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Globalisation taketh away!

T.K. JAYARAMAN

November 2008 is truly a remarkable month.

It witnessed the historic election of a non-white to the highest office in the United States. Secondly, there was seismic shift in global hegemony signifying the end of world dominance by seven rich countries and European Union, when they held the G-20 summit.

One more record was made on November 20 when IMF approved a loan for a Western European nation, for the first time, since 1976.

Normally, such loans in the past three decades were for the third world countries.

Industrialized countries were ever ready to preach on monetary, fiscal and exchange rate management matters to the rest of the world.

This time the dubious distinction fell on Iceland, geographically very near to UK, whose financial sharks were also equally responsible.

The two-year IMF loan of US$ 2.1 billion is for “restoring confidence and stabilizing the economy of Iceland.”

There are other European nations including Ukraine, Hungary and Turkey, in the waiting list of IMF borrowers, beside Pakistan in the third world.

Globalisation: leveler like death!

Strangely enough, Iceland’s financial crisis has nothing to do with the housing bubble in USA.

Iceland’s three major banks avoided troubled mortgage securities which brought Wall Street to its knees, but expanded aggressively at home and abroad.

It was due to the heady homebrew, a mix of domestic financial aggression and the neighbouring British depositors’ greed of making a quick buck, aided by poor banking laws.

It ended finally in the takeover of the banking system by government: the ultimate leveling of institutions, as witnessed in the nationalization of Northern Rock in UK and the bailout in USA.

How it all started

As a North Atlantic island country, Iceland (area 40.000 sq.miles with 320,000 people) was traditionally known for whaling activites. Following the international moratorium, it abandoned whaling and concentrated on fishing. Its major exports were cod and haddock to Britain and Germany. Though closer to Europe, Iceland did not want to join European Union.

Iceland's growth in the past was due to fishing. As fisheries showed signs of gradual contraction in early 2000s, Iceland wanted to diversify by attracting foreign investment in other areas.

Investors like Alcoa built giant aluminum plants, utilizing the country's cheap, clean hydro energy.

From 2002, Iceland deregulated its commercial banking. The three banks that make up almost the entire banking system went wild attracting savers from Europe, offering high interest on savings accounts.

For high returns, money poured in from UK. More than 120 British municipal governments, universities, hospitals and charities and even British police forces sent their deposits.

Total UK deposits in Iceland banks at one time were estimated around £4 billion.
The Icelandic banks did not invest in U.S. sub prime mortgages but went on their own lending binges.

Soon, Iceland underwent a metamorphosis from a fishing economy into a super North Star of global economy, holding assets nearly 10 times the nation's gross domestic product.

With borrowed money and profligate consumption, Iceland became another American economy. Its prosperity grew to reach annual per capita income at US $54,000 in 2007!

As Oscar Wilde wrote, "Nothing succeeds like excess!"

As the credit crunch spread across the globe with failure of institutions in USA and UK, the rumour mongering began early this year.

Financial speculators started doubting whether Iceland's three banks would default on huge foreign loans. As speculations became ripe, Iceland's currency, the krona, began to depreciate and the situation deteriorated into one of crisis of confidence in Iceland's ability to maintain the financial system.

That was sufficient.

British depositors began to pull out their funds. As Iceland's banks pulled their shutters down, depositors moved the British government for repatriation of their savings. Soon it degenerated into a diplomatic dispute with UK. British government invoked antiterrorism laws in October in an effort to get the money back from Iceland!

The central bank had foreign reserves of only US $2.5 billion.

As Iceland became nearly bankrupt and its currency went down in value by half, a loan from the lender of last resort, the IMF was necessary.

Out of an estimated requirement of US $6 billion to handle the meltdown, IMF would provide a two year loan of US $2.1 billion to meet the banking crisis, besides stabilizing its currency and overhauling its financial regulation system.

Following the IMF announcement, Finland, Sweden, Norway and Denmark promised they would lend Iceland an additional US $2.5 billion.

In the meanwhile, the economic projections are: Iceland would contract by 2.5 percent in 2009, after growing 3.8 percent last year and would decline by 1.5 percent in 2010.

The IMF intervention in Iceland marked the most unexpected reversal in the country's fortunes after a decade-long, debt-fueled binge by the country's banks, businesses and some citizens.

Globalization giveth and it also taketh away!

As Thomas Friedman wrote recently in New York Times, "Now we have to hope, that globalization will saveth!"

Associate Professor Jayaraman teaches monetary economics at USP.