



LESSONS FROM ICELAND

A Speech

by

the President of Iceland

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Distinguished guests
Ladies and gentlemen

It is a profound honour and a great pleasure for me to address you, such a challenging and stimulating gathering, here tonight at this splendid dinner, and to attempt to illustrate the lessons which can be drawn from the experiences of my country.

Undoubtedly most of you are thinking of the financial crisis, the collapse of the major banks and the economic difficulties which we faced two years ago, but are now gradually overcoming, faster and perhaps more effectively than other countries in Europe and certainly more effectively than most people, ourselves included, expected two years ago.

But there are also other lessons which Iceland can offer: Lessons showing how to achieve a clean energy transformation, to move, as we have done, from being over 80% dependent on imported oil and coal in my youth to having, as we have had now for decades, 100% of our electricity and space heating derived from clean energy resources, geothermal and hydro. This represents a clean energy revolution which has in recent times served as a major contribution to our economic recovery.

Thus, I hope to link financial and economic prosperity to clean energy achievements. However, I must also bring in the lessons which

were suddenly and alarmingly brought home to Europe last year by the volcanic eruption in Eyjafjallajökull, an easy Icelandic word which the world could not pronounce; when 500 tons of ash and volcanic rocks were thrown into the air every second, every hour for many days; yes, 500 tons every second; a reminder that we are not yet, and never will be, the masters of the universe.

But first let me turn to the financial and banking crisis. When Iceland joined the European Economic Area in 1994, we were brought into the legal and regulatory framework of European Union directives providing for the free movement of capital. The EEA agreement made it possible for Icelandic banks to operate freely across European borders. Their licences were not limited to Iceland but included all countries in the Union. They were given a European passport.

The banks had their headquarters in Reykjavík, but expanded their activities abroad by acquiring financial institutions in other countries, opening up branches, and stepping up their foreign operations. This phenomenal growth was made far easier by Iceland's EEA membership. In the last year of their operations, the majority of the banks' activities and their balance sheet figures were in other European countries.

When they collapsed in the autumn of 2008, it brought home the failure of the monitoring and the regulatory system, not only in Iceland but also in the European Union, in the countries where the banks had operated.

Thus the first lesson is that it is difficult, if not impossible, in the long run, to let a pan-European financial market function freely without an effective pan-European regulatory system. We cannot rely on national institutions fully to control a system which has, in effect, become wholly European, operating within a globalized world.

The second lesson is how old-fashioned the regulatory system was, compared with the fast-speed computer-driven high-tech IT nature of modern banking. The core of the now famous Icesave dispute between Iceland, the UK and the Netherlands was that the bosses at the bank in Iceland, Landsbanki, simply asked their computer boys in downtown Reykjavík to design an internet banking system aimed at other countries. Without much ado they started, with great success, gathering new customers in both the UK and the Netherlands, over the internet. The authorities in our three countries did not fully comprehend the scope and speed of the new high-tech banking. This experience demonstrates the need to examine fully the link between technical developments and the future of banking; an issue which has up to now not been sufficiently addressed in either Europe or the United States.

The third lesson relates to the benefit of a single currency versus a currency shared by many countries, like the Euro. The Icelandic experience highlights how difficult it was to build an international banking system on the basis of a small national currency. However, the economic adjustment of the Icelandic economy in the last two years has clearly been facilitated by our independent currency. Thus the Krona, which before was a part of the problem, has now become a part of the solution. The devaluation of our currency has significantly strengthened our export sectors, the fishing sector, the energy sector, the industrial sector, the IT sector and of course the tourist sector, making 2009 and 2010 the best years ever for tourism in Iceland, a significant achievement compared, for example, with the great difficulties now faced by tourism in Southern Europe.

The fourth lesson is that policies of financial stability focused too much on individual institutions and too little on the risk involved in the financial sector as a whole. It is imperative, both at the European and the global level, to develop monitoring of the possibility of comprehensive system breakdowns. We saw in Iceland how the banking sector collapsed in a few days and in parts of Europe and the United States it was indeed a close call.

The fifth lesson is not to be led astray by the so called “hype economy”; not to neglect the fundamental qualities of the export-driven productive sectors; not to be fooled by the false promises of financial institutions, by their big bonuses, executive lifestyles and their successful propaganda machines. In the long run it is what we produce, not what we can hype, that will be the basis of our lasting prosperity.

The Icelandic banks became so big that they prevented the creative sectors from realizing their own growth potential. They hired engineers, software and IT specialists, designers, artists, writers, musicians, thinkers and many others, attracting them with high salaries and big bonuses.

The sixth lesson from Iceland is the interesting phenomena that when the banks collapsed a wealth of talent suddenly became available to a multitude of creative companies, to new start-ups, IT companies, creative sectors, which in the last two years have consequently enjoyed a successful growth period. The failure of the banks led to a great boost for the creative side of our economy. Big banks are therefore bad news for countries which want to excel in the 21st century competition of creativity.

The seventh lesson is the danger involved in creating a system of banking which privatises the profits but nationalises the losses. The stance taken by the UK and the Netherlands in the Icesave dispute, and

supported by their EU partners, implied that the farmers and the fishermen in my country, the teachers and nurses, the industrial workers and others were being asked to shoulder, through their future taxes, the losses created by irresponsible private bankers. That is neither fair nor wise. If in the future the bankers can take great risks outside their own country knowing that if they succeed, they themselves and their shareholders will benefit tremendously but if they fail, the bill will simply be sent to the taxpayers back home, this will be a formula for failure and can lead to utter disasters.

The weakness of the British and the Dutch case against Iceland in the Icesave dispute was that the Governments of those two countries were in fact advocating such a system, which at its core is absolutely contrary to the essence of the European free-market structure.

The eighth lesson involves the consequences of losing our memory of history and believing, as most of us did over the last 20-30 years, that somehow the western world had found a magic formula for eternal non-stop growth, forgetting that the essence of capitalism lies in failures and collapses regularly occurring and the system restoring its balance in due course.

The ninth lesson brings us to the link between economic recovery and clean energy transformation. I come from a country where the capital city gained its name, Reykjavík, from the geothermal steam which took the early settlers by surprise; it was a phenomenon which was completely unknown to the Nordic Vikings who settled on the island more than a thousand years ago.

For ten centuries, our only use of geothermal power was for washing clothes and relaxing by sitting in the warm springs created by natural conditions. Even up to the early years of my parents' life, these were the only benefits we derived from our geothermal resources.

Then, between the World Wars, and especially in the second half of the 20th century, new technologies and engineering endeavours enabled Iceland, first, to replace coal and oil with geothermal energy for space heating, and then to power turbines and ultimately sell geothermally-generated electricity to aluminium smelters and data storage centers. Thanks also to hydropower, Iceland thus became the paramount clean-energy country in the world, with all our electricity and space heating provided by green energy resources. In addition, the geothermal sector has been the foundation of extensive greenhouse cultivation and fish farming, of world-famous tourist locations like the Blue Lagoon, of spas, healthier lifestyles and the production of cosmetics.

Clean energy has helped Iceland to survive the recent banking shock, especially because the cost of heating and electricity for ordinary people, families, homes and business companies is only a small proportion of what it is in other European countries. But also because our clean energy resources make Iceland a very attractive location for industrial investment, and will do so even more in the coming years: for aluminium smelters, data-storage centres, high-tech industries and other profitable enterprises.

The scale of the national savings resulting from geothermal space heating alone is demonstrated by the fact that every decade, Iceland saves what amounts to one year's GNP by not having to import oil and coal to heat its houses.

There are over 100 countries in the world which could similarly benefit from their geothermal resources, many of them in Europe, yet somehow, the great geothermal potential has been the forgotten secret of the European energy debate.

We should all remember that the fireball inside the earth which we learn about in school is under our feet in every country, every continent. Due to modern drilling technologies we can now get through the top layer and harness the enormous heat inside the earth.

Yes, Mother Earth holds many promises as well as surprises and the Eyjafjallajökull eruption last April was a reminder of her power, that despite all the technological and the scientific achievements, we are not yet the masters of the universe and will never be. It is not a question of whether similar occurrences will happen in the future; it is only a question of the scale, and of the consequences and how to deal with them.

If we look at Icelandic history, we find that our annals are full of descriptions of how volcanic eruptions in previous centuries led to what people at that time considered almost the end of the world, describing how darkness suddenly fell across large areas, whole valleys and regions.

So the Eyjafjallajökull eruption offers us the last two lessons which I bring you here tonight.

The tenth lesson: The Earth is still young; creation is still going on; volcanic eruptions will happen; we are not the masters of the universe.

And the eleventh lesson: We now live in an interdependent world in which we need to cooperate at every level of our societies in order to succeed, to be prosperous and safe.

The positive side of what occurred following the eruption in Iceland last year was that we saw millions of people, ordinary people, reacting to this crisis in a relaxed, orderly and responsible way. The crisis did not create the kind of pressure we would have expected if, in a workshop, we had tried to predict what would happen if air traffic over Europe suddenly stopped completely for a whole week.

This is very encouraging, and on a lighter note it may have been an interesting experience for some of my colleagues to be, so to speak, humanised by this eruption. For example my friend, the President of Estonia, described how he was in Istanbul and couldn't get back to his country by air, so he had to drive all the way from Turkey up to Estonia. Even the Chancellor of Germany had to fly from her summit in Washington, first to Madrid, then to Rome and then drive all the way from Rome to Berlin. The first time in the history of the German Republic, the Chancellor had to travel in such a way.

In that sense it was a very democratic eruption. Everybody was affected in the same way, whether they were young students, top executives or political leaders. Such an experience has a value in itself. It reminds us that we are all passengers on the same human journey.

But Iceland is not just the home of volcanoes. We are also the home of the largest glaciers in Europe, and our scientific community has demonstrated how they are melting and retreating – at an accelerating rate. It is predicted that in the early part of the next century, all or most of them will have completely disappeared.

The pressure which the glaciers put on the surface of the earth has kept the volcanoes from erupting as frequently as they otherwise would. In some of our locations the process of climate change will therefore increase the frequency of volcanic eruptions, which may produce more ash clouds of the kind which Europe felt so acutely last year.

All these elements which have served as the basis of my lessons here tonight demonstrate how interdependent we have become, that the solutions must be our common task, that we live in a single and shared world.

But the lessons Iceland can offer also demonstrate that we can indeed recover from crises. Through determined efforts, execution of comprehensive legal reforms and changes in economic policies, we are again stabilising the Icelandic economy. Exports are strong, inflation is down to 2%, unemployment is around 7%, high by our traditional standards but relatively low compared with the European situation; economic growth is expected to resume shortly.

We are now set on a better course, wiser from the experience, matured by the challenges and determined to share our lessons with others.

Therefore it has been both a pleasure and a privilege for Dorrit and me to be with you here tonight.