

Gordon Brown spills the beans on the IMF: Make Iceland pay for Incompetent British Bank Deregulation

Mán, 11/05/2009 - 00:00 | [Michael Hudson](#)

Last month the G-20 authorized the International Monetary Fund to increase its loan resources to \$1 trillion. It's not hard to see why. Weakening currencies in the post-Soviet states threaten to raise default rates on foreign-currency mortgages as collapse of the Baltic real estate bubble drags down Swedish banks, while the Hungarian property plunge threatens Austrian banks. It seems reasonable to infer that creditor-nation banks hope to be bailed out. The IMF is expected to lend the Baltic, central European and other debtor-country governments money to pay them. These hapless debtor economies are then to follow IMF "conditionalities" to squeeze enough money out of their populations to pay foreign creditors - and repay the Fund by imposing yet more onerous taxes on their labor and industry, making them even more high-cost and therefore pushing them even further into trade and credit dependency. This is why there have been so many riots recently in Latvia, Lithuania, Estonia and Ukraine, as was the case for so many decades throughout the Latin American countries that introduced the term "IMF riot" to the global vocabulary.

For fifty years the IMF has organized such payouts to creditor nations. Loans are made to debtor-country governments to "promote exchange-rate and price stability." In practice this means pouring tens of billions of dollars into currency markets to make bad gambles against raiders. This is supposed to avert the beggar-my-neighbor nationalism and financial protectionism that aggravated depression in the 1930s. But the practical effect of IMF lending is to demand that debtor countries impose onerous IMF "conditionalities" that stifle their domestic markets. This is why the IMF was left with almost no customers until last year's debt crisis deranged the world's foreign exchange markets.

It is supposed to be merely incidental that the largest IMF shareholders, the United States and Britain, happen to be the major creditor nations and their banks the main beneficiaries of IMF loans. But in a Parliamentary question-and-answer session on May 6, Britain's Prime Minister Gordon Brown spilled the beans. Under pressure for his notorious "light-touch regulation" as Chancellor of the Exchequer (1997-2007), he undid half a century of rhetorical pretense by announcing that he was pressuring the IMF to bail out Britain in its nasty dispute with the Icelandic owners of a British bank that went under. He was in a position to know the nitty-gritty of who owed what and which nation's monetary authorities were responsible for which banks. So when he said that he was strong-arming the IMF and other organizations to force Iceland's government to pay for his own government's mistakes, he must have known this was breaking the unwritten law of pretending that the IMF is not the servant of creditor nations in bilateral disputes with smaller economies.

Here's the background. Mr. Brown and his New Labour predecessor Tony Blair have saddled British taxpayers with a generation of payments to pay for their decade of deregulating London's financial sector. Bad mortgage lending led to the failure first of Northern Rock and then the Royal Bank of Scotland, whose ambitious junk-mortgage program had made it the world's largest bank. At \$3.8 trillion before it collapsed, it was nearly twice the size of Britain's \$2.1 trillion gross domestic product (GDP). (For a review of New Labour's deregulatory policies see Philip Augar, *Chasing Alpha: How Reckless Growth and Unchecked Ambition Ruined the City's Golden Decade* [2009].) So one can understand why Mr. Brown was flailing around to blame someone for New Labour's "Don't see, don't ask" policy.

Last autumn one of Iceland's most reckless banks, Landsbanki, announced that it had made so many bad gambles that its loans and investments could not cover what it owed its depositors. It had drawn many deposits from abroad by setting up foreign branches, including Icesave in Britain. And in a striking variation from normal practice, these branches were not incorporated as separate affiliates, which would have led them to be regulated by local British authorities. As branches of the Icelandic head office, Icesave was regulated only by Icelandic authorities - which were as thoroughly neoliberalized as those of Britain, and didn't really have a clue as to what was going on.

When Icesave went broke in October, British monetary authorities panicked. Mr. Brown sought above all to prevent its owner, Landsbanki, from doing what Lehman Brothers had just done on Sept. 14 when its New York office emptied out the funds in the account of its London affiliate just before the U.S. firm declared bankruptcy. Trying to grab whatever Icelandic assets he could, Mr. Brown overreacted (hardly a new experience for him). Responding far beyond Icesave itself, he resorted to anti-terrorist legislation passed in 2001 in the wake of the 9/11 attack on New York's World Trade Center to freeze Icesave's accounts - and also those of other banks in Britain owned by Iceland. Evidently he thought that classifying his peaceful NATO partner as a terrorist economy would panic its government into paying. But the effect was to cause a run on Iceland's currency, making payment impossible. The króna entered a period of freefall on foreign exchange markets.

Mr. Brown's bellicose behavior escalated as Britain's own currency sank. This set the stage for his explosion last Wednesday when he explained how he intended to make Iceland pay, not only for Icesave but also for Kaupthing S&F, for which the British authorities were responsible in the case of depositors who had lost money. Unlike the unfortunate IceSave (administered as a branch of Iceland's Landsbanki and hence subject to Icelandic regulatory authority), Kaupthing S&F is incorporated as a distinct British affiliate, and regulated and insured as such. The UK authorities accordingly have not claimed that Iceland's government has any obligations to reimburse British depositors who have lost money. Yet when asked about the "£6 million that the Christie hospital [in Manchester] stands to lose in the Icelandic bank Kaupthing," central banker Brown pretended that Kaupthing was not a British bank overseen by domestic deposit insurance authorities. "The fact is that we are not the regulatory authority and that many, many more people had finances in institutions regulated by the Icelandic authorities," he insisted before Parliament. "The first responsibility is for the Icelandic authorities to pay up, which is why we are in negotiations with the International Monetary Fund and other organisations about the rate at which Iceland can repay the losses that they are responsible for."

This naturally has prompted Icelanders to ask British authorities just which "other institutions" they may be talking to, and what they may be hoping to gain. The IMF's representative in Iceland, Franek Rozwadowski, was quick to explain to the Icelandic newspaper *Fréttablaðið* that it was not the IMF's role to intervene in "a bilateral matter that needs to be resolved bilaterally." But fears remain that Iceland's government will be pressured to squeeze out money from the economy to reimburse foreign speculators on the winning end of the many bad gambles that Iceland's banks made before being de-privatized.

Such fears are aggravated by the worry that Mr. Brown may have found help from a fifth column within Iceland itself. After the bank crisis last autumn, the Independence Party fell, and its coalition partner for the last six years, the Social Democrats, took charge of the administration. The government divided the failed Icelandic banks into "good" and "bad" parts so as to save what could be salvaged for Icelandic depositors to back their deposits (the "good" bank). The government then commissioned two British accounting firms to survey the loan portfolios of Landsbanki and Kaupthing to evaluate their assets at "fair value." But much as the U.S. stress test surrendered to the banking system's insistence on blue-sky optimism regarding what will be left over on high-risk loans and gambles, so the Icelandic contract defined "fair value" as it would exist if the global financial collapse was completely reversed and everything went back to normal as if nothing had happened. Under this assumption the good and bad bank assets would be worth much more than is the case under today's real-world conditions. This dangerously over-states the net worth of Iceland's failed banks.

It was dangerous to retain firms closely associated with major clients - and hence, their source of future business - that include the parties with whom Iceland's government stands in a potential adversarial relationship. Another problem is political pressure for a cover-up on the part of the vested Icelandic interests that had engaged in reckless behavior, and perhaps crooked self-dealing via foreign transactions.

In any event, the report was not made public on its scheduled date in mid-April, which was supposed to be just prior to the national elections on April 25. When a report on major bankruptcy by political insiders is not released on the promised date before a major election, one naturally suspects political pressure at work. Yet despite the financial crisis that plunged most Icelanders into a debt-strapped

condition, the election turned mainly on political factors. The Social Democrats advocated joining the European Union and adopting the euro, hoping that this in itself may lead to domestic economic reform. The Left-Green coalition opposed giving up Icelandic political and economic sovereignty and pressed for domestic reform, as did the centrist Progressive Party. As for the Independence Party, it was swamped by one scandal after another concerning election financing, insider crony dealing and the usual array of dirty neoliberal political practices.

All this occurred in an economy structured to be a creditor paradise - that is, a debtor's hell. On top of normal mortgage interest, Icelandic personal and real estate debts are subject to indexation of the principal to reflect the consumer price index - which in turn mirrors the fall in the króna's exchange rate, about 20% over the past year. This means that if someone bought a house for the equivalent of \$100,000 a year ago with a 100% mortgage, the debt would now have risen to \$120,000. But the collapse of Iceland's economy has sent unemployment soaring and business crashing, so real estate prices have fallen by about 25%. The former \$100,000 house would now have a market value of only \$75,000 - just 62% of its re-indexed \$120,000 mortgage, some \$45,000 in negative equity.

The situation actually is about to get much worse in the near future. The US\$ is currently at 125 krónur (IKR), down from 62 at yearend-2007 - a 100% increase. (For the euro, the increase over the same period is 85%.) Iceland's banks have linked many business loans, as well as auto loans and other debts to a market basket of foreign currencies, on the logic that they themselves have had to obtain money by borrowing yen, euros, sterling or dollars. Although these loans are denominated in krónur, their payment is indexed, so the effect is similar to denominating loans in foreign currency. Many loans are still benefiting from the moratorium placed on re-indexing the principal when the crisis hit last autumn, but many loans are about to be reset. Icelandic debtors who borrowed in the belief that the IKR was as stable as the dollar are now paying the price for their optimism - an optimism fed by the banks' marketing departments, which depicted these indexing arrangements simply as an accounting formality! Business debts are especially at risk.

This shows how urgently Iceland needs to straighten out its banking mess and restructure the economy to free the population from the unique debt squeeze its laws and a decade of neoliberal mismanagement have created. Now that the banks have been de-privatized and taken back into the public domain, credit needs to be turned back into what it was before - a public utility. But this cannot be organized without knowing how much can be recovered from the failed banks to back domestic depositors. And the reports from the British accounting consultancy firms still have not been made public. Only the major creditors have received copies!

Remarkably, the government said last week that they might not be released at all. The inference is that the crooked dealing has been so damning to vested Icelandic interests that it would cause a new political crisis to resolve the deepening economic crisis. The fear is that a sweetheart deal has been made with the kleptocrats whose reckless behavior (and it seems probable, illegitimate bank maneuverings with offshore accounts) plunged the economy into negative equity in the first place. The better the financial health of the failed banks appears on paper, the more presumably will be left over to pay foreigners - including the offshore accounts of the banks' former owners in their own dealings with the banks. So from the vantage point of Icelandic depositors and debtors to these banks, a realistic pessimistic estimate of the banks' position would protect them, while an unrealistic optimism would enable foreigners to siphon off much more money, leaving less for Iceland.

In fact, the IMF has failed to oblige Iceland's government to conform to the Letter of Intent it signed on November 15, 2008. This letter obliged Iceland to "bring loan values in line with expected market values" (#4), and to "include an assessment of whether or not managers and major shareholders have mismanaged or abused the banks" (#6). No such assessment has been made, and as described above, loan values are exceeding market values by a rising degree as property, businesses and households fall into negative equity status.

The Icelandic government's agreement with the IMF promised to make the bank assessments public upon their completion "by end-march 2009" (#10). This has not been done - perhaps (one worries) because the next sentence says that the government "will discuss in advance with IMF staff any changes to the adopted strategy." In view of the secrecy that now shrouds the events that pushed the banks under, one can only wonder at what developments have prompted the government and

IMF to change strategy.

What the IMF did demand - as it always does - is that once the government bails out the bankers for their bad loans, the whole privatization process is to start all over again, paving the groundwork for yet new rip-offs. In view of the fact that "the banking crisis will significantly constrain the public sector and burden the public for years to come" as the government pays off bad loans (#12), the agreement pledges (#14) that "A significant reduction in government debt through the sale of the government's stake in the new banks could help reduce the needed fiscal adjustment over the medium term."

Belatedly, the population is now up in arms - two weeks after the election! To stabilize the currency, Iceland has agreed to IMF conditionalities that prevent the government from pursuing the counter-cyclical Keynesian fiscal policy that Mr. Obama is leading in the United States. Unless the debt pressure is alleviated, Icelandic homeowners and businesses will be obliged to run down their savings each month until they are depleted - at which time they will lose their homes and forfeit their businesses to foreclosing creditors.

So on Saturday afternoon, May 9, a "pots and pans" protest was conducted outside of Iceland's Parliament in Reykjavik. The scenario is much like that of the color revolutions staged by U.S. neoliberals throughout the post-Soviet states. But Iceland's kitchen-utensil revolution is organized as a protest against neoliberal policies. The protesters have picked up the thread where it left off last October a similar set of protests dislodged the Independence Party from power. The National Labor Association has broken from the new Social Democratic coalition government, reflecting the growing anger among Icelanders at their debt squeeze.

Mr. Brown's statement that he intends to use IMF leverage to deepen Iceland's debt position by forcing its government to bail out British depositors has rubbed salt in this wound - precisely by demanding for his country what Icelanders are not receiving from their government! Its citizens want to know what pressure the country is responding to if it intends to put the interest of foreigners before their own. This double standard has motivated the population to act in a more confrontational way than would have occurred had the problem been merely domestic. Icelanders want to be told the magnitude of the financial problem - and apparent dishonesty and crony dealings - that the government is keeping secret. The answer may at long last move Iceland out of its post-feudal oligarchy. Its neoliberal privatizations and pro-financial policies may turn out not to be as entrenched and irreversible as the kleptocrats had hoped would be the case.

Counterpunch.org 5 may 2009

- [English](#)
- [Iceland](#)

Gordon Brown spills the beans on the IMF: Make Iceland pay for Incompetent British Bank

Published on Attac á Íslandi (<http://www.attac.is>)

Source URL:

<http://www.attac.is/greinar/gordon-brown-spills-beans-imf-make-iceland-pay-incompetent-british-bank-deregulation>