From neoliberal ruins to recovery: Iceland is real poster-boy

By Jón Baldvin Hannibalsson
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At a Nordic-Baltic Development Forum meeting, held in Riga some years ago, there arose a lively controversy on the relative merits of the Swedish (Nordic) model, on the one hand, and the minimal government and low-tax regimes of the Baltic countries, on the other.

Göran Person, former prime minister of Sweden, reminded the audience that Sweden, almost until the Great Depression (1930s), had been a low-tax minimal government country. The *market failure* of financial capitalism, which then started a global depression, had changed all that. The Nordic model was built, by necessity, to save capitalism from the capitalists. The Swedes came to the conclusion that the market system couldn't thrive without state supervision.

During this debate, Persson prophesised that, in the near future, the Baltic countries would have to raise their level of taxation to pay for hitherto unattended common needs and to build a more inclusive and cohesive society. After all, they had a considerable backlog of poverty, dilapidated infrastructure and environmental degradation to sort out.

The welfare state – and its enemies

What clinched the matter was when a well known Finnish social democrat asked the audience if they knew which countries topped the international list for lowest taxes? The answer was the *failed states* of the world. Haiti came top. It has next to no taxes. It has also next to no education, no healthcare, no infrastructure and – conspicuously – no economic growth. And no hope. This explains why *taxes are the price we all have to pay for living in a civilized society*.

At the heart of the controversy between the neoliberals (conservatives) and those of us who want to defend the achievements of the welfare state lie opposite conceptions of the role of the state in managing our common affairs, including interfering with the market when it fails. Contrary to the tenets of the "Washington Consensus", which has had a dominating impact on socio-economic development for the past few decades, we believe the democratic state is not only the guarantor of democracy, the rule of law and freedom. Without supervision by, and accountability to, the democratic state, markets can easily go astray, with unforeseen consequences.

The state is not in our view the anti-thesis of a well-functioning market economy, but the *sine-qua-non* of its acceptance. Where the state is weak, unrepresentative, repressive and corrupt, capitalism degenerates into plutocracy, and, in the worst case scenario, into kleptocracy.

This, in my experience, is a basic lesson to be drawn from the failed promise of the neoliberal era. It is a lesson still to be learned by the powers that be, in the gleaming headquarters of world capitalism in Washington D.C., or even in the Berlaymont tower, home of the EU Commission in Brussels.

We have been through all of this before, e.g. during the period of the 'robber barons' in the US, prompting the great chief justice Louis Brandeis to note, that the nation had a choice:

We can have a democracy or we can have great wealth in the hands of a few – but we cannot have both.

The Nordic model – a success story

But fortunately we have no reason to despair. The neoliberal *critique* of the welfare state has turned out to be mere propaganda, without much substance in reality.

As a matter of fact, the Nordic model is the only type of society, forged in the ideological conflicts of the 20th century, which has withstood the test of globalised competition in the 21st century with flying colours.

Communism has been relegated to the dustbin of history. And unbridled capitalism of the neoliberal variety is lurching from one crisis to another; and only survives for the time being after the biggest rescue operation in history by the state, where it remains in intensive care, awaiting its fate.

The facts speak for themselves. No matter which criteria we apply, the Nordic countries, without exception, are to be found in the top rank.

Economic growth, productivity, R&D, technological innovation, participation in the labour market – especially by women, creation of hi-tech jobs, level of education, equality of the sexes, social mobility, quality of infrastructure, health and longevity, absence of poverty and corruption, low level of crime and imprisonment, access to unspoiled nature, the general quality of life. And greater equality of income than anywhere else. Deep-rooted and assertive democracy. Where is it easiest to establish a company? In the US? No, they are number 48 on the list. Denmark is number one.

When you compare this record with that of Anglo-American capitalism, there is no doubt in most minds as to which type of society is preferable. Let the facts speak for themselves.

Iceland: From ruins to recovery

Iceland became the first victim (the canary in the coalmine – remember?) of the American financial crisis, which by contagion soon spread through the global system to Europe and beyond. In the case of Iceland, it didn't only concern individual banks, but the financial system *in toto;* the smallest monetary area in the world. This was the third biggest bankruptcy in financial history. No small achievement for a nation of less than 350 thousand souls.

The Icelandic Crash (*Hrunið*) has been thoroughly investigated by a special investigative commission, set up by parliament, which delivered its report in 2010 (nine volumes and ca. 3000 pages). Since many other countries were hard hit by this international financial crisis – not the least within the European Monetary Union (EMU) – it may be of interest to others to learn, how and why Iceland recovered sooner and better than most.

The Baltic countries, for instance, even if they were severely hit, enjoyed the good fortune that most of their banks were foreign-owned. There was, therefore, no question of tax-payers in those countries being forced to bail out the banks (like e.g. in Greece). The cost of restoring the banks' lending capacity had to be borne by their owners, with the back-up of their governments and the European Union. Other peripheral countries in the EMU were not so lucky.

Why did Iceland recover sooner and more decisively than most others? Here are some of the major reasons:

- Since this was a *systemic* bankruptcy, major creditors (e.g. Deutche Bank) simply had to *write off* their loans, and sold their claims on the after-market at fire-sale prices.
- For the same reason, there was no way Icelandic tax-payers could be forced to *bail out the banks.*They couldn't be saved.
- The IMF swiftly imposed *capital controls* to prevent capital flight. Initially meant to be short-term, they lasted many years. This enabled the government to negotiate tough terms for ultimately releasing assets, under the threat of a 'windfall-gains-tax', or its equivalent.
- The left-wing government rejected the proscribed *austerity package* and adopted instead some fiscal stimulus (e.g. through a more progressive tax system).

- Iceland's competitive position was enhanced through *devaluation*, promoting exports and reducing imports, restoring the balance of payments and adjusting living standards to a retracting economy, at the same time.
- An emergency law gave holders of savings deposits *priority* (over bond- and shareholders) when it came to assets of the bankrupted banks, enabling the banks to comply with the EEA minimum deposit guarantee, without state back-up. This was later confirmed to be in compliance with the law by the EFTA court.
- Finally we can add *pure luck* (such as record fish catches and the tourist boom) massively increasing foreign currency earnings.

This is why, already by 2011, the economy had been restored to growth. Since then Iceland has been enjoying an uninterrupted economic boom: record growth rates, no unemployment and record foreign currency earnings, enabling the state to reduce foreign debt. Instead, we now face the luxury problem of overheating.

If you compare this with the way the EU and the ECB (European Central Bank), under German leadership, have been treating the EMU-peripheral countries, it is easy to understand why support for EU membership of Iceland, strong immediately after the Crash, has rapidly evaporated.

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