Iceland´s (2008) and Argentina´s (2001) crises: Are there any similarities?

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Abstract:

Ever since the dreadful days in October of 2008, when the Icelandic financial system collapsed, questions about the failure have dominated the public debate in Iceland. To many local observers this still remains a mystery, because the three largest banks apparently were all well financed in the summer of 2008, and then suddenly went bankrupt in the fall. How could this happen and why?

A detailed answer to this urgent question was expected to be answered in a report by an Icelandic parliamentary commission published in mid-April of 2010. The commission was set up in December of 2008 by the Icelandic parliament and was charged with investigating the causes of the banking collapse and identifying those individuals responsible, in either pursuing financial wrongdoing, or allowing it to happen under their supervision.

The report was originally expected to be out in November of 2009, but was repeatedly postponed. This delay created enormous pressure and public speculations, about what might be expected in the report.

In the paper some of the commission´s findings will be presented and evaluated, by giving insights to both global and local circumstances, which eventually might have led to the Icelandic demise. The findings will also be compared to the banking crisis in Argentina (2001), to seek whether any similarities can be detected to the Icelandic experience.

Key words: Banking collapse, parliamentary commission, neo-liberalism, laissez-faire, government.

Iceland´s banking collapse

The Icelandic banks collapsed in October of 2008 in only a matter of few days. This turmoil in early October of 2008 took us all by surprise, because the banks were thought to be well financed, generating high returns only in the summer prior to their downfall. Suddenly, Iceland, a small nation of only 320 thousand citizens in the North Atlantic, found itself in the world-wide mass media, but for all the wrong reasons – as the nation worst hit by the global crisis (Chartier, 2010). Our local currency was drastically devalued, but the banks still managed to continue operating as before but in public ownership. Similar downfall of the local currency was also experienced in Argentina a few years earlier, or in the beginning of the new millenium.

Since the downfall, Icelanders have passionately debated the causes of this collapse; whether and how Icelandic officials and business community failed, and how much impact outside factors played in the crisis. Not surprisingly, key government figures and local business elites, all blamed outside affairs, such as the global crisis and the downfall of *Lehman Brothers* in the USA. Critics on the other hand, have focused on local responsibility, such as the faulty privatization of banks in 2002, and lax supervisory rules since by the government, in addition to greed and wreckless behavior of local bankers and entrepreneurs. The answer to this dispute was not entirely clear, untill a long-awaited report by an Icelandic parliamentary commission, finally came out in mid-April of 2010 (*Truth Commission*, 2010).

In the report, the commission found stark weaknesses of accountability. Three former ministers were accused, as well as three former Central Bank governors, and the Director of the financial regulatory body FME, of gross negligence. What explains the Icelandic banking meltdown? The fall of Lehman Brothers and the resulting paralysis of money markets was the trigger for the final collapse, but a crash would have come anyway, because of the giant structural imbalances and the overreaching of the financiers (Wade and Sigurgeirsdottir, 2010). Thus, what really took place in Iceland up to the crisis in the fall of 2008? The commission set up by Parliament, was mandated to investigate this road to collapse.

The *Truth Commission* launched

This commission was set up in December of 2008 by the Icelandic parliament and was charged with investigating the causes of the banking collapse, and identifying those individuals responsible in either pursuing financial wrongdoing, or allowing it to happen under their supervision. The commission consisted of three people; a member of the Supreme Court and a former Professor of Law at the University of Iceland, who chaired the committee; the Parliament´s Ombudsman, and finally a faculty in Economics at Yale University in the USA ("A commission appointed", 2008).

In January of 2009 the Icelandic parliament appointed an additional working group of three people to evaluate whether the downfall of the banks could in any way be traced to unethical behavior, or to the morality norms, prevailing in both business and politics up to the collapse ("Investigating business conduct and ethics", 2009).

The report from the commission, and the ethics group, was originally expected to be out in November of 2009, but was repeatedly postponed, untill it finally came out earlier this year (April 2010). Ever since the commission was set up, great expectations were built up among the public, while key players, both in politics and in the local banking sector, anxiously awaited its outcome. In public debates, many repeatedly referred to the report by stating „Oh well, let´s just wait for the findings of the commission“. This delay to some degree put an official lid on the debate on the causes of the collapse for a while, but at the same time created enormous public pressure and speculations about what might be expected in the report. Would this report be a cover-up by the government? The, then Prime Minister, Geir Haarde, at the outset, referred to the report as being a *White-Book*, which sounded to some as being a sort of white-washing of all responsibility for the collapse. Thus, from the beginning there were high hopes, but at the same time, mixed with suspicions that the whole thing was some how being rigged by the government.

Obstacles facing the *Truth Commission*

During the tenure of the commission several obstacles met them on the way. In June of 2009, one member of the commission was accused of being disqualified to execute their mission. This member had in an interview with a local student magazine at Yale University, where she was a faculty, expressed the view that the causes of the collapse in Iceland was due to both greed in the local business community, and lax supervison of government regulators. This accusation towards this member of the commission was made by the former director of FME, the Icelandic financial regulatory agency, who pleaded to the commission´s chair that she be removed from the commission – because these statements were not based on facts, but filled with emotions and allegations, made by the media and some politicians ("Pressured to resign", 2009). This question of the removal of her from the commission was in turn forwarded by the chair of the commission to the President of the Icelandic Parliament to settle, and created there some up-roar. After some debate, it was decided that this decision was up to the commission itself to make. They finally (the two other members probably) decided to keep her on board, after she had publicly claimed, she could still continue her work, despite these allegations.

Just prior to the deadline of the report November 1 2009, the chair of the commission, made a remark in a public radio interview, that the report would bring the Icelandic people the worst news this nation had ever received with their findings. Not unexpectedly, this comment made quite a stir in Iceland and magnified public expectations ("The bishop of Iceland asks priests to purchase a copy of the report", 2010).

Later, or in January 2010, at a press conference, when the commission announced their second postponement of the report, one of the members of the commission claimed, that he had previously been involved in several investigations of major crime and bankruptcy cases in Iceland – but that this one had exceeded them all in gravity. Often times during their work, he had almost been in tears and felt very frustrated about what they had discovered ("Almost in tears over the report", 2010). The magnitude of the problem at hand he claimed was not the commission´s fault: This whole affair would eventually become a major problem for the whole nation to resolve; what could best be described as a national disaster. Finally, the commission recommended that a public holiday should be declared for a few days to give all citizens an opportunity to read and digest the content of the report ("Tryggvi Gunnarsson: Annoyed and frustrated over what he has discovered", 2010). Understandably, comments like this from the commission´s members intensified public expectations and made everyone anxious to see the report´s findings.

In February of 2010, a press release from the commission announced that they had sent out a letter to a total of twelve individuals to respond to the allegations made against them in the report, and that this procedure, would postpone the outcome of the report for a few more weeks. These individuals turned out to be former ministers in the government just prior to the collapse; directors of the Central Bank and regulatory supervisors ("Twelve received letters of objection", 2010**).**

Shocking revelations in the *Truth Report*

Finally on April 12 2010, the report finally came out. This was a 2,300 page report in nine volumes, based on interviews with almost 150 key actors, and a thorough review of documents from the financial system, which the commission had been granted full access to.

If we ever thought that this report would be a cover-up, it definitely did not turn out that way. In short, we can safely argue that the report was positively received by the public. In a way some sort of relief was felt by many. Accusations of misconduct had been flying around informally; now the evidence was standing there right in front of us.

The content of the report includes damning revelations; exposing deep failings in the financial system with senior politicians, regulators and bankers, all believed to be at fault with mistakes or negligence. The deepest criticisms were reserved for the three largest banks, which all had failed in a few days in early October 2008 ("Iceland negligent over banks", 2010). These banks, which had grown up in a few years to be ten times bigger than the local economy, were said to have been effectively captured by some of their powerful majority shareholders, and their financial vulnerability been deliberately masked:

All of the banks were involved in a web of cross holdings of the owners and linked parties which were favorably treated by the banks they part-owned – and had been granted loans with a value of close to one-third of the equity of the banks by early 2008. Thus, rules about large risk exposures were not followed and difficult to see how the interests of the banks were protected

(“How Iceland´s banking flaws brought down the country´s economy“, 2010).

Not only the owners and the CEO´s of the banks were exposed and attacked in the report but also Iceland´s most senior politicians and civil servants, for their role in presiding over an out-of-control banking system. The most high profile of them all was undoubtedly the chairman of Iceland´s central bank at the time of the crash, who had shaped Iceland´s economy as prime minister between 1991-2004, during which he was the driving force behind rapid privatization of the banking sector – namely David Oddsson, the former leader of the largest political party, the *Independence Party*.

The report delivers him and other senior polical and regulatory authorities with „mistakes or negligence“ in conducting their official duties in protecting the interests of the financial system and the public.

Now it is thought likely that some of these accusations will form a basis for Iceland´s parliament to convene a long-dormant constitutional court with powers to punish misdemenors in public office. A new parliamentary commission was set up to decide on future actions. (“An investigative commission appointed by the end of the year“, 2009). In September of 2010 the Parliament finally decided to prosecute the then reigning Prime Minister of Iceland, Geir Haarde, for negligence up to the time of the collapse in 2008. A court and public prosecutor is now being set up to prepare the case against this former top figure of Iceland´s political system. Not surprisingly, this affair is totally new in Icelandic history, and evoked deep emotional feelings among many, and was very controversial in society and Parliament.

As for the owners of the banks and their CEO´s, a number of criminal cases are currently under investigation and some soon expected to end up in criminal indictments. How many it is difficult to say at this moment, but a few dozens quite possibly.

Iceland and Argentina: Are there any similarities?

Was the financial downfall really a question of a few bankers who went berserk in their greed, or due to public servants, who simply did not perform their official duties on their supervisory shift? Are things just as simple as that? We need to dig deeper in the social and economic environment, both in Iceland and in Argentina, for more meaningful answers to this question. The *Truth Commission* in Iceland gave this at least some lip service in their chapter on morals.

To speak out bluntly here; we can safely argue that an uncritical faith in the virtues of the market had captured the political and economic system in the western world – yet felt in grotesque dimensions and terms in the small economy of Iceland. Argentina also had earlier followed a similar pathway of faith to the market logic, transformation of society into a market, coupled with neo-conservatism and money reductions; a cocktail that just exploded in the hands of Argentinians. Together with hyper-presidentialism, characterized by a high political and administrative inefficiency, became the fuel that lit the fuse of the bomb during the past decade prior to the 2001 crisis (Acebo Ibáñez, 2009).

What we are referring to is a massive adoption of neo-liberal ideas by the ruling elites, with increased marketization, privatization of public assets, changing taxation policies favoring big businesses and the rich, growing materialism and an entrepreneurial spirit; all of this happened in Iceland and Argentina. At a time for Iceland when access to low interest loans was easily available on the international banking market; opening up routes for the notorious viking business raids, in Scandinavia and the UK in particular, where Icelandic entrepreneurs made huge investments.

At the same time, and closely associated with the free market rhetoric, we had a laissez-faire government policy in both countries, based on the premise that an unrestrained market logic is best for all, and a naive belief in the self-regulatory potential of market forces. All of this turned out to be false, and ended up in a major wreck in Iceland and Argentina.

Thus, we are not talking about 20-30 individuals who bankrupted Iceland as some local observers wanted us to believe (Iceland Review, 2008) and the commission seems to support, at least in part. We are witnessing a bankruptcy of a social and economic policy, favored by great many, not only in Iceland and Argentina, but widely in the western world.

Instead of individual and piecemeal government actions directed against specific individuals, we need to implement a broader social policy change towards greater protection of public interests in the private economy. In short, we need to save capitalism from itself - more welfare oriented policies, where market principles do not absorb everything else.

Iceland´s economic situation

But what is the economic situation like in Iceland? Obviously, Iceland is experiencing its deepest crisis since the country´s independence in 1944. A huge volume of financial assets was lost in the crash, our local currency took a huge dive, at the same time as interest rates sky-rocketed. A case in point, Iceland became the first western country to apply to the IMF for emergency financial aid since 1976.

These events have seriously affected financial resources of both central and local governments, which are experiencing major deficits and extensive cut backs. The University of Iceland for instance, needs to cut back their budget for 2011, by 7 percent. Our inflation currently stands at 7%, previously usually hovering around 1%. Prices in residential housing have been on a sharp decline, while price-fixed mortgages are creating a serious financial situation for great many households. Individuals and companies who took loans in foreign currencies prior to the crisis have in particular been severely hit. The current government has desperately been trying to alleviate this situation by various policy actions.

The immediate economic outlook for Iceland is therefore poor. The financial system is not fully functional; with currency restrictions still in effect, and some financial obligations, such as the *Icesafe* dispute still being unsettled. *Icesafe* was a banking scheme operated by an Icelandic bank in the UK and Holland, prior to the crisis, in which citizens of these countries were promised high returns of their deposits. As a result of the crisis these deposits were believed to be lost and the burning question was who was accountable – Iceland or the two countries in question.

In the long term Iceland´s future is however somewhat brighter, with the infra-structure of the economy close to being intact. Moreover, local production of goods for the domestic market and exportation looks promising. Thus, all is not entirely black for Iceland, despite hard times. We have a public saying in Iceland, perhaps capturing the national spirit; *things will become better*, one day, we will see better times. Let us all hope Iceland eventually will.

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