Chapter 1
Illusion of Prosperity

I have always had considerable respect for those who pursue their entrepreneurial vision, risking their money and foregoing consumption during the first few years of their business with the hope of future gains. This is what I used to think of as the fundamental element of capitalism.

I had several role models who contributed to this respect. One of them, Petur Snaeland, the grandfather of one of my best childhood friends, began with a small auto garage in the 1940s. Through careful management and kindness to his employees, many of whom were former convicts, he managed to support his family of six. But things didn’t always go as planned for Snaeland. One day, his garage burned to the ground, leaving the family with no assets and no livelihood. In an attempt to comfort his wife, Snaeland gave her a big hug and said: “Don’t worry honey, nobody lost anything on this, except for us.”

With little but his name and mechanical skills, Snaeland got started again, this time with an equipment rental business he built up by restoring obsolete machinery he bought as scrap from the US military base in Keflavik, Iceland. Business was good in the postwar years and in 1952 he opened one of the first rubber factories in Scandinavia. As the years went by, his business grew and in 1968 he added a foam production factory. By the 1980s, his company was among the best-known brands in Iceland, bearing his name “Petur Snaeland hf.”

When capital controls were lifted in Iceland in the 1980s, competition in the furniture production industry got tougher, and in 1988, Snaeland, having overextended himself with an additional investment in a new production plant, was forced to file for bankruptcy. By the time he was ready to retire, he had not only lost his business and his pension, but also his wonderful family home, inherited by his wife from her father, the former mayor of Reykjavik.
In my view, Petur Snaeland was one of those capitalists who form the pillars of a great society—who keep the wheels of the economy turning. They get ideas, invest their savings, work hard, and either reap the rewards, or fail. And this is how it has been for centuries.

I used to think that all entrepreneurs were like Petur Snaeland. It was a naïve view that changed over time, but never did I imagine how far we could stray from these fundamental aspects of capitalism. In 2009, however, I came to see just how far, when serving as senior researcher for Iceland’s Special Investigation Commission. The Commission was set up to investigate the causes and events leading to the fall of the three largest banks in Iceland in October 2008. It issued its 2,400-page report on April 12, 2010.

One of the main discoveries of the investigation was a complex ownership structure: a cobweb of holding companies. This complex structure (see front cover image) was used to avoid consolidated accounting, to accumulate dividend payments through off-shore special purpose vehicles (SPVs), and to successfully tunnel money out of the banking system through easy access to risky borrowing. Under such structures, there is no limit to how much risk owners are willing to take. They have little or no skin in the game. In the case of the fallen systemically important Icelandic banks, creditors and the rest of society bore most of the risk. In a remarkably short period of time after privatization, the Icelandic banking system collapsed, with severe consequences for the Icelandic nation. Most of those responsible for the collapse, however, escaped serious financial and legal repercussions and, unlike Petur Snaeland, can comfortably say to their significant other: “Don’t worry honey, everybody lost, except for us.”

Iceland—the Yardstick of Luxury

“Wow, have you seen the bathrooms in this place? They are so nice they could be in Iceland,” my friend Tinna said as she came walking out of the restroom at the Zaytinya restaurant in downtown Washington, DC in January 2006. She and her husband were visiting DC for the first time, and in an attempt to be a good host, I had put together a small itinerary, a list of the must-sees in Washington, DC. I wanted to impress them with everything the US capital had to offer, but I never considered putting the restroom at Zaytinya on the list.

Tinna’s comment, however, underscored the state of affairs in my home country of Iceland, which had been experiencing outstanding economic growth for several years and had been recognized in my research at the International Monetary Fund (IMF) as having