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# ICELAND'S FINANCIAL CRISIS IN 2008. POLITICAL, ECONOMIC AND SOCIAL CONSEQUENCES

**ABSTRACT:** The author analyzes the successful strategy of overcoming financial breakdown in the case study of Iceland. The aim of the article is to verify a hypothesis that the Icelandic model could become a panacea for future crises? A document analysis method is applied to present essential indicators such as GDP and trade balance. With the use of a source analysis method, the collapse of the financial sector is determined as the main cause of the slump. The systematization of crisis events is introduced and deepened by the social and political situation. Changes in the state's condition after the crash are provided and future forecasts about economic development are discussed. As a summing up, the author disapproves of the hypothesis that the Icelandic model of overcoming the financial breakdown as a panacea for future crises, pointing out that it is only applicable for specific cases and cannot be seen as a magical remedy for every kind of crisis.

**KEYWORDS:** Iceland, small state economy, Icelandic crisis causes, Icelandic crisis 2008, Icelandic banking system, Icelandic EU accession.

## Introduction

According to the Oxford dictionary a crisis is "a time of great danger, difficulty or confusion when problems must be solved or important decisions must be made". S. Miklaszewski defines a financial crisis as sudden changes in financial markets connected with liquidity shortage of entities, insolvency of participants and state intervention in economic processes. As W. Nawrot points out due to globalization, which is defined as dynamic development not

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only of societies but also technology, the face of financial markets change as well. On the one hand, it is a modern, cross border system creating unlimited opportunities for all participants of markets. On the other, this system is incredibly vulnerable to diverse slump occurrences. In the globalized world, a domino effect can take hold – the fast transmission of crises to markets, especially financial ones. The last financial crash stressed the growing role of the global market and demand mobility in the international view (Mitręga-Niestrój, 159).

The global financial crisis, which began in USA in 2007, is one of the biggest breakdowns in the world economic history and is often compared to the Great Depression of the 1930s. This breakdown was not merely an issue that influenced markets and financial institutions. In fact, it threatened the real economy of the whole world and "particularly affected the banking sector, crucial for the proper functioning of individual countries as well as international systems. Therefore this crisis had extremely negative consequences for entrepreneurships and households" (Mitręga-Niestrój, 160).

In literature one can find many descriptions of the Icelandic strategy of overcoming the crisis, which are presented by many authors as a magical cure, and the Icelandic government's intervention is widely regarded as successful, not only for the economic development of the state, but also (and most importantly) for Icelandic citizens. Very often it is contrasted with the case of Greece. The author, using the method of literature analysis, both Polish and foreign, and the monographic method, appraises the causes and timeline of the Icelandic crash and creates a forecast for futures situations in Iceland. The document analysis method, using data from *Hagstofa Íslands*, is applied to present essential economic indicators before the crisis and provide forecasts. The aim of the following article is to verify the hypothesis that the Icelandic model can be a panacea for crises for other countries.

## General characteristics of the Icelandic state

Iceland is a country between Europe and North America. The current population is 329 000 people, which with an area of 103 5000 km$^2$ has a density of 3.19 person per km$^2$. The capital region (*Garðabær, Hafnarfjorður, Kópavogur, Mosfellsbær* and *Reykjavík*) is inhabited by more than 1/3 of the country's entire population. In

Iceland there are only 30 cities with over 1000 inhabitants (the second biggest is Akureyri on the North of the island, with a population of almost 20 000). The main natural resources are geothermal energy, water and aluminum. Manufacturing represents 36% of exports. One of the biggest economic sectors is aluminum smelting in 3 aluminum plants: *Straumsvik* (1969), *Grundartangi* (1998), and *Reyðarfjörður* (April 2008). The base of the Icelandic economy is the fishing industry – catches exceed 13 000 tons per year. Only after the crisis did the role of tourism grow significantly. Current statistics show that 70% of citizens are employed in tourism and this sector generates more than 23% of export income (Tourism in Iceland 2). Iceland was visited by almost 1,792,200 people in 2016[1], (it's 2017!!)

The Icelandic banking sector, crucial in the context of the events in 2008, is led by the Central Bank (*Seðlabanki Íslands)* that was established in 1961. *Seðlabanki* is in charge of the monetary policy implementation in Iceland as well as:

- promoting an efficient and safe financial system;
- issuance of notes and coins;
- regulating interest rates;
- maintaining and managing the foreign exchange reserves.

Apart from *Seðlabanki*in Iceland there are three main banks (names before crisis in brackets):

- *New Landsbanki (Landsbanki),*
- *Arion Bank (Kaupthing bank),*
- *Islandsbanki (Glitinir).*

The Icelandic stock market has operated since 1985, with ICEX15 as its main index.

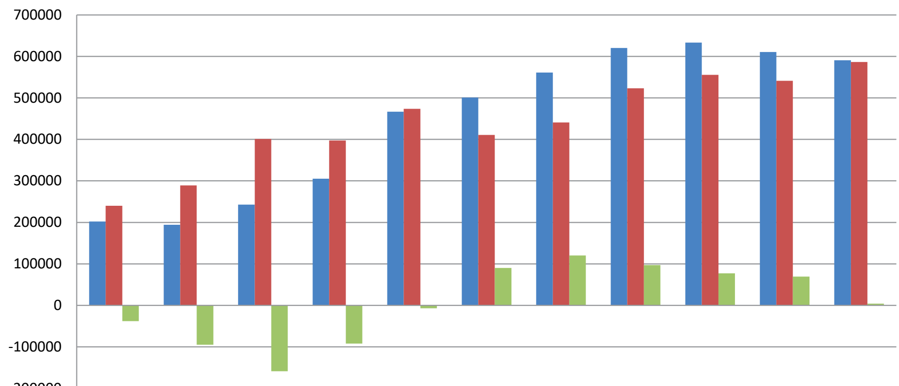
Before the crisis, Iceland could pride itself on a significant inflow of foreign capital (direct and portfolio investment). In the period between 2000–2004, the value of foreign direct investments (FDI) was 2–3% of GDP, and in 2007 the FDI was 33% of GDP (Wajda-Lichy 192). That phenomenon was connected with the privatization process in the banking sector that started in 2000 as well as the effective promotion of Iceland as a financial center with a cornerstone of the three biggest commercial banks (*Glitnir, Landsbanki* and *Kaupthing Bank*). The strategy of the financial sector's expansion has been implemented since 2007.

From the beginning of the 21st century, Icelandic economy was transformed into one that was dynamic, developed and globalized.

[1] https://www.ferdamalastofa.is/static/files/ferdamalastofa/Frettamyndir/2017/juli/tourism-in-iceland-2017-9.pdf

At the beginning of the decade, growth in its current account balance was mainly due to the construction of an aluminum plant in *Reyðarfjörður.* The role of exports was gradually growing and in 2007 they exceeded imports by over 25% (Figure 1).

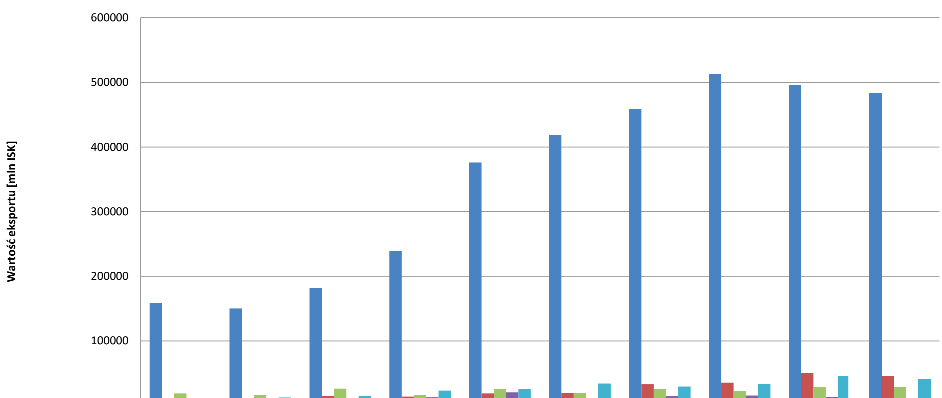
**Figure 1.** Exports and imports between 2004–2014 (million ISK)




| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Export | 202373 | 194355,3 | 242740 | 305095,8 | 466859,5 | 500854,5 | 561032,2 | 620127,4 | 633029,1 | 610691,6 | 590501,7 |
| Import | 240160 | 288894,8 | 401201,5 | 397241,1 | 473524,7 | 410574,8 | 440820,9 | 522985,3 | 555695,4 | 541361,9 | 586251,8 |
| Balance of trade | -37787 | -94539,5 | -158461,5 | -92145,3 | -6665,2 | 90279,7 | 120211,2 | 97142,1 | 77333,7 | 69329,7 | 4249,9 |

Source: Own elaboration, data: http://www.hagstofa.is/

**Figure 2.** Exports between 2004–2013



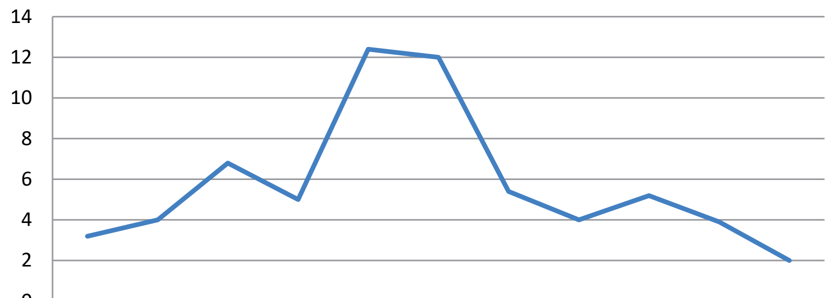

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|---|---|
| EEA | 158370,5 | 150248,6 | 181970,3 | 239116,4 | 376063 | 418346,9 | 458939 | 512894,5 | 495807,5 | 482961 |
| Other European countries | 8796 | 8906,9 | 15086,8 | 13903,9 | 18789,1 | 19711 | 32838,8 | 35562,4 | 50535,8 | 46457,1 |
| USA | 18769 | 16299,2 | 26131,3 | 16049,7 | 25720,1 | 19402,9 | 25429 | 22959,1 | 28338,1 | 28667,3 |
| Japan | 6076,7 | 6262,1 | 5019,2 | 12775,6 | 20453 | 9304,5 | 14283,4 | 15443,3 | 12925,1 | 11442,1 |
| Other countries | 10360,9 | 12638,5 | 14532,3 | 23250,1 | 25834,5 | 34089,3 | 29541,9 | 33268,2 | 45422,6 | 41164,1 |

Source: Own elaboration, data: http://www.hagstofa.is/

Markets, where most of the goods and services were exported from Iceland, were (and still are) countries participating in The European Economic Area (EEA). At the beginning of the decade, the second biggest market was the USA. After the financial crisis this has changed. Other European countries became the second biggest market. Recently this pattern of growth has been noticed in non-European markets possibly because of the poor economic situation in Western countries (Figure 2).

The estimates above clearly indicate an intensive development of the Icelandic economy at the beginning of the 21st century. In 2004, economic growth. The average level of income per capita (ppp) was far higher than the average in the Eurozone.

**Figure 3.** Inflation rate 2004–2014



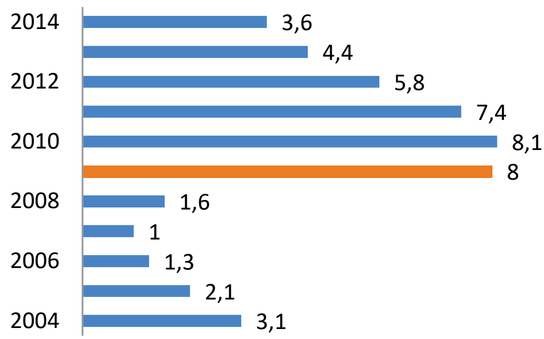

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Inflation (CPI) | 3,2 | 4 | 6,8 | 5 | 12,4 | 12 | 5,4 | 4 | 5,2 | 3,9 | 2 |

Source: Own elaboration, data: http://www.hagstofa.is/

In 2001, *Seðlabanki* had introduced an inflation target of 2.5% (with a range of 1.5%), that proved to be a sufficient method to limit inflation. It dropped from 6% in 2001 to 2% in 2003 (Figure 3). In the following years inflation started to grow again and from 2005 was above the inflation target. This caused *Seðlabanki* to raise interest rates. As a result, the inflow of foreign capital grew and was not a sufficient tool to reduce demand. A simultaneous reduction in taxes fuelled inflationary pressures.

Iceland before the crisis was characterized with a low unemployment rate (Figure 4). Between 2006–2008 it was between 1–1.6%. A jump in unemployment in 2009 (up to 6.5%) was observed due to the economic crisis. By 2014 this rate had dropped significantly and was only 3.6% and in July 2017 it hit the lowest – 1%.

**Figure 4.** Unemployment rate between 2004–2014




Source: Own elaboration, data: http://www.hagstofa.is/

## Causes of the Icelandic crisis

In 2008, the Icelandic economy was the first in the European system to be severely undermined by the financial crisis. Iceland represents a group of small states as well as small open economy – countries that are highly dependent on exports and imports of goods, that is more vulnerable than most to market fluctuations. Small state economies put pressure on specializations and economy of scale, to be able to compete in the international market. This usually leads to the export of one or two types of products. As Baldur Thorhallsson (2013) suggests that due to these factors smalls states are generally on the front line of these crises.

The case of the Icelandic economy, that is dependent on the export of fish products, fits perfectly into the small state scenario during a recession. After the privatization of three of the biggest banks in 2004, the Icelandic banking sector expanded by over 900% of GDP and led to higher levels of exposure to global market fluctuations.

Because Iceland was the clearest example of a country prevailing over the financial crash, many authors have scrutinized this example. I. Skibińska-Fabrowska (531–532) sums up the causes of the crisis' outbreak presented by both Polish and foreign authors. M. Budyta-Budzyńska sees excessive investments financed by foreign credits in the construction and energy sectors and the consequences of economic reforms in the 1990s. Bank privatization had induced its managers to seek opportunities of return (and profit) abroad. Meanwhile the domestic market was flooded with consumption loans that led to over-indebtedness and dynamic growth in consumption.

L. Kurkliński (2010) seeks the causes of the crisis in the banking sector deregulation that happened after the privatization of the biggest Icelandic banks. This allowed for the combining of investment, corporate and commercial banking. K. Pruchnik (2012) debates that it was not the liberal reforms but the malfunctioning of public institutions, mainly *Seðlabanki* and financial supervision which were the causes that led the whole country to the brink of bankruptcy. Ingimundur Fridriksson (2009) draws attention to exceptionally favorable conditions in the global financial markets at the beginning of the 21st century. Freedom to provide services abroad that was used by Icelandic banks, which willingly combined high liquidity in the global market with extra-ordinary low interest rates as well as high ratings of countries, had made these credit sources seem almost limitless. A. C. Sibert (2011) presents an interesting notion emphasizing the excessive penetration ratio of banking in Iceland while having its own currency, making the country vulnerable to a run on the banks (understood as uncontrolled withdrawal of deposits and suddenly cut off from financing sources).

Initial signs of the recession in Iceland were visible in the years before 2008. The earliest signs of the collapse were already seen in 2003 during the construction of the *Reyðarfjörður* aluminum plan. This investment equaled 1/3 of Icelandic GDP and led to significant growth in the current account deficit. In 2003, three of the biggest Icelandic banks were privatized. After this *Landsbanki, Glitnir* and *Kaupthing* started extensive international expansions. Most of their securities were investments in US securities and funds. In 2004, banks assets equaled 100% of Iceland GDP, as Danielsson (26) shows in 2007 it was more than 900%, making Iceland exposed to unfavorable tendencies in financial markets. Manipulation of interest rates as well as a lack of control of the banking sector and internal irregularities and fraud led to the inevitable collapse of the Icelandic banking system. The last cause of Icelandic breakdown was the lowering taxes in 2007 that resulted in a rise in salaries that led to an increase in disposable income for households. A growth in consumption was observed, followed by inflationary pressures with the current account deficit rising to 25% of GDP.

A direct cause, or maybe even the first stage of the crash, was the loss of capacity to refinance short-term liabilities by *Glitnir, Landsbankinn* and *Kaupthing*. *Landsbanki* and *Kaupthing*'s liquidity was lost due to a run on foreign branches of these banks. On 6th October 2008, the Prime Minister of Iceland threw Icelandic society into shock when three weeks after the collapse of Lehman

Brothers he announced that the three biggest banks were no longer able to finance their liabilities.

4. Crisis timeline.

**3rd October 2008** the European Central Bank makes a margin call of 400 million to Landsbanki. Even though this decision is taken quickly, it has a strong psychological impact on the British branch of the bank where panic spreads (Decyzja Urzędu Nadzoru EFTA nr 290/12/COL z dnia 11 lipca 2012 r).

**6th October** *Alþingi* passed emergency legislation (Emergency Act No 125/2008) enabling the government to intervene extensively in Iceland's financial system. *Fjármálaeftirlitið* (FME – Financial Supervisory Authority) is given power to take control over the financial institution and disposal of its assets. It became clear that Icelandic banks are no longer able to finance its short-term liabilities.

**29th September** the nationalization of *Glitnir* is announced in an attempt to stop the bank from sharing the same fate as *Landsbanki* and *Kaupthing* (**7th October**). The last step that finally plunges the entire Icelandic financial system into meltdown was the British government's decision to pass anti-terrorism legislation to freeze *Kaupthing* assets as an answer to the Icelandic banks' insolvency.

**9th October** the last and the worst effect happens. The Icelandic stock market is suspended and re-opens five days later (**14th October**). The new session sees a fall of 70% on the ICEX15 index.

**15th October** *Seðlabanki* cuts the interest rate from a record high of 15.5% to 3.5%. Initial estimates states that British tax-payers might have lost close to £1 billion. The Icelandic state is on the edge of bankruptcy. Icelandic government turns to IMF to get loan for saving the state.

**20th November** the International Monetary Fund approves a $ 2.1 billion loan for Iceland. Iceland becomes the first Western European nation to receive an IMF loan since 1976.

## The social situation

The reaction of Icelandic society is no less important than the dramatic market changes in the state. Just before the crisis, Icelanders were probably even more in debt than US citizens. The

American lifestyle was highly influential in Iceland, especially "life on credit". Icelanders had bought not only houses and cars on credit, but also computers and other home appliances. It would not be an exaggeration to say that every single Icelandic person has taken out a loan at least once in their lives, but most citizens had been indebted to Icelandic banks when they collapsed. Part of society also owned both deposits and savings accounts, since Icelandic banks offered highly competitive interest rates. Due to the depreciation of the Króna, Icelanders had lost up to 70% of their savings.

Citizens felt the crisis on many levels: "the withdraw of money and foreign transfers were restricted, the prices of import goods doubled. Before the crash Icelanders had taken out loans for houses, cars and other luxury goods with basically no limits. Then they started to have trouble paying off the loans, especially with the highest installments in foreign currency loans" (Budyta – Budzyńska, 98). Before the crisis, Icelanders followed the ruling party's (Sjálfstæðisflokkurinn) doctrine that made them believe that it is time to use years of hard work and bring puritan austerity to a close. The ruling party persuaded people that it was the perfect moment to build a house, buy a better car or spend their winter holidays in warmer climes. Obviously, all this could be done with credit that was available to everyone (Przemiany polityczne na Islandii w warunkach kryzysu bankowego i gospodarczego, 19).

The sudden devaluation of the Króna and higher repayments were beyond most Icelanders' financial capabilities. Moreover, the anger of people rose along with the behavior of the government especially the Prime Minister Geir Haarde and the head of *Seðlabanki* Davíð Oddsson, who were well-known for financial embezzlement on a grand scale as well as enormous estates. They simply belittled the social issues to care only about their own business[2]. Demonstrations had already begun in 2008 but by January 2009 even larger protests known as 'the pots and pan revolution' were taking place[3].

[2] Kamil Pruchnik calls such a phenomenon crony capitalism, pointing out that disordered privatization process had been held. Power and governance in the biggest companies went into the hands of influential businessmen closely connected with the government. Such a situation led to business depending on the goodwill of the government (e.g issuing licenses, tax refunds and tax exemptions or public auctions on favorable conditions) and not to free market competition.

[3] https://www.youtube.com/watch?v=sbVml3P4FBY

Starting from 20thJanuary 2009, thousands of people protested in the main square in Reykjavik, just in front of the *Alþingi* building. At this point it seems important to emphasize that the previous demonstration in Iceland had taken place in 1949 while discussing Icelandic membership in NATO[4].

Protesters wanted the government to step down and set up a new election date. Clashes with police took place, along with the use of tear gas and the arrest of demonstrators (Icelandic protesters demanded the government step down). In the end the protesters won – on 26th January Prime Minister Geir Haarde announced his resignation along with the whole government and set up a new election date for 25thApril 2009. The new Prime Minister of the temporary government was Jóhanna Sigurdardottr (Samfylkingin).

## Emerging from the crisis

The most important decision (supported by citizens), both from an economic and social perspective, was not to save banks by all means and not to use quantitative easing, but letting the banks fall. This saved the whole country from the situation that was observed in Greece and Spain. Such a decision put the whole country on the edge of bankruptcy, yet as the years after have shown, the risk was worth taking. Lowering interest rates as well as a devaluation of the Króna by up to 70% (1 euro = 90 ISK before the crisis, at its lowest, the exchange rate of the Króna equaled 1 EUR = 340 ISK, the current exchange rate is 1 EUR = 124 ISK) was possible due to the fact that Iceland is neither a member of the Eurozone nor a big state. The exchange rate of the Króna is now under restricted control. Of course such a decrease of the country's currency value that is so dependent on foreign markets pushed the inflation rate up to a peak of 18% in 2009. Between 2009–2010 it was necessary to limit the rise in salaries (Islandia kpi z Europy). Due to such a drastic devaluation of the Króna, living conditions in Iceland became more difficult as prices went up, yet it also resulted in the

[4] One can surely say that protests or demonstrations in Iceland was seen as absolutely the last resort in the average citizen's view. The decision of so many people to protest shows how desperate the nation was during the crisis especially concerning the ruling elites and government behavior.

recovery of the economy mostly based on export and helped in developing a relatively new branch – tourism. Healthy sectors of Icelandic economy were able to help the whole country recover and rebuild the economic potential with the favorable conditions of global markets. More and more tourists started to visit Iceland which was undoubtedly a positive driving force of the post-crisis economy. The fact that the liabilities of three biggest Icelandic banks were 75% denominated in foreign currencies prevented the government from paying off all deposits, since their value greatly exceeded the value of the Guaranty Fund and official reserve assets of *Seðlabanki* (Wajda-Lichy, 199).

In this regard, international aid – such as the loan from the IMF (2.1 billion dollars), also Polish participation (200 millions) for foreign reserve assets and the enormous help from the Nordic countries was indispensable and allowed a substantial amount of money to be pumped into the Icelandic financial system (Background information on Nordic loans to Iceland). Help from the IMF was strictly connected with the reconstruction of the entire financial system of the country that after significant changes had to focus mainly on the internal market. Controlled flow of capital was introduced and became a tool to diminish the effects of the crisis. New banks were established to replace collapsed ones – *New Landsbanki, Arion Banki* and *Islands Banki.* Moreover, a commission to administer the insolvency assets of previous banks was created. The issue of debts of foreign branches was far more complicated.

## Icesave

Icesave was a product of *Landsbanki* between 2006–2008 for both the British and the Netherlands market that offered saving accounts on very favourable conditions (Figure 5). In Britain there were three types of accounts: immediate – access saving accounts, ISA and fixed rate bonds. The interest rate of these accounts was more than 6%, making it one of the best offers for clients in Britain between 2006–2007. At the time of its collapse, Icesave handled more than 300 000 clients in the UK, whose total value of deposits was around 5 billion dollars.

**Figure 5.** Conditions of Icesave accounts in Great Britain

| **Immediate-access savings account** | **ISA** | **FIxed rate savings account** |
|---|---|---|
| High interest rate – **6.30% AER*** | High fixed interest rate – up to **6.76% AER*** | High interest rate – **6.10% AER* (variable)** – what's more, the tax man won't get a penny of your interest |
| We guarantee the AER will beat Base Rate* by at least 0.25% until 1 October 2009 and at least match Base Rate until 1 October 2011 | Save a lump sum for 6 months, 1, 2 or 3 years | We guarantee the AER will beat Base Rate* by at least 0.30% until 31 January 2011 and at least match Base Rate until 31 January 2013 |
| No notice period for withdrawals | Interest rate fixed for the term of the account | No notice period for withdrawals |
| No penalties for withdrawals | Choose when you receive your interest | No notice period for withdrawals |
| Choose to receive your interest monthly or annually | Save from just £1,000 | Choose to receive your interest monthly or annually |
| Start saving with just £250 | No withdrawals or additional deposits can be made during the term | Start saving with just £1,000 and save up to £3,000 each tax year |

Source: Own elaboration, data: http://web.archive.org/web/20080202162406/ www.icesave.co.uk/ savingsrange.html-

*Alþingi* created the *Icesave bill 1* in 2009. It anticipated returning the money to the governments of Britain and the Netherlands, which paid their citizens compensation money (almost 3.9 billion EUR deposited in Icelandic bank). The act was positively voted in *Alþingi* and signed by President Ólafur Ragnar Grímsson in September 2009, yet neither Britain nor the Netherlands agreed to this because of the condition that put a time clause on repayment until 2024 when any remaining liabilities would be automatically cancelled. The second proposal was put forward by the UK and the Netherlands (*Icesave bill 2)*, where the condition of the time clause was removed.

*Alþingi* accepted the bill, yet the President vetoed[5] it leading to a referendum. More than 90% of the voters were against the solution proposed in *bill 2*. The next agreement (*Icesave bill 3*) with the UK and the Netherlands was not signed until December 2010. The new agreement granted favorable repayment terms. The most important change was the lower interest burden. In February 2011, *Alþingi* ratified the agreement, yet once again it was vetoed by the President ,resulting yet again in another referendum in April 2011 (Budyta-Budzyńska, 101). Once again Icelanders voted against the bill, assuming the next generations of tax payers would be burdened with repayments, when they believed the crisis was a result of bad governance in the banking system and of leading politicians. Because of a lack of an agreement, the case was addressed at the European Free Trade Association (EFTA) Court. After *Landsbanki* collapsed, the governments of countries not only demanded the return of receivables for their citizens, but also made the Icelandic State Treasury responsible. Iceland presented a position that during the crisis in 2008,the government did its utmost to make sure that all deposits were returned. "This was made possible by changing the ranking of such claims in the case of the winding up of the banks, securing distributions ahead of general unsecured creditors. This has proven to be a necessary and successful measure as the UK and the Netherlands have already received approximately 50% of their total claims and stand to be paid in full" (Judgment in the Icesave court case due on January 28). The EFTA Court ruling on Icesave, on 28th January 2013, rejected all claims by the EFTA Surveillance Authority. The Court rejected the claim that Iceland has breached the Deposit Guarantee Directive or had discriminated against depositors contrary to EEA law.

Quoting professor Hannes Hólmsteinn Gissurarsson, a lecturer of political science on Háskóli Islands, the only method to overcome the crisis that a small country such as Iceland could afford to fight on their own (Kryzys? Islandia nie ratowała banków, ale uciekła przed widmem Unii). One has to emphasize

[5] Ólafur Ragnar Grímsson was the first president in history, who used his veto power against an act accepted in *Alþingi*. The veto against Icesave bill was the second ever case in Icelandic state history. This shows how important this decision was for the whole society. See more: Pascale J., Olafur Ragnar Grimsson re-elected for a 5th mandate as Head of State in Iceland, 4 May 2015, http://www.robert-schuman.eu/en/eem/1315-olafur-ragnar-grimsson-re-elected-for-a-5th-mandate-as-head-of-state-in-iceland

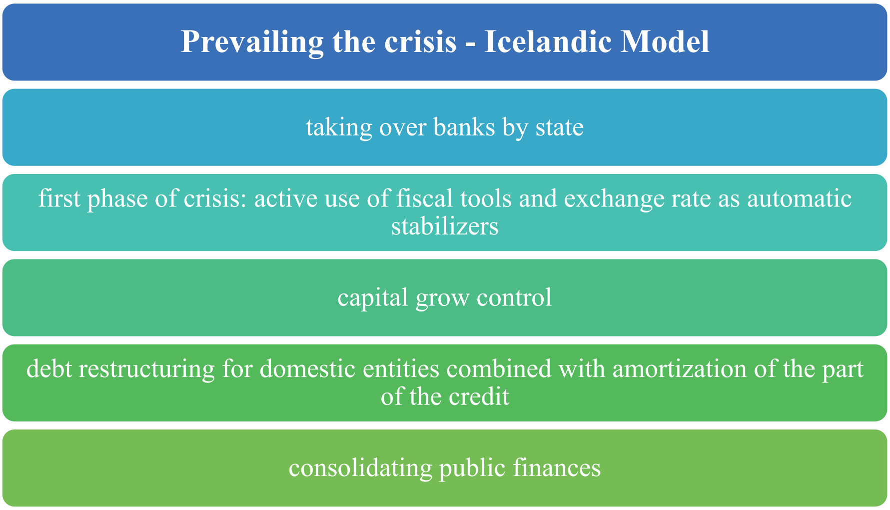
the incredible ability of Icelanders to adapt. This ability was created during centuries of fighting in a harsh climate as well as foreign governance over the island from the 12th century to the 1940s. The qualities of Icelanders such as a national unity against injustice, seen during the years of Danish rule, significantly contributed to the success of Iceland during the later crisis. The nation stood together against corrupt officials, politicians and bankers[6].

## Summary and predictions

The case of Iceland is often cited as a fortunate overcoming of the financial crisis. It is hard to deny that in comparison with other countries such as Greece, the Icelandic model (Figure 6) was a successful solution. From the perspective of seven years since the recession began in Iceland, the steps taken by *Seðlabanki* and the Icelandic government can be judged as a success. The controversial decision of letting the banks' collapse and to be later taken over by the state as well as the use of macroeconomic tools to achieve positive, yet long-term benefits, turned out to be a good remedy for the crisis.

[6] After the crisis many preventive proposals were considered e.g. changing currency (Canadian dollars or euros without joining the EU). The crises revived ongoing discussions about the need of EU membership. The government led by Prime Minister Jóhanna Sigurðardóttir proposed accession to the EU structures. (See more: Legutko A., Europejski wymiar polityki Islandii „Zeszyty Naukowe Skandynawistyki", vol. 3, 2014). On 23rd June 2009 Minister of Foreign Affairs Óskar Skarphéðinsson officially submitted a request to Carl Bildt, President of the EU Council. The case of EU membership after the crisis recovery has become less and less important in public discourse. It seems that after the worst wave of financial crisis had dissipated and the Icelandic economy had started to recover, Icelandic accession to the EU was pushed into the background. In mid-May 2015 Minister of Foreign Affairs of Iceland Gunnar Bragi Sveinsson announced, after consulting with government, that Iceland was no longer interested in becoming a part of the EU. Due to this fact, the government withdrew from accession procedures and requested a suitable act that confirmed the end of the negotiations. The letter was answered by the Latvian Foreign Affairs Ministers, since Latvia held the EU Presidency, and the need of strong co-operation and friendly ties were highlighted (see more: Foreign Ministry: Iceland's EU Application off the Table [2015] 20 May 2015, http://icelandreview.com/news/2015/03/12/foreign-minister-icelands-eu-application-table.

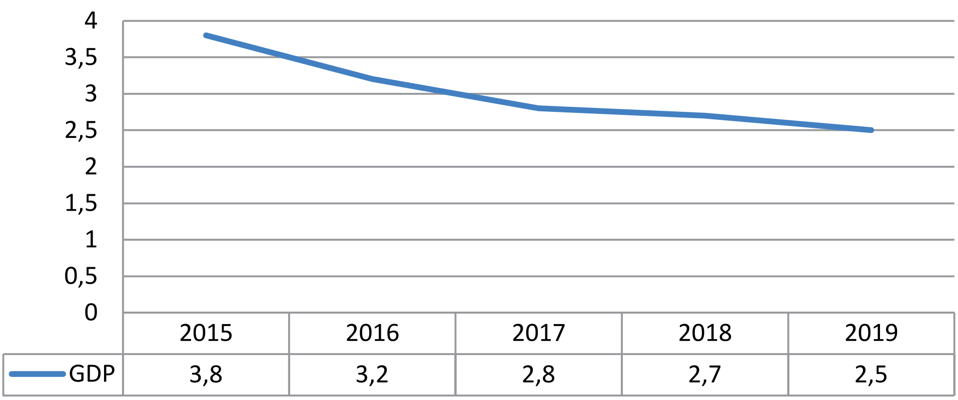
**Figure 6.** Prevailing over the crisis – the Icelandic Model




Source: Own elaboration

The Icelandic Króna has appreciated, inflation and unemployment rate has dropped and the Icelandic economy once again is developing at a stable pace and enjoys good financial health.

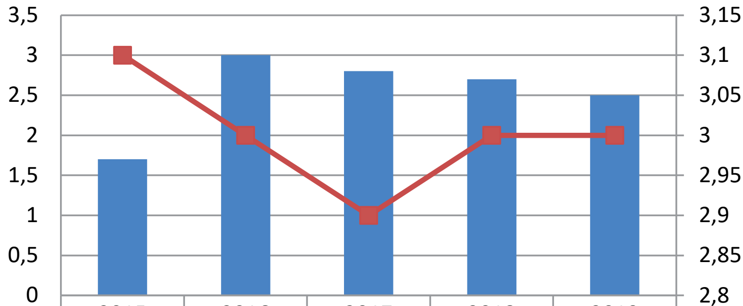
**Figure 7.** GDP growth prediction between 2015–2019




Source: Own elaboration, data: http://www.hagstofa.is/

GDP that in 2009 dropped to -5,1%, in 2014 rose to 1,9%. Unemployment rate that during the crisis was 8%, in 2014 fell to 3.6% and *HagstofaÍslands* forecasts a downward trend in the following years (Figure 7). The inflation rate which was 12.4% in 2008 declined to 2% in 2014. In a five-year period it should not exceed 3% (Figure 8).

**Figure 8.** Unemployment rate and inflation rate prediction between 2015–2019




| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Inflation | 1,7 | 3 | 2,8 | 2,7 | 2,5 |
| Unemployment rate | 3,1 | 3 | 2,9 | 3 | 3 |

Source: Own elaboration, data: http://www.hagstofa.is/

It is worth noting that the loan taken from the IMF was repaid before the set deadline. Undoubtedly, the reason of Icelandic prevailing over the crisis was the fact that the country is small. The importance of this factor is rarely mentioned but Thorhallson underlines of the country's small bureaucracy, leading to a shorter decision making process, faster adaptation to changing conditions in the domestic and global economies. The case of Iceland confirms this thesis. The Icelandic economy adapted fast to the low exchange rate of the Króna, using its competitive advantage in exports and the rapid development of the tourism sector. Drastic and risky steps, including control of capital and the refusal of refunding foreign liabilities, in the Icelandic case was dictated by the enormous scale of obligations that significantly surpassed the financial capabilities of such a small economy. The banking sector just before the crisis exceeded 900% of the state's GDP. One of the reasons, apart from being a small state, that makes the Icelandic strategy unsuitable for other counties was that the depreciation of the exchange rate is impossible to use in the case of the Eurozone countries which do not operate their own currency and carry on commercial activity mostly with other countries of the European Monetary Union. A drop in the value of the Króna has had an impact on the dynamic development of healthy economic sectors such as tourism and exports, allowing Iceland to rapidly overcome the crisis. The solution that was implemented in Iceland in 2008 and 2009 can hardly be seen as a new model to be used in different countries. Such radical moves would not be possible in countries of higher populations and geographical sizes, or which have more developed economic branches, and finally, which are part of the EU, and especially the Eurozone.

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