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ICELAND'S DEFAULT HAS MADE IT EUROPE'S GROWTH LEADER

Iceland is side-stepping Europe's plummet into a deep recession or depression by following the true capitalist's model of allowing its insolvent banks to fail and go bankrupt. With less than two years of pain and suffering, Iceland is emerging as the new growth leader in Europe by reporting a red-hot 4.7% economic increase last quarter. Perhaps it is time for Europe to also accept the inevitable and start letting ludicrously over-indebted countries and their banks in Portugal, Ireland, Italy, Greece, and Spain (PIGS) default and restructure their financial condition in order to return to growth.

When the "Great Recession" began in 2008, every country in Europe gave sovereign guarantees to their banks, except Iceland. All three of Iceland's major banks suffered losses equal to over 50% of the nation's Gross Domestic Product. Over the next year, the financial crisis devastated the Icelandic economy. Krona, the national currency, fell by 44% against the euro, inflation rose 18.6%, market capitalization of the Icelandic stock exchange dropped by more than 90%, gross domestic product fell by 7%, while unemployment rose from 2% to 9%.

Iceland, a fishing colony of Denmark for 600 years, achieved its independence in 1944. Over the next 40 years the country adopted a highly-regulated and tax financed Scandinavian social welfare model around its predominant fishing industry. Fourteen families, often referred by locals as the Octopus, controlled imports, transport, banking, insurance, fishing and supplies to a large Nato naval base. The local, state-owned banks were effectively run by the two dominant left wing and center political parties. Ordinary people were forced to go to party functionaries for loans to buy a car or to acquire foreign exchange to travel abroad.

In the 1980s, a popular uprising of Iceland citizens called the Locomotive Group took political power and forced privatizations of government activities and banking in the mid-1990s. In 2004, the Prime Minister, with virtually no experience outside of Iceland, had himself installed as governor of Iceland's Central Bank.

The privatized banks merged investment banking with commercial banking, so that both shared government guarantees. Powered by a very low level of sovereign debt, which gave the banks high marks from the international credit-rating agencies, the three major Icelandic banks began taking international deposits and provided loans of 90% of appraised value for real estate. Iceland lowered income tax and VAT rates to turn Iceland into a low-tax international financial center. City planners aimed to move Reykjavik from an ordinary city to that of a world financial capital. Despite its small population of 110,000 the city built grandiose new public and private buildings, saying "If Dubai, why not Reykjavik?"

By 2006, tiny Iceland managed to enter the bank big-leagues, sporting three of the world's largest 300 banks. Local bankers made large financial contributions to the governing parties and giant loans to key politicians to avoid regulatory support. The super-abundance of cheap credit allowed people to extravagantly consume and the resulting economic boom drove the stock market up by 900%. Government spending ballooned as Iceland's current account deficit soared from 5% of GDP in 2003 to 20% by 2006, one of the highest in the world. The leading Icelandic champion of free-market economics declared in The Wall Street Journal that Iceland's: "experiment with liberal policies is the greatest success story in the world".

When the Credit Crisis hit in 2008, the banks quickly collapsed. But when the dust cleared from the crash, it turned out that a majority of the Icelandic bank depositors were British and Dutch citizens and government entities. When the Icelandic government under tremendous pressure from the International Monetary Fund started to make preparations to guarantee the losses of foreigners, the population rioted and forced referendums on approving the government bail-outs. In what has become known as the Kitchenware Revolution. Iceland's citizens turned down two referendum attempts by majorities of 93% and over 60%. The banks were liquidated and the foreign and big dollar depositors were forced to take percentage losses.

The Icelandic use of referendums to offer citizens the right to vote on guaranteeing failed bank losses compares to the European Monetary authorities' imposition of austerity policies on the highly indebted PIIGS to bail-out speculators, northern European banks, and the IMF. As the populace of these nations become debt slaves, the Financial Times commented that the European sovereign debt bail-outs: "put citizens before banks".

Iceland is proving that capitalism with both its upside joy and downside pain seems to be better than the social welfare state's crony willingness to rescue its friends at the long-term expense of their citizens. Free market economist Friedrich August von Hayek said: "Emergencies' have always been the pretext on which the safeguards of individual liberty have been eroded." As the good people of Iceland watch Europe spiral down, they can only shake their heads and wonder why the people could be so dumb as to let their governments cause such damage.

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