NORDIC POLITICAL ECONOMY AFTER FINANCIAL DEREGULATION: BANKING CRISES, ECONOMIC EXPERTS, AND THE ROLE OF NEOLIBERALISM☆

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ABSTRACT

This analysis attempts a comparative specification of certain aspects of the country studies contained in this volume. The point of departure is the banking crises of the early 1990s (deep in Finland, Norway and Sweden, mini-crisis in Denmark and absent in Iceland) and the contrast to Iceland's financial meltdown in 2007/2008 (no crisis in the three, a new mini-crisis in Denmark). Detailed process tracing of the Icelandic crisis is

☆The completion of this paper, in a rushed situation in the summer of 2011, would not have been possible without the generous support and extensive comments from the other project members: Jørgen Goul Andersen, Ådne Cappelen, Lennart Erixon, Stefan Ólafsson, and Juhana Vartiainen. Especially in the section on economics expert knowledge, I have drawn extensively on material and judgments provided by the project's economists (Cappelen, Erixon, and Vartiainen). Since in that section, I appear as a sociologist of knowledge, I shall emphasize that I take responsibility for any misunderstandings myself. Additional comments from Birgir Bjørn Sigurjónsson and Rune Skarstein are also appreciated.

The Nordic Varieties of Capitalism
Comparative Social Research, Volume 28, 365–420
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ISSN: 0195-6310/doi:10.1108/S0195-6310(2011)0000028011

provided. The case account is then used to shed light on the different roles of neoliberalism, economics expert knowledge and populist right-wing party formation in the five Nordic political economies.

INTRODUCTION

Economic policies may well be one of the prime examples of how far the social sciences – represented by the discipline of economics – can come in terms of legitimate social engineering. Since the late interwar period, a new breed of economic and statistical engineers led the collection of national accounts statistics and developed a family of macroeconomic models that within a few post-war decades proved useful to the ministries of finance of the various Western mixed economies. Whether the overall theoretical orientation was Keynesian or not, this expert knowledge was mediated to politicians through finance ministries.

Governments pursued fiscal policies tuned to the business-cycle situation, in that way building the welfare state and an infrastructure for economic development. In most Western countries, governments also passed legislation that created systems of repressed finance, and later they formulated mandates authorizing the central bank to maintain a fixed exchange rate or manage the interest rate so that an inflation target is fulfilled. Finally, governments have played their cards more or less carefully vis-à-vis the social partners as they pursued their more or less centralized wage bargaining rounds.

This summary illustrates how the main fields of economic policy making are related to different institutional contexts. Fiscal policy is a case of state householding with its tax and revenue incomes as well as loans. Monetary policy has in the last 20 or so years been the prerogative of a semi-autonomous institution, the central bank. Incomes policy is hardly a "policy" at all, but amounts to a variety of efforts by the state to provide information and facilitate negotiations between various social partners.

On all counts, however, economics expert knowledge played a role, and at its best, a withdrawn, rather depoliticized role. As long as the economies were well managed, few people cared. But once unanticipated economic troubles surprised wage earners, investors and politicians in these complex mixed economies, the macroeconomic experts experienced their existential moments.

In this project, we particularly study the last two decades, although some of the analyses look further back. In the early 1990s, surely, the macroeconomic experts of Finland, Sweden and Norway had their moments of truth. Their expert advice had not been able to anticipate – and economic policy decision makers had not been able to counteract – very dramatic swings in the respective national economies. Although the timing was slightly different, all economies experienced that the highly overheated economies of the mid-/late 1980s rapidly fell into the deepest recessions ever in their history as modern semi-planned economies, coinciding with dramatic banking crises. Recessions occurred in Denmark and Iceland too, but these real economic movements were not as dramatic as compared to earlier similar turbulence.

Some 15 years later, a global financial crisis in 2007/2008 spread from the Wall Street/City of London-axis, with real economic crises everywhere in its wake. At that time, however, Finland, Norway and Sweden experienced no financial instability worth mentioning, while the Icelandic economy had its famous financial meltdown. Was this simply a delayed repetition of the effects of the financial deregulation, as it had played itself out in the 3 other countries 15 years earlier, or was there something extra about the Icelandic fate?

By paying specific attention to Iceland, we use the most extreme or deviant case as a benchmark in the comparative discussion. Studying financial instability, Iceland is the extreme case. As for economics expert knowledge, Norway is the extreme case. By trying to explain how it could be that the extremes deviate, we at the same time throw light on the processes at work in the remaining cases, whether aggregated as a group of relative similar cases (both Finland, Norway and Sweden had financial crises in the early 1990s, but not in 2007/2009), taken in pairs or individually.

BANKING CRISES IN INTERNATIONAL CONTEXT

The peculiar geopolitical and geoeconomic relationships between the United States and Western Europe in the Cold War period of embedded liberalism (Ruggie, 1982) consolidated a number of state interventionist, mixed economy 'varieties of capitalism' in Western Europe. The 'phase of blurred objectives' since 1973 (Maddison, 1982, p. 92) implied a lower pace of growth. Embedded liberalism was the international framework of the post-war 'age of oil, automobiles and mass production', and it passed through a synergy phase to maturity in the late 1960s. In the early 1970s, a new techno-economic paradigm initiated the 'age of information and telecommunications' that went through an irruption phase (as venture

capital discovered and developed the new digital technologies) in the 1970s and early 1980s, leading on to a frenzy phase in which financial capital split off from productive capital (Perez, 2002, p. 78).

Through this period, the financial regulations integral to embedded liberalism were evaded and dismantled step by step. This was the general background of the internal and external deregulations of the financial sector that affected all the Western European varieties of organized capitalism since the 1980s. We shall see how various asset inflation bubbles generated through this phase of "financialization" and "securitization" played important roles in the transformations of political-economic patterns in the Nordic area. Nordic developments were also crucially influenced by the regional geopolitical and geoeconomic responses to US dominance in Western Europe.

The Nordic area is a region of Western Europe. Since the late 1950s, the European Union developed as a quasi-state formation uniting the main continental enemies of the World War II. Since the early 1970s, this Western European integration process, built on the Franco-German axis, went through three integration offensives. The *first* offensive was the widening of the union as England, Denmark and Ireland joined from 1973. Plans were also made for economic/monetary union, countering the exchange rate turmoil at the end of the 1960s "Fordist" maturity period, as the United States was losing strength due to the catch-up development of Western Europe and Japan. But the union was not successfully implemented; instead there were various half-house attempts at monetary cooperation. The *second* offensive was since the late 1980s and the end of the Cold War. Trying to counteract the monetary chaos caused by competitive devaluations, the European Union launched its Single European Act (1992) followed by the economic and monetary union (EMU) (1999/2002). The *third* integration offensive was the 2000s widening of the union by 12 new members from Central and Southern Europe.

The background and dynamics of the financial instability and the banking crises in Finland, Norway and Sweden is covered in the national studies in this volume. According to Aliber (2011), these early 1990s crises represented a second wave of financial crises. The first was the third world debt crises of the early 1980s, the third was the Asian crisis of 1997.

The financial sectors of each of the three countries were severely destabilized in the 1980s as deregulation liberated the actors and firms from the systems of repressed finance, while economic policy makers were not able to adjust the tax system and the routines of interest rate determination. The boom/bust sequences (1985–1993) processes were

relatively similar in Finland, Norway and Sweden. Denmark and Iceland deviated.

Iceland had no serious banking crisis. By the early 1990s, its financial system was still predominantly repressed. First, housing credits were still channelled mainly through public loan institutions, and the housing mortgage system took care of most of the volatile housing credits. Second, Icelandic banks continuously wrote down lost credits instead of keeping hopes (Haflidason, 1993, pp. 63–64), used as they were to wild fluctuations typical of Iceland's post-war devaluation cycle. Third, reserve requirements in Iceland were kept much higher than elsewhere in Norden. Fourth, there was no free flow of short-term foreign capital; external deregulation only came in 1995.

Denmark only experienced a "mini-crisis." A bubble in the housing market burst as early as in 1987–1988. The harsh "potato cure", following the early 1980s problems of economic policy adjustment, was completed with a tax reform in January 1987. The Danish financial system differed from the three others in that it maintained a sharper distinction between various classes of financial institutions (Andersen, 2010, p. 273). Although de-segmentation of financial markets spurred increased competition, causing overstretch on the part of certain financial institutions, the troubles were more stretched out over the period 1989–1993. The Danish mortgage system was 'probably the most stable and problem-free in the world' (Andersen, 2010, p. 274). Housing finance had thus since the 1960s been more market oriented than in the other Nordic countries. In that respect, liberalization was less dramatic, particularly compared to Norway. All in all, bank failures spread over a longer period, affecting only small institutions. The eight worst hit banks represented less than 2 percent of the banking system's total assets (Andersen, 2010, p. 179). The major banks survived. The banks capital base was somewhat higher than in Finland, Norway and Sweden. Denmark also enforced higher reserve requirements. Supervision was more efficient.

In the fourth wave of financial crisis during the most recent frenzy period, 2007/2008, history repeated itself only in Denmark, despite the fact that the mortgage system had been significantly destabilized following EU single market coordination in the second integration offensive (Andersen, 2010, p. 274; Goul Andersen, this volume; Mortensen & Seabrooke, 2009). But while Finland, Norway and Sweden experienced no significant financial instability or banking crisis at all, Iceland now experienced the most dramatic financial meltdown. A broad analysis is given in the contribution by Ólafsson (this volume). In the following we add a more detailed process tracing of Iceland's road to financial disaster.[1]

ICELAND SINCE THE 1990S: A CASE STUDY OF OVERHEATING AND FINANCIAL COLLAPSE

In the 1960s, devaluation cycles marked Iceland and Finland off from the three other Nordics. The Icelandic cycles persisted longer than Finland's (Mjøset, 1987, pp. 426, 447). They grounded in a game about the sharing of the fisheries' resource rent. Fishermen earned a share of the catch in a share-cropping arrangement with shipowners. Trawlers were linked to villages. Fishermen were a labour aristocracy, with strong influence in the trade union confederation. As for the onshore workers, both in the fish-processing industries and in agriculture, they could push claims for higher wages/ subsidies in good times, thereby gaining a share of the wealth. In bad times, however, devaluation and tight policies reserved more of the resource rent and profits for the capital side (Sigurjónsson, 1985).

As early as in the 1970s, Iceland had experienced resource depletion problems. To exploit the wider waters gained after the successful Third Cod War against the British (1975/1976), massive foreign-financed investments in trawlers and upgraded processing facilities followed. This produced overheating and inflation.

Our analyses (in this volume) show how, in the four larger Nordic countries, economic policies since the late 1980s aimed to reduce inflation. Through the 1970s and 1980s, they had some incidences of double-digit inflation, but mostly close to 10 percent, never above 18. Iceland, in contrast, had inflation way above 18 percent for 17 consecutive years, 1973–1989, often around 50 and 80 in the peak year of 1983 (see Fig. 2, Ólafsson, this volume).

With credit controls, Icelandic real interest rates reached negative double digits. This again led to inflation indexing. New credit financed capacities led to more severe problems of overfishing. In an effort to pursue sustainable fishing, the government began to determine a total allowable catch (TAC), allocating quotas – titles to natural resources, and thus to the resource rent they represented – to shipowners according to their share of total catch 1981–1984. While distributional struggles in the Icelandic economy so far had taken the form of compensation claims to regain losses from devaluations, quotas now strengthened the control of the fisheries capital to the resource rent.

The depletion problems grew worse. The cod stock collapsed in 1989. The standard response followed: devaluation (20 percent) and nominal wage freeze. In 1990, quotas were made transferable (Ólafsson, this volume), a revision pushed by the federation of fishing-vessel owners in 1990 and supported by neoliberal intellectuals. Individually transferable quotas (ITQ) are property rights; they can be bought and sold, and used as collateral for loans.

At the same time (1989–1991), Iceland switched to a low-inflation regime. As Ólafsson (this volume, Table 1) notes, this social pact period implied stronger corporatism in wage setting, as well as continued credit rationing and capital controls. This reduced the role of wage-price spirals, and may be seen as an attempt to revise the incomes policy routines in a Nordic direction. (Although Finland was certainly not their model, Finland had revised its devaluation cycle model in this way since the late 1960s.) But the period was also marked by trends that pointed towards the "neoliberal experiment" that characterized the period 1995–2008 (Ólafsson, this volume, Table 1), notably turn to ITQs, and the first government led by the neoliberal Davið Oddsson in 1991. At the same time, pension fund corporatism (introduced 1969) was further developed, socializing unions into a "stakeholder" position.

The unusual neoliberal experiment in Iceland, according to Ólafsson (this volume), was stepped up from 1995 with a coalition government of the IP (the conservative Independence Party) and the PP (the agrarian Progressive Party). Both parties had major links to various sectors of Iceland's business sector. We shall see below that neoliberal political philosophy played an important role, and how these developments interacted with another Icelandic specificity (in a Nordic comparison), namely the extent of clientelist ties.

Iceland maintained a developmentalist, state-directed financial system longer than any other Nordic country. Interest rates were liberalized in 1985 (Jónsson, 2009, p. 44). Only in 1986, Iceland's stock exchange began operations. From the late 1980s, Iceland made the transition to a fully liberalized system *faster* and eventually took it *further* than any other Nordic country. Already before 1995, steps towards financial deregulation had been taken, together with major lowering of taxes on firms, and efforts at turning Iceland into a quite free-market-oriented economy. This development accelerated from 1995 onwards. Although Iceland was a genuinely Western, Atlantic country, a similarity to the East European transitions here comes to mind.

With the EEA-agreement (the European Economic Area; in effect since 1995), Iceland, like Norway, became integrated in the single European market (the second integration offensive), while its precious fish resources could be kept under sovereign control. This ended the regime of capital controls. The EEA immediately established free short-term capital flows. With its low unemployment, high labour force participation, highly educated workforce, and funded occupational pension funds along with a public social security system, Iceland immediately gained an AAA-rating.

As preludes to the financial instabilities mentioned above, the four large Nordics had experienced consumption, housing and stock market booms in the late 1980s, before the full liberalization of short-term capital flows. In contrast, Iceland now had consumption, housing and stock market booms in a setting of full external financial deregulation. By the 1990s, the world economy was in the midst of the frenzy phase, on its way into the dot.com bubble, which was followed in the 2000s by very low US interest rates and a number of new financial innovations. Rather than observing the trouble faced by their eastern neighbours on the Scandinavian peninsula, old and new Icelandic elites looked west, joining the US-based, worldwide investment bubble from the mid-1990s (Jónsson, 2009, p. 31).

Iceland needed to restructure its economic base as its fish resources became increasingly scarce. Areas of increased importance were tourism, health services, and research (deCODE genetics), Norwegian style aluminium-furnace industrialization (cheap, thermic energy), as well as high value-added linkages to the building of trawlers. Electricity would be cheap, since Iceland, unlike Norway, was too far into the Atlantic Ocean to be connected to any continental electricity grid.

The frenzy phase of a long world economic surge is characterized by increasing divergence between production and financial capital, an 'increasing tension between the inflated money economy gone wild and the restructuring real economy' (Perez, 2002, p. 111). Thus, while transformation went on in the real economy – in many respect also aided by the financial turbulence – the last 20 years of Icelandic economic history can be studied as an experiment in turning the *financial sector* into a *leading sector*. Investment banking activities earning bankers fees would be a new foreign exchange earner, compensating for declining fish catches. We shall see how this interacted with the internal stratification of older/younger elites (political and economic), and how it was influenced by certain aspects of the Icelandic social structure that makes it more like an emerging economy than the other Nordic countries.

Power, Elites and Politics

Social, sectoral, and techno-economic transformations of the economies influenced elites and power structures in all the Nordic countries. But in Iceland, these changes were particularly dramatic. Traditionally, a group of some 14 families ("the octopus"; Wade & Sigurgeirsdóttir, 2010) dominated transport, banking, insurance, fishing, and Nato-base supplies. Uniquely among the Nordic countries, the relation of these business networks to the state was of the *clientelist* type.

Within political science, clientelism and patronage are defined as 'the trade of votes and other types of partisan support in exchange for public decisions with divisible effects' (Piattoni, 2001, p. 4). Distinguishing the two, Piattoni relates patronage to the distribution of jobs in any kind of bureaucracy. Clientelism emerges in fully mobilized polities, where the access to such jobs no longer secure any fundamental advantage to those that gain them. If clientelism develops, parties are not programmatic and idealist, they are tools in the struggles between political elites to gain influence. Given the extension of state responsibilities in the 20th century, bureaucratic positions and jobs offered by the state have grown considerably. However, once the vote has been generalized to all voters, parties in patronage systems must be able to offer a larger set of advantages beyond public jobs. 'With clientelism, all public decision-making may become a token of exchange: from a birth certificate to a building permit, from a disability pension to public housing, from a development project to a tax exemption' (Piattoni, 2001, p. 6). Such mass clientelism often uses quite "impersonal" means (laws, or measures that favour broad categories of persons). Thus, studying such recent forms of clientelism, one should not focus too strongly on the personal patron–client relationship (Piattoni, 2001, p. 6n).

Applying Shefter's (1994) basic formula, that bureaucracies consolidated before mass politics tend to develop programmatic parties with non-clientelistic relations to voters, Kristinsson (2001, p. 172f) notes that Iceland is unique in the Nordic area in that its bureaucracy was weak and not embedded in society before home rule in 1904. As world trade broke down and protectionist strategies flourished in the 1930s, a number of clientelist ties developed in the Icelandic setting. Still, the cultural context was one of Nordic egalitarianism. Most domestic industries were regulated, many fundamental goods had administrated prices, and many economic activities were licensed. Officials and the politicians that appointed them here had many sources of patronage. By the late 1940s, each of the three main parties served their specific clienteles: *The Independence Party* (IP) served the private sector and parts of the farming sector, with the capital Reykjavik as their stronghold. *The Progressive Party* (PP) served agrarian interests and particularly the cooperative movement, strong in the provinces. The *Social Democrats* (SD) served the labour unions, particularly those within the fisheries. The left socialist *People's Alliance* (PA) was an outsider in this system, simply because it was less involved with the clientelist system. The

three other parties, for instance, all had stakes in contracts related to US government activities at Keflavik airport, while the alliance was a more programmatic, idealistic party, built on opposition to that base (Kristinsson, 2001, pp. 172f, 179).

The system reached its zenith in the early post-war period. A vast majority of public sector jobs (down to the level of swimming pool attendant) were distributed on a partisan basis. In the housing sector, subsidized loans, building sites, and permits were necessary factors included in the system. Within the system of credit rationing, fair shares went to the main segments linked to the parties. Anybody involved in foreign trade needed licences (rationing of foreign currency), and these were "split even" between the cooperative movement (PP) and the remaining private sector (IP). As for regional development, MPs would bring infrastructural investments to their constituencies. Despite these peculiar patterns (in a Nordic comparison), we shall define the Icelandic state as a developmental state (Evans, 1995; Johnson, 1999). Through the post-war period, growth rates have not deviated significantly from the other Nordic countries. All five had a lot of interventionism, but Iceland had interventionism with a high degree of clientelism.

The clientelist system was clearly intact in the 1970s. But following the educational revolution since the late 1960s, as more young Icelanders gained higher education, often abroad, it was met by increasing opposition. The interests of the educated higher middle classes are mostly opposed to clientelist practices (Kristinsson, 2001, p. 185). The introduction of proportional representation (already in 1959) changed the electoral system in favour of such urban groups. Administrative hirings increasingly came to be based on professional criteria, although the central bank director and ambassadors remained linked to the old practice. This restrained the more overt forms of pork-barrel politics, such as generous transfers for infrastructural developments in the peripheries. There was a wave of new party formation in the 1970s. Most of them did not survive long, but they all emphasized the ethics of government. The split-even arrangements in fisheries exports became increasingly difficult as Iceland joined the various free-trade treaties since the 1960s. The housing system became more bureaucratized from the 1980s onwards. With EEA-membership from 1995, EU's competition policy was implemented, and clientelist dividing up contracts and procurements became largely impossible. More regulatory agencies were established, and the judiciary became more independent.

With financial liberalization, from about the same time, the politicized financial sector was "being replaced by a professional one" (Kristinsson, 2001, p. 179ff). At the turn of the millennium, these trends seemed to generate

Icelandic convergence toward Nordic traditions. Kristinsson (2001, p. 187ff) also notes political trends such as the withering away of parties as membership organizations and their loss of control of the political agenda (as the media gained autonomy, the press would expose clientelist practices). Generally, he claims that globalization further undermined clientelism in Iceland.

Strikingly, already in the 1980s, a *programmatic* wing developed within the IP. In the late 1980s, when Davið Oddsson rose to dominance in the IP, a split in the party had a former prominent member (Albert Gudmundsson) break out to form a party that openly favoured clientelism (Kristinsson, 2001, p. 186). Let us look more closely at the programmatic neoliberals.

Iceland's first neoliberal network was formed in the 1970s. Described as a group of libertarians within the IP, they published the journal *Eimreiðin* (Locomotive) 1972–1975, and various edited volume later. Among the members were Davið Oddsson, Geir Haarde, and the historian/philosopher Hannes Hólmsteinn Gissurarson. In 1979, Gissurarson founded the Libertarian Association in Iceland, publishing in 1980–1988 the *Frelsið* (Freedom) magazine. He became an active member of Hayek's Mont Pelerin Society in 1984.[2] At the time, several economist intellectuals belonging to that network (Hayek, Friedman, Buchanan) gave public lectures in Iceland. This neoliberal faction gained dominance in the IP, proceeding to pursue British/New-Zealand-inspired "Thatcherite, free market-reforms" (Jónsson, 2009, p. 37). Oddsson played a crucial role by connecting several networks: neoliberal enthusiasts, the established business community, the traditional political class, and even some right-wing nationalists. He was IP prime minister for 13 years, 1991–2004. Gissurarson was his informal advisor. Oddsson took over as CBI (central bank) governor in September 2005, having been Iceland's foreign minister in the interim period.

The Emergence of Iceland's "Big Three" Banks

Two private banks expanded strongly in the late 1990s. Islandsbanki's (later *Glitnir*) origins were with smaller private banks that had acquired the original fisheries bank. It was based on industrial and commercial interests. *Kaupthing* originated from brokerage activities since the 1980s. Its very rapid transformation into a universal bank set an example for the other two.

By 1998, the Icelandic government decided to sell-off its shares in Landsbanki and Bunadarbanki in steps. Landsbanki was the oldest bank, with traditional links to IP. Bunadarbanki had traditional links to PP. Older clientelist networks were here still at work: the two banks were sold to circles

with close ties to the two parties. Kaupthing merged with Bunadarbanki in 2003. These "big three" – Landsbanki, Glitnir, and Kaupthing – then put their mark on Icelandic history in the 2000s. They started to expand at an international scale in the early 2000s, serving small marginal markets abroad. In the US-driven upturn after the dot.com-collapse 2000/2001, the big three reached fairly average European size.

When the transition out of repressed finance started in the early 1990, there was a very rapid inflow of young Icelanders that had benefited from the 1970s and 1980s educational revolution. The expanding banks thus recruited from a pool of talented economics and finance PhDs, mostly educated at universities abroad. Many of them idealized the free market and most of them had high hopes for the new financial instruments that were being introduced. They were sceptical of the clientelism, credit rationing, and bureaucratization associated with Iceland's developmental state. But we shall see that they came to be as intertwined with particular networks in the real economy as their predecessors. For some years, they were trusted by the dominant faction of the political class with a mission to become Iceland's new leading sector.

There was also another group, let us call them a group of younger "operators" or "business oligarchs" (Jónsson, 2009, p. 103 calls them "players") in the Icelandic bourgeoisie. They started out with fortunes made independently of the traditional business elite networks (retail trade, abroad). They openly challenged the clientelist ties between politicians and business, even though they were willing to make use of them for their own purposes. They were an opportunistic faction of the generation of the 1970s and 1980s. In the wake of the international expansion of the banks, they developed holding companies. These were initially just passive holders of shares (majorities in various firms, actively managing the strategies of these firms via representation on boards).

We may venture that the importance of clientelism for old-style Icelandic politics, and the fact that much of post-graduate education was outside of Iceland, either in Anglo-American or in Nordic countries, led to more pronounced generational conflicts in Iceland in the 1980s and 1990s than elsewhere in Norden. The system of clientelism in Iceland proved to be more resilient than expected, since Oddson's strong leadership continued to pursue clientelistic politics, as clearly evidenced in the privatization of the state banks in 1998–2003.

The Structure and Business Model of Iceland's Banking Industry

Iceland developed the seemingly most US-like group of aggressive–expansive banks in Western Europe, but the ISK (the Icelandic currency)

was certainly the very opposite to a currency with global ambitions, and the domestic retail market was miniscule. By 2006, Iceland's miniscule economy was home to three banks that were "large compared with the country but small in relation to international counterparts" (Jónsson, 2009, p. 71). At the brink of crisis, the banking system grew to 10 times the size of GDP.

The young bankers embraced the model of the American-style investment-brokerage bank (Jónsson, 2009, pp. 30, 210). Their very rapid development paralleled the evolution of US banking after the repeal in 1999 of the Glass/Steagall act. Wall Street investment banks were used to serving very rich clients striving for some extra percentage points of returns on their wealth. These brokers were thrown into competition with large former retail banks (such as Citigroup, J. P. Morgan). Following the slogan "Use your balance sheet" banks granted loans to corporations that accepted their services, or took equity positions in a company on their own account. They acquired subsidiaries and branches without undue administrative oversight (Jónsson, 2009, p. 131). Such a banking organization tends to lower lending standards in their quest for investment banking fees, one root of the 2007/2008 crisis (Jónsson, 2009, p. 42).

The three large Icelandic banks became universal banks. They held the retail deposits of Icelandic savers. But since they serviced a very small domestic market, they adopted a similar strategy as the US investment banks. They enlarged their balance sheets by rolling over short-term credits from wholesale markets, investing long term (i.e. holding illiquid assets, Jónsson, 2009, p. 55). They also sold their equity (bonds) in international markets. The formula was: wholesale funding, short maturity profile and private equity positions. Their main area was the North Atlantic, mainly the Nordic area and the United Kingdom. Thus, their international expansion started in London, the city that is also the financial centre for most Nordic banks and financial institutions. To some extent they even created wider pan-European networks.

This aggressive expansion abroad put them apart from other European banks. Their US broker–dealer style provoked the other Nordic banking communities. According to a consultancy evaluation of December 2007, their business model was 'entrepreneurial, almost private-equity-like.' They had no legacy in any of the markets they entered. They were portrayed as well managed, savvy investors, with good disclosure (Jónsson, 2009, p. 56).

Such a large banking sector (relative to GDP) was not unique. Many European banks had a similar business model. But Iceland was special because its pattern of financial risk was one normally found in emerging economies. This can be linked to the power structure as sketched above (see

Ólafsson, in this volume). Although clientelism was in decline in the political system, ownership networks were dominated by a small, national elite. Non-residents were not engaged buying the stock of Icelandic companies. Cross-ownership and cross-lending became endemic in the mid-2000s boom. With a tiny population (about 315,000) and a lack of foreign equity investment, Iceland's political, financial and business elites were cross-connected in a way that created systemic risk. This was not taken into account by the rating agencies (Jónsson, 2009, p. 75).

Through the 2000s boom three layers of Iceland's political economy – the neoliberal elites in politics, the young finance wizards and the young business players – converged in driving financial liberalization, bank expansion and stock exchange frenzy. The neoliberal faction in the Conservative Party, still in many ways linked to the old business elites, appreciated the new young financial wizards, who wanted to run the banks on an Anglo-American model. The old elites were often sceptical of the new players and their holding companies, but they all became thoroughly intertwined with the banks.

The Icelandic cross-connections became particularly dense because of the holding companies established by the operators. In the early 2000s, the holding companies had been important clients to the banks. By 2006, the big three had each become parties to *combine relationships,* bound to their earlier clients by a strategic alliance (e.g. Exista and Kaupthing, Landsbanki and Glitnir mainly to Burðarás and later to Straumur-Burðarás). The holding companies bought controlling stakes in the banks, giving rise to "a symbiotic – or incestuous – relationship between banks and their owners" (Jónsson, 2009, p. 96f). In this way, the increasingly leveraged holding companies became investment companies (financials), as these combines would both hold shares in and finance the companies that were bought abroad. The holding companies also financed themselves by loans from foreign banks. This constellation worried the bankers, but the "aggressive, leveraged giants" were profitable clients.

The prime example of such players in the newly liberalized Icelandic economy was Jón Ásgeir Jóhannesson, born 1968. He used all three banks and many other savings banks and bond-issuers to build an international investment empire. At the end, his Baugur group – according to rumours – was worth something between 70 and 80 percent of the nation's GDP (Jónsson, 2009, p. 103). With these combines, Iceland's productive and merchant capital became partners in the international financial expansion, taking off the real economy.

In an attempt to draw lessons from the "overbanked and undersized" case of Iceland, Sibert (2011) refers to research on the special working environment of senior administrators in very small countries: Decisions may be neutralized by personal interventions and pressures, and close personal and family connections can spur nepotism and corruption. But it should be noted that clientelism was an important legacy in Iceland's political economy, and that such networks can develop also in much larger states. It is an interesting question whether the extensive crossholding of shares in a stock market with no foreigners involved, leading to a veritable Ponzi pyramid, can be seen as a sign that globalization did not entirely rid Iceland of its clientelist networks (contrary to the interpretation in Kristinsson, 2001).

The banks counted – like the fisheries sector had traditionally done – on state support if some of their risky ventures created problems. As commercial banks they had a sovereign guarantee, but one resting with the very small Icelandic state and its economy. Icelandic bankers and "business vikings" privatized the gains (their dividends) but neglected the consequences of the borrowing for the country. Already by 2004, Iceland had become the world's most heavily indebted economy (see Ólafsson, in this volume).

In 2006, Geir Haarde (born 1951, with a US economics MA) became IP's prime minister in a four party coalition. After a decade of prosperity, a policy of stabilization was hardly on the agenda. Leading groups entertained the idea that Iceland could transform itself into an offshore financial centre. In February 2005, the earlier Prime Minister (Halldór Ásgrímsson of the PP) asked a committee to draft a policy proposal on how Iceland could be turned into a new global financial centre (Jónsson, 2009, pp. 109, 139). The most significant example of this hubris is the report *Island 2015,* published by Iceland's Chamber of Commerce in 2006. The report was sceptical of Icelanders' inclination to always compare themselves with the other Nordic countries: "The Chamber of Commerce suggests that Iceland stop comparing itself with the other Nordic countries, after all we are in many ways superior to them" (quoted in Wade, 2009, p. 5).

International Integration and Interaction: Towards the Geyser Crisis 2006

During the low-interest rate frenzy phase of the 2000s new instruments (CDS, CDO – both to be defined below – and subprime loans) and market players (carry traders, hedge funds) gained general importance. Not only was the big three business model an American one, their fates also became intertwined with the international financial dynamics that unfolded in this frenzy period.

The rapidly expanding financial sector in Iceland caught the attention of major free-floating financial actors in the high-liquidity world economy. It

was crucial that funds continually floated into the Icelandic economy. With its relatively high interest rate (inflation targeting since 2001, floating exchange rate), Iceland became interesting to carry traders (Jónsson, 2009, p. 69). The interest rate peaked at 11 percent in 2000, came down to 5 in 2003, but the central bank (CBI) increased it aggressively in 2005–2006 (Aliber & Zoega, 2011, Fig. 9.5). To avoid the punishing interest rate, many domestic businesses switched to foreign currency loans, thus taking a high currency risk. In late 2005, the CBI policy rate was 10.5 percent, comparing favourably with dollar and euro. The ISK appreciated. Carry trade employ loans in low-yielding currencies (e.g. yen) that are invested in high-yielding ones (such as ISK), earning the difference. Carry traders – many had a background in hedge funds – play a nervous, highly leveraged, high-risk game. Also, foreign banks got involved by means of "glacier bonds" (for the technicalities, see Jónsson, 2009, p. 70).

It was now visible to many that banks were very large compared to the country's economy. One Nordic player turned out to play an early part of what became the first warning signal, the Geyser crisis of 2006 (Jónsson, 2009, pp. 75, 78f, 117). Norway's Government Pension Fund Global (GPFG) was about to become a major actor in global financial markets, with Merrill Lynch as one of its prime brokers. GPFG was possibly the first actor that took large positions against Iceland and its banks in 2005. Analyzing the basic patterns (wholesale funding, short maturity profile and private equity positions), they found that the risk was much higher than what was reflected in the price of insurance. That is, the costs of insuring against, for example Kaupthing failing was way too cheap. In March and April 2006, Kaupthing corporate bonds were the most traded ones in Europe (Jónsson, 2009, p. 76). While banks in other countries were likely to be saved by their governments, GPFG sensed that Kaupthing was too large relative to the Icelandic economy.

A credit default swap (CDS) – one of the recent new financial instruments (designed by J. P. Morgan in 1997) – consists of bets on insurance without owning what is secured. It can also be used as an indicator: The higher the spread of this metric (measured for various companies in points above the LIBOR – the London interbank offered rate), the higher the probability of the company's default (Jónsson, 2009, p. 61). GPFG started a speculative attack, shorting Kaupthing's CDSs. This directed attention to the inaccurate risk assessment. The Norwegian broker sees this profit as a small price to pay for a warning.[3] Historians will scrutinize the archives to decide whether the Norwegian fund was the fist mover. But many hedge funds got involved in early March 2006, shorting both the bonds of Icelandic banks through the

CDS market and even Iceland's (debt free) government bonds. Note that they could not short Icelandic equities, as most of these were in Icelandic hands, so it was impossible for the speculators to borrow them.

At this time, the ISK depreciated and inflation went to 8 percent. One of the two largest Danish banks, Danske Bank, predicted a financial crisis (reprinted as chapter 8 in Aliber & Zoega, 2011), receiving much media attention. There was a sell-off in the Icelandic currency market, but a miraculous, domestically based rescue followed on April 21, 2006. Iceland's private sector (banks, fishing firms, pension/investment funds) resisted repeated hedge fund attacks. They pooled whatever foreign currency they had (a one day market turnover of 7 percent/GDP), buying ISK, defending its value (Jónsson, 2009, p. 78).

It is interesting that some of the early warnings came from large Nordic actors, Norway's GPFG and Danske Bank. Many Icelanders were provoked, turning to support their banks. The Norwegian and Danish actors, on their part, deny that they acted out of resentment towards the aggressive Icelandic banks, insisting that they only provided more realistic risk assessment than the rating agencies.

Displacing Expert Knowledge

Iceland had a National Economic Institute (established 1974) that had quite some influence as a centre for policy advice. While the NEI was formally under the Prime Minister's Office, its leadership did at times strive towards some professional independence. There were however growing tensions with the Oddsson government after 1995. In a 2002 policy statement, Oddsson accused the Institute of presenting too pessimistic forecasts, strolling "around in a raincoat with an umbrella up, in blazing sunshine and fine weather."[4] The government proceeded to close down the institute in that same year.

In the wake of the Geyser crisis, Iceland's Chamber of Commerce paid an American expert (F. Mishkin) handsomely to the coauthor with Tryggvi T. Herbertsson (Icelandic economics professor, elected in 2009 as MP for IP) to write a report that convinced the financial predators that Iceland did not "display meltdown characteristics" after all (reprinted as chapter 9 of Aliber & Zoega, 2011). Wade (2009/2010) claims that Mishkin just sold his name. However that is, economic science was here abused to produce conclusions demanded by elites under pressure. The report was a small media sensation, and both economists presented their conclusions in major financial capitals in May 2006 (Jónsson, 2009, p. 79). A year later, this exercise was repeated,

now with a paper by Richard Portes and other Icelandic collaborators (reprinted as chapter 10 of Aliber & Zoega, 2011).

Both reports were also used in the last desperate attempts to stave off the crisis in March 2008. Prime Minister Haarde insisted that the economy was strong and the banks were sound, adding that this "has been thoroughly confirmed by well-known scientists such as Fredric Mishkin, who has become a governor of the US Federal Reserve, and Richard Portes, a well-known academic expert in this field" (quoted in Wade & Sigurgeirsdóttir, 2010, p. 5). After the meltdown, Mishkin resigned from the Federal Reserve board and can be viewed as one of the attractions in Charles Ferguson's documentary film *Inside Job* (2010).

The Stock Market Bubble

Iceland's stock market bubble was a case of excessive lending on the value of inflated assets. Many other countries, including the Nordics, had such bubbles too, but the scale of betting on world equity markets was probably "unprecedented in the world's financial history" (Jónsson, 2009, p. 107). The bubble was intensified by lax fiscal policy and misguided monetary policy, as well as badly timed aluminium investments (Ólafsson, this volume).

Had Iceland's bubble burst in the Geyser crisis, the damage would have been smaller than in 2008. The banks played a more careful game after the Geyser crisis (Jónsson, 2009, p. 109), but failed to go moderate. The stock market boom revived. The major external reason was the U.S. structured credit industry. Since late 2006, there was demand for further Icelandic bond issues. These were securitized, wrapped in bundles with other corporate bonds, and issued as CDOs (collateralized debt obligations), another one of the new instruments. Risks and returns depended on the definition of the CDOs and their tranches. Most investors did not look at the underlying assets, they only considered the rating. In less than two years (2006–2008), Iceland's financial system amassed even higher foreign leverage. It became an "integral part of the evolving US credit bubble (...). CDO alchemists (...) weaved Icelandic banking bonds and bare CDS contracts into so-called synthetic CDOs" (Jónsson, 2009, pp. 90, 110). This revived the wholesale funding of the banks.

The main internal reason for the revival relates to the fact that the *stock market* boom was a domestic boom, since non-residents did not invest in Icelandic shares. By 2006, Iceland's relatively egalitarian distribution of income had become reversed in a few years (Ólafsson, this volume). The holding companies used recent capital gains to attract further external funding, that is as the basis of new leveraging. The holding companies increased their balance sheets and became investment bodies (Jónsson, 2009, p. 92). The big ones (especially Exista, that bought up shares in Nordic insurance companies: Sampo in Finland, Storebrand in Norway) pursued ambitious international goals, inspiring smaller imitators with local funding. The model was a Swedish one, for example Investor AB, but also Buffet's US funds, although Buffet warned against leverage (Jónsson, 2009, p. 94). As a result, "almost the whole financial system had now become a derivative of the successful foreign expansion of Iceland's three banks" (Jónsson, 2009, p. 95). At the peak of the boom in 2005 and 2007, enthusiasts baptized the cross-border expansions of Icelandic multinationals *útrás*, "outward attack" (Jónsson, 2009, p. 107), a term from the sagas. The banks financed them. In a brief period they were heroicized in business schools. Iceland's three largest banks were amongst the top 300 world banks.

The actions of the *útrás* were "mimicked by smaller players in the domestic market." Since the domestic opportunities were limited, even such actors entered the "cross-border, leveraged buy-out frenzy."[5] In a very small economy, this could not take the place in a piecemeal fashion, it required fast decision-making. Such operations were very risky if the underlying stock could be sold on short notice (i.e. after a margin call to repay the loan). The situation was similar in other countries. Specific to Iceland was the precarious liquidity of its stock exchange (ICEX), again related to the fact that this equity market had very little foreign ownership. The portfolios of all the bank's clients were very similar, that is highly correlated. The system as a whole could not be liquidated in an orderly fashion. While banks in such situations can engage in carry trade, Iceland's banks ended up playing a reverse carry trade, betting on foreign markets to offload currency risks. But the system as a whole, including the most recent adjustments by the banks, was extremely vulnerable to the kind of systematic liquidity crisis that emerged after August 2007. The holding companies could not get out in a discrete fashion either, since they were monitored by hedge funds that would block their exit if there were any rumours of sales.

In those last years, the whole financial system depended on 'foreign-funded investment banks with an incredibly high level of systemic risk'. The currency was overvalued, and all valuations were skewed (Jónsson, 2009, p. 89). Although the Icelandic state was not very indebted, national institutions had no resources if they should be required to "serve as lender of last resort for the banks or to offer guarantees to their creditors" (Jónsson, 2009, p. 109).

Another fateful development that also started in the wake of the Geyser crisis, in the last most frenetic stage of the stock market bubble, was product differentiation based on information and communication technology: In October 2006, Landsbanki established Icesave that paid higher interest rates than British competitors. Being entirely internet-based, costs were very low since there was no retail branch network (Jónsson, 2009, p. 124). This allowed Landsbanki to attract a large share of deposits, not just by individuals, but by charities, municipalities, London Police, Oxford University, and so on. Here was a case where Icelandic banks shifted much of "the risk onto the countries of their operations, away from Icelanders – a double moral hazard" (Wade & Sigurgeirsdóttir, 2010, p. 8).

At the peak of overheating, Iceland's macroeconomic performance was as follows: Growth was high, 19 percent in 2003–2005. Iceland was nearly the richest country in the world in per capita output terms (Jónsson, 2009, p. 104). There was a 25 percent current deficit in 2006, the interest rate was at nearly 14 to strengthen the ISK (carry trade) and contain inflation. There was also a political business cycle, as huge incomes from indirect taxes allowed the government to decide on fiscal stimulus to win the spring 2007 election. Higher stock prices had wealth effects that drove the real economy: lending boom, housing bubble, explosive construction activity based on an entirely new feature of the Icelandic labour market – eastern European immigrant workers flowed in after May 2006.

There are similarities here with Ireland, but in that case a building boom was the most striking feature. In the mid-1990s, Iceland had avoided a housing boom, with strict state controls on mortgage lending (Jónsson, 2009, p. 106). The big three had in 2004 moved in to compete with the state-owned housing financing fund. Housing prices escalated. But housing did not play a leading role in the inflation of the bubble. There were no parallels to US subprime mortgages. Even in the boom, most households' lending practices were conservative.

The bank borrowing to GDP ratio was 9/1 in 2008. Like the politicians of Greece, they played a Ponzi game – a game of pyramids – since there was too high risk to survive an economic setback. They benefited from the fact that the state's regulatory agencies were weak. Fatefully, they accepted equity as collateral, thus downplaying the systemic risk of cross-holdership. In the last phase of "incestuous" relations between equity companies and banks, this whole system bought up high street brands in the United Kingdom and Denmark, "leveraging up their balance sheets on the back of shaky or even fictitious collateral" (Wade & Sigurgeirsdóttir 2010, p. 8).

Spring 2008: Early Manifestation of Vulnerability

In 2007, rating agencies like Moody's still believed the banks were important to the domestic Icelandic economy and that the authorities would be able to secure financing for a rescue operation. Adjustment in advanced economies, they held, follows through GDP growth rates and flexible exchange rates, not by debt defaults (Jónsson, 2009, p. 91).

By 2007, not just Iceland was questioned, but tensions were growing in the world economy as such. The liquidity crisis started at the end of that year, despite the fact that Iceland's real economy (like Norway's) benefited from fish and aluminium exports at booming prices. In January 2008, Iceland again felt the pressure from hedge funds. Both banks and investment companies converted equity to euro to stave off the challenges. The Icelandic currency market collapsed two days before the Bear Stearns run (March 9, 2008) despite the 10 percent interest rate differential. The ISK lost 20 percent over the next 2 weeks. The equity conversion strategy was no longer possible (Jónsson, 2009, pp. 118, 133). Currency depreciation and inflation is a threat to banks in small, open economies. There were short-run defences. Devaluation boosted the equity of the banks and their loan margins (indexed loans), as double-digit inflation returned. Iceland's Financial Supervisory Agency (FSA) worked hard, with short-term success.

Jónsson (2009) holds that even if FSA had exercising keener foresight, it would not have been able to counteract the disaster. The risks involved for taxpayers by Landsbanki's Icesave arrangement were not clear to anyone. Iceland's bureaucracy only had a domestic focus. EU-rules (capital adequacy ratios, liquidity-requirements, imported via EEA) had been enforced mechanically. Wade (2009) finds several kinds of regulatory capture. Politicians were granted cheap loans by banks, becoming cheerleaders. FSA had 45 employees, including their telephone secretary. Experts with an economics or finance education could triple the salary with the banks across the street.

In the medium term, a game of dominoes followed as depreciation/inflation hit the client base and loan quality. Liquidity dried up, equity markets deteriorated. Iceland's stock exchange index did worse than any other European index. Banks had to serve as lenders of last resort for the investment companies. As foreign banks now made margin calls, the various defence strategies just bought time. Once banks had to replace foreign direct lending, the "cross-lending systemic risks" began to bother the financial system dramatically, since they were all connected by loans on the value of

the others' shares (Jónsson, 2009, p. 129). The basic structural dilemma was that the banks were big at home, but small abroad and even small compared to many of their clients. In the crisis, the holding companies were too big to fail in Iceland's financial system. As clients they tried to use power against their banks. Banks responded by pressing them to sell of holdings silently, to avoid panic and not alert hedge funds. But credit quality worsened. The banks used internet banking gains to buy time. For Landsbanki, this was fateful: Icesave was a branch, not a subsidiary. It was under Icelandic legislation, while a subsidiary operate under the auspices of the host country that was the source of the deposits (Jónsson, 2009, p. 125).

Government Economic Diplomacy to Counteract Collapse, Spring/Summer 2008

The early post-war Icelandic model (Sigurjónsson, 1985) displayed the following risk behaviour: One would borrow to upgrade equipment, fishing as much as possible in as short time as possible, making resource depletion appear as an unavoidable natural disaster, something that could never be counteracted by science and public regulation. But once quotas were introduced, public regulation was a fact, and there were limits to fisheries as a leading sector. The same risk behaviour was expressed in the strategies of banks and investment companies.[6] They borrowed enormous sums, investing in an effort to maximize short-term gains and fees. This seemed better than fishing, the supply of funds from abroad seemed impossible to deplete. But when they dried up, there were not even quotas!

Iceland's fate was now a matter for the politicians. The government tried to secure foreign currency reserves to back up the banking system. It was noted that Iceland had virtually no government debt in foreign currency, whereas 70 percent of corporate debt was in foreign currency. The government tried to shore up confidence by opening up lines with neighbouring central banks. IMF supported this, but in April 2008, the U.S. Fed, the Bank of England, and EU's ECB all rejected Iceland's pleas (Jónsson, 2009, p. 120). Only a 500 million euro line from Norway, Sweden, and Denmark restored some confidence. But to the large central banks, Iceland was simply "*not* too big to fail." (Jónsson, 2009, p. 136). Lobbying by EU banks vis-à-vis ECB may have been involved. There was resentment against Icelandic banks both in EU and US banking circles. Possibly they figured that Iceland might serve as a warning that other indebted small countries should better start deleveraging at once. Iceland was not a EU member, and no Cold War

imperatives motivated the United States any longer (they had left Keflavik in 2006). The larger Nordic countries were Iceland's only friends.

In June 2008, an attempt to borrow 5 billion euro in the international market was given up, since there was no funding to be had for Iceland at the time. On July 24 indicators of debt default risk peaked. IMF assistance could have been requested, but Iceland regarded itself as an advanced country not in need of such a thing (Jónsson, 2009, p. 148).

Paradoxically, Oddsson headed the CBI in a period when the external expansion of the big three made monetary policy almost powerless. When things start to come apart, Oddsson signalled increasing scepticism against some of the younger financial wizards and the holding company players (Baugur in particular). Although a neoliberal enthusiast, Oddsson voiced some nostalgia towards old-style clientelism. The excesses were the creations of his own policies of economic liberalization (Jónsson, 2009, p. 144), but he now regretted that "the right people" had not been in charge of the privatized banks and resources. He moved towards a more isolationist position.

Iceland in the International Crash September/October 2008

The worldwide fall 2008 crash started with the investment banker Lehmann's collapse on September 15, six times greater than any previous US corporate default. Within two weeks, the international interbank market dried up. Iceland's banks faced a major dilemma. They had to deleverage, but deleveraging was increasingly difficult in markets where trust withered away. They held no credit derivatives (Jónsson, 2009, p. 126), their problem was liquidity, not capital. Their assets could not be turned into cash to repay claims.

A run on the banks followed Thursday/Friday October 2/3. Being an internet bank, Icesave was exposed to a 24-hours run (Jónsson, 2009, p. 151). Most of the Icelandic savings pool was in the banks. Nearly all of it was wiped out. What remained was frozen in defaulted estates. Most of the stock market value evaporated. The ISK depreciated greatly. Many companies would soon be technically bankrupt. Inflation soared again. Firms were at the mercy of banks, but banks were at the mercy of their creditors. The payments and clearing system was potentially undermined.

The government could not issue deposit guarantees, since EU law required that these should be granted also to foreigners and total deposits were about 80 percent of GDP. A planned rescue package relied partly on foreign aid, but no such aid was forthcoming. Around the world, national

financial systems were shored up by state injections of liquidity. On Saturday/Sunday, October 4/5, expert regulators and lawyers wrote laws to erect a "wall of shield" around Icelandic savers and homes. The paradigm for this rescue plan was US action (by FDIC; the U.S. Federal Deposit Insurance Corporation) in which the major operating assets and liabilities of Washington Mutual were sold to J. P. Morgan. Depositors were saved and bondholders were stranded, creditors would only get 5–15 percent of their claims (Jónsson, 2009, p. 155). Bondholders had little sympathy anyway. But it was now very uncertain when Iceland would again be able to procure new foreign loans on the private market. It was also unclear whether the state would be the subject of litigation. The most immediate problem was that the "wall" could be seen as a violation of the EEA single market provisions, since domestic depositors were given precedence over foreign depositors.

Glitnir and Landsbanki were taken into administration on October 6 and 7. Up to a third of the employees were laid off. Kaupthing survived, receiving most of CBI's small resources. On Tuesday October 7, the Swedish central bank granted an emergency loan of 5 billion SEK, with Kaupthing's Swedish operations as collateral. Iceland's FSA was given extraordinary powers by an emergency law, but by then, the banks were "effectively dead" (Jónsson, 2009, p. 175). The banking crisis was solved by collapse and restructuring. The new law did away with the irresponsible banks by means of the old bank/new bank distinction, corresponding to the bad/good bank distinction in other European countries.

Like earlier, none of the large central banks offered relief. ECB and Bank of England demanded liquidity from Iceland (Jónsson, 2009, p. 154). In comparison, during the run on Irish banks after the Lehmann collapse, the Irish government issued a blanket guarantee worth twice the Irish GDP. This restored confidence; Ireland was not drowned by claims. Backing from the European Union was crucial (Jónsson, 2009, p. 209f).

Britain bailed out all British Icesave depositors. Based on an informal telephone conversation between the Icelandic finance minister and his British counterpart on Tuesday, 7 October (Jónsson, 2009, pp. 179–183), Britain took legal action against Iceland's authorities to recover the money lost. They enacted an antiterrorism law (Landsbanki Freezing Order 2008), seizing all Landsbanki assets. Iceland (later only Landsbanki) was classified with "financially sanctioned regimes" such as Al Queda, Taliban, and North Korea (Jónsson, 2009, p. 185).

On that same day, a rather paralyzed Oddsson at CBI organized the perhaps "shortest-lived currency peg ever." Its breakdown demonstrated that Iceland was not considered a safe credit risk. However, it has been claimed

that through the few hours it lasted, billions of ISK were exchanged into foreign currency at an exchange rate that was much more favourable (close to pre-crisis parity) than the low level the ISK soon reached. It has been speculated that this was not just Oddsson helping his friends to get out, but also an effort to weaken the one bank that still survived, Kaupthing (Wade & Sigurgeirsdóttir, 2010, p. 22). The allegation has however not been securely established.

On Wednesday morning, 8 October, the British FSA authority seized Kaupthing's deposits, selling them to a British bank. Kaupthing collapsed, and Iceland's FSA took over control at midnight. In this high diplomacy, the British were the professionals, the Icelanders (led by Haarde) the amateurs (Jónsson, 2009, p. 187). Iceland's international payments system collapsed. A payments system was rebuilt at the domestic level over the next months, assisted by J. P. Morgan. CBI now rationed foreign exchange, giving preference to trade in necessities (Jónsson, 2009, p. 191f).

The currency crisis – chronic since March – could only be resolved with an outside loan. Derivative or swap contracts representing about 80 percent of GDP were locked up in the defaulted estates of the banks. Foreign money (ISK 500 billion) was also trapped in government securities (nominal bonds and certificates of deposit). IMF provided a solution to Iceland's balance of payments problem by imposing capital controls. The remaining carry traders were stuck in the country. The interest rate was kept higher than anywhere else in Europe. Carry trade positions were invested in government securities (equalling the revenue from Iceland's cod fisheries).

The British and Dutch blocked Iceland's IMF application for further support (Jónsson, 2009, p. 198), insisting on refunding for the whole Icesave bail out, the same treatment that Iceland had given its citizens. Media in Iceland compared the claims to allied reparation claims on Germany (85 percent of GDP) after World War I (Jónsson, 2009, p. 176)! The number of British Icesave-account holders was about equal to the population of Iceland. The demand was that each Icelander would pay back one Icesave account. (Jónsson, 2009, p. 198). What the British saw as an indemnity, Icelanders saw as injustice. The British in the end also blocked Nordic support (Jónsson, 2009, p. 199). Their legitimation was the concern for the common European market in financial services, where the home country deposit guarantee was the ultimate backing.

At the time of writing, the Icesave case has not been solved. A negotiated solution was – following the intervention of Iceland's president – submitted to a referendum, and massively rejected. The matter is now taken to court, and cases will follow both in Icelandic courts and in the EU/EEA-system.

For the aftermath of the crisis, we refer to Ólafsson's account (this volume). We shall now make use of the extreme case of Iceland to sketch a Nordic comparison of neoliberal influence, populist politics, and expert knowledge.

NEOLIBERALISM, POPULIST POLITICS AND EXPERT KNOWLEDGE

Understanding Neoliberalism

Let us specify three different understandings of *neoliberalism*. First, it is basically an intellectual political philosophy. One of the crucial neoliberalists in Iceland, Hannes Hólmsteinn Gissurarson, with his Oxford DPhil thesis on *Hayek's Conservative Liberalism* (published 1987), is a case in point. Secondly, this philosophical tradition may inspire the political strategies – extensive reliance on market solutions – of particular non-socialist parties in parliamentary politics. We have seen that Iceland's IP under Oddsson (closely connected to Gissurarson) was such a party. Thirdly, with more specific reference to the economics discipline (Hayek was originally an economist), certain "anti-Keynesian or anti-planning" ideas evolving within the economics expert culture have been labelled neoliberal. We shall, however, question the value of this third understanding.

Let us first show how the first two understandings help us grasp important international developments in the 1970s and 1980s: Neoliberal political philosophy had a renaissance in the 1970s (Mjøset, 2011). At least Thatcher, elected prime minister in Britain in 1979, explicitly quoted Hayek as one of her favourite political theorists. As for Reagan, US president since 1981, the Heritage foundation, under the direction of a former US MPS-activist, had a major influence on his administration (Bair, 2009, p. 375). Such think tanks were a major force behind the neoliberal resurgence.

All over the Nordic area, conservative and liberal parties had to relate to the new trends. Ideologically outspoken neoliberals emerged all over the Nordic era. Some of the leading economists in Sweden had long been members of Hayek's liberal Mont Pelerin network. But it would be way too simple to claim that all the large non-socialist parties quickly revised their party programs, converging on some version of neoliberal fundamentals. In order to gain influence during the 1950s and 1960s period of "embedded liberalism" (Ruggie, 1982), these parties had all accepted regulations and mixed economy patterns that clearly violated the philosophical principles of

neoliberalism. Specifically in Iceland, as we have seen, the IP had been tightly weaved into a clientelist rationing system for all the most important state services.

But the problems of the 1970s, not the least the challenge of conducting stabilization policies in a more unruly world economy, made the large non-socialist parties more aware of the problems of interventionism and economic planning. Only in Iceland, however, we find an ideologically charged neoliberal faction rising to *dominate* the largest non-socialist party.

We shall return to the comparison of the structure of non-socialist parties below, but first we shall consider to the third understanding. Certain trends in macroeconomic theory since the 1970s have been labelled "neoliberal." Let us briefly consider some main points in these theories and their impact on economics expert knowledge that plays some role in the making of economic policies.

Modern Macroeconomics for Beginners

A quite common argument, especially among non-economist social scientists, is as follows: There was an intellectual community between the political ideas that grew to become important in Anglo-American right-wing politics since the late 1970s and the core ideas that define the disciplinary identity of the vast majority of contemporary economists, namely neoclassical theory in the Walrasian tradition (see Harvey, 2005, p. 20).

But Walrasian general equilibrium theory, further mathematized in the Arrow/Debreu model of the 1950s, has been taken as the basis for models of socialist planned economies, while Hayek's intellectual development led him out of this neoclassical framework. The famous interwar "socialist calculation controversy" started off such discussions (Mirowski, 2002, chapter 5). Thus, rather than a politicized reading of that framework, we shall see it as a set of mathematical formalisms that can be specified with reference to quite disparate political philosophies. But its most important role is not in such philosophical links, it is in the role it plays in defining the disciplinary identity of academic economists.

In the 1930s, some of the Nordic countries developed homegrown varieties of neoclassical economics (the Oslo and Stockholm schools) with a technocratic orientation. In fact, Frisch, founder of the Oslo-school, coined the term *macroeconomics* (Hoover, 2001, p. 63). In the post-war period, the neoclassical framework became an international, homogenized phenomenon. Samuelson's *Economics* was first published in 1948, becoming the

leading textbook of the 1950s and 1960s, promoting the "neoclassical synthesis" that supported planning efforts in mixed economies. However, 1970s macroeconomics rejected this Keynesian synthesis.

Summarizing the state of macroeconomics after the 2007 financial crisis, Paul Krugman (2009) concluded that its condition was "not good." The most general reason for this sad state, he found in the emulation of mathematical reasoning, so typical of modelling in natural science. Generalizing to the whole discipline, Krugman held that "economists, as a group, mistook beauty, clad in impressive-looking mathematics, for truth." They were led astray by "the desire for an all-encompassing, intellectually elegant approach that also gave economists a chance to show off their mathematical prowess." But he was primarily concerned with the two main factions in macroeconomics since the late 1970s. Since the 1960s revolution in higher education, the teaching of economists – at least across the Western world – has relied on US textbooks. Krugman thus used US terms to distinguish the two macroeconomics schools: saltwater (mainly at US coastal universities, Harvard, MIT, and Princeton) and freshwater (mainly at inland universities, especially Chicago).

Salt- and freshwater economics share the same methodological approach; they insist that economics should start from optimizing behaviour of micro agents, the neoclassical fundamentals. They both held that Keynesian demand management was not at all the efficient approach to macroeconomic stabilization that older Keynesians claimed it was. The view that active macroeconomic demand management policies were "inefficient" gained more followers. This change of emphasis was in the 1980s connected to the stronger influence of the central bank in a "disinflationary regime" (Forsyth & Notermans, 1997, Table I.1.III).

Freshwater macroeconomists use one-actor, aggregated models, assuming omnipotent computational capacities. On this basis, they challenged Keynesianism in the Samuelson version, including its applied econometric varieties. (Krugman thus holds 1960s Keynesianism to be "non-neoclassical," an ambiguity we return to later.) Robert Lucas' (Swedish Riksbank prize for economics 1995) in the mid-1970s claimed that large-scale macroeconometric forecasting models contradicted the fundamental phenomenon of rational expectations (see Hoover, 2001, p. 71f). That phenomenon has already been argued in Muth's critique (in 1961) of Simon's notion of satisficing. Lucas' critique was further developed into the theory of real business cycles. Another leading contribution was Friedman's conclusion that the only legitimate economic policy intervention is central bank management of money supply, and the criticism of the Phillips curve trade-off between unemployment and

inflation leading to the concept of a "non-accelerating inflation rate of unemployment" (NAIRU). Monetary policy should not be influenced by unemployment rates below that threshold. Within financial economics, such freshwater thinking pursued the idea that financial markets are efficient markets (since financial markets always price assets correctly, the best thing a corporate manager can do is to maximize their stock prices). They also developed capital asset pricing models that required physicist-level computations.

The charge that freshwater economists have ties to neoliberal political philosophy was raised not just because of Friedman's association with Hayek's Mont Pelerin Society, but more broadly because the freshwater economists take as a very fundamental belief that markets work. Lucas saw recessions as a result of confusion. More recently, Prescott claims they have nothing with price fluctuations and demand changes to do; they are the result of technological progress and decisions to voluntarily enter into unemployment. Krugman (2009) emphasizes that this view, packed in mathematics, dominate "the teaching of macroeconomics in many university departments." Prescott – and his co-author Kydland – received the Swedish Riksbank prize for economic research in 2004.

Saltwater macroeconomics accepts the view that 1960s Keynesian theory was not neoclassical enough. But they maintain a Keynesian vision of what a recession is. Economists such as Blanchard at MIT, Mankiw at Harvard, and Romer at Berkeley were thus called New Keynesians. Recessions were due to market imperfections, to various forms of rigidity, not the least in labour markets. Involuntary employment is possible, and it should be counteracted.

Krugman notes, however, that these debates were purely theoretical. The two factions did not fight over economic policies. He relates this to the fact that in the United States through the 1985–2005 period, inflation was subdued and recession was quite mild. Thus, unlike the "original Keynesians," the New Keynesians held that fiscal policies were unnecessary to fight inflation. Monetary policies were enough. Thus, when the Fed under Greenspan pulled the United States out of the dot.com recession in 2001, they did not see the signs of the subprime housing bubble. Freshwater economists did not think that the Fed mattered much, given their belief in efficient markets. One of their leading economists (Fama) denied the housing bubble as late as in 2007; the trends were all a reflection of fundamentals (technology and tastes)!

With the subprime recession of 2008, however, a new context could be discerned. Federal Reserve monetary policies had routinely brought the

interest rate down by buying US state debt (Treasury Bills), whereby investors would seek higher returns in other assets, driving down these interest rates too. But in the subprime recession, the interest rate came down to zero and monetary policy was inefficient. The 1929 situation had returned, the very context in which Keynes had suggested government spending through countercyclical fiscal policy. The Obama administration thus returned to classical Keynesian economic policies. This, however, was also a challenge to the saltwater macroeconomists, since even "the New Keynesian models that have come to dominate teaching and research assume that people are perfectly rational and financial markets are perfectly efficient" (Krugman, 2009).

Since saltwater macroeconomics includes the efficient-market view of the financial sector, their models cannot yield the dynamics of the subprime recession without introducing "some kind of fudge factor" that depresses private spending. The mechanisms behind this factor – and Krugman (Swedish Riksbank prize for economics 2008) here includes his own research – remain unspecified. Krugman's prediction for macroeconomics is "that flaws-and-frictions economics will move from the periphery of economic analysis to its centre," and one must focus on "dysfunctional finance." The fundamentals of such analysis are provided by behaviour economics. He does not return to the question that strikes the non-economist: Will economics as a discipline be able to pursue this program with some reflexive arms-length distance from the "mathematics as truth" vision that have been such an influential part of their disciplinary identity in the post-war period? Economists, says Krugman (2009), "need to abandon the neat but wrong solution of assuming that everyone is rational and markets work perfectly."

Krugman's polemic actually introduces us to three schools of macroeconomics: The (freshwater) rational expectations school, the (saltwater) New Keynesians, and a third approach that we may call *orthodox Keynesians*. Some of these economists (such as Tobin) never abandoned the 1960s Keynesian synthesis. They suggest fine-tuning through fiscal policies, which is a more ambitious stabilization policy than just stimulating the economy in very deep recessions. They are very critical of real business-cycle theory. Solow, for instance, rejects the modelling of an economy as one single, consistent person (see also Hoover, 2001, pp. 82–86). But they even counter the (saltwater) New Keynesians, rejecting their claim that equilibrium will emerge if only rigidities are counteracted by means of wage and price flexibility. They often draw directly on Keynes' original discussions of animal spirits and speculative demand for money in his 1936 classic *The General Theory*.

Orthodox Keynesianism thus has pre-1970s origins, but also relies on a specific research frontier in contemporary economics, namely the behaviour economics program of revising neoclassical fundamentals in order to make them more thoroughly grounded in interdisciplinary research in the borderland between psychology and economics. The earlier two, Krugman's salt-/freshwater schools, have few quarrels on fundamentals. For instance, both schools develop dynamic stochastic general equilibrium (DSGE) models; the main family of models now relied on in central banks.

It is impossible in this brief survey to draw up a clear-cut distinction between saltwater macroeconomics and orthodox Keynesianism. Some arguments bring them quite close. One might assume ad hoc that there are rationality failures and limited computational capacities. If this is so, one can model departures from (freshwater) real business-cycle solutions both in the short and medium term. However, among the younger generation, one finds some of the world's most famous economists who have done original work in very many fields. For instance, Akerlof and Stiglitz (Swedish Riksbank prize for economics 2001) started, contemporaneous with the Lucas critique, to investigate the consequences of relaxing the assumptions about information symmetry in fundamental neoclassical microeconomic models. This gave legitimacy to interventionist practices in modern mixed economies, as Stiglitz (1996) emphasized, with direct reference to the older calculation controversy. This position was consistent with another influential development, namely the inclusion of more "Schumpeterian" features in new (endogenous) growth theory.

Although orthodox Keynesianism was originally a macroeconomic approach, today's most influential spokesmen for this position are mainly known for research in microeconomics, or at least for research that is not directly relevant to economic policy making. A few examples are research on discrimination and identity (Akerlof), asymmetric information (Stiglitz), and trade (Krugman). They have launched radical criticisms of both branches of New Macroeconomics. Stiglitz questions the theory behind inflation targeting and independent central banks, that is, that wage cuts will generate increased employment and growth of GDP. Akerlof has saved the Phillips curve, drawing on the behaviour economics/psychology synthesis of Kahneman and Tversky. Krugman's views were surveyed above, but the research on information asymmetry, and even new growth theory, has so far not been taken in the direction of a macroeconomic theory of medium-term (roughly 10 year) cycles, which must be *the* most relevant theory for scholars who give macroeconomic advice. Furthermore, their efforts to develop new fundamentals require challenging accommodations with another discipline

(psychology), something that is not always easy, especially given the solid disciplinary identity that economics has built around certain traditions of mathematical modelling.

Thus, instead of seeing them as critics of neoclassical theory, it is also possible to extract from Stiglitz and others the immanent criticism that not even freshwater macroeconomics are neoclassical enough. According to this rather drastic position, the conditions for equilibrium and optimal solutions are so extreme that they have no relevance for empirical macroeconomics. Pure theorists such as Arrow, Hahn, Kirman, Grandemont, and others tend to defend such a view.

Moving from pure theory to a more pragmatist line of reasoning, we find another argument in favour of emphasizing convergence between orthodox Keynesianism and saltwater macroeconomics. Models based on standard neoclassical fundamentals are a safe bet for professional economists.[7] While a number of alternatives exist (e.g. endogenous growth, learning, bounded rationality, financial imperfections, information dilemmas, etc.), these alternatives differ from the neoclassical model in entirely non-converging ways. Since it is costly to build models, heads of economic research tend to prefer models based on the neoclassical mechanism of perfect information, rather than models based on one out of many other *different* mechanisms offered as alternatives. Only the very largest organizations can carry the costs of trying out promising alternatives. Within one of these (IMF), efforts are now made to develop a standard macro model (the GIMP-tradition) that integrates information imperfections typically present in financial markets.

Those who tend to emphasize convergence between orthodox Keynesianism and saltwater macroeconomics may also argue that it makes sense to start with a model in which actors behave rationally, that is they understand and anticipate the consequences of their actions. The dilemma that, in real life, people do not understand the consequences of economic policies as instantaneously as the actors of the model can be solved by using general equilibrium models that has an equilibrium module as well as a rigidities module. In the longer term, the latter converges on the former.

The Diffusion of Internationalized Neoclassical Economics in Norden

As for the Nordic economics, the main shift since the late 1970s has been from early Orthodox Keynesianism into (saltwater) New Keynesianism. At the academic level, and in research environments connected to the central

banks, attention was certainly paid also to the Lucas critique and real business-cycle models. Economists born in the 1950s and 1960s, specializing in macroeconomics, would follow both schools. Thus, we may just as well aggregate the two branches (freshwater and saltwater) under the one heading New Macroeconomics.

Criticism of the older Keynesian synthesis (Samuelson's *Economics*) struck a chord with those who analyzed the problems in the Nordic area: Keynesian policies were accused of generating inflation, lower growth, and other problems connected to the various sets of economic policy routines of the early 1980s. The new consensus was above all a recipe to fight inflation by counteracting inflation expectations. New Macroeconomics was thus important when economists gave advice with reference to the sequence of disappointments in economic policy making since the late 1970s. The new theory gave a rationale for the new and independent position of the central banks. As Krugman emphasized, both fresh- and saltwater economists embraced the theory of efficient financial markets.

The one surviving Keynesian element (among New Keynesians) was wage/price rigidities. Because of these rigidities, production and employment will be influenced by aggregate demand, at least in the short term. But the emphasis on rigidities has even legitimated a policy of relying more on markets. Thus, structural reforms in product and labour markets were suggested. These theories were drawn on in the period through which the C-complexes (the complex of market-organizing institutions built around the circulation of financial capital in a modern capitalist economy) of the Nordic countries were transformed (see Mjøset & Cappelen, this volume).

According to Erixon (this volume), two other theoretical traditions were also drawn on in the mainstream economics expert culture since the 1980s. One was *new political economy*, providing stylized analysis of political behaviour in terms of rationality, time inconsistencies, and utility maximization (Alesina, Hibbs, Persson, and others). It has been used to legitimate policies of central bank autonomy and fiscal rules, but it has not been important for the more technical aspects of macroeconomic modelling.

The final theoretical tradition drawn on (Erixon, this volume) is theories of bargaining, trade unions, and efficiency wages. The core of these theories is the determination of the equilibrium rate of unemployment, supporting the policy conclusion that this rate can be reduced by cuts in unemployment benefits. But Erixon notes with reference to the Swedish case that this tradition emphasizes collective bargaining and incomes policies more than alternative models. It is interesting to note that these theories gain popularity since the mid-1990s (i.e. later than New Macroeconomics),

when it turns out that the Nordic varieties of centralized bargaining are quite efficient institutions.

Research pointing in this direction was conducted both in Oslo and Stockholm. This can be seen as a European, or even Nordic branch of New Keynesianism, seldom to be found in the United States, and thus not emphasized in Krugman's brief overview. It is interested in institutions, particularly institutions that relate to labour (Calmfors & Driffill, 1988; Layard, Nickell, & Jackman, 1991). This may be connected to the point made in the Norwegian paper (Mjøset & Cappelen, this volume): Economic policies in Norway have never seriously tried to tamper with the L-complex, that is the complex of market-organizing institutions built around labour as a production factor in a modern capitalist economy. This may be generalized for all the Nordic cases, even Iceland. As Erixon (this volume) suggests, these theories legitimate incomes policies such as the industrial agreement in Sweden. We see here that while leading academic economists follow international trends, they also tailor these to the regional situation within which they eventually provide advice.

Such theories of bargaining would be a field for saltwater rather than for freshwater economists, since one set of rigidities they focus on is in the labour market. They invite communication between Orthodox Keynesians and saltwater macroeconomists. The ambiguity here concerns the extent to which the saltwater economists are willing to join the orthodox Keynesians in their search for alternative fundamentals that draw more on psychology than economists have been used to. Alternatively, one may claim that this is not so much about alternative fundamentals, but about introducing a new set of actors into the models. They earlier had Households, firms, and governments, they now also include private organizations.

In the following section, we provide brief accounts of the transition from early post-war economics to present-day economics in Norway, Finland, and Sweden, as well as a few remarks on Denmark. We start from a simple scheme of how – in the Norwegian case – expert knowledge (academic and applied economics) relates to economic policy making. Academic economics is one corner of what has in Norway been called an *iron triangle* in economic policy making (Fig. 1).[8] The two other corners are the ministry of finance and the applied research centre(s), especially those that provide policy advice in macroeconomics. At each corner of the triangle, we can distinguish developments that might challenge the workings of the triangle. There might be challenges to neoclassical economics at economics departments, alternative centres of applied research, or parliamentary politics dictating the ministry of finance.

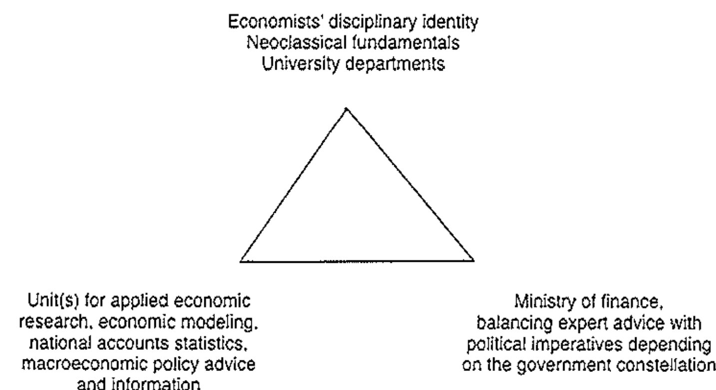

Fig. 1. The Iron Triangle of Economic Policy Making.

We start by showing that in Norway these networks have remained surprisingly robust. We then survey the further cases of Finland, Sweden and Denmark. In none of these cases, we find as robust a triangle as in Norway: Academic expert knowledge has not played the same organic role in these cases, and there have been more changes in the policy–advice relationship between applied research and the ministries of finance. Finally, we return to the case of Iceland.

Note that this scheme works best with reference to fiscal policies. As noted at the outset, the most successful incomes policies take the form of information to the social partners; it is not a "policy." Especially in Sweden and Norway, the ideal often associated with the name of Saltsjöbaden is that the state refrains from direct intervention into wage settlements. But information is provided on trends in the labour market, particularly calculations of the pace of wage growth at which the national economy will escape unsustainable external constraints. Decisions on centralization/decentralization, on participation in tripartite committees, etc. are matters that the social partners should deal with on their own. Thus, tripartite corporatist arrangements, where certain economic policy decisions (e.g. about taxes, prices, etc.) emerge as integral parts of wage settlement ("packages"), are seen as a deviance from the Saltsjöbaden ideal. This has some parallels in French-style indicative planning of the 1960s.

In the international institutional framework of the 1950s and 1960s Bretton Woods system, monetary policies were closely integrated with fiscal policies and the central banks were under close control of executives and

legislatures. The financial systems had been regulated as a response to the 1930s financial crash – close supervision, segmentation, and selective credit mechanisms (Forsyth & Notermans, 1997, p. 20, Table I.1.II). Only in the context of internal and external financial deregulation since the mid-1980s, central banks gained increasing autonomy. Since then, governments have given central banks mandates that they are supposed to pursue – based on their own expert knowledge about the financial system – relatively independent of the ministry of finance. The question of whether the central bank stance (e.g. determining the interest rate in an inflation targeting/flexible exchange rate regime) accommodates other policy goals or not is one dealt with in several of the contributions in this volume.

But through all periods of the post-war era, the ministries of finance have been the crucial centre of fiscal policy making. Tracing the relations between these ministries, economic theory and applied economics research, we take the Norwegian case as the extreme.

Norway's Iron Triangle

In Norway there have been tight, stable and durable networks between the three corners. In the 1930s, a new brand of economist engineers, drawing on mathematized models, challenged the older-type interdisciplinary economists (law/history/economics) that staffed the ministries in the early post-war period.

In the early post-war period, the triangle connected the dominant economics department within higher education (at the University of Oslo) with the main applied research centre (SN – Statistics Norway) and the ministry of finance. The economics department provided the socialization of the economics experts. Candidates from the department occupied all the key positions in the economic policy bureaucracy. The research centre collects and organizes national accounts statistics, providing expert advice (based on applied macroeconomic modelling) to the ministry.

The Norwegian model building tradition (Frisch, Johansen, Aukrust) was entirely different from the mainstream (Bjerkholt, 1998). The unique feature was that they used input–output tables for short-term planning; elsewhere such tables were only used for long-term planning. The point of departure was Frisch's work in the late 1920s on a system of accounting concepts that would provide detailed representation of economic circulation. While most systems use "a few aggregate figures," this accounting system relied on annual input–output tables.

SN developed differently from other statistical offices in that it included a modelling unit. Few other countries have such an institutional solution. Statistics Denmark, however, copied parts of the Norwegian approach much later, and there were parallels at INSEE (the French statistical institute), especially the period with E. Malinvaud as the director.

During Labour's political dominance since 1945, Norwegian expert economists succeeded in building a national budget, not just a system of fiscal accounts for the government, but a plan for the entire national economy in real terms. It was an integrative tool for planners, as it allowed them to link "the sub-budgets of ministries, subordinate government agencies and semi-official bodies in the process of working out the economic prospects and economic policies for the coming year" (Bjerkholt, 1998, p. 322).

Such a programmatic national budget differed from a forecast of national accounting aggregates. It had to be based on "realistic assessment of the functioning of the economy. The various sub-budgets had to be tied together in a way that took care of the interrelations of the economy" (Bjerkholt, 1998, p. 322). In the early days, this was done by a cumbersome "administrative interactive procedure," but eventually, one could begin to use models. The first model used for macro policy purposes was implemented on a first-generation computer at SN in 1959, and "used by the ministry of finance as the first in a series of models that were at the centre of macroeconomic policy preparation and coordination" (Bjerkholt, 1998, p. 317). Even today, the SN models rely on quite costly yearly updates of the input–output core. Similar models are also still used in Denmark, Finland, and France (the core is updated every fifth year), but not in Sweden.

Thus, since the 1960s, the macroeconomists have been running models. The applied unit has communicated the results to the ministry of finance. Business cycles, labour market trends, and other relevant variables have been observed and forecasted. The ministry of finance relies on this knowledge to develop policy proposals, thus linking expert advice to the practical and contextual decision-making situation of the politicians/parliament. The yearly national budget process has been depoliticized to some extent. The organizations of social interest groups position themselves around this triangle: for instance, both the LO (trade union confederation) and the employers state their views, but do not have strong expert collectives.

In the late 1960s, SN's research director, Odd Aukrust, was asked to head a commission discussing "technical calculations" of relevance to wage bargaining. This led to the development of the *Scandinavian inflation model*. Thus, as unbiased experts, SN scholars also plays a role in facilitating Norwegian wage bargaining, although this cannot be called "incomes policy."

As for monetary policies, the ministry was in charge of the administration of the interest rate (kept low, as credit was rationed), managing the financial system through corporatist ties with banks and other financial institutions. The central bank was also integrated in this network, but did not play an autonomous role. The networks of the triangle thus also played a role in monetary policy making.

The New Macroeconomics of the 1970s/1980s emerged as an international trend. Given the financial evasions and black markets experienced at the time, it was seen to confirm that more market-oriented solutions were needed. Establishing a knowledge base ahead of the restructuring of the C-complex, the ministry of finance took care to consult research centres other than SN. The central bank become stronger in research, and the business school in Bergen (NHH, the Norwegian school of Economics and Business Organization) was central for the 1980 report on reform of monetary policy. Particularly since the 1990s, the SN had to accept more of a division of labour with the rational expectations/DSGE-traditions that dominates in the bank. The bank decides on the interest rate (based on a mandate from the government), while SN continues to provide models to the ministry of finance (it certainly does not take its own decisions).

The knowledge generated by SN still relies on their traditional arsenal of models, updated to take into account the more important role of factors, such as the interest rate. The relation between SN and the ministry today is as follows: A large model is provided to the ministry every half year, including the most recent data and technical revisions. The model may well be called a saltwater model, and it reminds of the model used by large US institutions such as Brookings and the Fed. The ministry economists use the model to run their own analyses. Anomalies are thrown out by means of altered assumptions and residuals. A forecast is the result of interaction between a model and the technocrats who run it. SN pursues their own analyses on a quite similar model. The ministry has an eye not only on SN's findings, but also on calculations offered by other centres. It uses the SN models quite freely. There have been cases where the ministry disregarded Keynesian features of the model, regarding them as irrelevant for policy making. However, this happened much more frequently before 1995 than after.

Above, we mentioned specific Nordic/European theorists that include labour market institutions. Such models play an important role in the present iron triangle. At the department, there has been periodical tension between the Kydland–Prescott tradition (rational expectations) and the new growth/information asymmetry theories. A present centre for excellence at the department (the ESOP-project[9]) reflects inspiration both from Orthodox

Keynesianism and saltwater New Keynesian macroeconomics. It studies the Norwegian model with its iron triangle (the rationality of centralized wage bargaining), providing a pool of arguments as to why developing countries/emerging economies should learn from Norway/Norden. We find the same ambivalence as in our discussion of these two branches in US economics: they seem never to engage in disputes on fundamentals. They diverge strongly when it comes to macro policies and developmental strategies.

In sum, Norway's iron triangle may have been challenged, especially in the days of financial deregulation, but the challenge has been contained.

Finland's Axis

Rather than a triangle, the Finnish case displays an axis. The axis connects the central bank with the ministry of finance. Despite the fact that new generations of Finnish economists in the 1960s were educated in the relevant Samuelsonian neoclassical economics, with its general Keynesian orientation, this paradigm had next to no influence among economic policy decision makers. As pointed out by Pekkarinen (1989, p. 322ff), the main routines of Finland's economic policies in the 1950s and 1960s reminded of the "treasury view" (quantity theory of money, the principle of sound finance, balanced budget, every penny of state loans diminished private economic activity) that Keynesianism opposed. There was an inner circle of experts at the ministry of finance and the central bank, a considerable concentration of power in the old regime until the 1980s. Their links to academia were weak, often hostile. They owed their position to meritocracy and Weberian ideals of bureaucratic accountability. Some of them had started their careers in private banks or in other parts of the private sector. The statistical office (Statistics Finland) was never important for economic policy advice.

The Finnish pos-twar state has been described as a cameralist one, with weak, broad cabinets, strongly influenced by an autonomous bureaucracy. Parties that in other countries had supported the post-war Keynesian turn (social democrats and agrarians) showed little interest in Keynesianism in Finland. The bank – regarding economic policies as strictly depoliticized – controlled fiscal policy. It saw the state as equivalent to a private economic agent, possibly with even graver borrowing restraints. Monetary policy was pro-cyclical, creating a devaluation cycle where deflationary policies made room for successful devaluations that would shift the income in favour of profits, thereby stimulating capital accumulation.

Our earlier research showed how Finland's economic policies became increasingly "Scandinavianized" since the late 1960s (Mjøset, 1987, p. 431,

p. 446). Only a decade later there was the early change toward New Macroeconomics. Thus, while the Finnish devaluation cycle withered away and there was a turn toward more consensual incomes policies, the disciplinary framework of expert knowledge (New Macroeconomics) more clearly gave theoretical legitimation to the role the central bank had already played for several decades (Pekkarinen, 1989, p. 328).

As Finnish corporatism began to include labour, research institutes linked to the social partners became increasingly important: left/unions, business/bourgeoisie, and rural areas/agriculture. These institutes are invited to participate in the production of white papers and policy assessments. But the role of expert knowledge is still limited. The Labour Institute for Economic Research and ETLA[10] (The Research Institute of the Finnish Economy, connected to the employers) has contributed theoretical considerations in support of the corporatist arrangements. Again the family of labour market models with centralized bargaining and organized social partners often come up as the most suitable ones. Along the ministry/central bank-axis, decision makers now pay more attention to the knowledge-based views of the social partners. Here is a difference to Sweden. Swedish committees established to investigate matters of relevance to economic policies (published as SOUs) are dominated by experts drawn from academic institutions. In Finland, the ministry tends to appoint bureaucrats (non-theoretical economists) and representatives of the labour market partners. To the extent such commissions refer to academic research, it is used to legitimate views that they already hold: When in the late 1980s, the Calmfors–Driffil argument was published, it was soon used in order to legitimate incomes policies arrangements.

Sweden's Shifts

Like Norway, Sweden had a homegrown school of neoclassical Keynesians, some of whom were strongly linked to the social democrats already in the interwar period. It does seem, however, that the Stockholm school lacked an institutional entrepreneur that would – as Frisch seemingly did through his main students – succeed in joining detailed empirical input–output tables, national accounting, and modelling. A Swedish national budget approach, developed at National Institute for Economic Research (NIER) (Konjunkturinstitutet), played an important role, but only in the 1950s (Vartiainen, 2007). Furthermore, it does not seem that a close and more permanent – as in Norway – policy–advice relationship was established between one centre of business-cycle research and the ministry of finance.

The Swedish Labour Party held office more or less permanently between 1932 and 1976. In the post-war period, the most relevant axis into the ministry of finance was neither from an applied research centre (as in Norway) nor to the central bank (as in Finland). The relevant axis connected the ministry to the LO (Trade Union Confederation) unit for economic research. One of its leading economists, Rehn, also temporarily held posts in the planning bureaucracy.

The Rehn–Meidner model was not developed by academic economists (Erixon, 2010). Although both Rehn and Meidner were educated by Stockholm school academics, the model did not reflect the dominant views in the Stockholm school. Their suggested package of economic policy routines was a response to the challenges that LO faced as demands for consensual incomes policies arose in the late 1940s. The Rehn–Meidner idea was so strong and relevant that it actually influenced academic, theoretical debates, with a certain lag. There is a link between that model and Nordic/European labour market economics, mentioned several times already. The Rehn–Meidner model even influenced noneconomic disciplines such as political science!

This influence was lagged. Earlier, the impact of the Rehn–Meidner model led to some tensions with academic economists that were more in line with the early mainstream of Samuelson's *Economics*, but it is debatable how fundamental these objections were (e.g., the case of Lundberg's criticism, see Erixon, 2010, p. 100f). Thus, even before the international academic community of neoclassical economists slid toward New Macroeconomics, there was tension between an actual model of policy making and academic economics.

Another axis was between the ministry and the Swedish NIER. The latter was responsible for business-cycle analysis and forecasting, important to the extent fiscal policy measures were deemed necessary. (In the Rehn–Meidner model, fiscal policies should be restrictive, unless there are major recessions.)

In a political economy with two major opposed social partners, one might think that there was a similar axis to organized business interests. There was a de facto alternative theoretical centre in the form of networks around Erik Dahmén, professor at the business school (Stockholm School of Economics). In the tradition from Åkerman (who set up a unit for business-cycle research within SAF (The Swedish employers' association) in the 1920s), Dahmén here studied economic transformations and economic entrepreneurship. Dahmén was employed as advisor to Marcus Wallenberg for several decades. Swedish business also financed their own centres for applied research, most particularly Industriens utredningsinstitut (IUI)

(now named IFN, Research Institute of Industrial Economics). But Dahmén's more historical and Schumpeterian approach never gained a wide circle of followers in economics, and the research centres were not linked up with the ministry during the labour regime. This is a contrast to Finland's 1970s corporatism, where the social partners had their own centres for applied research.

As in all the countries, the early post-war period in Sweden implied extensive credit rationing. In both Norway and Sweden, the central banks had been nationalized. Sweden's financial sector was forced into monthly sessions of corporative coordination sessions, where the central bank discussed with and forced regulations on the banking associations. Sweden's leading family of businessmen, the Wallenbergs, mostly held the chair of the Bankers Association. As self-conscious capitalists, they "did not much like being told by Per Åsbrink, the social-democratic party functionary raised to Riksbank governor (1955–1973), how to set the banks' interest rates, and which bond issues to arrange or buy, in which amounts, and on which conditions, and which issues to abstain from. After such meetings, the Wallenbergs and other bankers would, of course, immediately start thinking about how the agreements could be circumvented" (Andersen, 2010, p. 258f).

In the 1970s and 1980s in Sweden, there were possibly stronger tensions between impulses from the trade union movement and from interest groups that supported the non-socialist governments (1976–1982). In the mid-1980s, the consequences of the Rehn–Meidner model were drawn sharply in the LO-backed proposals of wage-earner funds, but then the main lines shifted under the influence of internal and external financial deregulation.

Like in the other cases, New Macroeconomics at this time floated in from the United States to push the theoretical orientation toward "more market-solutions" and skepticism toward Keynesian demand management through fiscal policies. New Macroeconomics was the theoretical reference in various expert commissions drawn on as the "Only way" non-socialist policy makers criticized the "Third way" 1985–1993. Initially, the conclusion was a hard currency as a nominal anchor. Although this theory was critical toward mainstream internationalized Keynesianism, the advice given was in some respects compatible with the Rehn–Meidner model (this is detailed in Erixon, 2010). However, the devaluation/inflation targeting since 1993 did not fit the model entirely, at least not the way it de facto was conducted.

The axis from LO to the ministry of finance was weakened as LO itself was weakened (Erixon, this volume). Since the models favoured by central banks came to dominate, legislating an autonomous central bank with an inflation targeting mandate was an unsurprising solution. However, while the business-cycle research conducted at the Swedish central bank is strongly inspired by New Macroeconomics (both Real Business Cycles and New Keynesian), there are no formal links between the central bank and ministry of finance. The central bank has little influence on fiscal policies, despite the fact that the decision makers belong to the same expert culture (with common frames of reference and even interaction in seminars). Sweden maintains a rather strict division between monetary and fiscal policy.

As for centres of expert advice, Sweden now has a division of labour: NIER mainly provides information of relevance to incomes policies. It is also one among several centres that provide policy advice on fiscal policies. The ministry of finance in itself has strong expertise, some with a long bureaucratic experience, and others with a background at the central bank.

Denmark's ministry and Economic Council

There were close networks between Nordic economists, so even though there were no Danish schools as famous as the interwar Oslo and Stockholm schools, Danish economists were familiar with early homegrown Keynesianism. With its balance of payments problems through to the early 1960s, a consequence of the continued dominance of agricultural exports, Denmark's central bank played a relatively autonomous role (although less so than in Finland; Pekkarinen, 1989, p. 343). There was credit rationing as in the other countries. As for fiscal and incomes policy making, internal experts in the ministry of finance have played a considerable role.

In 1962, Denmark established an *Economic Council*, a construction not found in any other Nordic country. The Council has three chairmen, dubbed "wise men," representing the economics expert culture. They are appointed by the ministry of finance, but the tradition has been established that the wise men themselves suggest the economists to be appointed next. They are supposed to represent the best of expert knowledge, being entirely unbiased politically. The Council have another 26 members, appointed in accordance with suggestions from certain ministries, the central bank, and a number of civil society organization, including of course the organizations of the social partners.

The Council is supported by a large secretariat, preparing background materials, calculations, and forecasts (e.g., based on simulation models) that are synthesized in the Council's reports, published every half year. The reports survey trends in the national and international economy. The Economic Council thus links academic expert knowledge with applied

research and forecasting. But the reports are communicated into the public sphere. Such communication is less direct and less continuous than the various axes we have seen between research institutions and the ministry of finance, especially in Norway and Sweden. The Council was originally conceived as a forum for economic policy coordination, but the extent to which this has taken place is limited. The organizations on the council have quite limited influence. Some coordination takes place informally, particularly in incomes policies.

Since economics expert knowledge in the 1960s and onward was a function of the international trends we have surveyed, the same transition into New Macroeconomics can be traced in Denmark. We saw in the case of Iceland that Oddsson had a background in networks cultivating neoliberal political philosophy. Denmark's minister for taxation (1987–1992) and later prime minister (2001–2009), Anders Fogh Rasmussen, also started out as a devoted neoliberal. He graduated in economics in the late 1970s. As a minister of taxation, he promoted the rational expectations critique of Keynesian fine-tuning, promoting structural reforms typically suggested by the New Macroeconomics (see above, and Goul Andersen, this volume).

The situation in Denmark presently seems to be one of the quite weak networks, not just between expert knowledge and the bureaucracy, but even between bureaucracy and politicians.

FINANCIAL INSTABILITY, ECONOMICS EXPERTS, AND NEOLIBERALISM

The third understanding of economic expert knowledge mentioned above referred to a very aggregate notion of neoclassical economics. When it comes to economic policy advice, macroeconomics is the decisive branch of economic science. We have specified the influence radiating from post-war US economics with reference to Krugman's three varieties of macroeconomics: saltwater, freshwater, and orthodox Keynesian. Our comparison of their influence in the Nordic countries shows that while freshwater macroeconomics (real business cycles) is influential in central bank research units, they have not been very influential in advice on fiscal policy making. To the extent applied empirical research in the Nordic countries (Norway especially) have influenced policy makers in the ministry of finance, it has floated between saltwater (New Keynesian) and orthodox Keynesian. We have noted the particular influence in Norden of the modelling of labour market institutions in the borderland between the latter two inspirations. To

the extent that this latter tradition converges with orthodox Keynesian economics, it is difficult – as we have noted – to judge whether it confirms to or departs from neoclassical fundamentals. Different economists probably would make different judgments.

Most noneconomic social scientists, especially those with a social-philosophical orientation, would disregard nuances in macroeconomic reasoning and judge the models with reference to their origins in the neoclassical tradition. This makes it easy to stamp all these traditions as "neoliberal." However, only in certain moments of overt politicization, economists would argue with reference to some deep philosophical foundations on which the models are built. And not all economists would make such shortcuts. In most everyday activities, large applied models (with neoclassical assumptions) are tinkered with to provide short- and medium-term forecasts in stable contexts. Noneconomic social scientists who study the economics discipline have paid too little attention to this production of knowledge by economists. Since we regard this as the most important impact of economic research on economic policy making, we conclude that the term neoliberal is misplaced here. We shall now support this conclusion by relating our case study of Iceland to the comparison of relations between academic economics, empirical expert knowledge, and ministry of finance involvement in economic policy decisions.

The Icelandic case is extreme not just because of the 2008 crash, but also because the first two understandings of neoliberalism (political philosophy and capture of a large non-socialist political party) are so clearly present. We have already emphasized that neoliberal political philosophies have not been similarly successful in any of the larger Nordic countries. Let us sketch a brief comparative explanation.

The Role of Party System Transformations

The really new feature of Nordic Party systems since the 1970s is the emergence of the right-wing populist parties. The Danish/Norwegian parties started as a popular revolt against the tax-state in the 1970s, so there were liberal views involved. Finland's *Landsbygdsparti* had a different profile, marked by its concern for the rural interests. In the longer term, purely liberal reasoning did not mobilize many voters. Both the Norwegian and Danish progress parties had disappointing election results in the mid-1980s.

The really successful populist parties, the Progress Party/Danish People's Party in Norway and Denmark, soon learned that they could capture votes

by cunning use of xenophobic and nationalist political reasoning. Unlike Hayek's intellectualized neoliberalism, populism could mobilize with reference to *others* that were not to be welcomed into the national community. They would benefit politically from a focus on the growing minority of non-Western immigrants in the two countries, both labour migrants and refugees. The anti-planning, noninverventionist market-enthusiasm that is the core of Hayekian neoliberalism was toned down. Clearly, xenophobic nationalism requires tight control of national borders in the form of strict immigration policies, which is at odds with the liberal quest for borderless free markets.

Furthermore, given that these topics prove so potent in mobilizing voters for new parties, at least the largest of the other non-socialist parties (especially the conservative parties) will have to relate to them as well. Finally, the more the new right-wing parties emphasize populism and xenophobia, even gaining support from traditional groups of Labour voters, they emerge as defenders of the welfare state, at least for the natives. While the conservative and traditional liberal parties tried out elements of a more market-oriented reasoning in the 1980s, they learned through the 1990s that defence of the welfare state had to figure in their party programs.

This led to tensions between conservative and liberal fractions in some of the larger non-socialist parties. It is interesting to note that in 1993, Fredrik Reinfeldt published *Det sovande folket* (The Sleeping Nation), criticizing the Swedish welfare state, making a plea for neoliberal society. The same year, Anders Fogh Rasmussen published *Fra socialstat til minimalstat* (From Social State to Minimal State), advocating an extensive reform of the Danish welfare system along liberal lines. But when they became prime ministers (Fogh in 2001 and Reinfeldt in 2006), this programmatic idealism had been washed away. In Iceland, however, neoliberal activists, intellectuals, and politicians stuck to their views and managed to *dominate* the largest non-socialist party. Already in 1991, Oddsson was a *neoliberal* prime minister.

This leads to a core insight concerning Iceland's peculiarities: that small island in the North Atlantic had very little non-Western immigration. Before the 2000s the immigrant population was between 1 and 3 percent, mainly from Asia (Thailand, Philippines) and former Yugoslavia. The enormous bubble in the 2000s coincided with an opening up (thanks to the association with the European Union through EEA) for labour immigration from the poorest, newly accessed eastern and southern EU members. Immigration exploded during the 2000s, mainly from Poland and the Baltic states. By 2007 immigrants were close to 7 percent of population, a higher percentage than Finland.[11]

However, this immigration came later than the first waves into Denmark, Norway, and Sweden (the early 1970s). Even though Iceland's immigration expanded very fast in the bubble economy, there was full employment. Native workers felt little competition from immigrants. Immigrants from the EU periphery cannot serve as "others" to be stigmatized in xenophobic political rhetoric (this is also the experience from the other Nordic countries). Many new parties emerged in Iceland since the 1970s, but none of them were populist right-wing parties. Thus, there was no populism present that could complicate matters for the neoliberal enthusiasts. Given Iceland's clientelist legacy, a neoliberal reasoning about personal freedom and the "authoritarian" drift of planned economic systems would go down well with the voters.

What if we extend our comparison to Sweden and Finland? These countries have radical right-wing parties, but these entered national politics much later. Why did no neoliberal faction triumph in any of these countries? Iceland has traditionally had a weak bureaucracy, given its experience of clientelism. Many aspects of economic policies were closely tied up with old-style politics. We have seen that both Sweden and Finland have networks that keep policy advice and production of forecasts within certain limited networks. Their bureaucracies have not been wound up in clientelist practices. In sum, even in those cases where parties expressing radical departures (such as the recent right-wing populist *Sverigedemokraterne* in Sweden) are elected, they are not allowed into the broad consensus that most of the parties support. This consensus also protects the role of the bureaucracy in the making of economic policy decisions. When accounting for these two cases, we are turned back to the role of economics expert knowledge.

Neoliberalism and Economics Expert Knowledge

We can now specify the political context of Iceland's financial rise and fall as one of neoliberal political triumph falling victim to a resurgence of clientelist ties. This supports our rejection of on the use of "neoliberal" as a label to characterize macroeconomic expert advice. In the Icelandic context, namely, *serious macroeconomic policy advice played no role at all!* It was in fact displaced.

In the early post-war decades, the high years of Iceland's clientelism, there were probably neither triangles nor axes contributing economic expert knowledge to Iceland's ministry of finance. Only in 1961, a proper central

bank was set up (Jónsson, 2009, p. 27), and a research unit pursuing applied economic research (The National Institute of Economics, NIE) was established in 1974. This institute would hire economists socialized into Samuelson-type Keynesianism at universities abroad (Anglo-American or Nordic), and would eventually import the internationalized New Macroeconomics. Representing the well-educated middle classes, these would belong to the groups questioning clientelism. Recounting the fate of Iceland's small networks of economic experts since the neoliberals gained political dominance in the IP, we can expand on materials already contained in our case study above.

First, the main source of independent forecasting (NIE) and expert advice was closed down already in 2002. Thus, later tax reforms favouring the rich at the peek of the boom and other irresponsible fiscal practices were pursued without disturbing criticism from an applied research institute.

Second, there was extensive regulatory capture, as already noted above. In fact, Wade (2009) reports that in the boom, it seemed that the Chamber of Commerce – the main interest association for business – was in charge of economic policy making.

Third, there was opportunistic use of expert advice. When speculative attacks (Geyser crisis, 2006) first indicated that something was rotten in Iceland's financial system, the Chamber of Commerce bought expert advice (as detailed in the case study) and served the main conclusion in opportunistic lectures to calm the foreign investors and speculators. As Wade and Sigurgeirsdóttir (2010) inform us, critical analyses by economists abroad were ridiculed by leading politicians. The stock market boom picked up again after the 2006 incident, and the unsustainable state of affairs was allowed to develop for another two years into the massive crash and a total failure of all three banks, with dire consequences for the nation and the national economy.

These points illustrate that neoliberals in power do not appreciate independent and unbiased economic expert advice, however much of it is based on neoclassical foundations. Neoliberalism is a political project, likely to delink from any iron triangle or axis. In addition, however, Iceland's neoliberals did not refrain from exploiting clientelist networks that were still available. Oddsson is a fascinating "transitory" person: He rose to dominate the IP in a period where clientelism was under fire as the "old system." The idea of neoliberalism was very much an idea of the freedom of the individual from any kind of group ties. But after 13 years as prime minister, he had himself appointed as chairman of the board of governors of Iceland's central bank (CBI) in 2005. As one economics expert noted, he is a man with no economics education: 'The multi-talented Oddsson had studied law, been a theatre director, the producer of a comedy radio show, a political commentator, and the coauthor of several plays. He had previously been the mayor of Reykjavik, a long-time prime minister and, for a brief period, the foreign minister. Unfortunately, he appears to have had no expertise in economics and banking and was ineffective at either averting the financial crisis or playing a positive role in its aftermath' (Sibert, 2011, p. 337f). Some details on this can be found in the case study above.

It can be said for certain that such an appointment would not have been possible in any of the other Nordic central banks in the period of their new-won autonomy. Although a heavy formal education in neoclassical economics may not always be required, some kind of economic literacy and ability to interact with and require among the banks' leading economists *is* required. As a minimum, a prospective central bank president must have a solid track record with the economics-related parts of the bureaucracy. When Oddsson was sacked, Iceland temporarily imported a central bank head form Norway.[12]

In one way or another, we can speak of some *political power of economic ideas* in the four larger Nordic countries. But in the case of Iceland we end up emphasizing the *economic power of political ideas.* With reference to the points just listed above, it seems evident that neoliberal ideas certainly had a part of the responsibility for the 2008 meltdown.

The story does not end there. As Ólafsson (this volume) emphasizes, the ideological right wing in Iceland controls both newspapers and other media. When Oddsson was sacked as central bank president in 2009, he went straight on to become editor of *Morgunbladid,* the most influential newspaper. While this is yet another case of continuity with the old clientelist system, a more interesting question is whether an entirely new kind of finance/business "clientelism" developed ahead of the crash.

A Financial Sector of Clientelist Ties?

The actual privatization of the banks had, as we noted, elements of old clientelism, as the banks were bought by party-related interest groups. But the old families soon lost most of its control. The strategy of the banks were the work of the well-educated finance experts, and the various young players – outsiders to the old octopus network of families – soon came to dominate most of the important units such as Glitnir, investment firms such as Burðarás, Eimskip, and their subsidiary Brim (controlling a large share of

the fishing quotas), and the insurance company Sjóvá Almennar. The owners of banks and firms took out enormous sums during the boom. As we have seen, in the Icelandic bubble, the interaction between old elites, new players, and brokers with finance education led to the multiplication of ties as holding companies and banks developed "incestuous" mutual relations in order to leverage in ways that increased systemic risk. Whether the term new clientelism is appropriate, and whether this kind of accumulation of risk reminds of earlier risk behaviour in the fisheries sector, cannot be decided here. Obviously, these ties have withered away after the crash.

The neoliberal political offensive triggered the dynamics of the Icelandic neoliberal experiment. Like the sorcerers apprentice, the neoliberals could not bring their creation under control. The neoliberals neglected supervision, engaged in pro-cyclical economic policies, and marginalized independent expert advice, but all the actor-groups mentioned had their share of responsibility for the dramatic boom and bust that unfolded.

This leads us to conclude that even with a (counterfactual) stronger neoliberal political offensive in the other Nordic countries, it is unlikely that a similarly disastrous development of the financial system would have taken place. Again relating to the Icelandic case study, we emphasize the following points.

None of the other Nordic countries had clientelist politics. They had various versions of class-cleavage-based politics that yielded programmatic parties. Since they were larger countries, they had longer national historical traditions in several fields relevant in our comparison: systems of higher education, banking, and finance. Let us specify with comparative reference to these financial systems why they would not have developed "incestuous" Ponzi-finance during the 2000s frenzy period.

First, despite the phases of repressed finance in the early post-war period (1950s and 1960s), with banks and financial institutions tightly controlled by developmentalist governments, all four large Nordics had financial systems that had evolved since the early 19th century.

Second, these banking systems were dominated by medium-sized retail–corporate banks. Such banks are relatively risk averse in their lending to clients (Jónsson, 2009, p. 56). It is unlikely that they would generalize the US investment bank model in the way Iceland's big three did.

Third, we have seen that banks in Finland, Norway, and Sweden had been through severe banking crises in 1992–1993. They had burned themselves, and had not forgotten this, despite the bonanza during the frenzy period before and after the dot.com bubble. Denmark is somewhat closer to Iceland here. We have seen that there were mini-crises both in the

early 1990s and in 2008/2009. But as Goul Andersen (this volume) emphasizes, Denmark has the state finances to shore up their banks if the present problems escalate.

Fourth, there were structural differences, possibly related to size, but at least to the pattern of integration in the international financial system. Icelands financial system, as Jónsson (2009) emphasizes, was characterized by cross-ownership, little long-term foreign investment in the country, and banks' balances far outweighing the country's GDP. The four larger financial systems have less foreign lending, although with free short-term capital movements since the early 1990s, there is more than earlier. Furthermore, they have more foreigners active in their (larger) stock markets.

Fifth, the kind of "incestuous" combines fusing banks and holding companies acting as investment companies at the global level – possibly a new kind of financial clientelism – did not develop in the larger Nordic countries.

We conclude that Iceland's 2008 financial crisis was more than just a compressed and enlarged version of the early 1990s banking crises in Finland, Sweden, and Norway.

The Impact of Willful Politicians

Iceland emerges as a case where willful politicians get the upper hand. We have argued that in none of the other Nordic countries, neoliberal politicians get into as dominant a position as the Icelandic neoliberals. But we find milder cases of such willful politicians. The ministry of finance may be captured by politicians either from the far left or the far right. In these cases, the ministry has problems controlling fiscal policies in line with fiscal rules suggested by economics experts. It seems that wing-parties on the non-socialist side (more than the symmetric parties on the left wing) move into positions where they can exercise such willfulness. In Norway since 2005, there has been a red–green coalition government, but the left-wing coalition party (the small Socialist Left Party) was immediately co-opted as the party leader (Kristin Halvorsen) was appointed finance minister. She appeared immediately as a spokesperson promoting policy judgments based on expert knowledge and assessments produced in Norway's iron triangle.

In Finland and Denmark, however, there are some worries about increasing "economic populism," which implies a weaker role for economics expert advice. The exchange rate policy of these countries is entirely passive;

Finland has the Euro, while Denmark's currency (DKK) is permanently pegged to the Euro (hard currency option). Thus, fiscal policies emerge as more important in these countries than in Norway and Sweden, with their floating exchange rates. In Finland, there is presently a constant tension between the government and the ministry of finance: Government statements explicitly question ministry of finance estimates of sustainable fiscal policy, that is, politicians want to pursue more expansive policies! This may be an effect of the parliamentary decision to build a very broad coalition government, thereby isolating the right-wing populist True Finns, a party that recently rose from 4 (2007) to 19 (2011) percent of the votes (and 39 MPs).

In Denmark, there is a similar kind of development. Earlier on, non-socialist parties played the restrictive role, requesting balanced budgets and austere fiscal policies, arresting the socialist parties' efforts to generate welfare for the people. But modern non-socialist parties have become soft on fiscal policy questions. They now propose fiscal policies that are as "irresponsible" – either tax cuts or more welfare spending, or both – as those they earlier criticized in the socialist parties.

As Goul Andersen (this volume) shows, Danish fiscal policy turned pro-cyclical (a reverse potato cure) and contributed to the overheating in the mid-2000s boom. One reason may be the far-right Populist Party (Danish People's Party). It has actually been able to put some pressure on the governing non-socialist parties, due to its status as a party supporting the ruling coalition during budget negotiations.

This fits with our comparison above, indicating quite weak links between applied expert knowledge and the ministry's economic policy making. It seems that both the Economic Council and the central bank issued warnings that were not heeded. There was also a second round of deregulation, an adaptation of the Danish mortgage system to the EU single market and a string of new financial innovations (see Goul Andersen, this volume; Mortensen & Seabrooke, 2009). This led to overheating via the housing sector (investments strongly biased toward housing), possibly one reason why Denmark displays such low growth in the years before the 2008 financial crisis.

These cases of willful politicians are, however, "mild" compared to the Icelandic case. In all three cases, however, the autonomous and relatively depoliticised working of a network between economics experts and the ministry of finance has been weakened. At least with reference to Sweden and Norway, we can conclude that as long as the iron triangle or comparable networks are well integrated, the new market-oriented views are calibrated with reference to empirical business-cycle projections and political concerns as judged by the ministry of finance, respected as the centre for overall coordination.

We have had a glance into the drama of Iceland's crisis, even more dramatic than earlier events such as the Cod Wars or the 1980s hyperinflation. Many Icelanders have suffered after the crash. But on the other hand, as Ólafsson (this volume) shows, there are "Nordic elements" in the set of institutions that organize the market for labour. All through the post-war period, Iceland has been drawn between United States and Nordic elements. The attempt at a full "Americanization" of the institutions that organize markets for capital failed dramatically in the crash. In the future, the United States may not be such a precious paradigm for emulation any more, so maybe Iceland will look more to the other Nordic countries again. On the other hand, as Ólafsson reminds us, the neoliberal group retains its position on the non-socialist side, blaming the young bankers and players for the crisis.

At the other extreme, the remaining country studies in this volume show the prosaic and even boring success of the other cases. Norway is the extreme case of a country that moves smoothly through the 2008 financial crisis. Like, all the others, Norway is hurt by the real economic downturn in the wake of the financial turmoil, but even then, unemployment remains very low (below 4 percent). Finland and Sweden are not success cases in that respect, unemployment has risen considerably (above 8 percent). As the analysis of Sweden reports (Erixon, this volume), trade union influences on Swedish developments have been weakened, and some reforms (higher individual fees for unemployment insurance in industries with a high risk of unemployment) may imply a partial erosion of the protective institutions built around labour power in Sweden's political economy. It still seems, however, that the persistence of such institutions (what is called the L-complex in the Norwegian analysis; Mjøset & Cappelen, this volume) is a common key to the relative success of the Nordic cases since the mid-1990s (for a very detailed analysis of this, see Dølvik, Goul Andersen, & Vartiainen, 2011).

Another feature seems common to at least a majority of the cases. In the banking crises we have analyzed, it was actually risky to hold bank equity. We have seen how the bondholders lost everything in Iceland. This, as well as the massive devaluation, is a main reason why Iceland today has better prospects than, for example, Ireland. Also in Norway, those who held the equity of the three large nationalized banks lost everything in 1992. In Sweden, the rules were tightened as the 1992 crisis unfolded, so in the last stages of the crisis, owners of Götabanken lost everything when it went bankrupt. Finland was the main exception, as the bondholders were supported in 1992. Denmark, as we have seen, is on its way through a

second "mini-crisis." In line with legislation in two recent "bank-packages," Denmark runs a system whereby small banks go through "managed crashes" over a weekend: The depositors are saved, the bank is taken over by a larger bank, but the bondholders loose.

According to Perez (2002), when the frenzy phase ends in a crash, reregulation is necessary if the world economy is to move into a new phase in which productive and financial capital again work closely together. Maybe the Nordic countries sets an example in this respect, although one fears that this example will not count much in a world economy burdened by mountains of sovereign debt and a financial sector that still seems to resist new regulations.

NOTES

1. Parts of our "process tracing" relies predominantly on one source, an account by a banker (Jónsson, 2009). In this way, we are able to account for certain financial specificities in some detail.
2. Cf. the useful biography in http://en.wikipedia.org/wiki/Hannes_Hólmsteinn_Gissurarson
3. Interview with Herleif Håvik, *Dagens Næringsliv,* May 22, 2010. Accessed on September 28, 2010, at http://www.dn.no/forsiden/bors/Marked/article1903446.ece
4. http://eng.forsaetisraduneyti.is/minister/speeches-and-articles/nr/428. Accessed on August 15, 2011.
5. Jónsson gives this example: The small Reykjavik Savings Bank had a share in Exista as its main asset. Exista's main asset was Kaupthing. Both assets traded at nearly two times book value. At its peak (mid-2007) the market capitalization of this bank was roughly USD 2 billion. This amounted to "holding incestuous equity of Kaupthing at almost ten times book value" (Jónsson, 2009, p. 95).
6. This analogy was been suggested by Birgir Bjørn Sigurjónsson in project meetings in 2006 and 2007.
7. This paragraph reports an argument detailed by Juhana Vartiainen during our project discussions.
8. The notion of iron triangles have been used in US political science, where it refers to segments capturing state support. They usually take the form of a triangle between a lobbying organization, sectoral interests, and parliamentary committees. In contrast to this, we use the notion to discuss the relationship between political, administrative, and disciplinary factors in the making of economic policies.
9. http://www.esop.uio.no/
10. Notably, ETLA has published a string of comprehensive reports on the performance of the Nordic economies. The latest two can be identified as ETLA B 242 and ETLA B 232 at http://www.etla.fi/eng
11. This information has been provided to me by Stefan Ólafsson, August 2011.
12. Svein Harald Øygard was educated in economics from Norway's leading department, had worked in the Norwegian central bank, 1983–1990, served as assistant secretary at the Ministry of Finance 1990–1994 (for Labour, playing a central role in the management of the Norwegian 1992 banking crisis). Since 1995 he has worked with McKinsey.

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