

**THE RETURN OF TRUST?
INSTITUTIONS AND THE PUBLIC
AFTER THE ICELANDIC FINANCIAL
CRISIS**

This page intentionally left blank

Emerald Publishing Limited
Howard House, Wagon Lane, Bingley BD16 1WA, UK

First edition 2018

Copyright © 2018 Emerald Publishing Limited

Reprints and permissions service

Contact: permissions@emeraldinsight.com

No part of this book may be reproduced, stored in a retrieval system, transmitted in any form or by any means electronic, mechanical, photocopying, recording or otherwise without either the prior written permission of the publisher or a licence permitting restricted copying issued in the UK by The Copyright Licensing Agency and in the USA by The Copyright Clearance Center. Any opinions expressed in the chapters are those of the authors. Whilst Emerald makes every effort to ensure the quality and accuracy of its content, Emerald makes no representation implied or otherwise, as to the chapters' suitability and application and disclaims any warranties, express or implied, to their use.

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

ISBN: 978-1-78743-348-9 (Print)

ISBN: 978-1-78743-347-2 (Online)

ISBN: 978-1-78743-952-8 (Epub)



ISOQAR certified
Management System,
awarded to Emerald
for adherence to
Environmental
standard
ISO 14001:2004.

Certificate Number 1985
ISO 14001



INVESTOR IN PEOPLE

Contents

Foreword
Guðni Th. Jóhannesson vii

Editors' Introduction
*Throstur Olaf Sigurjonsson, David L. Schwarzkopf and
Murray Bryant* xi

Part I: The Situation

**Chapter 1 Restoring Confidence in the Aftermath
of Iceland's Financial Crisis**
Gyl Zoega 3

**Chapter 2 Discursive Control Using Emotion and
Economics During a Financial Crisis**
David L. Schwarzkopf and Throstur Olaf Sigurjonsson 29

**Chapter 3 Public Trust in Institutions in Pre- and Post-Crisis
Iceland (I): Take the Lift Down, But Use the Stairs Up**
Guðrún Johnsen and Sigurbjörg Sigurgeirsdóttir 53

Chapter 4 Trust: Some Questions from a Layperson
Einar Már Guðmundsson 77

Part II: Responses

**Chapter 5 'Not Just Crying About the Money':
Iceland and Globalisation During Boom and Crisis**
Kristín Loftsdóttir and Már Wolfgang Mixa 87

Chapter 6 Restoring Trust in Iceland: Iceland's IMF Programme <i>Friðrik Már Baldursson and Richard Portes</i>	111
Chapter 7 A Question of Trust: The Story of Reykjavík Energy <i>Guðrún Erla Jónsdóttir</i>	129
Chapter 8 Public Trust in Institutions in Pre- and Post-Crisis Iceland (II): Institutionalised Mistrust <i>Sigurbjörg Sigurgeirsdóttir and Guðrún Johnsen</i>	151
Part III: Moving Forward	
Chapter 9 Have Icelanders Learned Their Lesson? The Investigation of the Icelandic Collapse and its Aftermath <i>Vilhjálmur Árnason</i>	173
Chapter 10 Trust and Financial Services: The Impact of Increasing Digitalisation and the Financial Crisis <i>Andreas Oehler and Stefan Wendt</i>	195
Chapter 11 Post-Crisis Regulation and Supervision of Icelandic Banks <i>Jon Thor Sturluson</i>	213
Chapter 12 Restoring Trust Through Improved Corporate Governance and Adherence to Gender Quotas <i>Audur Arna Arnardóttir and Throstur Olaf Sigurjonsson</i>	227
Chapter 13 Governance Mechanisms Post-Crisis <i>Murray Bryant, Throstur Olaf Sigurjonsson and Már Wolfgang Mixa</i>	245
About the Authors	263
Index	269

Foreword

We call it the Collapse. In the Fall of 2008, in the midst of a global financial crisis, Iceland's banking system fell apart. The effects of the international catastrophe were felt far and wide but we Icelanders were among those who were hit hardest.

Yet it had all looked so promising. In the first years of the new millennium, the banks had expanded manifold. Supremely self-assured Icelandic businessmen (most of the key players were male) swelled in size as well, purchasing hotels and High Street stores, airlines and retail chains. Meanwhile, the public was generally content and unsuspecting. Wages and purchasing power increased substantially. Many people put their savings in money market funds and took out low-interest loans in foreign currencies, trusting the advice given that their investments were secure and that the króna would remain strong.

People trusted the politicians and the entrepreneurs. We seemed to live in a golden age of daring, optimism and self-confidence. Some academics and opinion-givers praised the so-called Icelandic style of dynamic management and quick decision-making. Similarly, the authorities fancied Iceland in all seriousness as an international financial centre, and many bankers and business leaders portrayed themselves as modern-day Vikings and voyagers, daring and courageous, yet conscious of their honour and trustworthiness.

Abroad, the big credit rating agencies were equally upbeat as they awarded Iceland's banks triple-A (AAA) ratings and foreign depositors entrusted the banks with their lifetime savings. The self-assured Icelanders were trusted; the good name of Iceland had become a symbol of trust.

And then it all collapsed. Before, there had been increased overseas warning signs of economic overheating and overexpansion, and concurrent scepticism and suspicion. Foreign governments, institutes and bankers, so happy and gullible before, began to lose faith in all things Icelandic, especially the financial institutions. Both at home and abroad, deposit-holders grew wary. A classic run on the banks ensued. The trust was gone. On the domestic front, the banks were too big to fail but at the

same time too big to be rescued. On the international scene, conversely, the Icelanders were considered too small to be saved, unless they accepted a monitored rescue package to put their house in order.

Instead of an international financial centre, Iceland got international assistance. Pride comes before the fall. As the banks were weakening and then crumbling, hopes for concerted rescue efforts vanished in a panicky haze of finger pointing, self-centredness, distrust and denial. Healthy self-confidence had turned into haughtiness.

Thousands of people lost their savings, loans skyrocketed and unemployment rose sharply. The public took to the streets. Amid flames outside parliament and devoid of trust, the government resigned.

The restoration process began. It centred on trust. A special prosecutor was given the authority to charge bankers and businesspersons and the courts handed out prison sentences. In general, the public felt that the legal system could be trusted. Also, a parliamentary commission investigated the causes of the banking crisis. While international factors were not overlooked, home-grown roots were highlighted, including arrogance and recklessness – the misuse of trust.

In the outside world, the authorities embarked on a faith-building mission, avoiding previous tendencies to highlight the superior qualities of Icelanders in the world of global trade and banking. Furthermore, the collapsed banks were restructured but gone was the notion that they should expand and entice customers abroad. A certain humility was in order.

And we weathered the storm. Almost a decade after the Collapse, the Icelandic economy has recovered. The Icelanders' self-confidence is back as well, buoyed by a tourist boom and the visitors' favourable impressions of the country and its people. Success in international football and other sports has also given us a welcome boost and Iceland is regularly near the top rank of surveys that measure welfare and prosperity, health and happiness. Of course, there is always room for improvement and reforms. Significantly, in one vital field trust is still lacking. So much more than the banks collapsed during those dire days in late 2008. People's faith in politicians, political parties and parliament plummeted. Ever since, as surveys demonstrate, it has remained at a critical low.

It is up to us all at public positions to work towards the restoration of trust in the political system. In that process, people will be measured by their actions. But any judgement must be fair, not spiteful or excessive. Likewise, key players before the Collapse can understandably be blamed for their mistakes and faults. On reflection, however, it was easy to get caught up in the mood of the times – and to explain is not to justify.

Finally, while self-confidence and optimism are welcome virtues, the boom years and the concurrent disaster must teach us the vices of complacency, conceit, falsehood and greed. Then again, this is nothing new. 'The root of all temptations is avarice and greed', wrote pastor Hallgrímur Pétursson in his 17th century *Passion Hymns*. 'He whose words are always fair', said the author of the ancient *Hávamál*, the wisdom of the heathen god Ódin, 'is untrue and not to be trusted'.

Guðni Th. Jóhannesson
President of the Republic of Iceland

This page intentionally left blank

Editors' Introduction

Reykjavík in the autumn of 2007 was an unusual sight for a visitor expecting a somewhat restrained and socially conscientious European capital. Instead of highly efficient automobiles, wary of costing their owners too much in petrol, there were SUVs and Hummers driving down the main shopping fares of Laugavegur and Skólavörðurstígur, with their studded winter tyres thrumming. The coffeehouses were packed with young people fashionably dressed (invariably in black), and on weekends the bars rang out with song from exciting young bands accompanied by less-than-well-tuned patrons, who would continue singing from new hit to old standard to rousing football chant well after the sun had risen. Places that offered a chance to dance were packed – often with young Poles who had come to the country to work on one or another of the large construction projects that relied on Iceland's natural resources. The more sedate had many new restaurants from which to choose, each one's chef competing with new taste combinations and food designs to match the especially chosen serving-ware. And late in the evening over cognac, older couples would discuss with dear friends the value of their respective residences. Could they get one million US dollars? After all, we are in Reykjavík 101, the centre of the city. The sumarhús (summer cottage) could use some improvements, you know. Oh, and did you see our new car? We financed it in Japanese yen – such a better exchange rate, you know.

Those of us in the city in the Fall of 2008 saw a frightening transformation. Our students came to class with their cell phones, checking with spouses or relatives on whether there was anything to procure at the grocery store, because everyone knew that no supplier was extending credit to the stores and so the shelves were growing bare. Breaks in class were times when students would call out to one another the latest króna-to-dollar or króna-to-euro exchange rate, everyone inhaling deeply with the typical Icelandic 'Herna!' ('Well!') as their savings plummeted. The stores whose windows once proclaimed 'Nytt!' ('New!') now said 'Útsala!' ('Clearance!'). Many closed in the coming months.

We, the three co-editors – an Icelander, a Canadian and an American – personally experienced the growth of the Icelandic economy prior to 2008, the crash and the aftermath. We saw our friends, colleagues and students share with their fellow-citizens their feelings of anger, frustration, distrust, disbelief, doubt, personal isolation and loss of national identity.

Now, 10 years on, Iceland is thrumming again. Coaches pull up to full hotels all year long. Whether it is to visit the natural and historic sites near Reykjavik (the 'Golden Circle' of Geysir, Gullfoss and Thingvellir) or to travel away from the city in the hopes of seeing the Northern Lights (really, why else would someone travel to Iceland in winter when there is barely four hours of daylight?), tourism is helping to restore the Icelandic economy.

Of course, in between the crisis (*kreppa*) and the recovery lies a tale. The contributors to this volume are not only some of the storytellers but they have been active participants in helping the nation recover from nearly complete financial collapse. A nation that had been accustomed to being neglected in world news has gone from being the poster-child of the financial crisis of 2008 to an economic phoenix.

So much for what the outside world sees. But within the country, how do things stand? As the reader will learn from the various contributions to this volume, many different players in national institutions – financial, general business, political – had led citizens into a set of beliefs that turned sour. It is no surprise, then, that the public's view of these institutions was less than rosy. In fact, the trust that the public had in most national institutions plummeted even faster than the *króna*.

The question is whether an economic phoenix can also carry with it a renewed public trust. It was with this in mind that we invited contributions to this volume. One can speculate that in a small democratic country, it is perhaps easier to believe that institutions are able to change more quickly than in a large nation. Such a rapid change could suggest that the society emerges from the disaster with a concerted will, a united voice and a renewed spirit. As our contributors note, in some cases, trust has slowly been restored. In others, there is a long way to go, as changes in institutions and structures have been able only to partially remove distrust and restore a sense of the common weal. Many of our authors come to the same conclusion: Trust remains elusive and even once restored, it is neither stable nor universal, and so building trust is always a work in progress.

Let us belabour the obvious: It is not just Iceland that has suffered this change in public reaction to public institutions. What lessons can we learn from one of the first (if not *the* first) nation to experience the financial

crisis, as those responsible for its business and political institutions try to recover the public's trust?

A look through the authors' backgrounds 'About the Authors' will show that we have invited some of the best Icelandic scholars to focus their talents on this situation. Beyond their academic backgrounds, many of the contributors also have been involved in the practical implementation of change over the past decade. Thus, our volume may seem a bit unusual to those expecting a purely academic resource. While the scholarly thinking is sound, we have let our contributors talk freely of their practical experience. In exchange, we as editors have refrained from applying an overly scholarly stratum on top of the various contributions herein. For example, rather than discuss the voluminous literature on trust in this introduction, we are content for the authors to present the most relevant parts of the theory on trust in their articles.

We have, however, endeavoured to provide the reader with a guide through the volume as he or she progresses. We include our summaries of the articles in each section as a preface to that section so that the reader can see the connections we consider important. Our hope is that the intelligent reader, even though not a specialist in financial or political matters, will gain some insights into the relationship between institutions and the public they purport to serve.

The population of Iceland is presently around 330,000 people, with about two-thirds located in or around the capital, Reykjavík. This means that many experienced the collapse as a community. The reader will see that reflected in the chapters within, as our contributors often recount the same historical sequence of rapid growth in financial institutions, early warnings of problems (ignored), banking disaster, parliamentary special investigations, arrests and trials. Many authors continue this sad chronology with such current events as the release of the Panama Papers and even the most recent government collapse in September 2017. We have not tried to reduce any repetition in recounting this timeline, since it is important to hear each contributor's view of the common experience.

A brief introduction to the highlights of Icelandic culture may provide additional context for the reader. We borrow here from observations made in one of the co-editors' earlier works (Arnardóttir & Sigurjónsson, 2017, pp. 78–79). Icelanders' attitudes have grown to represent a balance between their Scandinavian roots and their exposure to US culture via contact with Americans and through American media. In line with Nordic counterparts, the people generally expect power to be more or less evenly distributed in society, meaning also that they expect people to be responsible for the decisions they take. As one can imagine for a

small nation whose inhabitants can trace their ancestry back, thanks to voluminous written records, immediate family and close friends matter greatly. Again, similar to other Nordic peoples, the country shows more of an attitude towards gender equality than is commonly seen in western nations. Other aspects of Icelandic culture show stronger parallels to American views. Icelanders can be stereotyped as risk-taking, pragmatic with an eye towards planning (but willing to adjust plans as needed) and willing to try new ideas. At the same time, there is a respect for tradition and an overall optimistic view of the future.

There remain a few items to point out for one's reading comfort.

We have translated the names of most Icelandic institutions into English – thus, we use *Central Bank* rather than *Seðlabanki*. However, we have allowed authors to use *Althingi* and (Icelandic) *parliament* interchangeably. We point this out for those wanting to look for original sources.

We also have had to decide about matters of Icelandic names and orthography. Most Icelanders are known by a given (first) name and a patronymic, although there was a period when Icelanders could adopt a true surname. Thus, Eirík Sigurðsson's father is Sigurð and Eirík's children would be, say, Vilhjálmur Eiríksson and Erla Eiríksdóttir. This leads Icelanders to alphabetise by first name. We, however, follow the Anglophone tradition of alphabetising in reference lists and such by the patronymic or surname.

We have retained Icelandic letters in all citations and in the titles of Icelandic articles in the reference lists, with the exception of the Icelandic Þ or þ (an unvoiced 'th' sound) in authors' names and in citations. In those instances, we have used 'th'. Throughout, we keep the ð (a voiced 'th'). For the curious, the vowels we have kept in Icelandic are: 'æ' (approximately pronounced as 'eye' in English), á ('ow' as in 'how'); é (roughly an 'a' in 'late'); í (as in 'eel'); ó (as in 'go'); ö (as the German unlaute equivalent, roughly as in 'earth'); and ú (as in 'rule' – the *u* without an accent is the Icelandic equivalent of the German *ü*).

There remains only the pleasant task to thank our authors for their time and energy, not just in providing these chapters but also in contributing towards the return of trust among the Icelandic public. We must also single out for thanks our editor at Emerald Publishing, Eve Hawksworth, for her guidance and patience, and for never losing trust in her occasionally delayed academic colleagues.

Throstur Olaf Sigurjonsson, David L. Schwarzkopf and Murray Bryant

Reference

- Arnardóttir, A. A., & Sigurjónsson, Th. O. (2017). Gender diversity on boards in Iceland: Pathway to gender quota law following a financial crisis. In C. Seirstad, P. Gabaldon, & H. Mensi-Klarbach (Eds.), *Gender diversity in the boardroom. Vol. 1: The use of different quota regulations* (pp. 75–102). Basingstoke: Palgrave Macmillan.