

Article

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Basic Income—an early Icelandic experiment**

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Abstract: Old age, illness, and/or physical and/or mental disabilities may limit the ability of an individual to generate enough income to cover basic costs of living. Most developed nations provide financial assistance to persons with limited abilities. In 1974, an Icelandic government passed an act of law providing a tax credit, payable to taxpayers under certain conditions. The tax allowance was applied first 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. This social interaction between stakeholders on how to share the tax revenue between the taxpayers led to a government crisis. The shareholders in this partial universal basic income system, the state and municipalities, the old age community, the trade unions, and the employers all have different financial and political interests and were affected by this reform. The lesson is that a 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 labor market because of the interactivity of the social security system and the pension fund system, which is not a part of the fiscal system in Iceland. The conflict of interests becomes apparent.

1 Introduction

Most developed nations provide assistance for persons with reduced ability to support themselves economically because of 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 nontransparent. New reforms and new reform ideas are regularly presented under the slogan of simplification of the existing “system.” The idea of “basic income” is one such reform idea. “Basic income” implies that authorities grant eligible citizens unconditional cash payment to cover basic needs, that is, housing, clothing, and food, which is paid at regular intervals. Hence, basic income is paid irrespective of other income, wealth, or other criteria. 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, it is labeled as “universal.” Basic income could be inversely related to the citizens’ wealth and regular income. Such transfers would not qualify as “universal” but “partial,” involving only part of the estimated cost of covering basic needs. A full universal basic income would involve total estimated cost of covering estimated needs, but proponents hesitate to define [see (BIEN 2019a)].

In Finland, a pilot project has been launched, granting a fixed sum of money to a (random) sample of the population (those unemployed and those who benefit from social grants). The payment is not means-tested or conditioned on (un)employment status. Each person is allotted the amount of € 560 per month and qualifies as a partial basic income (KELA 2019). 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, and so on. The resolution did not reach the floor at the parliament. Citizens of Switzerland dismissed a similar proposal in a referendum on June 5, 2016 (Wikipedia 2019a). Thus, at this point, the idea of basic income has neither been wholeheartedly accepted nor definitively rejected.

In the present article, 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 the 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

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

2 From Utopia to tax credits

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 (BIEN 2019b) 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 Moore 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 (More 2003; BIEN 2019b). 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 emphasized 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 18th century (BIEN 2019b).

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, whereas benefits should be determined by needs: “From each according to his ability, to each according to his needs!” (Marx 1977). The concept of basic income was broadly discussed in the aftermath of WWI. The British universalist C. H. Douglas 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

(Wikipedia 2019b). 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, John Kenneth Galbraith, Harold Watts, James Tobin, Paul Samuelson, and Robert Lampman, initiated an open letter published in the New York Times to the US Congress, urging the government to adopt a universal guaranteed annual income. The letter was signed by some 1,200 economists.¹ The full text of the letter is printed in (Sreenivasan 2009) and (New York Times 1968).

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 (Bregman 2016). Basic income was made an issue in the US 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 (Wikipedia 2019c)]. 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 and individuals receiving income and credit payments below the threshold would be net receivers of transfers from the government (Maricá 2016 June 4th). It turned out to be easier to get governments around 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 (Kristjánsson 2016).

The idea of partial universal basic income surfaces at the eve of the medieval period and the dawn of modernity. The idea evolves until the middle of the 20th century without being implemented in its pure form at a grand scale anywhere.

¹ <http://query.nytimes.com/gst/abstract.html?res=9504E3D61E39E134BC4051DFB3668383679EDE&legacy=true>

3 Adjusting the tax system to openness

The late 1960s and through to the early 1980s was a period of profound changes in Iceland and elsewhere. In Iceland, the lucrative herring fisheries collapsed, herring catches in 1969 only amount to 7% of catches before 1966 (Hagstofa Íslands 2019a,b). 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 (Hagstofa Íslands 2019a,b).

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 on 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, whereas the value of the currency was fixed by the Central Bank so as to secure profitability in that sector (Karlsson 2014), [(Verðbólgunefnd 1978), p. 91-97]. On the other hand, the tax-related interests of manufacturing industries and 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 an essential part of the preparation for entering EFTA. The tax legislation was revised in order to align it with then-current OECD practices (Magnússon 1969).

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. Icelandic 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 Western Europe. Strikes and social unrest were commonplace. The Vietnam War and the presidential campaigns of 1968 in the United States had quite an impact in Iceland. Iceland was infrequently mentioned in international media. All that changed all of a sudden in 1972, when hordes 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 United States, 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.² Iceland was opening up 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.

A new government established a committee to revise the tax system. The committee delivered a detailed report in 1973. The committee had worked with the parliament, as well as with the various special interest groups and 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, etc.) were abolished, Act No. 7 of 1972 and Act No. 8 of 1972. The tax system was streamlined, 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. One of the new ideas that surfaced in Iceland at this time was the concept of a negative income tax.

4 New platform for direct taxes

The Icelandic Confederation of Labour held meetings in 1973, adopting resolutions whereby it was suggested that income taxes be considerably lowered. At that time, the lion’s share of the state revenue came from indirect taxes (73–80%) as it had been the policy of the government in the 1960s to rely on indirect rather than direct taxation. Income tax evasion was widespread causing discontent among the general public. The political reaction was to shift taxes from being income based to be consumption based as that was assumed to be more fair. Hence, the situation with respect to trust in the fairness of tax system was very much different from the situation in other Nordic countries. In Scandinavia, workers’ unions and worker-friendly political parties took active steps to use the tax system for making the income distribution more equal (Lodin

² 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, 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 (Cristol 2019)

2011). Obviously, if income taxes in Iceland were to be lowered, other sources of state revenue had to be secured. It was, therefore, suggested to increase the sales tax (from 13%). Increase in indirect taxes and the bracket erosion of direct taxes because of 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.³

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 deductible from earned income based on the number of children, whereas 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.⁴

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 was in the scale ISK 0–99,999.⁵ Taxable income between ISK 100,000 and 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 of 200,000–300,000 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 “skattafsláttur” in the text of the law instead of tax allowance for “persónu-

afsláttur”). 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, now, there 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 a 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 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-fledged partial universal basic income system: that is, 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 billion. With the amendment made to the tax system (extending the family allowance as explained above), this amount was reduced to ISK 3,700 billion, that is, 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 billion or almost 15% of the income tax accrued.⁶

In the year 1974, there were 101,539 taxpayers registered in Iceland. On the basis of 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 10% of the total

³ 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.

⁴ 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.

⁵ 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.

⁶ On the basis of unpublished research by Karlsson, J: *Saga skatta og skattlagningar á Íslandi frá öndverðu til vorra daga*.

amount of income tax received.^{7,8} 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 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. The US 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 for 1970–1980, that is, 7–8% of the gross domestic product. Several measures were made in order to prevent those who were overconsumers yet paid little tax or no tax at all, benefitting from the tax deduction. For example, the tax office was allowed to estimate the income of an individual, and base taxes on that estimated income rather than the 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 (Karlsson 2014).

Although the tax-credit system was conceived in cooperation with the labor unions, it soon became apparent that the labor union members were not the big beneficiaries of tax-credit transfers. The workers' unions probably did not see the tax-credit system as their baby. It is a remarkable fact that the workers' unions and employers' associations were, at the same time, in the process of con-

solidating a pension fund system that they had taken the initiative to establish outside both the tax system and the social security system, that is, totally beyond government control. The tax deductions soon became a matter of discussion between the state, the labor 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 (Vinnuhópur um endurskoðun lífeyrismála 2015). 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 (Starfshópur um erlendar fjárfestingar lífeyrissjóða 2017).

This social interaction between stakeholders on how to share the tax revenue between the taxpayers led to a government crisis. In August 1974, a “traditional” right-wing government took over. The government started by devaluating the Icelandic currency by 17% and again by 20% in February 1975. Thus, the right-wing government signaled a return to traditions, as devaluation was also a “traditional” method to make sure that the fisheries, that is, the main Icelandic special interest groups, got 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 third month), whereas the CPI rose by 15.2% during the period August to October 1974, and 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 6 months following the accession to power of the new right-wing government. The CPI rose by 25.3%, and the price of food by 42%, heat and electricity by 49%, telephone and postal services by 55%, and radio and television fees by 50–57%. To compensate, the lowest wages were increased by 5–7%.⁹ 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

7 On January 1, 1981, the Icelandic currency was changed as follows: 100 ISK became 1 ISK.

8 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, that is, 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, table12.10 and http://timarit.is/view_page_init.jsp?issId=115911&pageId=1454323&lang=is&q=SKATTSKR%C1%20Skattskr%E1.

9 On the basis of an unpublished work by Karlsson, J: Saga skatta og skattlagningar á Íslandi frá öndverðu til vorra daga.

amended in a fundamental way: unused tax credits were not paid out, whereas child benefits were paid out instead.

It can, therefore, be said that the 1975 implementation was similar to the US 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 United States, as there was no income ceiling in the Icelandic version.

5 Finale

In 1974 and 1975, the Icelandic economy was affected by an adverse terms-of-trade shock (because of an increase in oil prices and falling prices for fish products). This situation resulted in increased inflation and a significant increase in nominal wages. However, unemployment was not a problem. 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 was 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.¹⁰

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 1975, the government of Iceland was 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.

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. Second, the tax-credit system had few, if any, natural defenders. Labor 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 among labor unions, employer associations, and the government. So, even if the "basic-income experiment of 1974" lasted only for 1 or 2 years, 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 a 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 labor market because of the interactivity of the social security system and the pension fund system, which is not a 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.

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¹⁰ See, for example, Þjóðviljann 22. Apríl 1975, http://timarit.is/view_page_init.jsp?issId=221311&pageId=2844757&lang=is&q=skattaafsl%Et1ttur.

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