After the gold rush in Iceland: Causes and consequences of the banking collapse in 2008[1]

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Abstract
In 2010, University of Iceland organized a conference in Reykjavík on the banking collapse in Iceland in 2008. This event was a joint effort of Sociology, Anthropology and Ethnology, gathering dozens of scholars including international ones. The collapse was still fresh in the minds of all participants. The title of the conference was *After the Gold Rush*, and the topic centered on how the social sciences can help us understanding these historic events, unfolding around us at the time. This paper was presented at the conference in May of 2010, by the late professor from the United States, John Galliher, and Helgi Gunnlaugsson, professor of sociology at the University of Iceland, but was never published. The content, slightly revised in 2012, offers a valuable insight to some of the main themes believed to be paramount in explaining the crash, followed by the immediate social consequences for Iceland in the aftermath. How the Icelandic case of bust was seen in the foreign media is in turn reviewed followed by perceptions of local crime developments. The main findings show neo-liberal ideologies, hyper-consumptionism, and globalized market, playing leading roles in both the rise and fall of the local banking system. A few concluding remarks show that Iceland recovered remarkably fast, or in only a few years, fueled by explosion in tourism.

Key words
Icelandic banking collapse, neo-liberal ideology, crime, foreign press.

The Icelandic Collapse in 2008

Iceland experienced a deep economic crisis after all three of the country's major banks collapsed in late September to early October 2008. This constitutes the largest banking collapse in history relative to economic size (Jóhannesson, 2009) and made Iceland one of the biggest casualties of the

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global economic downturn (Jónsson, 2009). In fact, Iceland's crisis has been called the "greatest financial crisis ever" (Krugman, 2010). What is especially interesting to note is that Iceland's collapse was foreshadowed by a significant increase in economic inequality following excessive market liberalization, as was the case with the Wall Street Crash of 1929, which triggered the Great American Depression (Ólafsson, 2010).

Many have tried their hand in explaining why Iceland was hit this hard during the "Great Recession" (Ritzer, 2010). The most ambitious attempt is without a doubt the nine-volume, more than two thousand-page report by the Icelandic Parliament's Special Investigative Commission (2010) on the causes of the collapse of the Icelandic banking system. Among other things, the report singles out greedy and reckless bankers along with misguided politicians and government officials as the key actors in the banking collapse. The report is very wide-ranging and detailed and has been described as "probably the most important document in the history of Iceland" (Helgason, 2010) and the first of its kind in world history.

A promising theoretical perspective from which to view the collapse and its antecedents is the one of institutional anomie (Messner and Rosenfeld, 1994; 1997). In short, market rule became increasingly dominant in Iceland parallel to increasing neo-liberalization (Harvey, 2007) and other social institutions were weakened in the process. The market effectively took over other social institutions (Magnússon, 2008). This was evidenced by the growing dominance of greed throughout society. This development is captured in the following quote from an opinion piece in one of the main newspapers in Iceland when the bubble economy was just about fully inflated:

"Greed is the train that pulls our life into a brighter future…The so-called greedization of Icelandic society is hopefully here to stay, and hopefully it will grow day by day into the unforeseeable future, for all our sakes" (Ágústsson, 2005).

Nowhere was this more evident than seen by the fact that the assets of the newly privatized banks outgrew the national economy nine times, as measured by GDP. Well before that point was reached the banking sector was doomed to fail (Special Investigative Commission, 2010). How could all this happen in Iceland, a small island nation in the North Atlantic?

Background: Neo-liberalist ideology enters Iceland

Iceland market freedom did not only come from outside. In Iceland a new generation highly influenced by neo-liberalism came of age in the 1970s (Gunnarsson, 1979). Many of this generation later rose to political power, the most famous being Davíð Oddsson, elected the mayor of Reykjavik in 1982, and later Prime Minister from 1991 to 2004.

Under Oddsson's reign the Icelandic government, led by the right-wing Independence Party, "neo-liberalized" (Harvey, 2007) the Icelandic economy (Ólafsson, 2008), using Margaret Thatcher's Britain and Ronald Reagan's America as models (Gissurarson, 2004). Many state-owned companies were privatized, the economy deregulated, taxes on business and financial earnings were cut drastically, and the net wealth tax was abolished (Wade, 2009; Sigurjónsson, 2010). In fact, the taxation system underwent a complete overhaul and tax rates became among the lowest in Europe (Portes and Baldursson, 2007). The goal was to free up Iceland's economy and make Iceland more competitive in the global marketplace. At one point the Cato Institute rated Iceland as the least regulated country in the world, and in 2005 Iceland was ranked as having the fifth most economic freedom in the world.

As Iceland was being changed many of the world's most famous neo-liberals were brought to Iceland and most of them praised the country for being a justification of free market principles (Wade, 2009). As an example, in the fall of 2007, Arthur Laffer assured Icelandic business leaders that a fast-growing economy with a large trade deficit and growing foreign debt was a sign of success. "Iceland should be a model to the world," Laffer declared (Morgunblaðið, 2007). Soon he would be proven to be wrong.

Hyper-consumptionism in Iceland

Icelanders enjoyed considerable affluence in the beginning of the 21st century. As a case in point gross domestic product increased 130% from 2000 to 2007. Housing prices jumped 75% between 2004 and 2008, while disposable income rose 73% between 2000 and 2007 (Wilson, 2010). In 2006, the average income in Iceland was 1.6 times that of the U.S. (Vaiman et al., 2010). However, a significant part of this consumption was financed through debt. The significant jump in personal debt between 2003 and 2005 was mainly due to the fact that the newly privatized banks entered the housing loans market offering up to 100% loans and encouraging people to take out second mortgages on their house (Social Science Research Institute and the Institute of Economic Studies, 2009).

As early as 1985, Icelanders were only second to the U.S. in private consumption per capita (Karlsson, 2000). Since the late 1990s there was a significant increase and change in the nature of consumption in Iceland, inspired by the conspicuous consumption ideal set by the newly rich. The rise of conspicuous consumption has had a profound effect on Icelandic society by breaking a long-held social code of moderation in displays of wealth (Magnússon, 2008; Jónsson, 2009). A large part of the Icelandic population followed the tide as the consumption ideal steadily penetrated the Icelandic mindset. Credit enabled households to expand mortgage borrowing, increasing both home ownership and enabling households to finance consumption (Social Science Research Institute and the Institute of Economic Studies, 2009).

Icelanders' extensive use of credit and consumption was closely associated with the significant increase in economic inequality (Ólafsson, 2008; Kristjánsson and Ólafsson, 2009). In the face of rising inequality, credit offered the opportunity to keep up with others' consumption and thereby maintaining the belief in the relative "classlessness" of Icelandic society (Bjarnason, 1974; Björnsson et al., 1977). It has even been claimed that egalitarianism is the most dominant cultural value held throughout Icelandic history (Tomasson, 1980). Beliefs of this nature promote the idea that all households should be able to conspicuously consume. In the face of increased inequality, rather than confront the gap between ideology and reality, demand for credit apparently is likely to increase. In many ways Icelanders embraced both American style hyper-consumption (buying more than one can afford) and hyper-debt (owing more than one can pay back) (Ritzer, 2010). Many took out loans to buy new and expensive cars. In 2009, almost a third of the Icelandic population had car loans in foreign currency, which proved absolutely toxic after the banking collapse (Alþýðusamband Íslands, 2009).

No better example of Iceland's hyper-consumerism can be found that the experience of an Icelandic used car dealer named Guðfinnur S. Halldórsson, or Guffi for short (Halpern 2011). During the boom years 2002-2008 a man reportedly showed up at his dealership and purchased a used Porsche on credit with no money down. Guffi didn't care if the customer paid back the loan or not since this was a bank's problem and not his. The customer kept the Porsche until the first monthly payment was due and then returned it and Guffi sold it again for a profit. Guffi sold the Porsche five times in only six months each time for a higher price. Each time the bank involved did not care since the consumer took out a larger loan. This was clearly an unsustainable pattern. Iceland's stock market soared 900 percent during this six-year period and Guffi earned an amazing amount of money during this brief boom. All this came to an end in 2008. The banks and the final car owner were the ultimate losers since now the car was purchased at a greatly inflated price and the bank had no hope of receiving payments on the final loan.

Impact of 2008 collapse

The collapse proved to be a great blow for the population of the world's most "developed" country (Human Development Reports, 2009). The Icelandic króna plummeted to record lows (Central Bank of Iceland, 2009). By late December 2008 it had fallen to 147 to the dollar, from 82 just before the collapse and 60 a year earlier – reflecting a huge drop in purchasing power. The Icelandic average gross national income fell from 1.6 times that of the United States in 2007 to 0.8 times that level in February 2009 (Wade and Sigurgeirsdóttir, 2010). In January 2009 annual inflation reached 18.7%, by far the highest in Europe (Eurostat, 2009). Household debt increased significantly, and even before the collapse it was higher than in any other European country or the USA (IMF, 2009). Unemployment rose from 1.5% in September 2008 to its highest point of 9.1% in April 2009 (Directorate of Labor, 2009). Many had to take wage cuts to keep their jobs and others moved abroad (Wade, 2009). The International Monetary Fund was even called in to help, the first time helping a developed country since Britain in 1976. Furthermore, early in this turmoil a protest movement emerged and contributed to bringing down the government:

"Iceland remains the [first] government to have resigned as a result of the global financial crisis. It is also the only country to have shifted distinctly to the left in the aftermath of September 2008" (Wade and Sigurgeirsdóttir, 2010:23).

Icelanders largely blamed the more "adventurous" newly rich individuals for the economic collapse (Jóhannesson, 2009), the so-called "Surging Vikings", which effectively mortgaged the Icelandic public into the unforeseeable future (Ólafsson, 2008). There was also a considerable backlash against neo-liberal ideology, with much of it being directed against the traditionally right-of-center Independence Party, primarily responsible for the neo-liberal surge. This has increased political polarization and further undermined social solidarity.

The turmoil in Iceland manifested itself in different ways. Protests were common in the aftermath of the banking collapse, something rarely seen before the collapse. Before the collapse people gathered to ask for higher pay by occasionally doing marching walks. Now they protested each Saturday afternoon because they felt that the rebuilding effort was not working and that the people responsible for their woes had not been brought to justice. A special consultant to an "economic crime team" was hired from abroad, Eva Joly, to investigate suspicions of criminal actions in the period preceding the collapse of the Icelandic banks. Nonetheless, Icelanders grew increasingly disheartened with how matters were handled immediately in the aftermath of the collapse.

Social demographics of Iceland

From the late the 19th century onward, the population of Iceland grew rapidly (Karlsson, 2000). In fact, 2008, the year of the economic collapse, was the first year since 1889 that the population did not grow in raw numbers (Social Science Research Institute and the Institute of Economic Studies, 2009). Although the decrease was relatively small it apparently mirrors effects of the economic collapse. However, it must also be considered that even though birthrates were still relatively high they had and have been going down over time and that the population's age composition is becoming more unfavorable in terms of reproduction (Social Science Research Institute and the Institute of Economic Studies, 2009).

Employment participation in Iceland has for long been the highest among Western countries. Icelanders have long enjoyed relatively full employment and long-term unemployment has been uncommon (Gunnlaugsson and Galliher, 2000). This changed rapidly following the economic collapse, and still hovered above 5% in 2012, roughly four years after the crisis hit. The long-term implications of this are quite serious since employment is not only a means for income, but also a source of identity, self-respect and social relations.

Icelandic collapse as seen by the foreign press

A Canadian scholar views the situation through coverage of the financial collapse in the international press:

"The banks were privatized around 2000 in a hasty and politically driven process. Ownership went to people with close connections to the parties in the conservative coalition government, which had scant experience in modern banking" (Chartier, 2010:101).
According to Chartier a U.S. newspaper reported that:
"Over the last six years, a group of about two dozen young, U.S.-educated financiers took Iceland on a Viking voyage of acquisitions, grabbing airlines, banks, mortgage lenders and securities traders from Texas to Hong Kong" (Chartier, 2010:118).
The population of Iceland was alleged to have fallen in love with easy credit. And at this point traffic congestion with large SUVs in Reykjavik became a major problem. "Analysts strove to evaluate Iceland's real wealth at the peak of the boom and wondered whether its prosperity was not an organized system of poverty hidden by excessive prices" (Chartier, 2010:71). In April 2008 it was reported:
"Risk - adverse investors have begun pulling out. Since the beginning of the year, the Icelandic króna, the smallest independent currency in the world, has fallen by 25%. The stock market index has fallen by 40% […] interest rates reached 15.5% last week. The country has been running a large trade deficit, partly because of rampant consumer spending" (Chartier, 2010:88).

Therefore, the result was one billion dollars of debt for 330,000 people in 2008, or $300,000 for every person. Yet Chartier argues that Icelanders need not assume all the blame for the financial mess. Savers in other nations decided on their own to invest in Icelandic banks due to the high interest rates (Chartier, 2010:204). And during the crisis Iceland's Central Bank Director and former Prime Minister Davíð Oddsson accused those heading other national banks of failing to do all they could to help Iceland. In any case, apparently all that was left for Iceland was to fall back upon fishing (Chartier, 2010).

Bailing out Iceland

Soon after the 2008 collapse the International Monetary Fund agreed to assist Iceland ride out its banking crisis. The nation's three largest banks were nationalized again and cut their interest rates 3.5 percentage points (Guardian, 2008). Mark Weisbrot, who is co-director of the Center for Economic and Policy Research, argues that EU membership is more of a hindrance than a help because the European Central Bank has no interest in helping financially struggling nations including Greece, Spain, Portugal and

Ireland (Weisbrot, 2011). Because these nations have all adopted the euro they do not control their fiscal policy and thus forced austere budget cuts move them in the wrong direction since it is the view of creditor nations that prevails in the EU (Daley, 2011). What these creditor nations should do is to assert to the European authorities that they will refuse any bailouts that do not allow their economies to grow.

Icelandic losses

Once the crash began depositors outside of Iceland were quick to pull their funds out of the nation's banks. But the banks could not pay off depositors and the Icelandic government could not afford a bailout (Halpern, 2011). Therefore, the recently privatized banks failed. Iceland's government guaranteed that Icelanders would not lose any money from their saving accounts but did not and could not guarantee the many investment funds that the banks offered. As a result, many Icelanders lost large sums of money that they had been led to believe was safely invested. Between 2007 and 2011 the price of imports rose 85 percent and the unemployment rate went up to 9 percent from about one percent.

Icelandic authorities might have finally realized that the new owners and directors of the banks were not good at handling money and that Iceland should get back to things they really knew such as fishing (Halpern, 2011). Even in the face of this hardship Icelanders largely refuse to take the dirty job of cleaning fish that is largely left to Polish immigrants (New York Times Magazine, 2011). This is likely a byproduct of the fact that they have a total of seven universities in this tiny nation making them among the most-educated people in the world. In 2007 the assets of Icelandic banks equaled 744 percent of the nation's GDP. After the collapse imports rose 85 percent in price and overall consumer prices have gone up 34%. A local informant said that in Iceland as inflation occurs the level of a borrower's debt increases by the same amount unlike the cases of the US dollar or the British pound.

Just prior to the collapse Iceland's President proudly claimed Icelanders were Vikings not adverse to risks. Since the collapse he understandably did not repeat this. The Icelandic króna is highly volatile since it is such a small currency, but both the Icelandic President and former PM Davíð Oddsson oppose joining the EU and adopting the euro. The mayor of Reykjavik in 2010 believed that the nation should begin trading in the US dollar. Others have determined that the best alternative would be for Iceland to adopt the

Canadian dollar, but thus far Iceland has retained an independent currency in great part due to national pride. As of 2012 the Central Bank of Iceland issued a report on the future of the currency. Only two options were believed to be feasible for Iceland, keeping the króna or adopting the euro. However, the euro is only possible for EU countries which Iceland is not likely to join in near future.

The massive loans from Europe were arranged through European bankers who were knowledgeable professionals unlike the Icelanders who did not have much banking experience and headed the banks thru political ties or even despotism. These European bankers insisted on loans that had to be repaid once Icelandic banks interest rates sank below a specified level. This was an automatic trigger built into the loans. This helps explain why the crash occurred when it did.

Crime in Iceland in a globalized world

As Iceland has become increasingly globalized so has the extent and nature of crime and crime control in the country changed. Increased globalization has increased cross-border crime (Andreas and Nadelmann, 2006) and it has been speculated that foreign criminal cartels have operations in Iceland (Ministry for Foreign Affairs, 2009; National Commissioner of the Icelandic Police, 2010). These developments, coupled with advances in information and communication technology, have reportedly created new possibilities for global criminal cartels. These cartels are believed to send their operatives to Iceland to plan and deal drugs and commit theft and burglary, often with the intent to sell the proceeds outside Iceland. These cartels allegedly have also been involved in the sex industry and the drug trade. Sex crimes and drug crimes have increased rapidly in the new millennium in Iceland.

The ever-expanding global trade of drugs is the primary example of the increased global flow of illegal materials. Spearheaded by the U.S., drugs became an increasing global concern in the late 1960s and 1970s. It was also in the early 1970s that Icelandic police started having to deal with crimes related to drugs (Gunnlaugsson and Galliher, 2000). At the time drug use in Iceland was minimal and consisted mainly of cannabis use. Drug use and drug trafficking has increased significantly since then, as indicated by the amounts of drugs confiscated and the number of drug related crimes (National Commissioner of the Icelandic Police, 2003-2010). The crime that Icelanders have been most concerned about is the flow of drugs into the country (Gunnlaugsson and Galliher, 2000). In 1997 more than 60% of

Icelanders believed that drugs were the main cause behind crime and violence (Gunnlaugsson, 2008). Large drug busts also indicate that the drug market in Iceland is quite a bit larger than previously thought. Foreign criminal cartels have also become more heavily involved in the drug trade in Iceland in (National Commissioner of the Icelandic Police, 2010).

Since the 1970s most drugs have made their way into Iceland via Icelandic nationals who traveled abroad, bought drugs, smuggled them back to the country for sale. This seems to have changed around the turn of the 21st century with more foreigners getting involved (Sverrisdóttir, 2006). The quantity of drugs smuggled into the country has also increased significantly, with more dangerous and expensive drugs being smuggled (Johannessen, 2009; Gunnlaugsson and Galliher, 2010).

As for human trafficking, the increased global flow of people and better information technology has created more opportunities for traffickers to transport women (Altman, 2001). The sex industry also became increasingly important in global capitalism. Bars, dance clubs, massage parlors and the porn industry fuel the demand for sex labor around the globe. Icelandic police have had to deal with cases involving human trafficking and prostitution (National Commissioner of the Icelandic Police, 2010). Individuals residing in Iceland have trafficked women for sexual exploitation in cooperation with foreign criminal groups according to the local police (National Commissioner of the Icelandic Police, 2010). In 2010 Iceland, led by its new left-leaning local government, became the first European country to pass legislation banning striptease (Bindel, 2010). In the first few years of the 21st century hundreds of foreign strippers, mostly from E-Europe, had been transported each year to Iceland to serve as strip dancers in Icelandic bars. This business is believed to have grossed millions of US dollars and the number of strip places in Iceland numbered more than a dozen at its peak.

The increase in global crime activity has been met by an expansion of the "international component of policing and policing component of international relations" (Andreas and Nadelmann, 2006:6). In the global age, it is the nation-states of Western-Europe and the U.S. that have played the central role in defining global forms of deviance and crime:

"To an extent virtually unprecedented in world history, a few European states and the United States proved successful in proselytizing to diverse societies around the world, in shaping their moral views of substantial sectors of elite opinion outside their borders, and in imposing their norms on foreign governments" (Andreas and Nadelmann, 2006:20).

Many of the recent changes in Iceland have been going on in the U.S. for some time. In their book *Crime and the American Dream* (1994) Messner and Rosenfeld note the "ironic" interdependence between deviance and conformity in the American dream of financial success that applies to all crimes including the financial misdeeds of business leaders. This they refer to as the "dark side" of the American dream of financial success that emphasizes a "fetishism of money" (Messner and Rosenfeld, 1994, p. 71). One very negative consequence of these developments is that people begin to fear that the "local institutions that provide order, meaning, purpose and protection" have collapsed leaving individuals with a sense of terror (Messner and Rosenfeld, 1994, p. 35). All of this apparently happened to some degree in Iceland.

Rising inequality in Iceland

Iceland has long been characterized as one of the most egalitarian nations in the world (Gunnlaugsson and Galliher, 2000). It has been noted that every Icelander, including heads of state, are referred to by their first name and are equally likely to be found listed by first names in the national phone book. Icelanders also show notable lack of deference in their interactions (Tomasson, 1980) and some have even gone so far as to describe Icelandic society as uniquely equal and "classless" (Tomasson, 1980). Although this latter point has probably never held true, the myth of classlessness has traditionally been quite strong and widespread (Broddason and Webb, 1975; Björnsson et al., 1977).

Nonetheless, parallel to the neoliberal-globalization of the economy the market quickly became more predominant in structuring inequality and Iceland became more of a "class society" (Weber, 1978). One manifestation of this development is the increased concentration of the national income towards the top, where the share of the top 1% of families grew from 4% in 1993 to 20% in 2007 (Kristjánsson and Ólafsson, 2009). In fact, in 2007 the distribution of disposable income was comparable to that of the United States, the most unequal society in the developed world. What characterized this period was the increased purchasing power of those with the highest incomes. The equalizing effect of the Icelandic tax system has also decreased in recent years and was among the lowest among OECD-countries after the crash (Kristjánsson and Ólafsson, 2009). A glaring manifestation of this development is the substantial proliferation in the ranks of the newly rich, who rode the wave of the economic boom that began in the mid-1990s (Magnússon, 2008). As a result: "[t]he [Icelandic] class system has transformed over the last 15 years, from a relatively homogeneous class system into a polarized class system - in which the social cleavage between the transnational capitalist class and the traditional capitalist class is deepening alongside the increasing polarization between wage earners and the capitalist classes (Jónsson, 2008:143).

While inequality has been increasing in other developed countries in recent decades, what is special about Iceland is that inequality increased more and more rapidly than in other OECD-countries (Kristjánsson and Ólafsson, 2009). This aptly named "inequality crisis" (Oddsson, 2010) is likely to have undermined Icelanders' beliefs in the equality of the Icelandic society (Ólafsson, 2008; Oddsson, 2010). Another way of saying all this is that increased credit masked increased inequality.

Concluding remarks

Economist Paul Krugman (2011) observed in the *New York Times* that while Iceland's economy tanked in 2008 due to the unscrupulous practices of its leaders, Iceland was better off than some of its neighbors because it had not been forced by the European community to shrink its economy and did not bail out the thieving Icelandic bankers. Iceland allowed its banks to go bust and quickly nationalized them. Although Iceland did not avoid economic damage in the aftermath of the 2008 crash, its poorest citizens were protected, unemployment was controlled, and Iceland did not abandon, and even expanded, its social safety net.

In mid-2012 the *Wall Street Journal* reported that Iceland was recovering nicely (Forelle, 2012). Unemployment and emigration were no longer significant problems because Iceland unlike euro-zone nations had its own currency, central bank and thus its own monetary policy. And given the economic chaos in Europe at the time the euro was not a possible alternative and especially since Iceland values its sovereignty and independence so much. Iceland typically devalues its currency when things are rough for Iceland to boost exports such as fish even though consumer prices rise - like by a quarter during 2008-2011. Even with these difficulties, fishermen made twice as many Icelandic krónur during this period than before the 2008 collapse. Iceland let its banks fail and had foreign creditors rather than Icelanders cover its losses. On top of more exports Iceland also received record many tourists in the following years, also fueled by the Eyjafjallajökull volcano in 2010. All of this helped Iceland in its recovery from the collapse in 2008.

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