

From Goldrush to Collapse

Explaining Iceland's Financial Rise and Fall

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After the Goldrush

Plenum lecture at a conference organized by the
Faculty of Human and Social Sciences

University of Iceland

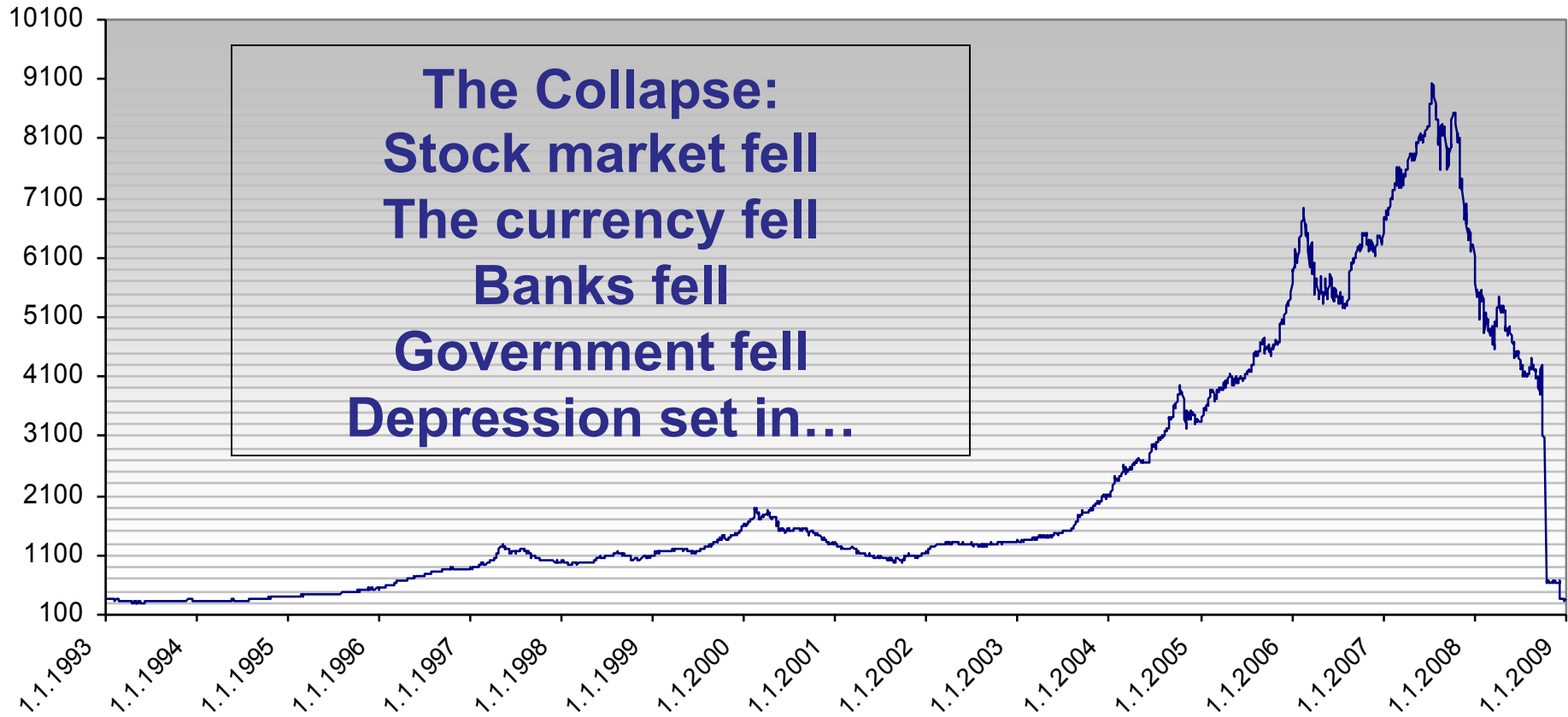
Reykjavík

27th-28th May 2010

The Biggest Bubble Economy

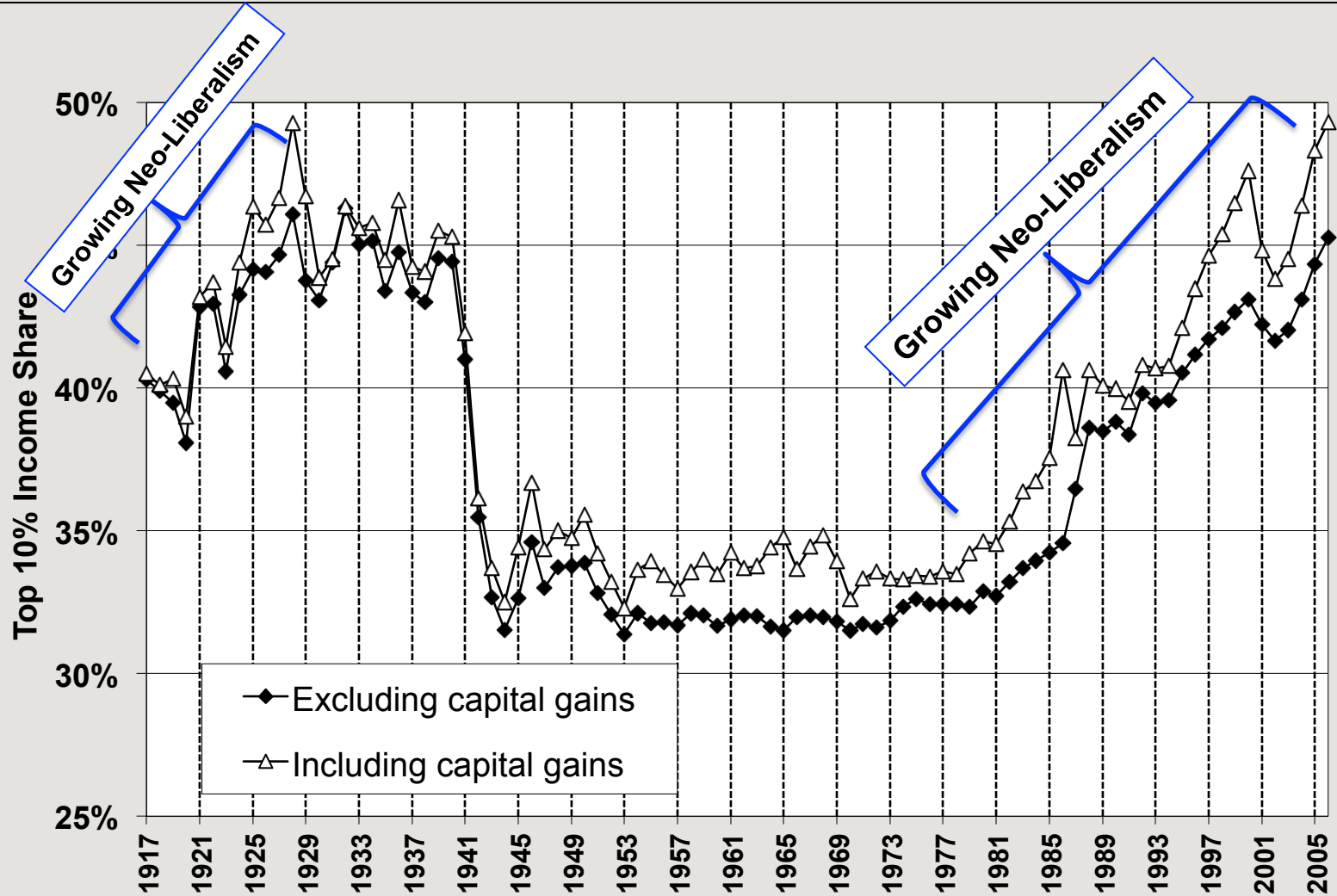
Rise and Fall of the Stock Market

The Icelandic Stock Market Index 1993-2009



Inequality and Neo-Liberalism in USA 1917-2006

Income share of top 10% - Source: E. Saez 2009



Policy and Power Shift from 1980s

- Influential group within the ruling Independence Party (IP) turned to neo-liberalism, from 1979 (Book: “The Revolt of the Libertarians”)...
- This involved a wholesale import of radical policy ideas from American neo-liberal think tanks
- Backed up by an army of visiting neo-liberal ideologues (Hayek, Friedman, Buchanan and others)
- Supported by employers and the most powerful daily newspaper. Economists generally supported it also.
- Put into practice by Oddson’s IP-led governments, from 1991, but with increasing strength from 1995 onwards...
- Hailed in 2004 as the most successful neo-liberal experiment (beyond Thatcher, Pinochet and New Zealand!)

From Neo-liberalism to Bubble Economy

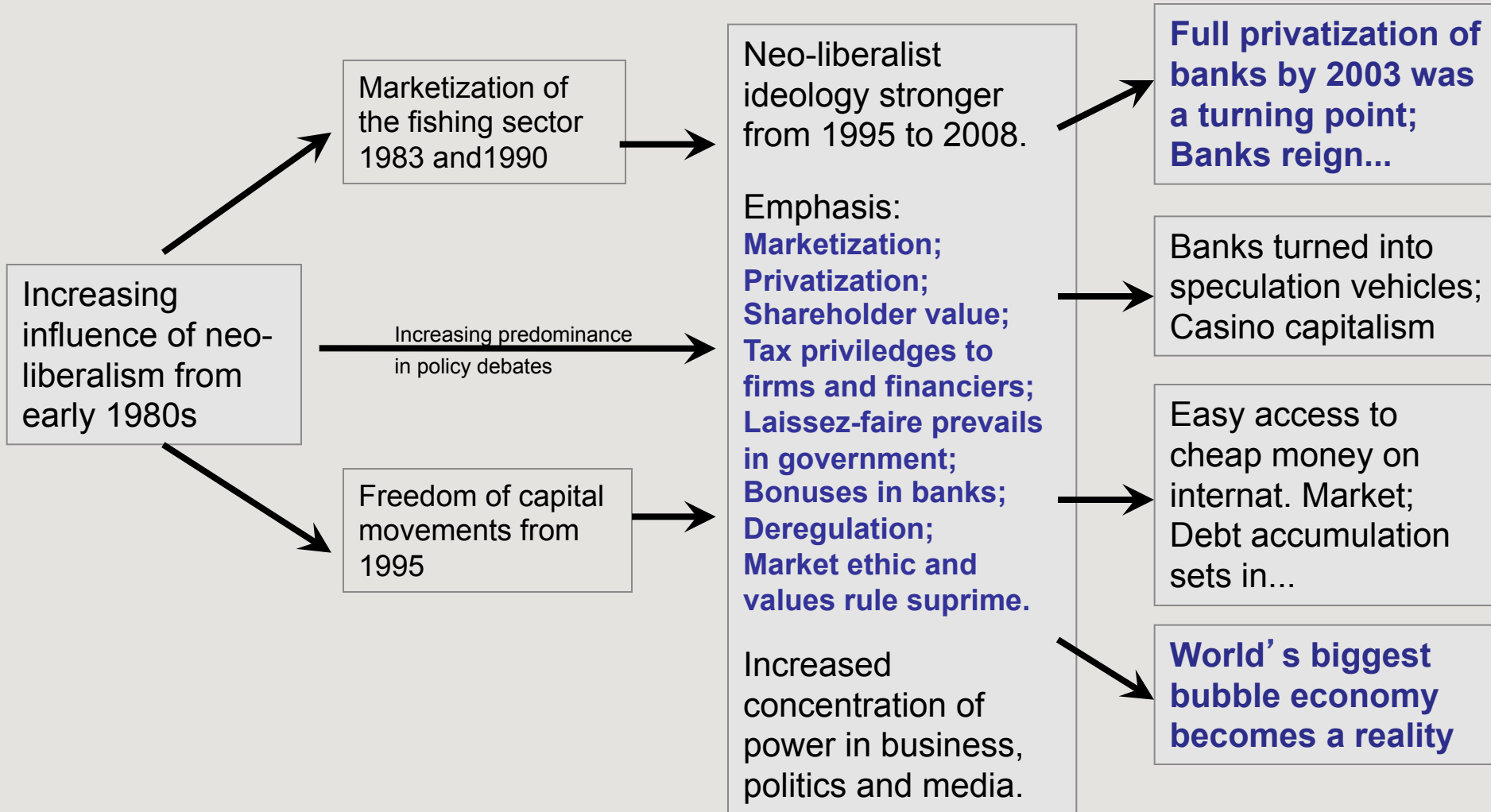
New ideology

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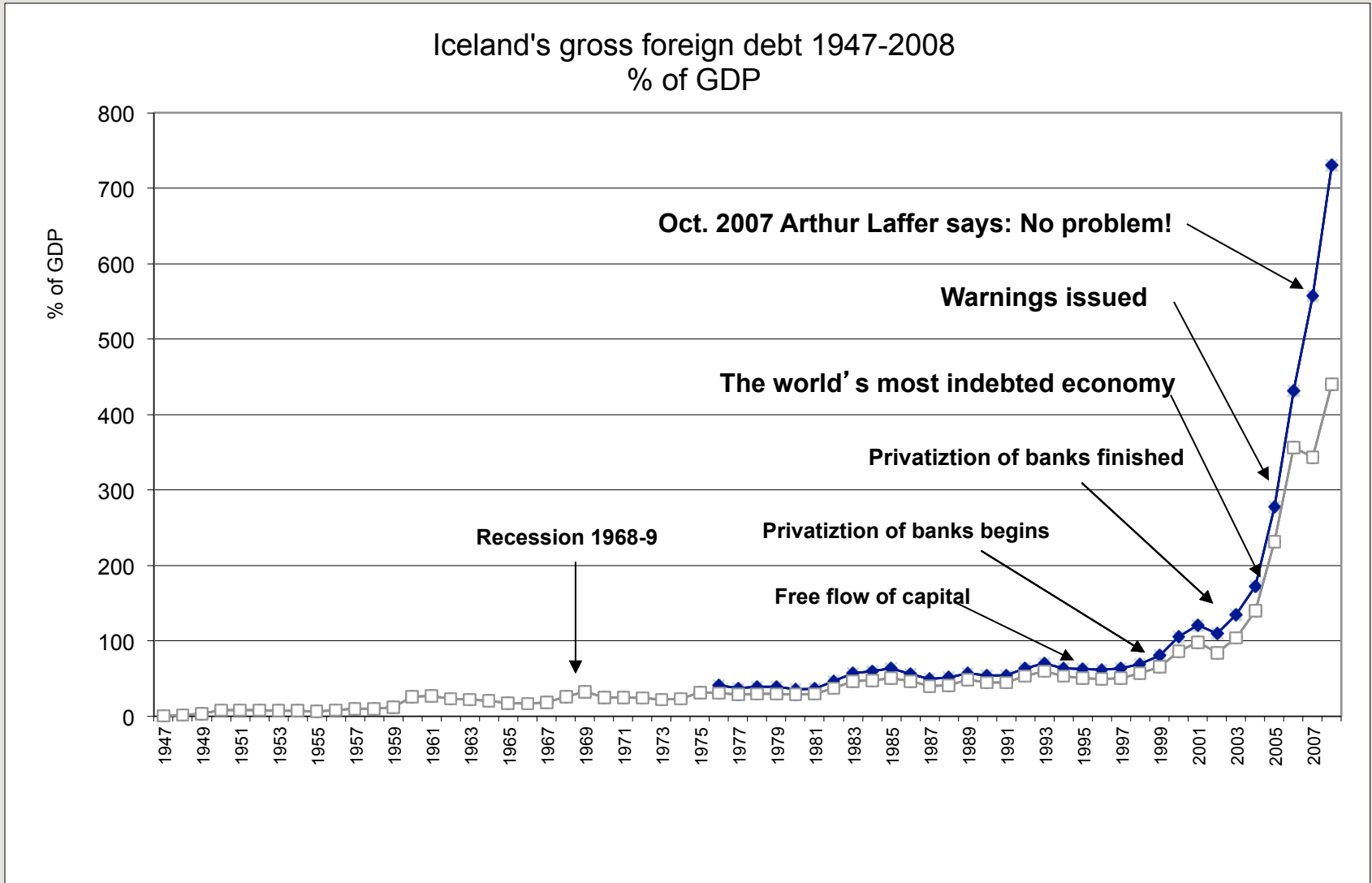
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New environment



Main Cause of Crisis: Debt Accumulation

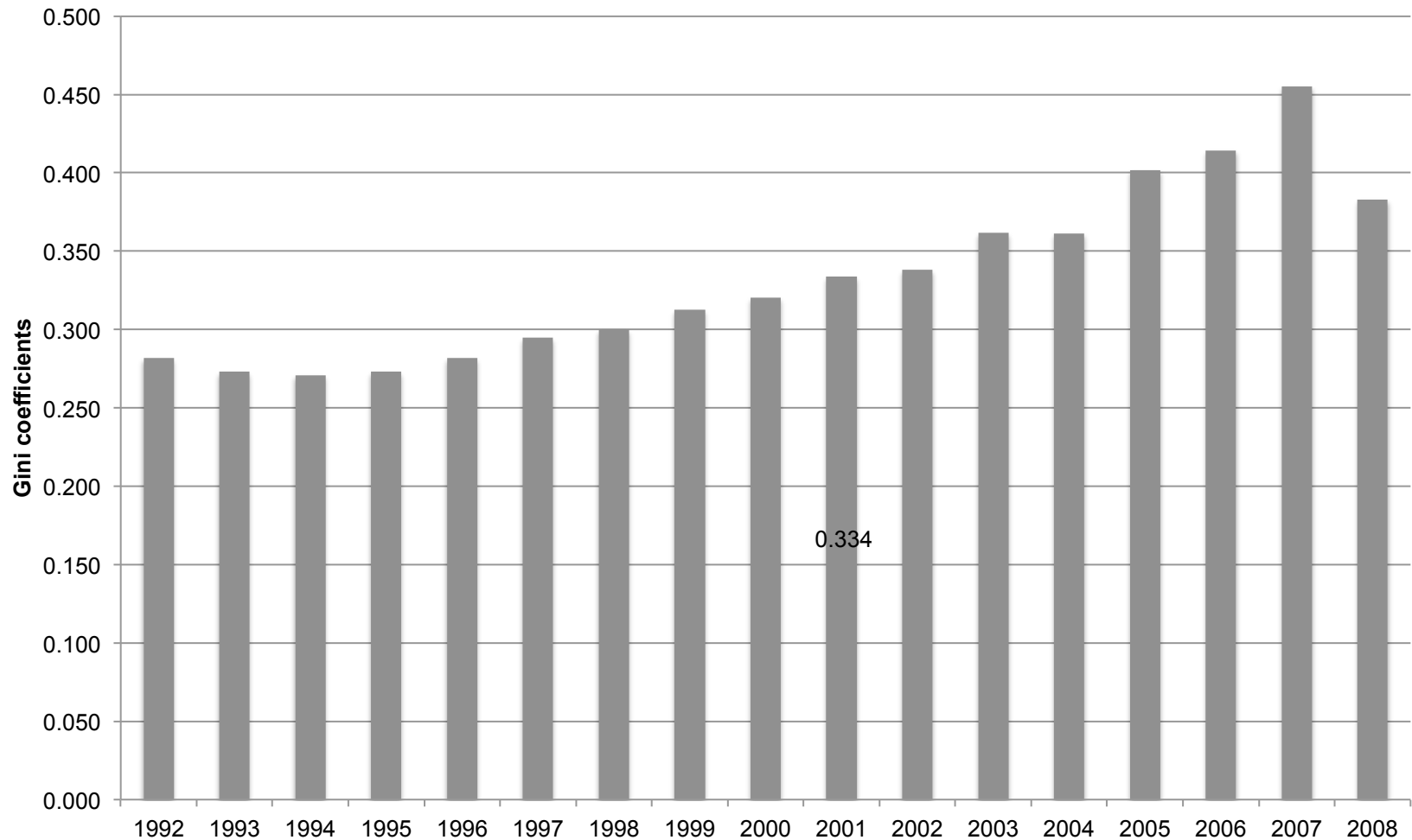


Banks went up to about 10 X GDP in size

Sources: Historical statistics and Central Bank

Growing income inequality from 1995

Gini coefficients for disposable income
(All taxpayers; all earnings counted; equivalized)



Size and Consequences of the Crisis

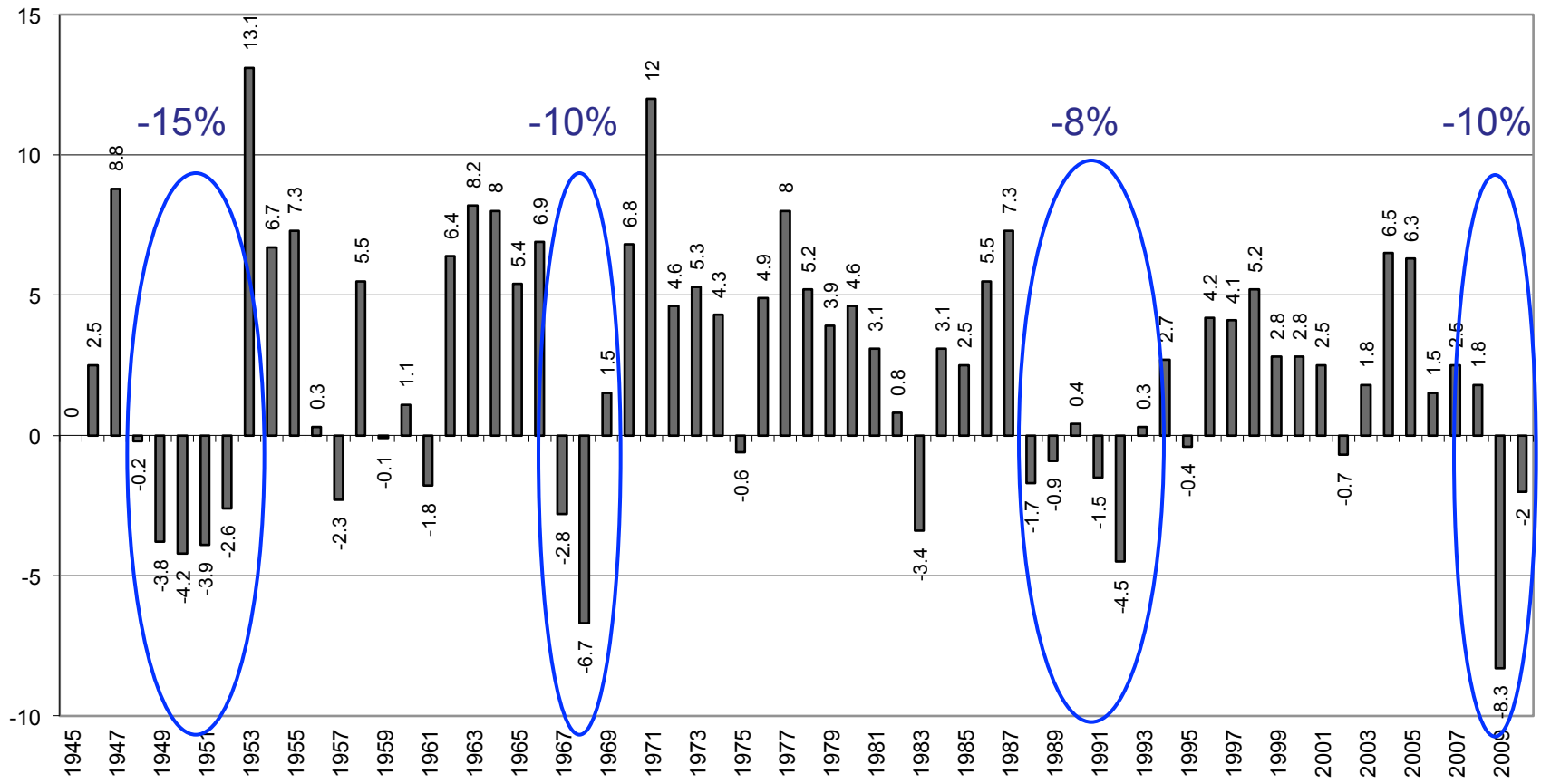
Characeristics

- Central Bank of Iceland and IMF prognosis:
- **10% cut in GDP from 2008-2010**
- **Up to 20% cut in purchasing power**
- **Unemployment approaches 10% by end of 2009**

- **Finland's crisis 1990-1994:**
- **About 14% cut in GDP 1990-93**
- **About 7-8% cut in purchasing power**
- **Unemployment 17-18% at top**

Economic growth 1945-2010

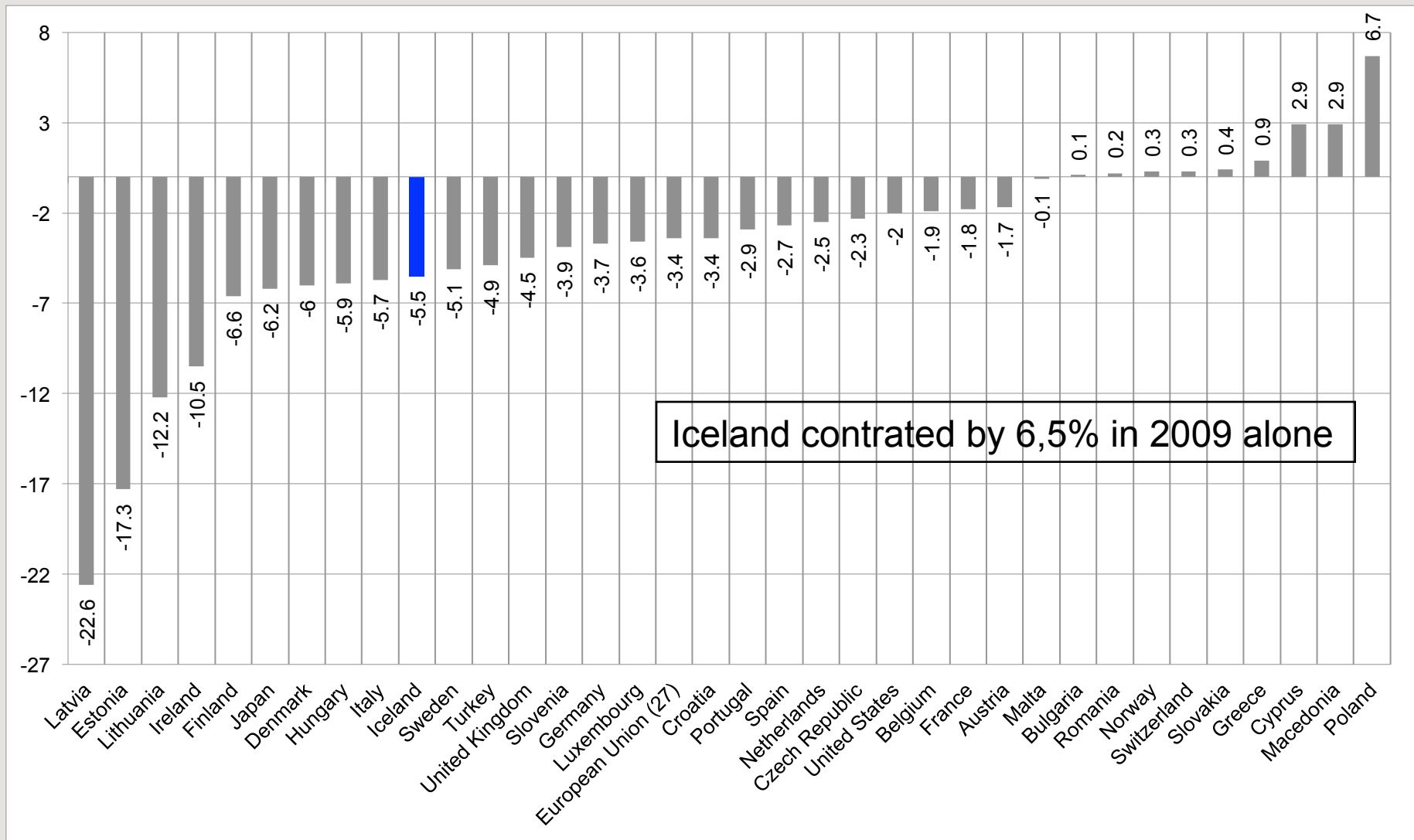
Historical Context of the Crisis (real yearly growth)



Yearly change of real GDP/per capita in %

Contraction of GDP in EU 2008 + 2009

Iceland's Position (EU data March 2010)

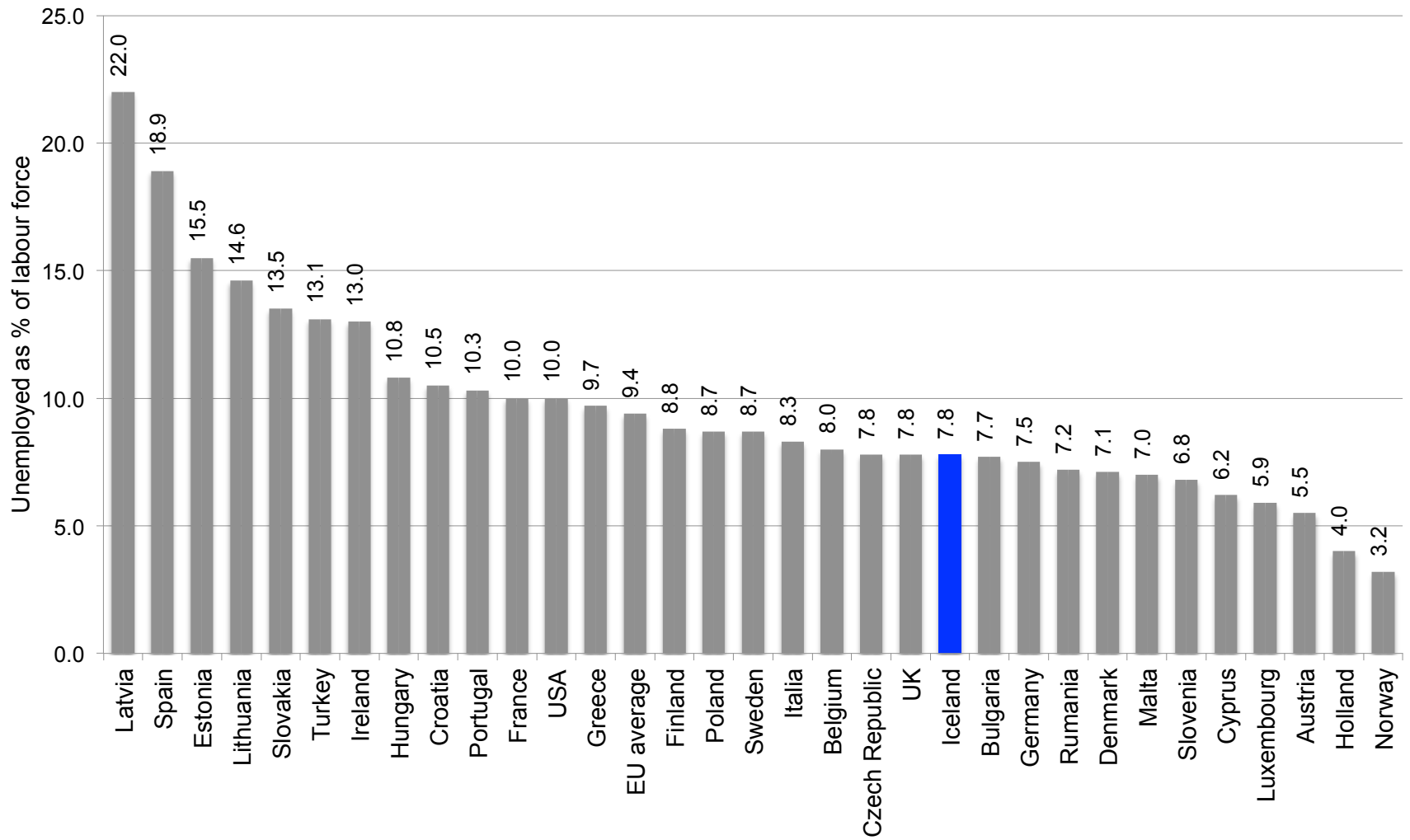


1. Unemployment Consequences

Prediction=10% by end of 2009

Unemployment in the EU in November 2009

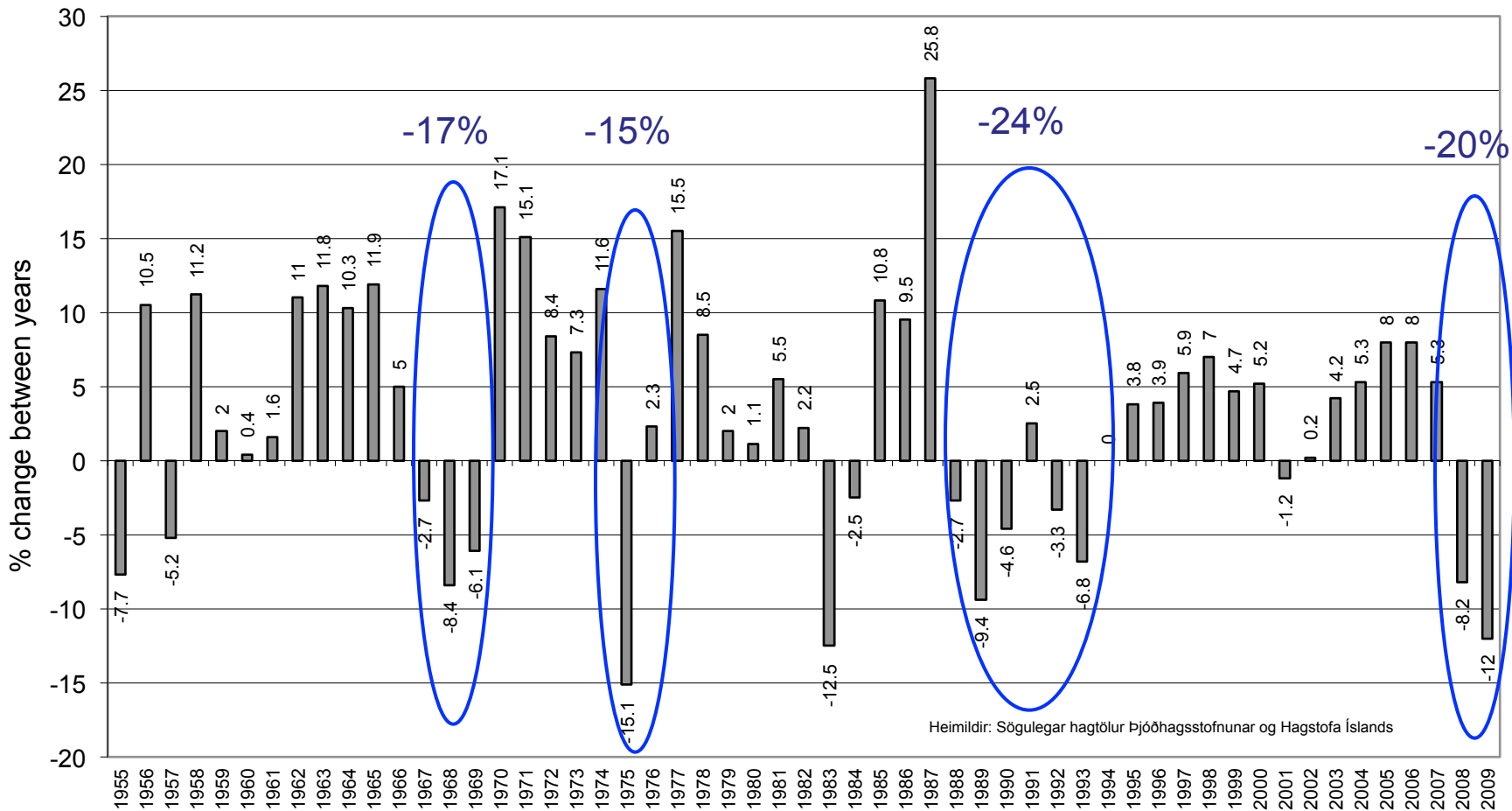
% of labour force



2. Level of Living Consequences

Purchasing power development 1955-2009

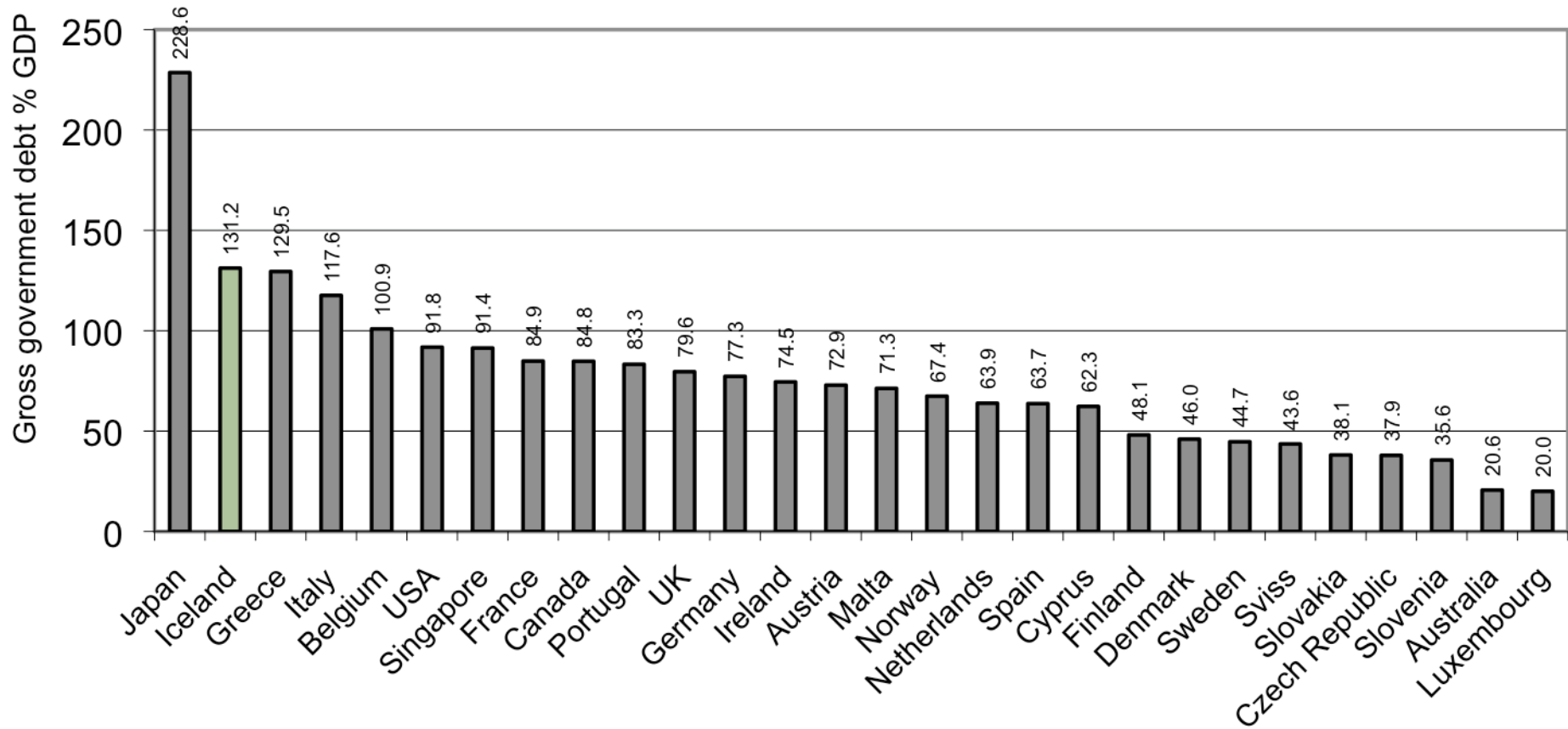
Comparable setbacks



Heimildir: Sögulegar hagtölur Þjóðhagsstofnunar og Hagstofa Íslands

3. Debt Consequences

Gross Government Debt - IMF forecast 2010



Total Debt Burden of Families

Serious debt burden of indebted households – April 2010
% which cannot make ends meet and % with very tight financial position

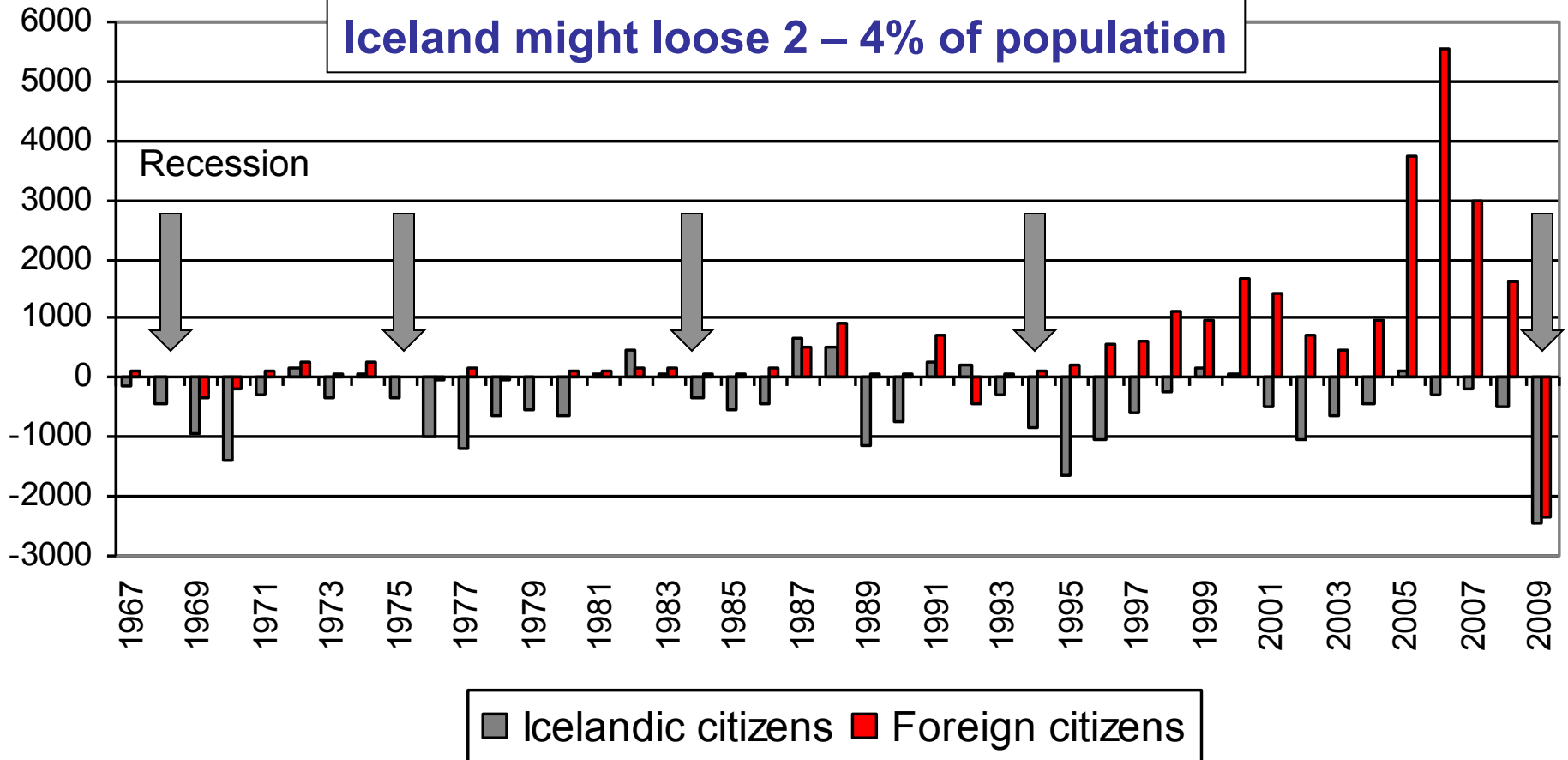
	All house- holds	Single parents	Couples w. children	Singles	Couples, no children
Can't make ends meet	14	20	15	14	10
Very tight finances	8	15	5	11	4
Total % in distress	22	35	20	25	14

Source: Central Bank of Iceland – Total Survey of Household Debts

4. Emigration risk

Net migration in Iceland 1967-2009

Number of immigrants – emigrants: Icelanders and foreigners



Social Protection Softens the Crisis

- Unemployment costs rise significantly
- Activation measures have been stepped up
- Minimum pensions were raised > Pensioners are now guaranteed to be above poverty line
- Taxes were cut for low income earners in 2010, raised for others. Further tax increases expected in 2011.
- Various measures to aid families in big debt
- Public expenditures face big cuts 2010-2012
- Biggest problems for families when **unemployment** goes with **high debt level** and **reduced purchasing power**.
- Biggest threat is political turmoil – demagoguery, splits and irresponsibility – difficult to face issues

Politics:

The Biggest Risk Factor Now

- **Split within one government party**
- **Referendum on Icesave issue - A Farce**
- **Parliamentary investigation into the crash delivered in April – Devastating**
- **Regular news of misdeeds**
- **General disillusion > Fragile conditions**
- **A period of political turmoil may follow**

Thank you!