Iceland’s Economic Revolution

Prime Minister Davíð Oddsson, enchanted with Milton Friedman’s free market ideas, implemented a course of tax cuts, cut the corporate income tax to 18%, abolished the net wealth tax, lowered the personal income tax and inheritance taxes and privatized the banking system, introducing financial deregulation along lines of the United States, for a nation with a population of a mere 239,000 citizens. He also entered a free trade agreement with the EU. Oddsson joined the charmed circles of Bill Clinton, of George H.W. Bush, who was invited to Rekyjavik to go salmon fishing. He became a regular at Bilderberg meetings. It seems it all went to his head.

Oddsson went on to become head of the Iceland National Bank in 2005 where he fed the megalomania of the three deregulated banks by in effect printing money at unprecedented rates, flooding the economy with liquidity, until he was de facto fired in 2009 by an act of parliament in the wake of the worst banking crisis in Iceland’s history.


Oddsson’s pals in the small country’s newly-deregulated private banks had abandoned caution to the winds as they decided Reykjavik was destined to become the new Wall Street, an emerging world financial center.

By the outbreak of the global financial crisis, the three banks had combined assets equal to more than 11 times of the Icelandic GDP. They held foreign debt in excess of €50 billion, compared with Iceland’s gross domestic product of €8.5 billion. The inexperienced Iceland bankers had financed their staggering growth by borrowing on the interbank market mainly from UK and Holland banks.

The government’s main priority was to insulate the nation’s population and economy from the effects of the wanton lending abuses of the three banks, something the present Greek government was elected to do for its citizens, to the horror of German Finance Minister Wolfgang Schäuble and others. By November 2008 Iceland’s unemployment had tripled in a matter of two months.

Decisive action

When the dust settled, relative to the size of its economy, Iceland’s systemic banking collapse ranked as the largest experienced by any country in economic history. By the October 2008 the country’s three major banks—Glitnir bank, Landsbanki and Iceland’s largest bank, Kaupþing were placed into state receivership, nationalized.

That was the same time US Treasury Secretary Henry Paulson, who deliberately triggered the Lehman crisis,
categorically refused nationalizing the criminal Wall Street banks, contemptuously stating, “Nationalization is socialism; we don’t do that here.” It was a lie at best as Paulson, with carte blanche control over an unprecedented $700 billion Troubled Asset Recovery Fund, bailed out AIG, Goldman Sachs and his old buddies on Wall Street with “socialized” losses dumped on American taxpayers.

Unlike Greece or Ireland or other EU countries or the USA, the Iceland Parliament and government refused to give unlimited state guarantee to save the private banks.

They nationalized them instead, creating a “Good bank-Bad bank” model loosely based on the successful Swedish 1992 experience with Securum. All domestic assets of the three banks were placed in new publicly-owned domestic versions of the banks. All foreign liabilities of the banks, which had expanded with subsidiaries in the UK and Netherlands, went into receivership and liquidation. British and Dutch bank counterparties and governments shrieked howls of protest, threatening Iceland with being blackballed and forever cut off from further credit by the world. The government also imposed currency controls.

The Parliament established an Office of Special Prosecution to investigate allegations of criminal fraud by government and bankers. People responsible went to prison. Baldur Guðlaugsson, Permanent Secretary of the Ministry of Finance went to prison for insider trading; the president of Glitnir bank went to prison for tax fraud; the president of Kaupthing Bank got 5 ½ years prison; former Prime Minister Geir H. Haarde was indicted.

Iceland decided to go it alone and focus on rebuilding her devastated real economy. The results are quite opposite the results in the EU where the brutal IMF and ECB and EU austerity policies have turned a banking crisis into a major economic crisis across the EU.

By March 2015, according to the IMF itself, “Overall, macroeconomic conditions in Iceland are now at their best since the 2008-9 crisis. Iceland has been one of the top economic performers in Europe over the past several years in terms of economic growth and has one of the lowest unemployment rates... Iceland’s strong balance of payments has allowed it to repay early all of its Nordic loans and much of its IMF loans while maintaining adequate foreign exchange reserves.” The report added, “This year, Iceland will become the first 2008-10 crisis country in Europe to surpass its pre-crisis peak of economic output.”

Revolution in banking next?

The most dramatic and heartwarming development from the Iceland financial crisis however is the Prime Minister’s proposal to revolutionize the country’s money creation process. The first country in the present world to consider such bold action, Prime Minister Sigmundur David Gunnlaugsson commissioned a major report, on reform of the monetary system to prevent future crises. The report, issued by Progressive Party parliamentarian and chair of the parliament’s Committee for Economic Affairs and Trade, Frosti Sigurjónsson, examined the very taboo subject of how private commercial banks are able to create money “out of thin air.”

The report considers the extent to which Iceland’s history of economic instability has been driven by the ability of banks to ‘create money’ in the process of lending.

They went to the Holy of Holies of the secrets of banking since the Bank of Amsterdam first introduced systematic fraud into credit lending in the late 1700’s before it went bankrupt—fractional reserve banking. That simply means a bank lends many times over its deposit or equity base. If there is a crisis of confidence and depositor bank runs, under fractional reserve banking, the bank goes under.

The Frosti report concluded its examination of the link between Iceland bank lending up to September 2008 and the severity of the crisis. Their conclusion was that, “the fractional reserve system may have been a long term contributing factor to various monetary problems in Iceland, including: hyperinflation in the 1980s, chronic inflation, devaluations of the Icelandic Krona, high interest rates, the government foregoes income from money creation, and growing debt of private and public sectors.” That’s a strong indictment and accurate.

It described the stages of every bank crisis since at least 1790 when the Bank of Amsterdam went bankrupt after a run: “A bank’s stock of cash and Central Bank reserves (both assets of the bank) is small compared to total deposits (the banks’ liability). A rumor that a bank may be in difficulty can therefore cause customers to withdraw their deposits in panic (a bank run). A bank run forces the bank to sell assets quickly to fund payouts to depositors. Such a sudden increase in the supply of assets can lead to a fall in market prices, putting other banks into trouble, and the whole banking system may follow.”
The report to the Prime Minister concludes that a revolutionary change in control of credit is needed to control the greed and voracity of the private banks. They call for something known as a Sovereign Money System. As they note, “In a Sovereign Money system, only the central bank, owned by the state, may create money as coin, notes or electronic money. Private commercial banks would be prevented from creating money.”

The report further notes a major positive gain from implementing the Sovereign Money System. The private banks would not make huge profits by buying and selling Government debt at taxpayers’ expense as the government must pay private bondholders interest on that debt: “By delegating the creation of money to private commercial banks, the Central Bank of Iceland, and thereby the state, foregoes considerable income that it would otherwise earn from creating new money to accommodate economic growth.”

They describe how it would function: “In a Sovereign Money system, private banks do not create money. Instead this power is in the hands of the Central Bank, which is tasked with working in the interest of the economy and society as a whole. In the Sovereign Money system, all money, whether physical or electronic, is created by the Central Bank. Although commercial banks will no longer create money, they will continue to administer payments services for customers and will make loans by acting as intermediaries between savers and borrowers.”

And a critical provision: “The payments service will consist of Transaction Accounts held by individuals and businesses. The funds in Transaction Accounts will be electronic sovereign money created by the Central Bank. Transaction Accounts are risk free, as they are kept at the Central Bank, and interest-free as they are not available to the bank to invest. The Central Bank will be exclusively responsible for creating the money necessary to support economic growth. Instead of relying on interest rates to influence money creation by banks, the Central Bank can change the money supply directly. Decisions on money creation will be taken by a committee that is independent of government and transparent in its decision-making, as is the current monetary policy committee.”

That very system was proposed by Chicago economist Irving Fisher and others during the 1930S Great Depression in the USA. The lobby of the bankers managed to kill it.

Wow! Were the US Congress to enact such legislation as Iceland is now discussing to adopt they would return the power over money creation away from the privately-owned Federal Reserve to the elected Congress as specified in the US Constitution, Article 1, Section 8, “The Congress shall have the power to coin Money, regulate the Value thereof...”

The key to the entire Iceland proposal is that the central bank is a State-owned central bank or a Public Bank, as Iceland has. So long as we relegate the power of money creation to central banks privately owned like the Federal Reserve, we ultimately end up in a system of recurring financial collapse, depression, unemployment.

A move to such a Sovereign Money System is not at all difficult technically. It requires only political will of governments to act in the interests of their citizens and nations. Russia would become de facto invulnerable to the ravages of the US Treasury Economic Terrorism Office and Greece could walk away from her unpayable debts to the ECB and IMF and get about rebuilding her real economy.

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