

# From Crisis to Direct Democracy? – The Case of Iceland

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## 1) Introduction

After the big financial crisis starting in 2008, Iceland has the potential to reinvent itself. In response to the devastating economic collapse caused by irresponsible bankers and politicians, Icelanders became active politically and struggled to find new ways of self-determination and democracy. First of all they started the so-called “pots-and-pans” revolution (so called because protesters were banging their pots and pans loudly) in the streets of Reykjavik that led to a new government in 2009 and a demand for a fully newly designed Republic of Iceland. In addition, Icelanders organized two referendums, in 2010 and 2011, to decide on the fate of two government bills regarding deposit guarantees. Last but not least, a total revision of the national constitution has been launched and a first draft presented in July 2011 which includes new instruments of direct democracy. All these elements were good reasons to travel to the world’s most northerly capital and explore Iceland’s latest direct democracy developments in more detail. Read the report by Carsten Berg.

## **2) Iceland's democratization process in the context of the financial crisis**

Three years ago Iceland was the first country to be hit painfully by the global financial crisis. The Lehman Brothers bank failed on September 15, 2008. By October 9, Iceland's three big banks – Glitnir, Landsbanki and Kaupthing – had collapsed. From then on Iceland was unable to refinance its loans and became the first Western European nation (since the UK in 1976) to get a loan from the International Monetary Fund. As happens in many countries these days, Iceland's political agenda was determined from outside. In exchange for rescue money Iceland had to implement the austerity measures dictated by the International Monetary Fund (IMF). To give only a few socio-economic indicators to show how greatly Icelanders suffered from the crisis: the unemployment rate tripled, the Icelandic Króna lost more than 50% of its value compared to the Euro, external bank accounts were frozen when the UK government bizarrely applied anti-terror legislation<sup>1</sup> to freeze Icelandic assets abroad, and thousands of Icelanders, many of them young and educated, left the country.

How did this happen? As elsewhere, responsibility for Iceland's crisis does not rest solely with the global finance industry. There also had to be politicians in the various countries affected who either accumulated too much debt, or - and this applies to Iceland - gave the banks too much freedom. That's precisely why many Icelanders want to hold their politicians to account. Many of them see David Oddsson, who as former head of government privatized the banking sector, giving it very wide room for maneuver, as the one primarily responsible for Iceland's financial plight - not least also because, as the subsequent CEO of Iceland's central bank, David Oddsson was later among those responsible for overseeing the banking sector. However, the first politician to be taken to court as a result of the global financial crisis was the former Prime Minister Geir Haarde<sup>2</sup>. Whatever the outcome of this particular case, Icelanders are very clear that the crisis is a result of human actions i.e. a problem brought upon themselves as a result of their current political system and of their elected representatives - the politicians; a problem which almost led the country into bankruptcy at the end of 2008. At that point in time Icelandic banks ultimately owed more than six times the country's GDP, a world record. In other words, Iceland's crash was the costliest financial crash on record relative to the size of the country (Gylfason 2011<sup>3</sup>).

## **3) 'Let banks fail' – one of the key lessons from Iceland's crisis?**

When the world's credit markets dried up, the Icelandic government was unable to pay back its loans. As a result, the Icelandic banks ended up defaulting on more than EUR 60 billion. In other words, instead of bailing out private banks with taxpayers' money as other countries in the world are doing, Iceland let its banks default. For the world these banks were not "too big to fail" and Iceland was simply too small to save them by bailing them out. Iceland's Finance Minister Steingrímur J. Sigfússon stated that defaulting wasn't really a choice, but was rather happening under coercion.<sup>4</sup> He concluded that: "People should be careful when it comes to drawing comparisons

<sup>1</sup> [http://news.bbc.co.uk/1/hi/uk\\_politics/7662027.stm](http://news.bbc.co.uk/1/hi/uk_politics/7662027.stm)

<sup>2</sup> <http://www.guardian.co.uk/business/2011/jun/07/iceland-former-premier-trial-banking-crisis>

<sup>3</sup> <http://www.voxeu.org/index.php?q=node/7077>

between Iceland on the one hand, and Greece, Portugal, Spain and Ireland on the other. Iceland didn't have the ability to save the banks". In the view of some renowned economists, however, the key lesson from Iceland's crisis is "let banks fail"; for them Iceland is a model for other debt-stricken European nations. "Where everyone else bailed out the bankers and made the public pay the price, Iceland let the banks go bust and actually expanded its social safety net", said Nobel Prize-winning US economist Paul Krugman in a recent New York Times piece.<sup>5</sup> Taking a similar stance, Martin Wolf has recently described "How Iceland survived the fire", analyzing the lesson to be learnt from Iceland and expressing the view that "Iceland is to be congratulated on having escaped the Irish folly".<sup>6</sup>

#### **4) Iceland's First Popular Vote Since 1944 – The "Icesave" Referendum**

After the three large private Icelandic banks ended up defaulting, Iceland transferred domestic loans and savings into new state-owned banks, but were not able to transfer foreign assets and debts into the new banks. This caused the so-called "Icesave dispute" between Iceland on the one hand and the United Kingdom and the Netherlands on the other. The dispute centres on the private creditors of the privately owned Icelandic bank Landsbanki, which had taken private deposits from more than 400,000 British and Dutch customers (by comparison, Iceland's total population is 320,000) through its branches in London and Amsterdam, through an Internet product known as "Icesave". However, when the bank collapsed, Iceland was not able to guarantee repayment of their deposits. As a result, the UK and Netherlands governments compensated their own citizens, but pushed for Iceland to repay the EUR 3.8 billion their citizens had lost when the Landsbanki failed.

Even though this issue was legally and politically questionable, in late 2009 the Icelandic parliament agreed, by a narrow margin of 33–30, on the so-called "Icesave" bill to compensate British and Dutch citizens. The Icelandic government agreed that the money would be paid back between 2017 and 2023. However many Icelanders were unhappy with the bill and organized themselves through the grassroots group InDefence<sup>7</sup>, which initiated a campaign that resulted in the two biggest petitions in Iceland's history. One petition to protest against the use of the Anti-Terrorism Act by the UK Government against Iceland, and the other for a referendum on the Icesave bill (see also the excellent presentation<sup>8</sup> by InDefence at the international conference "Towards Direct Democracy in Iceland - The Swiss experience and lessons to be learned"). The first petition turned out to become the largest petition in Icelandic history. The 83,300 signatures were handed in to the British Parliament in March 2009. In November 2009, InDefence launched a second successful petition signed by more than 60,000 people that finally triggered a referendum on the Icesave bill to be held on 6 March 2010.

Since the current Icelandic constitution does not provide for any binding right to citizen-initiated referendums, there was only one means of triggering a public vote - via the

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<sup>4</sup> <http://www.bloomberg.com/news/2011-06-15/greece-ireland-can-t-default-like-iceland.html>

<sup>5</sup> <http://www.nytimes.com/2011/10/28/opinion/krugman-the-path-not-taken.html>

<sup>6</sup> <http://blogs.ft.com/martin-wolf-exchange/2011/11/21/how-iceland-survived-the-fire/>

<sup>7</sup> <http://www.indefence.is/>

<sup>8</sup>

<http://stofnanir.hi.is/mannrettindastofnun/sites/files/mannrettindastofnun/DirectDemocracy15Sept2011.pdf>

President. Article 26 of the Icelandic Constitution<sup>9</sup> states that bills passed by the Althing (Icelandic Parliament) must be countersigned by the President or be put to a national referendum if he refuses to do so. After President Grimsson finally had a face-to-face meeting with campaigners from InDefence in early January 2010, he declared a few days later that he would not countersign a bill into law that was opposed by a quarter of the citizens. Consequently he called for a referendum to take place on 6 March 2010, the first to be held in Iceland since independence in 1944.

Grimsson's decision was followed by aggressive reactions from the UK government and media. (For just one example from a British TV channel of how President Grimsson had to defend his and the citizens' choice for a public vote, see this clip: between 6.00 and 7.00)<sup>10</sup>. In 2008 the then UK Prime Minister Gordon Brown had even announced his intention to launch legal action against Iceland making use of anti-terrorism rules<sup>11</sup>. In response InDefence demanded "a reasonable Icesave agreement to avoid national bankruptcy" (see Press Release<sup>12</sup>). According to InDefence, Icesave is not Icelandic debt. Instead the UK, the Netherlands and the EU must share responsibility with Iceland for a failure in the financial supervision of cross-border banking. For InDefence and for most Icelanders it was not about a categorical refusal that any repayments should be made. What they were really angry about were the conditions of the repayment agreement - according to which Iceland would have to pay fixed interest of 5.55% on the repayments - amounting to about half of the entire cost of the Icelandic health system. They also protested against the fact that the Icelandic state should have to guarantee the payments. According to InDefence the responsibility and costs for flawed banking regulation must be shared. They considered a payment obligation representing €48,000 per Icelandic family as highly disproportionate. Many Icelanders also felt that they were being treated unfairly in being expected to pay for the mistakes of private banks which grew on debt money and then collapsed as a result of the global financial crisis. As InDefence said: "It is unacceptable that private banks are able to reap the profits, but pass their losses on to the taxpayers". In addition, they referred to the unclear legal basis of the Dutch and British claims which would have to be clarified with the EFTA court and complained about the "draconian nature of the proposed Icesave settlement and the preceding aggressive use of anti-terrorism legislation against Iceland by the British government", adding that they felt that "larger and more powerful European nations would have been treated in a very different manner". The last point also referred to the UK and Netherlands' intention of "blocking vital IMF loans until Iceland forcibly signs this imposed repayment".

The running sore between Iceland and the UK would not be healed, but even worsened. It appeared that in contrast to their representatives, the Icelanders themselves were not prepared to be browbeaten. While the representatives in parliament had already voted in favor of the Icesave bill, a clear majority of 93% of the citizens voted against it in the referendum, with less than 2% in favour, on a high turnout rate of over 62%. A second referendum on the same issue (but with better interest rate and other terms) was held a year later, on 9 April 2011. According to an opinion poll carried out in Iceland on 20 and 21 February that year, 57.7% would vote to accept the legislation. However, in the end a clear majority of 59.8% rejected the bill, again on a high turnout of 75%.

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<sup>9</sup> <http://www.government.is/constitution/>

<sup>10</sup> [http://www.youtube.com/watch?v=e2VuElk5\\_Bg](http://www.youtube.com/watch?v=e2VuElk5_Bg)

<sup>11</sup> <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aXjIA5NzyM5c>

<sup>12</sup> <http://dl.dropbox.com/u/3133428/InDefence%20-%20Press%20Release%202010%20Feb%202010.pdf>

Iceland's Prime Minister Jóhanna Sigurðardóttir tried to defend the democratic decision morally, but not legally: "This sentiment among the Icelandic public is quite understandable and is presumably a sentiment shared among the public all across Europe in the aftermath of the financial crisis. People ask themselves: why do we, as taxpayers, have to shoulder the burden of problems caused by the behaviour of irresponsible bankers? Taxes should be used for public services, for the welfare of ordinary citizens, but not because of huge losses by financial institutions."<sup>13</sup> At the same time Prime Minister Sigurðardóttir did not represent and defend her people in practical and legal terms, stating immediately after the results of the referendum were published that "the worst option had been chosen".

As the UK and Dutch claims seem to have an unclear and doubtful legal basis the three countries are currently trying to settle the dispute in different ways. On the one hand they are trying to resolve it through the European Free Trade Association Surveillance Authority<sup>14</sup>. On the other hand, there is in Reykjavik the perhaps surprising belief that the dispute will soon be resolved out of court. According to recent estimates, the remaining assets of the Landsbanki are greater than the Icesave deposit debts - which would mean that the latter can be repaid without placing any burden on the Icelandic taxpayers, apart from the interests, which can not be taken from the bankruptcy estate. The Prime Minister announced that Iceland would be "providing the Netherlands and the United Kingdom with substantial payments towards the compensation payments those governments made to depositors in their countries. Latest estimates suggest the asset recoveries of Landsbanki will cover more than 90% of deposit claims, and there are strong indications that they may cover such priority claims in their entirety"<sup>15</sup>.

## **5) Will Iceland's citizens give themselves a new Constitution?**

In tandem with the first experiences of direct democracy in the wake of the financial crisis described above, Iceland also launched a constitutional process which has the potential to change the country even more deeply and sustainably. This process is still ongoing and it remains to be seen how successful it will turn out to be.

The "pots-and-pans" revolution noisily demanded the founding of a new republic and the replacement of the provisional constitution of 1944, which derives from the time when Iceland formally became fully independent from its former colonial power Denmark. In fact, Iceland's current constitution is basically a copy of the Danish one, with the term "monarch" replaced by "president". This constitution was supposed to have been changed after the general elections in 2009 when the first left-wing majority government in Iceland came into power, consisting of the Social Democratic Alliance and the Left-Green Party, with Jóhanna Sigurðardóttir as Prime Minister. Sigurðardóttir had campaigned for a total review of the constitution by means of a constitutional assembly in order to realize what Icelanders had in fact planned since the end of World War II but which the Althingi (parliament) had always failed to do i.e. to implement a complete revision of their constitution.

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<sup>13</sup> <http://www.guardian.co.uk/commentisfree/2011/apr/13/icesave-referendum-uk-payments>

<sup>14</sup> their latest statement on the issue <http://www.eftasurv.int/press--publications/press-releases/internal-market/nr/1527>

<sup>15</sup> <http://www.guardian.co.uk/commentisfree/2011/apr/13/icesave-referendum-uk-payments>

In June 2010, the Althingi finally passed the Act on a Constitutional Assembly<sup>16</sup>, which was to be held in the first months of 2011. This bill received widespread support in Parliament, including from the Liberal Conservatives, who had at first opposed the idea of a Constitutional Assembly but then agreed on condition that there would be an additional Constitutional Committee of seven persons who should be elected by the Parliament and work independently, in particular to prepare the issues to be addressed by the Constitutional Assembly. These issues are outlined in Art. 3 of the Act on a Constitutional Assembly:

1. The foundations of the Icelandic constitution and its fundamental concepts;
2. The organisation of the legislative and executive branches and the limits of their powers;
3. The role and position of the President of the Republic;
4. The independence of the judiciary and their supervision of other holders of governmental powers;
5. Provisions on elections and electoral districts;
6. Public participation in the democratic process, including the timing and organization of a referendum, and including a referendum on a legislative bill for a constitutional act;
7. Transfer of sovereign powers to international organizations and the conduct of foreign affairs
8. Environmental matters, including the ownership and utilization of natural resources.

In other words, direct democracy within the constitution and on the constitution was supposed to play a vital role (for more on that see below). On 6 November 2010, the above-mentioned Constitutional Committee also organized a citizens' summit, a so-called National Assembly on constitutional matters, consisting of about 1000 selected ordinary citizens. They were chosen by randomized sampling from the national population register according to certain distribution quorums relating to age, sex and geographic provenance. The citizens participating in the National Assembly proposed some basic principles for Iceland's constitution and recommendations<sup>17</sup> for the future members of the real Constitutional Assembly, which was then elected on 27 November 2010 on a relatively low turnout of 37% (due to antagonism by the conservative opposition). In this election 523 candidates stood for 25 seats in the constitutional assembly. No candidate could be a member of parliament or government. Due to technical flaws the election was nullified by the Supreme Court. However, since there was no evidence that the flaws in the process led to real problems (Arnason 2011), the Parliament appointed the 25 elected candidates to the Constitutional Council (not anymore Constitutional Assembly). On 29 July 2011 this Constitutional Council handed over the bill for a new constitution to the Parliament.<sup>18</sup>

On the occasion of the two direct democracy conferences in September 2011 we met Salvör Nordal. She is the president of the Constitutional Council and is in favour of Iceland making a fresh start democratically, with the inclusion of elements of direct democracy. Nordal has the typical Icelandic qualities of strong individuality and flexibility - the readiness to adjust rapidly to new situations. In conversation with Bruno Kaufmann, president of IRI Europe and co-organiser of both conferences on

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<sup>16</sup> [http://www.thjodfundur2010.is/other\\_files/2010/doc/Act-on-a-Constitutional-Assembly.pdf](http://www.thjodfundur2010.is/other_files/2010/doc/Act-on-a-Constitutional-Assembly.pdf)

<sup>17</sup> <http://www.thjodfundur2010.is/english/>

<sup>18</sup> <http://stjornarskrarfelagid.is/english/constitutional-bill/>

September 14th<sup>19</sup> and September 15th<sup>20</sup>, Nordal said: “Until recently I still believed that our parliamentary democracy was the best possible system in the world”, adding in self-critical vein: “but I learned something new”. Whereas very little concern had been expressed previously about the lack of adequate separation of powers in the existing Icelandic constitution, the sudden collapse of the country’s banking system revealed very clearly “how weak and vulnerable our democracy is”, said Nordal. The professor of ethics added: “I used to be very critical of direct democracy. I see things differently now”.

Nordal and her colleagues had surprisingly little time for their important task. The Constitutional Council was given a mere four months in which to come up with a completely new set of rules for Icelandic democracy. “We Icelanders are very impatient”, notes Nordal. “That’s a strength when it comes to responding to a volcanic eruption or some other crisis, but a weakness when we have to find longer-term, workable solutions”. But the Council made intensive use of their limited time. The proposed new constitution also benefitted from the direct involvement of the citizens: “More than 3000 suggestions were posted on the Council’s Facebook page; we included many of them in our draft constitution”, says Nordal. But before the Icelanders can express their opinion about their new constitution in a referendum, the national parliament has to review it first. “I have no idea what the politicians will do with our draft”, says Nordal. “Maybe they will tear our proposals to pieces, or put the whole thing on ice”. The fears are justified, since the parliament has so far shown little readiness to come up with longterm solutions. And since the old constitution is for the moment still in force, it is the national parliament, the Althingi, which remains the sovereign, not the people. Article 79<sup>21</sup> of the Icelandic Constitution states that proposals to change the constitution need two votes - the first one in parliament. If the proposal is adopted, parliament will be dissolved and a general election held. Then a second vote is needed by the newly elected parliament. In addition, a direct vote by the Icelandic citizens via a referendum is planned. In other words, all in all three votes need to be approved before a new Constitution can enter into force.

Here one faces a fundamental problem in the Icelandic constitution-making process, with parliament having too strong an influence. According to legal and constitutional theory “(t)he most important aspect is (...) that of reducing the scope of institutional interest: constitutions ought to be written by specially convened assemblies and not by bodies that also serve as ordinary legislatures. Nor should the legislatures be given a central place in the process of ratification.” (Jon Elster: 1995) This latter aspect is not guaranteed, as parliament currently has complete freedom to change the draft constitution.

## **6) What innovations are there in terms of Direct Democracy?**

On its website the Constitutional Council proudly proclaims the new direct-democratic elements in the draft constitution as a major innovation:<sup>22</sup> “With these changes, Iceland will be among the nations which best ensures the right of the public to participate in public decisions, or direct democracy.” But does the actual form of words in the draft constitution match this promise?

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<sup>19</sup> <http://eng.innanrikisraduneyti.is/news/nr/27264>

<sup>20</sup> <http://stofnanir.hi.is/mannrettindastofnun/en/conferences>

<sup>21</sup> <http://www.government.is/constitution/>

<sup>22</sup> <http://www.thjodfundur2010.is/frettir/lesa/item35473/>

Articles 65 to 67 of the draft<sup>23</sup> do indeed provide several participatory and direct-democratic rights. For example, according to Art. 65, 10% of the electorate can launch a legislative initiative or call for an abrogative referendum on a law passed by parliament. As in the Swiss model<sup>24</sup>, parliament can also present a counter-proposal, creating the space for a wider-ranging debate and avoiding 'binary' referendums - a simple choice between 'yes' and 'no' - as for example in California. Parliamentary counter-proposals "focus attention and debate on the contents of the two measures. The central question of such races is: what are the differences between these two measures? Such comparative campaigns produce scrutiny of the legislative details and help voters make more-informed choices" (Joe Matthews 2010).

According to Art. 65, the result of such an abrogative referendum would be binding. By contrast, Art. 66 sets out what, in terms of its scope and implications, is an even more important procedure, in which once again 10% of the electorate can launch a legislative initiative and trigger a referendum on a completely new subject. This goes beyond what is - in Art. 65 - in practice a right of veto against a law already passed by parliament. However, the provisions for this second procedure contain a serious flaw. Art. 66 ends with the statement: "The Althing can decide that the referendum should be binding". This implies that within the framework of this referendum procedure, parliament can declare the referendum to be non-binding - which would undermine the effectiveness of any referendum based on these provisions. There are serious doubts as to whether citizens would make any use of such a popular right if they know that the body to which their proposal is addressed could simply ignore the outcome of the referendum. It is at this point that the legislators' fear of their employers (the sovereign Icelandic people themselves) becomes apparent. For if one poses the question as to whose decision - in the event of a dispute - carries the greater legitimacy: that of the people, or that of their representatives - the Constitutional Council appears to have come to the conclusion that it is the representatives in parliament who should have the last word. Already at the beginning of the draft and the current constitution it is expressed in Article 1 where the source of all sovereignty is seen: "Iceland is a Republic governed by parliamentary democracy" (Art.1).

## **7) The problem of issue exclusion**

Article 67, entitled "Conduct of collections of signatures and referenda", reveals this distrust of the citizens even more strongly. It gives the 'sovereign parliament' the sole right to deal with certain key issues: "A referendum cannot be requested (...) concerning the State Fiscal Budget, the Supplementary Fiscal Budget, legislation enacted for the purpose of implementing undertakings under international law, nor concerning tax matters or citizenship".

Under these provisions Icelanders would not have been able to trigger a referendum on the Icesave agreements - nor on such important issues as membership of NATO or the EU. If these provisions were to remain, popular rights would be severely curtailed and the principle of self-determination would be considerably restricted.

It is hardly surprising that the "pots and pans" were still making themselves heard on the streets of Reykjavik as late as autumn 2011. The proposals for direct democracy at national level are far too faint-hearted; the readiness of the established powers - in particular the political parties - to share power with the citizens is still too weak. There seems little understanding of the fact that it is in their own best interests to grant

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<sup>23</sup> <http://stjornarskrarfelagid.is/english/constitutional-bill/>

<sup>24</sup> [http://www.iri-europe.org/fileadmin/user\\_upload/pdf/CHDD10.pdf](http://www.iri-europe.org/fileadmin/user_upload/pdf/CHDD10.pdf)

citizens equal rights of participation in the decision-making process - because direct democracy designed in a proper way has the potential to make indirect (parliamentary) democracy more representative.

It seems clear that in this process of democratization the Icelanders will still need a great deal of patience and perseverance. It is unlikely that there will be any rapid constitutional change, as this will require new elections to be held first (Art. 79, see above). Since the present government is not doing well in recent opinion polls, one suspects that it will wait until 2013 for new elections - emphasizing once again the extent to which party-political interests stand in the way of democratic development. On the other hand, this interim period presents an opportunity to review and correct the inadequacies of the draft constitution.

Last but not least one should take into account the potential for direct democracy at the local level where 20% of the electorate will receive the right to trigger a referendum. Several speakers at the direct democracy conference in Reykjavik considered this as the primary arena for direct democracy in the near future in Iceland rather than at the national level<sup>25</sup>

It remains to be seen whether the financial crisis will really result in the democratization of Icelandic democracy through direct democracy. The hopes expressed by many international observers<sup>26</sup> often appear exaggerated or overblown and are thus, not without justice, rejected by Iceland's media.<sup>27</sup> At the same time it is also surprising to see the same media's overcritical and conceptually flawed stance on direct democracy. To add to all that, there is as yet hardly any movement for direct democracy in Iceland. As Swiss parliamentarian and member of the Council of Europe Andi Gross notes: "It's not those who oppose direct democracy who are the problem, but those who are in favour of it - but who don't know how to explain it properly".

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<sup>25</sup>

<http://stofnanir.hi.is/mannrettindastofnun/sites/files/mannrettindastofnun/DirectDemocracy15Sept2011.pdf>

<sup>26</sup> <http://www.dailykos.com/story/2011/08/01/1001662/-Iceland's-On-going-Revolution>

<sup>27</sup> <http://grapevine.is/Features/ReadArticle/A-Deconstruction-of-Iceland's-Ongoing-Revolution>

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