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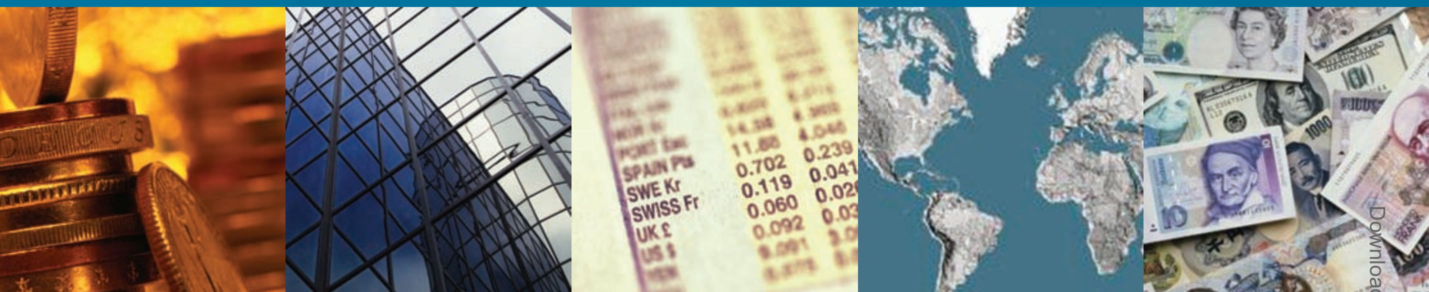

CAPITAL MARKETS LAW JOURNAL

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Iceland's capital controls and the constraints imposed by the EEA agreement

Annamaria Viterbo*

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Key points

- Capital controls can be used both as emergency measures, to avoid capital flight and help stabilize the exchange rate, and as crisis prevention tools.
- The web of international economic law treaties to which a State is a party can, however, greatly reduce its policy space to deploy capital controls.
- In fact, while members of the International Monetary Fund (IMF) retain the right to impose capital controls, trade and investment treaties as well as regional agreements require the liberalization of capital movements.
- In 2008, Iceland introduced strict controls on capital movements, which later became a key component of the programme supported by the IMF Stand-By Arrangement.
- Are Iceland's capital controls compatible with the European Economic Area rules? Does an integrated regional legal framework limit the number of emergency tools available at international level for contrasting an economic crisis?

1. Introduction

Iceland is a member of the International Monetary Fund (IMF) and of the European Economic Area (EEA), a party of the World Trade Organization, and a signatory of the Organization for Economic Co-operation and Development Code of Liberalisation of Capital Movements. While under the IMF Articles Iceland retains the right to impose capital controls, the EEA Agreement guarantees the free movement of payments and capital among the European Free Trade Association (EFTA) States and between those States and the European Union.

This notwithstanding, Iceland imposed strict controls both on capital inflows and outflows after being struck by a deep crisis in October 2008.

The aim of this article is to verify the compatibility of the capital controls introduced by Iceland under the IMF supervision with the EEA rules. The question is whether a regional legal framework may limit the number of emergency tools that are available at international level to contrast a financial crisis and to protect its national economy and welfare.

*Assistant Professor of International Law, University of Torino, Faculty of Law.

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2. The causes of Iceland's financial and economic crisis

Iceland is a small country with an economy that had always relied on fisheries and energy resources.[1] In the past decade, before being hit by an exceptionally deep crisis,[2] the country experienced low unemployment and a remarkably even distribution of income, achieving high growth rates through a rapid expansion of its tertiary sector, which amazingly leapt to two-thirds of the economic output.

The rapid growth of Iceland's economy between 2003 and 2008 was characterized by large investment projects benefitting from cheap energy, a sweeping deregulation of the financial sector, access to easy credit and a surge in consumer spending.[3]

Iceland's overheating economy and good sovereign ratings contributed to attract foreign capital[4] and generated the illusion of low exchange rate risk. Iceland became a perfect target for carry trade: international investors started borrowing in low-yielding currencies to be reinvested into króna-denominated financial instruments, like the so-called Glacier Bonds. These high-yielding Eurobonds paid rates above 10 per cent and had maturity periods ranging between 2 and 4 years.[5]

At the end of July 2008, the outstanding Glacier Bonds stock reached €2.7 billion (ISK 334.8 billion), amounting to roughly a quarter of the country's gross domestic product (GDP).[6] Offshore issuers of Glacier Bonds were mainly foreign financial institutions and companies with high credit ratings,[7] but also Iceland's three largest commercial banks—Landsbanki, Kaupthing and Glitnir—played a role in the scheme.[8]

After their privatization in the early 2000s, the three major Icelandic banks had adopted an aggressive strategy of growth. Driven by the will of a particularly concentrated

1 Its population reached 319,000 inhabitants in 2009.

2 On the crisis see: J Asgeir, *Why Iceland? How One of the World's Smallest Countries Became the Meltdown's Biggest Casualty* (McGraw-Hill, USA 2009); J Danielsson and G Zoega, *The Collapse of a Country* <http://riskresearch.org/> 12 March 2009; TT Herbertsson, 'The Icelandic Banking Collapse: A Story of Broken Promises', 14 February 2009, available at SSRN <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1339170> accessed 15 February 2011.

3 For instance, in March 2003, Iceland's BoP current account was nearly on balance, whereas in June 2008 it was negative having reached −29.3 billion ISK.

4 Iceland attracted both speculative inflows of capital as well as investments in residential and commercial constructions, in aluminium production, and in the energy sector.

5 In order to control the gradual acceleration of the inflation rate, the Central Bank of Iceland (CBI) continued to raise interest rates: in the span of 5 years they soared to 15 per cent (September 2008) compared with the 2.8 per cent rate applied at the beginning of 2004. Source: CBI database on general interest rates <http://www.sedlabanki.is/?PageID=224>. For inflation data see: Global Economics Research, TradingEconomics, Iceland Inflation rate database <http://www.tradingeconomics.com> accessed 15 February 2011. See also: IMF, Country Report on Iceland, n 08/362, November 2008, at 26.

6 Source: CBI, 'Economy of Iceland', 2008, at 38 <http://www.sedlabanki.is/lisalib/getfile.aspx?itemid=6372> accessed 15 February 2011.

7 RadoBank Holland, DeutscheBank, German Investment Bank KFW, EIB, ADB, IBRD, Rentenbank are among the biggest issuers of Glacier Bonds. It is important to underline that in order to purchase these bonds, foreign investors had to convert foreign currency into Icelandic krónur in the domestic foreign exchange market. No information is available on the current holders of the bonds.

8 For a description of this complex financial scheme, see Thorvardur Tjörvi Ólafsson, 'Króna-Denominated Eurobond Issues' (2005) 4 CBI Monetary Bull 55–83, and A Thorvaldsson, *Frozen Assets: How I Lived Iceland's Boom and Bust* (John Wiley and Sons Ltd, Chichester, UK 2009) 153, 239, 248. Relying on investors' preferences and risk aversion, foreign financial institutions with high ratings could issue króna bonds at a lower interest rate than the ones applied by Icelandic banks in the domestic market. Issuers of Glacier Bonds then usually swapped their króna liabilities for foreign currencies liabilities of Icelandic banks. In this way, issuers of Glacier Bonds managed to finance cheaply their main activity of lending in foreign currencies. At the same time, Icelandic banks could collect funds in króna at a lower interest rate than if they were borrowing on the domestic market.

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(and fraudulent[9]) ownership, they financed their domestic and international growth through highly leveraged deals, which however left them exposed to currency risk and increased the country's net external debt.

In order to limit dependence upon the financial markets and to gain easy access to foreign capital, they started opening branches and subsidiaries in the UK, the Scandinavian countries, the Netherlands, Luxembourg and Germany. The liberalization of financial markets guaranteed by the EEA legal framework facilitated the diffusion of Icelandic banks abroad.[10]

As they quickly grew in size, the banks also increased their domestic offer of foreign currency loans; even mortgages were increasingly denominated in foreign currencies. The overvalued króna[11] encouraged Icelandic households and businesses to resort to these loans to finance their investments abroad and to import luxury goods.[12]

Furthermore, some of the Icelandic banks started offering online banking services in the neighbouring countries.[13] The lower costs of managing online savings accounts were partly translated into higher interest rates, which attracted thousands of foreign depositors, mainly from the UK and Scandinavia.

However, when at the beginning of 2006 the króna started to depreciate,[14] the carry trade slowed and the cost of banks' liabilities denominated in foreign currencies soared. The sustainability of debts in foreign currency became a major problem also for Icelandic non-financial firms and households. With the value of assets already falling, the default rate of Icelandic businesses increased, adding financial stress to the banks. The first negative reports and the downgrading of Iceland's international State bonds by the major rating agencies sparked the fear of a banking crisis. Foreign capital flows started to revert.

As a reaction to the so-called '2006 mini-crisis', the foreign exchange reserves of the CBI were doubled, but the very much needed amendments to the Icelandic financial supervision framework were unfortunately postponed.

9 The Special Investigation Commission appointed by the Icelandic Parliament in December 2008 by Act No 142/2008 outlined in its Report that: 'The largest owners of all the big banks had abnormally easy access to credit at the banks they owned, apparently in their capacity as owners. ... In all of the banks, their principal owners were among the largest borrowers' (at 2); 'The operations of the Icelandic banks were, in many ways, characterised by their maximising the interests of the larger shareholders, who managed the banks, rather than running solid banks with the interests of all shareholders in mind, where due responsibility was demonstrated towards their creditors' (at 3) (Report of the Special Investigation Commission, 12 April 2010, partly available in English at http://sic.althingi.is/). See also RZ Aliber and Gylfi Zoega (eds), *Preludes to the Icelandic Financial Crisis* (Palgrave, Birmingham UK, 2011); Gylfason, Thorvaldur and others, *Nordics in Global Crisis* (The Research Institute of the Finnish Economy (ETLA), Helsinki, Finland 2010).

10 Having a licence from an EEA country, Icelandic financial institutions acquired the 'European Passport' status and could do business within the entire EU-EEA area. While branches are mainly under the jurisdiction of the bank's home country and the host country's authorities can supervise them only in cooperation with their national authority, subsidiaries are legal entities established under the regulatory framework of the hosting country. Therefore, the advantage of stemming from establishing foreign branches is that they are subject to the rules and regulations of the country of origin, and this applies also to deposit insurance schemes.

11 At the beginning of 2007, *The Economist* defined the króna as the most overvalued currency based on the Big Mac Index (*The Economist*, 1 February 2007). The IMF estimated that Iceland's real effective exchange rate was overvalued by 15–25 per cent in the first half of 2007 (IMF, Iceland 2008, art IV Report).

12 Many citizens bought their homes and cars borrowing in yen or in swiss francs and often spending beyond their means. After the crisis, these expensive goods have been aptly named 'game overs'.

13 The IceSave online accounts were introduced by Landsbanki's branches in the UK in October 2006. Afterwards, other internet-based accounts—like Kaupthing's Edge accounts—were made available in the Netherlands, Finland and Sweden.

14 See the CBI database on official ISK exchange rates <http://www.sedlabanki.is/?PageID=183> accessed 15 February 2011.

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At the end of 2007, despite the compelling need to downsize the banks' foreign-denominated-liabilities, on average 70 per cent of the balance sheet totals of the three main Icelandic banks was in foreign currencies.[15] At that time, those banks relied on short-term financing for two-thirds of their total funding, while only one-third came from deposits.[16] More than half of their total assets was accounted for by foreign subsidiaries, with assets located in Iceland amounting to four times the country's GDP, and their consolidated assets being roughly equivalent to 880 per cent of the country's GDP (compared with 170 per cent of GDP at the end of 2003).[17]

Iceland had become a highly leveraged financial institution with a massive mismatch between assets denominated in foreign currency (mainly illiquid and with long-term maturity) and short-term liabilities denominated in foreign currency.[18]

At the beginning of 2008, the European Central Bank and the UK supervisory authorities became concerned about the ability of Iceland to react to a likely banking crisis. In July 2008, the IMF considered the country's economy 'at a difficult and uncertain turning point. The long home-grown, foreign funded boom is coming to an end. Its legacies are overstretched private sector balance sheets, large macroeconomic imbalances, and high dependence on foreign financing. With tightening global liquidity conditions and fragile market sentiment, Iceland's banks and currency have come under significant pressure.'[19] As a result, Icelandic banks reached the lowest level of creditworthiness.

The liquidity crunch and the global financial crisis in the end made Icelandic banks unable to re-finance their obligations near maturity. After the bankruptcy of Lehman Brothers in September 2008, the reduced availability of funding from wholesale financial markets hit hard the Icelandic banks.[20] They found themselves unable to meet loan payments, with their creditors closing credit lines and refusing to roll over maturing credits.

At the beginning of October 2008—in just 1 week—Landsbanki, Kaupthing and Glitnir, which represented 85 per cent of the Icelandic banking system, were all placed into receivership after teetering on the verge of bankruptcy.

They had rapidly become so big compared with the size of the national economy that they could not be rescued. The ratio between their short-term liabilities in foreign currency and the foreign exchange reserves of the CBI should have made it clear that the latter were too small to provide the necessary liquidity:[21] the CBI's ability to act as a lender of last resort was *de facto* compromised.

15 Jännäri Report, n 25 below, at 15.

16 JK Jackson, 'Iceland's Financial Crisis', CRS Report for Congress, Washington DC, 20 November 2008, at 3.

17 OECD, 'Economic Surveys: Iceland 2009' (2009) at 10 <www.oecd.org/eco/surveys/iceland> accessed 15 February 2011.

18 WH Buiter and A Sibert, 'The Icelandic Banking Crisis and What to Do About It: The Lender of Last Resort Theory of Optimal Currency Areas', Centre for Economic Policy Research, Policy Insight n 26, October 2008, at 4ff.

19 IMF, Iceland Art. IV Consultation Concluding Statement, 4 July 2008 <http://www.imf.org/external/np/ms/2008/070408.htm> accessed 15 February 2011.

20 For an analysis of the effect of the US sub-prime crisis on the Icelandic banking system, see Buiter and Sibert (n 18) 4.

21 In October 2008, the CBI's foreign currency reserves in convertible currencies amounted to 410,000 million krónur (Source: CBI, Statistics, Time series, International Reserves and foreign currency liquidity <http://www.sedlabanki.is/?pageid=552&itemid=29d909f3-c66a-41a3-bc6c-dadb8cac486f&nextday=13&nextmonth=1>) accessed 15 February 2011.

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As Buiter rightly considers, the ability of a central bank to act as a lender of last resort providing a foreign-currency loan to a bank in distress is limited by the willingness of the markets to exchange hard currencies for the issuer's domestic currency.[22] And this obviously was not the case.

The situation quickly deteriorated and the resulting crisis was of extraordinary proportions. With the exchange rate of the króna dropping by more than 70 per cent in a few months and inflation starting to accelerate, the economy plunged into a deep recession. Both the on-shore and off-shore foreign exchange markets for the króna shutdown 'in the face of uncertainties about bank credit quality, the appropriate exchange rate, and an apparently huge excess supply of króna'.[23] Equity prices collapsed and the external payment systems were severely disrupted, hampering repatriation of export proceeds.

Because most of the private debt was either denominated in foreign currency or indexed to inflation, the devaluation of the króna combined with the rise of inflation severely strained households and corporate balance sheets. Many corporations found themselves on the brink of insolvency, the unemployment rate rose sharply, and real wages fell quickly.

After the crisis had hit, it became apparent to the international observers that the Icelandic banking system had not been supervised prudently and effectively enough. While financial sector regulations were largely transposed from the EU legal framework,[24] Iceland's supervisors were overwhelmed by the size and complexity of Iceland's institutions. As the Jännäri Report put it, Iceland's crisis was also the result of the deficiencies of the Single European Financial Market:[25] 'the chief characteristics of these flaws are a common market in financial services and a common legal framework for regulation, but with no common supervisor, no common deposit guarantee system, no common lender of last resort (except perhaps in the eurozone), and no common mechanisms for solvency support in case of major cross-border bank failures.'[26]

In sum, the reasons for the crisis are to be found in a combination of factors: an overleveraged banking sector, an inefficient banking supervision framework, an unsustainable and massive increase in the country's foreign debt,[27] carry trade and the global credit crunch.

22 Buiter and Sibert (n 18) 7. See also: T Gylfason, 'Events in Iceland: Skating on Thin Ice?', Figure 2 posted on <www.voxeu.org> on the 7th of April 2008.

23 IMF, Country Report on Iceland, No 08/362, November 2008, at 6.

24 Iceland fully implements the directives of the EU's Financial Services Action Plan.

25 For an analysis of the weaknesses of the banking supervision framework in Iceland, see: Report on Banking Regulation and Supervision in Iceland: Past, Present and Future (Kaarlo Jännäri Report), 30 March 2009, at 7ff <http://eng.forsaetisraduneyti.is/media/frettir/KaarloJannari__2009.pdf> accessed 15 February 2011. The assessment of the Icelandic regulatory framework and supervisory practices was undertaken by Kaarlo Jännäri in the context of the IMF Stand-By Arrangement programme (see below).

26 Kaarlo Jännäri Report, ibid, 10–11. See also OECD (n 17) 9.

27 At the end of 2007, Iceland's total foreign debt amounted to €78.3 billion, the equivalent of 558 per cent of the country's GDP. During 2008, the depreciation of the króna led to a further increase of the foreign debt. Source: CBI (n 6) 53.

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3. Iceland's Reaction to the Crisis

Emergency measures

When the crisis burst at the beginning of October 2008, the government took a number of immediate measures before turning to the IMF for financial assistance.

Saving the banks was the Government's first concern. By an emergency law the Icelandic Financial Supervisory Authority (FME) was given the power to dispose of the assets and liabilities of the three main commercial banks.[28] The following day Glitnir and Landsbanki were placed into receivership; Kaupthing joined them a week later. Each of the three banks was split into a 'new' bank and an 'old' one, with the aim of separating domestic and foreign operations. Domestic deposits and claims on residents were transferred to the 'new' banks. Activities in foreign branches and subsidiaries, as well as derivatives were left in the 'old' banks, funded mainly by foreign depositors and through the issuance of bonds.

Shortly after the beginning of the rescue operation, the Government declared that deposits in domestic commercial and savings banks in Iceland—the so-called 'new' banks—were fully guaranteed. The promise made to Icelanders that their domestic deposits would be reimbursed prevented, to a certain extent, panic withdrawals, but at the same time sent a worrying signal to depositors in foreign branches and subsidiaries of the Icelandic banks.[29]

28 The Emergency Act No 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, was adopted by the Icelandic Parliament on 6 October 2008 (see in particular, art 5). The following assets and liabilities remained with the 'old' banks: the majority of the assets of foreign branches, claims on foreign branches and subsidiaries, shares in foreign subsidiaries and loans with particular risk; all issuance of securities and other borrowing, all subordinated loans, tax obligations and all deposits in foreign branches.

Several foreign banks which prior to the collapse had provided loans to the Icelandic banks brought complaints to the EFTA Surveillance Authority. They claimed that the Emergency Act and the subsequent decisions of the FME discriminated against them giving depositors priority ranking in insolvency proceedings over unsecured creditors. In December 2010, the EFTA Surveillance Authority considered that the Emergency Act did not breach the EEA Agreement: depositors and general creditors are considered to be in a different position, the former being in greater need of protection in the event of bank insolvency. The decision does not resolve issues concerning the Deposit Guarantee Directive and discrimination between depositors in Icelandic branches compared to depositors with accounts in branches of the Icelandic banks in other States. See EFTA Surveillance Authority Decision of 15 December 2010, Cases Nos 65843, 66740, 66793, 66794, 66795, 66797 and 66935.

29 Deposits with foreign branches of Icelandic banks, like the IceSave accounts, were insured by the Icelandic Depositors' and Investors' Guarantee Fund (DIGF). According to the EU Directive 94/19/EC on deposit-guarantee schemes—which was transposed in Icelandic law in 1999—Iceland was obliged to operate a savings depositors insurance fund. The DGIF should have provided the minimum deposit protection of €20,000 in case of a bank's insolvency. However, the resources of the DGIF were insufficient to pay the total guaranteed amount of foreign deposits with branches of Icelandic banks outside Iceland.

The British and Dutch governments demanded compensation, amounting to over 100 per cent of Icelandic GDP, for their citizens who held high-interest deposits in local branches of Icelandic banks (in particular in IceSave, a UK-based branch of Landsbanki) and were excluded from Iceland's deposit guarantee scheme, in this way triggering the so-called 'Icesave dispute'. It has been calculated that the dispute involves more than some 300,000 UK depositors with deposits worth about £4 billion. The dispute revolves around the fact that the EU Directive does not stipulate the home State's final responsibility nor address a case of systemic bank failures. On the issue, see M Waibel, 'Iceland's Financial Crisis – Quo Vadis International Law', 14 ASIL Insight, 1 March 2010.

Following the negative vote of the Icelandic referendum of 6 March 2010 on the approval of the latest version of the agreement with the British and Dutch Governments, the EFTA Authority sent Iceland a letter of formal notice. According to the EFTA Authority, pursuant to the Deposit Guarantee Directive, Iceland is obliged to ensure payment of the minimum compensation to Icesave depositors in the UK and the Netherlands. See EFTA Surveillance Authority, Letter of formal notice to Iceland for failure to comply with the Act referred to at point 19a of Annex IX to the EEA Agreement (the EU Directive 94/19/EC) and art 4 of the EEA Agreement, Brussels, 26 May 2010, Case No 65560.

In January 2011, a new agreement on how to resolve the Icesave dispute between Iceland on the one hand, and the UK and the Netherlands on the other, was brought before the Icelandic Parliament.

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Controls on capital outflows were a key component of the emergency package. In response to the sharp depreciation of the króna and to the pressure on foreign exchange reserves, on 10 October 2008 the CBI issued the *Guidelines on Temporary Modifications to Foreign Currency Outflows*.[30] The allowances of foreign currency withdrawals on credit cards were reduced and a first step was taken for the establishment of a priority processing procedure to deal with foreign currency requests for imports of goods and services. Banks were invited to avoid using foreign currency for financial-related currency transactions of any sort, and to sell foreign currency to their customers only upon presentation of a travel ticket.

> The closure of the international payment system immediately affected foreign trade, importers could not pay suppliers and exporters could not transfer funds to meet domestic costs. Cash in Iceland was temporarily rationed and it became almost impossible to obtain foreign currency.[31]

On 15 October 2008, the CBI began trading foreign currencies at daily auctions to meet the demand for priority imports. The exchange rate of the króna at the auctions was determined by supply and demand and was considered a benchmark to establish its actual value. The CBI was virtually the only provider of foreign exchange until 3 December 2008, when the last currency auction was held.[32]

The IMF Stand-By Agreement

In November 2008, Iceland turned to the IMF for financial assistance, asking for the Fund's approval of the aforementioned—and already adopted—exchange measures. In their Letter of Intent, Iceland's authorities argued that those measures were in line with the Fund's policy as they were temporary, non-discriminatory and driven by balance-of-payments (BoP) reasons.[33] The IMF staff supported the request.[34]

On 19 November 2008, the IMF Executive Board approved—under the fast-track Emergency Financing Mechanism—a 2-year Stand-By Arrangement (SBA). The IMF loan amounted to US$2.1 billion,[35] and supplementary loans totalling US$3 billion were promised—and later granted—by Denmark, Finland, Norway and Sweden.[36]

30 CBI, Guidelines on Temporary Modifications in Currency Flows (10 October 2008) <www.sedlabanki.is> accessed 15 February 2011.

31 Danielsson and Zoega (n 2) 16.

32 In October 2008, the CBI's reserves fell by US$289 million. The domestic interbank foreign exchange market reopened on 4 December 2008 with the three 'new' banks as market makers. See: CBI, Rules on Foreign Exchange Market, No 1098, 3 December 2008.

33 Icelandic Authorities, Letter of Intent and Technical Memorandum of Understanding, 15 November 2008, at 7. Icelandic exchange controls included exchange restrictions on certain current account international transactions, which contributed to private external payment arrears.

34 IMF, Iceland: Request for Stand-By Arrangement—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Iceland, IMF Country Report No 08/362, November 2008, at 24.

Even if no mention of the issue may be found in the Staff Report, the exchange restrictions arising from the rationing of foreign exchange through daily auctions—being temporary, non-discriminatory and imposed for BoP reasons—could be considered in line with the Fund's policy. On foreign exchange auctions systems, see H Elizalde, 'The International Monetary Fund and Current Account Convertibility' (2006) 4 Curr Dev Monetary Fin L 17–53, 25.

35 See IMF, Iceland: Request for Stand-By Arrangement—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Iceland, IMF Country Report No 08/362, November 2008.

36 The agreement between Iceland, on the one hand, and Norway, Denmark, Finland and Sweden, on the other, was signed on 1 July 2009.

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A first instalment of US$827 million was immediately purchased from the Fund, with the remainder to be disbursed in eight equal tranches, subject to quarterly reviews of the programme. The high level of access to IMF resources granted to Iceland—and equivalent to 1,190 per cent of its quota—was unprecedented for a developed country.[37]

The economic recovery programme funded by the SBA was designed to achieve three key objectives: stabilizing the currency, ensuring medium-term fiscal sustainability and implementing a comprehensive restructuring strategy for the banking system. The regulation of capital movements became part of the economic programme supported by the IMF loan.

Our focus being the analysis of Iceland's exchange restrictions and capital controls, and of their consistency with the international economic law framework, we are not going to further investigate exchange rate or interest rate policies, medium-term fiscal consolidation plans, nor restructuring strategies for the banking sector.

Before analysing the consistency of the Icelandic Rules on foreign exchange with the IMF legal framework, we should underline that while under IMF art VIII Fund's members are bound not to impose restrictions on current payments, according to IMF art VI they retain the right to impose capital controls: they may determine at their own discretion whether controls are '*necessary*' to regulate international capital flows.[38]

Even more importantly, IMF art VI empowers the Fund to request a country to exercise controls to meet a large or sustained outflow of capital. This provision, read in conjunction with IMF art V, s 3(a),[39] has been interpreted as giving the Fund authority to make the introduction of capital controls a condition of its financial assistance.

It should be noted, however, that during the 1990s the IMF became a strong advocate of liberalization and encouraged member countries to liberalize the capital account.

More recently though, many influential voices have begun to argue in favour of capital controls. For instance, the so-called Stiglitz Report, presented as a background document to the 2009 UN Conference on the World Financial and Economic Crisis, considered that Governments may resort to less traditional policy tools, such as 'temporary restrictions on capital outflows' to stabilize the currency.[40] Along the same lines, the General Assembly of the United Nations reached the conclusion that developing countries can use temporary capital account measures to deal with an acute and severe shortage of foreign reserves.[41]

37 Both the cumulative and annual access to the IMF resources foreseen under the SBA programme exceeded the normal access limits, requiring a thorough evaluation of the exceptionality of the Iceland case. See: IMF Country Report on Iceland No 08/362 November 2008, Attachment IV, at 64.

38 See, in particular, F Gianviti, 'The International Monetary Fund and the Liberalization of Capital Movements' (1999) 1 Curr Dev Monetary Fin L 7–16; F Gianviti, 'Liberalization of Capital Movements: A Possible Role for the IMF' (2003) 2 Curr Dev Monetary Fin L 217–31.

39 According to IMF art V, s 3(a), the Fund may establish 'adequate safeguards for the temporary use of [its] general resources'.

40 Stiglitz Report, background document of the UN Conference on the World Financial and Economic Crisis and Its Impact on Development, 21 September 2009, para 205.

41 UN General Assembly Resolution, 'International Financial System and Development', 21 December 2009, A/RES/64/190, para 12.

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In the case of Iceland, the IMF has therefore reversed its long-held policy on capital account liberalization.

Iceland's Rules on Foreign Exchange and their consistency with the IMF legal framework

Shortly after obtaining the IMF loan, on 28 November 2008, the Icelandic Parliament (the Althingi) passed a bill amending the Foreign Exchange Act of 1992.[42] A new transitional provision authorized the CBI to temporarily restrict or suspend certain categories of capital movements and related foreign exchange transactions, 'if the Bank considers that such movements of capital to and from the country would cause serious and significant instability in exchange rates and monetary issues'.[43]

On the very same day, the CBI adopted a new set of *Rules on Foreign Exchange* (*Rules No 1082/2008*).[44] A few weeks later the Rules were amended again (*Rules No 1130/2008*).[45] The resulting regulation on foreign exchange transactions tightened and formalized the emergency measures introduced before the approval of the IMF Stand-By Arrangement. The newly passed legislation aimed at preventing capital flight and the collapse of the króna, protecting households and businesses with large un-hedged foreign currency exposures.

The main features of the new foreign currency regime can be summarized as follows.[46]

No restriction was imposed on international transactions of a 'current' nature. Therefore, foreign exchange and króna transactions between residents and non-residents resulting from a documented trade activity were unrestricted, in line with the obligations arising from IMF art VIII:2(a). Non-residents remained free to transfer abroad the proceeds from the sale of goods and services in Iceland.

Residents, however, became subject to a surrender requirement and a verification procedure. Within 2 weeks from the underlying transaction, they had to deposit the sums received from exports into a foreign currency account with a domestic financial institution.

42 The Act on the Amendment to the Foreign Exchange Act No 87/1992 was adopted by the Icelandic Parliament Althingi on 28 November 2008. Under the amended Foreign Exchange Act, the FME was authorized to impose administrative fines for breach of the restrictions on capital movements.

The Foreign Exchange Act No 87/1992 was amended again by the Icelandic Parliament on 31 March 2009, together with the Customs Act No 88/2005. The new amendment to the Foreign Exchange Act stipulated that until 30 November 2010 exports of goods and services had to be paid in foreign currency. Following the amendment to the Customs Act, the price of exports entered on export declarations had to be in foreign currency and the enforcement of these provisions would be monitored.

43 Act on Amendment to the Act on Foreign Exchange No 87/1992, 28 November, 2008, Transitional Provisions. The CBI was also given the power to oblige domestic parties to repatriate and surrender foreign currency sums acquired from the sale of goods and services or by other means.

The power to introduce restrictions on the movement of capital was explicitly conferred to the CBI as a derogation from art 9 of the Act on Investment by Non-residents in Business Enterprises according to which non-residents investing in Icelandic enterprises had the right to convert dividends or other profits and proceeds arising from divestment into any currency.

44 CBI, Rules on Foreign Exchange No 1082 (28 November 2008) <www.sedlabanki.is> accessed 15 February 2011. With the entry into force of the new Rules, the Guidelines issued in October were revoked.

45 CBI, Rules on Foreign Exchange No 1130 (15 December 2008) <www.sedlabanki.is> accessed 15 February 2011.

46 See also IMF, Iceland: Stand-By Arrangement—Interim Review Under the Emergency Financing Mechanism, IMF Country Report No 09/52, February 2009, Table 7.

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The surrender requirement should be considered consistent with the IMF provisions, under which a member State has the right to regulate the 'receipt' of foreign exchange payments connected to exports.[47] The monitoring procedure was delegated to Icelandic financial institutions: their supervision was essential for the correct implementation of the controls, as foreign currency accounts withdrawals and the purchase of foreign exchange were subject to proof that the sums would have been used for an international current transaction or for travel purposes.

Having regard to foreign direct investment,[48] while inwards investments were not subject to restrictions, divestment was not allowed: art 1 of the Rules prohibited 'to transfer or convey capital out of the country in connection with the sale of direct investments'.[49] However, according to art 8 of the Rules, dividends, equity income and contractual instalment payments remained free, as well as interest payments.

For what concerns portfolio investments, a distinction was made between financial instruments denominated in foreign currency and in króna. In both cases the rationale of the provision was to forestall the outflow of foreign currency.

New investments in securities, money market instruments, and other transferable financial instruments *denominated in foreign currency* were prohibited; only the króna could be used for their purchase. On top of that, parties that had invested in financial instruments denominated in foreign currency prior to the entry into force of the Rules were only permitted to reinvest the proceeds of their sale—or the sums received as full repayment of the principal—in the same type of financial instruments.

Similarly, proceeds from the sale of financial instruments *denominated in króna* were made non-convertible and non-transferable. Transactions with króna-denominated financial instruments could not be settled in foreign currency, and proceeds from transactions in króna-denominated financial instruments between a domestic and a foreign party had to be deposited to the seller's account in a bank in Iceland.

Capital gains were neither convertible nor transferrable.

Moreover, even if interest payments were not considered restricted capital movements under art 8 of the Rules, the CBI clarified with a *Memorandum*[50] issued on 28 May 2009

47 According to IMF art VIII:2(a) no member shall, subject to certain exceptions, impose new restrictions on the 'making' of payments and transfers for international transactions of a current nature without prior consent by the IMF.

48 Article 2 of the Rules No 1130/2008 defined foreign direct investment in the following terms:

> Direct investment refers to a capital contribution or other contribution to the equity of a commercial enterprise, or to the purchase of a holding with the aim of acquiring significant influence over its management. Significant influence means that an investor's holding in an undertaking represents 10 per cent or more of its equity capital, guarantee capital, or voting rights, or another holding that enables the exercise of substantial influence on the management of the company concerned. Long-term loans from a company's owners to the company are also considered direct investment.

49 Even if the clear motivation behind this provision was the prevention of controls circumvention, the IMF suggested exploring other less intrusive ways to deal with the issue. See IMF, Iceland: Stand-By Arrangement—Interim Review Under the Emergency Financing Mechanism, IMF Country Report No 09/52, February 2009, whose Table 7 describes the foreign exchange controls in place at December 2008.

50 CBI, Memorandum: Instructions on the Execution of Foreign Currency Sales Due to Art 8 of the Rules on Foreign Exchange No 1130/2008, 28 May 2009. The Memorandum intended to clarify Art 8 of the Rules No 1130/2008 on the free transferability of interest payments, according to which: 'Interest, indexation, dividends, equity income, and contractual instalment payments [were] not considered movement of capital in the sense of these Rules', and were thus unrestricted. The Memorandum

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that it was no longer possible to convert the payments of interest on króna-denominated financial instruments 'made by residents to non-residents'.[51] This meant that interest on króna financial instruments issued by non-residents was non-convertible and non-transferable.

The Memorandum *de facto* targeted the holders of Glacier bonds, which were prevented not only from selling them against foreign currencies or transferring the proceeds abroad, but also from converting into foreign currency coupons matured. The intended outcome was to avoid pressure on the króna connected with the payment of high returns on Glacier bonds, a large stock of which was going to mature in the following months.[52]

While art 8 of the Rules, *per se*, seemed to be perfectly consistent with the IMF requirements, the interpretation of the provision contained in the Memorandum gave rise to an exchange restriction forbidden by the IMF Articles. The issue was considered during the IMF First Review of the Stand-By Arrangement programme.

The remaining provisions of the Rules dealt with derivatives, borrowing and lending transactions, exports of foreign banknotes and exemptions.[53]

The IMF First Review of Iceland's economic performance under the SBA programme

The long due IMF First Review of Iceland's economic performance under the SBA programme was completed only on 28 October 2009.[54] The review—which would have made available a tranche of US$167.5 million and which was initially scheduled for the beginning of the year—was delayed for several reasons.[55] The implementation of key banks' restructuring and fiscal consolidation measures was lagging behind; the Act on the CBI was amended only in February 2009; and the change in government after the April 2009 elections further postponed the necessary reforms.

Thus, it was only months after the introduction in December 2008 of the new Rules No 1130 that the Fund acknowledged the existence of forbidden exchange restrictions.

specified that 'the free transferability of interest payments in Icelandic krónur applie[d] only to interest payments by residents to nonresidents'.

51 See art 1 of the CBI Memorandum. As a result it was not possible to convert into foreign currency: (i) interest on foreign financial instruments issued by non-residents in Icelandic krónur (eg Glacier bonds), (ii) interest payments on Icelandic krónur accounts held at non-resident financial institutions, or (iii) interest on any other financial asset/instrument issued by non-residents. Article 8 of the Rules had to be interpreted in the sense of a guarantee of the free transferability of interest paid in Icelandic krónur by residents to non-residents.

52 Non-resident investors' holdings of króna-denominated securities amounted to some $5 billion, or 40 per cent of GDP.

53 When unrelated to the trading of goods and services, derivative transactions between residents and non-residents were prohibited; borrowing and lending were tightly restricted. A limit was set on exports of foreign banknotes and on the movement of capital for gifts and endowments.

Exemptions could be authorized by the Central Bank of Iceland in exceptional cases by submitting an application. The amendment to Act No 87/1992 on Foreign Exchange, 31 March 2009 (art 2) establishes that in cases where the CBI refused the exemption, the application could be forwarded to the Minister of Commerce. Many businesses and large exporters were partly or fully exempted.

54 IMF, Iceland: Staff Report for First Review under Stand-By Arrangement and Requests for Extension of the Arrangement, Waivers of Non-observance of Performance Criteria, and Rephasing of Access, IMF Country Report No 09/306, 20 October 2009.

55 Among others, reaching an agreement with the UK and the Netherlands on the so-called 'Icesave dispute' was a *de facto* precondition for the disbursement of the second tranche of the IMF Stand-By Arrangement (see n 29 above).

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In its first Letter of Intent, Iceland had undertaken the obligation not to impose or intensify restrictions on the making of payments and transfers for current international transactions, nor to introduce multiple currency practices. These are in fact ordinary continuous performance criteria under the IMF programmes, and their breach entails a suspension of the disbursements.

In spite of this, the IMF Review highlighted the fact that the Icelandic foreign exchange regime did give rise to some exchange restrictions subject to the Fund's jurisdiction under IMF art VIII.

As a matter of fact, while payments for imports were generally free, the transfer of interest on bonds issued by non-residents and of the indexed portion of amortized principal on bonds was restricted.[56] The restrictions were made visible by the aforementioned Memorandum, adopted by the CBI after the 2009 parliamentary elections.

Nevertheless, the IMF granted Iceland a waiver for the non-observance of the continuous performance criterion by which Iceland should have refrained from imposing or intensifying exchange restrictions. The waiver was approved on the grounds that the measures were needed for BoP reasons, that they were temporary, and—mistakenly—that they had a '*non-discriminatory*' nature.[57]

A tightening of the capital controls regulations disguised as a phasing out programme

In the context of the First IMF Review, it was reaffirmed that both a capital controls regime and a policy of high interest rates continued to be needed in order to maintain exchange rate stability and to protect from bankruptcy firms and households with large un-hedged foreign currency exposures.

However, it was in principle agreed that a phasing out of capital controls should have started as soon as some preconditions were met. These included the implementation of credible macroeconomic stabilization policies, the building up of a strong international

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56 Payments due as interest on loans and on other debt instruments, as well as payments of a moderate amount for amortization of the principal of loans are considered 'payments for current transactions' by IMF art XXX(d).

IMF art XXX(d) defines 'payments for current transactions' as the payments which

> are not for the purpose of transferring capital, and includes, without limitation: (1) all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities; (2) payments due as interest on loans and as net income from other investments; (3) payments of moderate amount for amortization of loans or for depreciation of direct investments; and (4) moderate remittances for family living expenses. The Fund may, after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions.

Restrictions over investment-related payments arising from the liquidation of either the original capital or any capital appreciation do not fall under the IMF prohibitions.

57 Other waivers were approved as well: for non-observance of performance criteria related to the central government net financial balance and net international reserves; and for non-observance of the structural performance criterion concerning a capital injection into the three new banks. See IMF, Iceland: Staff Report for First Review under Stand-By Arrangement and Requests for Extension of the Arrangement, Waivers of Non-observance of Performance Criteria, and Rephasing of Access, IMF Country Report No 09/306, 20 October 2009, at 32 and IMF Completes First Review Under Stand-By Arrangement with Iceland, Extends Arrangement, and Approves US$167.5 Million Disbursement, Press Release No 09/375, 28 October 2009.

reserve position, an improved outlook for the balance-of-payments, and greater financial system stability combined with a reformed supervision framework.

The removal of controls would have taken place according to a sequencing designed to preserve the stability of the króna exchange rate.[58] Initially, controls on capital inflows will be removed. The second phase will gradually liberalize capital outflows, distinguishing between 'blocked accounts' or accounts, assets and transactions that could be released without the risk of large capital flight: having a high probability of outflows, the former would in fact remain restricted for a longer period.

Shortly after the approval of the second instalment of the IMF loan, and following improved macroeconomic conditions, Iceland modified its capital controls regime. The new version of the Rules on Foreign Exchange (*Rules No 880/2009*)[59] was announced by the CBI as the first stage of the phasing out of controls. Emphasis was placed on the main novelty of the Rules: the lifting of restrictions on all new investments (or capital inflows).[60] This was deemed an important step for economic recovery and for Icelandic businesses to have access to capital markets and new international investments.

This purpose was, though, partly frustrated by art 13 of the new Rules: foreign exchange inflows for new investments had to be converted into króna by a domestic financial institution and registered with the CBI. Investors were granted the right to convert and to transfer both the principal and the returns on new registered investments out of the country if they decided to resell them (leaving them to bear the exchange rate risk). In addition, the permission to expatriate sales proceeds was given only to the original investor, who was not allowed to transfer his right. Besides, certain types of portfolio investments, such as derivatives, were still excluded. Therefore, if there was an opening to investment inflows, it was ill-conceived because it discouraged investors.

What is more, the reform tightened other aspects of the regulation and reduced exemptions.[61]

At first, the new Rules only seemed to be reaffirming that cross-border capital movements between residents and non-residents, both in foreign currency and in króna, were restricted. However, the definition of 'cross-border capital movements' itself was rephrased by the CBI in a more restrictive sense: according to the *Guidelines on the Implementation of the Rules* issued in November 2009,[62] a transfer or transport of capital between residents and non-residents is considered a capital movement irrespective of

58 The liberalization strategy was outlined by the CBI in its communication titled 'Capital Control Liberalisation', 4 August 2009. See also: CBI, First Stage of Capital Account Liberalisation, press release, 31 October 2009.

59 The new Rules on Foreign Exchange No 880 of 30 October 2009 abrogated Rules No 1130/2008 and entered into force 31 October 2009. Exemptions to the Rules were granted to various parties—including municipalities and publicly owned undertakings, undertakings with investment contracts with the Icelandic Government, and others.

60 Foreign direct investments were already allowed pursuant to art 2 of the Rules No 1130/2008; proceeds from their sale however remain not transferable.

61 See also Table 10—Iceland: Changes to Capital Controls Rules in IMF, Iceland: Staff Report for Second Review Under Stand-By Arrangement and Request for Extension of the Arrangement, Rephasing of Access and Establishment of Performance Criteria, IMF Country Report No 10/95, April 2010, at 41.

62 CBI, Guidelines on the Rules on Foreign Exchange No 880/2009, issued 9 November 2009, with supplements 19 November 2009 and 15 December 2009. The issuance of the Guidelines was envisaged by art 15 of the Rules No 880/2009.

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whether the funds are moved between accounts owned by the same party or involve the transfer of funds to or from Iceland. Therefore, transfers of capital that take place in Iceland between residents and non-residents were also prohibited.

Moreover, controls on transactions in domestic currency were explicitly made tighter,[63] with exemptions limited to the trade of goods and services, real-estate purchases in Iceland, and transactions with financial instruments denominated in domestic currency (art 2 Rules No 880/2009). The clampdown is evident, as—under the previous regulations—transfers of króna from abroad and between residents and non-residents for the purchase and sale of króna-denominated financial instruments and other transactions were allowed, being forbidden for export payments only.

New measures were also introduced with the aim of closing loopholes used to circumvent controls (arts 5–6 Rules No 880/2009). For instance, the new Rules prohibited the cross-border transfer of foreign exchange for the prepayment of financial instruments issued in foreign currency, for the purchase of real estate abroad (unless for emigration and change of residence), for the purchase of commodities, vehicles and heavy machinery (unless they were part of the ordinary business operations of the resident party concerned).

Last but not least, the exchange restrictions temporarily approved by the Fund remained in place. According to art 10 of the new Rules,[64] the free transfer of interest was guaranteed only for 'the interest on deposit balances in *domestic* financial undertakings and accrued interest on *bonds issued by domestic entities*'. This provision amounts to a clear discrimination between domestic and foreign entities: in fact, only the interest on domestic deposits and bonds issued by Icelandic entities was freely convertible and transferable.[65] Interest on foreign bonds issued by non-residents in Icelandic króna (such as the so-called Glacier bonds) still could not be converted nor transferred abroad.

All the aforementioned changes clearly resulted in a tightening of the foreign exchange regime, the only openings being aimed at favouring new inflows of investments.

The IMF SBA programme and recent developments

In April 2010, following Iceland's submission of a new Letter of intent,[66] the IMF Executive Board completed the Second Review of the programme.[67] The completion of

63 The transfer of króna funds between residents and non-residents or between a foreign and a local króna account was prohibited with limited exceptions.

64 Article 10 of the new Rules was amended in order to incorporate the interpretation previously given by the CBI in the Memorandum issued 28 May 2009.

65 The CBI Guidelines on the Rules on Foreign Exchange No 880/2009 clarified that residents were authorized to buy foreign currencies for cross-border transfers of interest and dividends for the sole purpose of remitting such payments to non-residents.

66 See IMF, Iceland: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, 7 April 2010.

67 See also IMF, Iceland: Staff Report for Second Review Under Stand-By Arrangement and Request for Extension of the Arrangement, Rephasing of Access and Establishment of Performance Criteria, IMF Country Report No 10/95, April 2010.

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the Third review in September 2010 brought total disbursements under the programme to an amount equivalent US$1.36 billion.[68]

More recently, Iceland made impressive progress under its adjustment programme, implementing strong policies that helped to stabilize the economy and restore the financial system. The Fund acknowledged however that the time is not ripe yet to begin the liberalization of capital outflows: the lifting of controls needs a proper sequencing and it will be closely linked to policies on debt management and on the appropriate level of reserves.

The Rules on Foreign Exchange were lastly revised at the end of April 2010 with minor changes (*Rules No 370/2010*).[69]

4. The implications of Iceland's membership in the EEA for the design of its capital controls regulations

The aim of this paragraph is to evaluate whether the capital controls that Iceland adopted in the wake of the economic crisis are consistent with the EEA Agreement (to which Iceland is a party).

After a brief introduction on the EEA legal framework, we will describe the main features of the free movement of capital within the EEA, outlining the differences with the EU framework. Afterwards, the grounds on which EEA-EFTA States can legitimately restrict capital movements will be presented, together with an analysis of the constraints imposed by the EEA Agreement on the design of capital controls. In the end, we will verify if the measures adopted by Iceland meet the EEA requirements.

This research will show how a regional legal framework can limit the number of emergency tools otherwise available at international level to contrast an economic crisis.

The EEA Agreement: a brief introduction

The EEA was established in 1994 through the EEA Association Agreement.[70] Nowadays it comprises the 27 EU Member States and three (out of four) EFTA States: Iceland, Liechtenstein and Norway (the so-called 'EEA-EFTA States').[71]

68 See IMF, Iceland: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, 13 September 2010; IMF Completes Third Review under the SBA for Iceland, Press Release No 10/367, 29 September 2010.

69 The new Rules on Foreign Exchange No 370 of 29 April 2010 abrogated Rules No 880/2009 and entered into force 30 April 2010. They shall be reviewed within 6 months.

70 The Agreement on the EEA, published in the EU [1994] OJ L1 3 entered into force 1 January 1994 and was subsequently amended to take into account the accession of Liechtenstein in 1995 and the two EU enlargements of 2004 and 2007.

71 Iceland has been a member of the EFTA since 1970; it applied for EU membership on 16 July 2009, in the wake of the crisis. In 1992 Switzerland, that is a member of the EFTA since its foundation in 1960, held a referendum and voted against EEA membership. Austria, Finland and Sweden left the EFTA/EEA to acquire EU membership. On the EEA Agreement see: ME Mendez-Pinedo, *EC and EEA Law: A Comparative Study of the Effectiveness of European Law* (Europa Law Publishing, Groningen, The Netherlands 2009); Harbo Tor-Inge, 'The European Economic Area Agreement: a Case of Legal Pluralism' (2009) 78 Nordic J Int'l L 2, 201–23; C Baudenbacher and *et al.* (eds), *Festschrift for Carl Baudenbacher – Economic Law and Justice in Times of Globalisation* (Nomos, Baden-Baden 2007); JT Lang, 'The Principle of Loyal Cooperation and the Role of the National Judge in Community, Union and EEA Law' (2006) 7 ERA-Forum: scripta iuris europaei 4, 476–501; A Lazowski, 'EEA Countries (Iceland, Liechtenstein and Norway)', in S Blockmans and A Lazowski (eds), *The European Union and its Neighbours: A Legal Appraisal of the EU's Policies of Stabilisation, Partnership and Integration* (TMC Asser Press,The Hague 2006) 95–145; C Baudenbacher, P Tresselt and T Orlygsson (eds), *The EFTA Court: Ten Years On* (Hart Publishing, Oxford 2005); SM Stefansson, *The EEA Agreement and its Adoption into Icelandic Law* (Aschehoug, Oslo 1997).

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The EEA Agreement aims at establishing an area based on common rules and equal conditions of competition extending the core of the EU single market to the contracting EFTA States, while maintaining the two legal orders separate from each other. The Agreement protects the free movement of goods, persons, services and capital throughout its 30 contracting parties, also providing for a strengthened cooperation in flanking and horizontal policies.[72] The 22 Annexes to the Agreement thematically list the body of EU secondary legislation in force within the EEA context.

Securing homogeneity and a substantial identity between the EEA pillar and a large part of the EU economic law is the major objective of the EEA Agreement. What is more, the EEA Agreement aims at maintaining a level playing field for businesses and individuals across the area in a dynamic and homogeneous way.

The term 'dynamic' refers to a continuous process of transposition: whenever a legal act relevant for the EEA is adopted at EU level, it has to be reflected into the EEA system to ensure homogeneity. For this purpose, art 102 EEA establishes a mechanism for revising and integrating the framework of common rules following the developments of EU legislation and jurisprudence. In this process, the EEA Joint Committee bears the responsibility to timely incorporate into the Annexes new or amended EU legislation relevant for the area.

Furthermore, art 7 EEA obliges the contracting parties to implement all acts referred to in the Annexes to the EEA Agreement, as amended by decisions of the EEA Joint Committee.

The so-called 'legislative homogeneity obligation' finds a further basis in the duty of loyal cooperation laid down in art 3 EEA, which imposes upon the contracting parties to take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising from the EEA Agreement.

Besides, the Agreement also provides for a 'consistent interpretation principle': EU and EEA provisions which are identical in substance are to be interpreted homogeneously.[73]

As a result, the homogeneity principle lies at the heart of the EEA. This is achieved, though, without the Agreement conferring EEA law either primacy over EEA-EFTA States' national law or direct effect.

It is upon the EEA-EFTA States 'to introduce, if necessary, a statutory provision' so that EEA rules prevail over conflicting national provisions[74] and to implement the acts contained in the Annexes in national law.[75]

72 Such as environment, consumer protection, research and development, tourism, etc.

73 See EEA Preamble, art 6 EEA and art 3 of the ESA/Court Agreement. Under these rules, the EFTA Court shall follow the relevant case law of the ECJ on provisions of Community law that are identical in substance to provisions of EEA law rendered prior to the date of signature of the EEA Agreement (2 May 1992) and shall pay due account to the principles laid down by the ECJ relevant case law rendered after that date.

74 See EEA Preamble, art 7 EEA and Protocol 35. This facilitated the ratification of the Agreement by dualist States such as Iceland and Norway, for which ratified international treaties become part of the domestic legal order only if incorporated into national law.

75 See art 7 EEA. Through the application of the legislative homogeneity doctrine and of the consistent interpretation obligation, the EFTA Court is said to have affirmed the 'quasi' primacy and 'quasi' direct effect of EEA law; on this point see Méndez-Pinedo (n 71) 145–60.

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Besides, the EFTA Court affirmed that the State liability principle is an integral part of EEA law.[76] In arguing so, the Court referred in particular to the fact that the proper functioning of the EEA Agreement is based on individuals and economic operators being able to rely on the rights intended for their benefit and conferred on them by the EEA Agreement.[77] As a result, EFTA States are obliged to provide compensation for loss and damage caused to individuals by breaches of the obligations under the EEA Agreement for which the EFTA States can be held responsible.[78]

The free movement of capital under the EEA Agreement

Regarding the free movement of capital and payments, the EFTA Court heavily relied on the homogeneity principle to attain a level of integration similar to the one achieved within the EU. Without resorting to this argumentation, the freedom of capital movements within the EEA would have been frozen at a pre-EMU stage. In fact, the EEA Agreement was negotiated before the Maastricht Treaty[79] and since then the sector underwent a substantial evolution within the EU system.[80]

As a result, even if in principle the EEA Agreement fully liberalizes the movements of capital and payments,[81] some important differences remain. The EEA lacks a monetary pillar and the relevant EEA provisions (arts 40–45 EEA) do not fully reflect the EU provisions that resulted from the 'EMU revolution' (arts 63–66 and 75 TFEU, *ex* arts 56–60 EC).[82]

76 The EFTA Court founded its legal reasoning on the general aim of the EEA Agreement as laid down in art 1 EEA and on the EEA Preamble (in particular, the fourth and fifteenth recitals which emphasize the goal of establishing a dynamic and homogeneous area, and on the eighth recital according to which individuals are entitled to judicially defend the rights conferred on them by the EEA Agreement). EFTA Court, Case E-9/97 *Erla Maria Sveinbjörnsdóttir v Iceland Adv Op* [1998] EFTA Ct Rep 95, paras 44–69. The Supreme Court of Iceland applied the State liability principle and granted compensation: Supreme Court of Iceland, 16 December 1999, Case No 236/1999 *lslenska rikid v Erla Maria Sveinbjörnsdóttir*, Haestirettur islands Report 4916. See also Case C-140/97 *Rechberger et al. v Austria* (ECJ 15 June 1999).

77 'A further basis for the obligation of the Contracting Parties to provide for compensation is to be found in Article 3 EEA, under which the Contracting Parties are required to take all appropriate measures, whether general or particular, to ensure fulfilment of their obligations under the Agreement.' EFTA Court, Case E-9/97 *Erla Maria Sveinbjörnsdóttir v Iceland Adv Op* [1998] EFTA Ct Rep 95, para 61). See C Baudenbacher, 'If Not EEA State Liability, Then What? Reflections Ten Years after the EFTA Court's Sveinbjörnsdóttir Ruling' (2009) 10 CJIL 333–57.

78 State liability for failure to adopt the measures necessary to implement (or correctly implement) directives was affirmed in the Erla Maria Sveinbjörnsdóttir Case. Later on, the EFTA Court, in Case E-4/01 *Karl Karlsson v Iceland Adv Op* [2002] EFTA Ct Rep 241, held that the EFTA States were under the obligation to fulfil the obligations deriving from the EEA Treaty provisions even if direct effect was absent in EEA law and that compensation must be paid in case of failure/breach. See also EFTA Court, Case E-8/07 *Celina Nguyen v Norway Adv Op* [2008] EFTA Ct Rep 223.

79 The EEA Agreement entered into force 1 January 1994, a few months after the Treaty of Maastricht, which entered into force 1 November 1993.

80 EEA Annex II contains a reference to Directive 88/361. The EFTA Court relied on EEA art 40 together with the reference to the Directive contained in Annex II to affirm that 'Art. 40 EEA and the Directive abolish restrictions on movements of capital between the Contracting Parties to the EEA Agreement' (EFTA Court, Case E-1/00 *State Debt Management Agency v Íslandsbanki-FBA hf Adv Op* [2000–2001] EFTA Ct Rep 8, para 17). This reasoning rested on the Icelandic EEA Act (see below) and on the Restamark doctrine under which EEA law implemented in national provision—when sufficiently precise and unconditional—can be recognized to have direct effect and supremacy (EFTA Court, Case E-1/94 *Restamark Adv Op* [1994–1995] EFTA Ct Rep 15, para 77).

81 Whilst allowing for complete liberalization, art 40 EEA also requires Member States to implement the measures listed in EEA Annex II, in this way recognizing the lack of direct effect of the EEA provisions.

82 The freedom of capital movements is a prerequisite of a monetary union and it was achieved during the first stage of EMU. With the entry into force of the Lisbon Treaty, the free movement of capital is dealt with by arts 63–66 TFEU and art 75 TFEU.

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According to art 40 EEA, 'there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in EC Member States or EFTA States . . . '. Moreover, under art 41 EEA, 'current payments connected with the movement of goods, persons, services or capital between Contracting Parties within the framework of the provisions of this Agreement shall be free of all restrictions'. As a result all restrictions—whether on the movement of capital or payments—are prohibited.

Besides, only in 2004, the EFTA Court recognized that art 40 EEA 'confers a right upon individuals and economic operators to market access'.[83]

More interestingly for the purposes of our research, the EEA and the EU legal frameworks differ in identifying allowed derogations to the free movement of capital.

Article 43 EEA envisions restrictions to the freedom in two different situations: when movements of capital lead to disturbances in the functioning of the capital market of the concerned EFTA or EU Member State (art 43.2 EEA) and when difficulties arise from an overall disequilibrium of its balance-of-payments, or from the type of currency at its disposal (art 43.4 EEA). In the first case, Member States are granted the right to resort to 'protective measures in the field of capital movements'; in the second one, they are allowed to introduce 'protective measures', that include restrictions on payments.

Article 43 EEA, however, does not address derogations linked to taxation, prudential supervision, public and security policy, which—on the other hand—are expressly acknowledged within the EU (under art 65 TFEU, *ex* art 58 EC).

For this group of exceptions, the EFTA Court nevertheless concluded that, applying the homogeneity principle, 'national rules restricting the free movement of capital in the EEA may, as in Community law, be justified on grounds such as those stipulated in Art. 58 EC [now Art. 65 TFEU] or on considerations of overriding public interest'.[84] In this way, the EFTA Court bridged the gap between the EEA and the EU systems in order to safeguard the homogeneity of the area.[85]

Even if the conditions for the adoption of restrictions are met, it has to be emphasized that a Member State cannot resort freely to any type of protective measure: in order to be compatible with the EEA regime, capital controls shall in fact respect the principles of non-discrimination and proportionality.[86]

83 EFTA Court, Case E-1/04 *Fokus Bank ASA v Norway Adv Op* [2004] EFTA Ct Rep 11, para 25 and EFTA Court, Case E-10/04 *Paolo Piazza v Paul Schurte AG Adv Op* [2005] EFTA Ct Rep 76, para 33.

84 *Paolo Piazza v Paul Schurte AG Adv Op*, ibid, para 39. In an earlier decision the EFTA Court concluded that 'Art. 40 EEA does not preclude EEA States from applying the relevant provisions of their tax law' clearly referring to art 58 EC (EFTA Court, Case E-1/04 *Fokus Bank ASA v Norway Adv Op* [2004] EFTA Ct Rep 11, para 28). See D Buschle, 'The Free Movement of Capital in the EEA: A Lehrstück in Homogeneity' in Baudenbacher and others (eds), *Festschrift for Carl Baudenbacher – Economic Law and Justice in Times of Globalisation* (Nomos, Baden-Baden 2007) 95.

85 The flexible and functional approach adopted by the EFTA Court was never overstretched to fill the voids left in the EEA legal framework by major amendments of the EU Treaties. Careful redrafting or renegotiating will be necessary to take into account the far-reaching changes introduced by the Lisbon Treaty (see EFTA Consultative Committee, Opinion on the Treaty of Lisbon and the EEA, Brussels, 12 March 2008).

86 For what concerns EU law, the ECJ judgments had not always clearly distinguished between restrictions and discriminatory measures, sometimes linking the two. See Case C-302/97 *Klaus Konle v Republic of Austria* (ECJ 1 June 1999) para 49; Case C-367/98 *Commission of the European Communities v Portoguese Republic* (ECJ 4 June 2002) para 40.

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The prohibition of any discrimination made on grounds of nationality is contained in art 4 EEA. This general principle, however, applies only to situations in which the EEA Agreement does not lay further rules specifically prohibiting discrimination.[87]

Within the legal framework on the free movement of capital, art 40 EEA specifies that there shall be 'no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested'. Under the freedom of capital movements, the scope of the non-discrimination test is hence broadened.[88]

Does the non-discrimination test apply also to the protective measures allowed by art 43 EEA? Article 40 EEA envisions two separate obligations: the duty not to restrict the movement of capital belonging to EU or EFTA residents *and* the prohibition of discrimination. Hence, it can be maintained that even when the adoption of restrictions is foreseen by the EEA Agreement, the second prohibition stands.[89]

This reasoning is supported by the fact that according to art 65 TFEU (*ex* art 58 EC), even when justified by taxation, prudential supervision, public and security policy purposes, the restrictive measures 'shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments'. The EFTA Court already relied on this provision in applying the homogeneity principle to the free movement of capital within the EEA.

EEA and Iceland: the consistency of Iceland's foreign exchange regulations with the EEA requirements

Before verifying whether Iceland's rules on foreign exchange satisfy the EEA requirements, we will first consider the relevance of EEA law into the Icelandic legal order.

Turning to the relationship between national and international law, Iceland applies a strict dualist approach: international agreements do not acquire legal force in Iceland unless incorporated into national law.

This approach is compatible with the EEA Agreement, to which Iceland has been a party since 1994. The Agreement does not directly confer EEA law primacy and direct effect within the EFTA States' legal orders.[90] Besides, Protocol 35 to the EEA Agreement calls for dualist Member States to introduce a statutory provision to incorporate EEA law into their domestic legal order and to the effect that EEA rules will prevail over a conflicting national provision.

87 On the relationship between art 4 EEA—which, as a general principle, prohibits any discrimination based on nationality—and art 40 EEA reasserting the non discrimination requirement within the free movement of capital, see in particular EFTA Court, Case E-5/98 *Fagtún v Iceland Adv Op* [1999] EFTA Ct Rep 51; Case C-443/06 *Hollmann Case* (ECJ 11 October 2007) paras 28–29.

88 The non-discrimination obligation is also affirmed in art 42 EEA.

89 It can be argued, however, that the duty of non-discrimination applies only among EU and EFTA States, but not towards third countries.

90 This facilitated the ratification of the Agreement by dualist States such Iceland and Norway. The absence of primacy and direct effect is, however, tempered by the fact that Icelandic judges are—according to art 6 EEA—under the obligation to interpret national law consistently with EEA law, and by the fact that Iceland has to fulfil this duty of loyal cooperation as set forth in art 3 EEA. It is interesting to note that EEA law enjoys direct effect within the EU legal system (see Case T-115/94 *Opel Austria GmbH v Council of the European Union* (CFI 22 January 1997) [1997] ECR II-39).

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Accordingly, the EEA Agreement has been given the force of law under the Icelandic legal system through the adoption of Act No 2/1993 (the so-called *Icelandic EEA Act*).[91]

Article 2 of the Icelandic EEA Act states that the main provisions of the EEA Agreement shall have the force of an Act of Parliament.

Article 3 of the Icelandic EEA Act provides that 'statutes and regulations shall be interpreted, in so far as appropriate, to accord with the EEA Agreement and the rules based thereon'. Moreover, in its explanatory report to the bill, the Government specifically underlined that Icelandic legislation finding its origin in the EEA Agreement had to be interpreted as *lex specialis*, prevailing over a subsequent incompatible domestic law unless explicitly otherwise specified by the legislator.[92] As a result, EEA rules implemented in Icelandic national law will prevail over conflicting national provisions.[93] Besides, said rules—when unconditional and sufficiently precise—may be invoked by individuals and economic operators.

It follows from the above that Iceland should not adopt legislative acts inconsistent with the obligations arising from its EEA membership. Thus, its capital controls regulation should abide to the EEA requirements, both procedural and substantive.

In terms of procedure, art 45.3 EEA specifies that secrecy and urgency concerns can justify the introduction of capital controls without prior consultations or exchange of information within the EEA Joint Committee. Notice shall be given within their entry into force and consultations shall take place as soon as possible (art 45.5 EEA). Besides, EEA Protocol 18 describes the procedures to be followed for the implementation of art 43 EEA. Notice shall be given to the Standing Committee, which will examine the situation and deliver an opinion on the introduction of the measures, thereafter periodically reviewing the situation.

Iceland fulfilled all the procedural requirements and sent a notification to the EEA Joint Committee and the EFTA Standing Committee on 28 November 2008, the date of the entry into force of the *Temporary Provisions to the Foreign Exchange Act*.[94]

From a substantive point of view, Iceland's resort to capital controls has to be considered legitimate under the EEA exception regime as set forth in art 43 EEA: Member States are allowed to introduce restrictions to the free movement of capital when BoP deficits, capital flight or abrupt changes in the value of the currency can drive it to an economic crisis.

91 Lög nr 2/1993 um Evrópska efnahagssvæðið, 13 January 1993, as successively amended (see <http://www.althingi.is/lagas/137/1993002.html> accessed 15 February 2011). According to s 2 of the EEA Act, only the text of the Agreement and some Protocols and Annexes become part of Icelandic law, the greater part of the *acquis communautaire*.

92 See T Örlygsson, 'Iceland and the EFTA Court: Twelve Years of Experience', in Baudenbacher and others (eds), *Festschrift for Carl Baudenbacher – Economic Law and Justice in Times of Globalisation* (Nomos, Baden-Baden 2007) 229. EEA-EFTA States are under the obligation to incorporate into their domestic legal order the EU legal acts referred to in decisions of the EEA Joint Committee and contained in the Annexes to the EEA Agreement. Section 3 of the EEA Act prescribes that domestic statutes and regulations shall be interpreted, in so far as possible, in accordance with the EEA Agreement and the rules based thereon.

93 EFTA Court, Case E-1/01 *Hörður Einarsson v Iceland Adv Op* [2002] EFTA Ct Rep I, para 53.

94 See the Opinion of the Standing Committee of the EFTA States on the introduction of the measures notified by Iceland in accordance with art 43 of the EEA Agreement, 14 January 2009, ref 1088249.

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Undoubtedly, Iceland's capital controls were taken in extreme circumstances in order to contrast one of the deepest and most abrupt financial crises experienced by an advanced economy in peacetime and to safeguard domestic financial and social stability.[95] In just one week, in fact, the closure of the international payment system immediately affected foreign trade, importers could not pay suppliers and exporters could not transfer funds. Cash in Iceland was temporarily rationed and it became almost impossible to obtain foreign currency.

Despite these compelling circumstances, in drafting the foreign exchange regime, Iceland should have also observed the non-discrimination obligation arising from art 40 EEA. This article stipulates that, with respect to capital movements, no discrimination shall be made on the basis of nationality, residence or place where the capital is invested. The test applies both to measures directly discriminating and to measures which although formally neutral cause an indirect discrimination.

Despite these obligations, the CBI deliberately introduced a discriminatory clause in to the Rules on foreign exchange.[96] Article 10 of the Rules No 880/2009 provides for a different treatment between króna-bonds issued by domestic entities and those issued by foreign financial institutions: only the interest paid on króna-bonds issued by a *domestic* entity are freely transferrable, while repatriation of interest paid on króna-bonds issued by *non-residents* is not allowed. Nationality and place of residence of the bonds' *issuers* are the distinguishing criteria adopted. Furthermore, the measure indirectly also affects the *holders* of króna-bonds issued by a foreign entity, who are in a less favourable position with respect to their market exit compared with holders of Icelandic bonds.[97]

The actual targets of the provision were non-resident portfolio investors in the so-called Glacier bonds. Before the crisis, foreign financial institutions such as Deutsche Bank, ABN Amro, the German investment bank KFW, RadoBank Holland, but also the EIB and the IBRD extensively issued Eurobonds denominated in ISK (commonly referred to as Glacier bonds). With AAA credit ratings and high returns (with interest ranging from 8 to 14 per cent), they attracted mainly international investors.

In 2007 the total outstanding value of Glacier bonds was estimated to be roughly equivalent to a third of Iceland's GDP.[98] At the beginning of the crisis Icelandic authorities estimated that the majority of these bonds would have come to maturity within 1–4 years. At that time foreign issuers were relying on swaps with Icelandic banks

95 See also EFTA Surveillance Authority Decision of 15 December 2010, above n 28, paras 87–94.

96 The discrimination was first introduced in the CBI Memorandum of 28 May 2009 (art 1). Later it was incorporated into art 10 of the Rules on foreign exchange No 880/2009 and kept by the Rules No 370/2010 (currently in force). Until December 2008, FX transactions for the purpose of repatriating interest and indexation on bonds, ie ISK Eurobonds and Government bonds were permitted (see art 7 of the Rules No 1082/2008).

97 Holders of króna-denominated bonds issued by domestic and foreign financial institutions are in a comparable situation, but different rules apply to them. For instance, investors who own ISK bonds issued both by an Icelandic and a German bank will be able to convert and move out of the country only interest paid on the first ones.

98 I Fridriksson, 'Turbulence in Iceland's Financial Markets in 2006', Keynote address by Mr Ingimundur Fridriksson, Governor of the Central Bank of Iceland, at the UBS conference 'Annual Reserve Management Seminar for Sovereign Institutions', Thun, Switzerland, 4 June 2007.

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to repay bondholders at maturity: the swaps would have provided them with the necessary króna liquidity.

To prevent the risk that Glacier bonds payments of principal and interest would increase pressure on the króna, the CBI adopted comprehensive currency controls on portfolio investment outflows. Iceland's economy would otherwise have been flooded with claims on foreign exchange reserves.

The CBI hence decided to stop the flight of foreign currency caused by interest payments on Glacier bonds. Initially, it forbade their divestment, and later made payments of interest neither convertible nor transferrable abroad.

Payments of interest on bonds, together with receipt of dividends, are usually included in the current account of the balance-of-payments. This notwithstanding, the ECJ and the EFTA Court considered that the receipt of dividends from foreign investments were 'indissociable' from the movement of capital and thus that they fell within the scope of art 56 EC (now art 63 TFEU).[99] A similar reasoning can be applied to the payments of interest on bonds.[100]

Certainly, Glacier bondholders are among the impatient investors locked into their króna-denominated investments whose exit from the country should be carefully planned by the CBI. While capital controls are expected to loosen up during 2011, non-resident investors in Glacier bonds are likely to remain—illegitimately under EEA law—locked in for a longer period.[101]

5. Final remarks

Iceland's capital controls and the restriction on the payment of interest on krona-bonds were received in different ways by the IMF and the EEA authorities.

On the one side, the IMF endorsed Iceland's capital controls regime in the Stand-by-Arrangement programme and conceded a temporary waiver on the current account restrictions contained in the so-called 'Glacier bondholders clause' mistakenly considering them to be of a non-discriminatory nature.

On the other side, the EFTA Standing Committee delivered an opinion treating Iceland's capital controls as necessary under the crisis exceptional circumstances and justified by the safeguard provision of art 43 EEA.[102] Relying on this opinion, the EFTA Surveillance Authority never raised the issue of the discriminatory nature of the 'Glacier bondholders clause'.

99 Case C-35/98 *Staatssecretaris van Financiën v BGM Verkooijen* (ECJ 6 June 2000) para 26–30. EFTA Court, Case E-1/04 *Fokus Bank ASA v Norway Adv Op* [2004] EFTA Ct Rep 11, para 24. This conclusion was reached on the grounds that the EU Treaty does not define capital movements and that the nomenclature of capital movements contained in Annex I to Directive 88/361, often used for the purposes of defining what constitutes capital movements, is non-exhaustive. Neither the TFEU Treaty, nor the EEA Agreement define in fact the terms '*movements of capital*' and '*payments*'.

100 The EEA law states that limiting outflows of interest payments constitutes a restriction of capital movements. On the other hand, under the IMF Articles, the same limitation amounts to a forbidden current account restriction.

101 Standard & Poor's estimates that ISK52 billion of Glacier bonds will mature in 2010 (Standard & Poor's, Global Credit Portal—RatingsDirect®, 31 March 2010, at 20).

102 Opinion of the Standing Committee of the EFTA States, n 94 above.

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Even if in principle States are free to introduce capital controls under the IMF Agreement, the obligations arising from their parallel participation in a regional organization can limit their policy toolkit.

In particular, if a treaty establishes the free movement of capital and payments and foresees no safeguard provisions, the introduction of capital controls to contrast a financial crisis is illegitimate.[103]

Recently, the Deputy Governor of the CBI acknowledged that,

> [t]he controls are a violation of various international agreements signed by Iceland. They are tolerated as long as Iceland follows the economic recovery programme supported by the IMF, and thus indirectly by the member states of the EEA, OECD, and the Fund itself. Soon after this programme concludes, the controls will likely have to disappear; i.e., if the Icelandic government does not wish to renege on international treaties it has ratified. Eventually, frozen capital will have to be allowed to go wherever it wishes.[104]

Certainly, the effects of the crisis on the country's population (about 319,000 inhabitants) explain the international community's acceptance (or tolerance) of the Icelandic capital controls.

In fact, since the crisis hit, most Icelandic companies were declared insolvent or bankrupt, unemployment reached 9.3 per cent in March 2010 (while in the first quarter of 2008 was 1 per cent of labour force), wages were reduced and working hours were cut. In 2009, thousands of Icelanders, especially in the 20–35 years age bracket, left their country, which until then was attracting immigrants.[105] In the same year, as households' debts were indexed to the inflation rate (which peaked at 18.60 per cent in January 2009) or denominated in foreign currencies (the króna lost about half of its value against the euro in a year), 7.1 per cent of families were in arrears on the repayment of their mortgages and loans, 39 per cent of them were struggling to make ends meet, while 20 per cent of inhabitants could not meet unexpected expenses.[106]

Clearly, Icelandic families and international investors are bearing the consequences of the failure of the banking system supervision authorities, although a recent decision of the Supreme Court (16 June 2010), by declaring loans indexed in foreign currency rates illegal, has mitigated the effects of the crisis for households (thus transferring the burden to the already strained Icelandic banks).[107]

While capital controls have undoubtedly stabilized the currency, their phasing out and the removal of discriminations will be mandatory to reintegrate Iceland in to the world economy and restore investors' faith in the country.

103 If not applying the public international law rules on necessity and economic necessity (art 25 ILC Articles on the Responsibility of States for Internationally Wrongful Acts). See J Kurtz, 'Adjudging the Exceptional at International Law: Security, Public Order and Financial Crisis' Jean Monnet Working Paper No 06/08. See also A van Aaken and J Kurtz, 'Prudence or Discrimination? Emergency Measures, the Global Financial Crisis and International Economic Law' (2009) 12 JIEL 4, 859–94.

104 A Sirghvatsson, Deputy Governor of the CBI, Capital Controls, Fiscal Policy and Economic Recovery, address delivered at a morning meeting of the Iceland Chamber of Commerce on 24 March 2010 <http://www.bis.org/review/r100511d.pdf> accessed 15 February 2011.

105 Data available at <http://www.tradingeconomics.com> accessed 15 February 2011.

106 Statistics Iceland SILC Survey 2009 <http://www.statice.is> accessed 15 February 2011.

107 Iceland's Supreme Court ruled, however, that lending in foreign currency was lawful.

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The Icelandic case provides, therefore, a striking example of the difficulties a State hit by a financial crisis may face in protecting the national economy and its citizens' welfare, while complying with its international economic law obligations and guaranteeing the rights of foreign investors (even the rights of speculative investors like Glacier bondholders).

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