Iceland illustrates why political ‘hectoring’ from foreign countries is bound to fail in Greece

8/19/2015

Iceland entered a period of financial crisis in 2008, with the country subsequently involved in a prolonged dispute over losses generated in the Netherlands and the UK by an Icelandic bank. **Jon Danielsson** *writes that the crisis in Iceland has much in common with the ongoing crisis in Greece, not least the heavy pressure exerted on both countries by foreign governments. He argues that just as in Iceland, this pressure has been counterproductive in Greece, hardening opposition to any potential settlement.*

In observing what has been happening in Greece, I am struck by many parallels with the Icelandic crisis. The two crises demonstrate that the commonalities in crisis tend to be bigger than the differences. Leaving the economics aside, here I want to focus on the political and international relations aspects, and in particular how the Icelandic Icesave dispute has many echoes in how the Greek crisis is playing out and the impact of subjecting debt agreements to referenda.

A brief background to the Icesave dispute

I have discussed this before, so here is just a brief synopsis. An Icelandic bank, regulated and deposit insured in Iceland, when rejected by professional creditors in 2007 opted to get funding by opening online branches in Britain and the Netherlands, under the name of Icesave. It was quite successful, not least because it offered above market interest rates.

Credit: Ben Bodien (CC-BY-SA-3.0)

However, ultimately the professionals proved right and the bank failed in October 2008. This was at the height of the Global Crisis, and the UK and Dutch authorities opted to unilaterally bail out Icesave’s retail depositors, motivated by a desire to prevent even more disruption to financial markets.

After spending €3.9 billion on the bailout, the British and Dutch tried to claim the money back from the Icelandic deposit insurance fund. They found it lacking and hence wanted the Icelandic government to repay them instead. It hesitated, after all this amounted to 42 per cent of GDP and a sovereign default was looming.

However, the legal case was always uncertain and when the case was ultimately decided by international courts, it ruled in Iceland’s favour. Ultimately, it turned out to be a storm in a teacup, the estate of Icesave had more than enough money to make everybody whole. The British and the Dutch governments even profited from the whole thing.

Dictating an Icesave deal

The government of Iceland initially accepted the British and the Dutch claims and assembled a team to negotiate the terms. They were heavily outgunned. At the time, I likened this to Iceland sending my local first division football team, Grotta, to play against Manchester United. The Icelanders soon realised that the agreement was lacking and that its authorities were less than competent in their negotiations with the foreign powers. Opposition to the Icesave agreement started to build and an acrimonious debate started, both domestically and with the outside world.

At the time, Iceland came under very strong pressure from every relevant government to give in. Trade sanctions were threatened, the IMF held up its aid package to force Iceland to accept the claim, and Iceland's main international friend, Norway, took on the role of main enforcer. The Icelanders got the impression that they stood alone against the world, with Poland being the only country offering support. In the debate, Britain kept a very low profile; I do not recall any of its politicians commenting on Icesave publicly.

It was different in the Netherlands where Icesave became a major political issue. Two men stand out – the foreign minister, Maxime Verhagen, and the finance minister, Wouter Bos. Both frequently commented on Icesave, threatening Iceland if it did not pay back the Icesave money. Their domestic comments were immediately translated into Icelandic, influencing public opinion. At the time, Iceland was negotiating with the EU for membership and Mr Verhagen linked membership to Iceland accepting the Icesave obligations. The Dutch officials were joined by political leaders from across Europe. Still, all this public hectoring was counterproductive.

There were several reasons for this. The pressure and public exhortations were perceived as unreasonable. The Icelanders thought that the Dutch authorities were equally responsible; after all, they had been repeatedly warned against allowing the Icesave bank to start operations. They worried that adding on a foreign currency debt of 42 per cent of GDP might trigger a sovereign default. Ultimately, the Icelanders bristled at being dictated to by hectoring foreign officials.

The desire for reform needs to come from within

So what does this have to do with Greece? The parallel is in how the international community pressured Iceland to give in and how the Icelanders reacted to the pressure. Greece has been under continuous and very public pressure to reform its economy. Leaving aside the question of whether these reforms are needed, all the public hectoring seems to be quite counterproductive at least in terms of voter perceptions.

In their dealings with Greece, the foreign authorities have repeatedly and loudly told the Greek people they have to reform, that their way of doing things is wrong and that the way of the foreigners is right. I don't think this will work, and the recent referendum clearly suggests that voters would like to take an even harder line than their current leaders. This has ominous implications for the next election. After all, the Greek economy was collapsing when the troika was being obeyed. Leaving aside the question of whether there is causality, the voters certainly did see one.

Referenda

Iceland has another factor in common with Greece – they are the only two countries that have subjected sovereign debt settlements to a referendum, as analysed recently by Amber Curtis, Joseph Jupille and David Leblang. They argue that while the vote was supposedly about economics and Europe, it really was about domestic politics and the attitude of the voters toward the government. The outcomes therefore signal the political direction of the countries.

In addition, attitudes towards national sovereignty played a key role in both countries. Nationalists were more likely to say "no", and the pro-European cosmopolitans "yes". One long-term consequence of the Icesave dispute has been the hardening of Iceland's anti-European and isolationist views. And in the subsequent national elections, the Icelanders voted in parties that had campaigned against both the Icesave deal and EU membership, including a prime minister who built his career on the "no" vote.

One important difference between the Icelandic and Greek referendums is that in the former case, the question was clear and so were the consequences. In the Greek case that is not so, and this reflects the differences in the outcome – 61 per cent of Greeks said no, and over 90 per cent of Icelanders.

Conclusion

The lesson from Iceland is that the population will instinctively reject foreign pressure. It doesn't matter whether it is sensible or not, so long as it is imposed, it will be resisted.

If the Greeks don't want to reform their economy, the foreign authorities wanting that for them will be disabused. The hectoring by foreign officials, who are addressing their own voters as much as the Greeks, is likely to be counterproductive. At the end of the day, the will to reform needs to come from within, and the sooner the Troika realises this, the easier it will be to deal with the Greek situation.

Please read our comments policy before commenting.

Note: This article originally appeared at Vox. It gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.

Shortened URL for this post: **http://bit.ly/1KuJUT9**

About the author

Jon Danielsson – *LSE Department of Finance / Systemic Risk Centre*

Jon Danielsson is Associate Professor in Finance at the LSE's Department of Finance and Director of the LSE's Systemic Risk Centre. His research interests include financial risk modelling, regulation of financial markets, models of extreme market movements, market liquidity, and financial crisis. He has published extensively in both academic and practitioner journals, and has presented his work in a number of universities, public institutions, and private firms.

-