

Iceland.

A strong yet sustainable recovery

Following the devastating financial crisis, this Arctic nation staged an impressive comeback, but the challenge now is to ensure that the threat posed by climate change does not derail its economic recovery. Balanced growth is key, and with a renewed focus on green energy, innovation, tourism and the responsible use of natural resources, the future looks bright for the land of fire and ice.

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Rebuilt to run and run

Writer: Peter Grimsditch

OVERVIEW After seven painful years recovering from reckless and uncontrolled expansion by the local banks, Iceland has given its economy a rebirth along sustainable lines

It's been around for 18 million years, ever since the 103,000 square kilometres of lava that would become Iceland rose majestically from the Atlantic Ocean. The people arrived 1,100 years ago and grew to some 320,000, equivalent to the population of Coventry. Despite the remoteness of its location, the island's men and women have some remarkable achievements to their credit. The World Economic Forum's (WEC) Global Gender Gap Rankings put Iceland top for gender equal-

ity among 142 nations monitored. The first known militant action in pursuit of equal treatment came in 1975 when around 90 per-

“There is a great potential towards more environmental sustainability in Iceland”

Sigrún Magnúsdóttir
Minister of environment and natural resources

cent of the women went on strike for 24 hours. The women who worked as typesetters at the Morgunbladid newspaper showed they had pragmatic common sense as well as principle. As soon as midnight and the end time for the strike arrived, they went to work to prepare stories for the following day's issue, which was dedicated to their strike. A decade later, the country's women repeated their protest and were supported by the president, Vigdís Finnbogadóttir, a single mother



LANDFILL GAS POWER

Björn Halldórsson
CEO of Sorpa

Waste management company CEO Björn Halldórsson tells how landfill gas powers 1,100 vehicles

“Sorpa is a non-profit, so we aim to minimise cost, not optimise profit. There are about 20,000 vehicles around the capital, and we can eventually provide enough fuel from the landfill for around 4,000 cars. That would be our maximum. However, we are beginning to build plants where we will make biogas out of organic material.”

who stayed at home in solidarity with the strikers. By contrast, the US and the UK were placed 20th and 26th in the WEC gender equality list. Iceland's birth rate of 2.2 children per woman is the highest in Europe, making half its population under 35. Another unique feature of the society stems directly from the financial crisis. At the beginning of November, 2015, a former bank executive became the 26th person to be jailed in connection with the crashes of 2008. Between them, the men are serving 74 years. No top bank executive in the US or Europe has been charged with any offence.

The ill-fated venture into international finance that caused the closure of the three main banks and the imprisonment of the management has been abandoned. This leaves Iceland with opportunities to run a much more balanced and sustainable economy.

As Höskuldur H. Ólafsson, CEO of the new Arion Bank, put it, “If you go back 20 years, it was basically fishing and aluminium. Now we have the tourism industry as an equal to the other two pillars, and a growing IT-related business.” Fishing provides 42 percent of Iceland's exports. Recycling waste into either bio-fuel or solid fuel also has the potential to grow over time to be an export earner. “We plan to produce solid fuel from plastics, timber, rubber

and so on,” said Björn Halldórsson, CEO of waste management company Sorpa. Due to its geothermal and hydroelectric energy sources, Iceland is the world's largest electricity producer per capita and with only 25 percent of potential output used domestically there is room for international sales. This basket of activities, along with the establishment of data centres, forms the basis of the sustainable economy, provided the fish keep breeding, although supplies are already being helped by increased numbers of mackerel as the Atlantic Ocean has slightly warmed.

Even football is prospering. After finishing second in the group stage of Euro 2016, the national team is gearing up for its first appearance in a major international tournament.

“We plan to produce solid fuel from plastics, timber, rubber, and so on”

Björn Halldórsson
CEO of Sorpa

A plan for all seasons

Writer: Peter Grimsditch

FINANCE Bailed-out US and European banks were considered “too big to fail”. In Iceland's case, it was thought local casualties were “too big to save”

At the same time as sub-prime loan defaults were wreaking havoc upon the stability of the US banking system, Icelandic lenders were equally scattering credit on projects of dubious quality. Yet the Reykjavik path to salvation – let the reckless banks go to the wall and their miscreant managers to jail – seems to have produced a more durable solution than pouring public money into the offending institutions. “[In 2015], Iceland will become the first 2008-10 crisis country in Europe to surpass its pre-crisis peak of economic output,” according to Peter Dohlman, IMF Mission Chief for Iceland. “The key differentiating factors supporting Iceland's relatively strong recovery are worthy of further

study, but rapid external adjustment through depreciation and limited government absorption of private financial sector debt were likely important factors,” he added. Also important is the lesson learned. A sustainable future for Iceland rests on combining its traditional assets and skills, such as alu-

minium, fishing, energy, and tourism, with the development of newcomers such as pharmaceuticals, data centres, and bio-fuels. High interest rates offered by Icelandic banks had attracted so much money from abroad that banks were jointly worth ten times the country's GDP. This signalled an economic shift

Arion bank rose to become the biggest mortgage lender apart from the state housing fund
Photo: Arion Bank



VIEWPOINT

Thordur H. Hilmarsson
Managing Director of Invest in Iceland

Invest in Iceland, part of state agency Promote Iceland, believes the country's trade pact with China will appeal to investors. Director Thordur H. Hilmarsson explains

Is your FDI focus changing?
We are moving from heavy industry to

VERDICT

Mar Gudmunsson, Central Bank of Iceland governor, emphasises the need for a mainly domestically-oriented banking system.



“We will not allow banks to go on wild adventures abroad”

Mar Gudmunsson
Governor of the Central Bank of Iceland

Photo: Birgir Isleifur Gunnarsson

from exports into international finance, an area suffering from a dearth of experience. Fuelled by traders' pursuit of profits, the value of the krona rose ninefold between 1994 and 2008. Inevitably, disaster struck. Many businesses went bankrupt; the stock market fell by 95 percent; loan interest rocketed to 300 percent plus; almost two-thirds of bank assets were written off after the banks collapsed; and interest rates rose to 18 percent to curb inflation. Capital controls were introduced in November 2008 to avoid complete devastation. The major banks were reconstituted as state-owned domestic operations and will be sold off at a suitable time. But by summer this year, the government announced that it was now ready to phase out those capital controls, in a move widely seen as symbolic of the end of the crisis for Iceland. To discourage mass withdrawals by foreigners from the 1.2 trillion krona (£6.0 billion) in frozen bank assets, a 39 percent tax will be levied on all transactions. The downside of capital controls is that they deter foreign investment and increase borrowing costs. Lifting them will also make the sale of the reconstituted banks more likely.

Iceland has staged what appears to be the fastest recovery on record. The national debt is fall-

ing and the government has paid off ahead of schedule part of the billions in loans it received from the IMF. “Other indicators of Iceland's successful trajectory are its low inflation, stable exchange rate, and ready market access,” said Dohlman. The IMF loans were partly to prevent the krona from falling even further and to protect domestic bank deposits. Naturally, there are also temporary downsides to the recovery strategy. Loans, especially mortgages, became difficult to acquire and average household debt rose. Even here sustainable solutions are appearing. Half of Arion Bank's loan business is geared to individuals and it is now the biggest bank provider of mortgages.



Central Bank of Iceland. Photo: Birgir Isleifur Gunnarsson

Q&A

Höskuldur H. Ólafsson
CEO of Arion Bank

Höskuldur H. Ólafsson plots Arion Bank's progress after taking over the collapsed Kaupthing Bank

Kaupthing Bank was the biggest in the country. How tough was the rescue?

When Arion Bank was created, 56 percent of loans were non-performing. The bank had no direction or strategy. In 2010, we made long-term plans to build a robust bank which would eventually have new owners. Then we made a short-term plan to get our customers back on their feet. By 2014, we streamlined our operations and also made a significant change. Kaupthing was an international investment bank. We changed this into a much more balanced institution. Today, our loan portfolio is 50 percent individuals and 50 percent corporates. When we started, it was only around 25 percent individuals. Now, we are the biggest mortgage lender apart from the state housing fund. Our legacy was

very strong in big corporates, but we have deepened our portfolio among smaller companies.

Also, we have been a key contributor in getting the stock market back on its feet. We did the first listing after the crash, and have managed more than half of all the listings since.

What is the bank's ethos today?

We realise that this is not going to be the same bank that it was before the crash. When the crash happened there were positive aspects, one of which was that there were tremendous resources available to do new things. We decided to be progressive and innovative.



“Emphasis on loans has moved away from big firms to smaller companies and individuals”

knowledge-based projects. We have an ideal climate for data centres, for which international specialists like McKinsey rate us in the top three locations globally.

Where are your best connections?
We have good relationships in both

directions: free trade with Europe, a free trade agreement with Canada, and most-favoured-nation status with the US. Iceland is one of few places to have a free trade agreement with China, so it is a no-brainer to establish value-adding processes for tariff-free exports to that huge market.

“Establishing processes in Iceland to get goods to China tariff-free is a no brainer”

Q&A



Bjarni Benediktsson
Minister of finance and economic affairs

Bjarni Benediktsson, also Icelandic Independence Party leader, looks at crisis recovery and new investments

To what do you attribute recovery from the 2008 crisis?

It was the right decision not to save the banks by nationalising the private debt that was causing the problem. Instead, we established new, healthy banks, and a lot of private credit was written off.

Secondly, introducing an economic plan with the IMF to establish how to go forward was very important. If debt levels had been very high, we would not have had the opportunities that we had in taking on new debt to boost the reserves and finance the new banking system. Recent ratings agency upgrades signal we are back on track and will affect the terms on which both the private and the public sector approach the financial market

“Ratings agency upgrades show we are back on track and will affect our terms in the financial markets”

What are the main sectors seeking investment?

We hope to attract investment in traditional sectors as well as into the industries of the future. We are seeing investment in tourism, the pharmaceutical industry, new technologies, data centres, and new types of energy industries such as silicon factories. Politicians should not say where exactly investment should take place. We need to create a favourable environment, and, for that, stability is crucial.

What is your outlook?

At the moment we are enjoying the longest sustained growth period in recent history. Our challenge will be to try and maintain stability, maintain low inflation and lower interest rates. We are in a very favourable situation, but we need to make sure that we continue to take the right decisions so that the negative effects of a growing economy do not affect us.



Top of the World Internship

SORPA is the largest solid waste management company in Iceland, with years of experience in utilising landfill gas as vehicle fuel.

SORPA offers internship possibilities for graduate students in co-operation with interested universities.

The students' projects can be in the field of biogas, waste management and/or related areas. SORPA offers facilities and supervision that are second to none.

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