In the Wake of Economic Collapse. Iceland's Election: It's not about Left and Right

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I can hardly believe the news reports on Iceland's election on Saturday, April 25. Evidently in an attempt to interest readers in an island few know or have cared much about, the papers tried to attract reader attention by talking about the "left" unseating the "right." No doubt this political swing is going to continue for many years to come throughout the world. But for Iceland's voters the issues were more pragmatic. Reckless neoliberal bank privatization is indeed the main problem, but the proposed responses are not inherently left or right as such. At issue is whether voters have become so desperate in the wake of crooks wrecking the financial system that they will seek a more stable currency (the euro) by joining Europe on terms that forfeit control over Iceland's North Atlantic fishing waters and burden taxpayers with unprecedented public debt to compensate British, Dutch and other European bank depositors and speculators for *their* losses?

Europe would not dare make such a demand on the United States for the bad packages of junk mortgages it bought and for its losses when Lehman Brothers went bankrupt. But Iceland is a small country and may be easier and riper for plucking. For many voters the idea of joining the European Union is an attractive fantasy – adopting the euro to solve Iceland's financial problems. The alternative is for the country simply to change its destructive bank rules and reverse the giveaways made in times past to politically connected insiders. The victorious Social Democrats favor joining Europe, the Left-Green and formerly dominant Independence Party do not, while the centrist and largely rural Progressive Party (for many decades the second leading party) is wary but at least is willing to discuss the terms on which EU membership might benefit Iceland.

Everyone is against the oligarchy's insiders who ran up the debts. That is why their major sponsor, the Independence Party, lost one-third of its electoral support (down to just 20 percent from its usual 33-35 percent), the lowest percentage of votes and seats in the parliament (Althing) in the 80 years since it was founded in 1930. The days of the kleptocracy are over – and there is scarcely more sympathy for the foreign lenders and savers who were the enablers of these insiders. But voters are wary of the financial stance England and the rest of Europe have taken against Iceland, and of arrangements with the International Monetary Fund. Former Independence Prime Minister (and later head of the central bank) David Oddsson is adamant that Iceland's government and people not take responsibility for these bad debts, and shares the view I found to be unanimous among Icelanders: These crooks betrayed the country. The myth of deregulated "free" enterprise has been broken, and privatization is seen to have been a euphemism for kleptocracy.

I recently returned from a week in Iceland – a week in which I met with politicians and former prime ministers, financial officials, university professors and students, film makers, TV hosts and "just plain people." The terms "left" and "right" did not arise in a single conversation. The focus was on Iceland's pro-creditor practice of indexing consumer mortgages and other debts – a 17% "inflation" premium for creditors based on the consumer price index (in effect, the Icelandic krónur's exchange rate, as most consumer goods are imported), on top of the normal nearly 6% mortgage interest, leading a number of Icelanders to tell me they had lost their home to foreclosing bankers. Nobody can pay 23% interest rates on mortgages for long while house prices are plunging, along with the economy at large. Most families are now paying by running down their savings, trying to carry debts that are practically unpayable.

This explains the population's desire for a stable currency. It would remove the onerous interest rate add-on. Originally, wages as well as debts were indexed, Brazilian style. But one day the wage index was dropped, keeping the financial index on the spurious rationalization that it was a "contractual" payment for property, and agreements with labor were less legally grounded. In other words, big fish eat little fish. No creditor class, regardless of how greedy and aggressive, has ever achieved anything like this law. Yet Iceland let it happen – despite the country's heavy homeownership-on-credit. Joining the euro is widely viewed as easier than changing the law to get rid of this debt fee, unique to Iceland among all countries of the world. I find this legalistic inertia incredible, but it seems to be a testament to Iceland's faith in law, however crazy that may be.

The currency collapse was caused by the bankruptcy and nationalization of Iceland's three major banks (Glitnir, Kaupthing and Landsbanki), which engaged in a wave of hubristic incompetence and outright fraud after being privatized in a series of insider dealings in 2002-03. These banks went under owing nearly $100 billions, but nobody knows just how much, or even who really is on the other end of many of the transactions involved. A special prosecutor has been retained to discover the details, which are still opaque.

In fact, Iceland is in many ways like the post-Soviet kleptocracies. But instead of emerging out of Komsomol, Red Directors and other vestiges of Stalinist bureaucracy, Iceland's kleptocrats emerged from the great landowners and politically powerful families that have dominated the nation for centuries, long before it achieved independence from Denmark in 1944, at a time when Denmark was overrun by the Nazis and independence represented a pro-Allied position.

Privatization of Iceland's fishing grounds and their licenses

When the North Atlantic became free of German U-boats after the war, British trawlers competed with Icelandic fishing boats for the rich cod and other fish. After a series of showdowns extending into the 1970s, Iceland became the leader in establishing the 200-mile limit to define international sea rights – thanks largely to U.S. support, which Iceland has reciprocated politically ever since.

The Law of the Sea treaty deals with the issue of to whom the natural resources of the seas belong. To maintain the fish population (at least, that is the stated logic), Iceland issued licenses representing a specified proportion of the annual permitted catch, whose magnitude was set each year based on the estimated fish population. In contrast to classical economic practice, these licenses were not auctioned off each year by the government so as to recover fair value for the nation's natural resource in the sea. Rather, the licenses were issued much like taxicab licenses in New York City: once issued, they became permanent, and naturally have risen in market price over time. The initial holders – the leading political insiders a century ago – have bequeathed them to their heirs, to be rented out to the actual fishermen or simply kept them in the family. Iceland's Treasury receives no benefit from harvest the seas. Licenses simply have become a rent-extraction fee, a payment to the former insiders and their successors.

Under competitive bidding, the potential licensee would calculate the market value of whatever resources they projected can be extracted, calculate their costs of extraction, their targeted profit margin. The sea legally belongs to the Icelandic people, and the government would receive the proceeds. But today, the heirs or others who obtained the quota licenses from the original insiders from the 1980s receive this money. So it is no surprise that many Icelanders are so disgusted at the privatization of fishing licenses that they may not care if Iceland loses its fishing rights. After all, under the current rent-extracting system, the losers would be the owners of these artificially designed licenses, not the Icelandic people.

But this attitude loses sight of a highly desirable alternative – one that should appeal on free market grounds to the two traditional centrist parties as well as to the "left" because it is so economically fair: Auction off the fishing quotas each year, with the benefit going to the Icelandic people as part of the public budget, as should be the case with natural resources including the land itself. It is not necessary to join Europe, give its insiders fishing rights and its bankers the rights to create credit (which should be viewed as a public utility) to achieve fiscal efficiency.

The Icesave tangle with Britain

The other conflict with Britain concerns the Landsbanki's Icesave branches, which paid high enough interest rates to convince the Labour government to direct its local neighborhood councils to show "fiduciary responsibility" by placing their savings where rates were highest. It was as if high interest premiums were not a compensation for risk. And because Icesave took the form of local branches of Icelandic banks, Britain took no role in regulation or oversight of its own. I find this typical British economic incompetence, but it is in the character of incompetent governments to try to blame whomever else they can. So they reimbursed their depositors in full, and demanded that Iceland's government tax its own people as if these deposits were public loans!

To force the issue, Britain froze the accounts of all its Icelandic bank branches, including those of Kaupthing on the Isle of Man. This prevented them from remitting funds out of the country, forcing the head offices back in Iceland into insolvency. The only law at hand for this financial grab was emergency anti-terrorists legislation, presumably against Irish and

Arab groups. Britain branded Iceland as a terrorist country, while acting in a financially violent way itself. Icelanders naturally found it unreasonable that after having taken high interest charges, Britain should insist that its depositors not suffer any capital loss at all – in contrast to the huge losses they suffered in the U.S. and other foreign markets (not to mention Northern Rock and other reckless domestic mortgage lenders). But with some Icelanders thinking of bank debts as "our" debts, why not make as large demands as possible, despite the double standard obviously at work? (Imagine what the response would be if, say, Germany would accuse America of being a terrorist economy in order to seize U.S. assets to compensate for the losses that banks in Düsseldorf and Saxony suffered on U.S. subprime mortgages.)

Many U.S. newspaper reporters played along by calling Iceland "Vikings" and preferring to "Viking finance" to the more politically sensitive "oligarchy." But the implication of a rough-and-tumble Nordic Wild West is silly. Iceland has no standing army, and America's former NATO base has become Reykjavik's international airport (and a long drive it is into the city proper – but pleasantly scenic through the volcanic island and the almost perpetual rainbows resulting from the fact that it always seems to be raining somewhere in the sea-laden air). Iceland's hard-working and closely-knit population is as middle-class as one could imagine, with the world's highest home ownership rates, high educational standards, and typically Nordic social welfare system and communalist values. It is a Scandinavian-type social democracy, but much more local in scale. And that may be part of the problem. Many Icelanders are so middle-class that they believe that paying bad bank gambles is a matter of honor, as if these were personal debts among neighbors. But the big banks were not like most neighbors, and engaged in deep financial fraud. This required complicity of the foreigners now demanding to be recompensed.

The IMF enters the picture, but remains quiescent for the present

The IMF typically acts as a collection agent for global creditors, but in Iceland's case its local mission seems to feel uncomfortable in this role. No IMF funds have yet been drawn down from the $10 billion line of credit recently negotiated. I was impressed that the finance ministry was not going to draw down IMF funds to pay foreigners. Finance Minister Steingrimur Sigfusson heads the Green Party and is dubious about how much such borrowing – or joining the EU – can help matters by the government borrowing to stabilize today's inherently unstable situation.

This leaves the question of Iceland's krónur relative to the euro. As long as the creditor-oriented 17% foreign-exchange index is added onto mortgages, Icelandic homeowners (about 90% of the population) understandably will want to see price stability. But the euro will not necessarily provide this. It would merely impose austerity, shrinking the economy to cut back imports. The way to revive the currency is for the economy to grow, and this means getting rid of debt indexing, a free lunch that no other nation on earth has given the financial sector.

The myth that the EU will fight corruption and promote economic solvency

There is much confusion as to what "joining Europe" means in practice. For Central and

Eastern European members of the former Soviet Union, beauty was in the eye of the beholder. They voted to join the EU in the early 1990s under the impression that the EU would take them under tutelage to help them put in place a modernized Western-style industrial capitalism with rising living standards. Instead, the EU leadership looked at these post- economies simply as markets for their own farm and industrial exports, and for its banks to make a killing by entering into a virtual partnership with the Soviet-style kleptocrats who dominated these economies. The EU looked the other way when it saw crooks taking over and indeed, actively supporting them as long as these crooks sold to the Europeans much as a burglar sells to a fence, privatizing the public domain in insider dealings, selling off property and stock to European investors, and borrowing in foreign currency to fuel the world's most extreme (and unstable) real estate bubble. Collapse of this false start is tearing the euro apart.

The case of Latvia and its Baltic neighbors is instructive. Much like Iceland, they were burdened with a debt overhead far beyond their ability to pay – mortgage debts denominated in foreign currency, so that they cannot avail themselves of the time-honored policy of inflating their way out of debt. Nor will it help for the government to borrow from the IMF and EU to pay the debts of its insolvent real estate to Swedish and other foreign banks. Public-sector borrowing to bail out bad private-sector debts involves squeezing the money out of the domestic population by even higher taxes on labor, pricing it (and hence, domestic industry) out of world markets. In this condition the economy is unable to earn enough to cover its import dependency and the debt service with which it has been burdened.

This is the problem that Iceland must avoid. Unfortunately, the EU's treatment of the post-Soviet economies has shown how predatory and defensive of narrow national interests it can be. Joaqim Almunia of the European Commission made this clear in a letter of January 26, 2009, to Latvia's Prime Minister spelling out the terms on which Europe would bail out the foreign banks operating in Latvia – at Latvia's own expense. He was explicit that Latvia *not* use EU loans to develop its economy or to lighten the tax burden blocking new employment, but only to pay off debts to its creditors in the West (mainly Scandinavian banks) and to buy imports from them.

Extended assistance is to be used to avoid a balance of payments crisis, which requires … restoring confidence in the banking sector [now entirely foreign owned], and bolstering the foreign reserves of the Bank of Latvia. … financial assistance is not meant to be used to originate new loans to businesses and households. … it is important not to raise ungrounded expectations among the general public and the social partners, and, equally, to counter misunderstandings that may arise in this respect. Worryingly, we have witnessed some recent evidence in Latvian public debate of calls for part of the financial assistance to be used *inter alia* for promoting export industries or to stimulate the economy through increased spending at large. It is important actively to stem these misperceptions.

This leaves Latvia in much the position of a nation defeated in war and having to pay reparations. Riots broke out, and protesters stormed the Treasury. It was a scene that has been repeated in Hungary, Ukraine and other countries recently, akin to Latin America's "IMF riots" of the 1960s and'70s. It does not give much hope that joining Europe would, in itself, help Iceland solve its own similar economic clean-up needs. Instead of helping the post-Soviet nations develop self-reliant economies, the West viewed them as economic oysters to be broken up, indebting them to extract interest charges and capital gains, leaving them empty shells. After the domestic kleptocrats, foreign banks and investors have removed their funds from the economy, the Latvian lat will be permitted to depreciate. Foreign buyers then can come in and pick up local assets on the cheap once again.

This sounds remarkably like what Iceland has been going through. The danger is that it might surrender to European interests seeking to appropriate its fishing rights, obtain a monopoly on private bank credit, and lend to the government to bail out European investors who speculated and lost with the now-defunct Icelandic banks. One would hope that the Greens and Progressive Party would review the possible terms of entry into the EU and adoption of the euro, but not replace a domestic kleptocracy with foreign economic occupiers just because they are European. This would merely replace one group of politically well-connected insiders with others, largely to the benefit of Britain.

To call Saturday's election a "victory for the left" by turning toward the EU is thus a travesty. If we apply the traditional left/right dichotomies, the pro-Europe approach seems right wing in promoting financial interests (economic austerity to subordinate debtor to creditor interests, and debt deflation to dismantle public welfare spending). Social Democratic parties throughout the world have been the most ideologically extreme privatizers, from Tony Blair's New Labour to Roger Douglas's New Zealand Labour Party and the Australian Labour Party.

Iceland's Social Democrats are threatening to "fast-track" Europe, and to hold a take-it-or-leave-it referendum on whether to join on the terms her party negotiates, without bringing the citizenry into the process. Prime-minister elect Johanna Sigurdardottir hopes to start negotiations to join the EU within two months, and to hold a referendum on joining it by the end of next year. As far as parliamentary democracy is concerned, this plan is similar to the Independence and Progressive party leaders agreeing to join the Coalition of the Willing in Iraq, ignoring proper procedures by not consulting the Althing.

Meanwhile, the EU and euro are in danger of breaking up as the post-Soviet economies devalue, imposing austerity without having developed their economies outside of real estate. Yet I found little recognition of how the euro and indeed the expanded EU is being torn apart by the unstable post-Soviet economies that have no visible means of financing their structural trade deficits, now that the real estate bubble has burst and there is no more foreign-currency mortgage lending into these unfortunate countries. Europe's monetary management is looking nearly as irresponsible as Iceland's did.

The failure of EU tutelage in the Baltics and Central Europe suggests that Iceland would do best to set about solving its own problems, pursuing its national interest while cleaning up the residue from its disastrous neoliberal experiment. A true market reform would replace the remnants of feudal power with auctioned fishing rent rights so as to keep them as the tax base, and do restore a viable public banking system. Ultimately at issue is Iceland's economic independence itself.

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