

VANITY FAIR

FROZEN ASSETS



Demonstrators in front of Iceland's parliament building, in Reykjavík's Austurvöllur Square, on January 31. *Photographs by Jonas Fredwall Karlsson.*

Wall Street on the Tundra

Iceland's de facto bankruptcy—its currency (the krona) is kaput, its debt is 850 percent of G.D.P., its people are hoarding food and cash and blowing up their new Range Rovers for the insurance—resulted from a stunning collective madness. What led a tiny fishing nation, population 300,000, to decide, around 2003, to re-invent itself as a global financial power? In Reykjavík, where men are men, and the women seem to have completely given up on them, the author follows the peculiarly Icelandic logic behind the meltdown.

BY MICHAEL LEWIS
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Just after October 6, 2008, when Iceland effectively went bust, I spoke to a man at the International Monetary Fund who had been flown in to Reykjavík to determine if money might responsibly be lent to such a spectacularly bankrupt nation. He'd never been to Iceland, knew nothing about the place, and said he needed a map to find it. He has spent his life dealing with famously distressed countries, usually in Africa, perpetually in one kind of financial trouble or another. Iceland was entirely new to his experience: a nation of extremely well-to-do (No. 1 in the United Nations' 2008 Human Development Index), well-educated, historically rational human beings who had organized themselves to commit one of the single greatest acts of madness in financial history. "You have to understand," he told me, "Iceland is no longer a country. It is a hedge fund."

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An entire nation without immediate experience or even distant memory of high finance had gazed upon the example of Wall Street and said, "We can do that." For a brief moment it appeared that they could. In 2003, Iceland's three biggest banks had assets of only a few billion dollars, about 100 percent of its gross domestic product. Over the next three and a half years they grew to over \$140 billion and were so much greater than Iceland's G.D.P. that it made no sense to calculate the percentage of it they accounted for. It was, as one economist put it to me, "the most rapid expansion of a banking system in the history of mankind."

At the same time, in part because the banks were also lending Icelanders money to buy stocks and real estate, the value of Icelandic stocks and real estate went through the roof. From 2003 to 2007, while the U.S. stock market was doubling, the Icelandic stock market multiplied by nine times. Reykjavík real-estate prices tripled. By 2006 the average Icelandic family was three times as wealthy as it had been in 2003, and virtually all of this new wealth was one way or another tied to the new investment-banking industry. "Everyone was learning Black-Scholes" (the option-pricing model), says Ragnar Arnason, a professor of fishing economics at the University of Iceland, who watched students flee the economics of fishing for the economics of money. "The schools of engineering and math were offering courses on financial engineering. We had hundreds and hundreds of people studying finance." This in a country the size of Kentucky, but with fewer citizens than greater Peoria, Illinois. Peoria, Illinois, doesn't have global financial institutions, or a university devoting itself to training many hundreds of financiers, or its own currency. And yet the world was taking Iceland seriously. (March 2006 Bloomberg News headline: ICELAND'S BILLIONAIRE TYCOON "THOR" BRAVES U.S. WITH HEDGE FUND.)

Global financial ambition turned out to have a downside. When their three brand-new global-size banks collapsed, last October, Iceland's 300,000 citizens found that they bore some kind of responsibility for \$100 billion of banking losses—which works out to roughly \$330,000 for every Icelandic man, woman, and child. On top of that they had tens of billions of dollars in personal losses from their own bizarre private foreign-currency speculations, and even more from the 85 percent collapse in the Icelandic stock market. The exact dollar amount of Iceland's financial hole was essentially unknowable, as it depended on the value of the generally stable Icelandic krona, which had also crashed and was removed from the market by the Icelandic government. But it was a lot.

Iceland instantly became the only nation on earth that Americans could point to and say, "Well, at least we didn't do *that*." In the end, Icelanders amassed debts amounting to 850 percent of their G.D.P. (The debt-drowned United States has reached just 350 percent.) As absurdly big and important as Wall Street became in the U.S. economy, it never grew so large that the rest of the population could not, in a pinch, bail it out. Any one of the three Icelandic banks suffered losses too large for the nation to bear; taken together they were so ridiculously out of proportion that, within weeks of the collapse, a third of the population told pollsters that they were considering emigration.

In just three or four years an entirely new way of economic life had been grafted onto the side of this stable, collectivist society, and the graft had overwhelmed the host. "It was just a group of young kids," said the man from the I.M.F. "In this egalitarian society, they came in, dressed in black, and started doing business."

Five hundred miles northwest of Scotland the Icelandair flight lands and taxis to a terminal still painted with Landsbanki logos—Landsbanki being one of Iceland's three bankrupt banks, along with Kaupthing

and Glitnir. I try to think up a metaphor for the world's expanding reservoir of defunct financial corporate sponsorships—water left in the garden hose after you've switched off the pressure?—but before I can finish, the man in the seat behind me reaches for his bag in the overhead bin and knocks the crap out of me. I will soon learn that Icelandic males, like moose, rams, and other horned mammals, see these collisions as necessary in their struggle for survival. I will also learn that this particular Icelandic male is a senior official at the Icelandic stock exchange. At this moment, however, all I know is that a middle-aged man in an expensive suit has gone out of his way to bash bodies without apology or explanation. I stew on this apparently wanton act of hostility all the way to passport control.

You can tell a lot about a country by how much better they treat themselves than foreigners at the point of entry. Let it be known that Icelanders make no distinction at all. Over the control booth they've hung a charming sign that reads simply, ALL CITIZENS, and what they mean by that is not "All Icelandic Citizens" but "All Citizens of Anywhere." Everyone is from somewhere, and so we all wind up in the same line, leading to the guy behind the glass. Before you can say, "Land of contradictions," he has pretended to examine your passport and waved you on through.

Next, through a dark landscape of snow-spattered black volcanic rock that may or may not be lunar, but that looks so much as you would expect the moon to look that NASA scientists used it to acclimate the astronauts before the first moon mission. An hour later we arrive at the 101 Hotel, owned by the wife of one of Iceland's most famous failed bankers. It's cryptically named (101 is the city's richest postal code), but instantly recognizable: hip Manhattan hotel. Staff dressed in black, incomprehensible art on the walls, unread books about fashion on unused coffee tables—everything to heighten the social anxiety of a rube from the sticks but the latest edition of *The New York Observer*. It's the sort of place bankers stay because they think it's where the artists stay. Bear Stearns convened a meeting of British and American hedge-fund managers here, in January 2008, to figure out how much money there was to be made betting on Iceland's collapse. (A lot.) The hotel, once jammed, is now empty, with only 6 of its 38 rooms occupied. The restaurant is empty, too, and so are the small tables and little nooks that once led the people who weren't in them to marvel at those who were. A bankrupt Holiday Inn is just depressing; a bankrupt Ian Schrager hotel is tragic.

With the financiers who once paid a lot to stay here gone for good, I'm given a big room on the top floor with a view of the old city for half-price. I curl up in silky white sheets and reach for a book about the Icelandic economy—written in 1995, before the banking craze, when the country had little to sell to the outside world but fresh fish—and read this remarkable sentence: "Icelanders are rather suspicious of the market system as a cornerstone of economic organization, especially its distributive implications."

That's when the strange noises commence.





Stefan Alfsson: A fisherman turned banker, who was laid off from his trading job in October and now might return to fishing.

First comes a screeching from the far side of the room. I leave the bed to examine the situation. It's the heat, sounding like a teakettle left on the stove for too long, straining to control itself. Iceland's heat isn't heat as we know it, but heat drawn directly from the earth. The default temperature of the water is scalding. Every year workers engaged in street repairs shut down the cold-water intake used to temper the hot water and some poor Icelander is essentially boiled alive in his shower. So powerful is the heat being released from the earth into my room that some great grinding, wheezing engine must be employed to prevent it from cooking me.

Then, from outside, comes an explosion.

Boom!

Then another.

Boom!

As it is mid-December, the sun rises, barely, at 10:50 a.m. and sets with enthusiasm at 3:44 p.m. This is obviously better than no sun at all, but subtly worse, as it tempts you to believe you can simulate a normal life. And whatever else this place is, it isn't normal. The point is reinforced by a 26-year-old Icelander I'll call Magnus Olafsson, who, just a few weeks earlier, had been earning close to a million dollars a year trading currencies for one of the banks. Tall, white-blond, and handsome, Olafsson looks exactly as you'd expect an Icelander to look—which is to say that he looks not at all like most Icelanders, who are mousy-haired and lumpy. "My mother has enough food hoarded to open a grocery store," he says, then adds that ever since the crash Reykjavík has felt tense and uneasy.

Two months earlier, in early October, as the market for Icelandic kronur dried up, he'd sneaked away from his trading desk and gone down to the teller, where he'd extracted as much foreign cash as they'd give him and stuffed it into a sack. "All over downtown that day you saw people walking around with bags," he says. "No one ever carries bags around downtown." After work he'd gone home with his sack of cash and hidden roughly 30 grand in yen, dollars, euros, and pounds sterling inside a board game.

Before October the big-name bankers were heroes; now they are abroad, or laying low. Before October Magnus thought of Iceland as essentially free of danger; now he imagines hordes of muggers en route from foreign nations to pillage his board-game safe—and thus refuses to allow me to use his real name. "You'd figure New York would hear about this and send over planeloads of muggers," he theorizes. "Most everyone has their savings at home." As he is already unsettled, I tell him about the unsettling explosions outside my hotel room. "Yes," he says with a smile, "there's been a lot of Range Rovers catching fire lately." Then he explains.

For the past few years, some large number of Icelanders engaged in the same disastrous speculation. With

local interest rates at 15.5 percent and the krona rising, they decided the smart thing to do, when they wanted to buy something they couldn't afford, was to borrow not kronur but yen and Swiss francs. They paid 3 percent interest on the yen and in the bargain made a bundle on the currency trade, as the krona kept rising. "The fishing guys pretty much discovered the trade and made it huge," says Magnus. "But they made so much money on it that the financial stuff eventually overwhelmed the fish." They made so much money on it that the trade spread from the fishing guys to their friends.

It must have seemed like a no-brainer: buy these ever more valuable houses and cars with money you are, in effect, paid to borrow. But, in October, after the krona collapsed, the yen and Swiss francs they must repay are many times more expensive. Now many Icelanders—especially young Icelanders—own \$500,000 houses with \$1.5 million mortgages, and \$35,000 Range Rovers with \$100,000 in loans against them. To the Range Rover problem there are two immediate solutions. One is to put it on a boat, ship it to Europe, and try to sell it for a currency that still has value. The other is set it on fire and collect the insurance: *Boom!*

The rocks beneath Reykjavík may be igneous, but the city feels sedimentary: on top of several thick strata of architecture that should be called Nordic Pragmatic lies a thin layer that will almost certainly one day be known as Asshole Capitalist. The hobbit-size buildings that house the Icelandic government are charming and scaled to the city. The half-built oceanfront glass towers meant to house newly rich financiers and, in the bargain, block everyone else's view of the white bluffs across the harbor are not.

The best way to see any city is to walk it, but everywhere I walk Icelandic men plow into me without so much as a by-your-leave. Just for fun I march up and down the main shopping drag, playing chicken, to see if any Icelandic male would rather divert his stride than bang shoulders. Nope. On party nights—Thursday, Friday, and Saturday—when half the country appears to take it as a professional obligation to drink themselves into oblivion and wander the streets until what should be sunrise, the problem is especially acute. The bars stay open until five a.m., and the frantic energy with which the people hit them seems more like work than work. Within minutes of entering a nightclub called Boston I get walloped, first by a bearded troll who, I'm told, ran an Icelandic hedge fund. Just as I'm recovering I get plowed over by a drunken senior staffer at the Central Bank. Perhaps because he is drunk, or perhaps because we had actually met a few hours earlier, he stops to tell me, "Vee try to tell them dat our problem was not a solfency problem but a likvitiy problem, but they did not agree," then stumbles off. It's exactly what Lehman Brothers and Citigroup said: If only you'd give us the money to tide us over, we'll survive this little hiccup.

A nation so tiny and homogeneous that everyone in it knows pretty much everyone else is so fundamentally different from what one thinks of when one hears the word "nation" that it almost requires a new classification. Really, it's less a nation than one big extended family. For instance, most Icelanders are by default members of the Lutheran Church. If they want to stop being Lutherans they must write to the government and quit; on the other hand, if they fill out a form, they can start their own cult and receive a subsidy. Another example: the Reykjavík phone book lists everyone by his first name, as there are only about nine surnames in Iceland, and they are derived by prefixing the father's name to "son" or "dottir." It's hard to see how this clarifies matters, as there seem to be only about nine first names in Iceland, too. But if you wish to reveal how little you know about Iceland, you need merely refer to someone named Siggör Sigfusson as "Mr. Sigfusson," or Kristín Petursdóttir as "Ms. Petursdóttir." At any rate, everyone in a conversation is just meant to know whomever you're talking about, so you never hear anyone ask, "Which Siggör do you mean?"

Because Iceland is really just one big family, it's simply annoying to go around asking Icelanders if they've met Björk. Of course they've met Björk; who *hasn't* met Björk? Who, for that matter, didn't know Björk when

she was two? “Yes, I know Björk,” a professor of finance at the University of Iceland says in reply to my question, in a weary tone. “She can’t sing, and I know her mother from childhood, and they were both crazy. That she is so well known outside of Iceland tells me more about the world than it does about Björk.”

One benefit of life inside a nation masking an extended family is that nothing needs to be explained; everyone already knows everything that needs to be known. I quickly find that it is an even greater than usual waste of time to ask directions, for instance. Just as you are meant to know which Bjornjolfur is being spoken of at any particular moment, you are meant to know where you are on the map. Two grown-ups—one a banker whose office is three blocks away—cannot tell me where to find the prime minister’s office. Three more grown-ups, all within three blocks of the National Gallery of Iceland, have no idea where to find the place. When I tell the sweet middle-aged lady behind the counter at the National Museum that no Icelander seems to know how to find it, she says, “No one actually knows anything about our country. Last week we had Icelandic high-school students here and their teacher asked them to name an Icelandic 19th-century painter. None of them could. Not a single one! One said, ‘Halldor Laxness?’!” (Laxness won the 1955 Nobel Prize in Literature, the greatest global honor for an Icelander until the 1980s, when two Icelandic women captured Miss World titles in rapid succession.)

The world is now pocked with cities that feel as if they are perched on top of bombs. The bombs have yet to explode, but the fuses have been lit, and there’s nothing anyone can do to extinguish them. Walk around Manhattan and you see empty stores, empty streets, and, even when it’s raining, empty taxis: people have fled before the bomb explodes. When I was there Reykjavík had the same feel of incipient doom, but the fuse burned strangely. The government mandates three months’ severance pay, and so the many laid-off bankers were paid until early February, when the government promptly fell. Against a basket of foreign currencies the krona is worth less than a third of its boom-time value. As Iceland imports everything but heat and fish, the price of just about everything is, in mid-December, about to skyrocket. A new friend who works for the government tells me that she went into a store to buy a lamp. The clerk told her he had sold the last of the lamps she was after, but offered to order it for her, from Sweden—at nearly three times the old price.

Still, a society that has been ruined overnight doesn’t look much different from how it did the day before, when it believed itself to be richer than ever. The Central Bank of Iceland is a case in point. Almost certainly Iceland will adopt the euro as its currency, and the krona will cease to exist. Without it there is no need for a central bank to maintain the stability of the local currency and control interest rates. Inside the place stews David Oddsson, the architect of Iceland’s rise and fall. Back in the 1980s, Oddsson had fallen under the spell of Milton Friedman, the brilliant economist who was able to persuade even those who spent their lives working for the government that government was a waste of life. So Oddsson went on a quest to give Icelandic people their freedom—by which he meant freedom from government controls of any sort. As prime minister he lowered taxes, privatized industry, freed up trade, and, finally, in 2002, privatized the banks. At length, weary of prime-ministering, he got himself appointed governor of the Central Bank—even though he was a poet without banking experience.





Bjarni Brynjolfsson: A fishing guide, who is back to hosting fly-fishermen instead of bankers.

After the collapse he holed up in his office inside the bank, declining all requests for interviews. Senior government officials tell me, seriously, that they assume he spends most of his time writing poetry. (In February he would be asked by a new government to leave.) On the outside, however, the Central Bank of Iceland is still an elegant black temple set against the snowy bluffs across the harbor. Sober-looking men still enter and exit. Small boys on sleds rocket down the slope beside it, giving not a rat's ass that they are playing at ground zero of the global calamity. It all looks the same as it did before the crash, even though it couldn't be more different. The fuse is burning its way toward the bomb.

When Neil Armstrong took his small step from Apollo 11 and looked around, he probably thought, Wow, sort of like Iceland—even though the moon was nothing like Iceland. But then, he was a tourist, and a tourist can't help but have a distorted opinion of a place: he meets unrepresentative people, has unrepresentative experiences, and runs around imposing upon the place the fantastic mental pictures he had in his head when he got there. When Iceland became a tourist in global high finance it had the same problem as Neil Armstrong. Icelanders are among the most inbred human beings on earth—geneticists often use them for research. They inhabited their remote island for 1,100 years without so much as dabbling in leveraged buyouts, hostile takeovers, derivatives trading, or even small-scale financial fraud. When, in 2003, they sat down at the same table with Goldman Sachs and Morgan Stanley, they had only the roughest idea of what an investment banker did and how he behaved—most of it gleaned from young Icelanders' experiences at various American business schools. And so what they did with money probably says as much about the American soul, circa 2003, as it does about Icelanders. They understood instantly, for instance, that finance had less to do with productive enterprise than trading bits of paper among themselves. And when they lent money they didn't simply facilitate enterprise but bankrolled friends and family, so that they might buy and own things, like real investment bankers: Beverly Hills condos, British soccer teams and department stores, Danish airlines and media companies, Norwegian banks, Indian power plants.

That was the biggest American financial lesson the Icelanders took to heart: the importance of buying as many assets as possible with borrowed money, as asset prices only rose. By 2007, Icelanders owned roughly 50 times more foreign assets than they had in 2002. They bought private jets and third homes in London and Copenhagen. They paid vast sums of money for services no one in Iceland had theretofore ever imagined wanting. "A guy had a birthday party, and he flew in Elton John for a million dollars to sing two songs," the head of the Left-Green Movement, Steingrímur Sigfússon, tells me with fresh incredulity. "And apparently not very well." They bought stakes in businesses they knew nothing about and told the people running them what to do—just like real American investment bankers! For instance, an investment company called FL Group—a major shareholder in Glitnir bank—bought an 8.25 percent stake in American Airlines' parent corporation. No one inside FL Group had ever actually run an airline; no one in FL Group even had meaningful work experience at an airline. That didn't stop FL Group from telling American Airlines how to run an airline. "After taking a close look at the company over an extended period of time," FL Group C.E.O. Hannes Smarason, graduate of M.I.T.'s Sloan School, got himself quoted saying, in his press release, not long after he bought his shares, "our suggestions include monetizing assets ... that can be used to reduce debt or return capital to shareholders."

Nor were the Icelanders particularly choosy about what they bought. I spoke with a hedge fund in New York that, in late 2006, spotted what it took to be an easy mark: a weak Scandinavian bank getting weaker. It established a short position, and then, out of nowhere, came Kaupthing to take a 10 percent stake in this soon-to-be defunct enterprise—driving up the share price to absurd levels. I spoke to another hedge fund in London so perplexed by the many bad LBOs Icelandic banks were financing that it hired private

investigators to figure out what was going on in the Icelandic financial system. The investigators produced a chart detailing a byzantine web of interlinked entities that boiled down to this: A handful of guys in Iceland, who had no experience of finance, were taking out tens of billions of dollars in short-term loans from abroad. They were then re-lending this money to themselves and their friends to buy assets—the banks, soccer teams, etc. Since the entire world's assets were rising—thanks in part to people like these Icelandic lunatics paying crazy prices for them—they appeared to be making money. Yet another hedge-fund manager explained Icelandic banking to me this way: You have a dog, and I have a cat. We agree that they are each worth a billion dollars. You sell me the dog for a billion, and I sell you the cat for a billion. Now we are no longer pet owners, but Icelandic banks, with a billion dollars in new assets. “They created fake capital by trading assets amongst themselves at inflated values,” says a London hedge-fund manager. “This was how the banks and investment companies grew and grew. But they were lightweights in the international markets.”

On February 3, Tony Shearer, the former C.E.O. of a British merchant bank called Singer and Friedlander, offered a glimpse of the inside, when he appeared before a House of Commons committee to describe his bizarre experience of being acquired by an Icelandic bank.

Singer and Friedlander had been around since 1907 and was famous for, among other things, giving George Soros his start. In November 2003, Shearer learned that Kaupthing, of whose existence he was totally unaware, had just taken a 9.5 percent stake in his bank. Normally, when a bank tries to buy another bank, it seeks to learn something about it. Shearer offered to meet with Kaupthing's chairman, Sigurdur Einarsson; Einarsson had no interest. (Einarsson declined to be interviewed by *Vanity Fair*.) When Kaupthing raised its stake to 19.5 percent, Shearer finally flew to Reykjavik to see who on earth these Icelanders were. “They were very different,” he told the House of Commons committee. “They ran their business in a very strange way. Everyone there was incredibly young. They were all from the same community in Reykjavik. And they had no idea what they were doing.”



Hordur Torfason: An activist and a protest organizer.

He examined Kaupthing's annual reports and discovered some amazing facts: This giant international bank had only one board member who was not Icelandic, for instance. Its directors all had four-year contracts, and the bank had lent them £19 million to buy shares in Kaupthing, along with options to sell those shares back to the bank at a guaranteed profit. Virtually the entire bank's stated profits were caused by its marking up assets it had bought at inflated prices. "The actual amount of profits that were coming from what I'd call banking was less than 10 percent," said Shearer.

In a sane world the British regulators would have stopped the new Icelandic financiers from devouring the ancient British merchant bank. Instead, the regulators ignored a letter Shearer wrote to them. A year later, in January 2005, he received a phone call from the British takeover panel. "They wanted to know," says Shearer, "why our share price had risen so rapidly over the past couple of days. So I laughed and said, 'I think you'll find the reason is that Mr. Einarsson, the chairman of Kaupthing, said two days ago, like an idiot, that he was going to make a bid for Singer and Friedlander.'" In August 2005, Singer and Friedlander became Kaupthing Singer and Friedlander, and Shearer quit, he said, out of fear of what might happen to his reputation if he stayed. In October 2008, Kaupthing Singer and Friedlander went bust.

In spite of all this, when Tony Shearer was pressed by the House of Commons to characterize the Icelanders as mere street hustlers, he refused. "They were all highly educated people," he said in a tone of amazement.

Here is yet another way in which Iceland echoed the American model: all sorts of people, none of them Icelandic, tried to tell them they had a problem. In early 2006, for instance, an analyst named Lars Christensen and three of his colleagues at Denmark's biggest bank, Danske Bank, wrote a report that said Iceland's financial system was growing at a mad pace, and was on a collision course with disaster. "We actually wrote the report because we were worried our clients were getting too interested in Iceland," he tells me. "Iceland was the most extreme of everything." Christensen then flew to Iceland and gave a speech to reinforce his point, only to be greeted with anger. "The Icelandic banks took it personally," he says. "We were being threatened with lawsuits. I was told, 'You're Danish, and you are angry with Iceland because Iceland is doing so well.' Basically it all had to do with what happened in 1944," when Iceland declared its independence from Denmark. "The reaction wasn't 'These guys might be right.' It was 'No! It's a conspiracy. They have bad motives.'" The Danish were just jealous!

The Danske Bank report alerted hedge funds in London to an opportunity: shorting Iceland. They investigated and found this incredible web of cronyism: bankers buying stuff from one another at inflated prices, borrowing tens of billions of dollars and re-lending it to the members of their little Icelandic tribe, who then used it to buy up a messy pile of foreign assets. "Like any new kid on the block," says Theo Phanos of Trafalgar Funds in London, "they were picked off by various people who sold them the lowest-quality assets—second-tier airlines, sub-scale retailers. They were in all the worst LBOs."

But from the prime minister on down, Iceland's leaders attacked the messenger. "The attacks ... give off an unpleasant odor of unscrupulous dealers who have decided to make a last stab at breaking down the Icelandic financial system," said Central Bank chairman Oddsson in March of last year. The chairman of Kaupthing publicly fingered four hedge funds that he said were deliberately seeking to undermine Iceland's financial miracle. "I don't know where the Icelanders get this notion," says Paul Ruddock, of Lansdowne Partners, one of those fingered. "We only once traded in an Icelandic stock and it was a very short-term trade. We started to take legal action against the chairman of Kaupthing after he made public accusations against us that had no truth, and then he withdrew them."

One of the hidden causes of the current global financial crisis is that the people who saw it coming had more to gain from it by taking short positions than they did by trying to publicize the problem. Plus, most of the people who could credibly charge Iceland—or, for that matter, Lehman Brothers—with financial crimes

could be dismissed as crass profiteers, talking their own book. Back in April 2006, however, an emeritus professor of economics at the University of Chicago named Bob Aliber took an interest in Iceland. Aliber found himself at the London Business School, listening to a talk on Iceland, about which he knew nothing. He recognized instantly the signs. Digging into the data, he found in Iceland the outlines of what was so clearly a historic act of financial madness that it belonged in a textbook. “The Perfect Bubble,” Aliber calls Iceland’s financial rise, and he has the textbook in the works: an updated version of Charles Kindleberger’s 1978 classic, *Manias, Panics, and Crashes*, a new edition of which he’s currently editing. In it, Iceland, he decided back in 2006, would now have its own little box, along with the South Sea Bubble and the Tulip Craze—even though Iceland had yet to crash. For him the actual crash was a mere formality.

Word spread in Icelandic economic circles that this distinguished professor at Chicago had taken a special interest in Iceland. In May 2008, Aliber was invited by the University of Iceland’s economics department to give a speech. To an audience of students, bankers, and journalists, he explained that Iceland, far from having an innate talent for high finance, had all the markings of a giant bubble, but he spoke the technical language of academic economists. (“Monetary Turbulence and the Icelandic Economy,” he called his speech.) In the following Q&A session someone asked him to predict the future, and he lapsed into plain English. As an audience member recalls, Aliber said, “I give you nine months. Your banks are dead. Your bankers are either stupid or greedy. And I’ll bet they are on planes trying to sell their assets right now.”

The Icelandic bankers in the audience sought to prevent newspapers from reporting the speech. Several academics suggested that Aliber deliver his alarming analysis to Iceland’s Central Bank. Somehow that never happened. “The Central Bank said they were too busy to see him,” says one of the professors who tried to arrange the meeting, “because they were preparing the Report on Financial Stability.” For his part Aliber left Iceland thinking that he’d caused such a stir he might not be allowed back into the country. “I got the feeling,” he told me, “that the only reason they brought me in was that they needed an outsider to say these things—that an insider wouldn’t say these things, because he’d be afraid of getting into trouble.” And yet he remains extremely fond of his hosts. “They are a very curious people,” he says, laughing. “I guess that’s the point, isn’t it?”

Icelanders—or at any rate Icelandic men—had their own explanations for why, when they leapt into global finance, they broke world records: the natural superiority of Icelanders. Because they were small and isolated it had taken 1,100 years for them—and the world—to understand and exploit their natural gifts, but now that the world was flat and money flowed freely, unfair disadvantages had vanished. Iceland’s president, Olafur Ragnar Grimsson, gave speeches abroad in which he explained why Icelanders were banking prodigies. “Our heritage and training, our culture and home market, have provided a valuable advantage,” he said, then went on to list nine of these advantages, ending with how unthreatening to others Icelanders are. (“Some people even see us as fascinating eccentrics who can do no harm.”) There were many, many expressions of this same sentiment, most of them in Icelandic. “There were research projects at the university to explain why the Icelandic business model was superior,” says Gylfi Zoega, chairman of the economics department. “It was all about our informal channels of communication and ability to make quick decisions and so forth.”

“We were always told that the Icelandic businessmen were so clever,” says university finance professor and former banker Vilhjalmur Bjarnason. “They were very quick. And when they bought something they did it very quickly. Why was that? That is usually because the seller is very satisfied with the price.”

You didn’t need to be Icelandic to join the cult of the Icelandic banker. German banks put \$21 billion into Icelandic banks. The Netherlands gave them \$305 million, and Sweden kicked in \$400 million. U.K.

investors, lured by the eye-popping 14 percent annual returns, forked over \$30 billion—\$28 billion from companies and individuals and the rest from pension funds, hospitals, universities, and other public institutions. Oxford University alone lost \$50 million.



Geir Haarde: The former prime minister, on January 28, one of his last days in office.

Maybe because there are so few Icelanders in the world, we know next to nothing about them. We assume they are more or less Scandinavian—a gentle people who just want everyone to have the same amount of everything. They are not. They have a feral streak in them, like a horse that’s just pretending to be broken.

After three days in Reykjavík, I receive, more or less out of the blue, two phone calls. The first is from a producer of a leading current-events TV show. All of Iceland watches her show, she says, then asks if I’d come on and be interviewed. “About what?” I ask. “We’d like you to explain our financial crisis,” she says. “I’ve only been here three days!” I say. It doesn’t matter, she says, as no one in Iceland understands what’s happened. They’d enjoy hearing someone try to explain it, even if that person didn’t have any idea what he was talking about—which goes to show, I suppose, that not everything in Iceland is different from other places. As I demur, another call comes, from the prime minister’s office.

Iceland’s then prime minister, Geir Haarde, is also the head of the Independence Party, which has governed the country since 1991. It ruled in loose coalition with the Social Democrats and the Progressive Party. (Iceland’s fourth major party is the Left-Green Movement.) That a nation of 300,000 people, all of whom are related by blood, needs four major political parties suggests either a talent for disagreement or an unwillingness to listen to one another. In any case, of the four parties, the Independents express the greatest faith in free markets. The Independence Party is the party of the fishermen. It is also, as an old schoolmate of the prime minister’s puts it to me, “all men, men, men. Not a woman in it.”

Walking into the P.M.’s minute headquarters, I expect to be stopped and searched, or at least asked for photo identification. Instead I find a single policeman sitting behind a reception desk, feet up on the table, reading a newspaper. He glances up, bored. “I’m here to see the prime minister,” I say for the first time in my life. He’s unimpressed. Anyone here can see the prime minister. Half a dozen people will tell me that one of the reasons Icelanders thought they would be taken seriously as global financiers is that all Icelanders feel important. One reason they all feel important is that they all can go see the prime minister anytime they

like.

What he might say to them about their collapse is an open question. There's a charming lack of financial experience in Icelandic financial-policy-making circles. The minister for business affairs is a philosopher. The finance minister is a veterinarian. The Central Bank governor is a poet. Haarde, though, is a trained economist—just not a very good one. The economics department at the University of Iceland has him pegged as a B-minus student. As a group, the Independence Party's leaders have a reputation for not knowing much about finance and for refusing to avail themselves of experts who do. An Icelandic professor at the London School of Economics named Jon Danielsson, who specializes in financial panics, has had his offer to help spurned; so have several well-known financial economists at the University of Iceland. Even the advice of really smart central bankers from seriously big countries went ignored. It's not hard to see why the Independence Party and its prime minister fail to appeal to Icelandic women: they are the guy driving his family around in search of some familiar landmark and refusing, over his wife's complaints, to stop and ask directions.

"Why is *Vanity Fair* interested in Iceland?" he asks as he strides into the room, with the force and authority of the leader of a much larger nation. And it's a good question.

As it turns out, he's not actually stupid, but political leaders seldom are, no matter how much the people who elected them insist that it must be so. He does indeed say things that could not possibly be true, but they are only the sorts of fibs that prime ministers are hired to tell. He claims that the krona is once again an essentially stable currency, for instance, when the truth is it doesn't currently trade in international markets—it is assigned an arbitrary value by the government for select purposes. Icelanders abroad have already figured out not to use their Visa cards, for fear of being charged the real exchange rate, whatever that might be.

The prime minister would like me to believe that he saw Iceland's financial crisis taking shape but could do little about it. ("We could not say publicly our fears about the banks, because you create the very thing you are seeking to avoid: a panic.") By implication it was not politicians like him but financiers who were to blame. On some level the people agree: the guy who ran the Baugur investment group had snowballs chucked at him as he dashed from the 101 Hotel, which his wife owns, to his limo; the guy who ran Kaupthing Bank turned up at the National Theater and, as he took his seat, was booed. But, for the most part, the big shots have fled Iceland for London, or are lying low, leaving the poor prime minister to shoulder the blame and face the angry demonstrators, led by folksinging activist Hordur Torfason, who assemble every weekend outside Parliament. Haarde has his story, and he's sticking to it: foreigners entrusted their capital to Iceland, and Iceland put it to good use, but then, last September 15, Lehman Brothers failed and foreigners panicked and demanded their capital back. Iceland was ruined not by its own recklessness but by a global tsunami. The problem with this story is that it fails to explain why the tsunami struck Iceland, as opposed to, say, Tonga.

But I didn't come to Iceland to argue. I came to understand. "There's something I really want to ask you," I say.

"Yes?"

"Is it true that you've been telling people that it's time to stop banking and go fishing?"

A great line, I thought. Succinct, true, and to the point. But I'd heard about it thirdhand, from a New York hedge-fund manager. The prime minister fixes me with a self-consciously stern gaze. "That's a gross exaggeration," he says.

“I thought it made sense,” I say uneasily.

“I never said that!”

Obviously, I’ve hit some kind of nerve, but which kind I cannot tell. Is he worried that to have said such a thing would make him seem a fool? Or does he still think that fishing, as a profession, is somehow less dignified than banking?

At length, I return to the hotel to find, for the first time in four nights, no empty champagne bottles outside my neighbors’ door. The Icelandic couple whom I had envisioned as being on one last blowout have packed and gone home. For four nights I have endured their Orc shrieks from the other side of the hotel wall; now all is silent. It’s now possible to curl up in bed with “The Economic Theory of a Common-Property Resource: The Fishery.” One way or another, the wealth in Iceland comes from the fish, and if you want to understand what Icelanders did with their money you had better understand how they came into it in the first place.

The brilliant paper was written back in 1954 by H. Scott Gordon, a University of Indiana economist. It describes the plight of the fisherman—and seeks to explain “why fishermen are not wealthy, despite the fact that fishery resources of the sea are the richest and most indestructible available to man.” The problem is that, because the fish are everybody’s property, they are nobody’s property. Anyone can catch as many fish as they like, so they fish right up to the point where fishing becomes unprofitable—for everybody. “There is in the spirit of every fisherman the hope of the ‘lucky catch,’” wrote Gordon. “As those who know fishermen well have often testified, they are gamblers and incurably optimistic.”

Fishermen, in other words, are a lot like American investment bankers. Their overconfidence leads them to impoverish not just themselves but also their fishing grounds. Simply limiting the number of fish caught won’t solve the problem; it will just heighten the competition for the fish and drive down profits. The goal isn’t to get fishermen to overspend on more nets or bigger boats. The goal is to catch the maximum number of fish with minimum effort. To attain it, you need government intervention.



This insight is what led Iceland to go from being one of the poorest

Johanna Sigurdardottir: The new prime minister, the modern world’s

countries in Europe circa 1900 to being one of the richest circa 2000.

Iceland's big change began in the early 1970s, after a couple of years when the fish catch was terrible. The best fishermen returned for a second year in a row without their usual haul of cod and haddock, so the Icelandic government took radical action: they privatized the fish. Each fisherman was assigned a quota, based roughly on his historical catches. If you were a big-time Icelandic fisherman you got this piece of paper that entitled you to, say, 1 percent of the total catch allowed to be pulled from Iceland's waters that season. Before each season the scientists at the Marine Research Institute would determine the total number of cod or haddock that could be caught without damaging the long-term health of the fish population; from year to year, the numbers of fish you could catch changed. But your percentage of the annual haul was fixed, and this piece of paper entitled you to it in perpetuity.

Even better, if you didn't want to fish you could sell your quota to someone who did. The quotas thus drifted into the hands of the people to whom they were of the greatest value, the best fishermen, who could extract the fish from the sea with maximum efficiency. You could also take your quota to the bank and borrow against it, and the bank had no trouble assigning a dollar value to your share of the cod pulled, without competition, from the richest cod-fishing grounds on earth. The fish had not only been privatized, they had been securitized.

It was horribly unfair: a public resource—all the fish in the Icelandic sea—was simply turned over to a handful of lucky Icelanders. Overnight, Iceland had its first billionaires, and they were all fishermen. But as social policy it was ingenious: in a single stroke the fish became a source of real, sustainable wealth rather than shaky sustenance. Fewer people were spending less effort catching more or less precisely the right number of fish to maximize the long-term value of Iceland's fishing grounds. The new wealth transformed Iceland—and turned it from the backwater it had been for 1,100 years to the place that spawned Björk. If Iceland has become famous for its musicians it's because Icelanders now have time to play music, and much else. Iceland's youth are paid to study abroad, for instance, and encouraged to cultivate themselves in all sorts of interesting ways. Since its fishing policy transformed Iceland, the place has become, in effect, a machine for turning cod into Ph.D.'s.

But this, of course, creates a new problem: people with Ph.D.'s don't want to fish for a living. They need something else to do.

And that something is probably not working in the industry that exploits Iceland's other main natural resource: energy. The waterfalls and boiling lava generate vast amounts of cheap power, but, unlike oil, it cannot be profitably exported. Iceland's power is trapped in Iceland, and if there is something poetic about the idea of trapped power, there is also something prosaic in how the Icelanders have come to terms with the problem. They asked themselves: What can we do that other people will pay money for that requires huge amounts of power? The answer was: smelt aluminum.

Notice that no one asked, What might Icelanders want to do? Or even: What might Icelanders be especially suited to do? No one thought that Icelanders might have some natural gift for smelting aluminum, and, if anything, the opposite proved true. Alcoa, the biggest aluminum company in the country, encountered two problems peculiar to Iceland when, in 2004, it set about erecting its giant smelting plant. The first was the so-called "hidden people"—or, to put it more plainly, elves—in whom some large number of Icelanders, steeped long and thoroughly in their rich folkloric culture, sincerely believe. Before Alcoa could build its smelter it had to defer to a government expert to scour the enclosed plant site and certify that no elves were on or under it. It was a delicate corporate situation, an Alcoa spokesman told me, because they had to pay hard cash to declare the site elf-free but, as he put it, "we couldn't as a company be in a position of acknowledging the existence of hidden people." The other, more serious problem was the Icelandic male:

he took more safety risks than aluminum workers in other nations did. “In manufacturing,” says the spokesman, “you want people who follow the rules and fall in line. You don’t want them to be heroes. You don’t want them to try to fix something it’s not their job to fix, because they might blow up the place.” The Icelandic male had a propensity to try to fix something it wasn’t his job to fix.

Back away from the Icelandic economy and you can’t help but notice something really strange about it: the people have cultivated themselves to the point where they are unsuited for the work available to them. All these exquisitely schooled, sophisticated people, each and every one of whom feels special, are presented with two mainly horrible ways to earn a living: trawler fishing and aluminum smelting. There are, of course, a few jobs in Iceland that any refined, educated person might like to do. Certifying the nonexistence of elves, for instance. (“This will take at least six months—it can be very tricky.”) But not nearly so many as the place needs, given its talent for turning cod into Ph.D.’s. At the dawn of the 21st century, Icelanders were still waiting for some task more suited to their filigreed minds to turn up inside their economy so they might do it.

Enter investment banking.

For the fifth time in as many days I note a slight tension at any table where Icelandic men and Icelandic women are both present. The male exhibits the global male tendency not to talk to the females—or, rather, not to include them in the conversation—unless there is some obvious sexual motive. But that’s not the problem, exactly. Watching Icelandic men and women together is like watching toddlers. They don’t play together but in parallel; they overlap even less organically than men and women in other developed countries, which is really saying something. It isn’t that the women are oppressed, exactly. On paper, by historical global standards, they have it about as good as women anywhere: good public health care, high participation in the workforce, equal rights. What Icelandic women appear to lack—at least to a tourist who has watched them for all of 10 days—is a genuine connection to Icelandic men. The Independence Party is mostly male; the Social Democrats, mostly female. (On February 1, when the reviled Geir Haarde finally stepped aside, he was replaced by Johanna Sigurdardottir, a Social Democrat, and Iceland got not just a lady prime minister but the modern world’s first openly gay head of state—she lives with another woman.) Everyone knows everyone else, but when I ask Icelanders for leads, the men always refer me to other men, and the women to other women. It was a man, for instance, who suggested I speak to Stefan Alfsson.

Lean and hungry-looking, wearing genuine rather than designer stubble, Alfsson still looks more like a trawler captain than a financier. He went to sea at 16, and, in the off-season, to school to study fishing. He was made captain of an Icelandic fishing trawler at the shockingly young age of 23 and was regarded, I learned from other men, as something of a fishing prodigy—which is to say he had a gift for catching his quota of cod and haddock in the least amount of time. And yet, in January 2005, at 30, he up and quit fishing to join the currency-trading department of Landsbanki. He speculated in the financial markets for nearly two years, until the great bloodbath of October 2008, when he was sacked, along with every other Icelander who called himself a “trader.” His job, he says, was to sell people, mainly his fellow fishermen, on what he took to be a can’t-miss speculation: borrow yen at 3 percent, use them to buy Icelandic kronur, and then invest those kronur at 16 percent. “I think it is easier to take someone in the fishing industry and teach him about currency trading,” he says, “than to take someone from the banking industry and teach them how to fish.”

He then explained why fishing wasn’t as simple as I thought. It’s risky, for a start, especially as practiced by the Icelandic male. “You don’t want to have some sissy boys on your crew,” he says, especially as Icelandic captains are famously manic in their fishing styles. “I had a crew of Russians once,” he says, “and it wasn’t that they were lazy, but the Russians are always at the same pace.” When a storm struck, the Russians would

stop fishing, because it was too dangerous. “The Icelanders would fish in all conditions,” says Stefan, “fish until it is impossible to fish. They like to take the risks. If you go overboard, the probabilities are not in your favor. I’m 33, and I already have two friends who have died at sea.”

It took years of training for him to become a captain, and even then it happened only by a stroke of luck. When he was 23 and a first mate, the captain of his fishing boat up and quit. The boat owner went looking for a replacement and found an older fellow, retired, who was something of an Icelandic fishing legend, the wonderfully named Snorri Snorrasson. “I took two trips with this guy,” Stefan says. “I have never in my life slept so little, because I was so eager to learn. I slept two or three hours a night because I was sitting beside him, talking to him. I gave him all the respect in the world—it’s difficult to describe all he taught me. The reach of the trawler. The most efficient angle of the net. How do you act on the sea. If you have a bad day, what do you do? If you’re fishing at this depth, what do you do? If it’s not working, do you move in depth or space? In the end it’s just so much feel. In this time I learned infinitely more than I learned in school. Because how do you learn to fish in school?”

This marvelous training was as fresh in his mind as if he’d received it yesterday, and the thought of it makes his eyes mist.

“You spent *seven* years learning every little nuance of the fishing trade before you were granted the gift of learning from this great captain?” I ask.

“Yes.”

“And even then you had to sit at the feet of this great master for many months before you felt as if you knew what you were doing?”

“Yes.”

“Then why did you think you could become a banker and speculate in financial markets, without a day of training?”

“That’s a very good question,” he says. He thinks for a minute. “For the first time this evening I lack a word.” As I often think I know exactly what I am doing even when I don’t, I find myself oddly sympathetic.

“What, exactly, was your job?” I ask, to let him off the hook, catch and release being the current humane policy in Iceland.

“I started as a ... “—now he begins to laugh—“an adviser to companies on currency risk hedging. But given my aggressive nature I went more and more into plain speculative trading.” Many of his clients were other fishermen, and fishing companies, and they, like him, had learned that if you don’t take risks you don’t catch the fish. “The clients were only interested in ‘hedging’ if it meant making money,” he says.

In retrospect, there are some obvious questions an Icelander living through the past five years might have asked himself. For example: Why should Iceland suddenly be so seemingly essential to global finance? Or: Why do giant countries that invented modern banking suddenly need Icelandic banks to stand between their depositors and their borrowers—to decide who gets capital and who does not? And: If Icelanders have this incredible natural gift for finance, how did they keep it so well hidden for 1,100 years? At the very least, in a place where everyone knows everyone else, or his sister, you might have thought that the moment Stefan Alfsson walked into Landsbanki 10 people would have said, “Stefan, you’re a fisherman!” But they didn’t. To a shocking degree, they still don’t. “If I went back to banking,” he says, with an entirely straight face, “I would be a private-banking guy.”

Back in 2001, as the Internet boom turned into a bust, M.I.T.'s *Quarterly Journal of Economics* published an intriguing paper called "Boys Will Be Boys: Gender, Overconfidence, and Common Stock Investment." The authors, Brad Barber and Terrance Odean, gained access to the trading activity in over 35,000 households, and used it to compare the habits of men and women. What they found, in a nutshell, is that men not only trade more often than women but do so from a false faith in their own financial judgment. Single men traded less sensibly than married men, and married men traded less sensibly than single women: the less the female presence, the less rational the approach to trading in the markets.

One of the distinctive traits about Iceland's disaster, and Wall Street's, is how little women had to do with it. Women worked in the banks, but not in the risktaking jobs. As far as I can tell, during Iceland's boom, there was just one woman in a senior position inside an Icelandic bank. Her name is Kristin Petursdottir, and by 2005 she had risen to become deputy C.E.O. for Kaupthing in London. "The financial culture is very male-dominated," she says. "The culture is quite extreme. It is a pool of sharks. Women just despise the culture." Petursdottir still enjoyed finance. She just didn't like the way Icelandic men did it, and so, in 2006, she quit her job. "People said I was crazy," she says, but she wanted to create a financial-services business run entirely by women. To bring, as she puts it, "more feminine values to the world of finance."

Today her firm is, among other things, one of the very few profitable financial businesses left in Iceland. After the stock exchange collapsed, the money flooded in. A few days before we met, for instance, she heard banging on the front door early one morning and opened it to discover a little old man. "I'm so fed up with this whole system," he said. "I just want some women to take care of my money."

It was with that in mind that I walked, on my last afternoon in Iceland, into the Saga Museum. Its goal is to glorify the Sagas, the great 12th- and 13th-century Icelandic prose epics, but the effect of its life-size dioramas is more like modern reality TV. Not statues carved from silicon but actual ancient Icelanders, or actors posing as ancient Icelanders, as shrieks and bloodcurdling screams issue from the P.A. system: a Catholic bishop named Jon Arason having his head chopped off; a heretic named Sister Katrin being burned at the stake; a battle scene in which a blood-drenched Viking plunges his sword toward the heart of a prone enemy. The goal was verisimilitude, and to achieve it no expense was spared. Passing one tableau of blood and guts and moving on to the next, I caught myself glancing over my shoulder to make sure some Viking wasn't following me with a battle-ax. The effect was so disorienting that when I reached the end and found a Japanese woman immobile and reading on a bench, I had to poke her on the shoulder to make sure she was real. This is the past Icelanders supposedly cherish: a history of conflict and heroism. Of seeing who is willing to bump into whom with the most force. There are plenty of women, but this is a men's history.

When you borrow a lot of money to create a false prosperity, you import the future into the present. It isn't the actual future so much as some grotesque silicon version of it. Leverage buys you a glimpse of a prosperity you haven't really earned. The striking thing about the future the Icelandic male briefly imported was how much it resembled the past that he celebrates. I'm betting now they've seen their false future the Icelandic female will have a great deal more to say about the actual one.

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