil-rich Norway.⁴² In many ways, the quality of life is also as good or even better in those three North American states and provinces as in the Nordic countries.

In the late 1970s and 1980s the Swedish economy slowed down. Economic problems mounted. Reluctantly, the Social Democrats started some reforms, deregulating credit and foreign exchange markets and changing the tax system, lowering marginal income tax from 73% to 51% and the capital gains tax to 30%. In 1991 a non-socialist government was voted in again. Now it was also anti-socialist, and it immediately abolished the wage earner funds, transferring the money which had accumulated there to pension funds and research institutes. It also continued deregulation: energy, postal, telephone, railway, and airline markets were all deregulated. Public opinion in Sweden was now changing. Leaders of the business community, faced by the threat of gradual expropriation, had decided that they had to support the intellectual defence of the free society, cogently provided by thinkers such as Ludwig von Mises, Friedrich A. Hayek, and Milton Friedman.

³⁷ Ibid., pp. 58–60.

³⁸ Data on the US and Sweden, OECD 2009. GDP per capita: US\$, using current PPPs, in OECD in Figures. Paris: OECD Publishing. Data on Swedish-Americans, Nima Sanandaji, The surprising ingredients of Swedish success – free markets and social cohesion. (London: Institute of Economic Affairs, 2012), p. 21.

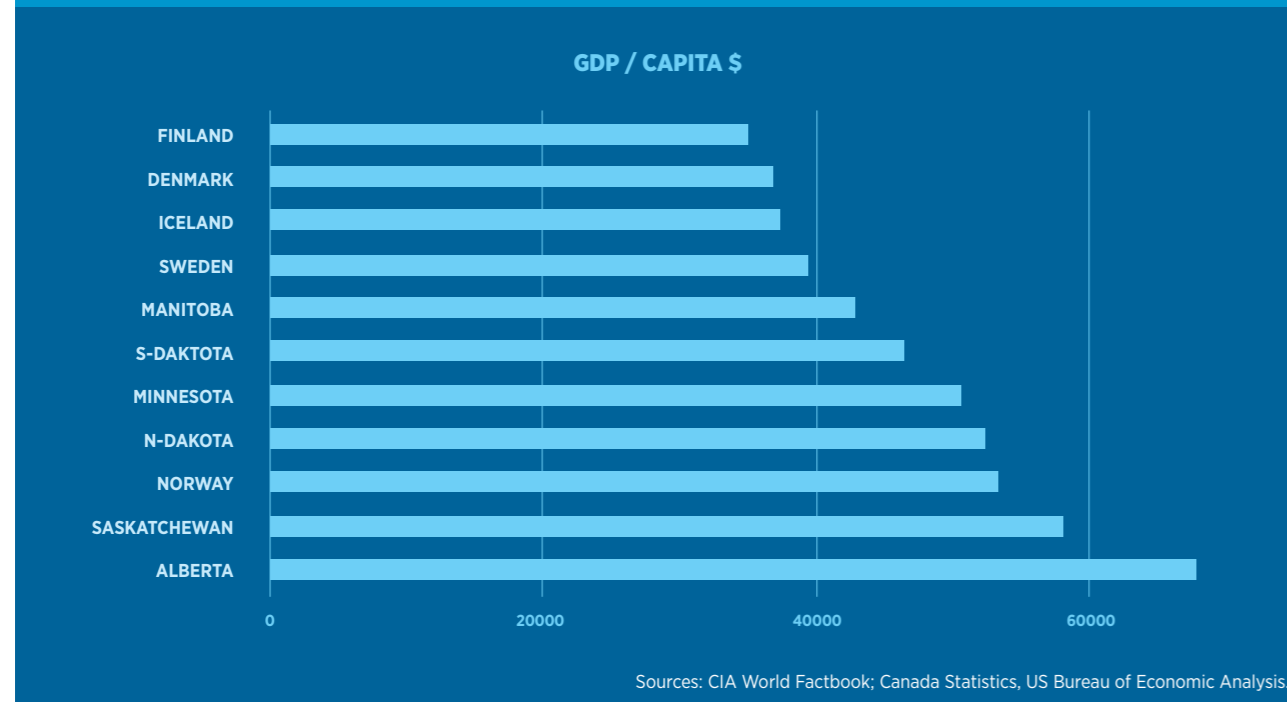
³⁹ Nima Sanandaji, Scandinavian Unexceptionalism, pp. 61–4.

⁴⁰ Purchasing Power Parity Converted GDP Per Capita Relative to the United States, G-K method, at current prices for Sweden. Federal Reserve Bank of St. Louis, Economic Research, website.

⁴¹ Fredrik Bergström and Robert Gidehag, EU versus USA (Stockholm: Timbro, 2004), <http://www.timbro.se/bokhandel/pdf/9175665646.pdf> Fredrik Bergström, Europe versus the USA, Cutting Taxes to Increase Prosperity, eds. Hannes H. Gissurarson and Tryggvi Thor Herbertsson (Reykjavik: Bokafelagid, 2007), pp. 41–60.

⁴² Canadian data (Table A.34 gross domestic product per capita, provinces and territories, in current dollars) from Canada Statistics for 2009–2010. The data are in C\$ which was then almost equal to US\$. See www.statcan.gc.ca Data on Nordic countries from CIA World Factbook (GDP per Capita, PPP, USD) 2010. Data on states in the US from J. E. Avery, T. P. Siebeneck and R. P. Tate, Gross Domestic Product by State. Advance Statistics for 2010 and Revised Statistics for 2007–2009. Price level 2010. Bureau of Economic Analysis (2011). See www.bea.gov

FIGURE 3 ELEVEN NORDIC ECONOMIES



Suddenly, old Professor Sven Rydenfelt ceased to be a voice in the wilderness and became, if not exactly a prophet in his country, at least somewhat of an icon for a new generation of liberals. One of them, Johan Norberg (b. 1973), dedicated his history of Swedish liberalism to Rydenfelt. In 1978, Sture Eskilsson (1930-2016) from the Confederation of Swedish Enterprise was instrumental in founding the publishing house and think tank Timbro which started to revive the Swedish liberal tradition, by republishing classics, Swedish and foreign, commissioning books and reports by Swedish authors and holding conferences and other events. An offshoot from Timbro, Ratio Institute, became independent in 2002 and specialises in academic research, whereas Timbro is more policy-orientated. Swedish liberals have organised two regional conferences in Stockholm of the Mont Pelerin Society, in 1981 and 2009, and Swedish liberal Dr. Carl-Johan Westholm (b. 1947) was long the Society's Secretary. Some renowned intellectuals also forcefully spoke up about the domination of the Left in Swedish social discourse: in 1981, the philosopher Lars Gustafsson (1936-2016) published 'For Liberalism', criticizing collectivist trends in Swedish society and analysing attempts of the Left to set the agenda and choose the use of words: the Left had grabbed

the privilege to formulate the problems, as he put it.⁴³ In 1994, Per Ahlmark (b. 1939), former leader of the People's Party, wrote 'The Left and Tyranny', documenting how prominent left-wing intellectuals ignored, or even defended, violence perpetrated by socialist movements and systematic oppression in socialist countries.⁴⁴

The 1991-1994 centre-right government faced a severe banking crisis, with interest rates temporarily going up to 500% in 1992 and a great depreciation of the *krona*. Open unemployment went up to 8.2%, and the budget deficit increased to around 8% of GDP. For a while, public expenditures were no less than 73% of GDP.⁴⁵ The economy had stopped growing and actually contracted in 1991-1993. The centre-right government responded to the problems, again in a typical Swedish fashion, by working with the social democratic opposition which could not but admit that some cuts in welfare benefits were necessary. The government introduced school vouchers, sold state-owned companies, and carried out reforms in the labour market, especially designed for small businesses and private job agencies. The government also allowed for some choice in health care and assistance to the elderly. Even when the Social Democrats returned to power in 1994, it was widely accepted that liberal reforms had to

⁴³ Lars Gustafsson, *För liberalism: En stridsskrift* (Stockholm: Albert Bonnier, 1981).

⁴⁴ Per Ahlmark, *Vänstern och tyranniet: det galna kvartsseket* (Stockholm: Timbro, 1994).

⁴⁵ The data, as well as the description below, are from Nils Karlson's lecture in Iceland, <http://www.rnh.is/?p=2642>



be continued. The central bank was made independent; the budget process was reformed; welfare benefits were cut; a new pension system was established, partly with self-funded pensions; collective bargaining was reformed; the inheritance tax was abolished. The centre-right government which was in power 2006-2014 continued liberalising the Swedish economy: the wealth tax was abolished, tax credits were given on earned income, tax deductions were allowed for 'household services', choice in health care and in assistance to the elderly was increased, property rights were strengthened, and the corporate tax was cut to 22%. The Social Democrats who came back into power in 2014 have not tried to reverse these changes.

In the 1990s and 2000s, the Swedish economy was liberalised more than almost any comparable economy in the world, as seen by the index of economic freedom and other criteria. A third Swedish

model was emerging. Individual responsibility and choice have been extended, taxes and welfare benefits have been reduced; markets have been deregulated, companies have been privatised, and private provision of publicly financed welfare services has been introduced. The ideal has however not been abandoned of a safety net where every citizen is guaranteed access to welfare services, even if he or she was unable to pay for them. This new and liberal Swedish model was largely brought about unintentionally by pragmatic responses to the crisis of the unrestrained high-tax welfare state, but it enjoys wide support. It shows the self-corrective ability of Swedish society. Many problems remain however: even if taxes have been reduced, they are still high; the labour market is heavily regulated; housing is also strictly regulated so that there is little construction and low mobility; and freedom of enterprise, especially in services, is restricted. •

4

ECONOMIC LIBERALISM IN DENMARK AND NORWAY

In the 18th century, while Sweden and Finland were ruled together from Stockholm, Denmark and Norway were two distinct kingdoms, both under the same king who also reigned over the old Norwegian tributaries in the North Atlantic Ocean: Iceland, the Faroe Islands, and Greenland. After humiliating defeats against Sweden in mid-17th century, the Danish king had assumed absolute power, and Denmark-Norway was, on paper at least, one of the most despotic powers in Europe. However, a natural law tradition was strong and courts were relatively independent. In 1770 a German reformer, Johann Friedrich Struensee, who was personal doctor to the insane Danish king as well as the queen's lover (as the 2012 film 'A Royal Affair' describes), took power and initiated a series of reforms, abolishing censorship and introducing freedom of the press. Struensee's rule lasted for less than two years, but censorship was not re-established, and in 1784 a new reformist government took power in Denmark. It initiated agrarian reforms, including the abolition of a bond of domicile for peasants, increased security of tenure for peasants, the facilitation of land enclosure, and the sale of farms to peasants.⁴⁶ A class of independent farmers emerged. The reforms came from above. Danish high officials were influenced by the ideas of freedom and progress then being promoted in Europe: Adam Smith's 'Wealth of Nations' was translated into Danish already in 1779. In 1797, a new tariff stipulation abolished some economic controls in Denmark and the southern part of Norway and lowered tariffs.

In 1814, the ties between Denmark and Norway were severed when a coalition led by Great Britain and Russia defeated Napoleon and gave Norway to Sweden in compensation for Finland, which Russia had annexed. The Norwegians rebelled against

Swedish rule, proclaimed a Norwegian kingdom under a Danish prince and adopted a liberal constitution at Eidsvoll 17 May 1814. While the Swedes suppressed the rebellion by force, they decided to grant Norway self-rule under the Eidsvoll constitution with only minor changes. Norway became a kingdom in personal union with Sweden. The Eidsvoll constitution, with separation of powers, guarantees of the freedom of the press, association, religion, and contract, and protection of private property rights, was a crucial document in the history of Norwegian liberalism.⁴⁷ Interestingly, the Swedes did not lay a claim to the old Norwegian tributaries in the North Atlantic Ocean, which remained under Danish rule. For most of the 19th century, Norway was governed by an enlightened elite of high officials sympathetic to the liberal principles of free trade and free press, but suspicious of unlimited democracy. The bureaucrats in power were opposed by farmers who however sometimes took liberal positions themselves, especially when opposing high taxes and regulation. The most prominent liberals of this period were Anton Martin Schweigaard (1808–1870) and Frederik Stang (1808–1884). Schweigaard was member of parliament in 1842–1869 and influential in politics, even if he chose not to take up a political office. He was Professor of Social Economics at Christiania (now Oslo) University. As alternatively a government minister and high official in 1845–1880, and Prime Minister in 1873–1880, Stang was tireless in modernising Norway. In 1884, parliamentarianism was recognised in Norway and the farmers wrested power from the high officials. Economic liberalism nevertheless prevailed in theory and practice in Norway until the First World War. In Denmark, enlightened despotism was brought to an end in 1849 when the king relinquished his

⁴⁶ Karen J. Friedmann, *Bureaucracy, Land Reform, and Technological Progress: Denmark, 1755–1810*, Food Research Studies, Vol. XVII (2: 1979), pp. 219–234.

⁴⁷ For the short account here of Norwegian liberalism, I am indebted to Øystein Sørensen, *Liberalismens historie i Norge: Noen hovedlinjer, Ideer om frihet*, Vol. 7 (1–2: 1991), <http://www.idealomfrihet.no/1991-7-sorensen.php>



absolute power and a liberal constitution was adopted on 5 June, with separation of powers and freedom of the press, religion, association, and contract. The dominant party, the National-Liberals, were liberal as the name suggests, but Danish politics were complicated because of the thorny question of the two duchies of Schleswig and Holstein, where the Danish king was duke. The population of Holstein was German-speaking and the duchy was a member state of the German Federation, whereas Schleswig was divided between a Danish-speaking population in the northern part and a German-speaking one in the southern part. The National-Liberals wanted to maintain the union of Schleswig and Denmark, but were content to sever the ties with Holstein. When they tried to implement their policy, a war broke

out between Denmark and the German Federation, led by Prussia, resulting in the resounding defeat in 1864 of Denmark and the loss of both Schleswig and Holstein. The defeat was traumatic for the Danish nation, coming after the loss of Norway to Sweden in 1814 and of several territories earlier to Sweden. The National-Liberals were totally discredited and conservatives took power. Nevertheless, liberal ideas remained strong in Denmark. Government ministers and high officials, while distrustful of democracy, firmly supported free trade, sound money, and the rule of law. The poet Holst expressed a widespread feeling in the country in a poem with the words, 'What is lost outside has to be regained inside.'⁴⁸ This was a sentiment similar to that of Tegnér after Sweden lost Finland in 1809: the lost territory had to be

⁴⁸ In Danish: "hvad udad tabtes, det må indad vindes." Holst wrote this for an industrial exposition in Copenhagen in 1872.

regained within the Swedish borders, by progress and growth. The Danes abandoned all dreams of military conquests and focused on agriculture, industry, and trade. With the loss of Norway, Holstein, and the southern part of Schleswig they had also become a homogenous nation. (In 1920, after Germany's defeat in the First World War, Denmark regained the northern and Danish-speaking part of Schleswig.)

In Denmark, many committed economic liberals were influential in the 19th century. Oluf Christian Olufsen (1764–1827) was Professor of Economics at the University of Copenhagen and a disciple of Adam Smith. Christian G. Nathan David (1793–1874) was an economist and politician. Jewish by birth, he converted to Christianity in 1830 and was in the same year appointed Professor of Economics at the University of Copenhagen. He lost his job six years later for his strong criticisms of the government. Later David became more conservative in politics, remaining however an economic liberal. He said that he was as much or even more against modern absolutism wearing wool as the ancient one dressed up in purple.⁴⁹ David was for a while Governor of the National Bank and later Finance Minister. Four other professors of economics at the University of Copenhagen, Carl Johan H. Kayser (1811–1870), Niels Christian Frederiksen (1840–1905), William Scharling (1837–1911) and Vigand A. Falbe-Hansen (1841–1932), also argued for liberal ideas, both as teachers and as members of parliament. In particular, Kayser and Frederiksen were inspired by the French economist Frédéric Bastiat.⁵⁰ In 1901, parliamentarianism was recognised in Denmark and the Left Party (*Venstre*) replaced the conservatives in government. Agricultural products were Denmark's main exports and the Left Party, deriving much of its support from farmers, was strongly for free trade. There was also a significant liberal faction in the Conservative Party, and the two parties drew gradually closer to each other as the Social Democratic Party, founded in 1871, grew, claiming to represent the working class. In 1924, the Social Democrats became Denmark's largest party, forming their first government which lasted for two years. Then Thomas Madsen-Mygdal (1876–1943), the leader of the Left Party and a committed

liberal, formed a government. Tall, eloquent and uncompromising, Madsen-Mygdal was known for his fierce opposition to government subsidies: 'Let that which cannot stand on its own, fall down' was his favourite expression.⁵¹ The Social Democrats again formed a government in 1929 and then led various governments, sometimes in coalitions and sometimes in minority, until 1968, with only three short exceptions, in the special circumstances of the German occupation in 1942–5, and by governments of the Left in 1945–7 and in 1950–3.

Friedrich A. Hayek's warning against socialism, 'Road to Serfdom', had an impact both in Norway and in Denmark. In Norway, the most prominent liberal in the 1940s and 1950s was Dr. Trygve Hoff (1895–1982), who had written his dissertation on Mises' and Hayek's arguments against central economic planning. Between 1935 and 1966, Hoff was editor of the widely-read business magazine *Farmand*, and in 1945 he published a book about his liberal principles, 'Peace and the Future'.⁵² It was partly written when Hoff, as adamantly opposed to national socialism as to communism, was imprisoned by the German occupation force. The Norwegian business community was also apprehensive about the advance of socialism and in 1947 some businessmen founded the organisation Libertas, whose purpose it was to promote liberal ideas and fight socialism. However, both Hoff and Libertas were outside the Norwegian mainstream in the 1950s and the 1960s, and even the Rightwing Party (*Høyre*) sought to distance itself from Libertas. In Denmark, the distinguished Economics Professor Carl Iversen (1899–1978) was sympathetic to liberalism, but confined himself mostly to technical economics and administration and never argued publicly for liberal ideas. Both Hoff and Iversen attended the first meeting of the Mont Pelerin Society, which Hayek founded in Switzerland in the spring of 1947, and became active members, especially Hoff. In Denmark, like Norway, the business community was apprehensive about the radical ideas espoused immediately after the war by the Social Democrats, not to speak of the communists, and in 1945 some businessmen founded the Enterprise Information Council. The economist Christian Gandil (1907–1999) was hired as its director. One of his first

projects was to have Hayek's 'Road to Serfdom' translated into Danish.⁵³ Gandil joined the Mont Pelerin Society in 1948 and remained a committed liberal throughout his life. But gradually he lost his Danish audience. He was regarded more as an ideologue than a serious writer and was even nicknamed Propa-Gandil in the press. He found however some solace in the Mont Pelerin Society, being the only member who attended all its meetings after its foundation and until 1986. Gandil also wrote poetry where he expressed his sense of isolation.⁵⁴

While institutions and general attitudes in Denmark and Norway were probably no less liberal than in Sweden, both countries lacked the strong intellectual liberal tradition which Gustav Cassel and Eli Heckscher, both internationally renowned economists, represented. (Because of her historical and political circumstances and its non-Nordic language, Finland was more of a special case.) However, in the last quarter of the 20th century, liberalism underwent a remarkable revival both in Denmark and in Norway, although in neither case it was as well-organised and well-funded as in Sweden. Between 1980 and 2001 in Norway a group of young liberals published the magazine *Ideas on Freedom*, promoting the ideas of Ludwig von Mises, Friedrich A. Hayek, Ayn Rand, Milton Friedman, James M. Buchanan, and Robert Nozick. The publishers included History Professor Øystein Sørensen (b. 1954), who has since been a prolific writer on political ideas in Norwegian, and economist Lars Peder Nordbakken (b. 1957), who is an independent consultant but works also for Civita, a think tank started in 2003, partly with funds received from the old foundation Libertas which ceased to operate in 1988. Civita is active in supporting the publication of books on liberal themes and in organising events.⁵⁵

In Denmark, Christian Gandil was a voice in the wilderness, like Trygve Hoff in Norway and Sven Rydenfelt in Sweden. Even if the distinguished Economics Professor and politician Thorkil Kristensen (1899–1989), Finance Minister in 1945–7 and again in 1950–3, accepted Hayek's invitation to become

a member of the Mont Pelerin Society, he was, perhaps out of necessity, more sympathetic to 'social liberalism' than the modern version of classical liberalism, espoused by Hayek. However, there were some efforts to counter the overwhelming dominance of socialism in Danish intellectual life. Poul A. Jørgensen (1934–1996), a school teacher with a strong interest in liberalism, started a small publishing house in 1977. He produced reprints of classic books such as the Danish translation of Friedrich A. Hayek's 'Road to Serfdom' and some original texts in Danish, including a book on John Rawls and Robert Nozick by Philosophy Professor Justus Hartnack (1912–2005), a liberal who left his professorship in Aarhus in disgust over student rebellions and Marxist effrontery, accepting a position at City College in New York.⁵⁶ Jørgensen sold his operation to a group of young liberals that started publishing a magazine called *Libertas* in 1982 and established an organisation under the same name in 1986. The group included economist Otto Brøns Petersen (b. 1961) who became a high official in the Ministry of Taxation, and Peter Kurrild Klitgaard (b. 1966), who became Professor of Economics at the University of Copenhagen. Both were influenced mainly by the Austrian School of Economics and James M. Buchanan's Public Choice School. The *Libertas* magazine published many articles about classical and modern liberalism. After a few years of little activity, Libertas was in 2005 replaced by the think tank CEPOS, Centre for Political Studies, where both Brøns Petersen and Kurrild Klitgaard are involved. CEPOS has become an active forum for liberal ideas in Denmark, publishing a lot of books and commissioned reports. It focuses on problems of the welfare state, as seems appropriate in Denmark.⁵⁷ At present, despite some disappointments in the political arena, liberal institutes are flourishing both in Norway and Denmark and providing support and encouragement to many liberal scholars. Social Democrats have lost their once-dominant position in the politics of the two countries and liberalism is no longer marginalised, as was the case in the second and third quarters of the 20th century. Nordbakken in Norway and Kurrild Klitgaard and Brøns Petersen in Denmark are all members of the Mont Pelerin Society. •

⁴⁹ Helge Larsen, C. N. David, Dansk Biografisk Leksikon, <http://denstoredanske.dk/index.php?sideid=288737>

⁵⁰ For the short account here of Danish liberalism, I am indebted to Peter Kurrild Klitgaard, *Classical Liberalism and Modern Political Economy in Denmark*, *Econ Journal Watch*, Vol. 12 (3: September 2015), pp. 400–31.

⁵¹ Helge Larsen, Thomas Madsen-Mygdal, Dansk Biografisk Leksikon, <http://denstoredanske.dk/index.php?sideid=294012>

⁵² Trygve Hoff, *Fred og fremtid: liberokratiets vei* (Oslo: Aschehoug, 1945).

⁵³ Friedrich A. Hayek, *Vejen til trældom* (København: Gyldendal, 1946).

⁵⁴ Niklas Olsen, *A Second-Hand Dealer in Ideas: Christian Gandil and Scandinavian Configuration of European Liberalism, 1945–1970, Re-Inventing Western Civilisation: Transnational Reconstructions of Liberalism in Europe in the Twentieth Century*, eds. Hagen Schulz-Forberg and Niklas Olsen (Cambridge: Cambridge Scholars Publishing, 2014), pp. 137–67.

⁵⁵ More information is available at the website, <https://www.civita.no/en>

⁵⁶ Justus Hartnack, *Menneskerettigheder: grundlæggende politiske begreber og forhold i ny belysning* (Haarby: Forlaget i Haarby, 1980).

⁵⁷ More information is available at the website <https://cepos.dk/english>

5

ICELAND: PRIVATE ENFORCEMENT OF LAW

The smallest Nordic country, Iceland, is a remote island with a tiny population, so an independent and sophisticated liberal tradition is not to be expected there. Nevertheless, the Icelanders have developed some interesting institutions facilitating individual choice and responsibility. The island was settled in 874–930, mostly from Western Norway. One reason why it was settled relatively quickly was that in Norway, a local chieftain by the name of Harald had in 872 conquered the whole of the country and established a kingdom, driving out those of his enemies whom he did not kill. It may be argued, therefore, that Iceland was the first ‘tax haven’, settled by individualists who did not want to pay tax and subject themselves in other ways to an alien king. An anecdote in one of the Icelandic sagas, ‘The Saga of the People of Vatnsdalur’, probably written in late 13th century, illustrates this. Two Norwegians are discussing the newly discovered island. One of them, Grim, announces his intention to settle there, because the climate is, he says, ideal for rearing sheep, the lakes and rivers are full of fish, there is plenty of wood there, and ‘men are free from the assaults of kings and criminals’.⁵⁸ In Grim’s mind, kings and criminals obviously belonged in the same category. Another telling example is found in ‘The Saga of Grettir the Strong’, probably also written in late 13th century. An old Viking, Onund the Tree-foot (so named because he had lost one foot in a battle), is reluctant to return to Norway. ‘He had no intention of becoming the king’s slave, he said, and begging for what he had

previously owned himself, but would rather find another place to establish himself.’⁵⁹ Here the idea of independence and autonomy is clear: Onund did not want to beg for what was rightfully his; he was a free man, not the king’s slave.

A third example of the sturdy individualism of the Icelanders is a short story in the ‘Book of Settlements’, written in early 12th century:

“ Steinunn the Old, Ingolf’s kinswoman, went to Iceland and stayed with him the first winter. He offered to give her the whole of Rosmhvalanes, west of Hvassahraun, but she paid for it with a spotted coat and called it an exchange. She thought this would make it more difficult to break the arrangement.”⁶⁰

Steinunn wanted to deal with her kinsman Ingolfur as an equal, and this she could do if she paid a price, however low, for the land she acquired from him instead of accepting it as a gift, which could, as she pointed out, be withdrawn. This contrast between insisting on a right and accepting a favour is encountered in many other Icelandic sagas and chronicles.

Probably the Icelandic farmers early on had formed local assemblies and local courts to resolve disputes, as had been the custom of German tribes for millennia, but in 930 they decided to establish what has later been called the ‘Icelandic Commonwealth’ stretching



over the whole of the country.⁶¹ The Commonwealth was remarkable in that it constituted order without government. The founders agreed upon a body of law that would apply to all, but where enforcement was essentially private. The law was interpreted and developed by the Law Council (logretta) consisting of 39 chieftains (godar) meeting every summer at Thingvellir, an uninhabited place in the Southwest of Iceland and probably the easiest place to get to from all corners of the country. The aim of the Law Council was not to create new law, but rather to discover the good, old law, inherited by generations down the centuries, unwritten, but preserved in memory. If a piece of genuinely new law was to be passed, it required unanimous agreement in the Law Council.⁶² The only elected official of the Commonwealth was the Law-speaker, a chieftain chosen for his thorough knowledge of the law. He was required to recite a part of the law publicly each year at Thingvellir. The chieftains were farmers, usually affluent and from respected families, and probably in pagan times performing religious functions as well. The chieftains also nominated their fellow farmers to the four farthing courts, one in each of the four farthings, or quarters, into which the whole country was divided. Those cases which were not resolved in a farthing court were brought to Thingvellir where the ‘Fifth Court’ (fimmtardomur) sat at the same time in the summer as the Law Council.

A chieftainship was a commodity. It was inherited, but it could also be bought and sold, or given. Every farmer had to belong to a chieftainship, or in other words to declare his allegiance to a chieftain, but he could

choose between chieftains in his farthing. Thus, the chieftainships were not strictly geographically defined, but were formed by choice rather like modern security firms. A chieftain acted like a protector and ally of his ‘subjects’ or farmers who had declared their allegiance to him. The main problem of stateless societies, that the weak enjoy little or no protection from the strong or the wicked, was solved, or at least reduced, in Iceland by three means. First, of course, an individual farmer was protected by his family. Marriages were seen not primarily as love affairs, but rather as family alliances to strengthen this kind of protection. Some of the dramas in the Icelandic sagas indeed arose when those two considerations came into conflict. In the second place, the farmer would expect protection from his chieftain. Thirdly, individual cases could be transferred from a weaker to a stronger person, for example from a poor smallholder to a rich and powerful farmer. Then the stronger person undertook to enforce claims or court decisions on behalf of the weaker one, probably for a fee. Punishments were mainly based on restitution: if a man was killed, for example, the perpetrator had to pay damages to his kinsmen.

From the beginning, the Icelandic Commonwealth was considered quite remarkable, even unique. Already in the 11th century the German chronicler Adam from Bremen wrote about the Icelanders: ‘*Apud illos non est rex, nisi tantum lex.*’ They have no king but the law.⁶³ More recently, Professor David Friedman has said that the institutions of the Icelandic Commonwealth ‘might almost have been invented by a mad economist to test the length to which market systems could supplant

⁵⁸ The Saga of the People of Vatnsdal, Ch. 10. The Complete Sagas of Icelanders, Vol. IV, ed. Vidar Hreinsson (Reykjavik: Leifur Eiriksson Publishing, 1997), p. 15.

⁵⁹ The Saga of Grettir the Strong, Ch. 3. The Complete Sagas of Icelanders, Vol. II, ed. Vidar Hreinsson (Reykjavik: Leifur Eiriksson Publishing, 1997), p. 51.

⁶⁰ The Book of Settlements, tr. by Hermann Palsson and Paul Edwards, ed. by Hermann Palsson (Winnipeg: University of Manitoba Press 2007), §394, p. 146.

⁶¹ Birgir Thor Runolfsson, Institutional Evolution in the Icelandic Commonwealth, Constitutional Political Economy, Vol. 4 (1: 1993), pp. 97–125.

⁶² Sigurdur Lindal, Law and Legislation in the Icelandic Commonwealth, Journal of Scandinavian Law, Vol. 37 (1993), pp. 53–92.

⁶³ Adami Gesta Hamburgensis ecclesiae pontificum (1072–80), Book IV.

government in its most fundamental functions.⁶⁴ Friedman argues that pricing of crime was relatively efficient in the Icelandic Commonwealth. He also points out that even if modern man may regard the Icelandic Commonwealth as primitive and violent, it was not necessarily so in comparison with European states at the time, where large armies drafted by kings and emperors were engaged in seemingly endless wars while violence was rampant. Moreover, the Icelandic Commonwealth produced impressive literature, not only the sagas and the Eddas, but also interesting historical works such as Snorri Sturluson's account of the lives and times of the Norwegian kings, written in brisk and lucid prose and without the servile attitude towards the king and his courtiers often found in contemporary European chronicles.

However, those who stress the choice that individual farmers had between chieftainships in the Icelandic Commonwealth, or the absence of oppressive centralised power, should not overlook the involuntary character of the other main institution under which every Icelandic farmer had to live. It was a rural community called *hreppur*, usually demarcated by the high mountains surrounding the river valleys. (Possibly the word refers to the terrain or range of land that a man on foot could walk across without difficulties: the Icelandic verb *hreppa* means to seize or to gain.) There was no choice between those rural communities and there had to be at least twenty farmers in each of them. This was because those rural municipalities were essentially mutual insurance companies. If the house of a farmer burnt down or if his livestock suffered from deadly disease, the other farmers had to help him. The insurance task understandably required a minimum number of participants. These rural municipalities also administered the adjacent mountain pastures which were held in common. The sheep were driven there in spring to graze and collected back in the autumn. The utilisation of the mountain pastures was also a common task, defined by location. Economics Professor Thrainn Eggertsson has argued that this was an efficient institution. Every farmer was allocated a quota, or a given number of sheep he could drive into the mountains in spring, where the total number of allowable sheep in each pasture was determined in such a way, according

to the law, that the sheep was as fat as it could be when collected in the autumn. What was maximised, correctly from an economic point of view, was the yield from those mountain pastures.⁶⁵

A separate Icelandic identity, based not least on the deep suspicion of kings that is also encountered in the sagas, is stressed in a tale told by Snorri Sturluson. In 1024, an Icelander working for king Olav the Fat of Norway was sent to Iceland to bring the king's greetings to the Icelanders and to inform them that the king was willing to be their sovereign if they wanted to be his subjects. The emissary, Thorarinn Nefjolfsson, arrived when Parliament was in session at Thingvellir. He delivered the king's greetings to the Icelanders and his tentative offer of becoming their sovereign, but also more concretely he asked the Icelanders to give the island of Grimsey north of Iceland to the king and then the king would reciprocate their generosity. The farmers of the North called a meeting to discuss this. One of them, Einar Eyjolfsson from Thvera, was asked why he kept silent about the matter. He replied that nobody had asked him for his opinion which was however clear: that the Icelanders should remain friends of the king, but that they should not at all become his subjects, undertaking to pay the same heavy taxes as the Norwegians:

“ [T]his heavy burden we will lay not only upon ourselves, but on our sons, and their sons, and all our race, and on all the community dwelling and living in this land, which never after will be free from this slavery. Now although this king is a good man, as I well believe him to be, yet it must be hereafter, when kings succeed each other, that some will be good, and some bad. Therefore if the people of this country will preserve the freedom they have enjoyed since the land was first inhabited, it is not advisable to give the king the smallest spot to fasten himself upon the country by, and not to give him any kind of tax or service that can have the appearance of a duty. On the other hand, I think it very proper that the people send the king such friendly presents of hawks or horses, tents or sails, or such things which are suitable gifts; and these are well applied if they are repaid with friendship.⁶⁶



This speech probably owes more to Snorri Sturluson in 1225 or thereabout than to the farmer Einar Eyjolfsson from Thvera two centuries earlier, in 1024. Nevertheless, it illustrates a clear awareness by the Icelanders of their separate collective identity and their suspicion of kings, especially the royal propensity to lay heavy taxes on the people.

The Icelandic Commonwealth was based upon a delicate balance of power between the 39 chieftains. After taxation was introduced in 1096 by the resolute and influential bishop Gissur Isleifsson, however, this balance was gradually upset. Chieftains who built churches on their farms were largely exempt from the tax, and they began to accumulate great wealth. In early 13th century, many chieftainships had been merged, finally ending up under the control of only five families that started fighting for supremacy over the whole country. At the same time, a strong and aggressive king, Haakon the Old, had assumed power in Norway. He sought to extend his reign to

all Norse settlements in the North Atlantic, from Greenland through Iceland to the Faroe Islands, the Orkneys, Shetland, the Hebrides and the Isle of Man. Mixing favours with threats, he gained many allies in Iceland who, as Thorarinn Nefjolfsson two centuries earlier, argued that Iceland needed a king. When Snorri Sturluson proved reluctant to obey him, King Haakon ordered one of his Icelandic allies, the cunning chieftain Gissur Thorvaldsson from the Haukdaelir family, to kill Sturluson, which he did in 1241. In the next two decades, after violent conflicts, Thorvaldsson emerged as victor. By then, some Icelandic farmers had however had more than enough of rulers, as can be surmised from 'Sturlunga', a compilation of historical accounts from the 12th and 13th century. For example, when Thorgils Bodvarsson from the Sturlungar family in 1255 asked a meeting of farmers at Vallalaug in Skagafjörður for acceptance as their ruler, one farmer, Broddi Thorleifsson from Hof, wearily said: 'If I have to serve a master, then I would choose Thorgils Bodvarsson, but it would be best to

⁶⁴ David Friedman, Private Creation and Enforcement of Law: A Historical Case, *Journal of Legal Studies*, Vol. 8 (2: 1979), pp. 399–415.

⁶⁵ Thrainn Eggertsson, Analyzing Institutional Successes and Failures: A Millennium of Common Mountain Pastures in Iceland, *International Review of Law and Economics*, Vol. 12 (1992), pp. 423–437.

⁶⁶ Snorri Sturluson, *Saga of King Olaf Haraldsson the Saint*, *Heimskringla*, Vol. II, Ch. CXXXIV (London: Longman, Brown, Green and Longmans, 1844), p. 188. Translated by Samuel Laing.

have no master if that were possible.' When another chieftain, Thorvard Thorarinsson from the Svinfellingar family, and supported by the Sturlungar, the same year asked an assembly of farmers at Djupadalsa in Eyjafjordur for acceptance as their ruler, one farmer, Thorvard Thordarson from Saurbaer in Eyjafjordur, said: 'I find the present ruler acceptable, but it would be best to have no rulers at all.'⁶⁷

In 1258 Gissur Thorvaldsson was given the title of Earl of Iceland by King Haakon with the explicit mission to bring Iceland under the Norwegian crown. According to a contemporary account, after Icelandic farmers learned in 1261 of Thorvaldsson's commitment to make Iceland a Norwegian tributary, they 'promised the Earl a huge amount of money in order to relieve them of the payment that was demanded.'

But Thorvaldsson went at great length to persuade the farmers to swear allegiance to the king, going so far as to calling 'it a plot against his own life if they did not accept.'⁶⁸ In 1262, the Icelanders finally gave in, despite their deep-seated distrust of kings, and agreed to a Covenant between themselves and the Norwegian king whereby they became his subjects. Fearing that the king would try to isolate them, the Icelanders stipulated that at least six ships should sail from Norway to Iceland in the next two summers and after that as many as the king 'and the most judicious farmers in Iceland' believed to be in the best interest of the country. They also stipulated that the king would let them 'enjoy peace and the Icelandic laws' and that they would be free of all obligation if the king broke the Covenant.⁶⁹ A nascent social contract theory constraining the ruler and creating the possibility of exit can be seen in these stipulations. •

6

THE LIBERAL AWAKENING: JON SIGURDSSON



If the Icelanders thought that they had obtained a shelter by yielding their country to the Norwegian crown, then they would be greatly disappointed because they found themselves in a trap. As a result of innovations in shipbuilding technology, in the early 15th century English fishermen started to harvest fish in the Icelandic waters and to trade with the Icelanders. This should have opened several possibilities for Iceland of developing her fisheries and trading with foreigners. But now the Norwegian and Danish crowns had been united, and the Danish king was quick to prohibit all trade with foreigners, although it proved difficult to uphold his authority in the remote island: in 1467, English fishermen and traders even killed the crown's governor of Iceland. Thrice in the 16th century, the Danish king offered to sell Iceland to his English counterpart, the notorious Henry VIII, who was however not interested.⁷⁰ The present writer has calculated that the price the king wanted for the country was approximately six million dollars (in 2017 dollars).⁷¹

But slowly the Danish king reestablished his authority in Iceland and imposed a total Danish monopoly of foreign trade. In alliance with the domestic landowning class, the Danish crown outlawed fishing and trade as full-time occupations: every able-bodied person had to be either a farmer or a dependent of a farmer or a farmhand, registered in one of the roughly 5,000 farms of the country. As a consequence, the paradox arose that the Icelanders often went hungry even if they were surrounded by some of the most fertile fishing grounds of the world.⁷² In mid-16th century, the Danish king imposed the Reformation on Iceland and seized many church properties, and in 1662 he forced the Icelanders to accept the absolute power that he had already established in Denmark. The country was ravaged by cold spells, volcanic eruptions, earthquakes, epidemics, famines, and economic isolation, with the population going down to around 35,000 in 1785 and the Danish government seriously considering evacuating it to another Danish territory.⁷³

⁶⁷ Thorgils saga skarda, Sturlunga, Ch. 452 (Reykjavik: Svart a hvitu, 1988).

⁶⁸ Sturla Thordarson, Hakonar saga Hakonarsonar (Oslo: Forlagsentralen, 1977), Ch. 311, pp. 189–90. Translated by Gunnar Karlsson. Quoted after Karlsson's History of Iceland (Minneapolis: University of Minnesota Press, 2000), p. 85.

⁶⁹ The Covenant is reprinted in Gunnar Karlsson, A History of Iceland pp. 83–4.

⁷⁰ Bjorn Thorsteinsson, Henry VIII and Iceland, Saga-Book, Vol. XV (London: Viking Society for Northern Research, University College, 1957–61), pp. 67–101.

⁷¹ Hannes H. Gissurarson, Proposals to Sell, Annex or Evacuate Iceland, 1518–1868, Rannsóknir i felagsvisindum, Vol. XVI (2015), online at <http://skemman.is/item/view/1946/23162>

⁷² Thrainn Eggertsson, No experiments, monumental disasters: Why it took a thousand years to develop a specialized fishing industry in Iceland, Journal of Economic Behavior & Organisation, Vol. 30 (1996), pp. 1–23.

⁷³ Anna Agnarsdottir, Scottish Plans for the Annexation of Iceland 1785–1813, Northern Studies, Vol. 29 (1992), pp. 87.

The severe economic crisis in late 18th century marked however the downfall of the old landowning class and consequently the passing of its stranglehold over the economy.⁷⁴ Under the influence of liberal ideas, the Danish government abolished the monopoly trade, and farms belonging to the church and the crown were sold, creating a new class of independent farmers, alongside a few intellectuals, officials, merchants, and even full-time fishermen. It was into this emerging new society that Iceland's first liberal leader, Jon Sigurdsson (1811-1883), was born. A pastor's son from the Western Fjords, in 1833 he went to Denmark to study philology at the University of Copenhagen. He soon became an expert on Icelandic history and literature and worked for most of his life at an institute established by the Danish authorities to keep old Icelandic manuscripts. Well-read in economics and politics, Jon Sigurdsson was influenced by the liberalism of John Locke, Adam Smith, and John Stuart Mill.⁷⁵ In 1841 he started a magazine, *New Social Review*, where he expressed his political views: he was a firm believer in progress, economic liberty, and national self-determination. 'Individual liberty should not be limited unless where society as a whole (the nation) would be harmed by it,' he wrote in 1841.⁷⁶ Jon Sigurdsson was untiring in preaching that the Icelanders should and could learn from other nations without having to sacrifice their pride, self-consciousness and identity. 'We have advanced the most when we have travelled widely and traded with other countries, but with many countries, not only with just one', he wrote in 1842.⁷⁷ He was a strong advocate of free trade and in an essay in 1843 he argued for it in the spirit of Adam Smith (of whom he knew by reading the works of Smith's disciple, French economist Jean-Baptiste Say):

“ Our trade is confined to just one country, and we are not allowed to do business with any other countries. This goes against the nature of exchange and evolution, because progress and prosperity depend on trading what is necessary, so that people in fact support one another. When a nation disregards this rule and this law of nature, it will be punished, and the punishment will be its own humiliation and loss. No country



⁷⁴ Gisli Gunnarsson, *Monopoly Trade and Economic Stagnation: Studies in the Foreign Trade of Iceland 1602-1787* (Lund: Ekonomisk-Historiska Föreningen, 1980).

⁷⁵ Pall Eggert Olason, *Jon Sigurdsson*, Vol. I (Reykjavik: Hid Islenska thjodvinafelag, 1929), pp. 364-70.

⁷⁶ Jon Sigurdsson, *Um Althing a Islandi* [On Parliament in Iceland], *Ny felagsrit*, Vol. 1 (1841), p. 73.

⁷⁷ Jon Sigurdsson, *Um skola a Islandi* [On Schools in Iceland], *Ny felagsrit*, Vol. 2 (1842), pp. 146-7.

in the world is completely self-sufficient, even if human foolishness has tried to make it so. Neither is any country such that it cannot contribute something and thus obtain what it needs. But when a country has obtained what it needs, which is what trade brings about, then it is as if itself had possessed these necessities. When trade is free, then every nation offers what it has in surplus, to those who have what it needs.⁷⁸

In 1844, Jon Sigurdsson pointed to England as the example the Icelanders should follow. Its rapid progress could, he wrote, without doubt be attributed to its great freedom of enterprise and association.⁷⁹

Jon Sigurdsson's most influential paper, 'An Exhortation to the Icelanders', was published in 1848, when the Danish king, under pressure to renounce his absolute power, was preparing a constitution for the Danish Realm which included not only Denmark, Iceland, Greenland, and the Faroe Islands, but also the two duchies of Schleswig and Holstein. The king was keen on retaining his duchies, but Holstein was to all purposes a German territory, whereas Schleswig was mixed. As noted earlier, therefore many Danes wanted to abandon Holstein and annex Schleswig to Denmark, while both the leaders of Holstein and of the German states were adamantly opposed to that idea. In his 'Exhortation'

Jon Sigurdsson argued that the 1262 Covenant had been made between the Icelanders and the Norwegian king, not the Norwegian nation. Later, the Danish king had replaced the Norwegian king, so the Covenant was between the Icelanders and him. In 1662, the Covenant had been annulled when the Icelanders had recognised the absolute power of the Danish king. This was also a treaty just between them and the monarch. When the Danish king was now renouncing his absolute power in Denmark, appointing a representative government in that country, this meant for the Icelanders that the 1262 Covenant between them and the monarch became valid again. The government of Denmark therefore had no right to govern Iceland. The logical next step, Jon Sigurdsson argued, was to establish a legislative parliament in Reykjavik and to appoint a government with a representative in Copenhagen. It should be emphasised, however, that Jon Sigurdsson did not solely base the claim to national self-determination on an old document, the 1262 Covenant. His two other arguments, perhaps more convincing to foreigners, were from identity and prudence. He pointed out that the Icelanders were a separate nation with their own history, literature, and language. Moreover, it was prudent to assume that they knew better than Danish officials far away what was necessary for the country; self-rule was, Jon Sigurdsson submitted, a prerequisite for the progress which Iceland desperately needed.⁸⁰



⁷⁸ Jon Sigurdsson, *Um verslun a Islandi* [On Trade in Iceland], *Ny felagsrit*, Vol. 3 (1843), pp. 52-3.

⁷⁹ Jon Sigurdsson, *Um felagsskap og samtök* [On Associations and Corporations], *Ny felagsrit*, Vol. 4 (1844), p. 10.

⁸⁰ Jon Sigurdsson, *Hugvekja til Islendinga* [An Exhortation to the Icelanders], *Ny felagsrit*, Vol. 11 (1848), pp. 11-16.

In 1848, Jon Sigurdsson became the recognised leader of the Icelandic independence movement. Most Icelanders accepted his three arguments for national self-determination, from legality, identity, and prudence, even if the motive of some of his supporters, especially conservative farmers, may paradoxically have been resentment at the attempts by Danish authorities to liberalise Icelandic society, with measures such as the stipulation of freedom of the press and of religion and the abolition of labour bondage (*vistarband*, the old requirement that everybody should be registered and employed at a farm).⁸¹ From 1845, Sigurdsson was a member of a consultative parliament which had been established by royal decree two years earlier and which convened every other year in Reykjavik. In 1849 he was elected Speaker of the Parliament. In 1851, the Danish government summoned a National Assembly in Reykjavik to decide on Iceland's future political arrangements. The Danish Governor introduced a bill on the status of Iceland within the Danish Realm which was essentially that it should be governed as a Danish province with some self-rule. While the Assembly was deliberating, a Danish warship with a troop of twenty-five soldiers was kept in the harbour. The Assembly decided to reject the government bill and presented another bill which amounted to a constitution for an independent Iceland in a personal union with Denmark, but with provisions for some cooperation with the Danish government. Saturday 9 August 1851 the Governor rejected the Icelandic proposal and dissolved the Assembly. Jon Sigurdsson stood up and protested, and then almost all the members of the Assembly rose and said as if with one voice: 'We all protest!'⁸² Thus, the attempt failed to find an arrangement for conducting Icelandic affairs which would be agreeable both to the Danish government and the Icelanders.

Most of Denmark's leaders were by now well disposed to Iceland which they not only recognised as a country with a distinct identity, but which they also respected as the guardian of the ancient Nordic cultural heritage. But they wanted to maintain control of Iceland for three reasons. First, the question of Schleswig and Holstein was still unresolved. If Iceland were allowed to leave the Danish Realm, then the two duchies might do the same. In the second place, it may have been a matter of prestige to some Danes to include Iceland in the Realm, because

at that time it certainly was not a matter of profit: in the 1850s, the Danish Treasury paid about double the amount of money to Iceland that it derived in revenue from the country. Thirdly, many Danes were afraid that Iceland – a poor, stagnant, remote country with a tiny population – could hardly survive on her own. One of them was Carl Emil Bardenfleth, a childhood friend of King Frederik VII, who had been Governor of Iceland for a few years before he became Danish Minister of Justice. The 'young generation's fantasies about the golden fruits of Icelandic autonomy would show themselves to be nothing but illusions', Bardenfleth wrote in his autobiography. He was convinced that self-government would only lead to 'long-lasting stagnation in Iceland's progress towards culture and civilization'.⁸³ Iceland needed Denmark, he thought.

In fact, Jon Sigurdsson may have agreed, up to a point. He was a practical man, realizing that Iceland needed economic progress to be sustainable as an independent country and economic progress required foreign capital, which could probably only come from Denmark. But Sigurdsson thought that the Icelanders also needed self-respect and dignity, especially because they were so few and poor. Therefore, he brought forward the argument from the 1262 Covenant which many would think absurd: it enabled the Icelanders to approach the matter as not asking for a favour, but as insisting on a right. Like Onund the Tree-foot a thousand years earlier, he did not want to beg for what he regarded as being rightfully his.



⁸¹ Gudmundur Halfdanarson, *Icelandic Modernity and the Role of Nationalism*, Nordic Paths to Modernity, eds. Johann Pall Arnason and Björn Wittrock (New York: Berghahn Books, 2012), pp. 251–273.

⁸² Gunnar Karlsson, *The History of Iceland*, pp. 212–13.

⁸³ Quoted from Gudmundur Halfdanarson, *Icelandic Modernity and the Role of Nationalism* (2012), p. 260.

Jon Sigurdsson adopted the same approach when he in the early 1860s was a member of a committee appointed by the Danish government to prepare the separation of the official finances of Iceland and Denmark. The committee members were unanimous in proposing that the finances should be separated and that the Danish Treasury should transfer a sizeable sum annually to the Icelandic Treasury. The transfer was partly regarded as compensation for the landed properties of the Icelandic church: first, revenues from them had been used to finance schools in Iceland, and then when the properties had been sold the money had been paid into the Danish Treasury. All the committee members except Jon Sigurdsson agreed that this sum should be about 42,000 *rigsdaler* or 'realm dollars', the Danish currency at the time. Jon Sigurdsson however tried to calculate what the Danes really owed the Icelanders, not only for the landed properties they had acquired and then sold, but also for Iceland's share in the profit of the monopoly trade. He concluded that Iceland had a reasonable claim on Denmark for an annual transfer of about 120,000 *rigsdaler*, from which he subtracted 20,000 *rigsdaler* as Iceland's contribution to the Royal House and central government: Thus, he proposed an annual transfer from Denmark to Iceland of 100,000 *rigsdaler*.⁸⁴

Needless to say, Danish leaders remained unconvinced by Jon Sigurdsson's calculations. His chief purpose may also have been to define the contribution from the Danish treasury in a manner consistent with the self-respect of the Icelandic nation: not as poverty relief, but as rightful compensation for past wrongs. It was important for the Icelanders to meet the Danes as equals, as Steinunn the Old has insisted on doing when she dealt with her kinsman Ingolf Arnarson a thousand years earlier. Tall, handsome, with snow-white hair from middle age, friendly, but uncompromising, for thirty years Jon Sigurdsson was not only the leader of Iceland's struggle for independence, but also the central figure in the Icelandic community in Copenhagen: he and his wife entertained regularly and their house was always open to Icelanders passing by. In addition, Jon Sigurdsson was a tireless informal facilitator in Denmark, assisting the mighty and the humble back home in various tasks that had to be undertaken on their behalf in the distant capital. He kept his strong belief that Iceland needed, above all, economic freedom, writing in 1866 to his brother:

“ You think that someone will absorb us. Let them all absorb us in the sense that they trade with us and do business with us. Freedom is not about living alone and not having anything to do with others. I doubt that Simon Stylites or Diogenes [two famous hermits] were freer than any other unfettered people. True enough, freedom comes mostly from within, but no freedom relevant in society is realized except in exchanges, and they are therefore necessary for freedom.”⁸⁵

Jon Sigurdsson was however no radical. In Reykjavik in 1875, young students organised a celebration for him, one of them, Gestur Pálsson, composing a poem about him. When Jon Sigurdsson thanked them, he took issue with a statement in the poem, 'You the leader who never knew any restraints.' He rejected the notion that he had never known any restraints. Discipline and restraints were needed for human development, he said. Restraints were necessary both within and outside, both for individuals and for nations. Unrestrained freedom, without any limits, was no freedom, but simply turmoil and disarray.⁸⁶ Thus, Jon Sigurdsson could best be characterised as a conservative liberal. After he passed away, Thorlakur O. Johnson, a Reykjavik shopkeeper, led a movement to make his birthday, 17 June, a day of celebration. The first such celebration was held in 1886, becoming a tradition in early 20th Century. The Icelandic republic was established 17 June 1944, and Sigurdsson's birthday has since then been the national holiday. •



⁸⁴ Gunnar Karlsson, *A History of Iceland*, p. 219.

⁸⁵ Letter to Jens Sigurdsson 3 October 1866, Lbs. 2591 4to.

⁸⁶ Account by Jon Jakobsson in a letter 7 March 1911 about the incident 10 June 1875, printed in *Bref Jons Sigurdssonar*. Nytt safn [Jon Sigurdsson's Letters: A New Collection] (Reykjavik: Menningarsjodur, 1933), p. xxi.

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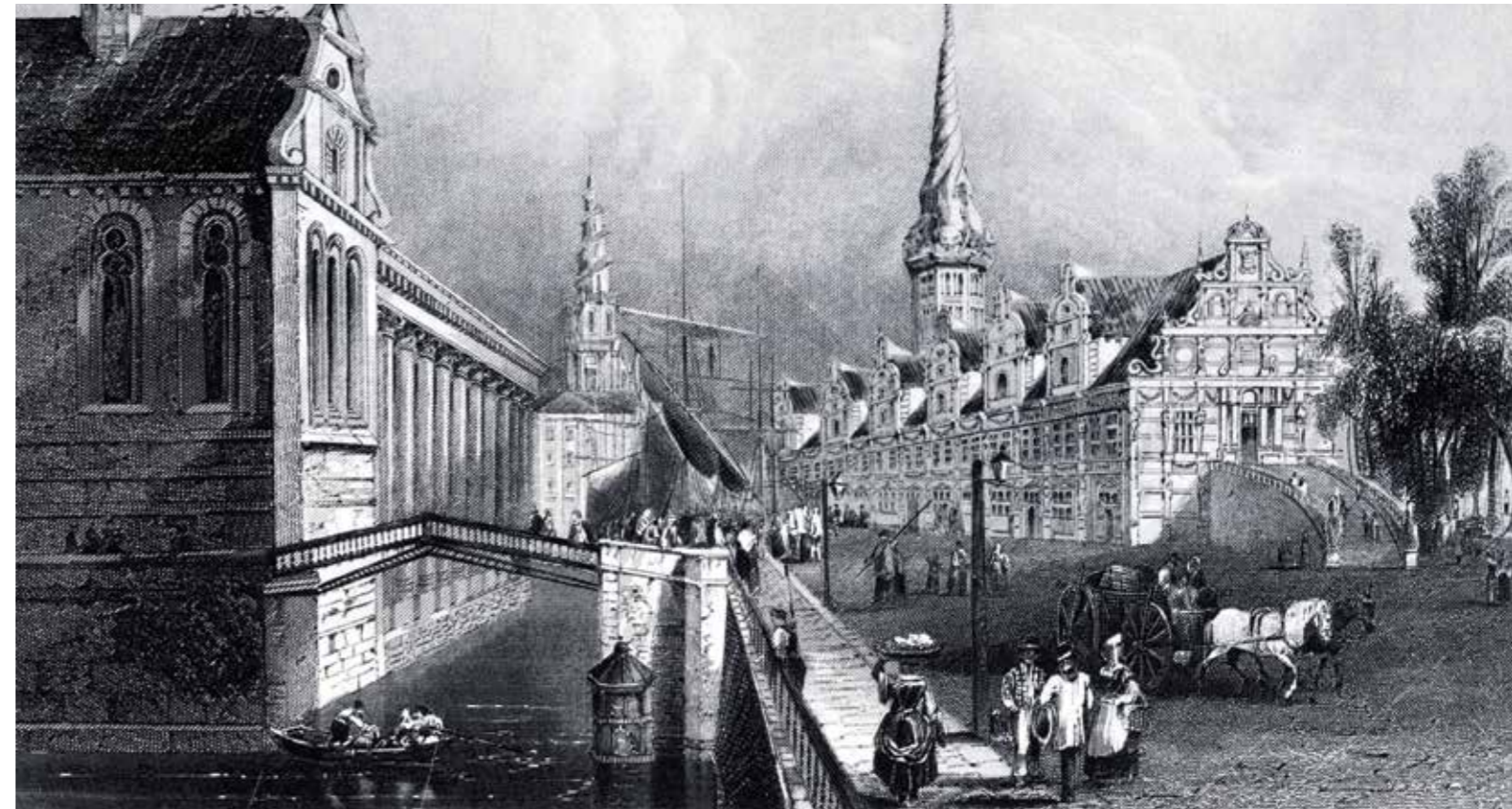
BASTIAT, MILL AND CASSEL IN ICELAND

Even those few Icelandic intellectuals who disagreed with Jon Sigurdsson's historical and legalistic arguments tended to share his liberal views. One of them was Arnljotur Olafsson, (1823–1904) who in 1880 published the first book on economics in Icelandic, 'An Inquiry into Wealth' (Audfraedi). Olafsson had gone to Copenhagen in 1851 and studied economics for a few years at the University. Lacking the means to complete his studies, he had taken on various odd jobs, including that of being private tutor in the household of a Danish baron, Blixen-Finecke. Olafsson accompanied the baron and his son on tours to Southern Europe. He eventually returned to Iceland, married, and completed in 1863 a degree in theology which was then the most practical line of study. Subsequently, he became a pastor in Northern Iceland and was also elected several times to the Icelandic Parliament, where he was too independent, and perhaps also too obstinate, to become influential. In his first years in Parliament, he argued for the establishment of an Icelandic bank and against the labour bondage. While Olafsson became a prosperous farmer as well as a respected pastor, he maintained a lively interest in economics and statistics and published several learned papers on Iceland's economic history. His well-stocked library included books by Herbert Spencer and John Stuart Mill.

Arnljotur Olafsson's book, 'An Inquiry into Wealth', was a vigorous defence of economic freedom, mainly based on Frédéric Bastiat's 'Economic Harmonies'.⁸⁷ Everybody had an interest in competition because it induced producers to serve their fellow beings:

'Competition is initially guided by self-interest, because competition is liberal, it is liberty itself; but it reins itself in, by reins which are in fact non-coercive, and thus it leads self-interest against its will to work for the general good.' Olafsson observed that the free market set prices much more efficiently than any institution: 'Competition is the invisible setter of prices in every free economy. It prices human goods, and it does it more effectively than the old Icelandic chieftains priced the goods of Norwegian merchants, or the later royal sheriffs priced the goods of the Hansa merchants and the English sailors.'⁸⁸ By no means a mere translation or summary of Bastiat's 'Economic Harmonies', Olafsson's book was well-written and abounding with Icelandic allusions and examples. The author also translated an extract of Bastiat's 'Laws' into Icelandic: in 1890, it was published in two parts in an Icelandic magazine.⁸⁹ As Olafsson grew older however, he became more conservative, opposing, like some other affluent farmers, the complete abolition of labour bondage against which he had campaigned as a young man.⁹⁰ It should be noted that in 1886 an Icelandic journalist and adventurer, Jon Olafsson, translated John Stuart Mill's 'On Liberty' into Icelandic. At about the same time, an Icelandic student in Copenhagen, Sigurdur Jonasson, translated Mill's 'Subjection of Women' into Icelandic. It was however only published in 1900, and had a strong impact on the Icelandic women's movement.⁹¹

In the second half of the 19th century, Icelandic society underwent a transformation. Capitalism came to the island. In 1855, foreign trade became totally free, having previously been confined to Danish subjects



even after the abolition of the monopoly. In 1886, the first Icelandic bank, Landsbanki, was established by the government. It put into circulation Icelandic *kronur*, equivalent to Danish *kroner*. While it was nowhere written into a legal statute, everybody assumed that it was on the gold standard like the Danish currency. In 1904, a private bank, Islandsbanki, was established by Danish and Norwegian investors, being given the right to issue *kronur* and now legally backed by gold. The two banks provided the capital necessary to replace the old open row boats with modern fishing vessels, first decked sailships, then trawlers. The fisheries replaced agriculture as the most important sector of the economy, owners and captains of fishing vessels prospered, and to the chagrin of farmers, poor people from the countryside flocked to the fishing towns on the coastline, mainly to Reykjavik. The Danish government granted Iceland home rule in 1904, the governor being replaced by an Icelandic minister who, while a member of the Danish Council of State, was only answerable to the Icelandic parliament. But Icelandic capitalism had its opponents, both intellectuals who identified a potential political constituency in the rapidly expanding class of urban labourers and even conservative farmers who resented seeing their former farmhands leave for the towns and

the banks mainly providing capital to fishing firms. As Iceland had gained home rule and was rapidly approaching full sovereignty, the old parties of the struggle for independence gradually became obsolete. Political ideas or social identities guided the formation of new parties. In 1916, the Icelandic Social Democrats founded a party (*Althyduflokkurinn*), which tried to gain the support of urban labourers and cooperated closely with the Icelandic Confederation of Labour and with its Danish sister party. The same year some farmers in parliament also established the Progressive Party (*Framsoknarflokkurinn*) which was backed by the Cooperative Movement and had much support in rural districts.

In 1918, after peaceful and friendly negotiations, Iceland became a sovereign state in a personal union with Denmark, which undertook to represent her internationally and to protect her fisheries limit in cooperation with the Icelandic Coast Guard.⁹² Jon Sigurdsson's political programme had finally been implemented, seventy years after he had published his 'Exhortation to the Icelanders'. But his political heirs were split into several factions, challenged by the Social Democrats on the one hand and class-conscious farmers on the other hand. It fell

⁸⁷ An extract of one of Bastiat's most famous papers was published in Icelandic: *Brotni askurinn* (What Is Seen and What Is Not Seen), where the examples were changed into an Icelandic setting, *Isafold*, Vol. 7 (24: 25 September 1880), pp. 93–94.

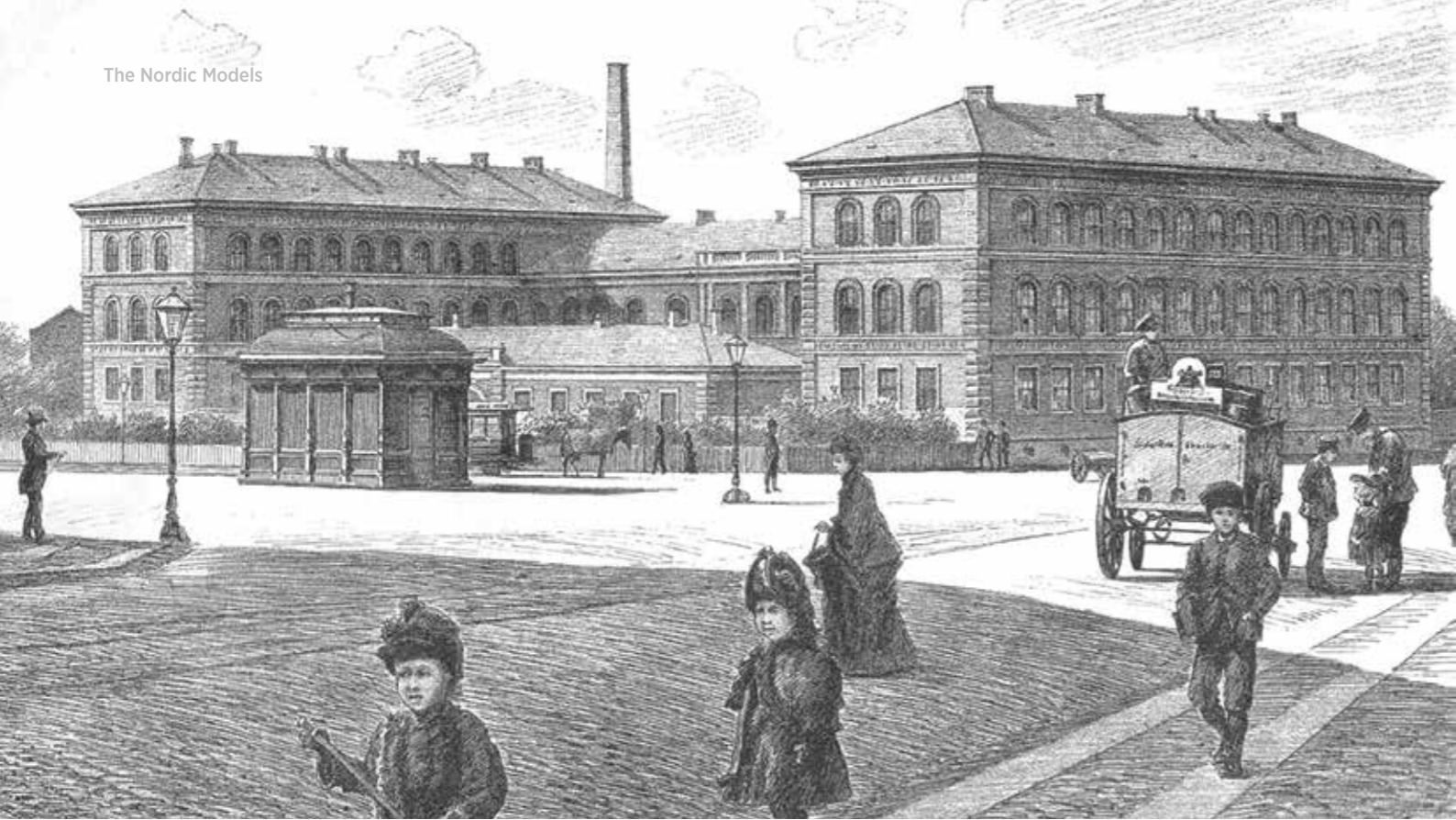
⁸⁸ Arnljotur Olafsson, *Audfraedi* (Kaupmannahofn: Hid islenska bokmenntafelag, 1880), pp. 81 and 79.

⁸⁹ *Login* [The Law], *Fjallkonan*, Vol. 7 (7–8: 1890), pp. 25–6 and 29–30.

⁹⁰ Bjorn M. Olsen, *Fra Arnljoti Olafssini* [About Arnljotur Olafsson], *Andvari*, Vol. 31 (1906), pp. 4–27.

⁹¹ John Stuart Mill, *Um frelsid* (Reykjavik: Hid islenska thjodvinafelag, 1886); *Kugun kvenna*, (Reykjavik: Hid islenska kvenfelag, 1900).

⁹² Gudmundur Halfdanarson, *Iceland: A Peaceful Secession*, *Scandinavian Journal of History*, Vol. 25 (1-2: 2000), pp. 87-100.



to Jon Thorlaksson (1877–1935), a civil engineer and successful businessman, to try and organise a conservative-liberal or centre-right party in the spirit of Jon Sigurdsson. A farmer's son from the North of Iceland, Thorlaksson was a brilliant student who completed grammar school with the highest marks ever given. In 1903, he graduated as a civil engineer from the Technical University in Copenhagen (then *Polyteknisk Læreanstalt*, later *Danmarks Tekniske Universitet*) and two years later he became Iceland's Chief Government Engineer, in the following years building many roads and bridges around the country.⁹³ He later said that as a young man, his strongest desire was to use technology to bring his poor and backward country into the modern age.⁹⁴ A long-time member of Reykjavik City Council, he strongly supported the 1906 construction of the city aqueduct and the 1913 construction of the Reykjavik harbour, both crucial for modernisation in the capital. He left his government position in 1917, devoting himself after that to independent engineering projects and to his business company which imported various kinds of building materials. Thorlaksson was also one of the pioneers in harnessing Iceland's many waterfalls, rivers and geysers to produce hydroelectric power. In 1921, on commission, he built the first power plant serving

Reykjavik. In 1926 he presented a well-developed plan of using warm springs to heat up the houses of Reykjavik; this plan was gradually implemented in the 1930s and 1940s.⁹⁵ While left-wing intellectuals sat in Reykjavik coffeehouses eloquently lamenting the inadequate living conditions of the Icelandic working class, sometimes in moving poems, Jon Thorlaksson sat in his office designing projects that would greatly improve the living conditions of all Icelanders, including common workers, providing them with heat and light and water, and roads and ports and bridges.

When elected to parliament in 1921, Jon Thorlaksson immediately started to try and bring the remainder of the old parties of the independence struggle together into a centre-right party. In early 1924, under his leadership, most members of parliament for the old parties founded the Conservative Party (*Ihaldsflokkurinn*), which became the largest group in parliament, almost commanding a workable majority. Thorlaksson explained that the name was chosen because the new Party wanted to defend the values of economic freedom, private property rights, and fiscal and monetary stability which had been firmly in place before the Great War and which now were being threatened by the emerging Left. He wrote,

'Our ideal is that society should consist of as many independent and free individuals as possible, and that each and every one of them should have as many opportunities as possible to increase the welfare of their families and thus the welfare of society, without harming anyone.' Thorlaksson distinguished between four political dispositions. One was the liberal one, 'the absence of an urge to control other people'. Another disposition was conservative: it was to be cautious and to want to maintain useful traditions. A third disposition was authoritarian, an urge to control other people. A fourth disposition was radical, the desire to break down the established order and to build something new on its ruins. Thorlaksson said that these four dispositions could exist in various combinations. In backward countries, liberals had for example to be radical. But in the 1920s Iceland, liberal and conservative people had a common cause: the defence of the liberty gained in the 19th Century. Their chief adversaries were the socialists, who combined authoritarian and radical dispositions.⁹⁶ Thorlaksson's party was not modelled on the Danish Conservative Party, which derived its support mostly from the old establishment of landowners, high government officials, industrialists, and businessmen, but rather on the free-trade wing of the British Conservative Party. Like Jon Sigurdsson, he admired the Anglo-Saxon political tradition. In a 1927 speech in parliament, Thorlaksson said: 'Experience here in Europe shows that those countries have fared the best where the written statutes are the fewest, and where the constitutional customs are the firmest. Here I am referring to Great Britain.'⁹⁷

While Thorlaksson was universally respected for his intelligence, unflinching honesty and capacity for hard work, he lacked charisma, and in early 1924 another member of his party, more amenable to the centre, formed a Conservative government. Thorlaksson became Finance Minister and in the autumn of 1924 he authored what was the second book on economics published in Icelandic, 'Currency Depreciation' (*Laggengid*), where he tried to explain why the Icelandic *krona* had sunk in value in the preceding years and what should be done about it. Thorlaksson's analysis of monetary affairs closely followed that of the Swedish economist Gustav Cassel, then one of the best-known economists in the world.

Thorlaksson's answer to the first question was that the *krona* had sunk in value because too much of it had been produced during and after the Great War. Thorlaksson did not give a direct answer to his second question, taking it for granted, however, that monetary stability could only be reintroduced by returning to the gold standard and becoming a full participant in the Scandinavian Monetary Union, as Iceland had indirectly been when she was under Danish rule.⁹⁸ But the choice, as he presented it, was between returning to the gold standard at the pre-war rate or at the present rate. It was clear that he personally favoured a return to the gold standard at the pre-war rate, like Churchill in the United Kingdom. In 1924–1925, there was a boom in Iceland and the *krona* was allowed to appreciate, from around 47 per cent of its pre-war value in gold, to around 82 per cent. But Thorlaksson did not have sufficient support to carry his monetary stabilisation any further, and in the 1927 parliamentary elections his party was defeated. A minority government was formed by the Progressive Party with the support of the Social Democrats. Feeling that traditional liberties were under threat, in 1929 the last remaining members of parliament for the old parties of the independence struggle joined Thorlaksson's Conservative Party, which subsequently changed its name to the Independence Party. Thorlaksson was elected its first leader.

During the five years of his leadership, Jon Thorlaksson set out the position of the Independence Party in almost purely liberal terms. His opponents conceived of unfettered competition in the free market as a battle in which the weakest lost. It was, they said, a race in which the devil took the hindmost, a modern Colosseum. Thorlaksson considered this to be a grave misconception. In schools, he argued, competition was between students for grades; it was about them developing their individual talents, not about harming others. Likewise, in sports, competition was between athletes for prizes; it was about them training to perform to the best of their individual abilities, and again, not about harming others. Similarly, in the marketplace competition was between providers of goods or services for profit; it was about satisfying the needs of customers in the best way, either by quality or price, and not about harming others. The case for competition, Thorlaksson submitted, echoing Adam Smith and other classical liberals, was that it led people

⁹³ Hannes H. Gissurarson, *Jon Thorlaksson forsætisráðgjafi* [Prime Minister Jon Thorlaksson] (Reykjavik: Almenna bokafélagid, 1992).

⁹⁴ Jon Thorlaksson, *Fra fyrstu stjórnarárum Hannesar Hafstein* [Of Hannes Hafstein's First Years as Minister], *Odinn*, Vol. 19 (1–6: 1923), p. 9. All the works by Thorlaksson quoted are reprinted in Jon Thorlaksson, *Ræður og ritgerðir* [Speeches and Papers], ed. Hannes H. Gissurarson (Reykjavik: Stofnun Jóns Thorlákssonar, 1985).

⁹⁵ Jon Thorlaksson, *Hitaveita Reykjavíkur* [Geothermal Heating in Reykjavik], *Timarit Verkfræðingafélags Íslands*, Vol. 11 (5: 1926), pp. 41–4.

⁹⁶ Jon Thorlaksson, *Ihaldsstefnan* [Conservatism], *Eimreidin*, Vol. 32 (1: 1926), pp. 1–18.

⁹⁷ *Althingistíðindi* (1927), B 4422.

⁹⁸ Jon Thorlaksson, *Laggengid* [The Depreciation of the Currency] (Reykjavik, Bokaverslun Thorarins B. Thorlákssonar, 1924).

who were only working for their own interest to seek to serve the needs of their fellow beings. In a paper read in 1929 to the last general meeting of the Conservative Party (and the first meeting of the Independence Party), Thorlaksson said:

“The purpose of economic activity, to satisfy human wants, cannot be better served than by allowing the human instinct for self-preservation to lead everyone to serve others to their best ability. In the self-regulating machinery of free trade, the pursuit of self-interest is the power engine which drives everything forward, while the great accomplishment of the machine is the production to satisfy everybody’s wants.⁹⁹”

Thorlaksson’s ideas on the competitive economic order were directly derived, as was his monetary analysis, from Gustav Cassel, who was very active in popularising economic liberalism, as mentioned earlier. In 1928, Cassel had published a series of articles under the name *Socialism or Progress*, and one of them, ‘Capital and Progress’, was obviously the inspiration for Thorlaksson’s exposition.¹⁰⁰ Some of Cassel’s newspaper articles were indeed translated into Icelandic and published in the magazine of the Young Independents.¹⁰¹

Jon Thorlaksson firmly rejected the idea that political parties should be based on classes. Instead, different ideas about the common good and how to attain it should divide them. Thorlaksson shared many traits with Thomas Madsen-Mygdal, the robust leader of the Danish liberal party, *Venstre*, and Prime Minister of Denmark in 1926–1929. The differences between them were less in their views than in their situation. In Iceland, there was no conservative party competing with the liberal one, and Thorlaksson was not as narrowly focused on any one sector of the economy as Madsen-Mygdal was on agriculture. Thorlaksson’s Independence Party was, to some extent, what a merger of the Conservative People’s Party and *Venstre* in Denmark would possibly have looked like,

or of the People’s Party, *Folkpartiet*, and the Moderate Unity Party in Sweden (*Högerpartiet*, the Right Wing Party, until 1969). However, in the Great Depression of the early 1930s, classical liberal ideas lost their credibility with many. While people continued to respect Thorlaksson, his party did not do well in two out of three elections fought under his leadership. Even if the Independence Party received most of the votes, the Progressive Party commanded the largest parliamentary group, as the rural districts where it had its main support were vastly overrepresented.

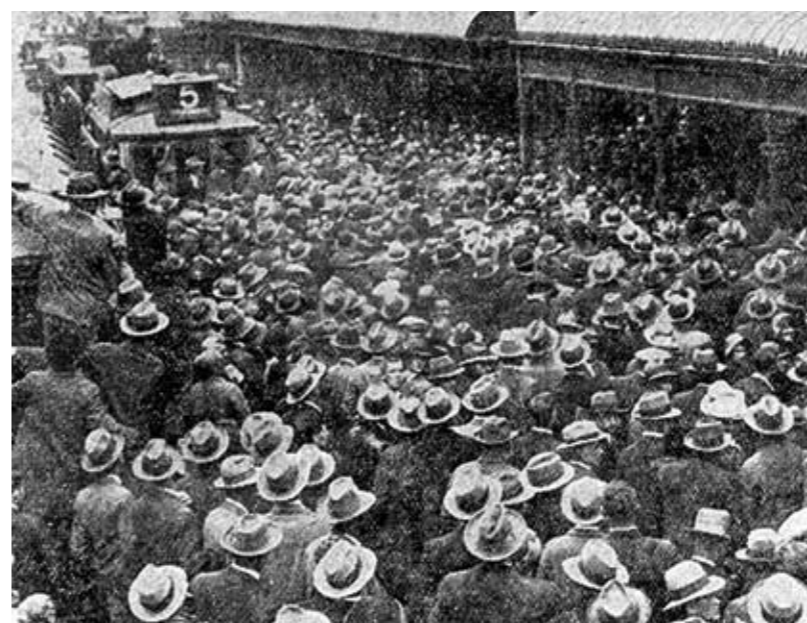
In the early 1930s strict economic controls were imposed in Iceland, which enabled government commissions to transfer a lot of trade from private merchants, usually supporters of the opposition Independence Party, to the cooperative movement, closely aligned with the ruling Progressive Party.¹⁰² Islandsbanki collapsed and was nationalised under a new name, Utvegsbanki. The Progressive Party government established a third bank, Bunadarbani, whose main task was to provide capital to agriculture. Moreover, in the 1930s a strong communist movement emerged, enjoying political and financial support from Moscow. Protesting against wage cuts, the communists showed their strength in a fierce street riot in Reykjavik on 9 November 1932 when they managed to overpower the tiny Reykjavik police force and bring about the withdrawal of the cuts. From that point on, wages in Iceland were regarded as ‘sticky’ or ‘rigid’.¹⁰³ The idea of providing monetary stability by returning to the gold standard became moot. In bad health, Thorlaksson resigned in 1934 as Independence Party Leader. A year earlier, he had however been elected as Mayor of Reykjavik, an Independence Party stronghold. During his short tenure as Mayor, before his premature death, he was very active, encouraging the operations of small, privately-owned boats from Reykjavik and starting to build for the City both a big hydroelectric power plant and a geothermal system for heating up houses.

The third book in Icelandic on economics dealt with the economic controls imposed in the 1930s. Its author was Benjamin Eiriksson (1910–2000), who well illustrated Trotsky’s remark that anyone wishing to live a quiet life

did badly to be born in the 20th century. The son of a poor fisherman in a village near Reykjavik, Eiriksson soon showed himself to be an excellent student and an older brother, a taxi driver, financed his education. Graduating in 1932 from Reykjavik Grammar School, Eiriksson started reading economics at Berlin University (then called the Friedrich-Wilhelm University and later the Wilhelm Humboldt University). He was then a committed communist and when he went to meetings of left-wing students, it was not uncommon that Nazi gangs tried to break them up, even by shooting at them. Eiriksson witnessed when Hitler and the Nazis took power at the end of January 1933 and decided that he should move to Stockholm, where one of his teachers was the radical social democrat Gunnar Myrdal. Still a communist, Eiriksson decided in 1935 to accept an offer to train at one of the clandestine schools which the Comintern operated in Moscow, the so-called Western University (KUNMZ), where his code name was Erik Torin. In Moscow, Eiriksson fell in love with a German girl, Vera Hertzsch, who had moved to the Soviet Union, married and separated, and was working as a journalist and a part-time student. But now Stalin’s purges were beginning, and Hertzsch’s nominal husband was denounced as a Trotskyite. When the Western University was closed in 1936, Eiriksson could not stay much longer in Moscow. He decided to return to Stockholm, where he received a degree (*fil kand*, roughly comparable to an M.A.) in Economics and Slavic languages. When Eiriksson left, his girlfriend had

become pregnant, and she bore their child in March 1937. A year later, in March 1938, Hertzsch was however arrested, as the wife of a Trotskyite, in the presence of an Icelandic writer, the Stalinist Halldor Kiljan Laxness, who was travelling in the Soviet Union. She was sent to a prison camp where her child apparently soon perished and she herself died of malnutrition after five years. Laxness told Benjamin about the arrest, but kept otherwise quiet about it for 25 years, continuing staunchly to defend Stalinism.¹⁰⁴

In the summer of 1938, Benjamin Eiriksson returned to Iceland as an economist and, not immediately finding a job, wrote his book, ‘Causes of the Economic Problems and Currency Shortage’. He pointed out a contradiction in the policies of the Icelandic government. At the same time as it wanted to reduce imports in order to save foreign currency, it stimulated demand for imports by loose credit offered by the three government banks. When the government was trying to control imports, it was dealing with a problem which it had itself created. Moreover, whereas the strict import and currency controls were ineffective, they were harmful to the economy, distorting it and stifling entrepreneurship. The overvalued *krona* was also a great burden to the export industries, mainly the fisheries. The only feasible way out, Eiriksson argued, was to devalue the currency, to abolish the strict import and currency controls, and to reintroduce free trade with other countries.¹⁰⁵ The economic analysis in Eiriksson’s book was plausible, but nevertheless he did not get much of a reception. His comrades in the Communist Party and the social democrats were adamantly against currency devaluation, as it would reduce labour’s purchasing power, and the leaders of the Independence Party and the Progressive Party regarded the young communist, recently returned from Moscow, with suspicion. However, in early 1939 the *krona* was devalued, even if extensive economic controls remained. Eiriksson’s analysis had not brought this about, but it may be argued that it correctly predicted it. In that year, Eiriksson however left the Socialist Party which had been formed in 1938 as a merger of the Communist Party and a radical faction of the Social Democrats: he could not accept the Party’s slavish devotion to Stalinism. In 1942, Eiriksson left Iceland, going to the United States to pursue graduate studies in economics.¹⁰⁶ ●



⁹⁹ Jon Thorlaksson, *Milli fataektar og bjargalna* [Between Poverty and Affluence], *Stefnir*, Vol. 1 (1: 1929), pp. 16–32, and (2: 1929), pp. 144–52.

¹⁰⁰ Gustav Cassel, *Socialism eller framåtsskridande* [Socialism or Progress] (Stockholm: P. A. Norstedt & Söner, 1928).

¹⁰¹ Gustav Cassel, *Fjarmagn og framfarir. Hvað er audlegd?* [Capital and Progress. What is Wealth?] *Stefnir*, Vol. 2 (1930), pp. 156–62; *Fjarmagn og framfarir. Undirstoduatriði fjarmalanna — Peningamalin* [Capital and Progress. Fundamentals of Finance, Monetary Affairs], pp. 249–55; *Fjarmagn og framfarir. Tekjurnar verða að hrokkva til. Skattamal o. fl.* [Capital and Progress. Income Has to Suffice. Tax Issues, Etc.], pp. 436–43; *Socialismi eða framfarir* [Socialism or Progress], pp. 532–9. Gustav Cassel, *Tvaer greinar um atvinnuleysi og atvinnubaetur* [Two Articles on Unemployment and Job Creation], *Stefnir*, Vol. 4 (1932), pp. 78–90.

¹⁰² Jakob F. Asgeirsson, *Thjod i hafti* [A Nation in Fetters] (Reykjavik: Almenna bokafelagid, 1988).

¹⁰³ Hannes H. Gissurarson, *Islenskir kommunistar 1918–1998* [Icelandic Communists, 1918–1998] (Reykjavik: Almenna bokafelagid, 2011).

¹⁰⁴ Hannes H. Gissurarson, *Kiljan*, Vol. 2 of Laxness’ biography (Reykjavik: Bokafelagid, 2004).

¹⁰⁵ Benjamin Eiriksson, *Orsakir erfðleikanna i atvinnu- og gjaldeyrismalum* (Reykjavik: the author, 1938). Repr. in Benjamin Eiriksson, *Rit 1938–1965*, ed. Hannes H. Gissurarson (Reykjavik: Stofnun Jons Thorlakssonar, 1987).

¹⁰⁶ Hannes H. Gissurarson, *Benjamin H. J. Eiriksson i stormum sinna tida* [Benjamin H. J. Eiriksson in Turbulent Times] (Reykjavik: Bokafelagid, 1996).

8

MISES AND HAYEK IN ICELAND



In the spring of 1938, Benjamin Eiriksson was not the only Icelander to graduate in economics. In Copenhagen, Olafur Bjornsson (1912–1999) finished his studies after six years at the University. A pastor's son from the North of Iceland, as a young man Bjornsson had briefly flirted with socialism in the midst of the Great Depression, but his views changed when during his last winter in Copenhagen he came across two books, 'Socialism' by the Austrian economist Ludwig von Mises and 'Collectivist Economic planning', a collection of papers edited

by another Austrian economist, Friedrich A. Hayek. In his book, which had originally been published in German in 1922, Mises argued that collectivist economic planning such as socialists traditionally envisaged was bound to fail because the planners could not price resources and other goods according to their relative scarcity. They could not make rational decisions about whether to build a road or a railway between two places, or whether to use a plot of land to grow corn or wine, or about thousands of other matters. In a free market economy, such decisions

were however made spontaneously by the individual agents on the basis of prices and rational calculations. 'And then we have a socialist community which must cross the whole ocean of possible and imaginable economic permutations without the compass of economic calculation', Mises wrote. 'All economic change, therefore, would involve operations the value of which could neither be predicted beforehand nor ascertained after they had taken place. Everything would be a leap in the dark. Socialism is the renunciation of rational economy.'¹⁰⁷ Hayek added several important considerations to Mises' critique of socialism. Knowledge, he pointed out, was dispersed amongst individuals in the economy, not only the knowledge special to each of them of place and time, but also the knowledge how to do things, for example various skills. These kinds of knowledge, by their very nature, could not be put together and processed in a government bureaucracy, however well-staffed and well-equipped. Hence, the fact of the decentralisation of knowledge required the decentralisation of decisions, if they were to be fully rational. Hayek also observed that capitalists and entrepreneurs performed a necessary role in a dynamic economy: their acquisition and transmission of knowledge through trial and error could never be fully simulated by government experts and bureaucrats.¹⁰⁸

Olafur Bjornsson was probably also influenced by some of his teachers at the University of Copenhagen. One of them, Laurits Birck, was a conservative elitist rather than a liberal, but offered many economic insights and had some impact in Denmark, not least because of his biting wit and ability to appeal to a wide audience. Bjornsson often recalled his remark that under the gold standard a central bank only needed a parrot as governor for it to function properly. Axel Nielsen was an able but non-ideological monetary economist. Jens Warming, who taught statistics to Bjornsson, was at that time a somewhat underestimated economist. It was only later that his peers fully realized that he had written original studies in the economics of non-exclusive resources. He had

as early as 1911 analysed over-fishing as the necessary consequence of unlimited access to a limited resource, such as a fishing ground.¹⁰⁹ His work anticipated some important points made by Arthur C. Pigou in his welfare economics, and his analysis of over-fishing was almost identical to that of the two English-speaking economists who are usually regarded as the pioneers of fisheries economics, H. Scott Gordon and Anthony Scott.¹¹⁰ Bjornsson's supervisor at Copenhagen University was the aforementioned liberal, Carl Iversen. However, Iversen hardly ever publicly expressed his liberal views and became somewhat, like the liberal economist Lionel Robbins in the United Kingdom, an establishment figure, serving for many years as rector of the University of Copenhagen.¹¹¹

In Iceland, Olafur Bjornsson first worked at the Statistical Bureau and then, in early 1939, he started teaching at the newly-established High School of Commerce which was a year later merged with the University of Iceland. Bjornsson was appointed Associate Professor (docent) at the University in 1942. He published textbooks on his teaching subjects and wrote many articles where he restated Mises' and Hayek's argument that socialism was not economically feasible and that it would lead to tyranny. In 1944 he joined the Independence Party and in 1945, on the initiative of young Independence Party members, he translated into Icelandic an extract of Hayek's 'Road to Serfdom' which had been published in *Reader's Digest*. The translation was serialised in the leading Icelandic newspaper *Morgunbladid*. It provoked angry reactions from both the social democratic newspaper *Althydubladid* and the socialist newspaper *Thjodviljinn* that wrote of the 'international freak' Hayek and the 'national freak' Bjornsson.

A young socialist who had just graduated in economics and politics from Stockholm University, Jonas H. Haralz, responded in *Thjodviljinn* that Hayek was making unrealistic assumptions about

¹⁰⁷ Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (London: Jonathan Cape, 1936), p. 122.

¹⁰⁸ *Collectivist Economic Planning*, ed. F. A. Hayek (London: George Routledge & Sons, 1935).

¹⁰⁹ Jens Warming, Om Grundrente af Fiskegrunde, *Nationaløkonomisk Tidsskrift*, Vol. 49. (1911), pp. 499–505, tr. in Peder Andersen, On Rent of Fishing Grounds: A Translation of Jens Warming's 1911 Article, with an Introduction, *History of Political Economy*, Vol. 15 (3: 1983), pp. 391–96; Jens Warming, Aalegaardsretten [The Eel Trap Right], *Nationaløkonomisk Tidsskrift*, Vol. 69 (1931), pp. 151–62; N. Kærgård, P. Andersen and N.-H. Topp, The Danish Economist Jens Warming – An Odd Genius, *European Economists of the early 20th Century*, ed. W. J. Samuels, Vol. I (London: Edward Elgar Publishing, 1998), pp. 331–48.

¹¹⁰ H. Scott Gordon, The Economic Theory of a Common Property Resource: The Fishery, *Journal of Political Economy*, Vol. 62 (1954), pp. 124–42; Anthony Scott, The Fishery: The Objective of Sole Ownership, *Journal of Political Economy*, Vol. 63 (1955), pp. 116–24.

¹¹¹ Peter Kurrild-Klitgaard, *Classical Liberalism and Modern Political Economy in Denmark* (2015), p. 402.

competition and the free market: technology required bigger units of production. Hayek was also attacking a straw-man, Haralz said: western socialists had no intention of introducing centralised economic planning; they just wanted to nationalise a few key industries in order to ensure rational investment. Haralz added that the Independence Party should listen to more prescient and relevant prophets than Hayek, for example Beveridge or Keynes. Bjornsson replied that Hayek's book should not be interpreted as a scientific prediction, but rather as a warning against the possible consequences of power concentration. Moreover, it was by no means obvious that new technology was making competition obsolete. For example, the common concern about transport monopoly in the age of railways had disappeared with the private car. Bjornsson pointed out that often monopolies were created or maintained by governments. He also said that the Independence Party did not need a prophet, but that it was sensible to listen to and learn from prominent scholars. In a rejoinder, Haralz wrote that government officials, backed by democratic assemblies, could, with the assistance of experts, make and administer comprehensive national plans. Bjornsson replied yet again, recalling the danger which the concentration of economic and political power in the hands of a few posed for individual freedom. 'Even if all members of a society had a formal right to employment, it would be easy to implement it in such a way that the life of those whom government regarded as its opponents would be as if in a prison camp.' But whereas Bjornsson may have won the argument, the socialists had their say. In 1944-1947, the Socialist Party was in a coalition government controlling the Ministry of Education. The Minister, Stalinist Brynjolfur Bjarnason, flatly refused to appoint Bjornsson a professor of economics, as tradition prescribed. Bjornsson therefore served unusually long as associate professor, for five years. But as soon as the socialists left office, he was appointed professor, in 1947.¹¹²

In early 1939, the Icelandic export industries, mainly the fisheries, had been on the brink of bankruptcy because of the overvalued *krona*. This changed, not only with the devaluation of the *krona* that year,

but also during the Second World War when the Icelanders were the only nation to harvest fish in the fertile fishing grounds off the island and when they could sell as much fish as they wanted to in the United Kingdom and the United States. But when the War ended, this demand suddenly fell while harvests diminished as foreign vessels re-entered the Icelandic waters. It was difficult to reduce nominal wages because militant socialists and communists, backed by Moscow, controlled many labour unions. Therefore, the first post-war governments reintroduced strict import and currency controls.

While the leadership of the Independence Party reluctantly went along with the controls, they also sought a way out of them. They found an economic expert who shared their concerns: Benjamin Eiriksson, the ex-communist who had in 1946 completed a doctorate at Harvard University, where his supervisor had been the Austrian economist Joseph Schumpeter. Eiriksson was now working for the IMF, International Monetary Fund, in Washington DC. When the Independence Party formed a minority government in 1949, its leadership invited Eiriksson to Iceland and asked him and Professor Olafur Bjornsson to prepare a programme for abolishing the economic controls. Their programme, which required a substantial devaluation of the *krona*, was accepted and implemented in 1950 by a coalition government of the Independence Party and the Progressives. However, because of sudden and unexpected economic difficulties, including the Korean War and failed harvests in the fisheries, the controls could only partly be abolished then; the remainder was abolished in 1960, by a coalition government of the Independence Party and the Social Democrats. In the 1950s and 1960s, Professor Olafur Bjornsson and Benjamin Eiriksson were prominent spokesmen for free trade. Bjornsson was a member of parliament for the Independence Party in 1956-1971. Eiriksson, however, suffered a nervous breakdown in 1965 and was promptly released from his job as the director of a development fund. Whether or not there was a connection, two years earlier, Halldor Kiljan Laxness – who received the Nobel Prize in literature in 1955 – had published a well-written and moving account of Vera Hertzsch's arrest that he had personally witnessed in Moscow twenty-five years earlier.¹¹³ •

9

HAYEK, BUCHANAN, AND FRIEDMAN IN ICELAND

The 1960s in Iceland were characterised by a common belief that the world had seen 'the end of ideology'. The traditionally free-market Independence Party had moved towards social democracy, and the Social Democrats had abandoned their old calls for the nationalisation of key industries and a steeply progressive income tax. But the radicalisation of many young people at the end of the decade changed this and posed a challenge for those who supported liberty under the law, especially economic freedom. In 1972, a group of young people in the Independence Party took over the editorship of an old magazine called *The Locomotive*, which had been published since 1895. The name had been chosen by the first editor and publisher to emphasise the necessity for Iceland of modernising. The 'Locomotive Group' as the publishers were called now wanted to rejuvenate the Independence Party and to make the Icelandic economy at least as free as the other Nordic economies. It was also strongly anti-communist. The leader of the group was a businessman, Magnus Gunnarsson, and it included three later prime ministers, Thorsteinn Pálsson, David Oddsson and Geir H. Haarde, and two later Supreme Court judges as well as the present writer

(b. 1953). While the magazine *Locomotive* folded in 1975 as a result of a conflict in the ranks of its owners, the group (which had not been involved in the conflict) continued as an informal luncheon club. It had an impact on them and many other Icelanders interested in economic liberty when the Nobel Prize in Economics was awarded to Friedrich A. Hayek in 1974 and to Milton Friedman in 1976. Younger people also became aware of, and interested, in their ideas. When Professor Olafur Bjornsson published a book on libertarianism and totalitarianism in 1978, he found a receptive audience. For example, the present writer interviewed him on a radio programme and wrote a series of newspaper articles about his book. Written in a clear and accessible style, Bjornsson's book closely, and perhaps somewhat uncritically, followed works on similar issues by Mises, Hayek, and a third Austrian thinker, the philosopher Karl Popper.¹¹⁴

On Hayek's 80th birthday, 8 May 1979, the Icelandic Libertarian Alliance was founded by the present writer and a few other people interested in classical liberal, libertarian, and conservative ideas. When Hayek was informed of the foundation of the LA, he expressed his delight and said that he was willing to visit Iceland



¹¹² Hannes H. Gissurarson, Olafur Bjornsson, Andvari, Vol. 141 (2016), pp. 11-74.

¹¹³ Halldor Laxness, Skaldatimi [A Poet's Time] (Reykjavik: Helgafell, 1963). A book has been written in Icelandic about the tragic fate of Vera Hertzsch, Jon Olafsson, Appelsinur fra Abkasiu [Oranges from Abkhazia] (Reykjavik: JPV, 2012).

¹¹⁴ Olafur Bjornsson, Frjalshyggja og alraedishyggja [Libertarianism and Totalitarianism] (Reykjavik: Almenna bokafelagid, 1978).

in the spring of 1980. This offer was eagerly accepted, and the present writer translated 'Road to Serfdom' into Icelandic before his arrival.¹¹⁵ Hayek gave two lectures in Iceland: on 2 April at the University of Iceland on competing currencies and on 5 April at a meeting of the LA on 'The Muddle of the Middle', whereby he meant John Stuart Mill's controversial distinction between principles of production and rules on distribution. Both papers were published in the present writer's translation in a journal, *Liberty* (Frelsid), that the LA started publishing in 1980.¹¹⁶ Hayek's message was widely discussed in Iceland. He was interviewed on television, and in a television programme a debate on his ideas took place between two economists, a liberal and a socialist. Ironically, the liberal economist who was now siding with Hayek was Jonas H. Haralz (1919–2012), his vehement critic 35 years earlier in the 1945 debate on 'Road to Serfdom'. Haralz had abandoned socialism and become a bank director and one of the most eloquent spokesmen for the free market, although more on grounds of efficiency than individual choice. He was also an influential adviser to the Independence Party leadership. In 1981, the Libertarian Alliance published a collection of his essays, 'Ill Fares the Welfare State'.¹¹⁷

During his visit to Iceland Hayek was personally agreeable and intellectually alert despite being almost 81 years old. Tall, slim, whitehaired, bearing himself with quiet dignity, speaking elegant English, but with a German accent, he seemed to be precisely what he was: a scholar from the ranks of the old nobility in the Habsburg Empire. He was intrigued that in 1945 there had been a heated debate about 'Road to Serfdom' in Iceland, and he met and chatted with the chief protagonists, Professor Olafur Bjornsson and Bank Director Jonas Haralz, now both on the liberal side. When Hayek had dinner with Geir H. Haarde, then chairman of the Young Independents, and the present writer, he joked that he was only deaf on the left ear, whereas he had heard that Marx had been deaf on the right ear. He recalled the time when he had become an outsider in the economics profession as a result of having published 'Road to Serfdom'. When he for example attended a meeting

of the American Economic Association in 1949, he congratulated a young economist on a recent book. Afterwards, Hayek later learned, the friends and colleagues of the economist told him that now he had just received the kiss of death.¹¹⁸ Hayek told the others of his impressions of Keynes who was, in his opinion, a brilliant thinker, but not very knowledgeable about the history of economics. He was, Hayek said, overconfident about his abilities to sway public opinion. During the War, Hayek lived in Cambridge. In January 1946, he had dinner with Keynes where he asked him whether he was not concerned that some of his disciples, in particular Joan Robinson, Nicholas Kaldor and Richard Kahn, were interpreting his ideas in such a way that if implemented, they might lead to inflation. 'Oh, they are fools,' Keynes said. 'When I wrote the General Treatise, unemployment was the real problem. Then my ideas were badly needed. If inflation would become the real problem, I should write another work against it to swing round public opinion, just like this.' Keynes made a quick movement of his hands to illustrate to Hayek the swing.¹¹⁹ Three months later he was dead.

While in Iceland, Hayek invited the present writer to attend the upcoming meeting of the Mont Pelerin Society, held in Stanford in the autumn of 1980, and the present writer became a member of the society four years later, frequently running into Hayek at the meetings. On those occasions, he was always friendly and gracious. When the present writer went in the autumn of 1981 to Oxford to write a doctoral dissertation on Hayek's combination of conservative insights and classical liberal principles, and founded, with others students also interested in Hayek's ideas, the Hayek Society, he visited the group once in Oxford, and a few members also had dinner with him in London in the spring of 1985. The latter occasion was particularly memorable. Hayek was in a good mood. The group was at the Ritz, and there was a group of musicians moving from one table to another, playing songs at the behest of the guests. When the band approached the group's table, one of the students, Chandran Kukathas, who was writing a doctoral dissertation at Oxford on Hayek's theory



of justice, whispered to them to play 'Vienna, City of My Dreams'. When Hayek heard the music start, his eyes lit up, he smiled broadly and started softly to hum the text of the song. Hayek also told the group how Mrs. Margaret Thatcher had once completely disarmed him. Soon after she became prime minister, she heard that he was in London and invited him to 10 Downing Street. She greeted him at the entrance, saying: 'Professor Hayek! I know precisely what you are going to say. You are going to say that I have not done enough. And you are absolutely right!' During their conversation, Hayek observed that liberation always seemed to be in conflict with liberty, although he did not explain this in any detail. At the end of the dinner Hayek spoke a few words. He expressed his pleasure that young people were taking interest in his ideas, but he added that he had one favour to ask the students for their own sake as much as his: that they would not become Hayekians, as he had observed that the Marxists were much worse than Marx and the Keynesians much worse than Keynes!

The group in the Icelandic Libertarian Alliance was not only interested in the Chicago School's resolute use of price theory or in the Austrian conception of

an economic process in which the agents slowly, and erratically, coordinated their pursuits of different aims. It was also fascinated by the public choice approach to politics, where it was deromanticised and analysed as the interplay of individuals promoting their own interest. A member of the group, Fridrik Fridriksson, in 1981 started doing postgraduate work in economics at Virginia Polytechnic Institute and University where James Buchanan and Gordon Tullock taught. In the autumn of 1982 Buchanan visited Iceland and spoke about the economic analysis of politics at a meeting which was well-attended and widely discussed.¹²⁰ During his stay, David Oddsson, who had in the spring become Mayor of Reykjavik, gave a dinner in Buchanan's honour at Hofdi House (which was four years later to become famous as the meeting-place for Reagan and Gorbachev at their Reykjavik summit). Even if Oddsson was first and foremost a practical politician, he listened carefully to new ideas, not least if they fitted in with his robust, old-fashioned individualism mixed with deep scepticism about arrogant elites.

The same year, in 1982, the present writer published his translation of Milton Friedman's 'Capitalism and

¹¹⁵ Friedrich A. Hayek, *Leidin til anauðar* (Reykjavik: Almenna bokafelagid, 1979).

¹¹⁶ They were reprinted in *Lausnarordid er frelsi*, ed. and tr. Hannes H. Gissurarson (Reykjavik: Stofnun Jons Thorlaksosonar, 1994).

¹¹⁷ Jonas H. Haralz, *Velferdarriki a villigotum* (Reykjavik: Felag frjalshyggjumanna, 1981).

¹¹⁸ A year later, Hayek told this story in a review of Thomas Sowell's *Knowledge and Decisions, Reason*, Vol. 13 (December 1981), pp. 47–49.

¹¹⁹ This anecdote is related in Nicholas Wapshott, *Keynes-Hayek: The Clash That Defined Modern Economics* (London: W. W. Norton & Company, 2012), p. 205, but without all the names of those concerned.

¹²⁰ His lecture, *Hagfraedi stjornmalanna* [The Economics of Politics], was printed in *Frelsid* and reprinted in *Lausnarordid er frelsi*, ed. and tr. Hannes H. Gissurarson (Reykjavik: Stofnun Jons Thorlaksosonar, 1994).



Freedom'.¹²¹ Two years later, in the autumn of 1984, Friedman visited Iceland with his wife Rose. It is fair to say that he, like Caesar long ago, came, saw, and conquered. Small of stature, but thoughtful and witty and totally in command of his subject, he made a strong impact. When he met the press during his first day in Iceland, a reporter asked whether he could sum up his recipe for Iceland in just one word, he replied: 'Yes, I can!' Slightly surprised, the reporter asked what that word would be. 'Freedom,' Friedman said with a broad smile. At a luncheon given by the Minister of Trade, the present writer introduced a governor of the Central Bank of Iceland to him with the words: 'Here is a man, Professor Friedman, who would lose his job if your ideas were implemented in Iceland: a governor of the Central Bank.' Friedman was quick to reply: 'No, no. He would not lose a job; he would just have to move on to a more productive job.' The Chamber of Commerce gave a dinner for Friedman, and one of the businessmen present asked him over coffee what he thought was the greatest

danger to capitalism. 'Look into a mirror,' Friedman answered. 'The greatest danger to capitalism is the capitalists themselves. They are always ready to ask for small and big favours from government. They do not like competition.'

Friedman gave a lecture 1 September 1984 at a luncheon meeting organised by the Faculty of Economics and Business Administration at the University of Iceland on cooperation the Libertarian Alliance. He spoke about the 'tyranny of the status quo', the unholy alliance of three groups, politicians, bureaucrats, and recipients of government transfers, whether imaginary or real. This alliance resisted all reforms and could only be reined in, Friedman submitted, by constitutional limits on the powers to tax and to print money.¹²² Even if admission to the luncheon meeting cost a little less than \$40 per person (in current prices), the house was full to the brink. The night before, the government broadcasting service had televised a lively debate

between Friedman and three left-wing intellectuals. At the close of the debate, one of the three, Sociology Professor Stefan Olafsson, pointed out that this was probably the first time an admission fee had been charged for a lecture at the University of Iceland (even if the lunch was included in the price). This was not his idea of freedom, Olafsson wistfully said: while he found Friedman's ideas stimulating, he could not afford to attend the lecture. Friedman was quick to reply that he thought this was not a correct use of the word 'freedom'. He had nothing against charging admission fees to guest lectures at universities. When other guests had been invited in the past to give lectures at the University of Iceland, it could not have been costless. Their travel costs and accommodation had to be paid; meeting rooms had to be rented; advertisements had to be taken out; and so on. What Olafsson meant to say, obviously, was that he wanted those who did not attend a lecture to pay for it and not only those who did attend. Icelandic television viewers all understood Friedman's message: there is no such thing as a free lecture. It should be pointed out, in addition, that the admission fee was roughly what a university student would then have spent on a jolly night out in Reykjavik. Also, although it has not been disclosed before, the reason why the Libertarian Alliance charged an admission fee was that it wanted to pay Friedman a fee for his lecture, even if he had not mentioned, let alone requested, any payment when he offered to visit Iceland. The net revenue from the luncheon meeting was used to pay him. To his great surprise, the present writer gave him the cheque at the airport when he was leaving.

In the 1980s, slowly economic liberals, not only from the Locomotive Group and the Libertarian Alliance, but also others, gained influence. The visits by Hayek, Buchanan and Friedman undoubtedly contributed to this, but also a stream of publications from the Libertarian Alliance and later from a small research institute, the Jon Thorlaksson Institute, which operated for a few years with the present writer as director. They

included collections of papers by Jon Thorlaksson and Benjamin Eiriksson and translations of the lectures by Hayek, Friedman and Hayek. In 1983, Thorsteinn Pálsson from the Locomotive Group was elected chairman of the Independence Party, and in 1985 he became Finance Minister, instigating a lot of tax reforms, replacing a sales tax with a value-added tax and introducing pay-as-you-earn income tax.¹²³ However, under Pálsson's leadership, the Independence Party split after he managed to offend a popular party member, and it suffered a thunderous defeat in the 1987 parliamentary elections. Nevertheless, Pálsson formed a coalition government of his Independence Party, the Progressives, and the Social Democrats that only lasted a year because he managed to offend the leaders of the other two parties. In 1988, the present writer, having completed a doctorate at Oxford University,¹²⁴ was appointed Professor of Politics at the University of Iceland, against the protests of most of the very left-wing faculty. Two other applicants for the job (neither of whom had completed a doctorate) complained to the Icelandic Ombudsman who in his written opinion found however no fault with the appointment.¹²⁵ In 1989, the group which had founded the Libertarian Alliance ten years earlier decided to dissolve it, as its job of promoting classical liberalism or libertarianism in Iceland had been done. Meanwhile, liberals were active on the political front. After the break-up of Pálsson's government, many prominent members of the Independence Party felt that there was need for a more decisive leadership. The forceful and popular Mayor of Reykjavik, David Oddsson, who had gone from one electoral success to another was encouraged to stand against Pálsson and in 1991 he was elected leader of the Independence Party. Oddsson was, like Pálsson, a member of the Locomotive Group, and there was no basic disagreement between the two that Iceland needed comprehensive liberal reforms. In the 1991 parliamentary elections, the Independence Party won a victory, and Oddsson formed a coalition government with the Social Democrats. •

¹²³ Marco Bianchi, Bjorn R. Gudmundsson and Gylfi Zoega, Iceland's Natural Experiment in Supply-Side Economics, *The American Economic Review*, Vol. 91 (5: December, 2001), pp. 1564-1579.

¹²⁴ Hannes H. Gissurarson, *Hayek's Conservative Liberalism* (New York: Garland, 1987).

¹²⁵ Ombudsman of the Icelandic Parliament, case no. 87/1989, <http://www.umbodsmaduralthingis.is/ViewCase.aspx?Key=665&skoda=mal> The two plaintiffs received financial assistance from the University to prepare their case. One of them, Gunnar Helgi Kristinsson, had in 1981 completed a BA in political science from the University of Iceland and in 1982 a MSc in political science from the LSE; he was in 1990—eight years after his Master's degree—to complete a PhD in comparative politics from the University of Essex. The other plaintiff, Olafur Hardarson, had in 1977 completed his BA in political science from the University of Iceland and in 1979 a MSc in political science from the LSE; he was in 1994—fifteen years after his Master's degree—to complete a PhD in political science from the LSE. I completed my BA in history and philosophy in 1979 and my MA in history in 1982, both from the University of Iceland, and my DPhil in politics in 1985 from Oxford University.

¹²¹ Milton Friedman, *Frelsi og framtak* (Reykjavik: Almenna bokafelagid, 1982).

¹²² Milton Friedman, *I sjalfheldu serhagsmunanna*, Lausnarordid er frelsi, ed. and tr. Hannes H. Gissurarson (1994).

THE ICELANDIC ITQ SYSTEM IN THE FISHERIES



While the formation of the first Oddsson government certainly can be regarded as a turning point in the economic history of Iceland, in some fields reforms which had started earlier were mostly consolidated and continued. This applies in particular to the fisheries, by far the most important sector of the Icelandic economy. Iceland had extended her fishing limit four times, until it finally reached 200 miles in 1975, which meant that the Icelanders became sole users of the fertile fishing grounds in the territorial waters: earlier, around half the total catch or more

had been harvested by foreigners. But at the same time, it seemed that the most valuable fish stock, the cod, was in danger of depletion, as had happened to herring some years before. Moreover, it was clear that too much capital had been invested in the fisheries, as economists would have predicted about any non-exclusive resource.¹²⁶ The fishing fleet had grown much faster than the total catch. The government decided to try and limit effort, defined as fishing days out at sea, but this did not seem to be successful, at least not in reducing over-investment.

¹²⁶ Cf. the papers already quoted by Jens Warming, H. Scott Gordon and Antony Scott.

In the autumn of 1980, when the present writer was still a student of history at the University of Iceland, he was invited to a conference at Thingvellir, the site of the old Icelandic parliament, on 'Iceland in 2000'. One speaker after another asserted that capitalism could not deal with environmental problems such as overfishing. Instead, judicious government planning was needed. From the present writer's reading of Mises and Hayek, he had drawn the conclusion that individual property rights and their free transfer in a market were necessary to bring about the most efficient utilisation of resources. In the general discussion at the conference, he therefore stood up and innocently suggested that property rights be defined either to particular fish stocks or to particular fishing grounds, and then the problem spontaneously would be solved by the owners. Needless to say, his suggestion was derided, and a journalist from the socialist newspaper *Thjodviljinn* who was present at the conference wrote ironically in his paper that 'he had found a solution to the problem of utilising fishing grounds. It was either to entrust the fisheries to a public company which would charge an admission fee to them, or to hand over to fishing firms the full ownership of the fishing grounds previously held in common.'¹²⁷

Something like this is however what happened, not because people started to listen to the present writer, but because groping for solutions, in a process of trial and error, the Icelandic fishing community, in cooperation with government agencies, developed a feasible system in the fisheries. After the collapse of the herring stock in the late 1960s, a complete moratorium on herring was imposed. In 1975, harvesting of herring started again, but it was governed by catch quotas which each herring boat received. Each boat could only harvest a limited amount of herring, defined by its quota. The allocation was not complicated, because the herring boats were similar in size: they all simply received the same quota. In 1979, the herring quotas were made transferable to make the system more flexible. A similar system was also introduced for capelin, a pelagic fish similar to herring (pelagic fishes roam around close to the surface of the sea and migrate

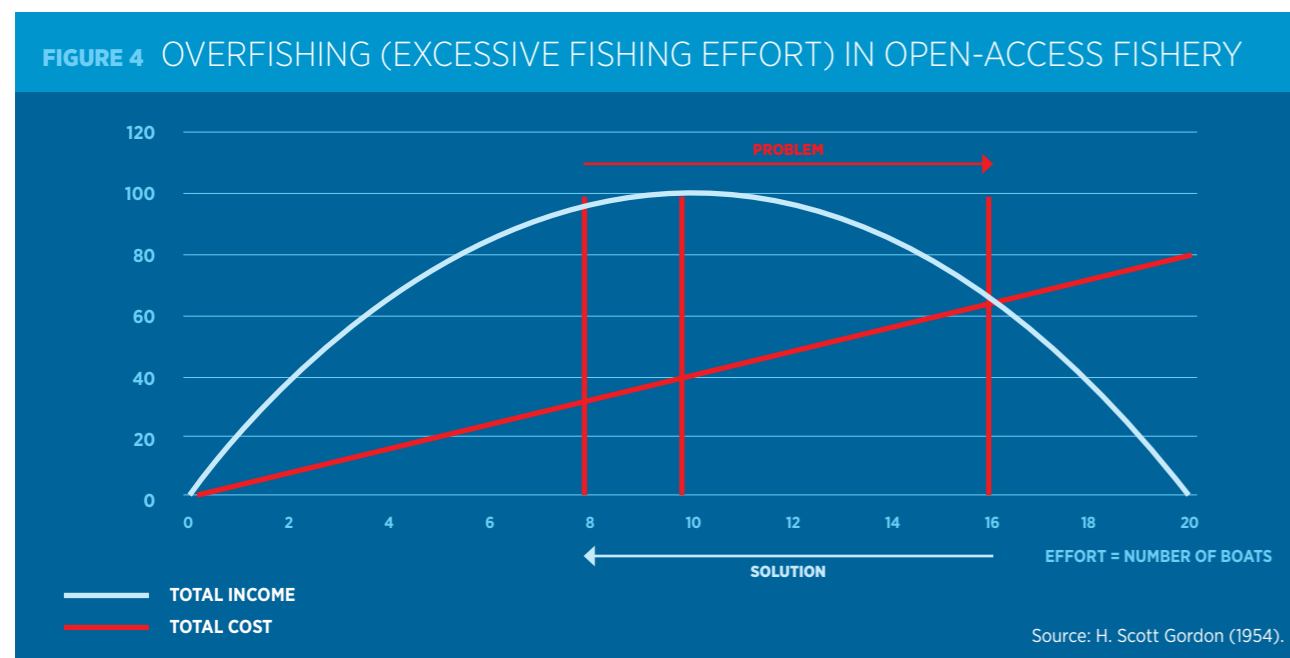
over long distances, whereas demersal fishes like cod tend to stay in the same deep underwater locations). But in the far more important demersal fisheries it proved difficult to solve the problem of overfishing. After attempts to limit fishing effort failed, the government decided to try to limit catch instead, as had been done in the pelagic fisheries. In 1983, it allocated catch quotas to fishing vessels according to their catch history in the previous three years. If a vessel had for example harvested 1% of the total catch in cod during this period, then it received a quota consisting in a permit to harvest 1% of the total allowable catch in cod over the fishing season. First, the catch quotas were only allocated for a year, and then for two years, and then without a time limit. They were also gradually made transferable. The experience with the individual transferable quotas, the ITQs, was generally positive, and in the spring of 1990, the system was made comprehensive, as the present writer strongly supported in a book which he published during the deliberations of the parliament on the issue.¹²⁸ The Ministry of Fisheries sets a total allowable catch, TAC, in each fish stock, and allocates catch quotas, a proportion of the TAC, to each fishing vessel. The quotas are freely transferable which means that over-investment could be reduced. The more efficient fishermen bought quotas from the less efficient who left the fisheries, and subsequently the buyers combined the new quotas with their own quotas better to utilise their fishing vessels. The quota holders also gained a vested interest in maximising the long-term profitability of the resource of which they regarded themselves as being partial owners. Their behaviour changed: they wanted the Ministry of Fisheries to set the TAC cautiously, and they invested in research and development.¹²⁹ It amounted to a quiet revolution how the owners of fishing firms accepted the great reductions of TACs in various fish stocks that turned out to be necessary in the early 1990s.

From the beginning, the ITQ system was nonetheless controversial in Iceland. Initially, its opponents argued that catch quotas were not as effective in hindering over-fishing as effort limits (such as fishing days), but those voices fell slowly silent as the efficiency of the system was amply demonstrated. However,

¹²⁷ ab [Arni Bergmann], Thadan skin ljós (Therefrom Comes the Light), *Thjodviljinn* 14 November 1980.

¹²⁸ Hannes H. Gissurason, *Fiskistofnarnir vid Island: Thjodareign eda rikiseign?* [The Fish Stocks in Icelandic Waters: Property of the Nation or of the State?] (Reykjavik: Stofnun Jons Thorlakssonar, 1990).

¹²⁹ Hannes H. Gissurason, *Overfishing: The Icelandic Solution* (London: Institute of Economic Affairs, 2000); Hannes H. Gissurason, *The Icelandic Fisheries: Sustainable and Profitable* (Reykjavik: University of Iceland Press, 2015). Ragnar Arnason, *Iceland's ITQ System Creates New Wealth*, *The Electronic Journal of Sustainable Development*, Vol. 1 (2: 2008), www.ejsd.org



the very success of the system has given occasion to harsh criticisms. Some people resent that the fishing firms have become profitable unlike their counterparts in most other countries. These critics point out that the owners of the firms initially received the quotas on the basis of catch history, and not in a government auction. Friedman's old opponent, Sociology Professor Stefan Olafsson, writes, for example, 'This form of original allocation was by many seen as unfair, closing the formerly open access to the commons that the fishing grounds had been and producing privileges in a more closed industry.'¹³⁰ But this objection to the ITQ system shows that Olafsson has not fully comprehended the nature of the problem arising from non-exclusive or open-access scarce resources. According to fisheries economists, from Jens Warming to H. Scott Gordon, under open access to a fishery fishing effort will inevitably increase to the point when there is no more profit to be gained in the industry – when access becomes worthless. Consider a simple model of a fishery, based on Warming's and Gordon's analysis, illustrated in Figure 4. Assume there is one fish stock in one fishing ground. Cost is assumed to be the same for each boat, so the cost line goes straight up. Catch, and with it catch income, however increases rapidly first, as marine biologists submit, but then it reaches a maximum, the maximum sustainable yield, MSY, and after that it goes down, and would fall all the way to zero if the fish stock would collapse (as has sometimes happened, not only in the Icelandic herring fishery in the 1960s, but also

in the cod fishery off Newfoundland in the 1990s). Fisheries economists point out that in this example effort will, under open access, increase to 16 boats. That is the point when income equals cost. But the optimal point of fishing effort is 8 boats because there the difference between income and cost, in other words net profit, is the greatest. There one would have the same or even more catch and income as with 16 boats, but with only half the cost. The task is therefore to reduce fishing effort from 16 to 8 boats. When individual transferable quotas are allocated to the 16 boats according to catch history, the more efficient boat owners will buy quotas from the others who consequently leave the fishery and the number of boats will gradually go down to 8 boats because that is the point of maximum profit.

Some interesting things can be observed from this simple, but generally accepted model of a fishery. First, the MSY, maximum sustainable yield, is not necessarily the most efficient goal in the fishery. The owners of fishing boats wish to maximise the dollars in their pockets, not the cods in their trawls. Or, to put it differently, they wish to maximise net income, not gross income. Therefore, in this example, they would go for 8 boats and not 10 (where the catch is greatest). What economists are interested in is economic overfishing, when too much effort is put into harvesting, here after the 8th boat, and not biological overfishing, when the fish stock diminishes with increased effort, here after the 10th

boat. Secondly, it can be observed that, under open access, there is enormous waste which is eliminated when access is confined to quota holders. This waste consists in utilising 16 boats to harvest the same or even less total catch that 8 boats could harvest. The special profit captured by the initial quota holders consists in the elimination of waste within their sector of the economy, and not in a transfer of a good from some to others. A third point, particularly important in discussions of initial allocation, emerges from this illustration. The only right that others are deprived of with this enclosure of a commons is the right to become the 16th fisherman and to harvest fish at no profit. This is by definition a worthless right. Nothing of any value is really taken from others when the fishing grounds are enclosed. It is therefore somewhat surprising when Professor Olafsson writes, 'The new system of marketization and private property rights in fishing quotas left a deep scar on Icelandic society, a scar that still is a source for conflicts in politics.'¹³¹

It is true that the ITQ system is still a source of conflicts in Icelandic politics, paradoxically not because of its failure, but because of its success. But it should be observed that the alternative method of initial quota allocation which some Icelandic intellectuals suggested, a government auction, would have caused much graver conflicts.¹³² This can easily be seen from the simple model presented here: the idea would have been to reduce the number of boats on the fishing ground by government auctioning off the quotas in such a way that only the 8 more efficient boat owners would have been able to rent the quotas and to continue harvesting fish. The 8 more efficient boat owners would not have been better off, because they would simply have paid to government in rent for the quotas what they previously spent on their boats, fishing gear and acquisition of fishing skills. They would not therefore have had any incentive to support the enclosure of the fishing ground. More importantly, the 8 less efficient boat owners would have had to leave the fisheries because of their inability to pay the rent for the quotas. They would have lost in just one day, at the stroke of a pen, all their investment in boats, fishing gear and fishing skills. They would therefore have had a strong incentive to oppose this

change. The only agent that would have been better off by the change would have been government. The difference between the two alternatives can be put differently. A social change is said to be Pareto-optimal if all, or at least some, benefit by it, while nobody is harmed.¹³³ Initial allocation on the basis of catch history is Pareto-optimal in this sense. Initially, the boats receive the right to harvest the same amount as they previously did, then some buy new quotas, while others sell theirs, leaving the fishery, quite content with their money. But initial allocation by a government auction is not Pareto-optimal. Government is much better off. Those who remain in the fishery are no better and no worse off. Those who suddenly have to leave the fishery because of their inability to pay high rents for the quotas are much worse off. They are suddenly being deprived of their livelihood. These considerations may explain why Icelandic politicians chose allocation by catch history rather than by government auction.

As of 2017, catch quotas have been in place for 42 years in the herring fishery and for 33 years in the much more important demersal fisheries, such as the cod fishery. Most of the quotas held by individual fishing firms have been bought at market prices. Nevertheless, Professor Olafsson, Economics Professor Thorvaldur Gylfason, and some other intellectuals still think it is feasible for government to seize the quotas from the fishing firms and to auction them off. The present writer has, however, not been the only university professor defending the ITQ system. Professor Ragnar Arnason (b. 1949) has for decades been a forceful advocate of free markets and private property rights in Iceland. Originally a socialist, he changed his view when he studied resource economics, obtaining a doctorate from the University of British Columbia in fisheries economics in 1984 and becoming professor in fisheries economics at the University of Iceland. Even if the ITQ system was mainly developed by stake holders, cooperating with government agencies in a process of trial and error, Professor Arnason made an important contribution to its development as an adviser to various government bodies.¹³⁴ Two of Arnason's colleagues at the Faculty of Economics at the University of Iceland have also

¹³⁰ Stefan Olafsson, *Icelandic Capitalism – From Statism to Neoliberalism and Financial Collapse*, The Nordic Varieties of Capitalism, ed. Lars Mjøset, Comparative Social Research, Vol. 28 (Bingley: Emerald Group Publishing, 2011), p. 18.

¹³¹ Stefan Olafsson, *Icelandic Capitalism – From Statism to Neoliberalism and Financial Collapse* (2011), p. 18.

¹³² The following objections would also have applied to the idea of imposing a special tax on the fishing firms in order to reduce fishing effort, and keeping the tax high enough that only half of the fishing fleet could have continued in operation.

¹³³ James M. Buchanan, *Positive Economics, Welfare Economics and Welfare Economics*, *The Journal of Law & Economics*, Vol. 2 (October 1959), pp. 124–38.

¹³⁴ Ragnar Arnason, *Minimum Information Management in Fisheries*, *Canadian Journal of Economics*, Vol. 23 (1990), pp. 630–53.



publicly defended economic liberty, including the ITQ system. Professor Birgir Thor Runolfsson (b. 1962) wrote his doctoral thesis under James Buchanan and Gordon Tullock on the Icelandic Commonwealth and has published papers on that subject as well as on the fisheries. Professor Thrainn Eggertsson (b. 1942) is internationally known for his contributions to institutional economics, which he has applied to several Icelandic subjects.¹³⁵

In the debate in Iceland after the ITQ system had proved its efficiency, Professor Arnason identifies three fallacies in the argumentation of those who want now to seize the quotas from the fishing firms:¹³⁶ first, it is not correct that the fisheries' profit (or resource rent) is derived from the resource alone, and not created in any way by the fishing firms. If it were true, why was then the income from the fisheries not much higher when in the past much more was harvested from much bigger stocks? In the second place, it is not correct that the quota holders are the only ones to benefit from the system of exclusive rights. In the end, everybody benefits when a sector of the economy

becomes profitable, as Adam Smith pointed out long ago.¹³⁷ The fishing firms pay taxes and employ people, and since they export most of their products they keep the exchange rate for the *krona* higher than it otherwise would be. Their owners use their profits for consumption or investment. Thirdly, it is not correct that a resource tax, imposed directly or indirectly on the fisheries, would not reduce the total fisheries profit. It would reduce the international and domestic competitiveness of the Icelandic fisheries, discourage research and development in the fisheries, and remove the incentives the fishermen have to try and maximise the long-term profitability of the resource, for example, by a cautious setting of the TAC, total allowable catch, over the season.¹³⁸ Moreover, by creating a new source of income for the politicians, political rent-seeking would be encouraged, as Professor Runolfsson has emphasised. Instead of fishing firm owners over-investing in a chase for dwindling fish stocks, advocates of special interests would waste resources on capturing as much as they could of the new and dwindling government revenues. Onshore waste would replace offshore waste.¹³⁹ •

¹³⁵ Thrainn Eggertsson, *Economic Behavior and Institutions: Principles of Neoinstitutional Economics* (Cambridge: Cambridge University Press, 1990). Cf. Eggertsson's papers on grazing rights in the Icelandic mountain pastures during the Commonwealth and on the poverty trap construed by the Danish crown in conjunction with the Icelandic landowners, quoted earlier.

¹³⁶ See Arnason's lectures at three conferences on the fisheries, in 2012, <http://www.rnh.is/?p=2258>, 2014, <http://www.rnh.is/?p=5304>, and 2016, <http://www.rnh.is/?p=9010>, two of which are available (in English) on Youtube: <https://www.youtube.com/watch?v=NKNR702KSJE> and <https://www.youtube.com/watch?v=vY0Jnv6CE-w>

¹³⁷ "The rich only select from the heap what is most precious and agreeable. They consume little more than the poor, and in spite of their natural selfishness and rapacity, though they mean only their own convenience, though the sole end which they propose from the labours of all the thousands whom they employ, be the gratification of their own vain and insatiable desires, they divide with the poor the produce of all their improvements. They are led by an invisible hand to make nearly the same distribution of the necessities of life, which would have been made, had the earth been divided into equal portions among all its inhabitants, and thus without intending it, without knowing it, advance the interest of the society, and afford means to the multiplication of the species." Adam Smith, *Theory of Moral Sentiments*, ed. A.L. Macfie and D.D. Raphael (Indianapolis: Liberty Press, 1982 [1759]), IV, 1, 10.

¹³⁸ The last point is also made by R. N. Johnson, *Implications of Taxing Quota Value in an Individual Transferable Quota Fishery*, *Marine Resource Economics*, Vol. 10 (1995), pp. 327–40.

¹³⁹ Birgir Thor Runolfsson, *ITQs in Iceland. Their Nature and Performance*, *Individual Transferable Quotas in Theory and Practice*, eds. Ragnar Arnason and Hannes H. Gissurason (Reykjavik: University of Iceland Press, 1999), pp. 103–140.

LIBERAL REFORMS OF THE ODDSSON GOVERNMENTS

During David Oddsson's tenure as prime minister, 1991–2004, the ITQ system was not only maintained against fierce opposition, but also reformed by removing various exemptions from it and facilitating quota transfers. The pension funds were also strengthened, becoming some of the strongest in the world. 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 to those receiving adequate pensions from occupational pension funds or other sources of income. A pensioner with no other source of income 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% of his or her wage, 4% paid by the employee, and 8% 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.

This was done to make the system sustainable in the long run. The reforms also included facilitating additional private pension schemes, where payments of up to 6% of wages into special accounts with recognised and registered pension funds were exempted from tax. These accounts were inheritable, 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.¹⁴⁰ The total assets of the pension funds (both mandatory and voluntary) amounted to more than the GDP and when David Oddsson stepped down as prime minister in 2004, they had become the second-largest in the OECD. Even after the 2008 bank collapse, they remain strong, as illustrated in Figure 5. The strong position of the pension funds means that Iceland may avoid the bankruptcy of the pension system, foreseeable in many European countries where the labour force (and with it the tax pool) is shrinking at the same time as the number of pensioners is greatly increased with a higher average age.

FIGURE 5 TOTAL PENSION FUND ASSETS IN 2012 IN SELECTED OECD COUNTRIES, AS % OF GDP



¹⁴⁰ Marianna Jonasdottir, *The Icelandic Pension System* (Reykjavik: Ministry of Finance, March 2007). https://eng.fjarmaalarduneyti.is/media/Lifeyrismal/The_Icelandic_Pension_System_032007.pdf

When pension funds are made sustainable, as happened in Iceland under the leadership of David Oddsson (and the liberal Minister of Finance Fridrik Sophussón), 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. This can therefore be understood as a major tax reduction. Another kind of invisible and involuntary taxation is inflation: it transfers value from the owners and users of money to government and to (other) debtors. Iceland had had much more inflation for decades than the neighbouring countries. There are three main reasons for this: an economy based on fisheries and therefore prone to great fluctuations, both in harvests and prices; a militant labour movement, dominated by communists, receiving 'advice' and financial support from Moscow and using force regularly to dictate excessive wage rises; and 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). This 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 the fish catches became predictable. Even before the collapse of the Soviet Union, the unions had abandoned their former militancy. They had, for example, in 1990 entered into a 'National Pact' with the employers and the government about moderate wage increases if 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 strict rules on lending and investing. It was said, half in jest, 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 monetary and fiscal discipline, inflation went down to what it was in the neighbouring countries, as illustrated in Figure 6.

A third kind of invisible and involuntary taxation is accumulation of public debt, as the present generation of taxpayers transfers the burden of its spending to future generations. When the Oddsson government took power in 1991, the public deficit was 3.3% of GDP.¹⁴¹ It was decided to try and bring it down gradually, both by 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 used to reduce the public debt with the result that net public debt went down from 25.3% of GDP in 1992 to 3.9% in 2006.¹⁴²

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 in the market, such as series of fishmeal factories, a share in a ferrosilicon factory, and an investment bank (FBA, *Fjarfestingarbanki atvinnulífsins*), which had been established by a merger of four public investment funds. Consequently, FBA merged with a bank which had been privatised already in 1990, 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 (in 2005 *kronur* and euros).¹⁴³

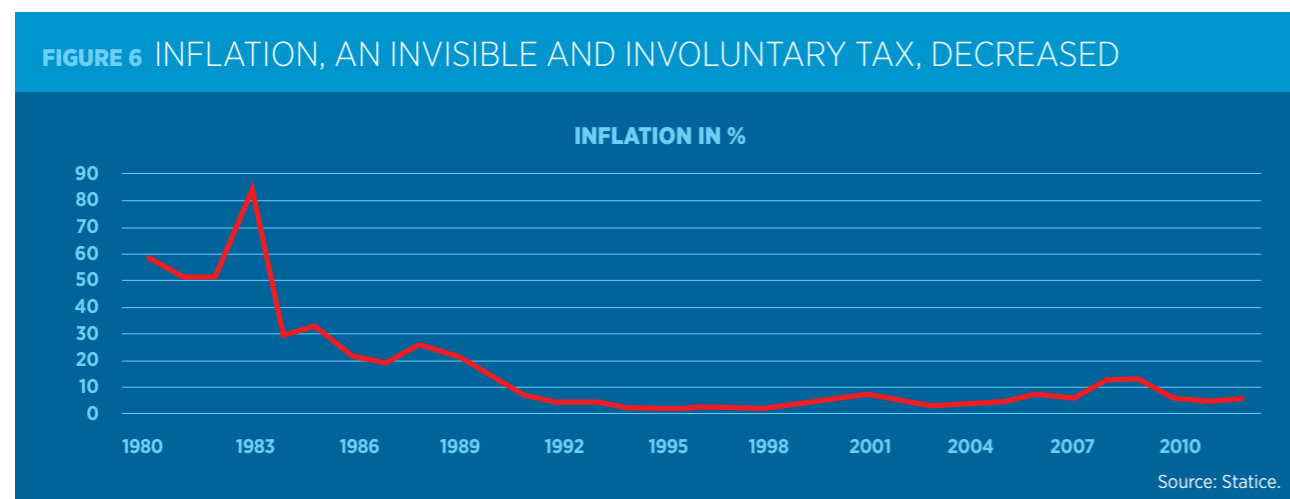
¹⁴³ Einkavaeding fra 1992 – Tafla, <https://www.forsaetisraduneyti.is/raduneyti/verkefni/Einkavaeding/nr/247> The exchange rate at the end of 2005 is used, \$1=63.13 kronur, <http://www.sedlabanki.is/hagtolar/opinber-gengisskraning/>

TABLE 2 PRIVATISATION IN ICELAND, 1992–2005

COMPANY	YEAR SOLD	% OF SHARES	PRICE (MILLIONS)
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	1992–5	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-Mjol)	1993	100	1,050.8
Fishing firm (Thormodur rammi)	1994	16.6	127.7
Medicine import and production	1994–5	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
TOTAL			141,185.2

¹⁴¹ General government main aggregates, Financial balance, <http://www.statice.is/statistics/economy/public-finance/general-government/>

¹⁴² Ministry of Finance, Debt Statistics, <https://www.ministryoffinance.is/government-finance/debt-statistics/>



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 capitalists and entrepreneurs so that loss could be turned into profit and new jobs would be created, not necessarily in those very companies, but through economic growth. This is indeed what happened. Many of the companies sold had rarely or never shown any profits, but now they became lucrative enterprises. The companies which did not turn out to be feasible on the other hand, were wound up instead of being kept in operation with taxpayers' money. The argument for giving subsidies to public companies had been similar to the common excuse for drinking champagne: in success, one deserves it; in failure, one needs it. 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 the other Nordic countries, where, for example, banks were privately run. For some of the companies sold, listed in Table 2, it seems in retrospect strange that they had ever been run 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 businessmen 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.

At the same time as the Oddsson governments were reducing the three kinds of invisible and involuntary taxes imposed by former governments – unfunded pension obligations, inflation, and accumulation of public debt – they started to simplify and reduce the traditional kinds of 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 discriminatory 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% of the estate in question. A 10% capital income tax was introduced: before, some income from capital had not been taxed at all, such as interest, while other 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% in 1990 and 45% in 1991, was gradually lowered to 18% in 2001 and finally to 15% in 2007. Describing changes in the personal income tax is somewhat more complicated, because in the years after 1991 it was lowered for central government while the income tax which went to municipalities was raised, as 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 by 7.5%, from 30.41% in 1997 to 22.75% in 2007. A special surcharge on high incomes which had been introduced in 1993 at the demand of the Social Democrats was gradually phased out later and had disappeared by 2007. This meant that the marginal tax rate for personal income tax (with both parts included, that of central government and the municipalities) went from 46.84% in 1994 to 35.72% in 2007.

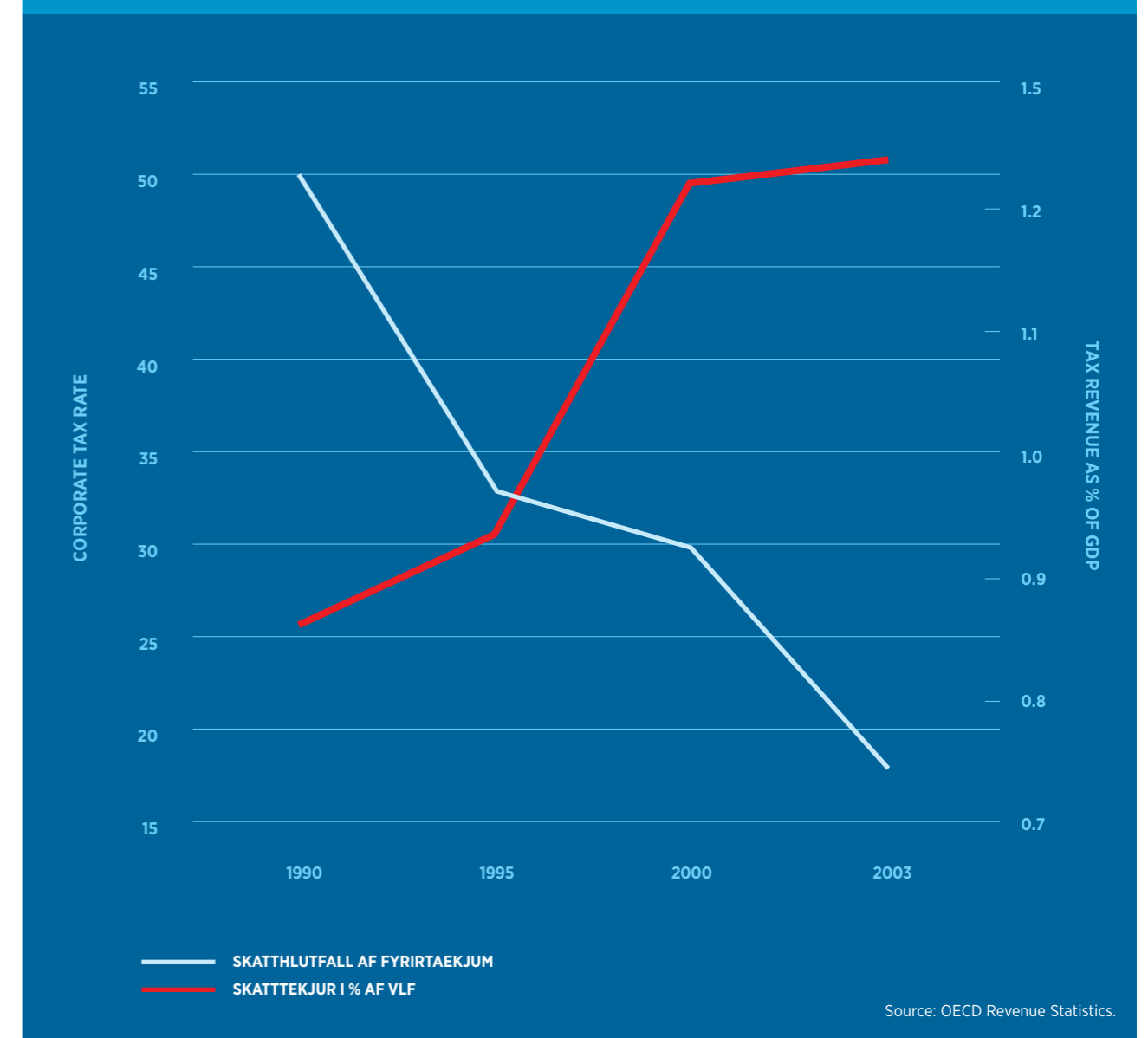
The lower tax rate, both for corporate and personal income tax, generated more tax revenue. In Figure 7 the corporate tax rate is plotted against corporate tax revenue as a proportion of GDP, for the period 1985–2003 (and therefore before the credit bubble preceding the 2008 bank collapse).¹⁴⁴ The result is a striking confirmation of Arthur Laffer's famous insight that tax revenue can sometimes actually increase with a lower tax rate. Incidentally, this was well-known to Jon Thorlaksson, who said in 1925, while Minister of Finance: '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 rate does not lead to an increase in tax revenue, but to a decrease.'¹⁴⁵ The new capital income tax also generated much 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.

This was not least because in 1994 Iceland joined the European Economic Area, 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 within the EU.

For example, the EEA did not apply to natural resources like the fertile Icelandic fishing grounds or to tax issues. 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 the strengthening of the ITQ system and the pension funds; tax reductions; and privatisation. Also, of course, if Iceland needed cheaper goods from abroad, she could lower her customs unilaterally. This does not change the fact that EEA membership opened up a lucrative market to the Icelandic export industries.

FIGURE 7 LOWER TAX RATE AND INCREASED TAX REVENUE



¹⁴⁴ This type of graph was suggested to me by US economist (and Nobel Laureate) Edward S. Prescott whose visit to Iceland I organised in 2007.

¹⁴⁵ Althingistidindi (1925), C 1174.

In hindsight, it may seem as if the Oddsson governments of 1991–2004 were smoothly implementing a liberal master plan. This was not so. 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 because of that. Nevertheless, the Oddsson governments were indeed 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.¹⁴⁶ In 2004, Iceland had the freest economy of all the Nordic countries (which all were however relatively free) and was one of the countries in the world where economic freedom had increased the most in the preceding ten years.

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.¹⁴⁷ He, Professor Ragnar Arnason, and other liberals held conferences and edited books on the ITQ system and on taxation, usually working through the University of Iceland where Arnason and he were both based rather than through the Jon Thorlaksson Institute, which gradually became defunct. Icelandic liberals were not only defending past or present accomplishments, but also discussing new and radical ideas, such as that Iceland should lower her taxes in order to attract foreign corporations and capital and that the ITQ system in the fisheries should

become self-governing by transferring authority to set TACs (total allowable catches in each fishery over the season) and responsibility for marine research from government agencies to the association of fishing firm owners.¹⁴⁸ They also encouraged translations of works by liberal thinkers: in 1997, the first part of Adam Smith's 'Wealth of Nations' was published with a foreword by the present writer;¹⁴⁹ books by Hernando de Soto, Frederic Bastiat, Henry Hazlitt and others were also published.¹⁵⁰ In the summer of 2005, classical liberals, conservatives, and libertarians from all over the world gathered in Iceland to attend a regional meeting of the Mont Pelerin Society, organised by Professor Harold Demsetz and the present writer, with the help of Dr. Edwin Feulner. Speakers at the conference included President Vaclav Klaus of the Czech Republic, former Prime Minister Mart Laar of Estonia, Professor Arnold Harberger and several Icelandic scholars, including Ragnar Arnason and Thrainn Eggertsson. David Oddsson was also one of the speakers. He had formed a coalition government of his Independence Party and the Progressives in 1995 after the Social Democrats had split in 1994. This 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.

There were dark clouds on the horizon, however. Milton Friedman's remark to Icelandic businessmen in 1984, that the worst enemies of capitalism are the capitalists, proved to be prescient. A group of powerful businessmen led by retail magnate Jon Asgeir Johannesson was turning against Prime Minister David Oddsson, even though they had flourished in the now much freer Icelandic economy, buying up a lot of companies. The origin seems to be that in early 2002, Oddsson expressed his agreement with leading social democrats that increased concentration in the retail market was not

desirable.¹⁵¹ Apparently, Jon Asgeir Johannesson took great offence at this. When later in the year a disgruntled former business associate of his living in the United States reported him to the Icelandic police for breaking book-keeping rules, Johannesson blamed it on Oddsson. Subsequently the police started an investigation into Johannesson's business affairs. Oddsson denied any involvement in the case, although he did not hide his low opinion of Johannesson. Both Johannesson's original accuser and police investigators also categorically rejected Johannesson's allegations.¹⁵² Be that as it may, after an almost frantic battle for several years before the courts Johannesson was finally convicted on the original charge and given a suspended three months prison sentence. But in the meantime, he had organised a vendetta against Oddsson, enlisting many of Oddsson's old opponents who, even if professed left-wingers, seized the opportunity of allying themselves with a powerful businessman. In 2002 Johannesson secretly bought the newspaper *Frettabladid*, which relied on advertisements (not least from Johannesson's many companies) and which was distributed free of charge to every home in Iceland.¹⁵³ In the 2003 parliamentary election campaign Johannesson used his newspaper against Oddsson who thereupon publicly revealed that Johannesson had indirectly and very cautiously, 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 his fight against Johannesson.¹⁵⁴ 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 private television in Iceland, as well as a tabloid, *DV*, and some magazines.¹⁵⁵

By now, Jon Asgeir Johannesson owned not only a retail empire (by Icelandic standards) and several other companies, but also almost all the private media in Iceland. Unsurprisingly, 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 manoeuvres during the police investigation and court case against him.¹⁵⁶ When Oddsson in 2004, shortly before he stepped down as Prime Minister, proposed a law against media concentration, it was approved by parliament. Even many economic liberals 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 Icelandic-speaking consumers.¹⁵⁷ But for the first time in Icelandic history, the president, Olafur R. Grimsson (who had in 1984, as a left-wing intellectual, debated 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, and Grimsson's daughter occupied a managerial position in one of Johannesson's companies. Instead of holding a national referendum on the law, the government decided to withdraw it. This outcome was seen as a defeat for Oddsson and a victory for Johannesson, changing in many ways the public attitude towards aggressive businessmen like him who suddenly seemed invulnerable, almost invincible, going or even resolutely marching from one success to another, turning everything they touched into gold like Croesus, but unlike him allowing others to have a share in it. An uncommon, but undeniable factor in the course of events over the next four years was a generally favourable public opinion in Iceland towards businessmen like Jon Asgeir Johannesson, dealing and wheeling all the time, tirelessly expanding and taking high risks. •

¹⁴⁶ Hannes H. Gissurarson, Ahrif skattahaekkana a hagvoxt og lifskjor [The Impact of Tax Increases on Economic Growth and Living Standards] (Reykjavik: Bokafelagid, 2009), p. 18. There is a slight discrepancy between these figures and those on the website of the index of economic freedom, but that is because the data are being revised as additional economies are being measured. These figures were those which were available in 2009 when the book was written.

¹⁴⁷ Hannes H. Gissurarson, Jon Thorlaksson forsætisradherra (1992); Hvar a madurinn heima? [Where Does Man Belong?] (Reykjavik: Hid islenska bokmenntafelag, 1994); Benjamin Eiriksson i stormum sinna tida (Reykjavik: Bokafelagid, 1996); Hadesisverdurinn er aldrei okeypis [There Is No Such Thing as a Free Lunch] (Reykjavik: Hid islenska bokmenntafelag, 1997); Fiskar undir steini [Twists in the Tales] (Reykjavik: University of Iceland Press, 2001).

¹⁴⁸ Individual Transferable Quotas in Theory and Practice, eds. Ragnar Arnason and Hannes H. Gissurarson (Reykjavik: Institute of Economic Studies at the University of Iceland, 1999); Tax Competition: An Opportunity for Iceland? eds. Hannes H. Gissurarson and Tryggvi Thor Herbertsson (Reykjavik: University of Iceland Press, 2001); Cutting Taxes to Increase Prosperity, eds. Hannes H. Gissurarson and Tryggvi Thor Herbertsson (Reykjavik: Bokafelagid, 2007); Advances in Rights-Based Fishing, eds. Ragnar Arnason and Birgir Thor Runolfsson (Reykjavik: Ugly, 2008).

¹⁴⁹ Adam Smith, Audlegd thjodanna, tr. Thorbergur Thorsson, Parts I–III (Reykjavik: Bokafelagid, 1997).

¹⁵⁰ Henry Hazlitt, Hagfraedi i hnotskurn [Economics in One Lesson] (Reykjavik: Nyja bokafelagid, 2000); Frédéric Bastiat, Login [The Law] (Reykjavik: Andriki, 2001); Hernando de Soto, Leyndardomar fjarmagnsins [The Mystery of Capital] (Reykjavik: Bokafelagid, 2005).

¹⁵¹ Kemur til greina ad skipta upp eignum, Morgunbladid 23 January 2002. Oddsson's comment was in response to a query from Ossur Skarphedinsson, former leader of the Social Democrats.

¹⁵² The whistle blower, Jon Gerald Sullenberger, says that he did not know David Oddsson at the time. He did not make any secret of the fact that his reason for reporting Jon Asgeir Johannesson to the police was personal as well as professional: He felt that Johannesson had made improper advances to his wife. He also knew that he was accusing himself as well as Johannesson, since he had participated in the book-keeping irregularities of which he was accusing Johannesson. Segir einkaspaeyjara hafa njosnad um sig (interview with Jon Gerald Sullenberger), Morgunbladid 27 September 2005; Solvi Tryggvason, Jonina Ben (Reykjavik: Sena, 2010), pp. 133 and 150.

¹⁵³ His ownership of the newspaper was not revealed until 2003: Hagnadur af rekstri og traustur efnahagur, Frettabladid 2 May 2003. Those who invested in the newspaper with him were his partner, Ingibjorg Palmadottir, his father, Johannes Jonsson, and the businessmen Arni Hauksson and Palmi Haraldsson.

¹⁵⁴ I thessu samtali folst enginn halfkaeringur [This discussion was not in jest] (interview with David Oddsson), Morgunbladid 4 March 2003.

¹⁵⁵ From the various accounts of the incident it is clear that this 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.

¹⁵⁶ Bjorn Bjarnason, Rosabaugur yfir Islandi: Saga Baugsmalsins (Reykjavik: Ugly, 2011).

¹⁵⁷ Hannes H. Gissurarson, Frjalshyggyja, samkeppni og eignarhald a fjolmidlum, Morgunbladid 6 May 2004.

CRITICS OF ODDSSON'S LIBERAL REFORMS

At the dawn of the 21st century, the two most active and vocal critics of David Oddsson's liberal reforms had become Professors Thorvaldur Gylfason and Stefan Olafsson, both at the University of Iceland. Both professors had connections to Jon Asgeir Johannesson: Gylfason was a regular and well-paid columnist for Johannesson's newspaper, *Frettabladid*, and Olafsson's wife was the anchorwoman of the evening news in Johannesson's television station. But even if Olafsson had in 1984 claimed that he could not afford the admission fee charged to Milton Friedman's lecture in Iceland, the two professors were probably less motivated by financial considerations than by a strong disagreement with Oddsson's political agenda, possibly mixed with some reservations about, or even hostility towards, the Prime Minister personally. Gylfason mainly criticized the ITQ system in the fisheries, suggesting either that government seize the quotas and then rent them back to the fishing firms at public auctions or that it impose a heavy resource rent tax on the fisheries, designed to transfer all the resource rent from the owners of fishing firms to the government.¹⁵⁸ Gylfason also attacked Oddsson personally. For example, in 1998 he publicly alleged that Oddsson had let government pay for his 50th birthday party in January.¹⁵⁹ This was not true: the Independence Party had paid for a well-attended reception held in the afternoon, and the profits from a *Festschrift* for Oddsson were used to pay for a lavish dinner party in the evening for him, his family, friends,

colleagues, and authors of papers in the *Festschrift*.¹⁶⁰ Gylfason also alleged that the police investigation of Jon Asgeir Johannesson was politically motivated, writing in Johannesson's newspaper, 'It seems that now the aim is to go after Johannesson and five other people before the courts. What is behind this? Perhaps just a lack of respect for the free market and the division of power that goes with it, and also for the necessary separation of executive, legal and judiciary powers. Who knows?'¹⁶¹

While Professor Stefan Olafsson also criticized the ITQ system in the fisheries,¹⁶² his main focus was on the Icelandic welfare state. He argued that Oddsson and his 'neoliberal' associates were trying to move Iceland away from the Scandinavian model of the welfare state to the Anglo-Saxon one. In his analysis Olafsson used well-known concepts constructed by Danish sociologist Gøsta Esping-Andersen: the Scandinavian model of the welfare state implied high levels of taxation and redistribution and general and generous welfare benefits, whereas the Anglo-Saxon model implied relatively low levels of taxation and redistribution and means-tested welfare benefits, directed to group on the basis of their need rather than as a general social right.¹⁶³ '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

¹⁵⁸ While Gylfason has not written any scholarly paper on the ITQ system, he has published many newspaper articles against it, collected in several books he had published, including *Almannahagur* (Reykjavik: Hid islenska bokmenntafelag, 1990); *Hagfraedi, stjornmal og menning* (Reykjavik: Hid islenska bokmenntafelag, 1991); *Hagkvaemni og rettleiti* (Reykjavik: Hid islenska bokmenntafelag, 1993); *Sidustu forvod* (Reykjavik: University of Iceland Press, 1995); *Vidskiptin efla alla dad* (Reykjavik: Heimskringla, 1999); *Framtidin er annad land* (Reykjavik: University of Iceland Press, 2001); *Tveir heimar* (Reykjavik: University of Iceland Press, 2005).

¹⁵⁹ Thorvaldur Gylfason, *Hagur, log og sidir* [Efficiency, Law and Morality], *Morgunbladid* 24 May 1998; *Vill ekki utskyra nanar* [Refuses to Provide Further Explanation] (interview with Thorvaldur Gylfason), *Morgunbladid* 3 June 1998.

¹⁶⁰ David Oddsson *fimmtugur*, eds. Thorarinn Eldjarn, Hannes H. Gissurarson and Jon S. Gunnlaugsson (Reykjavik: Bokafelagid, 1998).

¹⁶¹ Thorvaldur Gylfason, *Kannski tuttugu manns* [Perhaps Twenty People], *Frettabladid*, 7 July 2005, <https://notendur.hi.is/~gylfason/kannski.htm>

¹⁶² Besides the earlier quotation, see, for example, Katrin Olafsdottir and Stefan Olafsson, *Economy, Politics and Welfare in Iceland*, *Fafo Report* (2014: 13), p. 17.

¹⁶³ Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Oxford: Polity Press, 1990).



the Scandinavian welfare states', Olafsson wrote in a 2005 paper. 'Inequality and poverty levels seem to be slightly higher in Iceland than in the Scandinavian welfare states.'¹⁶⁴ This Olafsson found somewhat surprising because 'one could have expected the forces of the colonial union of Iceland and Denmark until 1945', he writes, 'to have pushed Iceland more into the direction of the Scandinavian model.'¹⁶⁵ But what is really surprising here is Olafsson's contention that there was a 'colonial union of Iceland and Denmark until 1945'. First, Iceland became a republic in 1944, severing her last ties with Denmark, not in 1945. In the second place, Iceland had already in 1918

become a sovereign state in a personal union with Denmark, as previously stated. During that period, from 1918 to 1944, Iceland was definitely not a colony. Thirdly, even before that Iceland was not regarded as a colony. She was first, under early Norwegian and Danish rule, considered a tributary, and later she was defined as a Danish dependency (*biland* in Danish), never a colony like, for example, the Danish West Indies (later sold to the US and now the US Virgin Islands).¹⁶⁶ These facts should be known to all Icelanders, let alone a university professor.

In 2001, Professor Stefan Olafsson became director of a research institute on municipal affairs set up jointly by the University of Iceland and Reykjavik City, since 1994 controlled by a coalition of left-wing parties under the leadership of Mayor Ingibjorg S. Gisladottir.¹⁶⁷ In 2003, Gisladottir, a Social Democrat, decided to resign as Mayor and to stand as candidate for Prime Minister in the forthcoming parliamentary elections. In her campaign, she emphasised two main issues. One was the allegation – also made by Professor Thorvaldur Gylfason – that David Oddsson was abusing his great power and even greater influence after twelve years as Prime Minister to go after certain companies whose owners he did not like, in particular Jon Asgeir Johannesson.¹⁶⁸ This allegation drew strong criticisms from the Association of Policemen who asserted that the police investigation of Johannesson was perfectly normal and had not been ordered or suggested by any politician or other outside agent.¹⁶⁹ Five years later, in 2008, as noted earlier, the Supreme Court convicted Johannesson of the original charge, while acquitting him of other charges.¹⁷⁰ Some commentators on current affairs (but not those employed by Johannesson's media empire) expressed surprise at the leniency of the judgement.¹⁷¹ For example, when Johannesson's retail chain Baugur

¹⁶⁴ Stefan Olafsson, *Normative Foundations of the Icelandic welfare state*, *Normative Foundations of the Welfare State: The Nordic Experience*, eds. Nanna Kildal and Stein Kuhnle (New York: Routledge, 2005), p. 233.

¹⁶⁵ *Ibid.*, p. 224.

¹⁶⁶ Jon Sigurdsson, *Um fjarhagsmalid, Ny felagsrit*, Vol. 26 (1869), p. 348; Gudmundur Halfdanarson, *Iceland: A Peaceful Secession*, *Scandinavian Journal of History*, Vol. 25 (1-2: 2000), pp. 87-100.

¹⁶⁷ *Opnun Borgarfraedaseturs HI og Reykjavikurborgar*, *Morgunbladid* 26 May 2001.

¹⁶⁸ Her exact words in a speech at Borgarnes 9 February 2003 were: "Are the criticisms and, in the relevant cases, the investigation of these companies based on material and professional considerations or are they politically motivated?" Unfortunately, the Social Democrats have disabled a link to the speech which used to be at <http://www.samfylking.is/Forsida/Umraedan/Raedur/LesRaedu/12> The speech can however be read here, <http://wayback.vefsafn.is/wayback/20090403234238/www.amx.is/skjalasafn/264bb17f00e419b8e78270cff621ed14/original.pdf> or here, http://timarit.is/view_page_init.jsp?pageld=3465628

¹⁶⁹ *Yfirlýsing fra Landssambandi logreglumanna* [Declaration from the Association of Policemen], *Morgunbladid* 26 February 2003.

¹⁷⁰ *Haestarettardomar*, Case No. 385/2007, 5 June 2008, <https://www.haestirettur.is/default.aspx?pageld=347c3bb1-8926-11e5-80c6-005056bc6a40&id=75655b13-7d59-4d21-ab3e-2c4e7b0afdb3>

¹⁷¹ Oli Bjorn Karason, *Sidasta vornin: Haestirettur a villigotum i eitruðu andrumslofti* [The Last Defence: The Supreme Court on the Wrong Track in a Poisonous Environment] (Reykjavik: Uglya, 2011).

was still a publicly registered stock company, he had personally and secretly, through intermediaries, bought some companies for a relatively low price and resold them to the public stock company for a significantly higher price. The court did not find him to be in breach of law while doing this. Ironically, the whistle blower, Jon Gerald Sullenberger, was also convicted, receiving the same suspended three-month prison sentence as Johannesson, because he had helped Johannesson in preparing a fraudulent invoice which was precisely what he had originally reported Johannesson for, then freely admitting his own participation. In 2013, Johannesson was also convicted of tax fraud, receiving a suspended prison sentence of 12 months and fined 62 million *kronur*, €400,000.¹⁷²

Gisladdottir's other issue in the election campaign was that the Icelandic boom since 1994 had its dark side. In Iceland, she said, there existed real poverty even if Prime Minister Oddsson and his associates chose to deny this. She referred specially to research made by Professor Stefan Olafsson and his associates at the research centre for municipal affairs. One of Olafsson's students, Harpa Njalsdottir, had written an MA thesis purporting to demonstrate that poverty was much more widespread in Iceland than had earlier been envisaged. According to her, 7–10% of the population could be considered poor. Her thesis was published as a book, with great fanfare, just a month before the elections.¹⁷³ In public, Olafsson used the occasion to reassert his view that the Icelandic welfare system was moving towards a 'neoliberal' variant of the Anglo-Saxon model.¹⁷⁴ However, some economists criticized the analysis in Njalsdottir's thesis, pointing out that the concept of poverty she used was not the standard one and that other studies showed less poverty in Iceland. According to them, relative poverty

(defined as the proportion of people having less than half the median income) in 2001 was around 5.4%, whereas it was 4–6% in other Nordic countries and higher elsewhere.¹⁷⁵ Others added that one reason for poverty in Reykjavik was that the city authorities, under Mayor Gisladdottir's leadership, had tightened up rules about social assistance, for example ceasing to allow for family size in meting out such assistance and freezing for four years (1995–9) the amount payable to each recipient.¹⁷⁶ In the 2003 elections the Social Democrats failed to oust the Independence Party, Gisladdottir not even winning a parliamentary seat. Some time after the elections, the University of Iceland wound up Olafsson's research centre for municipal affairs, after it had received complaints about its politicisation.¹⁷⁷

While the debate on poverty raging through the 2003 election campaign had been mainly about data from 2001, it is worth noting that in 2007 Eurostat published a comprehensive report on poverty in Europe, using data from 2003–4. According to the report, relative poverty in Iceland was then 5.3%, almost the same as Olafsson's critics had calculated for Iceland in 2001. There was less (relative) poverty in Iceland than in all other European countries except Sweden.¹⁷⁸ It should be recalled that relative poverty is really about how many people in a country have less income than half the median income. It is therefore more about income distribution than the real living standards of the poor, such as food and other necessities at their disposal. Since Iceland was in 2004 a richer country than Sweden in terms of GDP per capita,¹⁷⁹ this suggests the remarkable conclusion that absolute poverty was in 2003–4 less in Iceland than in any other country in the world despite the fact that Ingibjorg S. Gisladdottir and Professor Olafsson chose to make poverty a major issue

in the 2003 election campaign. Thus, the 2007 Eurostat report was a resounding refutation of Olafsson's claims in the 2003 election campaign.

Undaunted, Professor Olafsson continued to criticize the government for its 'neoliberal' policies, writing: 'The income distribution became more unequal from 1995, with growing speed from 2002 onwards. The inequality trend was closely associated with growing financial income associated with the asset bubble, while taxation and benefits policy also had its share of influence on the inequality development.'¹⁸⁰ Since Olafsson mentioned taxation and benefits policy, it is necessary to take a look at those issues. Olafsson argued, for example, that the tax cuts of the Oddsson era were largely illusory 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.'¹⁸¹ It is true that the tax-free bracket did not for a while follow the price level which meant that people with income just exceeding the bracket paid tax on their income which they would not otherwise have done. But Olafsson left out several important details. First, the tax-free bracket has traditionally been much higher in Iceland than in the other Nordic countries, as can be seen in Table 3 with numbers from 2006:

TABLE 3 TAX-FREE BRACKETS IN VARIOUS COUNTRIES 2006

COUNTRY	MINIMUM KR.	MAXIMUM KR.
Iceland	948,647	948,647
Denmark	450,980	536,490
Finland	129,336	336,448
Norway	730,247	1,048,644
Sweden	110,249	288,343
United Kingdom	644,266	644,266

Source: Íslenska skattkerfið: Samkeppnishæfi og skilvirkni (report, 2009)

In the second place, and most importantly, Olafsson completely disregarded the fact that in 1995 contributions to occupational pension funds became tax-exempt and that in 1999 contribution to private pension schemes also became tax-exempt. This had the effect of raising the net tax-free bracket for individuals, as can be seen in Table 4 with numbers at the 2007 price level:

TABLE 4 TAX-FREE BRACKETS 1988–2007

YEAR	FORMAL BRACKETS THOUSAND KR.	FORMAL BRACKETS THOUSAND KR.
1988	1387,3	1387,3
1989	1279,7	1279,7
1990	1218,7	1218,7
1991	1241,7	1241,7
1992	1225,4	1225,4
1993	1125,0	1125,0
1994	1103,1	1103,1
1995	1107,8	1124,6
1996	1085,3	1124,7
1997	1065,0	1109,4
1998	1072,7	1117,4
1999	1054,1	1121,3
2000	1047,3	1138,4
2001	1007,1	1094,7
2002	995,5	1082,0
2003	1005,5	1092,9
2004	997,8	1084,5
2005	1010,0	1097,8
2006	996,3	1083,0
2007	1080,1	1174,0

Source: Íslenska skattkerfið: Samkeppnishæfi og skilvirkni (report, 2009)

¹⁷² Haestarettardomar, Case No. 74/2012, 7 February 2013, <https://www.haestirettur.is/default.aspx?pageid=347c3bb1-8926-11e5-80c6-005056bc6a40&id=6b557094-1975-4fa5-8c18-f144609d000f>

¹⁷³ Harpa Njalsdottir, *Fataekt á Íslandi við upphaf nýrrar aldar* (Reykjavik: Borgarfræðasetur, 2003); Um 7 til 10% thjodarinnar bua við fataekt (interview with Harpa Njals), *Morgunbladid* 11 April 2003.

¹⁷⁴ Ae fleiri thurfa adstod vid ad greida leikskolagjold, *Morgunbladid* 30 April 2003.

¹⁷⁵ Um 2.6% barna undir fataektarmorkum (interview with Sigurdur Snaevarr), *Morgunbladid* 1 May 2003; Stefan Olafsson, *Athugasemdir vegna umraedu um fataekt*, *Morgunbladid* 7 May 2003.

¹⁷⁶ Asta Moller, *Littu ther naer!* *Morgunbladid* 26 April 2003; Katrin Fjeldsted, *Fataekt i Reykjavik og R-listinn*, *Morgunbladid* 5 May 2003.

¹⁷⁷ Thryst a fyrnum rektor HI ad beita ahrifum sinum (interview with Stefan Olafsson), *visir.is* 2 September 2006, <http://www.visir.is/thryst-a-fyrnum-rektor-hi-ad-beita-ahrifum-sinum/article/20060902037> Olafsson mentions three professors who asked for a meeting with University Rector Pall Skulason to express their worries about the politicisation of certain university institutes; they were economist Ragnar Arnason, physicist Hafliði P. Gislason and sociologist Thorolfur Thorlindsson. Rector Skulason immediately after the meeting contacted Olafsson who misinterpreted the visit as a demand that he should be fired from his position. This, according to the three professors, was never mentioned.

¹⁷⁸ Poverty and Social Exclusion in Europe. Luxembourg: Statistical Office of the European Communities. Available at <http://epp.eurostat.ec.europa.eu>. Also available in an Icelandic Extract at <http://www.hagstofa.is/?PageID=95&NewsID=2599> (Note that the Icelandic Bureau of Statistics uses the fiscal year 2004, where the EU Office uses the year 2005.)

¹⁷⁹ According to the CIA Yearbook for 2004, the GDP per capita in Iceland was \$30,900 and \$26,800 in Sweden. Iceland was the 9th and Sweden the 23rd richest country in the world, http://www.immigration-usa.com/wfb2004/rankings/economy/gdp_per_capita_2004_0.html

¹⁸⁰ Katrin Olafsdottir and Stefan Olafsson, *Economy, Politics and Welfare in Iceland* (2014), p. 9.

¹⁸¹ Stefan Olafsson, *Welfare Trends of the 1990s in Iceland*, *Scandinavian Journal of Public Health*, Vol. 31 (2003), pp. 401–4. See also several newspaper articles by Olafsson, *Stora skattalaekkunarbrellan* [The Big Tax Reduction Trick], *Morgunbladid* 18 January 2006; *Heimsmet i haekkun skatta?* [World Record in Raising Taxes?] *Morgunbladid* 24 February 2006; *Aukning ojfagnarar á Íslandi* [The Icelandic Increase in Inequality], *Morgunbladid* 31 August 2006.

Thirdly, it can be seen from Table 4 that the tax-free bracket was actually cut more drastically during the tenure of Olafur R. Grimsson as Finance Minister in 1988–1991 than it was after that. Grimsson, then leader of the socialist People’s Alliance, was however certainly no ‘neoliberal’. Fourthly, nothing much can be explained by the fact that in 1995–2007 the tax-free bracket remained more or less the same in real terms. No great sums were involved, and they did not make much difference for the Treasury. A strong argument however for actually lowering the tax-free bracket is that it is not desirable that large groups in society do not pay any income tax themselves, because their income is below the tax-free bracket, at the same time as that they are nevertheless able to vote for such tax being raised on others.

It is also true, in a sense, that during the Oddsson governments of 1991–2004 the tax burden of low-income people increased. But this was because their income, even if low, increased: a higher proportion of their income was above the tax-free bracket than before, so they paid a higher proportion in tax of their income. Many would regard this as a desirable development rather than the opposite. To see this more clearly, consider a company which is first operated at a loss or just breaking even and then eventually it makes a profit. First, it does not pay any corporate income tax, and then, after it becomes profitable, it starts to pay such tax. Most people would welcome this development, even if they could say that the company’s tax burden had increased from zero to something significant. In his writings, Professor Olafsson made much of the fact that in 1995–2004 the income of high-income groups in Iceland increased more rapidly than that of low-income groups. But another and perhaps more useful comparison would be with low-income groups in other countries. Using Olafsson’s data, it can be seen that during this period, the average income of the 10% worst-off in Iceland had increased by 2.7%, while the income of other income groups had increased more. But when the income increase of the worst-off group in Iceland was compared to that of similar groups in other OECD countries, it was actually more rapid during this period than in

all of them except Norway which of course was an oil-rich country. Indeed, the increase in Iceland was double that of the OECD average. ‘The poor you will always have with you,’ according to the Holy Book.¹⁸² there will always be a 10% or 20% worst-off group in terms of income, and their average living standards will always leave something to be desired. There was in 1991–2004, and still is, some real poverty in Iceland as in other countries. But it is safe to say that poverty is much less of a problem there than in almost all other countries in the world. There is also less social exclusion in Iceland than in many other countries, as can be seen from perhaps the most serious form of exclusion which is enduring long-term unemployment, much less in Iceland than in most other OECD countries.

The groups that are traditionally considered to be vulnerable, single parents and the elderly, are also better provided for in Iceland than in most other countries, even other Nordic countries. In 2011 Professor Olafsson wrote that nowadays Iceland in some ways resembled the Anglo-Saxon countries, mainly because of ‘somewhat lower benefits to families with children’ than were found in the other Nordic countries.¹⁸³ In 2014, Olafsson wrote, ‘Child benefit expenditures however declined significantly from 1990 to 2008.’¹⁸⁴ Both these statements were strictly speaking not untrue, but nevertheless they were misleading half-truths. Consider child benefits in Iceland and Sweden in 2006, the year when Olafsson published a series of articles in Iceland criticizing the government for not spending enough on welfare. Then, total outlays per each child were lower on average in Iceland, whereas the amount spent per child in low-income households was higher. In Sweden, child benefits were equal for rich and poor. In Iceland, on the other hand, child benefits were low for the rich and high for the poor. This is illustrated in Table 5 which shows child benefits for a single parent in Iceland and Sweden in 2006 in current U.S. dollars:¹⁸⁵ There was a fundamental difference between the approach in the two welfare systems. In Iceland, the transfer was based on the need of the single parent or the parents. In Sweden, the transfer was regarded as the right of the child. It is therefore highly misleading to say,

TABLE 5 CHILD BENEFITS IN ICELAND AND SWEDEN

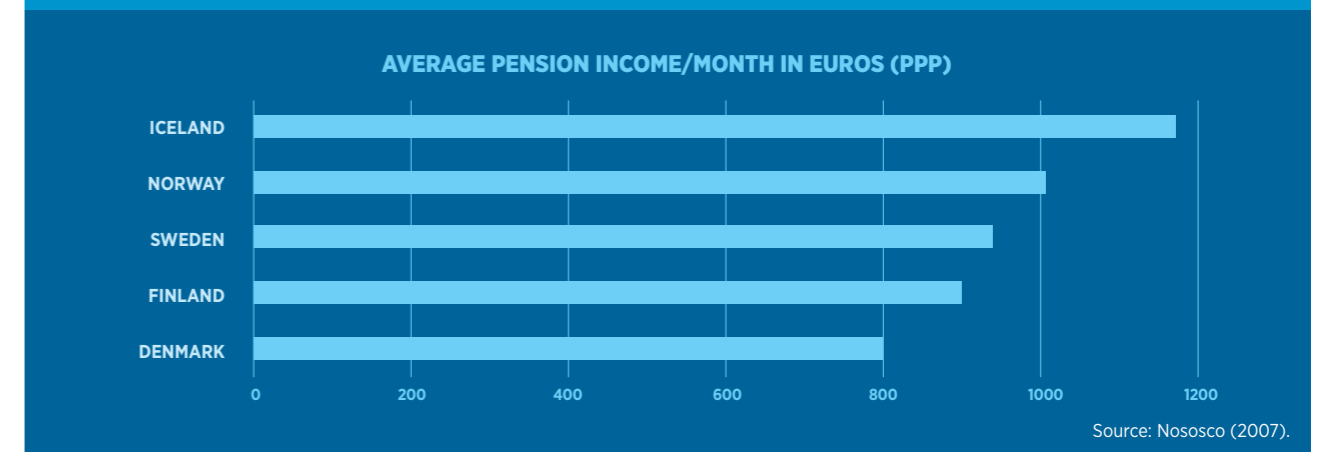
ANNUAL PARENT INCOME	IS: 1 CHILD YOUNGER THAN 7	SE: 1 CHILD YOUNGER THAN 7	IS: 2 CHILDREN, 1 YOUNGER THAN 7	SE: 2 CHILDREN, 1 YOUNGER THAN 7
13,281	3,991	1,823	7,399	3,819
28,571	3,532	1,823	6,329	3,819
57,143	2,675	1,823	4,329	3,819
71,429	2,246	1,823	3,329	3,819

without any explanation, that total outlays were lower on average in Iceland than in Sweden without adding that the outlays were targeted to the poor, not to all. The worst-off were better off in Iceland than in Sweden.

It is also instructive to compare the living standards of the elderly in Iceland and the other Nordic countries in 2004, because data from that year was available to Professor Olafsson when he was criticizing the Oddsson governments for their ‘neoliberal policies’. In 2007, shortly before the parliamentary elections, Olafsson rejected recent statements from the Finance Ministry, based on data from Nososco, the Nordic Social Statistical Committee, that in 2004 pensions were higher in Iceland than in any other Nordic country.¹⁸⁶ Olafsson pointed out that average pension payments per person were in fact lower in Iceland than in three other Nordic countries and only higher than in Finland.¹⁸⁷ But this was misleading, if not plainly wrong: of the 31,000 Icelanders who had reached retirement age in 2004, about 5,000 had continued to work and postponed taking their pension.

It was true that if one divided total pension payments by the total number of Icelanders of pension age then the average was lower than in most other Nordic countries.¹⁸⁸ But this was a meaningless outcome because 5,000 of this total did not take pension. The fact remained that the average income of the 26,000 people of pension age who took their pension was higher than in the other Nordic countries. Here again, one of the characteristics of the Icelandic welfare system is illustrated: recipients of benefits were fewer relatively, but their benefits were on average greater. This is illustrated in Figure 8. Moreover, there was less poverty in the ranks of the elderly than in any other Nordic country. This was for two reasons. First, the growing and self-financing occupational pensions were starting to have an impact. Secondly, the Icelanders tended to work for more years and start to take their pension later than many other nations. This was also desirable in another sense, because then there was less danger of social exclusion of the elderly.

FIGURE 8 AVERAGE PENSION INCOME OF NORDIC PENSIONERS 2004



¹⁸² Matthew 26:11.

¹⁸³ Stefan Olafsson, *Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse* (2011), p. 8.

¹⁸⁴ Katrin Olafsdottir and Stefan Olafsson, *Economy, Politics and Welfare in Iceland* (2014), p. 8.

¹⁸⁵ Information on child benefits provided in 2006 from the Icelandic Social Security Agency (Tryggingastofnun) and from the Swedish Forsäkringskassen 2006.

¹⁸⁶ Social tryghed i de nordiske lande 2004 (København: Nososco, 2006), Table 7.8, <http://nom-nos.dk/nososco.htm>

¹⁸⁷ Stefan Olafsson, Einar Arnason and Olafur Olafsson, *Rangfaerslur raduneyta um hag aldradra*, Morgunbladið 20 March 2007.

¹⁸⁸ Social tryghed i de nordiske lande 2004 (2006), Table 7.25, <http://nom-nos.dk/nososco.htm>

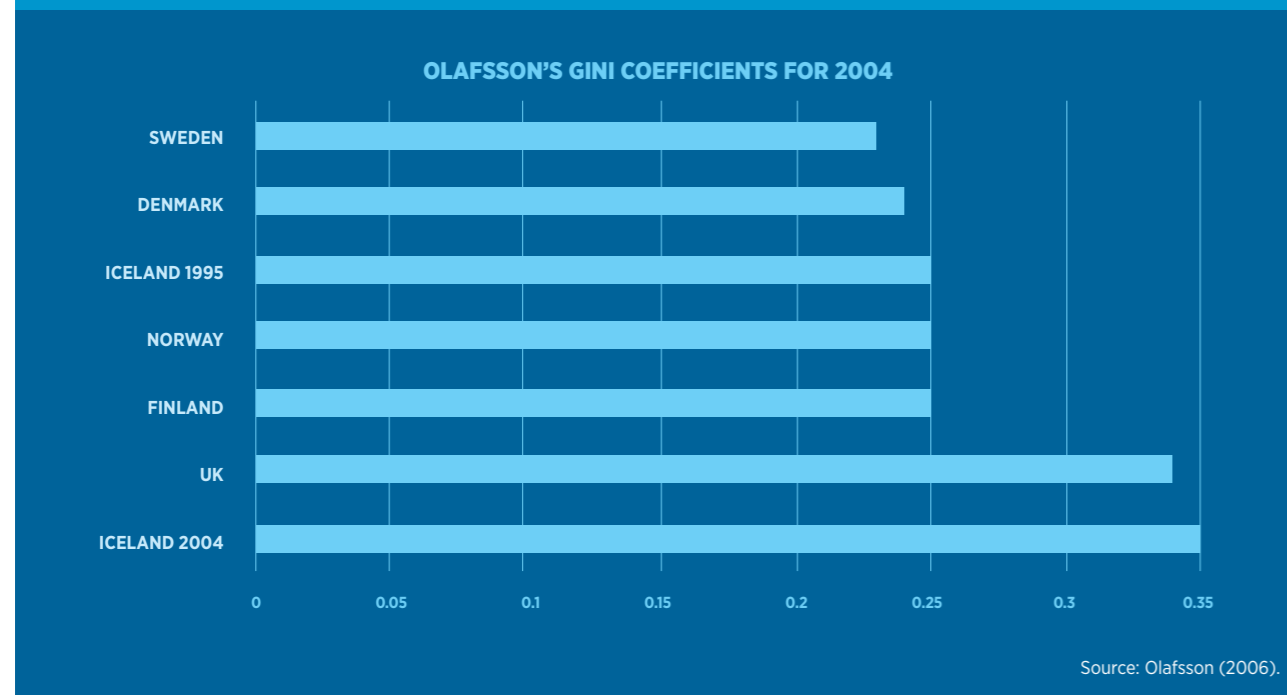
Before the 2007 parliamentary elections, Professor Stefan Olafsson and his associates changed their approach (or perhaps a more appropriate word would be their strategy). They had asserted before the 2003 parliamentary elections that there was more poverty in Iceland than in the other Nordic countries, and that this was because of the neoliberal policies pursued by the Oddsson governments. This has not seen to be plausible at the time, and they had later been proved wrong on this. The poverty level in Iceland, one of the lowest in the world, was both in 2001 and 2004 similar to that in the other Nordic countries. Now, Olafsson and his associates decided to concentrate on income distribution in general. Olafsson wrote that the poor had been left behind in the general improvement of living standards in Iceland. Income distribution had become more unequal, which showed, once again, that Iceland, under the influence of neoliberal ideologues, was turning her back on the Nordic model. He even asserted that income distribution in Iceland 'appeared to have become more unequal than in the United States under Reagan, in the United Kingdom under Thatcher, in Chile under Pinochet and also more unequal than during the libertarian revolution in New Zealand after 1984.'¹⁸⁹

Olafsson based this assertion on the calculation of Gini coefficients for Iceland and other countries. (The Gini coefficient is a way of measuring income distribution. It varies between 0 and 1: if all have equal income, then the coefficient is 0, and if only one person has the income, then the coefficient is 1.) Olafsson claimed that it strengthened his case that Professor Thorvaldur Gylfason had reached similar conclusions about income inequality in Iceland, based on a calculation of Gini coefficients.¹⁹⁰ In a newspaper article Olafsson published a comparison of Gini coefficients for the five Nordic countries and the United Kingdom in 2004 in addition to an estimate of a Gini coefficient for Iceland in 1995 to illustrate his assertion that Iceland was adopting the Anglo-Saxon model. His Gini coefficients reflected disposable income of each member of a family household. He claimed that his data came from a comparative study on income distribution in European countries undertaken by Eurostat.¹⁹¹ His graph is reproduced in Figure 9.

Other commentators presented different calculations where the Gini coefficient for Iceland in 2004 was shown to be much lower.¹⁹² Moreover, on closer scrutiny, Olafsson's data turned out not to be accurate. Probably the error was not originally his. The Icelandic Statistical Bureau, Statice, had provided Eurostat with data on income distribution without excluding capital gains from corporate shares whereas the data on income distribution from other countries did not include such capital gains. This made quite a difference. When the mistake was discovered and data from Iceland were processed in the same way as data from other European countries, it turned out that the Gini coefficient for Iceland in 2004 was very similar to that of the other Nordic countries which means that income distribution, as traditionally measured, had not become more unequal in Iceland than in the other Nordic countries. When Olafsson had been comparing a Gini coefficient for Iceland with capital gains from shares included with Gini coefficients for other countries with such gains excluded, he had been comparing the incomparable, like apples and oranges, as it were. The correct data are shown in Figure 10.

Professor Olafsson did not really admit the error, even if it was not his originally. He just changed the subject. He pointed out, correctly, that when capital gains from shares were included in the calculations, income distribution in Iceland became much more unequal than before, writing, 'It is agreeable that Iceland gets good results in a recent Eurostat and Statice study. But I have showed here and elsewhere that it is crucial when discussing inequality in income distribution which concept of income is used. It is most appropriate to use all disposal income.'¹⁹³ In his publications on income distribution after this, Olafsson replaced 2004 with 2007 or 2008 as the final point of his findings because there was actually some increase in income inequality in the years from 2004 until the bank collapse, even if capital gains from shares were excluded. If such gains were included, the data showed a significant increase in income inequality. Olafsson simply ignored the conclusion in the Eurostat study that in 1995–2004 income inequality had not increased more in Iceland than in the other Nordic countries.

FIGURE 9 OLAFSSON'S GINI COEFFICIENTS FOR 2004

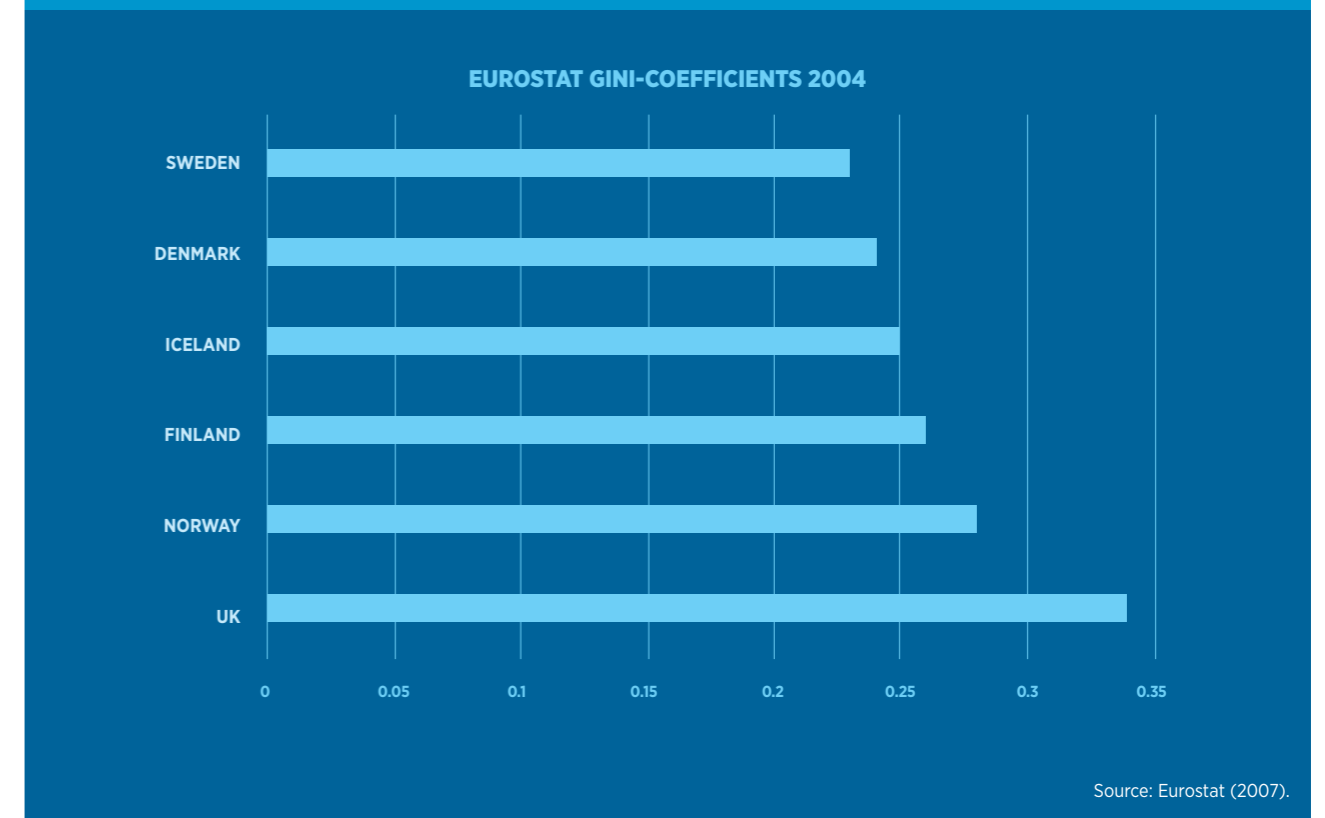


¹⁸⁹ Stefan Olafsson, Aukinn ojfnudur á Íslandi [Increased Inequality in Iceland], Stjornmal og stjornsysla, Vol. 2 (2: 2006), p. 134.

¹⁹⁰ Thorvaldur Gylfason, Thogn um aukinn ojfnud [Silence on Increased Inequality], Frettabladid 25 May 2006; Hernadur gegn jofnudi [The War Against Equality], Frettabladid 17 August 2006. Gylfason claimed that his data on Gini coefficients came from the Internal Revenue Service. But when Professor Ragnar Arnason approached the Icelandic IRS and asked for the data, he was told by the staff that no such data had been provided to anyone. It is a mystery wherefrom Gylfason received his data. The reason why the data fit in well with those of Olafsson was presumable that Gylfason had also included capital gains from shares.

¹⁹¹ Stefán Ólafsson, Aukning ojafnadar á Íslandi [The Icelandic Increase in Inequality], Morgunbladid 31 August 2006.

FIGURE 10 EUROSTAT'S GINI COEFFICIENTS FOR 2004



¹⁹² They included mathematician Benedikt Johannesson and economist Ragnar Arnason.

¹⁹³ Stefan Olafsson, Ojfn kaupmattaraukning [Unequal Increase in Purchasing Power], Morgunbladid 26 February 2007.

Olafsson's many papers and articles before the 2007 parliamentary elections about increased income inequality in Iceland did not have the intended impact. The Independence Party gained votes. But liberal social democrats and economic liberals would however agree that this debate was not important and that some of the points Olafsson made, whether right or wrong, were largely irrelevant. Social democrats in the tradition of John Rawls would ask how the worst-off fared in Iceland in comparison to their counterparts in other countries. There is a clear answer to that, already given: the data presented by Professor Olafsson himself show that in 1995–2000 the income of the 20% worst off in Iceland rose double the average rate in the OECD, and that the only country where it rose more rapidly was oil-rich Norway. On the other hand, economic liberals would ask what was wrong with an income distribution which was the consequence of free choice, of course in the absence of monopolies and coercion. To see this more clearly, consider the example provided by the previously mentioned exchange on television between Milton Friedman and Stefan Olafsson in 1984.

Assume a remote island where there is a just income distribution, D1, according to Olafsson's criteria. Then Friedman visits the country and holds a lecture, charging an admission fee of \$40. The meeting hall is full to the brink, with 500 people in the audience. Friedman's gross income is \$20,000. Assume that his net income is \$15,000. Now there is a different and less equal income distribution, D2, where Milton Friedman is richer by \$15,000 and 500 islanders are poorer each by \$40. But where is the injustice? What would Olafsson have to complain about? Friedman is satisfied, and the members of his audience are happy. Nobody has been wronged or done down.¹⁹⁴ Olafsson's original point, that some cannot afford to attend the lecture, becomes less relevant with more affluence and is hardly relevant at all in Iceland, neither in 1984 nor today. Remaining is only another point which is that some people simply envy Friedman of his \$15,000. But in the Western tradition envy has been considered a vice to be condemned, not a virtue to be encouraged. It is indeed one of the seven cardinal sins. •

13

THE 2008 ICELANDIC BANK COLLAPSE

Until 2008, Professors Stefan Olafsson and Thorvaldur Gylfason did not find much resonance in Iceland for their criticisms of the Oddsson governments or of its successors. Having been foreign minister for a year, until 2005, David Oddsson became governor of the CBI, Central Bank of Iceland, while Geir H. Haarde became prime minister in 2006. After the 2007 parliamentary elections, Haarde formed a coalition government of his Independence Party and the Social Democrats, now led by former mayor Ingibjorg S. Gisladdottir. Professor Olafsson was appointed chairman of the board of the large Social Security Agency, and Professor Gylfason became one of Gisladdottir's economic advisers. But with the Icelandic bank collapse in the autumn of 2008, which came as a shock to the nation, both Olafsson and Gylfason suddenly gained a new audience, whereas economic liberals (including the present writer) appeared to be totally discredited. After all, the collapse happened on the Independence Party's watch. It is therefore necessary briefly to analyse the 2008 Icelandic bank collapse and Olafsson's and Gylfason's interpretations of it.

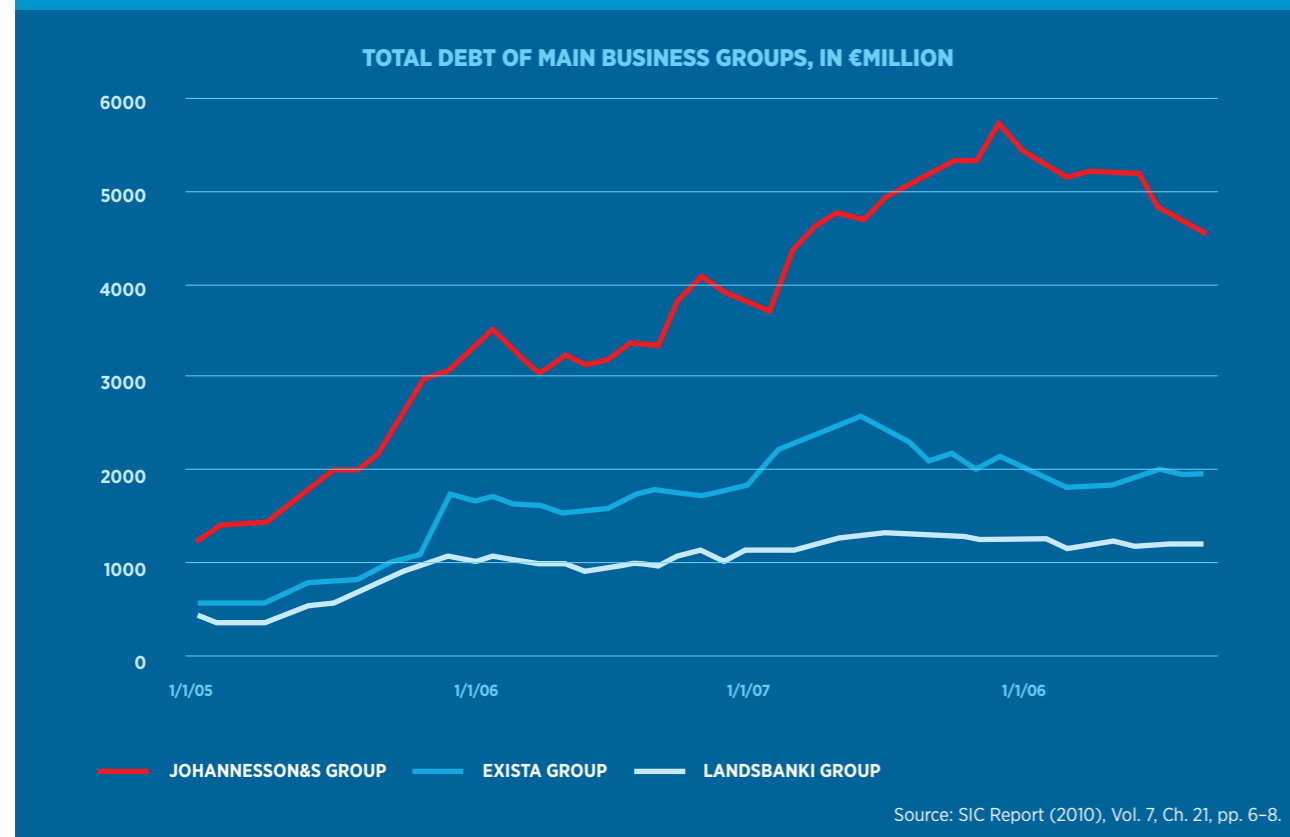
The undisputed facts on the bank collapse are the following: in 1990, the first of the three main banks,

Utvegsbanki, was privatised, eventually becoming Islandsbanki. In 1994, Iceland joined the EEA, European Economic Area, which meant not only that capital could move freely between Iceland and other member countries, but also that Icelandic banks could establish branches and subsidiaries in other member countries. In 1998–9, an investment bank, FBA, was privatised, and soon merged with Islandsbanki. In 1998–2003, the two remaining government banks were privatised: a controlling stake in Landsbanki was bought by a company owned by Bjorgolfur Gudmundsson, his son Bjorgolfur Thor Bjorgolfsson and an associate; and a controlling stake in Bunadarbanki was bought by a so-called S-group which soon sold it to the investment bank Kaupthing. In the next few years the banks expanded rapidly, partly benefitting from Iceland's good credit ratings and reputation abroad and partly enjoying the cheap and plentiful credit available in international markets in the early 2000s. At the same time, more capital was also becoming available in Iceland as a result of the strong pension funds and the profitability of the ITQ system. The banks financed many investments by Icelandic businessmen abroad, in particular those of Jon Asgeir Johannesson and his group, who became their greatest debtors by far, as shown in Figure 11.¹⁹⁵

¹⁹⁴ This is, of course, the famous Wilt Chamberlain example in Robert Nozick's *Anarchy, State, and Utopia* (New York: Basic Books, 1974), pp. 160–161, which can also be found much earlier (about the baseball player Joe DiMaggio, Marilyn Monroe's husband) in William Buckley's *God and Man at Yale* (Chicago: Regnery, 1951), p. 57.

¹⁹⁵ As the SIC, Special Investigation Commission, wrote in its report: "Of all the business blocks, which had borrowed liberally in the Icelandic banking system, the most conspicuous one was business associated with Baugur Group [Johannesson's group]. In all three banks, as well as in Straumur-Burdaras, this group had become too large an exposure. The SIC considers that this has constituted a significant systemic risk, as collapse of one enterprise could affect not only one systematically important bank but all the three systematically important banks. The financial stability, therefore, would be significantly threatened by, for instance, Baugur Group, which had as indicated in the report, ... substantial liquidation problems in the latter half of 2008." SIC Report (Reykjavik: Althingi, 2010), Vol. 7, Ch. 21, p. 14. A few chapters of the report are available online in English, <https://www.rna.is/eldri-nefndir/addragandi-og-orsakir-falls-islensku-bankanna-2008/skyrsla-nefndarinnar/english/>

FIGURE 11 JOHANNESSESSON'S GROUP WAS THE MAIN DEBTOR



(The SIC identified three major business groups in the Icelandic economy and in its report criticized the banks, and in passing the IFSA, Icelandic Financial Supervisory Authority, for regarding individual companies in each group as separate debtors, thus underestimating the total risk involved in the debts of each group.) In 2006, the banks suffered a setback, as foreign analysts pointed out their vulnerability both because they were engaging in high-risk loans to connected companies with little real equity and because they were operating in a small economy with limited lender-of-last-resort facilities.¹⁹⁶ While the ownership of Landsbanki and Kaupthing remained relatively stable after some initial changes, in the spring of 2007 Jon Asgeir Johannesson and his group managed to get control of Islandsbanki, and used it to increase credit still further to themselves (as can be seen from Figure 11).

In the autumn of 2007, the international credit crunch hit the Icelandic banks particularly hard. Lending long-term and financing themselves short-term, as banks do, they ran into great difficulties. Both

Landsbanki and Kaupthing responded by reinforcing their collection of retail deposits abroad, especially in the United Kingdom. Landsbanki ran its operations in a branch so that the deposits in its Icesave accounts were covered by the Icelandic Investors' and Depositors' Guarantee Fund, whereas Kaupthing used subsidiaries to collect deposits abroad so that deposits were covered by the domestic schemes of each country.¹⁹⁷ In early 2008, the CBI, Central Bank of Iceland, tried to obtain credit facilities in the European Central Bank, the Bank of England, and the US Fed, so it could provide credit in foreign currencies to the banks, and, perhaps more importantly, so it could demonstrate its ability to do so. But the CBI was everywhere turned down except in the three Scandinavian central banks that grudgingly provided some credit. It became clear that the relatively small Icelandic Depositors' and Investors' Guarantee Fund could not compensate Icesave depositors in the case of Landsbanki's failure. As the year went on, the credit crunch worsened, and so did the situation of the Icelandic banks. When the US Fed announced 24 September 2008 that it had made dollar swap

¹⁹⁶ Lars Christensen, Iceland: Geyser crisis. 2006 report, repr. in *Preludes to the Icelandic financial crisis*, eds. Robert Aliber and Gylfi Zoega (Chicago: University of Chicago Press, 2011), pp. 89-106.

¹⁹⁷ The legal ramifications of the situation are well explained in the English part of the SIC Report, Chapter 17.



deals with the three Scandinavian central banks, Iceland's absence was painfully obvious.¹⁹⁸ One day later, Jon Asgeir Johannesson's bank, Glitnir (the former Islandsbanki), was the first bank to seek an emergency loan of €600 million from the CBI, because it could not raise the money to pay its foreign creditors. Instead of giving Glitnir the emergency loan, the government decided, on the advice of the CBI, and with the approval of the opposition parties, to buy a 75% stake in Glitnir for €600 million. This implied a significant write-down of existing shares in Glitnir, and was strongly resisted by Jon Asgeir Johannesson.

The announcement of the government recapitalisation of Glitnir did not calm the financial markets, as had been hoped, and a run started on the Icelandic banks both in Iceland and abroad. Realizing that not all the banks could be saved, the government, again on the advice of the CBI, but after some internal conflicts, had an Emergency Act passed by parliament Monday 6 October whereby the claims of depositors were given priority over other creditors' claims and the

IFSA was given power to take over banks.¹⁹⁹ At the same time, government ministers publicly announced that the Icelandic state would guarantee all domestic bank deposits. As the run on Landsbanki was becoming unstoppable, the IFSA took it over Tuesday 7 October. Meanwhile, the British government closed Landsbanki's branch in London and also the bank's subsidiary, Heritable Bank. The IFSA took over Glitnir 8 October. In the hope of saving one of the three banks, Kaupthing, the government had decided to give to it an emergency loan of €500 million. But on Wednesday 8 October, at the same time as Alistair Darling, the British Chancellor of the Exchequer, announced a £500 billion rescue package for British banks, he closed Kaupthing's subsidiary in London, Kaupthing Singer & Friedlander, even though it was a British bank. This meant that the parent company in Iceland, Kaupthing, went under, as credit to it was automatically cancelled because the British subsidiary had been closed.

Moreover, the same day, 8 October 2008, Chancellor Darling issued an order under the British anti-terrorist

¹⁹⁸ Federal Reserve System, Press Release 24 September 2008, <http://www.federalreserve.gov/newsevents/press/monetary/20080924a.htm>

¹⁹⁹ Law No. 125/2008. The law was supported by the Independence Party, the Progressives and the Social Democrats, whereas the Left Greens abstained. The law has withstood several court challenges.

law freezing the assets of Landsbanki and Icelandic institutions, including the CBI and the IFSA.²⁰⁰ Subsequently, the names of Landsbanki, the CBI, and the IFSA were published at the Treasury's website on a list of terrorist organisations, with the Taliban, Al-Qaida, and the governments of Sudan and North Korea. After a few days, the names of the Icelandic institutions were removed after protests by the Icelandic government, and the name of Landsbanki was later moved down, to a separate list on the website. The imposition of the anti-terrorist law meant that all credit lines to and from Iceland were suddenly closed, and the CBI staff had to work day and night resolving emergency situations, such as importing medicine and food.

At the same time as the UK government closed KSF in London, thus bringing about the fall of Kaupthing, and imposed an anti-terrorist law against Landsbanki and Icelandic institutions, it unilaterally decided to compensate at once all owners of Icesave accounts in Landsbanki (instead of waiting for them to be paid back from the estate of the failed bank), and then demanded that the Icelandic government would fully reimburse this 'loan' with full interest for a few years. The government, now against the advice of the CBI, decided to seek assistance from the International Monetary Fund, which was granted, but only on the condition that the UK demands in the Icesave matter were accepted. The large depreciation of the *krona* which had preceded the bank collapse affected many, not only because their purchasing power diminished, but also because some had taken loans in foreign currencies, against the advice of the CBI.

Also, shareholders in the fallen banks made huge losses, while a side effect of the bank collapse was that many other companies went into bankruptcy. This, and the general shock and dismay of the nation, led to protest meetings and almost unprecedented street riots in Reykjavik. The Social Democrats found the situation unbearable and left the coalition government, forcing Prime Minister Geir H. Haarde to resign. In early 2009, Johanna Sigurdardottir formed a minority government of her Social Democrats and the Left Greens whose first action was to pass a new law to drive the three CBI governors, David Oddsson and his two colleagues, out of their jobs. In the 2009 parliamentary elections, the Social Democrats and the Left Greens won a resounding victory and were able to form a left-wing majority government. In early 2010, the SIC, Special Investigation Commission on the bank collapse, which had been appointed by the Haarde government, delivered its report, criticizing bankers, politicians, and government officials alike. The government made two deals in the Icesave conflict with the UK, agreeing to reimburse the British government for its outlays and to pay interest on the 'loan' from it. Both deals were however rejected by the Icelandic voters, and in early 2013 the EFTA Court decided that the Icelandic government was not responsible for the financial obligations of the Icelandic Depositors' and Investors' Fund and that it had not been in breach of any EEA statutes or agreements.²⁰¹ In the 2013 parliamentary elections the two government parties suffered a defeat, indeed a rout, going down from 51.5% of the votes to 23.8%. In the 2016 parliamentary elections the Social Democrats continued to lose support, going down to 5.7%. •

ERRORS AND LOGICAL FLAWS IN THE ANTI-LIBERAL NARRATIVE

Professor Stefan Olafsson has published several papers in English as well as Icelandic about the bank collapse, blaming it on 'neoliberalism' embodied in Iceland's counterpart to Thatcher and Reagan, David Oddsson. Olafsson presents a narrative on, rather than an analysis of, the collapse. But narratives are not all equally plausible. They have to be based on facts and not easily refuted. Unfortunately, there are many glaring errors, small and big, in Olafsson's narrative. He writes, for example, that in the Independence Party 'from the late 1970s, a group of radical neoliberals had been formed, called the "Locomotive Group" ("*Eimreidarhopurinn*")', with the aim of promoting increased marketization, privatization, and smaller government. One of the famous slogans from that group was "Away with the Beast!" ("*Baknid burt!*"), referring to the size of government.²⁰² In fact, this slogan was coined in 1977 (two years after the magazine *Locomotive* had folded) by the chairman of the Young Independents, Fridrik Sophusson (later Finance Minister), and his main associates, Vilhjálmur Egilsson and Einar K. Gudfinnsson. None of them belonged to the Locomotive Group. '*Baknid burt!*' was the title of a report published that year.²⁰³ A more accurate translation would actually be 'Get rid of big government'.

In his description of the deposit collection of the Icelandic banks abroad before their collapse, Olafsson writes, 'Landsbanki was the frontrunner in this, and offered the accounts through its UK subsidiary. Kaupthing Bank offered similar saving accounts later (Kaupthing Edge). Thus, the inflow into the Icesave accounts could be channelled directly to Iceland to

relieve the tight liquidity position of the bank.'²⁰⁴ This is an extraordinary error and an important one. The point of the whole Icesave conflict was precisely that Landsbanki collected deposits through its branch, not its subsidiary, in the UK. This meant that the deposits were covered by the Icelandic Depositors' and Investors' Guarantee Fund, not by its British counterpart, whereas the Icelandic Fund did not have sufficient means to compensate the depositors. If the deposits had been collected in a subsidiary, then there would not have been any Icesave conflict.

Again, Olafsson writes, 'A controversial publication of private e-mails of a prominent IP [Independence Party] member, Mr Styrmir Gunnarsson, an influential editor of Morgunblaðid at the time, has him on record talking about the need to get the Landsbanki into the hands of individuals "on good speaking terms with



²⁰⁰ HM Treasury, Landsbanki Freezing Order 2008, http://www.legislation.gov.uk/uksi/2008/2668/pdfs/ukxi_20082668_en.pdf

²⁰¹ EFTA Court, Judgement of the Court, 28 January 2013, http://www.eftacourt.int/uploads/tx_nvcases/16_11_Judgment_EN.pdf

²⁰² Stefan Olafsson, The Political Economy of Iceland's Boom and Bust, Iceland's Financial Crisis: The Politics of Blame, Protest, and Reconstruction, eds. Valur Ingimundarson, Philippe Urfalino, Irma Erlingsdottir (New York: Routledge, 2016), p. 61.

²⁰³ Baknid burt (Reykjavik: Samband ungra sjalfstaedismanna, 1977).

²⁰⁴ Stefan Olafsson, The Political Economy of Iceland's Boom and Bust (2016), p. 66.

the IP.”²⁰⁵ Editor Gunnarsson did indeed write some of the words that Olafsson puts within quotation marks, but he did so in an article about David Oddsson for a book on Icelandic prime ministers from 1904 to 2004.²⁰⁶ Olafsson however adds the word ‘good’ to the quotation, whereas there is a clear difference between being on speaking terms with someone and being on good speaking terms with him or her. Even if Editor Gunnarsson wrote this, it would be his personal interpretation of events rather than any conclusive evidence of something amiss in the privatisation process. Moreover, Olafsson has mixed up his sources. No words to this effect were found in an exchange of intimate emails between Editor Gunnarsson and the former stepmother of Jon Asgeir Johannesson, Jonina Benediktsdottir, who had turned against her former partner and his son and worked with the whistle blower who had originally reported Johannesson to the police. These emails were stolen from Benediktsdottir and partly published in Johannesson’s newspaper in 2005.²⁰⁷ Those that were deemed too intimate to publish in the newspaper were published in a special website with a foreign domain. It can only be a matter of speculation in whose interest it was to make those emails public.²⁰⁸

Professor Olafsson says that bank privatisation ‘was started in 1998’.²⁰⁹ But the first of the three main banks, Utvegsbanki, were privatised in 1990, and that privatisation was overseen by a minister of business affairs from the Social Democrats, Jon Sigurdsson, later chairman of the board of Olafsson’s ill-fated research centre for municipal affairs. Olafsson also says that after the collapse the IMF facilitated ‘loans from the other Nordic countries, Russia, Poland and

the Faroe Islands’.²¹⁰ In fact, Russia did not lend money to Iceland, although the Putin government was briefly engaged in loan negotiations with Iceland. The loans came from the IMF, the Nordic countries, Poland, and the Faroe Islands. Olafsson also calls political scientist Eiríkur Bergmann a ‘spokesman’ for the view that foreigners are to blame for the Icelandic bank collapse.²¹¹ This is a misrepresentation of Bergmann’s view: while he seeks to explain the collapse mostly by domestic factors, he also criticizes the UK government for imposing the anti-terrorist law on Iceland.²¹² It is also somewhat odd to call Bergmann a ‘spokesman’: even if he was a vocal and prominent supporter of the Social Democrats, in this case he was not, it seems, arguing on behalf of any interest group or party in Iceland.

Not only are there many glaring errors in Professor Olafsson’s publications on the bank collapse, but also logical flaws, misleading statements, unsubstantiated claims, and half-truths. One example of a logical flaw is Olafsson’s suggestion that one reason for the electoral success of the Independence Party was that the largest newspapers supported it.²¹³ But the centre-right parties in the Scandinavian countries enjoyed much stronger newspaper support than the Social Democrats, which did not change the fact that there the Social Democrats were for a long time dominant. It is true that two of the five dailies in Reykjavik supported the Independence Party, but this does not seem out of proportion given that 40–50% of the population in Reykjavik voted for the party. Another statement which makes little sense is when Olafsson writes about the period from 1960 to 1990 that ‘in hindsight one can see that the employees

gained decisively in these decades of high growth and high inflation’.²¹⁴ It cannot be true that in the long run labour gained anything by high inflation which is, as has already been pointed out, an invisible and involuntary tax on ordinary people. Usually the weakest groups in society – such as the elderly on fixed pension income – have much less ability to protect themselves against inflation than stronger groups. For example, most bank debt is owed by businesses, not individuals, whereas most deposits are owned by individuals, and in the absence of indexation, those businesses gain by an unexpected bout of inflation while depositors lose.

A third example of confused thinking is when Professor Olafsson writes that the expansion of the banks created ‘a high-risk situation and totally unsustainable once the growth was slowed’.²¹⁵ He does not clarify what he means: unsustainable for whom? The logical answer to that question is that the situation may have been unsustainable for the creditors and the debtors, but not necessarily for the rest of society. Olafsson writes in the same vein, ‘The public Special Investigative Committee into the Fall of the Banks put the prime blame on the governors of the banks for making the excessive debt accumulation possible’.²¹⁶ It is true that the SIC, Special Investigation Commission, concluded that the rapid expansion of the banks were one of the main causes of their collapse – which is in a sense a tautology, because things cannot collapse unless they have been built. But the Icelandic banks did not, and could not, make a unilateral decision to expand. The reason they could expand was that they were able to obtain a lot of credit abroad. Their directors may have made some wrong decisions, perhaps a lot of them, but then the individuals who made the decisions to lend money to the Icelandic banks also made some wrong decisions. Olafsson seems to forget the other side of the equation, that of the foreign creditors to the banks.

There is a classic example of a *non sequitur* – where the conclusion does not follow from the premises

– in Olafsson’s response to the suggestion that the banks collapsed because they were denied liquidity support from foreign central banks. ‘These are, however, weak arguments. It was, indeed, a blessing that central bankers and governments of neighboring countries turned down requests to provide Iceland with the loans needed to save the banks from collapse.’²¹⁷ It was probably a blessing in disguise that Iceland did not have the means to save her banks. But that observation is not a refutation of the suggestion that the banks collapsed because they were denied liquidity support from foreign banks. The two statements are logically independent. It is in fact obvious that the banks collapsed because they were denied liquidity support. That is how the collapse happened. It is now known that many other banks in Europe, for example Danske Bank in Denmark, RBS in Scotland and UBS in Switzerland, would have collapsed too if they had not obtained liquidity support. Moreover, even if it is accepted that it was a blessing in disguise that Iceland could not save her banks, it should be pointed out that the bank collapse imposed enormous and unnecessary costs on those involved, for example in the form of ‘fire sales’ of bank assets, not to mention the shock, outrage, and political upheaval in Iceland (what some would call the erosion of social capital). Olafsson continues, ‘The sums required were of such an order that the Icelandic economy would never have been able to pay them back.’²¹⁸ He seems to miss the main point about liquidity support. It is that it is a trust-building measure. Credit lines are not always used. If the CBI had been able to announce that it had obtained a dollar swap deal of \$10 billion with the US Fed, then probably the run on the Icelandic banks would have stopped and the CBI would never have had to use the dollar swap arrangement.²¹⁹ This is what happened in other countries: when depositors and other bank creditors realized that banks would be saved by governments, almost at any cost, they extended their credit to them and the banks did not collapse. •

²⁰⁵ Ibid, p. 75.

²⁰⁶ Forsaetisradherrar Islands, ed. Olafur Teitur Gudnason (Akureyri: Holar, 2004), pp. 466–7.

²⁰⁷ Hofdu samrad um mal Jons Gerald's gegn Baugi [Discussed Jon Gerald's Case Against Baugur], Frettabladid 24 September 2005; Styrmir og Jonina sendu Baugsgogn til skattsins [Styrmir and Jonina Sent Documents to the Tax Authorities], Frettabladid 25 September 2005.

²⁰⁸ What the stolen emails revealed was that when Jon Gerald Sullenberger in 2002 came to Iceland in order to report his former friend and business associate Jon Asgeir Johannesson to the police, he contacted Jonina Benediktsdottir who by now shared his hostility to Johannesson and his father. Benediktsdottir was a close friend of Editor Styrmir Gunnarsson and she sought his advice on how to operate as Johannesson and his father were powerful and rich and therefore potentially difficult and dangerous adversaries. Gunnarsson advised her to tell Sullenberger to hire Jon Steinar Gunnlaugsson (who had a reputation as a tough lawyer) as his attorney, and so he did. In one email Gunnarsson told Benediktsdottir that she should not worry. Gunnlaugsson would not be swayed by the power and wealth of Jon Asgeir Johannesson and his father; he was and would stay a good and loyal friend of David Oddsson (who was not named directly); Gunnarsson knew of course as well as everybody else that Oddsson and Johannesson were no friends. Gunnarsson added that he had discussed the impending case at a lunch meeting which he had had with Gunnlaugsson and Kjartan Gunnarsson. They met regularly for lunches: Jon Steinar Gunnlaugsson was the lawyer for Morgunbladid, and Kjartan Gunnarsson had family ties to Styrmir Gunnarsson. It was obvious to all of them that the case could become a big one, because of the dominant position Johannesson occupied in Icelandic business life. This email was implausibly interpreted by Johannesson as evidence of a conspiracy organised by Oddsson against him.

²⁰⁹ Stefan Olafsson, Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse (2019), p. 27.

²¹⁰ Katrin Olafsdottir and Stefan Olafsson, Economy, Politics and Welfare in Iceland (2014), p. 42.

²¹¹ Stefan Olafsson, The Political Economy of Iceland's Boom and Bust (2016), p. 72.

²¹² Eiríkur Bergmann, Iceland and the International Financial Crisis: Boom, Bust and Recovery (New York: Palgrave Macmillan, 2014).

²¹³ Stefan Olafsson, Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse (2011), p. 8.

²¹⁴ Ibid., p. 15.

²¹⁵ Ibid., p. 31.

²¹⁶ Stefan Olafsson, The Political Economy of Iceland's Boom and Bust (2016), p. 68.

²¹⁷ Ibid., p. 72.

²¹⁸ Ibid., p. 72.

²¹⁹ This sum is not chosen at random. This is the amount of money Timothy Geithner of the US Fed thought necessary to mention in a dollar swap deal. SIC Report, Vol. 1, Ch. 4, p. 171.

UNSUBSTANTIATED CLAIMS IN THE ANTI-LIBERAL NARRATIVE

Professor Olafsson's eagerness to blame the Icelandic bank collapse on 'neoliberal' ideologues taking over the Independence Party gives rise to several misleading statements. Olafsson says, for example, about the Independence Party that it 'traditionally had been a rather modest right of centre party, by European standards'.²²⁰ It has however been demonstrated here that the party had strong free market roots, in the ideas of Jon Sigurdsson, the 19th century leader of the independence struggle, and of Jon Thorlaksson, the first party leader. Of course the Independence Party was never a pure free market party; no real political party is. Again, of course its leaders operated under different circumstances and often had to compromise, especially in the 1940s and 1950s when economic interventionism prevailed in Iceland. All practical politicians have to choose their priorities. Even 'conviction politicians' like Margaret Thatcher frequently have to adjust to circumstances, accommodate conflicting interests. But David Oddsson and the Locomotive Group did not regard themselves as breaking with the conservative-liberal tradition of Jon Sigurdsson and Jon Thorlaksson, rather as continuing it as well as reinforcing it. The reforms of the welfare state under Oddsson and Geir H. Haarde were not about moving it from a Scandinavian to an Anglo-Saxon model; they were about reinforcing the special Icelandic model of the welfare state where the emphasis was on encouraging work and helping only the needy, not the affluent who could look after themselves. As Professor Olafur Bjornsson wrote in a newspaper article when he stood in 1956 as an Independence Party candidate for parliament, 'He supported the party not because he thought that its representatives would implement

the prevailing and extensive economic controls any better than their counterparts from other parties, but because it was the only party to call for the abolition of those controls.'²²¹

It is also misleading to contrast a powerful and well-financed Independence Party to small and underfunded parties of the left, as Olafsson does, even if it fits his narrative of capital pitted against labour, wealth against poverty, neoliberalism against social democracy. He says, for example, about the Independence Party and the Progressives that 'the links to the business community have up to this date [2011] provided very important advantages for these two parties, and more so for the IP [Independence Party]'. He adds that 'the political parties with the strongest power resources also enjoyed the largest voting support' and that the left 'struggled to publish their tiny papers'.²²² This raises the question of cause and effect: were the parties larger because they were better-funded or were they better-funded because they were larger? Perhaps there is some truth in both possibilities. Certainly, the more affluent, for example businessmen and professionals, tended overwhelmingly to vote for the Independence Party, and probably over the years it received more financial support from private companies than other parties, which was to be expected as it proclaimed itself to be the party of free enterprise. But that was probably not crucial for its strength. As Olafsson himself admits, two other factors played a significant role in the relative strength of the Independence Party in Iceland: widespread and deep rooted individualism, a respect for self-reliance and hard work; and a pervasive sense of national unity, developed in the independence struggle.²²³



Then there is another question: were the two left-wing parties in Iceland really underfunded? At least this cannot be said about the Socialist Party, formed in 1938 by a merger of the Communist Party and the left wing of the Social Democrats. The leadership of the Socialist Party was in close contact with the Communist Party of the Soviet Union and enjoyed generous financial support from it. This was well-known and confirmed already in 1999.²²⁴ It has been calculated that in 1940–1972 the financial contributions from Moscow to the Socialist Party and its front organisations amounted to at least \$3.5 million in today's dollars, a hefty sum indeed for a population then around 150,000.²²⁵ The party itself and its newspaper as well as some front organisations employed many people; the party handed out grants to university students going to the communist countries and countless

invitations to much-coveted tours to the Soviet Union and other communist countries.²²⁶ It is true that, not least because of its close ties to Moscow, well-known at the time, the Socialist Party did not have continuous access to the power structure in Iceland, but it certainly had access to the power structure in the Soviet Union; thus, it was able to extend significant patronage to its members. However, when the People's Alliance, which had been an electoral alliance since 1956, with the Socialist Party as its most powerful member, became a political party in 1968, it severed all formal ties with the Soviet Union, while some individual members kept secretly in contact with the comrades in Moscow. The Social Democrats also received some financial aid from their more powerful counterparts in the Scandinavian countries, although much less relatively than the Socialists.²²⁷

²²⁰ Stefan Olafsson, *Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse* (2011), p. 24.

²²¹ Olafur Bjornsson, *Eiga menntamenn erindi i stjornmalabarattuna?* Morgunbladid 6 June 1956.

²²² Stefan Olafsson, *Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse* (2011), pp. 20, 21 and 26.

²²³ *Ibid.*, p. 7. This is also emphasised by a leftwing historian, Guðmundur Jonsson, *The Icelandic Welfare State in the Twentieth Century*, *Scandinavian Journal of History*, Vol. 26 (3: 2001), p. 267.

²²⁴ Arnor Hannibalsson, *Moskvulinan* (Reykjavik: Bokafelagid, 1999); Jon Olafsson, *Kaeru felagar* (Reykjavik: Mal og menning, 1999). Both authors had gone to Moscow and done research in the Comintern archives.

²²⁵ Hannes H. Gissurarson, *Hvers virði var Russagullid? Visbending*, Vol. 33 (29: 2015), pp. 3–4.

²²⁶ Hannes H. Gissurarson, *Islenskir kommunistar 1918–1998* (Reykjavik: Almenna bokafelagid, 2011).

²²⁷ Thorleifur Fridriksson, *Gullna flugan* (Reykjavik: Orn og Orlygur, 1987); Undirheimar *islenskra stjornmala* (Reykjavik: Orn og Orlygur, 1988).

The present Icelandic Social Democratic Party was formed in 1999 in a merger of the old Social Democrats, the more moderate faction of the People's Alliance, the Feminist Party, and a break-out group from the old Social Democrats. It inherited two funds which had supported the old Social Democrats and the People's Alliance, respectively. In 2017, it is estimated that the assets of the fund for the old Social Democrats are 478 million *kronur*, or €3.8 million, while the assets of the fund for the old People's Alliance are 109 million *kronur*, or €874,000.²²⁸ No further information about the two funds is however available. Probably some of the assets of the fund for the old People's Alliance originally came from the generous contributions from Moscow. In addition, the left-wing book club (*Mal og menning*) still exists with considerable assets, and it seems to have shared with the Socialist Party the 'Russian gold' as it was called in Iceland.

This is not all. In 2007, a new law in Iceland set strict limits to corporate and individual contributions to political parties. Therefore, 2006 was the last year when corporations could make large and confidential donations to parties. It was leaked to the press just before the 2009 parliamentary elections that an investment company, FL Group, had in 2006 made a donation of 30 million *kronur*, or €317,000, to the Independence Party.²²⁹ This was done shortly before the company was taken over by Jon Asgeir Johannesson. This piece of news was met with outrage, not least within the Independence Party itself, which only grew when it became known that Landsbanki had in the same year donated 25 million *kronur*, or €264,000, to the party. The party leadership swiftly promised to return these two large donations, admitting that they were inappropriate. In the 2009 election campaign, the Social Democrats disclosed that in 2006 they had received a total of 45 million *kronur*, or €476,000, in corporate donations. After the elections, the National Audit Office investigated donations to all the political parties in 2006 and published a report about it in early 2010. It turned out that in 2006 the Independence Party had

received a total of 104 million *kronur*, or €834,000, in corporate donations, but that the Social Democrats had not received 45 million, as they had claimed before the elections, but 102 million *kronur*, or €1.1 million. In other words, the Social Democrats had not provided accurate information about this before the elections. It was also interesting that of this sum, about one-fourth, 25.5 million *kronur*, or €270,000, consisted of donations from companies controlled by Jon Asgeir Johannesson.²³⁰ It should be pointed out that all this information would have been available to Stefan Olafsson when he wrote in 2011 about the 'very important advantages' of the Independence Party's links to business. It should also be recalled that in the 2003 election campaign it was Ingibjorg S. Gisladdottir from the Social Democrats who suggested that the police investigation of Jon Asgeir Johannesson was politically motivated.

Professor Olafsson suggests that favouritism played a crucial role in the privatisation of the Icelandic banks. He says in a 2011 paper that Landsbanki was sold to 'businessmen with close contacts to the IP [Independence Party] leadership' and that Bunadarbanki was sold to business 'close to the PP [Progressive Party] leadership'.²³¹ He repeats this allegation in a 2016 paper: 'Businessmen with close contacts to the IP leadership were allowed to buy the larger bank (Landsbanki). This happened even though the buyers in question had not delivered the best offer.'²³² In the same paper, 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 and the PP). That privatization process had all the hallmarks of a corrupt interlinking of politics and business.'²³³ It is interesting that Olafsson does not mention the first privatisation, of Utvegsbanki in 1990. Moreover, he only mentions in passing the sale of Bunadarbanki, even if it is clear in that case that the buyers of a controlling share in the bank were close to the Progressive Party leadership: one of the members of the group of buyers, Finnur Ingolfsson, was indeed a former government minister for the Progressives.

Professor Olafsson concentrates on the sale of a controlling share in Landsbanki because that fits in with his narrative of Oddsson's Independence Party as the chief culprit in the bank collapse. He is however wrong that the three businessmen who in 2003 bought a controlling share in Landsbanki were close to the Independence Party leadership. Only one of them was a party member, Bjorgolfur Gudmundsson. He had been an avid supporter of David Oddsson's main rival in Reykjavik City Council, the popular former soccer star Albert Gudmundsson. He had even managed Gudmundsson's campaign in the 1981 Independence Party primaries, where Oddsson won a narrow victory against Gudmundsson. In 1987, Albert Gudmundsson split the Independence Party and founded the Citizens' Party. By then, Bjorgolfur Gudmundsson had moved abroad, only to return in 2002. Bjorgolfur Gudmundsson and David Oddsson were not personal enemies and were certainly 'on speaking terms', but the evidence shows that they were in no way close. Bjorgolfur Gudmundsson's son, Bjorgolfur Thor Bjorgolfsson, had moved from Iceland long ago and wanted to have nothing to do with Icelandic politics. The third member of the group, Magnus Thorsteinsson (who later sold his shares), was a member of the Progressive Party.²³⁴ Olafsson is also wrong that the eventual buyers of a controlling share in Landsbanki had not made the best offer. The chief consultant to the privatisation commission, HSBC, had recommended that their offer should be accepted

because it was deemed on the whole to be the most advantageous one, not least because the buyers were expected to bring a lot of the money they had earned abroad into Iceland. It should also be noted that the National Audit Office did two thorough investigations of the 2003 bank privatisations, reaching the conclusion that they were carried out in a professional way.²³⁵ Olafsson's attack on these two privatisations is therefore also an attack on the integrity of HSBC and the Icelandic National Audit Office.

A leading theme in Professor Olafsson's narrative on the 2008 Icelandic bank collapse is that Iceland was, and had long been, corrupt. He writes about 'crony capitalism growing out of the extensive links between politics and business, a feature that seems to have prevailed up to the present [2011].' As partial evidence, he quotes a student thesis that he himself supervised. Olafsson makes an observation about the past, from the end of the war to the early 1990s: 'Clientelism and nepotism also characterized Icelandic politics and political administration to a very large extent.'²³⁶ He adds that a recent study by his colleague, Professor Gunnar H. Kristinsson, showed that about 40% of appointments of high officials in 2001–2005 were politically motivated rather than based on professional skill (the applicant with the most merit) or a bureaucratic position (the applicant next in line).²³⁷ In these observations Olafsson is partly right and partly wrong. He is right that during



²²⁸ Hannes H. Gissurarson, Svar Margretar S. Bjornsdottur, Morgunblaðid 12 November 2016.

²²⁹ All numbers are calculated at the exchange rate at the end of 2006, on the CBI website, <http://www.sedlabanki.is/hagtolar/opinber-gengisskraning/>

²³⁰ Fjarframlag til Samfylkingarinnar 2002–2006 [Donations to the Social Democrats, 2002–2006], (Reykjavik: National Audit Office, 2010), <http://rikisendurskodun.is/wp-content/uploads/2016/01/framl0206samf.pdf>

²³¹ Stefan Olafsson, Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse (2011), p. 27.

²³² Stefan Olafsson, The Political Economy of Iceland's Boom and Bust (2016), p. 64.

²³³ Ibid., p. 65.

²³⁴ Bjorgolfur Thor Bjorgolfsson, Billions to Bust — and Back (London: Profile Books, London), p. 100.

²³⁵ Greinargerð um utbod a fjordungshlut rikisins i Landsbanka Islands hf. [Investigation of the Tender for One-Fourth of the Government Share in Landsbanki] (Reykjavik: Ríkisendurskodun, Október 2002); Einkavaeding helstu rikisfyrirtækja arin 1998–2003 [Privatisation of main government companies 1998–2003] (Reykjavik: Ríkisendurskodun, Desember 2003).

²³⁶ Stefan Olafsson, Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse (2011), pp. 10 and 21.

²³⁷ Gunnar H. Kristinsson, Patronage and public appointments in Iceland, working paper 2006, <https://ecpr.eu/Filestore/PaperProposal/f48667ec-8cc9-4137-bfc7-45352b3fe2f7.pdf>. An almost identical paper was published the same year in Icelandic, Politískar stöduveitingar a Islandi, Stjornmal og stjornsysla, Vol. 2 (1: 2006), pp. 5–29.

the period from 1930 to 1960 nepotism, clientelism, favouritism and party patronage were all common in Iceland, mostly because the economic policies pursued provided ample opportunities for this, with strict and comprehensive import and currency controls and with political dominance over the banks which, with negative real interest rates, were sometimes distributing gifts rather than providing loans to their debtors. Also, as Professor Kristinsson observes in the paper Olafsson quotes, the 1927–1932 minority government of the Progressive Party, initially supported by the Social Democrats, broke with the tradition of bureaucratic professionalism inherited from Denmark, and other parties eventually adopted the same attitude: Icelandic society was quite politicised in 1930–1960.²³⁸ This changed however with two trends, as Kristinsson also recognises: the 1960 abolition of the strict economic controls and a gradual introduction of professionalism in the public administration, not least in the early 1990s, after parliament passed comprehensive laws on public administration and the right to information.

Professor Olafsson is however wrong that crony capitalism persisted during the Oddsson governments or that political patronage was then rampant. As the liberal reforms of the Oddsson era which have been described here showed, they achieved their goal of breaking or at least weakening links between business and politics. With the market setting interest rates and the banks being transferred into private hands, it was not those favoured by politicians who received loans, and those loans again had to be fully repaid. With the privatisation of many companies, politicians lost the power to control jobs in those companies. With the abolition of government investment funds providing cheap and easy credit, Oddsson and his associates renounced the power to hand out money to unsustainable companies, as their predecessors had done generously.²³⁹ With the abolition of invisible and involuntary taxes such as unfunded pension schemes, inflation, and accumulation of public debt, politicians lost the power to obtain money by stealth. With membership in the EEA, it became much more difficult to protect Icelandic companies from competition by various means. With the new laws on

public administration and the right to information, the Oddsson government introduced yet more self-denying ordinances.

The study by Professor Kristinsson of Icelandic party patronage in 2001–2005, quoted by Professor Olafsson, was based on interviews with 17 people close to or in public administration. They were asked to evaluate 111 appointments of high officials in 2001–2005, whether they were bureaucratic, professional, or political. (Of course some appointments might be based on all three criteria: a successful applicant might have been the next in line to the high official that he or she was replacing; he might be the most qualified person for the job; and he might belong to the same political party as the government minister who made the appointment.) The main conclusion of Kristinsson's study was that 'the professional model has become the predominant model of appointments in Iceland'. 68% of the appointments were compatible with the professional model, 57% with the bureaucratic model, and 41% with both models. 44% of the appointments were compatible with the political model, according to Professor Kristinsson, and of them 16% – 18 appointments altogether – were only compatible with that model, by which he presumably meant that they could not be explained by professional or bureaucratic considerations. It is therefore clear that Professor Olafsson is misinterpreting the study when he quotes it as showing 'that about 40% of hirings to top positions were directly political rather than bureaucratic or professional'. He should have said that according to the study 16% of appointments in this period seemed to be solely politically motivated.

Even if Professor Olafsson misinterprets Professor Kristinsson's study and greatly exaggerates his findings about political appointments, the study itself is flawed. Who were the 17 'experts' surveyed and how were they chosen? Was Olafsson perhaps one of them? Olafsson and Kristinsson have worked closely together, indeed so closely that a Law Professor once came to the conclusion in a legal opinion sought by the Faculty of Social Sciences that Olafsson could not serve on an appointments committee where Kristinsson was one

of the applicants. Kristinsson seems to share Olafsson's hostility towards the Independence Party, once stating in a television interview that it was controlled (or at least heavily influenced) by 'monsters'.²⁴⁰ As Professor of Politics, Kristinsson has also personally vetoed invitations to former Independence Party leader David Oddsson to talk at events organised by the Institute of Public Administration and Politics affiliated with the Politics Department at the University of Iceland.²⁴¹ Moreover, both Olafsson and Kristinsson are, as some other university professors, at the margin of politics rather than in the mainstream. For example, they both supported the first Icesave deal between Iceland and the United Kingdom in 2009, rejected by 98% of the voters in a national referendum.²⁴² It is therefore by no means certain that 17 people chosen and interviewed (and agreeing to be interviewed) by Kristinsson would reflect any mainstream view or general opinion.

In the second place, Kristinsson's study was made of appointments in 2001–2005 when there was in place the same coalition government of the Independence Party and the Progressives. It would have been more fruitful to survey appointments during different types of coalitions. For example, in 1986–1990 there were four coalition governments: 1986–1987 the Progressives and the Independence Party; 1987–1988 the Independence Party, the Progressives and the Social Democrats; 1988–1989 the Progressive Party, the People's Alliance and the Social Democrats; 1989–1990 the three aforementioned parties and the Citizens' Party (a splinter group from the Independence Party). By a survey of appointments in this period, Professor Kristinsson would have obtained information about all the main parties, not only the Independence Party and the Progressives.

Thirdly, the 17 people interviewed in Kristinsson's study were said to be mainly in or close to public administration in Iceland. This means that they were mostly, if not solely, public employees or 'insiders' which may have created a bias against 'outsiders', for example officials who would be appointed against the wishes of the staff of the agency where they are serving.



Fourthly, it would have been instructive to see a list of the 111 appointments surveyed by the experts chosen by Kristinsson and especially a list of those 18 appointments which Professor Kristinsson and the people he interviewed considered to be purely political. That list has not been made available despite requests.²⁴³ From Kristinsson's discussion of his findings it seems however clear that they would include two appointments to the Supreme Court, of Olafur B. Thorvaldsson in 2003 and Jon S. Gunnlaugsson in 2004. But both appointments could have been made on other grounds. Thorvaldsson was the only applicant in 2003 who was chief justice in a district, and therefore the candidate who best fitted the bureaucratic model of predictable advances in a hierarchy. Gunnlaugsson was a renowned attorney. His reputation as an able and tough lawyer was amply confirmed in 1989, when a Supreme Court judge was impeached: of all the defence attorneys he had seen practising, he chose Gunnlaugsson to argue his case. Moreover, when Gunnlaugsson was appointed to the Supreme Court, two leading Social Democrats, one of them a former chairman of the party, the other one the chairman of the left-wing book club, wrote in support of him.²⁴⁴ The government minister appointing Gunnlaugsson undoubtedly

²³⁸ Even Professor Thorvaldur Gylfason seems to agree that 1927 was a crucial year: Iceland's blend of old and new, VoxEU.org 10 July 2008, <http://voxeu.org/article/iceland-and-its-financial-predicament-history-and-context>: "For decades, beginning in 1927 when a farmers' party gained majority in parliament with the support of just a third of the electorate, the Icelandic economy was more heavily regulated than most in Western Europe, with the possible exception of Ireland. Interference and planning were the norm; enterprise and markets were viewed with scepticism if not hostility. Without much exaggeration, the state tried to restrain almost anything that moved." Professor Gylfason leaves out that the minority government formed by the Progressive Party in 1927 was indirectly supported by the Social Democrats. Contrary to what he said, the Progressives did not obtain a majority in the 1927 elections.

²³⁹ For an example of past mistakes, see Halldor Halldorsson, *Laxaveislan* (Reykjavik: Fjölvi, 1992). For a report on past losses of public investment funds, *Skýrslur nefndar um fortíðarvanda ríkissjóds* (Reykjavik: Forsætisraduneytið, 1991).

²⁴⁰ Television interview 19 August 2009, http://www.mbl.is/frettir/innlent/2009/08/19/bjarni_fridar_skrimsladeild/

²⁴¹ A colleague of his, Professor Omar Kristmundsson, then the chairman of the board of the Institute, had asked me to invite David Oddsson (who rarely appears in public) to give a lecture at the Institute. I managed to get Oddsson's agreement to give such a lecture in 2013. But Professor Kristmundsson came to me and asked me to withdraw the invitation, because Professor Kristinsson was opposed to it! Oddsson certainly had a lot to say, having been Mayor of Reykjavik 1982–91, Prime Minister 1991–2004, Foreign Minister 2004–5, and CBI Governor 2005–9.

²⁴² Interview on State Television 10 August 2009, <http://eyjan.pressan.is/frettir/2009/08/10/gunnarhelgi-kristinsson-stjornarkreppa-ef-althingifellir-icesave/>

²⁴³ Email from Hannes H. Gissurarson to Gunnar Helgi Kristinsson 5 December 2016. Kristinsson has not answered the email.

²⁴⁴ Jon B. Hannibalsson, *Ad njota sannmaelis* [Fair Judgements], *Morgunblaðid* 27 September 2004; Throstur Olafsson, *Tilgatur radi ekki for* [Innuendos Should Not Control Discussion], *Morgunblaðid* 29 September 2004.

thought that he was choosing the best qualified candidate.²⁴⁵ It is true that in both cases the Supreme Court had recommended others to the minister, but that may have been because the incumbent judges preferred ‘insiders’, instead of basing their view on bureaucratic or professional criteria. It is also true that Thorvaldsson is Prime Minister Oddsson’s first cousin and that Gunnlaugsson is Oddsson’s good friend. But this is hardly relevant, as the Justice Minister, not Oddsson, made the appointments. People are not automatically disqualified if they have some relationship with Oddsson. Iceland is a small society, and the legal community is much smaller. Until recently, all Icelandic lawyers received their education at the Law Faculty of the University of Iceland, where they became friends (or sometimes enemies) and formed luncheon groups and soccer teams or became bridge or golf partners. For example, a member of the Locomotive Group (Gunnlaugur Claessen) had been appointed Supreme Court judge in 1994; one of Oddsson’s bridge partners (Arni Kolbeinsson) had been appointed Supreme Court judge in 2000. Neither appointment generated any controversy.

Even if Professor Kristinsson’s study would not have suffered from its deep internal flaws, no conclusions could have been drawn from it about party patronage in Iceland compared to other countries. Was it more extensive in Iceland than elsewhere? Certainly, during the heyday of Social Democracy in the Scandinavian countries party patronage was extensive there: while all parties participated in a series of governments in Iceland from the foundation of the republic in 1944 until 1991,²⁴⁶ Sweden, for example, saw more than 40 years of unbroken social democratic rule. According to some analysts, the Scandinavian states almost became one-party states.²⁴⁷

Indeed, the social democratic parties in Sweden and Norway even used the secret services to spy on their political opponents.²⁴⁸ It is however true that ‘hard’ corruption, such as bribes, extortion, and embezzlement, is, and for a long time has been, almost negligible in all the Nordic countries, which all have a tradition of honesty, transparency, professionalism, and a strong sense of equality before the law.

It should be noted that at the time Kristinsson conducted his survey of party patronage in Iceland, approvingly quoted by Professor Olafsson, Iceland was perceived as one of the least corrupt countries in the world: according to the corruption perceptions index of Transparency International, she was 4th out of 102 countries in 2002, 2nd out of 133 in 2003, 3rd out of 145 in 2004, and 1st out of 158 in 2005.²⁴⁹ It so happens, also, that a comparative survey of party patronage was conducted in 2008 of 15 European countries, including Iceland, Denmark and Norway, with the participation of Professor Kristinsson. The conclusion was that party patronage was least common in the UK, the Netherlands, Denmark, Iceland, and Norway, with the Index of Party Patronage going up from 0.09 in the UK to 0.26 in Norway. Party patronage was most common in Greece, Austria, Italy, Germany, and Hungary, with the Index going down from 0.62 in Greece to 0.43 in Hungary.²⁵⁰ These findings are a dramatic refutation of Olafsson’s description of Iceland as a very politicised society. These findings also suggest that Kristinsson’s survey of appointments in Iceland in 2001–2005 may have exaggerated party patronage in Iceland, possibly because of the biases mentioned. In other words, Olafsson’s statement that clientelism, nepotism, and party patronage still characterise Icelandic politics seems to be an exaggeration of an exaggeration. •

²⁴⁵ Gunnlaugsson has written in detail about the appointment, Jon S. Gunnlaugsson, *I krafti sannfaeringar* [Governed by Conviction] (Reykjavik: Almenna bokafelagid, 2014), pp. 267–289.

²⁴⁶ The Independence Party was in government 1944–1956 and 1959–1971 and 1974–1978 and 1983–1988, for 33 years; the Progressive Party was in government 1947–1958 and 1971–1979 and 1980–1991, for 30 years; the Social Democrats were in government 1944–1949, 1956–1971, 1978–1979 and 1987–1991, for 25 years; The People’s Alliance (and its predecessor, the Socialist Party) was in government 1944–1947, 1956–1958, 1971–1974, 1978–1979, 1980–1983 and 1988–1991, for 15 years.

²⁴⁷ Jens Arup Seip, *Fra embedsmannsstat til ettpartistat og andre essays* (Oslo: Universitetsforlaget, 1963); Erik Anners, *Den socialdemokratiske maktapparaten* (Stockholm: Askild & Kärnekull, 1976).

²⁴⁸ On the Swedish case, Lars Olof Lampers, *Det grå brödrskapet. En berättelse om IB* (Stockholm: SOU, 2002), <http://www.regeringen.se/rattsdokument/statens-offentliga-utredningar/2002/01/sou-200292/> On the Norwegian case, the report of the Lund Commission, <https://www.stortinget.no/no/Saker-og-publikasjoner/Publikasjoner/Dokumentserien/1995-1996/Dok15-199596/>

²⁴⁹ Transparency International, *Corruption Perceptions Index*, <http://www.transparency.org/research/cpi/overview>

²⁵⁰ Petr Kopecký and Peter Mair, *Conclusion: Party Patronage in Contemporary Europe, Party patronage and party government in European democracies*, eds. Petr Kopecký, Peter Mair and Maria Spirova (Oxford: Oxford University Press, 2012), p. 367. The authors give a website where the data are said to be available, but they are not to be found there: <https://www.universiteitiden.nl/en/social-behavioural-sciences/political-science/research>

SOME HALF-TRUTHS IN THE ANTI-LIBERAL NARRATIVE

In addition to the misleading statements and unsubstantiated claims by Professor Olafsson about Icelandic society and politics, he presents some half-truths which would lead some of his more innocent readers to misinterpret crucial events. For example, he correctly describes the aggressive and reckless behaviour of the banks after privatisation had been completed in the beginning of 2003.²⁵¹ But, in that context he does not mention the banks’ most prominent critic: Prime Minister David Oddsson. Friday 21 November 2003, for example, Oddsson went to the newly-privatised Bunadarbanki (soon to be taken over by Kaupthing and assuming that name) and closed his private savings account there in protest against generous share deals that the new leadership of the bank had made with themselves. Publicly, he expressed dismay at the behaviour of the bankers, quoting a famous passage on greed from the ‘Hymns of the Passion’ by the 17th century poet Hallgrímur Petursson.²⁵² 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, the bank leadership backed out of the share deals. They did so grudgingly. Sigurdur Einarsson, Chairman of Bunadarbanki’s Board, said that ‘he found it strange that a nation’s leaders could attack a private company in this way. This would not happen anywhere else except perhaps in Russia and some African countries.’²⁵³ Olafsson does not mention, either, that Ingibjörg S. Gísladóttir, leader of the Social

Democrats, in the 2003 election campaign saw fit to defend Kaupthing against what she perceived to be the hostility of Oddsson towards it. Neither does Olafsson mention that it was discovered in the 2010 audit of the political parties that in 2006 Kaupthing was the single biggest donor to the Social Democrats, contributing 11 million *kronur*, or €116,000.²⁵⁴

Professor Olafsson also more or less accurately describes the attempts in the first half of 2008 by the Icelandic government, acting in conjunction with the Icelandic business community, to muster ‘support for the ailing financial system’ abroad – attempts that in hindsight may seem misguided, although understandable at the time.²⁵⁵ He does not however say even one word about the worries of, and warnings by, CBI Governor David Oddsson on the banks.²⁵⁶ Already in the autumn of 2005, during his first months as CBI governor, Oddsson was worried about the banks. While he had, in his position, to be cautious about what he said publicly, this is clear from an interview in *Financial Times* with his former assistant, economist Illugi Gunnarsson. Having described the recent conflict between Oddsson and Jon Asgeir Johannesson, the journalist making the interview writes,

“In his new post at the central bank Oddsson has other concerns. They include the safety of the country’s financial institutions. ‘We are worried about how much of the growth is sustainable and whether there is a bubble,’

²⁵¹ Stefan Olafsson, *Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse* (2011), p. 27.

²⁵² Hallgrímur Petursson, *Hymns of the Passion*, tr. by Arthur Charles Cook (Reykjavik: Hallgrímskirkja, 1978), 16, 8. The verse is a variation of Timothy 1, 6, 10: “For the love of money is the root of all evil.”

²⁵³ Falla fra kauprettinum vegna hardrar gagnryni, *Morgunblaðið* 22 November 2003.

²⁵⁴ Fjarframlög til Samfylkingarinnar 2002–2006 [Donations to the Social Democrats, 2002–2006], (Reykjavik: National Audit Office, 2010), <http://rikisendurskodun.is/wp-content/uploads/2016/01/framl0206samf.pdf>.

²⁵⁵ Stefan Olafsson, *Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse* (2011), pp. 31–2.

²⁵⁶ The present writer sat on the Board of Overseers of the CBI in 2001–9 and could observe at first hand Oddsson’s worries. His warnings were indeed more frequent and couched in stronger terms than is usually recorded, for example in the SIC Report.

says Gunnarsson, the adviser. 'I don't think Icelanders suddenly became incredibly clever overnight. This often happens in economies that are liberalised. People are willing to take bigger risks than you would in a more mature economy.' Jon Asgeir shrugs it off. He believes his opponent, now without political power, is finally vanquished. 'It's going to be safer now. As these people go away, so will the problems. The businessman in Iceland can lead a normal life.' But he expects to spend much of the future outside the country.²⁵⁷



Johannesson's 'normal life' included a private Dassault Falcon 2000EX jet, a Heesen 4400 yacht, a luxury flat in Manhattan and a chalet in Courchevel. He had therefore plenty of opportunity to spend time abroad. But unlike him, the problems did not go away.

As is described in the 2010 Report by the SIC, Special Investigation Commission, on the bank collapse, to which Professor Olafsson had access when he made his comments, Governor Oddsson and his two colleagues at the CBI, Eirikur Gudnason and Ingimundur Fridriksson, made several attempts in 2008 to warn the government of a possible imminent disaster. For example, Sunday 13 January 2008, Governor Oddsson privately met with two leading members of his old team from the Independence Party, Prime Minister Geir H. Haarde and Finance Minister Arni M. Mathiesen, and told them that he had grave worries about the Icelandic banks and their

ability to survive in the next twelve months.²⁵⁸ A year later, Mathiesen said that David Oddsson's worries about the possible collapse of the banking sector had 'been a recurrent theme in all their discussions for years prior to the event.'²⁵⁹

One of the most important encounters with government ministers took place Thursday 7 February 2008. Governor Oddsson and his two CBI colleagues met with Prime Minister Geir H. Haarde, Finance Minister Arni M. Mathiesen, and Foreign Minister Ingibjorg S. Gisladdottir, leader of the Social Democrats. Oddsson gave an account of a recent trip to London where he had had discussions with rating agencies and banks. He said that there were great concerns abroad about the Icelandic banks in general. They had apparently lost all credibility. 'It is criminal if they are falling and bringing the country down as well,' Oddsson said. Representatives of the rating agency Moody's had expressed concerns to the governor about Landsbanki's Icesave accounts. A run on the bank might be possible. Since the deposits were in a branch of an Icelandic bank, and not in a British subsidiary of an Icelandic bank, they were only covered by the Icelandic Depositors' and Investors' Guarantee Fund. When Oddsson left the meeting, he said to the CBI staff members who accompanied him, 'If this does not move them, then nothing will.' Later, Foreign Minister Gisladdottir stated that she had thought that Oddsson had been 'a little dramatic' in his presentation at this meeting.²⁶⁰

The Icesave accounts and other problems of the three Icelandic banks were discussed at many more meetings in 2008. Thursday 6 March 2008, for example, Oddsson met with Prime Minister Geir H. Haarde, giving him an account of a recent meeting with Bank of England officials. He told Haarde that the British officials were concerned about Landsbanki's Icesave accounts. He also gave the Prime Minister a report which had been prepared at the CBI by an English expert, Andrew Gracie, on the possible collapse of the banks and how to prepare for it. Oddsson did not mince words at this meeting, speaking of his suspicion of a 'scam' at Kaupthing Bank and of potentially criminal behaviour of some bankers. Haarde was shocked, but rather at

Oddsson's strong words than at the bankers' alleged behaviour.²⁶¹ Tuesday 18 March Oddsson and his two CBI colleagues met with Prime Minister Haarde, and Sunday 30 March Governor Oddsson met with Prime Minister Haarde and Finance Minister Arni M. Mathiesen, informing them that he thought that the banks were not providing sufficiently reliable information about their situation.²⁶² Oddsson did not only warn the government. He also suggested to the people concerned at least three ways to reduce the banking sector and thus to reduce the risk for Iceland: that Kaupthing would move its headquarters to another country, perhaps Denmark (where Kaupthing had a large subsidiary); that Landsbanki would transfer the Icesave accounts from its London branch to a subsidiary (possibly Heritable Bank); and that Glitnir would sell a Norwegian bank that it had recently acquired.²⁶³

Speaking publicly, Governor Oddsson obviously had to tread more carefully than in private meetings. But already in the autumn of 2007 he had begun to admonish the bankers. Tuesday 6 November 2007, in a speech at a breakfast meeting of the Icelandic Chamber of Commerce, he said,

“For a while, cheap capital was readily available, and some were bold enough to grab the opportunity. But the flip side of expansion, and the side that cannot be ignored, is that Iceland is becoming uncomfortably beleaguered by foreign debt. At a time when the Icelandic government has rapidly reduced its debt and the Central Bank's foreign and domestic assets have increased dramatically, other foreign commitments have increased so much that the first two pale into insignificance in comparison. All can still go well, but we are surely at the outer limits of what we can sustain for the long term.”²⁶⁴

At the annual CBI meeting, 28 March 2008, Oddsson criticized those who were overly optimistic about the end of the liquidity crisis:

“Of course, it is far from inconceivable that strong gusts of wind could come from any direction, dispersing pitch-black storm clouds in a moment's time, bringing leveraged buyouts of heavily indebted companies under the aegis of credit institutions offering minimum terms and slick collateral, and bright, sunny morning would smile on markets in Iceland and elsewhere. But even though this is not inconceivable, and though history shows that the market is living proof of the most improbable outcomes, the likelihood is that the probability of winning the wait-and-hope game is measurably poorer than that accompanying the purchase of a Lotto ticket.”²⁶⁵

This could only be read as another admonition to the Icelandic banks and a warning that they had to prepare for a severe crisis. Alas, instead of acting on Oddsson's warnings and preparing for a possible bank failure in the autumn of 2008, as the English expert, Andrew Gracie, brought in by the CBI, had suggested, the government chose to conduct a campaign seeking to improve the image of the banks abroad, as Professor Olafsson correctly observes.

Tuesday 1 April 2008, Governor Oddsson and his two CBI colleagues met with Prime Minister Geir H. Haarde and Foreign Minister Ingibjorg S. Gisladdottir. Oddsson said that a run on Landsbanki was entirely possible, adding that the British FSA wanted Landsbanki to transfer the Icesave accounts from its London branch to a subsidiary.²⁶⁶ Wednesday 7 May 2008, Oddsson and the other two CBI governors met with three government ministers, Prime Minister Haarde, Finance Minister Mathiesen, and Foreign Minister Gisladdottir. Oddsson gave an account of recent meetings with European central bankers, stressing the lack of trust in the Icelandic banks and concerns about Landsbanki's Icesave accounts.²⁶⁷ Thursday 8 May 2008, Oddsson said, in response to a question at a press conference,

²⁵⁷ Henry Tricks, Norse Code, Financial Times 5 November 2005, <https://www.ft.com/content/22b28436-4da1-11da-ba44-0000779e2340>

²⁵⁸ SIC Report, Vol. 6, Ch. 19, p. 102. Also the author's interview with Arni M. Mathiesen 13 January 2016.

²⁵⁹ Styrmir Gunnarsson, Umsatrid [The Siege] (Reykjavik: Verold, 2009), p. 24.

²⁶⁰ SIC Report, Vol. 6, Ch. 19, pp. 117-124.

²⁶¹ Ibid., pp. 136-7.

²⁶² Ibid., p. 143 and 148.

²⁶³ The evidence is in the SIC Report, Vol. 6, Ch. 19. On a Kaupthing move, pp. 122 and 124; on the transfer of the Icesave accounts, p. 124; on the sale of the Norwegian bank, pp. 256-7.

²⁶⁴ Speech by David Oddsson, 6 November 2007, <http://www.cb.is/lisalib/getfile.aspx?itemid=5491>

²⁶⁵ Speech by David Oddsson, 28 March 2008, <http://www.cb.is/publications-news-and-speeches/news-and-speeches/news-and-speeches/speeches/2008/03/29/Speech-by-Dav%C3%AD%C3%B0-Oddsson--Chairman-of-the-Board-of-Governors--at-the-Annual-Meeting/>

²⁶⁶ SIC Report, Vol. 6, Ch. 19, p. 152.

²⁶⁷ Ibid., p. 173.

“It’s a new development if banks are supposed to be able to expand at will and take the risk that they choose to take, and then the public, through the central bank, is believed to function as some sort of inexhaustible guarantee fund. Such a thing would not be considered seriously anywhere. It is not the role of the Central Bank as such. However, the Central Bank of Iceland wishes to—and should—promote monetary stability and the stability of the financial system.”²⁶⁸

This could be read as a critique of the Icelandic banks, as well as a reaffirmation of the traditional role of central banks. None of this is mentioned by Professor Olafsson, nor the plans quietly being prepared in the CBI in the summer and autumn of 2008 for ring-fencing Iceland in the case of a bank collapse: with the aim of preserving financial sovereignty as well as the interests of depositors, the domestic part of the banks would be taken over by government, while the foreign part would be put into resolution. Almost all this information is to be found either at the CBI website or in the 2010 SIC Report. Needless to say, Olafsson does not either mention that Ingibjorg S. Gisladdottir was so unaware of the real problems on the banks that as late as 4 September 2008 she suggested, in a newspaper article, that the banks should continue collecting deposits abroad.²⁶⁹

Another half-truth is that it was David Oddsson who tried to make Iceland into a financial centre.²⁷⁰ Although Professor Olafsson does not mention it, the first person to present a sustained argument for this idea was Philosophy Professor Mikael Karlsson, in a series of articles in 1987–1988.²⁷¹ The present writer developed the argument further in a book published in 2001, noting Karlsson’s initiative.²⁷² The plan was to attract foreign capital and corporations to Iceland by low taxes, political stability, freedom of contract, and the rule of law. It was, essentially, the model of the

Isle of Man or the Channel Islands. This was an idea quite different from what happened in reality, which was the expansion of the Icelandic banks abroad by accumulating foreign credit and using it to compete with other European banks. While Oddsson was mildly sympathetic to the idea, it was never implemented.²⁷³ However, Oddsson’s immediate successor as prime minister, Halldor Asgrimsson from the Progressive Party, in late 2005 appointed a committee to study the possibilities of Iceland becoming a financial centre. One of Olafsson’s research associates and co-authors, economist Katrin Olafsdottir, was a member of the committee, which delivered its report in late 2006. The committee emphasised the model of an onshore financial centre, whereas the proposals by Karlsson and the present writer had focused on the possibilities of an offshore centre (Karlsson had even coined the Icelandic word *fjarhaeli*, literally money haven). The committee discussed ways of provided highly developed financial services such as were found in the United Kingdom, the Netherlands, Luxembourg and Switzerland.

However, the committee’s report had very little impact, except perhaps by influencing the British government in taking a tough stance against Iceland, as the minutes of an October 2008 meeting of the non-executive board of directors of the Bank of England show.

“The number of countries that promoted themselves as centres for financial services ought to reduce [sic]. Iceland was a very telling example. It was noted that the Icelandic central bank had visited the Bank [of England] at the beginning of the year and had been told that they should sell their banks now. Iceland’s balance sheet was far too large. It was stated that the Bank would be supportive of efforts to constrain the use of tax and regulatory havens. It was noted, however, that there was a legacy

of Foreign & Commonwealth advice, which had encouraged former dependencies to enter financial services as a means of reducing their reliance on commodity products.”²⁷⁴

Even if Iceland had not really become a financial centre in the same sense as the Isle of Man or some former British colonies such as the Cayman Islands, officials at the Bank of England seem to have thought otherwise. And of course, the CBI had no power to sell any bank, or bank assets, as the Bank of England people apparently assumed.

Unfortunately, despite glaring errors, logical flaws, misleading statements, unsubstantiated claims, and half-truths, Olafsson’s several papers have passed peer reviews and seem to be taken at face value by some in the academic community. For example, in *Acta Sociologica*, a reviewer writes about Olafsson’s contribution to a book on the Nordic countries,

“The Iceland chapter, by Stefan Olafsson, for understandable reasons is structured as an explanation of the volcanic financial crisis of 2008. It points out that the one critical dimension by which Iceland differs from mainland Scandinavia is not smaller size and relative isolation, but rather the persistence of a clientelist politics right up until the crisis. Like, but later than, the Scandinavian economies, Iceland deregulated its financial system, but it did so into the hands of a small inter-connected business elite who ramped up each other’s shares in order to borrow excessively from abroad.

Political connections produced lax financial supervision of these over-leveraged and over-ambitious banks, opening the way for Iceland’s *kreppa*, or crisis.”²⁷⁵

To see how far-fetched this interpretation is, it is sufficient to note the fact that the most powerful businessman in Iceland, as well as the main debtor of the banks (owing them almost €6 billion at the end of 2007)²⁷⁶ and the major shareholder in one of them, Jon Asgeir Johannesson, was since 2002 a tenacious and resolute foe of David Oddsson who is however blamed by Olafsson for the bank collapse. The two myths propagated by Olafsson of ‘the persistence of a clientelist politics right until the crisis’ and ‘political connections’ producing ‘lax financial supervision’ are both repeated in this book review. Whose political client was Jon Asgeir Johannesson supposed to be? If clientelism was rampant in Iceland, why had he not been brought down? It is true that Johannesson donated a lot of money to the Social Democrats, but he had no influence to speak of in the Independence Party, and the Social Democrats only got into power in 2007, a year before the collapse – which is not altogether implausible – it was more because public opinion favoured Jon Asgeir Johannesson and his group of daring businessmen after their victory over David Oddsson in 2004 than because of any political pressure exerted on the regulatory agency, the IFSA, Icelandic Financial Supervisory Authority, which incidentally was under the control of a ministry occupied by a Progressive in 1995–2007 and by a Social Democrat in 2007–2009. It should also be noted that the IFSA operated under the same set of law and statutes as its counterparts in other member states of the EEA. •

²⁶⁸ Board of governors press conference, 8 May 2008, <http://gamli.sedlabanki.is/?PageID=287&NewsID=1762>

²⁶⁹ Ingibjorg S. Gisladdottir, Unnid a thrithaettum vanda, *Frettabladid* 4 September 2008.

²⁷⁰ Stefan Olafsson, *Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse* (2011), p. 32.

²⁷¹ Mikael Karlsson [originally Michael Marlies], *Fjarhaeli a Islandi? Visbending*, Vol. 5 (41: 23 December 1987), p. 3, and *Starfsemi fjarhaela*, I. *Visbending*, Vol. 6 (7: 17 February 1988), pp. 2–4. There had been some vague proposals presented earlier, for example by bank director Jon G. Solnes in *Lesbok Morgunbladsins* 9 May 1971 and by economist Geir H. Haarde in the book *Uppreisn frjalshyggjunnar* 1979.

²⁷² Hannes H. Gissurarson, *Hvernig getur Island orid rikasta land i heimi?* [How Can Iceland Become the Richest Country in the World?] (Reykjavik: Bokafelagid, 2001).

²⁷³ Stefan Olafsson is therefore not correct, alas, when he writes about my book, in his paper *The Political Economy of Iceland’s Boom and Bust* (2016), p. 74: “Although the book was very superficial and Lafferian in its arguments, it was probably more influential than many have thought. After all, it was where the idea of Iceland as an international financial center was clearly formulated.” Note the sudden introduction of the word “Lafferian” where it is totally out of context. Laffer argued that lowering taxes might stimulate the domestic economy and thus eventually result in increased tax revenues. The argument of Karlsson and I was that offering low taxes to foreign capital and corporations might encourage them to move to Iceland and keep some of their money there.

²⁷⁴ Committee of Non-Executive Directors (Nedco) meeting, Wednesday 15 October 2008, <http://www.bankofengland.co.uk/archive/Documents/archivedocs/codm/20072009/codm2008b2.pdf>

²⁷⁵ Herman Schwartz, *Book Review of The Nordic Varieties of Capitalism*, *Acta Sociologica*, Vol. 56 (2: 2013), p. 194.

²⁷⁶ SIC Report (2010), Vol. 7, Ch. 21, pp. 6–8.

17

IMPLAUSIBLE EXPLANATIONS OF THE BANK COLLAPSE

Icelanders, in shock after the bank collapse and the hostility they encountered everywhere abroad, desperately wanted to know the explanations for the collapse. Their self-image, as a civilised, affluent, respectable Nordic nation, had been shattered. In late 2008, Parliament appointed a Special Investigation Commission, SIC, into the collapse and gave its three members personal immunity, a generous budget and wide-ranging powers such as unlimited access to all public documents and authority to compel anyone the SIC chose to give testimony. The personal immunity of the SIC members meant that people who thought the SIC had violated their rights could not refer their cases to a court. But Iceland is a small country. One of the three members of the SIC, the Parliament Ombudsman, Tryggvi Gunnarsson, had in the spring of 2004 had a public clash with Prime Minister David Oddsson, even feeling obliged to complain to the speaker of the parliament about a phone call which he received from Oddsson.²⁷⁷ He could therefore be expected to bear a grudge against Oddsson. Gunnarsson was also the father-in-law of a fairly high-ranking lawyer on the IFSA staff, which may have been an incentive for him to divide a possible responsibility for complacency before the bank collapse equally between the IFSA and the CBI, even if IFSA was the regulator and not the CBI.²⁷⁸

Another member of the SIC publicly disclosed what would be its conclusions when its investigation was about to start. When economist Sigridur Benediktsdottir, who taught at Yale University, was interviewed by *Yale Daily News* 31 March 2009, she described the task of SIC:

“We’re supposed to build a case for what went wrong for this to have happened. We’ll probably go back to when the banks were

made into private companies. We’re going to try to figure out maybe if the ownership of the banks were not regulated efficiently, and how this led to the complete failure of the banking system. We’re also supposed to look at the whole regulation around it: how they regulated [the three main private banks] and how they could have done it differently; the central bank and how they regulated that system; and the mandates which were to keep the system intact.

Benediktsdottir elaborated on this: ‘It’s a very complex problem that is at the same time very easy to see. You’ll understand why it collapsed when I tell you the size of the system. The banks were 10 to 20 times the GDP; after the fall of the Lehman Brothers, there was no way the central bank could save them. It should have been obvious that this was not viable.’ Then, she was asked about her personal feelings on the bank collapse. Her response was,

“I am disheartened by this failure; I feel it is a result of extreme greed on the part of many and reckless complacency by the institutions that were in charge of regulating the industry and in charge of ensuring financial stability in the country. Iceland will end up with a huge foreign debt as a result, which may not be the worst of it, since our reputation is completely tattered. This will take future generations some time to work through.

She added, ‘Many people also feel cheated and are rightfully demanding that those who got the country into this position answer for it. They want to know the truth as to what happened.’ She also said, ‘I think we can actually draw lessons from America. We have



a strict regulatory system in America, whereas the Icelandic banks were allowed to do things that should have been regulated.²⁷⁹ The third SIC member, Pall Hreinsson, a former professor of law and a Supreme Court judge, was a distinguished legal scholar who had written a thorough and comprehensive doctoral dissertation on grounds for recusal and disqualification in public administration.

When the SIC report was published in the spring of 2010, long after it was due and at the total cost of 450 million *kronur*, or €2.9 million,²⁸⁰ the main conclusions were those that Benediktsdottir had already revealed a year earlier in an American school magazine: the banks had become too big, and their collapse was brought about by a combination of the ‘extreme greed’ of the bankers (and perhaps also their customers) and

the ‘reckless complacency’ of both the institution that was supposed to regulate the banking sector, the IFSA, and the institution that was supposed to ensure financial stability, the CBI. However, in the very thorough and long SIC report, many examples were given of the warnings to both the banks and the government by the CBI, as has been mentioned here. Nonetheless, the SIC charged the CBI governors with negligence on two grounds. One was that in August 2008, after the British Financial Services Authority had insisted on strict conditions for a possible transfer of Landsbanki’s Icesave accounts from a branch to a subsidiary, the CBI should have verified both the reasons for FSA’s conditions and Landsbanki’s financial position. The second criticism was that in September 2008 the CBI should have consulted with specialists before offering to buy 75% of Glitnir for €600 million.²⁸¹

²⁷⁹ Iceland seeks help of Yale professor, *Yale Daily News*, 31 March 2009, <http://yaledailynews.com/blog/2009/03/31/qa-iceland-seeks-help-of-yale-professor/>

²⁸⁰ Of this, 340 million went directly to the SIC, and 110 million to print the report and to file documents, http://www.mbl.is/frettir/innlent/2014/08/14/kostnadur_faerdur_a_nefndina/ The printing of the report cost 96 million *kronur* which for anyone working in the publishing industry is amazing.

²⁸¹ SIC Report (English version), Ch. 21, pp. 153–160. The first criticism is stated thus that it “refers to the response of the Board of Governors whereby it was on the one hand omitted to ascertain whether the position of the Financial Services Authority had been described correctly, and on the other hand, there was no attempt to examine the quality of the loan portfolio of Landsbanki in light of the aforesaid information, and consequently whether the bank was experiencing equity problems.”

²⁷⁷ Umbodsmadur setur samskiptareglur, *Morgunblaðið* 22 May 2004.

²⁷⁸ SIC Report, Online Addenda, David Oddsson, Addendum 11, <http://rna.is/media/skjol/RNAvefVidauki11-5DO.pdf>

Governor David Oddsson and his colleagues firmly rejected these two criticisms. Against the first one, they pointed out that, unlike the IFSA, the CBI was not a regulator of the banks. It did not have any authority to request information from the banks and no power to discipline or punish them even if it felt that they were straying from their role or breaking the rules. The Icelandic legal tradition was one of a strict interpretation of the authority and power of institutions, as both Pall Hreinsson, in his doctoral dissertation, and Tryggvi Gunnarsson, in his many legal opinions as Ombudsman, had strongly stressed. The CBI governors emphasised that the SIC actually agreed that they had acted correctly by turning down Landsbanki's request to facilitate the proposed transfer of accounts, as it would have involved the CBI in great risks and would also probably have been illegal. At this time, several tasks were more urgent than to verify the obvious. Against the second criticism, the CBI governors pointed out that the decision to buy a controlling stake in Glitnir was taken by the government and approved by the opposition parties, even if it was done on the advice of the CBI. The decision had to be made within a weekend, before the markets opened. There was no 'right' price for the bank which could be found by calculations or consultations with experts. The price eventually set was found by a simple rule: the bank needed €600 million. The government needed to buy a controlling stake while it did not want to write too much down the shares of the existing owners. Therefore, it bought a 75% controlling share in Glitnir for €600 million. This was, in the circumstances, a perfectly appropriate process.²⁸² At the same time, for example, the US Secretary of the Treasury, Hank Paulson, was making many and much larger decisions about the price of financial firms in a matter of a few hours, even minutes, over the phone, without any paperwork, simply because in the desperate situation in which he found himself decisions had to be made quickly.²⁸³

It is no exaggeration to say that Governor David Oddsson was a controversial person in Iceland, not unlike Margaret Thatcher in her later years as British prime minister. Oddsson was undoubtedly the most controversial of all the prominent persons under investigation after the bank collapse. The SIC must

therefore have been under much pressure to find him guilty of something, if not a violation of law or tradition, then at least of negligence. But it only found these two rather implausible cases, both of which must appear to those familiar with the handling of the 2007–2009 financial crisis in other countries as overly formalistic and about minor, even negligible, issues. The SIC seemed to disregard two overriding concerns in the situations when the decisions it discussed were made, that they had to be taken swiftly and to remain strictly confidential until publicly disclosed. Therefore, it was for example necessary to involve as few people as possible in them and not necessarily to keep written notes about everything. The major issues were whether the CBI was correct in rejecting the requests for credit facilitation, made by Landsbanki in August and by Glitnir in September. There the SIC agreed with the CBI. In other words, for the SIC the decisions were correct, but some more paperwork should have preceded them. Therefore, even if one would accept the premises of the SIC, one would find Professor Stefan Olafsson to be rather unfair when he writes,

“ It was one of the main conclusions of the report of the Althingi's Special Investigating Committee into the fall of the banks (SIC) that regulators (the Central Bank of Iceland and the Financial Supervisory Authority) had grossly failed to carry out their duties. In fact, the governors of these institutions (including David Oddsson, the most influential neoliberal politician) were found guilty of gross negligence by the Committee.²⁸⁴

The SIC does not mention 'gross negligence' in the English version of its report, only negligence,²⁸⁵ and certainly the two criticisms it made of the CBI governors could not be regarded as a part of its 'main conclusions'. After all, it was not lack of paperwork which brought about the bank collapse. It is interesting, however, that Olafsson singles out Oddsson, but does not mention, for example, the Prime Minister; the Foreign Minister (who had as late as 4 September 2008 wanted the banks to continue collecting foreign deposits); the head of the IFSA; or Jon Asgeir Johannesson, the main debtor of the banks.

It is logically unsatisfying to try and explain the Icelandic bank collapse by the rapid expansion of the banks, as the SIC does. The Spanish bank Santander expanded rapidly without collapsing. It cannot be explained, either, by the size of the banking sector. In Iceland, it was certainly unusually big in proportion to GDP, in the end between eight and ten times GDP depending on the time and means of measurement. But the banking sectors in some other countries were just as big in proportion to GDP as in Iceland: it was times twelve in Scotland, ten in Switzerland, and eight in Cyprus.²⁸⁶ Why did those banking sectors not collapse totally like the Icelandic one? The answer is clear: because they received liquidity assistance, even if this assistance was so restricted in Cyprus that the banking sector almost went under. When someone says that a banking sector is too big, the response has to be: in relation to what? All the banks in the City of London may be too big for that small territory, but they may not be too big for the United Kingdom as a whole. To put it differently, the big size of the Icelandic banks was a necessary, but not a sufficient, condition for the bank collapse. Of course, if the banking sector had been small and mostly local, there would hardly have been any collapse. The most interesting question is therefore what enabled the banks to grow so rapidly. The SIC gives a plausible answer in its report: it was a combination of the good reputation of Iceland, with excellent credit ratings from which the banks benefitted; the special conditions on the international financial markets, with ample cheap credit; and Iceland's membership in the EEA, with free capital movements.²⁸⁷ One conclusion is therefore that in an explanation of the bank collapse a systemic error has to be taken into account: while the field of operations for the Icelandic banks was the whole of Europe, the institutional arrangements to support them in a time of crisis were confined to Iceland alone. It was this which was not a feasible situation, rather than the size of the banks or the behaviour of individuals.

Another explanation for the bank collapse, not offered by the SIC, but by Professor Stefan Olafsson and some other left-wing intellectuals, is not cogent either. It is that it was brought about by 'neoliberalism'. One reason this explanation is logically unsatisfying is that even if Iceland was one of the freer economies of the

world before the collapse, it was by no means the freest. If it was economic freedom that brought about the bank collapse, why did such a cataclysm then not take place in the countries freer than Iceland? In 2007, according to the index of economic freedom, there were fourteen countries freer than Iceland, including the five Anglo-Saxon countries – the US, the UK, New Zealand, Canada, and Australia – and two Nordic countries – Finland and Denmark.²⁸⁸ Why did the banking sectors in for example Finland, Denmark, and New Zealand not collapse? Moreover, if critics of 'neoliberalism' are to be believed, then it started to have real impact in the 1980s, with Margaret Thatcher in the UK and Ronald Reagan in the US, being reinforced by the fall of the communist countries in 1989–1991, after which capitalism seemed to have triumphed; some even spoke of the 'end of history'.²⁸⁹ But why did the system collapse in 2008, almost thirty years after it started to have a significant impact? What brought it about? Were low interest rates and subprime loans in the US somehow connected to 'neoliberalism'?

A third common explanation, the recklessness of the Icelandic bankers and businessmen, is partly true. Of course, the Icelandic banks overextended themselves: after all, they failed. Despite some flaws in the SIC Report, it provides a wealth of information about all kinds of manoeuvres of the Icelandic bankers and businessmen. But an explanation in terms of reckless individuals is not intellectually satisfying. Why did almost all the businessmen and bankers do the same things? The answer cannot be that they were all stupid and short-sighted. Indeed, some very intelligent and well-educated people, with degrees from respected universities, were among the Icelandic bankers and businessmen. Some would perhaps protest that the Icelandic bankers did not have the training and traditions on which their Swiss counterparts could rely, for example. But the two biggest Swiss banks, UBS and Credit Suisse, had to be rescued during the financial crisis. And they could not be proud of some of their history. Consider UBS. It was founded in 1998 by a merger of two Swiss banks. One of them, Schweizerische Bankgesellschaft, had been caught a year earlier in destroying documents about the property of Jews from Nazi Germany. This, and several

²⁸² SIC Report, Online Addenda, David Oddsson, Addendum 11, <http://rna.is/media/skjol/RNAvefVidauki11-5DO.pdf>

²⁸³ Hank Paulson, *On the Brink: Inside the Race to Stop the Collapse of the Global Financial System* (New York: Business Plus, 2010).

²⁸⁴ Stefan Olafsson, *The Political Economy of Iceland's Boom and Bust* (2016), p. 63.

²⁸⁵ In the Icelandic version the word "vanraeksla" is used, SIC Report, Vol. 7, Ch. 21, pp. 321 and 325.

²⁸⁶ Scotland analysis: Financial services and banking (London: The Stationary Office, May 2013), pp. 17 and 26.

²⁸⁷ SIC Report, English version (2010), Vol. 1, Ch. 2, p. 1.

²⁸⁸ Economic Freedom, <https://www.fraserinstitute.org/economic-freedom/map?page=map&year=2007>

²⁸⁹ Francis Fukuyama, *The End of History, The National Interest*, Vol. 16 (Summer 1989), pp. 3–18.

other incidents, resulted in UBS and Credit Suisse agreeing to pay \$1.225 billion into a settlement fund for Holocaust victims and their survivors.²⁹⁰ In 2009, UBS paid a fine of \$780 million in the US for helping customers to evade taxes and hide assets.²⁹¹ In 2012, UBS paid a fine of \$1.5 billion for its role in rigging LIBOR, London Interbank Offered Rate, during the preceding six years.²⁹² The Swiss banks certainly had some training and some traditions not found in the Icelandic banks. Tales could also be told about greed, irresponsibility, and recklessness of other bankers and businessmen, for example in RBS, Royal Bank of Scotland, and in Danske Bank in Denmark.²⁹³

The problem is that recklessness by itself does not explain much. It is the name given to audacity when it goes wrong. What is interesting is why people take too much risk, become reckless. The common and plausible answer for bankers is that in their profession it pays. Since the Great Depression at least big banks have been regarded as systemically important, too big to fail.²⁹⁴ If they would fail, then people would panic and the whole system would become unstable. Therefore, if a big bank has a liquidity problem – which is another way of saying that it cannot pay its debts – then government, usually through its central bank, provides it with liquidity by either printing money or creating credit in some other way. Bankers know all this. They realize that the bigger their bank is, the safer it is, because it becomes systemically important, and that if they make a profit, then they can keep it. If they make a loss, however, then they can seek assistance from the central bank and wait for better times. The consequence is that in good times, spurred on by profits, they take too much risk. It is almost built into the system. Everybody within the system is acting rationally, but the outcome may be irrational. In other economic sectors, the way to separate the sheep from the goats, the sound enterprises from the rotten ones, is through a survival

test such as bankruptcy. But it is difficult to apply this test to banking because of the precariousness of the system. When is a bank rotten? The price of the assets banks can hold varies greatly between good and bad times. If a bank has to pay out most of its debts at a time when assets only fetch a low price, then it may fail. And no bank, whether sound or rotten, can survive a sustained unassisted run like the one Icelandic banks experienced. Therefore, both those who were pessimistic about the chances of the Icelandic banks, like Robert Aliber, and those who were optimistic, like Frederic Mishkin, may have been right – but at different points in time.²⁹⁵

In Iceland, in addition to this general incentive in modern banking to take excessive risk, there were two special factors. One was the peculiar Icelandic situation, more or less created by the victory of Jon Asgeir Johannesson over David Oddsson in 2004, where public opinion was firmly on the side of the risk-takers, the audacious, the gamblers. The ‘modern vikings’ were heroes, untouchable, invincible. Towards the new vikings, the police were cautious, the judges lenient, most of the journalists and commentators (those who worked for Jon Asgeir Johannesson) sympathetic, the politicians friendly, the regulators (especially the Competition Authority and the Financial Supervisory Authority) meek. This does not mean that Jon Asgeir Johannesson was responsible for the bank collapse. No single individual was, and he certainly would not have wanted the Icelandic banks to collapse. But he was, with his associates and perhaps also his acolytes, largely responsible for the unusual public opinion in Iceland in 2004–2008, of which there are many accounts. The other obvious factor special to Iceland was that while the banks were big for the country, they were small in the European perspective. While systemically important in Iceland, they were expendable in Europe. They were not too big to fail for Europe, but they were too big to save for Iceland. •

²⁹⁰ Henry B. Meir, John E. Marthinsen and Pascal A. Gantenbein, *Swiss Finance, Capital Markets, Banking, and the Swiss Value Chain* (Hoboken, NJ: Wiley, 2013), p. 147.

²⁹¹ UBS Enters into Deferred Prosecution Agreement, Department of Justice, Department of Justice Press Release 18 February 2009, <http://www.justice.gov/opa/pr/2009/February/09-tax-136.html>

²⁹² UBS Securities Japan Co. Ltd. to Plead Guilty to Felony Wire Fraud for Long-running Manipulation of LIBOR Benchmark Interest Rates, Department of Justice Press Release 19 December 2012, <http://www.justice.gov/opa/pr/2012/December/12-ag-1522.html>

²⁹³ Alex Brummer, *Bad Banks: Greed, Incompetence and the Next Global Crisis* (London: Random House Business Books, 2014).

²⁹⁴ Andrew Ross Sorkin, *Too Big to Fail* (New York: Viking, 2009).

²⁹⁵ Some analyses of the Icelandic banks were published in *Preludes to the Icelandic financial crisis*, eds. Robert Aliber and Gylfi Zoega (Chicago: University of Chicago Press, 2011). But not a single author foresaw the refusal by European central banks and the US Fed to make dollar swap deals with the CBI, or the decisions of the British government not to assist the British banks owned by Icelanders at the same time as it assisted all other British banks and then to impose an anti-terrorist law on Iceland, or the decision of the same British government to demand reimbursement from the Icelandic government for its outlays in connection with the Icelandic banks, and to enlist the Nordic countries and the EU for its cause. This was a series of unforeseeable and incredible events.

ICELAND'S REMARKABLE RECOVERY

The most common explanations offered for the 2008 Icelandic bank collapse are implausible. They only explain why the Icelandic banking sector was vulnerable, but not why it collapsed. As noted earlier, it is almost a tautology to say that the Icelandic banks fell because they were vulnerable (prone to fall, in other words), and then to go on and list all their vulnerabilities. It is like saying that glass breaks because it is breakable or that opium puts people to sleep because of its sleeping power, an idea ridiculed by Molière in ‘The Hypochondriac’: an arrogant doctor asks a pretentious student why opium causes sleep, and the student replies that opium has *virtus dormitiva*, which is simply Latin for sleeping power.²⁹⁶ Banks elsewhere were also vulnerable, and they would have failed if they had not been saved, even such big banks as RBS in Scotland, UBS in Switzerland, and Danske Bank in Denmark.²⁹⁷

It was a great mistake that the hearings of the SIC did not take place in public and that the documents which it obtained were not immediately put in the public domain. Moreover, while its report provides much valuable information, especially about the sometimes-shocking manoeuvres of the Icelandic bankers and businessmen, it has four main shortcomings. First, as noted earlier, and perhaps a minor issue, the SIC was overly formalistic, demanding that decisions that had to be made in a hurry, on the basis of limited information, were backed by paperwork and formal consultations. In the second place, the situation, or even trap, in which Icelandic bankers and politicians found themselves was not adequately analysed, even if it would have been intellectually interesting to do so. These people were really in what game theorists call the ‘prisoners’ dilemma’, where nothing they could do was likely to lead to the desired outcomes.²⁹⁸



²⁹⁶ Molière, *The Hypochondriac*, *The Works of Moliere*, Vol. 5 (Glasgow: John Gilmour, 1751), p. 350.

²⁹⁷ On Danske Bank, see the television documentary *Sikke en fest* (2012), <http://finans.tv2.dk/nyheder/article.php/id-60667554:danske-bank-var-taet-pa-afgrund.html> Also Niels Sandøe and Thomas Svaneborg, *Andre folks penge: Historien om den danske finanskris* (København: Jyllands-Postens Forlag, 2013).

²⁹⁸ For a fascinating account of different kinds of games, Edna Ullmann-Margalit, *The Emergence of Norms* (Oxford: Oxford University Press, 1977).

This kind of situation has been made famous in literature as ‘Catch-22’ and is often described by the old saying, ‘Damned if you do; damned if you don’t’.²⁹⁹ If bankers sold assets at the prices offered during the credit crunch, then the markets would have realized that the net worth of the banks had gone down. If bankers did not sell assets, then they were increasing their risk. If central bankers expressed their opinion that the banks were in dire straits, then they would have hastened their collapse. If they kept silent, or did not cover themselves by writing memoranda, then they risked the kind of censure that the SIC meted out. The third shortcoming of the SIC Report is not properly to analyse the unusual public opinion in favour of aggressive risk-takers created by Jon Asgeir Johannesson – the biggest debtor of the banks and the owner of almost all of the private media in Iceland – in his struggle with David Oddsson in 2002–2008; this put constraints on politicians and regulators and it possibly brought the previously good name of Iceland into disrepute. The fourth and most important shortcoming of the SIC Report was how it almost completely disregarded events abroad. It was surprisingly parochial in its approach, describing the bank collapse as almost solely an Icelandic event, just like one SIC member, Benediktssdottir, had said at the outset.

The real explicandum in the Icelandic case is why the banks were not saved from abroad, like RBS, UBS, and Danske Bank were: if they had been saved there would not have been a collapse (although there would certainly have been a deep recession of the type Islanders are used to). As Armann Thorvaldsson, the pre-collapse head of KSF in London, wrote,

I always believed that if Iceland ran into trouble it would be easy to get assistance from friendly nations. This was based not least on the fact that, despite the relative size of the banking system in Iceland, the absolute size was of course very small. For friendly nations to lend a helping hand would not be difficult.³⁰⁰

The main explanation cannot be that it was beyond the capacity of Iceland’s traditional allies to save the banks. As noted earlier, if the US Fed had made a \$10 billion swap deal with the CBI – a small sum of money for the US Fed – then probably the banks would not have collapsed, although they might not have survived under the present ownership which had, after all, indisputably over-extended them. What caused the collapse of the banks was that they, already in a vulnerable situation, partly created by the Icelanders themselves and partly the result of circumstances to which everybody would have reacted in the same way, entered five decisions taken abroad, none of them explored, alas, in any detail by the SIC.

One decision was taken by hedge funds in 2007 and 2008. It was to bet against the Icelandic *krona* and later against the Icelandic banks. By its nature, information is scarce on this activity. But Iceland was certainly in the sights of some foreign investors. Already in early 2007, investors George Soros and Bruce Kovner expressed interest in betting against the Icelandic *krona*, even if it is not clear whether they did this or not.³⁰¹ At a closed Drobny conference of investors in the spring of 2003, Jim Leitner of Falcon Fund had recommended buying indexed linked housing bonds from Iceland.³⁰² Three years later, he recommended selling the Icelandic *krona* and received the ‘Drobny’ award for this at a closed Drobny conference in the spring of 2006.³⁰³ Leitner actually also bought some shares in an Icelandic investment bank. In the autumn of 2006, the hedge fund chiefs even held one of their regular closed conferences in Iceland. One of the persons attending the Iceland conference was Scottish investor Hugh Hendry, who runs Eclectica Asset Management. He had said in an interview with the *Times* 8 July 2006 that he would like to be known as the man who brought down Iceland.³⁰⁴ In January 2008, hedge fund managers came to Iceland again, to a meeting organised by Bear Sterns which was to go under two months later. ‘All the people in the party, except me, of course, are out to short Iceland,’ an Icelandic bank executive later said.³⁰⁵ It is not fully known who bet against the *krona*

and then against banks or how much, but it is clear that this was done. For example, credit default swap spreads for Icelandic banks rose dramatically from mid-2007 to March 2008. Moreover, those who made those bets had a vested interest in bad news about Iceland. Did they act on this interest?

The second decision was taken by European central banks in early 2008 not to extend credit lines to the CBI in order to solve or reduce the liquidity crisis of the Icelandic banks. The reason given for this decision was that the Icelandic banking sector was too big. But the real reasons may have been that the Icelandic banks and their owners may have caused irritation and distrust abroad with their aggressive and competitive behaviour, and also that commercial banks in other countries may not have liked competition from these newcomers. ‘By this time, the two Icelandic banks had accumulated almost £10 billion of retail deposits in the UK and Europe. I am fairly confident that this annoyed the big banks in these countries no end,’ Thorvaldsson, head of KSF, writes.³⁰⁶ Possibly, in the UK it annoyed the smaller banks and building societies even more, because they were in a more direct competition with the Icelandic banks. Also, as can be seen from the minutes of the Board of Non-Executive Directors of the Bank of England, already quoted, British central bankers did not like Iceland to become a financial centre of any kind.

The third decision was taken by the US Fed: it was not to provide liquidity in the form of dollar swap deals to Iceland, while it provided it to many other European countries, including Sweden and Switzerland that had never been allies of the US.³⁰⁷ The reason given for this decision was again that the Icelandic banking sector was too big. But the real and underlying reason was different and obvious. Iceland was no longer of any strategic importance for the US, or so US authorities at least thought. For strategic reasons the US had protected and helped Iceland after the war. The US government had given Marshall aid to Iceland, even if she had not suffered much in the

war, and the US government had practically forced its UK counterpart to recognise all four extensions of the Icelandic fisheries limits, from 3 to 200 miles, even if it meant the loss of livelihood for many British fishermen. Now, however, the US government and military had lost interest; Iceland was expendable. Therefore, bureaucrats and calculators in the US Fed were left to make their predictable decision.

The fourth and fifth decisions were both taken by the British Labour government. First, it decided, in a series of measures over weeks and even months prior to the collapse, to close down the two British banks owned by the Icelandic banks, Landsbanki’s Heritable Bank and Kaupthing’s KSF, Kaupthing Singer & Friedlander. This it did, acting through the FSA, by gradually making the operations of the two banks, and Landsbanki’s London branch, more difficult. The FSA demanded more liquidity at a time when the Icelandic parent companies were suffering from a lack of liquidity, before finally closing them down on 8 October 2008. At the same time as the British government was tightening its grip on the Icelandic-owned British banks, it was providing several other British banks with liquidity, for example Bradford & Bingley and Alliance & Leicester (which received a secret transfer of £3 billion).³⁰⁸ The very same day when the British government closed down Heritable Bank and KSF, 8 October, it presented a rescue package for British banks of no less than £500 billion. The British banks owned by Icelanders were the only UK banks not included in the rescue. Instead, they were closed down, with the foreseeable result because of contractual obligations that the parent company Kaupthing in Iceland fell along with its subsidiary KSF. While British taxpayers may lose billions of pounds because of RBS and Bradford & Bingley,³⁰⁹ the two British banks in Icelandic ownership in resolution turned out to fully or almost fully solvent: the recovery rate for non-preferential creditors of Heritable Bank is 94p on the pound and of KSF 86p on the pound, despite the fact that the estates of both companies have had to pay enormous amounts of money to auditors and lawyers.³¹⁰

²⁹⁹ Joseph Heller, *Catch-22* (New York: Simon and Schuster, 1961).

³⁰⁰ Armann Thorvaldsson, *Frozen Assets: How I Lived Iceland’s Boom and Bust* (Chichester, West Sussex: John Wiley & Sons, 2009), p. 194.

³⁰¹ Thad freistar theirra ad radast a kronuna, DV 18 October 2007.

³⁰² Drobny Global Monitor, 4 April 2003.

³⁰³ Drobny Global Conference, Santa Monica 20–21 April 2006, slides with photographs. In the possession of the author.

³⁰⁴ Quoted from Hagnast a gengisfalli, Morgunbladid 1 April 2008.

³⁰⁵ Roger Boyes, *Meltdown Iceland: Lessons on the World Financial Crisis from a Small Bankrupt Island* (New York: Bloomsbury, 2009), p. 156. While Boyes’ gossip and entertaining book is unreliable about much, especially Icelandic history and contemporary politics, it is unlikely that he was inventing this remark.

³⁰⁶ Armann Thorvaldsson, *Frozen Assets* (2009), p. 194.

³⁰⁷ Federal Reserve System. Report to Congressional Addressees (Washington, DC: Government Accountability Office, 2011).

³⁰⁸ The help to Alliance & Leicester, given in late 2007, was disclosed as late as 2015. Minutes of the Bank of England Committee of Non-Executive Directors meeting 12 December 2007, <http://www.bankofengland.co.uk/archive/Documents/archivedocs/codm/20072009/codm2007b.pdf>

³⁰⁹ Taxpayer support for UK banks: FAQs (London: National Audit Office, 2012), <https://www.nao.org.uk/highlights/taxpayer-support-for-uk-banks-faqs/>

³¹⁰ Heritable Bank (in Administration). Seventeenth progress report to all known creditors (London: Ernst & Young, 29 August 2014), pp. 7–8, http://www.heritable.co.uk/Uploads/Documents/news/Heritable_Bank%20Plc_In_Administration_17th_Progress_report_final.pdf Kaupthing Singer & Friedlander Limited (in Administration) (London: Ernst & Young, 2016), p. 2, http://www.kaupthingsingers.co.uk/media/2103/ksf_progress_report_to_7_october_2016_.pdf



The second decision taken by the British Labour government was to impose on 8 October 2008 an anti-terrorist law on Landsbanki and briefly, also, on the CBI, the IFSA, and the Icelandic Ministry of Finance.³¹¹ This meant not only that Landsbanki, and also briefly the CBI and the Icelandic Ministry of Finance, were put on the same list maintained at the UK Treasury's website as terrorist organisations such as the Taliban, Al-Qaida, and rogue countries such as Sudan and North Korea, but also that almost all financial transactions to and from Iceland were immediately halted. The alleged purpose of the act was to hinder illegal transfers from Landsbanki's London branch, but this was an excuse and not a reason because five days earlier, 3 October 2008, the FSA had issued a so-called Supervisory Notice to Landsbanki, prohibiting it from transferring money out of the UK without obtaining three days in advance the written consent of FSA; Barclays Bank, which technically did the transfers, was also notified of the Supervisory Notice.³¹² It was therefore unnecessary to impose the anti-terrorist law.

The reasons for these two decisions by the British government are still not quite clear. They seem to be politically motivated rather than justified by the facts of the situation. Two possibilities have already been mentioned: hostility at the Bank of England towards the idea that Iceland should become a financial centre, and resentment at the aggressive behaviour and competitiveness of the Icelandic bankers and businessmen. Three additional possibilities may be briefly mentioned. First, the Labour government may have been tempted to try and create a small and

inexpensive 'Falklands Factor'. In the second place, it may have had an interest in trying to divert the attention of the British public from the fact that with its huge bailout package announced on 8 October 2008 it was mainly rescuing the two large Scottish banks, RBS and HBOS, Halifax Bank of Scotland, with both Prime Minister Gordon Brown and Chancellor of the Exchequer Alistair Darling coming from Scotland. Thirdly, it may have been keen to demonstrate to the Scottish nation that independence could be risky. Indeed, in his memoirs Chancellor Darling gleefully writes, 'Iceland, along with Ireland, was part of what Scotland's nationalist first minister, Alex Salmond, like to refer to as an "arc of prosperity", to which he yearned to attach Scotland. It was now an arc of insolvency.'³¹³ Was this a Freudian slip?

The Icelandic Parliament, on the advice of the CBI, had passed an Emergency Act on 6 October 2008,



³¹¹ HM Treasury, Landsbanki Freezing Order, 8 October 2008, http://www.legislation.gov.uk/uksi/2008/2668/pdfs/ukxi_20082668_en.pdf

³¹² Financial Services Authority, First Supervisory Notice, Landsbanki, 3 October 2008, <https://www.fca.org.uk/publication/supervisory-notices/landsbanki.pdf>

³¹³ Alistair Darling, *Back from the Brink: 1000 Days at Number 11* (London: Atlantic Books, 2011), p. 138.

according to which the IFSA could take over failing banks and claims on the banks by depositors were given priority over other claims. Landsbanki was taken over 7 October, Glitnir 8 October, and Kaupthing 9 October. After the Icelandic banks had all collapsed, not least as a result of decisions taken by the British government, a new worry was added to Iceland's woes. Probably to avoid panic elsewhere, the British government decided immediately to compensate all depositors in Landsbanki's Icesave accounts and then to present the hefty bill of €4–5 billion to the Icelandic government which was, it claimed, responsible for the accounts.³¹⁴ When he was CBI governor, David Oddsson had time and again stressed that the Icelandic government was not responsible for the Icesave accounts, only Landsbanki itself and then, in case of its failure, the Icelandic Depositors' and Investors' Guarantee Fund. Initially, the Icelandic government took the same position, also pointing out its precarious situation after the bank collapse. But under pressure from the IMF (International Monetary Fund), the Nordic countries, and the EU, the left-wing government formed by Johanna Sigurdardottir in early 2009 decided to make a deal with the UK: the contribution by the UK Treasury to the depositors was to be regarded as a loan to the Icelandic Treasury, bearing full interest from the beginning, but payable in instalments after a few years. The Icesave deal was very controversial in Iceland. Oddsson, whom the left-wing government had forced out of the Central Bank, was now editor of *Morgunblaðid* and fought forcefully against the deal. He pointed out that no government guarantee of the accounts had ever been given.

Icelandic taxpayers could not be held responsible for private transactions between a bank and its creditors. If the British government believed that the Icelandic authorities owed it some money under the law, then it should refer its claim to the district court of Reykjavik, which would resolve the matter.³¹⁵

Professor Stefan Olafsson strongly disagreed. He said that Iceland had a moral obligation to reimburse the British government for its outlays, because Icelandic authorities had repeatedly confirmed that the Icelandic Guarantee Fund was responsible for the deposits. Olafsson said that now Editor Oddsson

and other people were supporting the 'court option'. But in an eventual court case, Iceland would have to argue that the deposit guarantee scheme was only for the Icelandic depositors, not the foreign one. 'Does anyone believe that any court would favour Iceland in such a case? Hardly. Much more likely, such an initiative would have exposed us as a nation of thieves.'³¹⁶ But there were two errors in Olafsson's statements as well as a factual omission. First, while the Icelandic Depositors' and Investors' Guarantee Fund was certainly liable for the deposits in the case of Landsbanki's failure, this did not imply that the Icelandic Treasury was liable as well. The Guarantee Fund was an independent organisation, co-owned by the banks. In the second place, the Emergency Act passed by Parliament on 6 October 2008 had given the claims of all depositors, also in the UK, priority over claims by other creditors, such as bondholders. In this case, it was irrelevant that at the same time Icelandic ministers had declared publicly that they guaranteed all domestic deposits. This was only a declaration and not a binding law, and similar declarations were made in several other European countries at the same time. In fact, by the Emergency Act Iceland had ensured that claims by British depositors would have priority over claims by Icelandic and German bondholders, for example. Olafsson's factual omission was that Landsbanki's directors claimed all the time that the estate would have sufficient assets to cover all priority claims, including those of British depositors. This eventually turned out to be true.

Iceland's President refused to sign the Icesave deal into law, and as noted earlier, it was rejected by 98% of the voters in early 2010. Another deal was made, with lower interest payments and some other improvements for the Icelanders, but the President also refused to sign it into law, and it was also rejected, in early 2011, now by 60% of the voters. Then the UK government decided to refer the case to the EFTA Court which decided in January 2013 that Iceland was not in any way liable for the obligations of the Icelandic Investors' and Depositors' Fund since it had been set up and operated fully in accordance with EEA stipulations.³¹⁷ Professor Olafsson turned

³¹⁴ It is difficult to estimate the total amount, since the "principal" of the "loan" (as the British government defined it) carried interest which would depend on the rate of recovery of Landsbanki assets and the rate of payments towards the "debt", neither of which number was known in the summer of 2009.

³¹⁵ His campaign against the Icesave deal started with an interview before he became editor, *Aetla ad daema thjodina til aeverandi fataektar*, *Morgunblaðid* 5 July 2009.

³¹⁶ Stefan Olafsson, *Sidfraedi Icesave-malsins* [The Ethics of the Icesave Case], *Frettabladid* 17 August 2009.

³¹⁷ Judgement of the EFTA Court, 28 January 2013, http://www.eftacourt.int/uploads/tx_nvscases/16_11_Judgment_EN.pdf

out to be wrong in his prediction that a court decision would have exposed the Icelanders as ‘a nation of thieves’. He may however have been too busy to notice. The left-wing government formed in 2009 by Johanna Sigurdardottir was crippled by internal dissent and power struggles. Foreign Minister Ossur Skarphedinsson, from one of the warring factions of the Social Democrats, wrote in his diary 8 November 2012:

The message I get in phone calls is clear. Stefan [Olafsson] is in Johanna Sigurdardottir's innermost circle. He is being paid to write thick tomes for Gudbjartur Hannesson whom Johanna's faction are going to support against Arni Pall [Arnason]. People think it is impossible that Stefan wrote his blog on his own. This is all organised at the Prime Minister's Office where they cannot bear the thought of Arni Pall becoming chairman.³¹⁸

Widely seen as having been too accommodating to the British government in the Icesave Dispute, the Social Democrats suffered a resounding defeat in the 2013 parliamentary elections, and again in the 2016 parliamentary elections.

Meanwhile, the Icelandic economy made a stunning recovery. Contrary to a common perception, the IMF had almost nothing to do with it. Most of the

measures in the IMF programme would have been undertaken anyway by any Icelandic government, and the IMF loan was never used, just lying in an account in New York, but bearing high interest. One reason for the recovery was, of course, that because Iceland was not a part of the eurozone, she could devalue the *krona* and thus stimulate exports. Another reason was partly a consequence of this: suddenly Iceland experienced a tourist boom which has lasted since, even though the *krona* has slowly regained some of its former value. But the main reason for the recovery was that Iceland was never bankrupt. It had basically a sound economy, with foundations laid in the period of liberal reforms, 1991–2004, profitable fisheries (as a result of the ITQ system defended by David Oddsson), large energy resources (whose utilisation Jon Thorlaksson had envisaged and even started), accumulated human capital, strong pension funds (greatly strengthened in the Oddsson era), and the aforementioned tourist boom as a welcome bonus. Iceland, which had been left out in the cold at the height of the international financial crisis, had suddenly become a hot spot. In 2013, Sigmundur D. Gunnlaugsson formed a government of his Progressive Party and the Independents, where Bjarni Benediktsson had replaced Geir H. Haarde as leader. Prime Minister Gunnlaugsson and Finance Minister Benediktsson managed to make an advantageous deal with the remaining bank creditors. According to

a 2016 study by Economics Professor Asgeir Jonsson and statistician Hersir Sigurgeirsson, the government may even recover all its outlays in connection with the bank collapse (and perhaps more than that). The main reason is that the assets of the fallen banks are worth much more than earlier estimated.³¹⁹

The biggest cost of the 2008 Icelandic bank collapse was social: for a few years, the nation took the course of accusations, denunciations, and recrimination. The Left tried to criminalise the Right, or the ‘neoliberals’. Not only were David Oddsson and his two colleagues forced out of the Central Bank in a breach with the principle of CBI independence, but under an ancient law, a special court, composed of representatives of the political parties and Supreme Court judges, was summoned to hear charges against Geir H. Haarde. The majority acquitted him of all charges except not having called enough meetings in the government to discuss the pending crisis; the minority wanted to acquit him of all charges.³²⁰ Many found absurd the decision to indict Haarde alone instead of charging either no one or at least including as a defendant his government colleague, Ingibjorg S. Gisladdottir, leader of the Social Democrats. They found the final judgement in Haarde's case equally absurd. Professor Olafsson, on the other hand, seemed to want more recrimination, not less:

Evasion of responsibility for what went wrong in the bubble years is pervasive. David Oddsson, the neoliberal political leader whose government organized and carried out the neoliberal experiment (cf. Gissurarson, 2004) is now the editor of the right wing Morgunbladid (the second largest morning daily newspaper at present) and fights the government fiercely along with his radical followers.³²¹

In the first years after the bank collapse, left-wing intellectuals at the University of Iceland thought they had triumphed. Professor Olafsson and his associates even organised, with taxpayers' money, a series of lectures at the University on ‘An Autopsy



of Neoliberalism’.³²² It was however a major setback for this group when the EFTA Court decided in 2013 that Iceland as a country was not liable for private transactions on the financial markets of Europe. Suddenly, ‘the bill for capitalism’, as the Icesave deal had once been called, had been greatly reduced.³²³

In 2011–2012, economic liberals in Iceland decided that they had to try and meet the challenges posed by the bank collapse, the sudden resurgence of anti-liberalism, and the need to explain the principles of liberty under the law to a new generation. In 2011, they revived the old anti-socialist Public Book Club, (*AB, Almenna bokafelagid*) which had been dormant for many years, and in 2012 they founded RNH, *Rannsóknarsetur um nyskopun og hagvoxt* (Research Centre for Innovation and Economic Growth), as a direct continuation of the Jon Thorlaksson Institute. Jonas Sigurgeirsson became the managing director of both entities. Asset Manager Gisli Hauksson is chairman of the RNH board, and its academic council is comprised of Professors Ragnar Arnason and Birgir T. Runolfsson and the present writer who is academic director. The Public Book Club has commissioned translations of classical and timely works such as three novels by Ayn Rand, ‘The Fountainhead’, ‘Atlas Shrugged’, and ‘We the Living’; Matt Ridley's ‘The Rational Optimist’; and ‘Red Notice’ by Bill Browder. It has also republished, both in print and online,



³¹⁸ Ossur Skarphedinsson, *Ar drekans* (Reykjavik: Sogur, 2013), p. 305.

³¹⁹ Asgeir Jonsson and Hersir Sigurgeirsson, *Kostnadur og endurheimtur ríkissjóds af falli bankanna* [Treasury Outlays and Recovery Level because of the Bank Collapse] (Reykjavik: Ministry of Finance, 2 June 2016), <https://www.fjarmaladaruneyti.is/media/frettatengt2016/Kostnadur-og-endurheimtur-ri%CC%81kissjo%CC%81ds-af-falli-bankanna-skyrsla.pdf>

³²⁰ Landsdomur, Case No. 3/2011, 23 April 2012, <http://landsdomur.is/media/skyrslur/nr.-3-2011-Domur-a-vef.pdf>

³²¹ Stefan Olafsson, *Icelandic Capitalism — From Statism to Neoliberalism and Financial Collapse* (2011), p. 41.

³²² They used the Icelandic word “uppgjör” which can mean postmortem or dissection as well as autopsy. Olafsson's associates in this project included History Professor Gudmundur Jonsson and Gender Studies Professor Thorgerdur Einarsdottir. Some of the lectures were published in a book, *Eilífðarvelin: Uppgjör við nyfrjalshyggjuna* [A perpetuum mobile: an autopsy of neoliberalism] (Reykjavik: University of Iceland Press, 2010).

³²³ Sigurdur Mar Jonsson, *Icesave-samningarnir: Afleikur aldarinnar* [The Icesave Deals: the Blunder of the Century] (Reykjavik: Almenna bokafelagid, 2011).

several past works against totalitarianism: 'Articles on Communism' by Bertrand Russell; 'Women in Soviet Prison Camps' by Elinor Lipper and Aino Kuusinen; 'Out of the Night' by Jan Valtin (Richard Krebs); 'The Secret Speech on Stalin' by Nikita Khrushchev; '*El Campesino*' by Valentín González and Julián Gorkin; 'Baltic Eclipse' by Ants Oras; 'Estonia: A Study in Imperialism' by Andres Küng; and 'Service, Servitude, Escape' by Aatami Kuortti.

RNH has established ties to several institutes and organisations internationally, such as Atlas Network, Cato Institute, Ayn Rand Institute, the Platform of European Memory and Conscience, and New Direction. RNH also runs two projects jointly with ACRE, the Alliance of Conservatives and Reformists in Europe: 'Europe, Iceland and the future of capitalism' and 'Europe of the Victims'. RNH has organised many lectures in Iceland by scholars and activists, including Matt Ridley on progress, Nils Karlson on the Swedish models, Stéphane Courtois on communism, Anna Funder on oppression in East Germany, Douglas Rasmussen on individualism, Daniel Mitchell on taxation, Phil Booth on the financial crisis, Marta Andreasen on corruption in the EU, Eamonn Butler on the financial crisis, John O'Sullivan on the real

Iron Lady, Ralph Townsend on self-governance in the fisheries, François Heisbourg on the failure of the euro, Robert Lawson on the index of economic freedom, Gary Libecap on initial allocation of fishing rights, Tom Palmer on liberal ideals, and Barbara Kolm on the EU crisis.³²⁴ The present writer has published four books since the bank collapse, three of them in Icelandic – a collection of quotations, a treatise on taxation, and a history of the Icelandic Communist Movement, 1918–1998 – and one in English – 'The Icelandic Fisheries: Sustainable and Profitable'. He is now working on a comprehensive report in English for the Ministry of Finance on the bank collapse, but his intention after that is to continue and explore the liberal tradition in Iceland, as embodied in institutions, articulated by thinkers, and practised by politicians, entrepreneurs and capitalists. The present author shall try to work in the spirit of Adam Smith and John Locke, Anders Chydenius and Gustav Cassel, Ludwig von Mises and Friedrich A. Hayek, Milton Friedman and James M. Buchanan, Einar Eyjolfsson and Snorri Sturluson, Jon Sigurdsson and Jon Thorlaksson. He shall try to explain, yet again, but under changed circumstances and with new evidence, why individuals need to constrain and divide up power and how they can cooperate without coercion, to their mutual benefit. •

³²⁴ Accounts of events organised and works published by, or with the help of, RNH are found on the institute's website, both in Icelandic and English, <http://www.rnh.is/?lang=en>

CONCLUSIONS AND RECOMMENDATIONS

The Nordic countries hardly show that 'a generous welfare state is not a road to serfdom but rather to fairness, economic equality and international competitiveness,' as Jeffrey D. Sachs asserts. The one model he alludes to, the Swedish social democratic model of 1970–1990, turned out to be untenable. But there are many other Nordic models, such as the Swedish liberal model of 1870–1970, which was very successful and produced the wealth on which the social democratic model could then be sustained for a while, and the Swedish liberal welfare model since 1995, which retains a welfare state, but restrains it and focuses on the conditions for wealth creation. Writing in 2006, Professor Sachs was ten years too late. There is also the Icelandic model which does not provide generous welfare benefits to all, for example not the affluent, but seeks rather to target only those in need of assistance. The main reasons for the overall success of the Nordic countries are their open economies, a strong rule of law, the protection of private property rights, the freedom of contract, social cohesion, civic participation, respect for hard work and self-reliance (unfortunately somewhat eroded by the welfare state), and the lack of social exclusion (until recently and then produced by the welfare state). The Nordic countries are successful despite, but not because of, social democracy, which had anyway lost much credibility in the Nordic countries.

The anti-liberal narrative widely presented abroad about both the liberal reforms during David Oddsson's tenure as Prime Minister, 1991–2004, and about the causes of the 2008 bank collapse does not stand up to scrutiny, either. By abolishing public investment funds, privatising public companies, reducing taxes, and passing new laws on public administration and the right to information, the Oddsson governments removed opportunities for clientelism, favouritism, and political patronage. While economic freedom increased significantly in this period, Iceland did

not move from a Scandinavian to an Anglo-Saxon model, as for example Professor Stefan Olafsson claims. The Icelandic welfare state remained firmly based on the Icelandic model. In 1991–2004, income distribution in Iceland remained similar to that in the other Nordic countries and the poverty level was one of the lowest in the world, if not the lowest. Indeed, social exclusion is almost nowhere less than in Iceland, with little unemployment, strong pension funds, and late retirement. Recent studies and surveys have also shown that, at least in the 1991–2004 period, corruption was at a very low level in Iceland, as was political patronage. Claims to the contrary remain unsubstantiated, and some of them are the results of statistical illusions, rhetorical tricks, or simple miscalculations. It is also wrong that Landsbanki was sold to special friends of the government, or clients of the Independence Party, although the buyers of Bunadarbanki certainly were well-connected to the Progressive Party. On the whole, privatisation worked well in Iceland, establishing financial discipline and facilitating entrepreneurship. The tax cuts were also successful, expanding the tax pool by encouraging people to create wealth, and thus eventually bringing in more – not less – tax revenue.

Professor Olafsson and other authors of the anti-liberal narrative blithely ignore the fact that the strongest critic of the Icelandic banks and their excesses was in fact David Oddsson, both as Prime Minister and CBI Governor. His main adversary, business mogul and media magnate Jon Asgeir Johannesson, was indeed the biggest debtor of the banks and also, from 2007, in control of one of them. The reasons why the Icelandic banks collapsed, while banks elsewhere survived the international financial crisis, were not that the Icelandic banks were too big or that the bankers were too reckless (although there is some truth in both statements), but that they were not rescued like other banks. Neither had 'neo-liberalism' anything to do with the bank collapse.



The Icelandic banks were regulated in the same way as financial institutions elsewhere in the EEA, and many countries had freer economies than Iceland. The reasons why the Icelandic banks were not rescued, unlike banks elsewhere, are still not completely clear. One reason may be that Iceland's good reputation, earned in 1991–2004 and subsequently facilitating foreign credit to the banks, may have turned around as a result of the banks' excesses and aggressive behaviour abroad and thus may have made it difficult and in the end impossible for government to obtain assistance abroad. Other reasons may include hostility to the idea of Iceland as a financial centre, although that idea was never implemented, and an attempt by the Scottish leadership of the British Labour Party to demonstrate to the Scots the perils of independence. Be that as it may, the fact remains that Iceland has made an astonishing recovery. She was not a canary in a coal mine, as claimed by the left-wing intellectuals who composed the anti-liberal narrative on the bank collapse; she was rather a falcon that suffered a temporary setback, a blow from which she has recovered, and now she is flying again.

On the basis of the analysis in this report, several lessons may be learned and recommendations made:

- The Nordic countries are free and prosperous despite social democracy, not because of it. What other countries can learn from them is to combine large and open economic units with small and transparent political units.
- The social democratic Swedish model could only be sustained for a while, consuming the

physical and social capital accumulated during the liberal era. This model would be even less appropriate in poorer countries with less social cohesion.

- A major lesson to be learned from studying the Nordic countries is the importance of culture, respect for hard work, self-reliance, civic participation, and a willingness to compromise. These virtues grow (and erode) slowly and cannot easily be transmitted internationally, but the school curricula in other countries might be revised to encourage these virtues.
- The legal system of the 930–1262 Icelandic Commonwealth was remarkable in that law was based on consensus and also privately enforced. The farmers constituting the political community could choose between chieftains who essentially operated private protection agencies. The lesson from this is that sometimes there are market solutions to problems where government has usually been taken for granted.
- The Icelandic pension system, based on the three pillars of a basic state – funded pension for those in need, self-financed occupational pension funds, and private pension accounts – is at once sustainable and equitable. It could serve as a model for other countries.
- The Icelandic system of individual transferable quotas in the fisheries is both sustainable and profitable. The oceans cover 7/10 of the earth's surface, but marine resources have not been

taken into stewardship like land. The ITQ system could serve as a model for other countries.

- The reductions of invisible and involuntary taxes in Iceland during the Oddsson governments, 1991–2004 – the reduction of the government's pension obligations, the reduction of inflation, and the reduction of public debts – were successful. It was financed partly by spending cuts, partly by proceeds from privatisation, and partly by increased tax revenues brought about by economic growth. This could serve as a model for other countries.
- The direct tax reductions in the Oddsson era, 1991–2004, were successful and confirmed the old truth that tax revenues need not go down, even if tax rates are lowered. In particular, this applied to the corporate tax rate.
- The privatisations in the Oddsson era were also successful. Companies that had required large subsidies now had to survive on their own. The abolition of many special funds that had been used to subsidise enterprises and the sale of public companies changed the outlook and approach of business managers.
- The Icelandic model of the welfare state is different from the 'Anglo-Saxon' and 'Scandinavian' models. Even if it is general, it is means-tested: welfare benefits, such as child benefits, go to fewer relatively than in the other Nordic countries, but they are more generous and go to those who most need them. This system seems more sustainable and equitable

than the Anglo-Saxon and Scandinavian systems.

- Social inclusion is high in Iceland, because of little unemployment, strong pension funds, and late retirements. Possible lessons from this are to increase flexibility in the labour market and to raise the retirement age.
- One of the main reasons for the 2008 Icelandic bank collapse was a systemic error in that the field of possible operations for the banks was much larger than the field of real support. This error needs to be corrected.
- The reason the Iceland banks collapsed was not that they were vulnerable (although that is true), but that they did not receive any liquidity assistance from abroad. The lesson from this is that a small and expendable country cannot rely on big allies.
- The main reason for Iceland's astonishing recovery after the bank collapse is that the economy was basically sound. But what helped it was the stimulation of the export industries when the *krona* tumbled. The lesson is that in a crisis, it is essential to have flexible pricing of the currency.
- Icelandic conservative liberals are responding to new challenges, not least the sudden resurgence of socialism after the bank collapse. The lesson is that liberty requires vigilance. As the famous Red Queen in Lewis Carroll's novel, liberals have to run just in order to stand still. •



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