

**“With or without the Euro: Italy and Iceland tackling their
financial crises“**

Distinguished audience, Ambassador Bandini, dear friends,

When I see my friend, Ambassador Bandini, in the front row it reminds me of the fact that when he first broached to me the idea of this interesting seminar we had just witnessed a very young Italian, Grand Master Fabiano Caruana, win a prestigious chess tournament, the Reykjavik Open.

I don't know if Ambassador Bandini, or economists present agree with me, but as an old chess player and a politician I have long ago come to the conclusion, that whilst chess is based on logic with a whiff of psychology, the subject of today, the euro and the economy, is mostly based on psychology – perhaps with a whiff of logic.

In any case, I want to thank you for the opportunity to participate with you today, and to expand my thoughts to a captive audience.

When I read the Anglosaxon newspapers, and listen to some wise guys in my place of work, the Parliament, the prediction has for a long time been that the euro is collapsing, if not this week, then definitely the next.

The fact is, however, that the euro has proved its mettle, and shown it is made of some pretty tough stuff. And I agree with that old, crafty politician, Göran Persson, the former Prime Minister of Sweden, who

at this very podium predicted only a few weeks ago, that the euro would not only survive, but prosper and become a stronger currency in the future. And to answer the question implied in the title of this seminar – that is why I believe it is the right thing for Iceland to meet the future **with** the euro – and not without.

It can take a long time to change the course of a large vessel. But if we look to Europe the good news these days is that things seem to have calmed down. The various robust measures undertaken by the EU, ECB and Member States to address the debt crisis are slowly, but surely, having the effect intended. As a result the markets are calmer, and most importantly, some key numbers are turning in the right direction.

While Europe, and in fact most of the world, continues to work her way out of the crisis towards a sustainable future, it is important to learn the right lessons from the past so that the missteps and mistakes are not repeated in future. I know from some pretty memorable experience, that crisis is also a learning process.

That is exactly the aim of today's seminar.

For a scientist like me, the mistakes are in fact no less interesting, or, to quote the most famous economist of my youth, John Kenneth Galbraith:

“If all else fails, immortality can always be assured by spectacular error.”

When we discuss our two countries with a view from the euro, we have to keep in mind, that apart from the euro itself, the economies of our respective countries differ in one aspect, that can only be described as fundamental.

In Iceland, we were forced by the banking collapse in 2008 to restrict free movement of capital by enforcing severe controls. This is now becoming the most complicated, and the most challenging, economic task of today’s politics in Iceland. This, fortunately, is not one of the hurdles that Italy has to overcome on her path out of the present difficulties.

In Iceland, most of us agree that she should remain an open and free market economy and almost everyone that the abolition of the capital controls is an economic necessity and a political priority.

But the question is how? How can we get rid of the capital controls without jeopardizing the so far successful economic recovery? How can we re-enter the Single Market, reconnecting the four freedoms, without risking inflation and a rise in interest rates, with the accompanying detrimental effect on families, households and companies?

Here, I maintain that we have to focus on the currency choices, and the Icelandic krona.

We have already consumed a large part of the EU menu, except the common currency and the economic policy. In my mind these are the missing link.

We recently received a very well argued report by the Central Bank of Iceland on our alternatives in terms of our currency. It basically threw out all the magical options, such as adopting unilaterally or bilaterally the Canadian dollar, which by the way led perplexed Canadian economists to politely ask why we wouldn't rather consider the Australian dollar – and why not? (Both are equally detached from reality in my mind.)

The Central Bank basically came to the conclusion, that in fact Iceland has only two main choices to consider for the future.

On one hand, Iceland can join the European Union and eurozone by a process of negotiations. On the other hand, Iceland can maintain a freely floating exchange-rate based of its own currency, accompanied with what I as a politician allow myself to call capital restrictions in disguise.

Ladies and gentleman,

At least my view is clear: An economic future with the Icelandic krona continuing to be a source of instability, inflation and interest

rates much higher than everywhere else in Europe, is not acceptable to me.

An economic future based on the krona in a strait-jacket of capital controls of some sort, leading to less foreign investment, less export, less growth and less jobs, is likewise not acceptable.

Surely, the euro is not a silver bullet, but several facts convince me that Europe and the euro is the right path forward for Iceland.

First, despite all its woes and predicament for two years, the euro still stands 6,5 % stronger than the dollar. From its inception the euro indeed has on average been 4 % stronger than that noble currency. Do we need to compare this to the instability and fluctuations of the króna?

Secondly, I don't disagree that the krona may have contributed to the solution to our problems by improving profitability in the export sector. But it is profoundly clear to every family in Iceland that it is also responsible for disastrous side effects on the public as reflected by increases in the debt-burden of households and the reduction of their purchasing power that are much more severe than has been the case for the citizens of the euro zone.

Thirdly, I want a future environment that is fully open for capital movements, attractive to foreign direct investment and is benefitting the economy and at the same time the general public and consumers.

The euro, with the accompanying long-term stability, low rates, and stable prizes, is inducive to this, whilst experience, logic – even with a whiff of psychology - forbids to ascribe such expectations to the krona.

Fourthly, we should draw lessons from the recent McKinsey report on Iceland. Its conclusion was abundantly clear: The Icelandic economy is underperforming. We are not making the best use of our manpower and opportunities. We are not as strong as we could be. To realize the possibilities described by the McKinsey report we need to address the structural flaws in our economy. In my mind, the best way to do that is through the path provided by the EU Accession.

Finally, the journey towards the euro is as important as the destination. Our economy will be strengthened as on our way we can find a shelter for the króna within the ERM II, until we finally adopt the euro. This will provide us with much needed outside discipline and valuable support which will assist us to reach our main objective of long-term economic stability.

Dear friends,

Just like in Iceland, Italy has enacted tough fiscal reforms and public deficit and debt is coming back under control in both countries. In this respect the Italian government has acted with the logic of the young Grand Master Caruana I referred to earlier, with more than a whiff of sensible psychology. Despite the present turbulence in Italian politics I predict they will stay the course – just like Iceland has - and swallow

the bitter medicine needed to recuperate. It's bad, it gets worse, but it ends.

Finally, I am a strong believer in the common sense of the people - despite the politicians they sometimes elect.

Just as I believe the Italians will elect a government that will steer them out of the rough seas I also believe that when it comes to the crunch, the Icelanders will take the best decision for their future. When all the arguments will be clear and polished, and weighed on the scales of common sense I think they will embrace the euro as the best choice for Iceland.

In politics I have learned from chess that it always is the end-game that matters.

I wish you all a successful conference.