



Written by [Charles Scaliger](#) on March 10, 2010

Iceland Debt Small Part of Global Debt Crisis

Iceland's recent vote not to repay billions of dollars owed to Britain and the Netherlands underscores the growing risk involved in bailing out sovereign debtors. When Icesave, an Iceland-based Internet bank, collapsed back in 2008 along with most of Iceland's banking sector, the tiny North Atlantic nation nearly collapsed along with it. Fortunately for the short term, Britain and the Netherlands agreed to bail out Iceland's depositors in Icesave.



Now, however, voters have resoundingly rejected (by a margin of 93 percent to about two percent) a government plan to repay the British and Dutch by having \$135 garnished from every paycheck monthly for the next eight years. Although Iceland's leaders continue to insist that Icelanders are obligated to repay the money, ordinary Icelanders, understandably reluctant to accept responsibility for the actions of politicians and central bankers, are balking.

The problem with sovereign debt, including debt incurred by the U.S. government, is that responsibility for it is diluted. While pundits may insist in the abstract that every American owes tens of thousands of dollars in his share of the national debt, millions of Americans — especially those who (like this writer) have long deplored the unconstitutional and illegitimate profligacy of politicians in Washington and state governments — are unlikely to comply when America's creditors begin demanding that Americans be shaken down for decades of irresponsible government borrowing and spending.

When American taxpayers are no longer willing or able to pay for the party that the politicians have thrown for themselves, Washington will have little recourse except to try to print its way out of debt. But that too will be difficult when creditors refuse to purchase any more government debt (since issuing debt, primarily through "open-market operations," is the primary way that central banks like the Fed create new money). When the day of reckoning finally dawns, Washington with little choice besides outright default.

Besides Iceland, Greece is also veering towards national insolvency, with angry citizens refusing to accept new austerity measures. Argentina, perhaps the first casualty of the end of the Age of Keynes, has already experienced, starting in 2002, the calamitous consequences of excessive debt. In 2002, Argentina defaulted on a large portion of its national debt, roughly \$93 billion. The immediate consequence was that foreign capital fled the country and Argentina's foreign currency reserves (a last line of fiscal defense for many countries) were quickly depleted. The Argentine peso underwent massive hyperinflation, and the entire country collapsed, with Argentine society — once one of Latin America's



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stablest and most affluent — sliding into anarchy. Mobs looted and destroyed, and criminal gangs terrorized the country for the next couple of years. Kidnapping became the favorite crime, and anyone with money lived in terror of being abducted. Argentina became an international pariah for four years, and even today, with the situation stabilized, her yawning national debt is far from under control.

While the amount owed by Iceland (\$5.3 billion) is paltry in absolute terms, parceled out among a mere 300,000 citizens it is a paralyzing debt to contemplate servicing. And although the world economy could probably absorb an Icelandic default with scarcely a hiccup, how will it be able to paper over a Spanish debt repudiation in the fairly near future, with Spain's economy one of the world's largest? And what will happen should America go the way of Iceland and Argentina, not too many years hence?

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