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## Basic income: An early Icelandic experiment

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Basic Income – an Early Icelandic Experiment

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# Basic Income – an early Icelandic experiment

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## Abstract

Old age, sickness and/or physical and/or mental disability may limit the ability of an individual to generate enough income to cover basic cost of living. Most developed nations provide financial assistance for persons with limited ability to support themselves economically. In 1974, the Icelandic Parliament, headed by a left-wing government passed legislation providing a tax credit, payable to taxpayers under certain conditions. The tax allowance was applied firstly to settle the taxes and public levies owed by the taxpayer, with any amount remaining paid out to the individual. This system can be seen as a first, limited attempt at establishing a partial universal basic income of sorts. The lesson is that basic income, would need strong supporters if implemented, where the role of the government and/or the parliament would be mapped. Its supporters must be able to withstand the pressure from the social partners in the labour market because of the interactivity of the Social security system and the pension fund system which is not part of the fiscal system in Iceland. The conflict of interests becomes apparent.

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**Keywords:** Basic income experiment, income tax reform, Icelandic tax system, income tax credit.

Most developed nations provide assistance for persons with reduced ability to support themselves economically due to age, sickness, or physical or mental disability, either by direct financial transfers or by participation in the costs of basic necessities such as housing. The grant and subvention systems are, as a rule, complicated and non-transparent. New reforms and new reform ideas are regularly presented under the slogan of simplification of existing “system”. The idea of “basic income” is one such reform idea. “Basic income” implies that authorities grant each citizen the means to cover basic needs, i.e. housing, clothing and food. The idea is simple enough and could be implemented in a number of ways. Universal basic income would be granted unconditionally to all citizens, hence labelled “universal”. Basic income could be inversely related to the citizens’ wealth and regular income. Such transfers would not qualify as “universal”. Basic income could be partial, covering only part of the estimated cost of covering basic needs. Partial universal income could be universal or not. A full universal basic income would cover total estimated cost of covering estimated needs, but proponents hesitate to define (see <http://basicincome.org/basic-income/>).

In Finland, a pilot project has been launched, granting partial basic income to a (random) sample of the population (those unemployed and those who benefit from social grants). Each person is allotted the amount of €560 per month and qualifies as a partial basic income.<sup>1</sup> Parliamentarians from the Icelandic Pirate Party suggested a formal inquiry into the attractiveness of adopting basic income and abolishing social security payments, payments to farmers, payments to literary authors, etc. The resolution did not reach the floor at the parliament. Citizens of Switzerland dismissed a similar proposal in a referendum on June 5, 2016.<sup>2</sup> Thus, at this point, the idea of basic income has neither been wholeheartedly accepted nor definitively rejected.

In the present paper, we will trace the idea of basic income to its origin in the early 1500s. Then we will give an account of a forgotten episode in recent Icelandic tax history when an experiment that has some of the characteristics of a basic income was conducted in the early 1970s. We will seek to explore the ideas on which the tax system amendments were based in the late 1960s and early 1970s, and look at similar instances

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<sup>1</sup> <http://www.kela.fi/web/en/basic-income-experiment-2017-2018>

<sup>2</sup> <https://is.wikipedia.org/wiki/Borgaralaun>

as in the more recent past. What problems arose, and why did the early Icelandic “experiment” come to a halt?

## II

Money transfers within a social security system are frequently related to income, and may be reduced if certain income and/or asset limits are exceeded. Surveillance is expensive, and the subjects of the surveillance find it humiliating to have to prove that their working capacity is impaired or that they are unable to sustain themselves. The idea of a universal, full basic income is to unconditionally guarantee everyone belonging to a predetermined group sufficient funds to support her/himself without the need for applications on behalf of the recipient or surveillance on behalf of the payer. The introduction of a universal and a generous regime of basic income would mark a shift in the administration of social security. Yet the idea is not new as is well documented in <http://basicincome.org/basic-income/history/> and in Standing (2017). It can be traced back to the dawn of humanity, illustrated by the notion that mankind is forever seeking the garden of Eden from which it was expelled for its sins (Adam and Eve). Thomas More has his fictions character in Utopia discuss theft of food. One suggestion is to provide *everyone* with some means of livelihood, in effect stating that Partial Universal Basic Income could be the solution to serious social problems.<sup>3</sup> Proponents of Universal Basic Income confer the introduction of the full-blown idea of Universal Basic Income to a close friend of More, Johannes Vives (1492-1540) who emphasised that a creature created by God had the right to necessities of life (and the plight to work as a secondary demand). Political activist (Condorcet, Paine) keep the idea at life in the 18<sup>th</sup> century.<sup>4</sup>

In his review of a document that later became the German Socialist Party's manifesto, Karl Marx puts forward the principle that an individual's contribution to production should depend on capacity, while benefits should be determined by needs: “From each according to his ability, to each according to his needs!”<sup>5</sup> The concept of basic income was broadly discussed in the aftermath of WWI. The British universalist C. H. Douglas

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<sup>3</sup>Thomas More: Utopia xxx 1516, see also <http://www.basicincome.org/basic-income/history/>

<sup>4</sup> <http://basicincome.org/basic-income/history/>

<sup>5</sup> “From each according to his ability, to each according to his need.” Karl Marx, Selected Works, Volume Three. Critique of the Gotha Programme, Chapter I: <https://www.marxists.org/archive/marx/works/1875/gotha/ch01.htm>

believed that a gap was being opened between total output per working hour and the wages paid per working hour. Consequently, workers would not be able to afford to buy their production unless the government intervened by correcting (lowering) prices of merchandise and by transferring unspent income to society at large.<sup>6</sup> The basic income idea fell out of fashion for a while but came back into vogue in the late 1960s. In 1968 five world-famous economists, i.e. John Kenneth Galbraith, Harold Watts, James Tobin, Paul Samuelson, and Robert Lampman, initiated an open letter published in the New York Times to the U.S. Congress, urging the government to adopt a universal guaranteed annual income. The letter was signed by some 1200 economists.<sup>7</sup> The full text of the letter is printed in Srinivasan: Poverty and the Government in America: A Historical Encyclopedia, Volume 1.<sup>8</sup>

When Richard Nixon was President of the United States, he considered the idea seriously. His advisors were not impressed. They maintained, without evidence or proof, that the guaranteed income would encourage divorce.<sup>9</sup> Basic income was made an issue in the U.S. presidential campaign of 1972 between Richard Nixon and George McGovern. McGovern made basic income a central brick of his economic policy. McGovern lost the election to Richard Nixon, but the concept of basic income survived, albeit in another form. In 1975, the United States passed a law on tax credit (Earned Income Tax Credit).<sup>10</sup> This idea is based on proposals for a negative income tax presented by Milton Friedman in his book *Capitalism and Freedom*, published in 1962. Friedman's idea is closely related to the idea of basic income. Every individual of a given age would be eligible for tax credit of a given size. The credit would be taxed as any other income. Hence, individuals receiving income and credit payments above a given threshold pay a predefined percentage of their income in tax, individuals receiving income and credit payments below the threshold would be net receivers of transfers from the government.<sup>11</sup> It turned out to be easier to get governments around

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<sup>6</sup> [https://en.wikipedia.org/wiki/C.\\_H.\\_Douglas](https://en.wikipedia.org/wiki/C._H._Douglas)

<sup>7</sup> <http://query.nytimes.com/gst/abstract.html?res=9504E3D61E39E134BC4051DFB3668383679EDE&legacy=true>

<sup>8</sup> <https://plus.google.com/104092656004159577193/posts/3hXQZaiWyRD> and "Economists' Statement on Guaranteed Annual Income," 1/15/1968 -- 4/18/1969 folder, General Correspondence Series, Papers of John Kenneth Galbraith, John F. Kennedy Presidential Library

<sup>9</sup> <https://www.jacobinmag.com/2016/05/richard-nixon-ubi-basic-income-welfare/>

<sup>10</sup> [https://en.wikipedia.org/wiki/Earned\\_income\\_tax\\_credit](https://en.wikipedia.org/wiki/Earned_income_tax_credit).

<sup>11</sup> <http://www.economist.com/news/briefing/21699910-arguments-state-stipend-payable-all-citizens-are-being-heard-more-widely-sighing>.

the world to accept and adapt a variant of the concept of negative income tax than the concept of basic income. A negative income tax or a system where a taxpayer earns a tax credit because of a low income is much cheaper to put into practice than the basic income system.<sup>12</sup>

The idea of partial universal basic income surfaces at the eve of the Medieval Period and the dawn of the Modernity. The idea evolves until the mid 20<sup>th</sup> Century without being implemented in its pure form at a grand scale anywhere.

The late 1960s to the early 1980s was a period of profound changes, in Iceland and elsewhere. In Iceland, the lucrative herring fisheries collapsed, catches in 1969 were only 7% of catches in 1966 (770,698 metric tons in 1966 compared to 56,689 metric tons in 1969).<sup>13</sup> Lack of development of sectors other than fisheries and agriculture slowed the recovery of economy, GDP contracted by 1.3% in 1967 and by 5.5% in 1969.<sup>14</sup> Post-WWII baby-boomers had a vision of using increased national income partially generated by the fast development of the herring fisheries to develop a stagnant and backward society in step with the development in Scandinavia and in Western Europe. The collapse of fisheries later followed by rising oil prices, further revealed the fragility of an undeveloped economy. Prospects were so gloomy that emigration in 1969 and 1970 exceeded half the natural increase in population for those years. Some moved as far as to Australia. Strikes and social unrest were commonplace. The Vietnam War and the presidential campaigns of 1968 in the USA had quite an impact in Iceland. Iceland was infrequently mentioned in international media. But that changed all of a sudden in 1972, when hoards of journalists came in to cover a very unusual chess challenge. The chess champions, each representing the main adversaries in the Cold War, Boris Spassky of the USSR and Bobby (Robert) Fischer, then citizen of the USA, met in Reykjavík for what the Icelanders termed “the tournament of the century”; an event that had all the elements of a Cold War confrontation.<sup>15</sup> Iceland was opening up

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<sup>12</sup> Arnaldur Sölvi Kristjánsson: Eru borgaralaun raunhæfur kostur? an answer at the Icelandic Web of Science at the University of Iceland: September 30, 2016, downloaded June 22, 2017:

<https://www.visindavefur.is/svar.php?id=72617>

<sup>13</sup>

[http://px.hagstofa.is/pxis/pxweb/is/Sogulegar/Sogulegar\\_\\_sogul\\_sjavarutvegur/SOG16001.px/table/tableViewLayout1/?rxid=cdbc17ce-0af4-4507-b32d-3aa529e85023](http://px.hagstofa.is/pxis/pxweb/is/Sogulegar/Sogulegar__sogul_sjavarutvegur/SOG16001.px/table/tableViewLayout1/?rxid=cdbc17ce-0af4-4507-b32d-3aa529e85023)

<sup>14</sup>

[http://px.hagstofa.is/pxis/pxweb/is/Sogulegar/Sogulegar\\_\\_sogul\\_thjodhagsreikningar/SOG08000.px/table/tableViewLayout1/?rxid=9c6b6f50-dadb-4417-b060-1e9652e4642c](http://px.hagstofa.is/pxis/pxweb/is/Sogulegar/Sogulegar__sogul_thjodhagsreikningar/SOG08000.px/table/tableViewLayout1/?rxid=9c6b6f50-dadb-4417-b060-1e9652e4642c)

<sup>15</sup> In the words of Gary Kasparov: “I think the reason you look at these matches probably was not so much the chess factor but to the political element, which was inevitable because in the Soviet Union,

to new ideas and trends from abroad, as many journalists from abroad visited Reykjavík to cover the tournament, which in turn increased interest in Iceland internationally, along with the curiosity of Icelanders regarding foreign affairs. One of the new ideas that surfaced in Iceland at this time was the concept of a negative income tax as a part of an extensive reform of the Icelandic tax system in 1974. The reform was initiated by a government headed by Mr. Ólafur Jóhannesson. Several parties were represented in this government, and it was considered, both by the media and the public, to lean to the left.<sup>16</sup>

### III

In 1970, Iceland joined the European Free Trade Association, EFTA, and the national system of taxes and duties had to be revised. The then-existing tax system had been adapted to the needs of strong special interest groups, especially those involved in fisheries and agriculture. Icelandic agriculture based its existence largely upon subventions. Fishing firms paid considerably lower taxes than other firms, and were protected against risk as landing price of catch was fixed by a semi-governmental body, while the value of the currency was fixed by the Central Bank so as to secure profitability in that sector,<sup>17</sup> <sup>18</sup> On the other hand, the tax-related interests of manufacturing industries and of households were largely ignored. Commerce and manufacturing had difficulty in adapting to frequent devaluations and the subsequent inflation. Depreciation was defined in the tax code in such a way that firms that based their operation on inventory (commerce) or were capital intensive were at a disadvantage. Hence, revision of the tax code was essential part of the preparation for

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chess was treated by the Soviet authorities as a very important and useful ideological tool to demonstrate the intellectual superiority of the Soviet communist regime over the decadent West.”, see <http://conversationswithbillkristol.org/transcript/garry-kasparov-transcript/>

<sup>16</sup> <https://www.althingi.is/thingmenn/althingismannatal/radherrar-og-raduneyti-1904-2010/raduneyti-1917-2011/>.

<sup>17</sup> Karlsson, J. (2014). *Moulding the Icelandic Tax System. Primary-Industry-Based Special Interest Groups, Taxation, Tax Expenditure, Direct and Indirect State Support, and the Shaping of Tax Rules*. MSc thesis in Economics, supervised by Matthiasson, Th., Reykjavík. Retrieved from <http://skemman.is/handle/1946/19766>.

<sup>18</sup> Verðbólgu nefnd: Verðbólguvandinn, Reykjavík 1978, p. 91-97.



entering EFTA. The tax legislation was revised in order to align it with then-current OECD practices.<sup>19</sup> The fruits of this endeavour were Act No 68 of 1971.

#### IV

The amended legislation on taxation improved the situation of the manufacturing industries in Iceland. Nevertheless, the amendments were not sufficient, as they did not touch upon the taxation of households, the social security system, or the repartition of revenues between state and municipalities. In 1971, the government of Ólafur Jóhannesson established a committee to revise the tax system. The committee delivered a detailed report in 1973. That report became the basis of the governmental policy until 1990. The committee had worked with the Parliament, as well as with the various special interest groups. The committee concluded that the tax rules governing state revenues had become much too complicated and unclear. The committee also concluded that fiscal and tax policy could be used more effectively as tools to regulate overall economic activity.

The committee's conclusions were adopted step by step, and in 1972, individual taxes (poll taxes, lump-sum taxes, and such) were abolished, Act No 7 of 1972, and Act No 8 of 1972. The tax system was stream-lined, and the distinction between state and municipalities became clearer, as the state took charge of the social security system and the police forces, both of which had been partly or fully a municipality affair.

#### V

The Icelandic Confederation of Labour held meetings in 1973, adopting resolutions whereby it was suggested that income taxes be considerably lowered. At the time, such taxes were an insignificant part of the state revenue (20-25%), and it can be deduced from the resolutions that the proposal was based upon the suspicion that tax evasion had become widespread among several categories of income-tax payers. Hence, the situation with respect to trust in the fairness of tax-system was very much different from the situation in other Scandinavian countries. In Scandinavia, workers' unions and worker-friendly political parties took active steps to use the tax system for making the

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<sup>19</sup> Magnusson, G. (1969) Íslenskur iðnaður og EFTA. Þróun íslenzks iðnaðar frá 1960, ástand og horfur, einkum með tilliti til aðildar Íslands að Fríverzlunarsamtökum Evrópu. Reykjavík, Ministry of Industry.

income distribution more equal.<sup>20</sup> Obviously, if income taxes in Iceland were to be lowered, other sources of state revenue had to be secured. It was therefore suggested that the sales tax be increased (from 13%). Increase in indirect taxes and the bracket-erosion of direct taxes due to inflation increased the tax-burden on those groups who had the lowest income. Child allowances and other tax related allowances were not tied to the CPI and lagged behind in the inflationary environment. It was therefore deemed necessary to amend the tax system further.<sup>21</sup>

A major change of the tax code was initiated with Act No 10 of 1974, effective for income earned in 1974. (Pay-as-you-go taxation was not introduced in Iceland until 1988). In 1960, the government had introduced a special family allowance within the Social security system unrelated to the tax system, based on the income and the number of children. However, according to the tax code, the tax payer could also get a tax allowance based on the number of children deductible from earned income, while the tax payer did not get a tax allowance for other co-habiting dependent persons. The 1974 reform merged the family allowances from the Social security system and the tax system and integrated such allowances into the tax code. The difference was that the new tax allowance was not only based on the number of children as the taxpayer was also “counted in”, so to speak.<sup>22</sup>

Hence, the extension of the tax allowance narrowed the base for personal income taxation considerably, or by a whopping 42% (see below). There were income tax brackets. A base rate of 20% for taxable income on the scale ISK 0-99,999.<sup>23</sup> Taxable income between ISK 100,000 to 199,999 was subject to a 30% marginal tax rate, and all income above that was subject to a 40% marginal tax rate. For those with an annual income 200 to 300 thousand ISK, taxes for couples with two children decreased by 4%, for single parents by 3%, and for unpartnered individuals by 2.5%. However, the main innovation in the 1974 reform was the introduction of a tax credit (termed

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<sup>20</sup> Lodin, Sven-Olof. *The Making of Tax Law. The Development of Swedish Taxation.* Uppsala, Lustus Förlag AB 2011.

<sup>21</sup> Inflation increase during the period 1970-1975 amounted to 27% on a yearly basis, reaching a whopping 42% yearly average during the period 1975-1980.

<sup>22</sup> The allowance amounted to ISK 238,000 for an individual, ISK 355,000 for a couple, and an additional ISK 50,000 for each child. A single parent got an extra allowance amounting to ISK 96,000, and a special allowance for each child, ISK 11.000. Taxable income was then defined as earned income minus the tax allowance described above.

<sup>23</sup> Equal to earned income of ISK 238,000-337,999 for an individual and ISK 355,000-454,999 for a couple without children if pooling income for taxation.

“skattafsláttur” in the text of the law instead of tax allowance for “persónuafsláttur”). If the tax credit was higher than the taxes due, the balance was paid out. This was not the case for “tax-savings” caused by the tax allowance. The tax credit was intended as income support for those with the lowest income and was based on the taxable income. The tax credit amounted to ISK 11,000 for each taxpayer declaring income as an individual and ISK 18,500 for couples pooling their income. The tax credit was increased by ISK 3,300 for each child younger than 16 living in the household. Special provisions were made for single parents and parents pooling their income for tax purposes. However, there now was a ceiling for the amount. The tax credit could not be higher than 6% of the income of an individual. In cases when the tax credit was higher than the income tax payable, the surplus was to cover any debt that the taxpayer might have to the treasury (from earlier years), the municipality and the state-run student loan fund. Should there still be something left of the tax credit once the above were settled, it was paid out to the taxpayer. The tax credit of 1974 was universal and unconditional. It was supposedly recurrent (on yearly basis). Hence, the tax credit had some of the characteristics of a partial universal basic income. The tax credit of 1974 was used to pay state taxes. Hence, the individual recipient was thus not in full control of the use of the payment, weakening the characteristics of the tax credit as partial universal basic income. The chosen implementation was much cheaper for the government than a full fledge partial universal basic income system: I.e. instead of paying everyone the same amount regardless of income, only those who earned less than a certain amount got a tax credit. This system could be adapted to those who were in need. According to the budget for 1974, the total yield to the treasury from income taxes on individuals was estimated to be ISK 6,400 billions. With the amendment made to the tax system (extending the family allowance as explained above), this amount was reduced to ISK 3,700 billions, i.e. by 42% before accounting the effect of the “basic income” or tax deduction. The government assumed in the budget that the tax allowance would cost ISK 550 billions, or almost 15% of the income tax accrued.<sup>24</sup>

In the year 1974, there were 101,539 taxpayers registered in Iceland. Based on the tax-credit rule, about 50,000 of them, close to 46% of all taxpayers, received a cheque from the Treasury, and the total sum amounted to 501,613,000 ISK (the old currency), about

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<sup>24</sup> Based on unpublished research by Karlsson, J: *Saga skatta og skattlagningar á Íslandi frá öndverðu til vorra daga*.

10% of the total amount of income tax received.<sup>25,26</sup> The tax-credit was a significant economic instrument, indeed.

It should be emphasized that the system of tax credits introduced in Iceland in 1974 differed from the system established in the United States of America in 1975. The US system only creates a tax credit that the taxpayer has earned income during the tax year. Potential taxpayers not receiving income do not receive any tax credit. The tax credit increases with increasing income to a certain extent, replaces for a while but is impaired until a certain income ceiling is reached. U.S. taxpayers who do not earn a living income or who have an income exceeding a certain limit do not enjoy tax credits.

The Icelandic system, whereby individuals whose consumption was in excess of income declared on tax-returns, received payments from the Treasury, was not sustainable as things then stood with the tax and surveillance system. The main reason was the tremendous opportunity for tax evasion, estimated to be as high as 20-25% of the tax revenue over the years 1970-1980, i.e. 7-8% of the gross domestic product (GPD).<sup>27</sup> Several measures were made in order to prevent those who were over-consumers yet paid little tax or no tax at all, benefitting from the tax deduction. For example, the tax office was allowed estimate income of an individual and base taxes on that estimated income rather than declared income. That rule did not discourage many as exemplified by a wave of protests that broke out a few years later, leading to the tax system amendment of 1978-1981.<sup>28</sup>

Although the tax-credit system was conceived in cooperation with the labour unions, it soon became apparent that the labour union members were not the big beneficiaries of

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<sup>25</sup> On January 1, 1981, the Icelandic currency was changed as follows: 100 ISK became 1 ISK.

<sup>26</sup> In 1974, there were 101,539 tax returns in Iceland. In Reykjavík, there were 43,844, thereof 19,256 received a payment from the Treasury, i.e. 44%. In Reykjavík alone, the total amount of such reimbursement was ISK 192,581,151, the grand total countrywise being ISK 501,613,000. Thus the reimbursements in Reykjavík amounted to 38%, as the income was generally higher in Reykjavík than the average of the country. It is thus possible to estimate that the number of persons who got a reimbursement in 1974 were around 43-49% of the total number of individuals registered by the Treasury. It must be borne in mind that the tax family, a couple and children aged 0-15, was considered as one individual. Icelandic Historical Statistics, table 12.10 and [http://timarit.is/view\\_page\\_init.jsp?issId=115911&pageId=1454323&lang=is&q=SKATTSKR%C1%20Skattskr%E1](http://timarit.is/view_page_init.jsp?issId=115911&pageId=1454323&lang=is&q=SKATTSKR%C1%20Skattskr%E1)

<sup>27</sup> See and article in Nordic Tax Journal by the authors: <http://www.degruyter.com/view/j/ntaxj.ahead-of-print/ntaxj-2015-0006/ntaxj-2015-0006.xml>

<sup>28</sup> Karlsson, J. (2014). Moulding the Icelandic Tax System. Primary-Industry-Based Special Interest Groups, Taxation, Tax Expenditure, Direct and Indirect State Support, and the Shaping of Tax Rules. MSc thesis in Economics, supervised by Matthiasson, Th., Reykjavík. Retrieved from <http://skemman.is/handle/1946/19766>.

tax-credit transfers. The workers' unions probably did not see the tax-credit system as their baby. Noticeable is the fact that the workers' unions and employers' associations were at the same time in the process of consolidating a pension fund system which they had taken the initiative to establish outside both the tax system and the Social security system, i.e. totally beyond government control. The tax deductions soon became a matter of discussion between the state, the labour unions and the employers' unions. Lowering the tax-credit could be a way of financing lower marginal taxes, which again could help in reducing demand for nominal wage increases. Those who were granted the tax-credit did not have any leverage in such three-party negotiations. Furthermore, instead of granting direct salary raises, the pension contributions were raised and social services reduced, especially old age pensions from the Social security system.<sup>29</sup> In contrast to the tax-credit system the pension-fund system has grown considerably since 1974. The funds are now (2018) the principal owners of all publicly traded enterprises in Iceland! Thus, there was a conflict of interests built in the systems, with curious consequences.<sup>30</sup>

In August 1974, the left government fell, and a "traditional" right-wing government, headed by Mr. Geir Hallgrímsson of the Independence Party, took over. In August 1974, the Icelandic currency was devalued by 17%, and again by 20% in February 1975. Thus, the right-wing government signalled a return to traditions, as devaluation was also "traditional" methods of this party in order to make sure that the fisheries, i.e. the main Icelandic special interest groups, get the profits as usual. The tax surveillance system was weak, and it was not a priority of the new government to strengthen it. The sales tax was raised by 2%, from 17% to 19%, and other taxes were increased as well. Wages had been indexed by the CPI (adjusted every 3rd month), while the CPI rose by 15.2% during the period August-October 1974, wherefore the indexation of wages was abolished temporarily. All official price controls were revoked. Following these measures, the price of goods and services skyrocketed during the first six months following the accession the new right-wing government. The CPI rose by 25.3%, the price of food by 42%, of heat and electricity by 49%, of telephone and postal services by 55%, and of radio and television fees 50-57%. To compensate, the lowest wages

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29 <https://www.stjornarradid.is/media/fjarmalaraduneyti-media/media/frettatengt2015/Skyrsla-03072015.pdf>

30 <https://www.stjornarradid.is/media/fjarmalaraduneyti-media/media/frettatengt2016/Skyrsla-starfshops-um-erlendar-fjarfestingar-lifeyrissjoda.pdf>

were increased by 5-7%.<sup>31</sup> Furthermore, the rules governing the tax credit, introduced in 1974, were amended by Act No 11 of 1975. The system of tax credits and allowances was amended in a fundamental way: Unused tax-credits were not paid out, while child benefits were paid out instead.

It can therefore be said that the 1975 implementation was more similar to the U.S. Congress's implementation of the Earned Income Tax Credit (1974). According to the 1975 implementation, the only parties who benefited from the deduction were those who had earned income during the taxation year. The Icelandic version, however, was more general than the one adopted by the USA, as there was no income ceiling in the Icelandic version.

## VI

In 1974 and 1975, the Icelandic economy was affected by an adverse terms of trade shock (due to an increase in oil prices and falling prices for fish products). This situation resulted in increased inflation, and a significant increase in nominal wages. Unemployment was not a problem, however. In 1974, the government introduced an economic reform package. Direct taxes were lowered in order to reduce the need for nominal wage increases. The government had intended to lower expenditure, but in fact expenditure in the public sector were increased. The tax credit of 1974 was not a very useful instrument for reaching the government's goals. Furthermore, the opposition in Parliament maintained that the tax changes of 1975 (including the abolition of the tax credit) badly affected pensioners.<sup>32</sup>

The tax-credit system of 1974 included payment of unused credit. It is clear that the purpose was to reach specific goals with respect to income distribution, and reduce the need for social support, which is consistent with similar ideas in the United States and elsewhere. However, it must be kept in mind that in 1974 and in 1975, the government and the administration of Iceland were busy trying to contain rampant inflation. Social experiments, such as basic income (tax credit), were not priorities of the right-wing libertarian government, which advocated uncontrolled pricing.

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<sup>31</sup> Based on unpublished work by Karlsson, J: Saga skatta og skattlagningar á Íslandi frá öndverðu til vorra daga.

<sup>32</sup> See e.g. Þjóðviljann 22. Apríl 1975, [http://timarit.is/view\\_page\\_init.jsp?issId=221311&pageId=2844757&lang=is&q=skattaafsl%E1ttur](http://timarit.is/view_page_init.jsp?issId=221311&pageId=2844757&lang=is&q=skattaafsl%E1ttur).

The practice of paying out any unused tax-credit in cash can be seen as the timid start of an experiment with basic income. The administration of the tax credit implied that all those who fulfilled certain condition got the same amount. How would this system have evolved if the payable tax-credit had not been abolished in 1975? Would it have been extended?

The lesson to be learned from the tax credit experiment in Iceland in 1974 is twofold. First, the tax credit was part of a tax system that the public considered faulty because of built-in tax evasion possibilities and the fact that the tax rules were shaped to fit powerful special interest groups. Secondly, the tax-credit system had few, if any, natural defenders. Labour unions probably assumed that few of their members would get tax-credit cash. Pensioners probably assumed that increases in pension payments were preferable to an increase in tax credits. Of course, the inflation-linked economy had an impact that became apparent as soon as the tax credit became a matter of negotiations between labour unions, employer associations, and the government. So, even if the “basic-income experiment of 1974” lasted only for a year or two, and even if the amount of the tax credit was far from a basic income as envisioned by its advocates, we still can learn from it. The lesson is that basic income would need strong supporters if implemented, where the role of the government and/or the parliament would be mapped. Its supporters must be able to withstand pressure from the social partners in the labour market because of the interactivity of the Social security system and the pension fund system which is not part of the fiscal system in Iceland. The conflict of interests becomes apparent yet again. In times of dwindling competition, a system of high basic income is an invitation to the social partners to trade a lower basic income for lower taxes, reducing the need for nominal wage increases. The Icelandic experiment of 1974 clearly shows that this is a considerable challenge to the idea of basic income.