

November 12, 2009
Open Civil Meetings
c/o Gunnar Sigurðsson
Holmgaroi 27
108 Reykjavik
Iceland

Dear Mr. Sigurðsson

Thank you for writing to me about your concerns on behalf of the group that you represent. I couldn't agree more that the current economic crisis is the most serious challenge that Iceland has had to face in recent memory. I also agree that we all—including us here at the IMF—need to do a better job of explaining what is being done to address it. So let me offer a few reflections on the points you raise.

First, on the Icesave dispute. Resolution of this dispute has never been a condition of the IMF-supported program. The IMF is not supposed to involve itself in bilateral disputes between its member countries and did not do so in this instance. However, the Icesave dispute did indirectly affect the timing of the program's first review since it held up needed financing from Nordic countries (for whom resolution of this dispute was a condition). I am sure you will agree that the government's program must be internally consistent—it makes no sense to agree on a macroeconomic framework if the money is not available to finance those policies.

Second, on the more general point about Iceland's indebtedness. The IMF and the Icelandic authorities recognized from the beginning that Iceland's post-crisis level of indebtedness would represent a huge challenge to the country. That is why we agreed, as a key principle, that the government should not absorb creditor losses. As I am sure you are aware, investors and creditors have in fact sustained very large losses due to this crisis. Despite repeated appeals for bail outs, the government has not stepped in to shield them.

Third, regarding the origins of Iceland's crisis. I agree that they lie in the financial sector. Banks took outsized risks, and supervision and regulation failed to rise to the challenge. Privatization did set the stage for this, but this was not a matter of following IMF policy: we did not then and do not now have any policy which requires countries to privatize banks. I want to assure you that the IMF-supported program recognizes that this tragedy cannot be allowed to repeat itself. This is the key reason why there is a focus on reforms to strengthen banking regulation and supervision.

Looking back over the last year, I am certain that the cooperation between the IMF and Iceland has been to Iceland's benefit. The financing provided by the IMF, together with loans provided by countries within the context of the IMF-supported program, is exceptional relative to the size of Iceland's economy. This massive assistance has helped stabilize Iceland's exchange rate, protecting citizens who were exposed to foreign exchange and inflation-indexed debt from enormous increases in their debt service burden. It has also made it possible for the government of Iceland to run a large fiscal deficit that has cushioned the impact of the crisis on the economy. And while I realize it may not seem that way for many of Iceland's citizens, Iceland's economic contraction has in fact been milder

than what many other countries that have been hit hard by the crisis have gone through to date.

Looking ahead, the IMF will continue to support Iceland's efforts to extricate itself from this crisis for as long as your government requires it. Without wanting to minimize the hardship your country is going through right now, we are confident that the policies and financing now in place are in Iceland's best interest and will continue to ease the burden of adjustment.

I regret that I will not be able to meet with your group in person, but I hope that this letter has helped clarify the IMF's stance on some of the challenges facing Iceland. The IMF's resident representative in Iceland, Mr. Rozwadowski, whom some of you have already met, would be happy to meet with you to further clarify the Fund's role in Iceland.

Yours sincerely,

Dominique Strauss-Kahn
Managing Director