

## THE SPOKEN WORD APPLIES

### Commemorative speech at the 50<sup>th</sup> anniversary of the Central Bank of Iceland

by  
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Mr. President, Honoured Governor, Ladies and Gentlemen:

Gylfi Þ. Gíslason, Minister of Commerce at the time the Central Bank was founded and one of the chief proponents of Iceland's adaptation to international co-operation and free trade, described the purpose of the newly established Central Bank as being *to conserve and expand the nation's foreign exchange reserves so as to ensure free trade by guaranteeing the availability of foreign currency for external trade, and to "promote Iceland's financial security abroad."*

Throughout history, the financial markets in the West have often experienced overheating and bubbles followed by financial crises, with catastrophic consequences for the real economy, on which the rank and file of humanity bases its survival. Gylfi Þ. Gíslason knew this. This was why he considered safeguarding Iceland's financial security a prerequisite for free external trade. Then, as now, the attempt to ensure both of these – free trade and economic security – was one of the most complex tasks of economic policy in Iceland.

#### I.

The term "the Crash" has followed us ever since the fall of 2008 – and follows us still. To a degree, it no longer refers to the past and to clearly demarcated events. In the minds of many, the word has come to symbolise a persistent bleakness bringing with it the sense that Iceland's misfortune is a vicious cycle of terminal decline.

As we commemorate the Central Bank of Iceland's 50<sup>th</sup> anniversary, many may expect me to take this opportunity to castigate the Bank for its defeats and read out a long register of its sins. And to be sure, the first decade of this century was not the Central Bank's finest hour, nor was it the pinnacle of Icelandic economic policy. But I am not going to take that tack today. The Icelandic nation is faced with the very real danger that public discourse will be steered by righteous accusers who thrive on and feed a hypocritical view of the past that ignores the future, that only understands personal history, that evades collective responsibility and shields itself from understanding what actually happened – and therefore, what is on the horizon.

It is said that the Swedes have not yet reached a consensus on what caused the banking and currency crisis that struck their country in 1992. The Parliamentary Special

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Investigation Commission presented the causes of the failure of Iceland's banks in 68 points, without specifying cause and effect, without international comparison, and without any historical analysis. It is said of Argentina that its banking crisis developed into a lasting political and economic crisis because the people were unable to reach a consensus on how to rise from it. Such divisiveness has many followers in Iceland, and our most important task is to defeat it once and for all. Core institutions – whether they are the Government, Parliament, or the Central Bank – must realise that their duty is to identify Icelanders' collective interests and allow those interests to take precedence in all things.

How can Iceland continue to have an open economy in the global capital markets?

The passage of the new Central Bank Act in 2001 entrusted the Bank with safeguarding financial stability in Iceland, partly because the supervision of deposit institutions and pension funds had been transferred out of the Bank and all financial supervision placed in a single institution. The new Act was the final step in bringing Iceland's financial market into line with the structure in our neighbouring countries. According to a 2001 report compiled by Joseph Stiglitz for the Central Bank of Iceland, on the dangers that could face a small, open economy with free movement of capital, it was important that the Central Bank both have and apply macroprudential tools so as to contain excessive growth or risk-taking in the financial system.

The Central Bank of Iceland's explanation of what went wrong in this regard during the run-up to the crash is fettered by the attempts of the then-current Chairman of the Board of Governors to defend himself and cast blame on others. The Bank's duty is to present a free and critical scholarly assessment of why its assessment of financial stability proved incorrect. The alleged warnings made by the Chairman of the Board of Governors, which were unrecorded and unrelated to any assessment of financial stability, are now the grounds for prosecution of the former Prime Minister. Could such practise, even though it may have been used, have ever been considered legitimate, professional, or befitting the institution?

Assessing financial stability is still the legally mandated role of the Central Bank of Iceland, as it was before 2008, and that assessment must be carried out seriously, steadfastly, and in a professional manner. The question is this: *What is the correct assessment of the financial stability of a small, open economy in unstable global financial markets?* The nation awaits an explicit and impartial answer from its Central Bank.

## II.

The Icelandic economy has changed radically in the 50 years since the Central Bank was founded. At that time, Iceland was still defined as a developing country by the United Nations. Its economy was homogeneous and weather-beaten after decades of spasmodic attempts by the authorities to contain the home-grown spiral of capital controls and current account deficit. Global confidence in Iceland was at a low ebb. Political

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corruption was endemic. Capital from State-owned banks was provided to cronies at bargain-basement rates, and taxes were levied arbitrarily.

It was never possible to achieve significant price or exchange rate stability, probably because the economy was small and susceptible to volatility. The Central Bank's greatest achievement was to bolster confidence in Iceland's economy and economic policy, enhancing the country's creditworthiness and raising its sovereign credit ratings. As a result, it became possible to acquire credit for development projects that benefited Iceland and brought increased prosperity.

By 2003, Iceland's creditworthiness had become a resource – a resource that we overutilised just as we overfished herring at one time. When Iceland's credit ratings had climbed as high as they could, the newly privatised banks took advantage of the situation and sought out unlimited capital for relending, with the disastrous results that we all know so well. But it was not only irresponsible bankers who lost their footing. Politicians were blinded as well by the advantages attached to a good credit rating. The Housing Financing Fund was changed from a mortgage lender that loaned to the public at the lowest possible rates with minimum risk into a financial institution that took on significant operational risk and was unprotected against a run on the market. Municipalities took colossal loans at unbelievably advantageous rates in order to fund projects of varying quality. Many savings banks played the game as well and turned into hedge funds. Tens of thousands of Icelanders borrowed more than was prudent.

### III.

The time has come to put an end to “the Crash.” The premise for economic security is the Central Bank and the Government's renewed campaign for global trust and confidence in the Icelandic economy. That campaign must be based on the main objectives of the Central Bank's operations, those that Gylfi Þ. Gíslason spoke of decades ago – to promote Iceland's financial security abroad and to ensure free trade. Jóhannes Nordal, the first Governor of the Central Bank, often mentioned in his writings the importance of being both a good world citizen and a true Icelander. Never in the history of Iceland's sovereignty has this been as important as it is today.

We must fully understand the interplay between the nation and the multinational structure of the financial markets if we are to protect our own interests. Our assessment of financial stability, of cross-border banking operations, of the premises for an independent currency and an open economy, and the structure of our own economic policy – all these things require new ways of thinking. Economics in Iceland needs the contrapuntal interplay of many voices, not the monophonic drone that resulted in there being not a single economist who warned publicly against the excessive expansion of the banking system, as economics professor Gylfi Zoëga has written in a new book.

We need to rethink a number of things. Money is going to be expensive. We will not be able to rely on cheap credit to fuel a high employment rate or to drive GDP growth in

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Iceland over the next several years. On the contrary: we need new solutions in order to lay sustainable foundations for growth. We need to build a new framework for funding large investments in the Icelandic economy. We must establish strong foundations for healthy investment, domestic and foreign, and increase Icelandic firms' access to foreign investment financing. We must establish a sound financial system that supports the creation of value in the Icelandic economy and permits competitive firms to grow and prosper here.

We must redouble our efforts to improve banking operations in Iceland. Virtually in one fell swoop, the collapse of the króna obliterated most of the equity held by businesses, households, municipalities, and utility companies. We must throw away what is worthless, and banks and others have to recognise lost claims. As long as the banks' annual accounts provide an unrealistic view of their operations, and as long as credit is bottlenecked, there is the risk of a paralytic stagnation in the Icelandic economy. On what grounds do the banks calculate high interest income when revaluing their loan portfolios, when half of the loans are in default? Banks must operate on healthy premises, and the number of jobs in the financial system must be reduced substantially. If this is delayed, an overly large and expensive banking system will suck the strength and resilience out of Iceland's businesses and households.

We have to re-establish a mortgage lending system that enables people to borrow reasonable amounts of money with minimum risk. All mortgages should be pre-financed with bond issues, and it must always be permissible to pay off a mortgage. The newly established banks should be involved in mortgage lending on these sustainable premises, alongside the public sector.

Just a few days before his death, Thor Vilhjálmsson said in an interview that we needed to *"emerge from this craze and stand together, all those whose bodies house a soul,"* and quoted Jóhannes Kjarval: *"People who never lift anything in co-operation will never become a nation."* He added: *"This is of critical importance: Co-operate, become a nation, and work for us as a nation among the nations of the world."*

We are at a turning point. Will we be able to find our way out of the fog – emerge from the craze, as Thor put it? Our task is to create economic stability and a competitive standard of living. And in order to do so, we must be citizens of the world and true Icelanders: We must understand the opportunities that lie in the Icelandic economy, but we must dare to define an international and competitive framework for the economy and create a fitting position for Iceland among the nations of the world. In order to do this, we need a strong and professional Central Bank with an understanding of the past and a clear vision for the future.